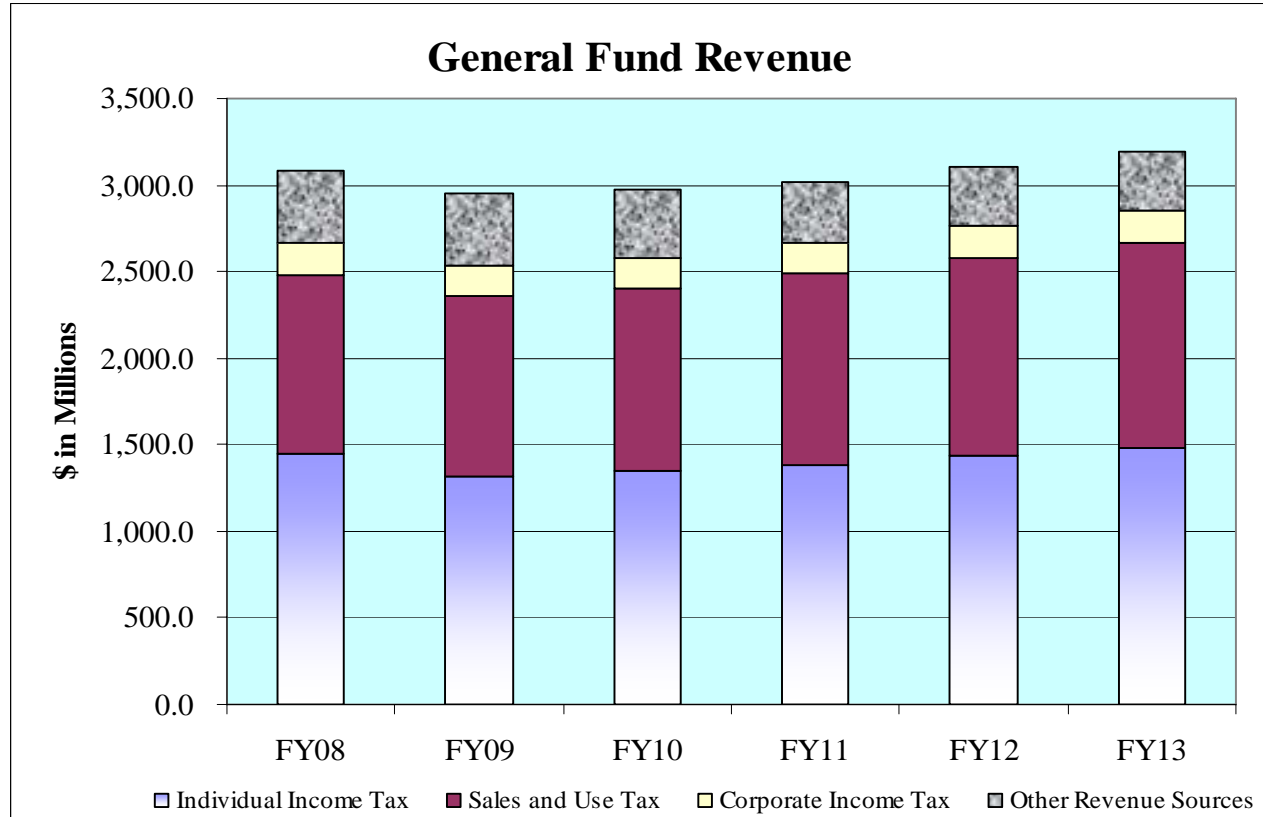


REPORT OF THE MAINE STATE REVENUE FORECASTING COMMITTEE

December 2008



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Report of the Maine State Revenue Forecasting Committee December 2008 Forecast

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I. INTRODUCTION AND BACKGROUND TO REVENUE FORECAST

This report represents the conclusion to the fall forecast for the December 1st statutory reporting deadline of the Revenue Forecasting Committee (RFC). A description of the revenue forecasting process is provided in Appendix F. This report and appendices provide a description of all the key elements of the General Fund and Highway Fund revenue forecasts. In addition to the statutorily required updates of General Fund and Highway Fund, the RFC also includes forecasts of revenue accruing to the Fund for a Healthy Maine and the dedicated revenue from the Medicaid/MaineCare provider taxes. This forecast updates the current revenue forecasts through the fiscal year ending June 30, 2011 and adds new revenue projections for the fiscal years ending June 30, 2012 and June 30, 2013. This forecast also reflects all legislative changes through the 1st Special Session of the 123rd Legislature and the effect of the November referendum vote on the People's Veto of the tax changes to fund the Dirigo Health initiative. This forecast is also driven by the recent revisions to the underlying economic forecast of the Consensus Economic Forecasting Commission (CEFC), which the CEFC concluded for its November 1st reporting deadline. The RFC met on November 21st to deliberate and discuss the recommendations of Maine Revenue Services and the results of the RFC subcommittee that reviewed the other revenue categories not covered by Maine Revenue Services.

A. Economic Forecast Update

The December 2008 revenue update began with the fall economic forecast in October. The Consensus Economic Forecasting Commission (CEFC) met on October 16th to review and update its February 2008 forecast. After that meeting, the CEFC felt the need to meet again by a conference call to further lower projections of job growth and personal income, a testament to the uncertainty and volatility of the current economic situation/crisis. Table I-A below summarizes the incremental change of the CEFC forecast. The full report of the CEFC is included in Appendix E.

TABLE I-A
Consensus Economic Forecasting Commission
Comparison of February 2008 and November 2008 Economic Forecasts

<u>Calendar Years</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
• Wage & Salary Employment (Annual Percentage Change)						
> Consensus 2/2008	0.0	0.6	0.7	0.6		
> Consensus 11/2008	-0.2	-0.7	0.4	1.0	0.8	0.7
Difference	-0.2	-1.3	-0.3	0.4		
• Personal Income (Annual Percentage Change)						
> Consensus 2/2008	3.5	4.1	4.2	4.1		
> Consensus 11/2008	3.7	2.6	3.9	4.0	4.3	4.3
Difference	0.2	-1.5	-0.3	-0.1		
• Consumer Price Index (Annual Percentage Change)						
> Consensus 2/2008	2.3	2.1	2.1	2.2		
> Consensus 11/2008	4.4	2.5	2.5	2.2	2.2	2.2
Difference	2.1	0.4	0.4	0.0		

The latest CEFC forecast projects a slowdown in national and state economic activity in 2008 and 2009, with a slow recovery starting in 2010. The adjustments the CEFC made to its February economic forecast primarily reflect changes in macroeconomic conditions – the continued weakness in the US housing market, volatility in energy prices, significantly reduced consumer and business spending and confidence, and the on-going stresses in the financial system – as well as expected changes in employment due to the closure of the Brunswick Naval Air Station starting in mid-2009. In considering these changes, the CEFC referred to economic forecasts from Global Insight, Moody’s Economy.com, and the New England Economic Partnership (NEEP), all of which projected lower growth than previously forecast.

The CEFC is projecting challenging, but not catastrophic times ahead for Maine. Employment and income are now forecast to be lower than projected in February, but still better than headlines would lead one to believe. Maine will experience a tough fourth quarter, resulting in negative job growth for the year of -0.2%. 2009 will also see job losses (-0.7%), exacerbated by the closing of NAS Brunswick, and slow income growth. A slow economic recovery will start in 2010, with a return in 2011–2013 to historical trends in employment and income growth.

B. Capital Gains Forecast

A major variable that is not included in the economic forecast of the CEFC is a projection of net capital gains. This variable has introduced some significant volatility into the forecast of individual income tax collections since Maine’s exceptional capital gains growth during the stock market “bubble” of the late 1990’s. The RFC and Maine Revenue Services, like their counterparts in other states and the federal government, have had much difficulty trying to accurately forecast this variable. Maine data is not captured at the state level and may only be accessed through federal tax data. That information is shared by the Internal Revenue Service with Maine Revenue Services, but it lags by as much as 2 years. Since November 1999, Maine Revenue Services has been required to provide a report on the net capital gains and losses realized by taxpayers filing Maine individual income tax returns. Due to the timing of the release of federal tax data this year, that report is included as a separate appendix to this report (see Appendix H). Table I-B on page 3 summarizes the current assumptions. The major differences from the assumptions included in the March 2008 report are:

- Tax year 2007 projections were increased substantially from 8% growth to nearly 30% growth based on updated data from the IRS;
- 2008 projections of net capital gain realizations are now assumed to decline by 50% due to the performance of the financial markets in the last half of 2008, previously a 15% decline had been assumed; and
- Projections for 2009 through 2013 have been adjusted to reflect the more abrupt decline in 2008, resulting in a slightly lesser decline in 2009 projections, no growth in 2010 and then modest growth beginning in tax year 2011.

Table I-B
Maine Resident - Net Capital Gains

<u>Tax Year</u>	<u>Capital Gains Realizations (\$ Millions)</u>	<u>Capital Gains Realizations Annual % Change</u>	<u>Capital Gains Tax Liability (\$ Millions)</u>	<u>Capital Gains Tax Liability Annual % Change</u>	<u>Capital Gains % of Resident Tax Liability</u>
1995	\$551.7		\$38.3		6.2%
1996	\$799.7	45.0%	\$57.3	49.6%	8.4%
1997	\$1,218.7	52.4%	\$104.5	82.4%	13.6%
1998	\$1,551.0	27.3%	\$120.0	14.8%	13.9%
1999	\$1,867.2	20.4%	\$141.7	18.1%	15.5%
2000	\$2,360.4	26.4%	\$179.6	26.7%	17.3%
2001	\$1,079.3	-54.3%	\$74.1	-58.7%	7.6%
2002	\$908.8	-15.8%	\$59.1	-20.3%	6.1%
2003	\$1,069.4	17.7%	\$69.4	17.4%	6.8%
2004	\$1,526.9	42.8%	\$104.9	51.2%	9.2%
2005	\$1,960.3	28.4%	\$137.0	30.6%	11.3%
2006*	\$2,266.9	15.6%	\$159.9	16.7%	12.4%
2007*	\$2,945.5	29.9%	\$215.1	34.6%	15.5%
2008*	\$1,473.1	-50.0%	\$98.8	-54.1%	7.5%
2009*	\$1,325.7	-10.0%	\$87.4	-11.6%	6.6%
2010*	\$1,325.8	0.0%	\$86.4	-1.1%	6.3%
2011*	\$1,378.6	4.0%	\$92.1	6.6%	6.5%
2012*	\$1,437.7	4.3%	\$96.7	5.0%	6.6%
2013*	\$1,499.5	4.3%	\$100.6	4.0%	6.6%

* Represents Projections

C. Corporate Profits

Corporate profitability is a major variable of the tax models that drives the corporate income tax forecast. As with capital gains, this variable is not part of the CEFC economic forecast. The RFC used Global Insight's November 2008 forecast of pre-tax corporate profits. Table I-C on the next page presents a comparison of Global Insight's forecasts used in the March 2008 forecast and the current national forecast, which calls for a 13.9 decrease in calendar year 2008, then a moderate increase in profitability in calendar year 2009 (2.9%), a stronger rebound in 2010 and a modest increase in 2011. The dominant taxpayers in Maine's corporate income tax liability mix have shifted to national retailers and energy companies. As a result, Maine is insulated from significant regional variances in corporate profitability as a result of Maine's method of corporate income taxation. For national companies operating in Maine, the amount of corporate income tax due to Maine is calculated by apportioning total profits earned in the continental United States by the amount of business that they conduct in Maine based on sales.

**Table I-C
Corporate Profit Growth (Percentage Annual Change)**

	2006	2007	2008	2009	2010	2011
March 2008 Forecast	14.3%	4.2%	-14.8%	20.9%	-0.1%	0.7%
December 2008 Forecast	15.6%	0.7%	-13.9%	2.9%	9.7%	1.3%

D. Oil Prices

Recent experience in Maine’s sales tax collections seems to demonstrate a substantial effect from variations in oil prices, which is most noticeable during the winter months. Sales tax collections dropped below budgeted projections at about the same time as energy prices began their steep ascent in the spring of 2005. Maine Revenue Services has added this variable to the sales and excise tax model so that the model might better capture the effect that oil and fuel price changes have on taxable sales and fuel purchases. Relying on Global Insights’ November 2008 US economic forecast, the RFC used the assumption that oil prices, which are currently in the \$60 per barrel range and have spiked above the \$140 per barrel mark, will average out to \$101.36 for calendar year 2008. The assumption is that oil prices will remain in the \$60 per barrel range through 2010. This is roughly \$15 per barrel lower than the March 2008 forecast’s assumptions. The difference between this forecast and the March 2008 forecast is an increase in calendar year 2008 and a 2009 average that is roughly \$22 per barrel lower.

**Table I-D
Oil Price Assumptions
(West Texas Intermediate - Price per barrel - Calendar Year Average)**

	2006	2007	2008	2009	2010	2011
March 2008 Forecast	\$66.12	\$72.18	\$78.53	\$74.33	\$74.02	\$73.42
December 2008 Forecast	\$66.12	\$72.18	\$101.36	\$52.75	\$63.25	\$80.38

E. Legislative Changes

The RFC bases the revenue forecast on current law. This forecast now incorporates all legislative changes through the 123rd Legislature’s 2nd Regular and 1st Special Sessions that were held from January 2008 to April 2008. The repeal by the People’s Veto of certain tax and revenue provisions to support the Dirigo Health program enacted by PL 2007, c. 629 has also been factored into this forecast. Table I-E on following page summarizing the effect of legislation enacted during the 2008 sessions excludes the additional General Fund revenue generated by PL 2007 c. 629. In the December 2007 and March 2008 reports, a revenue transfer provision affecting the Fund for a Healthy Maine enacted during the 1st Regular Session in 2007 was not factored into the tables summarizing Fund for a Healthy Maine revenue. That oversight is corrected in this report.

Table I-E
Summary of Legislative Changes
123rd Legislature, 2nd Regular and 1st Special Sessions
General Fund

	FY08	FY09	FY10	FY11
Sales Tax	(\$176,600)	\$270,793	\$391,027	\$405,430
Individual Income	(\$484,904)	\$2,874,506	\$2,835,459	\$1,826,865
Corporate Income	\$0	\$7,824,770	\$1,454,901	\$2,009,113
Cigarette Tax	\$0	\$0	\$21,906	\$22,344
Prop. Tax - UT	\$0	(\$124,137)	(\$132,127)	(\$136,068)
Investment Earnings	(\$1,370)	\$820,000	\$1,000,000	\$1,000,000
Revenue Sharing	\$33,737	(\$559,472)	(\$243,432)	(\$220,554)
Lottery Transfer	\$320,000	\$2,215,000	\$2,200,000	\$2,200,000
Other Revenue	\$115	\$13,434,447	(\$1,758,971)	(\$1,020,038)
Totals	(\$309,022)	\$26,755,907	\$5,768,763	\$6,087,092

Highway Fund

	FY08	FY09	FY10	FY11
Fuel Taxes	\$0	(\$20,875)	(\$18,834,462)	(\$19,085,759)
Motor Vehicle Reg. & Fees	\$0	\$13,179,050	\$15,776,450	\$15,766,950
Fines	(\$1,000)	\$0	\$0	\$0
Other Revenue	\$0	(\$108,083)	(\$15,676,283)	(\$15,676,783)
Totals	(\$1,000)	\$13,050,092	(\$18,734,295)	(\$18,995,592)

II. OVERVIEW OF REVENUE PROJECTIONS

This section provides a summary of the revenue projections in this forecast. These summaries are supplemented by additional detail in 4 corresponding appendices, which provide descriptions of the major revenue categories. Appendix G contains the materials presented by Maine Revenue Services on November 21st to support the forecast recommendations for the major tax categories.

A. General Fund

As expected, increasing recognition that the national economy is in worse shape than assumed by the previous (March 2008) revenue forecast has meant sizeable reductions in most of the major tax lines. With tightened credit markets, increased unemployment and the plunge in the stock market, consumer confidence has eroded and spending has dropped. Although lower fuel prices and any additional federal economic stimulus initiatives should help disposable income, the severity of the economic decline has required further revenue reductions. The effect is particularly acute in the short-term as the new forecast for FY09 for total General Fund Revenue represents a 4.3% decline from FY08 levels and then only modest growth for the next two years, 0.5% and 1.6% respectively. The FY09 decline is driven primarily by Corporate and Individual

Income Taxes and Estate Tax. In addition, tax lines associated with consumption, such as the sales tax and cigarette excise tax, are now projected to be lower in FY09 by \$23.8 million and in the 2010-2011 biennium by \$85.1 million.

Table II-A - General Fund Summary

	FY08 Actual	FY09	FY10	FY11	FY12	FY13
Current Forecast	\$3,087,818,992	\$3,095,374,998	\$3,146,183,758	\$3,168,987,904		
Annual % Growth	2.3%	0.2%	1.6%	2.4%		
Net Increase (Decrease)		(\$140,340,829)	(\$177,152,264)	(\$152,711,369)		
Revised Forecast	\$3,087,818,992	\$2,955,034,169	\$2,969,031,494	\$3,016,276,535	\$3,107,064,427	\$3,190,005,450
Annual % Growth	2.3%	-4.3%	0.5%	1.6%	3.0%	2.7%
Summary of Revenue Revisions by Major Revenue Category						
Sales and Use Tax		(\$20,306,608)	(\$37,365,436)	(\$39,870,977)		
Service Provider Tax		\$0	\$0	\$0		
Individual Income Tax		(\$76,441,151)	(\$74,400,740)	(\$66,822,641)		
Corporate Income Tax		(\$28,090,000)	(\$29,860,000)	(\$24,586,103)		
Cigarette and Tobacco Tax		(\$3,459,658)	(\$3,974,048)	(\$3,916,438)		
Public Utilities Tax		\$1,145,602	\$0	\$0		
Insurance Companies Tax		(\$5,190,769)	(\$5,609,734)	(\$6,031,464)		
Estate Tax		(\$14,236,055)	(\$17,038,096)	(\$1,455,740)		
Prop. Tax - Unorganized Territory		\$740,341	\$648,122	\$454,783		
Income from Investments		\$3,618,740	(\$1,974,593)	(\$1,857,990)		
Transfer to Municipal Rev. Sharing		\$6,366,727	\$7,364,561	\$6,826,546		
Transfer from Lottery Commission		(\$500,000)	(\$500,000)	(\$500,000)		
Other Revenues		(\$3,987,998)	(\$14,442,300)	(\$14,951,345)		
Total Revisions - Increase (Decrease)		(\$140,340,829)	(\$177,152,264)	(\$152,711,369)		

Individual Income Tax is reduced by \$76.4 million in FY09 and by \$141.2 million over the 2010-2011 biennium. A reduction in assumed capital gains tax liability is a major factor that adds to the negative impact in this category from other economic parameters, particularly lower personal income, fed through the tax model.

The slowing national economy is expected to reduce estimates of corporate income tax receipts by \$28.1 million in FY09 and by \$54.4 million in the 2010-2011 biennium.

Because of reduced home sales, the RFC projects a reduction in the Real Estate Transfer Tax of just under \$1 million in FY09 and \$4.0 million in the 2010-11 biennium.

The Estate Tax is reduced by \$14.2 million in FY09 and by \$17.0 million in FY10. FY11 is reduced by much less, \$1.5 million, because the Estate Tax will be phased out completely by the end of that year.

Insurance Companies Tax is reduced by \$5.2 million in FY09 and by \$11.6 million in the 2010-2011 biennium.

Parimutuel and Gaming Revenue, revenue from the “Racino”, is reduced by \$3.6 million in FY09 and by \$9.2 million in the 2010-2011 biennium.

Unclaimed Property Transfers are reduced by \$7.1 million in FY09 and by \$10.6 million in the 2010-2011 biennium. This arises from assumptions that the value of sold equities will be lower than previously expected and that less property may go unclaimed.

Appendix A provides additional explanations and detail of the General Fund revenue changes recommended in this forecast.

B. Highway Fund

Highway Fund revenues are projected lower by \$8.4 million in FY09 and \$11.2 million in the 2010-2011 biennium. High oil prices, which spiked over the summer, have lowered Fuel Taxes revenue by decreasing demand for gasoline. Despite the recent sharp decline in fuel prices, the demand is not expected to rise quickly because of the distressed economy. As the economy improves demand should pick up through FY10 until fuel prices eventually rise again. The gasoline tax, like other consumption taxes, is the most severely affected, while diesel fuel consumption seems to be less affected by consumer decisions.

Table II-B - Highway Fund Summary

	FY08 Actual	FY09	FY10	FY11	FY12	FY13
Current Forecast	\$328,136,579	\$350,242,726	\$328,233,831	\$331,962,554		
Annual % Growth	-0.8%	6.7%	-6.3%	1.1%		
Net Increase (Decrease)	\$0	(\$8,384,119)	(\$5,552,253)	(\$5,696,819)		
Revised Forecast	\$328,136,579	\$341,858,607	\$322,681,578	\$326,265,735	\$328,629,895	\$331,798,186
Annual % Growth	-0.8%	4.2%	-5.6%	1.1%	0.7%	1.0%
Summary of Revenue Revisions by Major Revenue Category						
Fuel Taxes		(\$4,405,842)	\$406,187	(\$1,430,380)		
Motor Vehicle Registration & Fees		(\$3,123,001)	(\$5,620,366)	(\$4,170,838)		
Inspection Fees		(\$258,109)	(\$102,964)	(\$108,849)		
Fines, Forfeits and Penalties		\$0	\$0	\$0		
Income from Investments		(\$596,228)	(\$733,354)	(\$615,287)		
Other Revenues		(\$939)	\$498,244	\$628,535		
Total Revisions - Increase (Decrease)		(\$8,384,119)	(\$5,552,253)	(\$5,696,819)		

The RFC has also lowered revenue estimates for motor vehicle registration fees and title fees necessitated by reduced assumptions for auto sales. Some of this is not consumption-driven and is related to competition for long-term trailer registrations.

Reduced Highway Fund balances and lower earnings rates in the Treasurer’s Cash Pool also contribute to lower revenues.

See Appendix B for additional detail of the Highway Fund revenue changes recommended in the table on the previous page.

C. Fund for a Healthy Maine (FHM)

The Fund for a Healthy Maine (FHM) revenue forecast is revised downward to reflect lowered assumptions for slot machine revenue and an increased lag time for recovery of disputed tobacco settlement payments currently in legal proceedings. See Appendix C for the additional explanations of the changes summarized below.

Table II-C - Fund for a Healthy Maine Summary

	FY08 Actual	FY09	FY10	FY11	FY12	FY13
Current Forecast	\$62,044,739	\$65,614,578	\$70,462,845	\$69,510,670		
Annual % Growth	21.8%	5.8%	7.4%	-1.4%		
Net Increase (Decrease)		(\$1,228,388)	(\$6,702,060)	(\$5,031,855)		
Revised Forecast	\$62,044,739	\$64,386,190	\$63,760,785	\$64,478,815	\$70,939,420	\$71,202,694
Annual % Growth	21.8%	3.8%	-1.0%	1.1%	10.0%	0.4%
Summary of Revenue Revisions by Major Revenue Category						
Base Payments		\$440,982	(\$4,617,183)	(\$2,862,514)		
Racino Revenue		(\$1,633,303)	(\$2,068,988)	(\$2,162,430)		
Income from Investments		(\$36,067)	(\$15,889)	(\$6,911)		
Total Revisions - Increase (Decrease)		(\$1,228,388)	(\$6,702,060)	(\$5,031,855)		

D. MaineCare Dedicated Revenue Taxes

Medicaid/MaineCare Dedicated Revenue Taxes are revised downward in FY09 by \$.36 million and upward by \$.72 million for the 2010-2011 biennium. The adjustments are based on updated trends indicating a drop in the Nursing Facility Tax offset by increases in the Hospital Tax and Service Provider Tax.

Table II-D - Medicaid/MaineCare Dedicated Revenue Taxes Summary

	FY08 Actual	FY09	FY10	FY11	FY12	FY13
Current Forecast	\$130,173,249	\$141,414,054	\$142,385,798	\$144,241,149		
Annual % Growth	3.6%	8.6%	0.7%	1.3%		
Net Increase (Decrease)		(\$356,755)	\$402,580	\$321,586		
Revised Forecast	\$130,173,249	\$141,057,299	\$142,788,378	\$144,562,735	\$146,381,450	\$148,245,634
Annual % Growth	3.6%	8.4%	1.2%	1.2%	1.3%	1.3%
Summary of Revenue Revisions by Major Revenue Category						
Nursing Facility Tax		(\$1,993,113)	(\$2,092,525)	(\$2,194,421)		
Residential Treatment Facilities Tax		\$154,457	\$152,858	\$151,219		
Hospital Tax *		\$100,047	\$938,402	\$938,402		
Service Provider Tax (PNMIs)		\$1,381,854	\$1,403,845	\$1,426,386		
Total Revisions - Increase (Decrease)		(\$356,755)	\$402,580	\$321,586		

III. CONCLUSIONS

The RFC has in past reports expressed its concern over the economic variables that drive the revenue forecast. With extreme uncertainty surrounding the national economy, that concern has never been as great as it is now for the December 2008 forecast. The severe credit crisis, a distressed housing market, rising unemployment, reports of instability at any number of financial institutions and lowered corporate profitability have all dealt blows to consumer confidence. Government intervention, both real and anticipated, and the debate surrounding the intervention, have contributed to the uncertainty about the depth and duration of the current economic downturn. The realization that one of the factors keeping oil prices low is the dampening impact of global economic downturn has created additional anxiety over long-term oil prices. Nowhere has the anxiety been more visible than in the massive decline and marked volatility of the stock market, where millions of investors have watched their savings and future pensions disappear in a few short months. The timing and effectiveness of any additional stimulus package cannot be predicted. Under these turbulent conditions, the RFC must account for a greater level of uncertainty when estimating revenue from capital gains, auto sales, corporate profits, personal income and other sources. With this in mind, the RFC has, with guidance from the CEFC, done its best to estimate revenues under these challenging conditions.