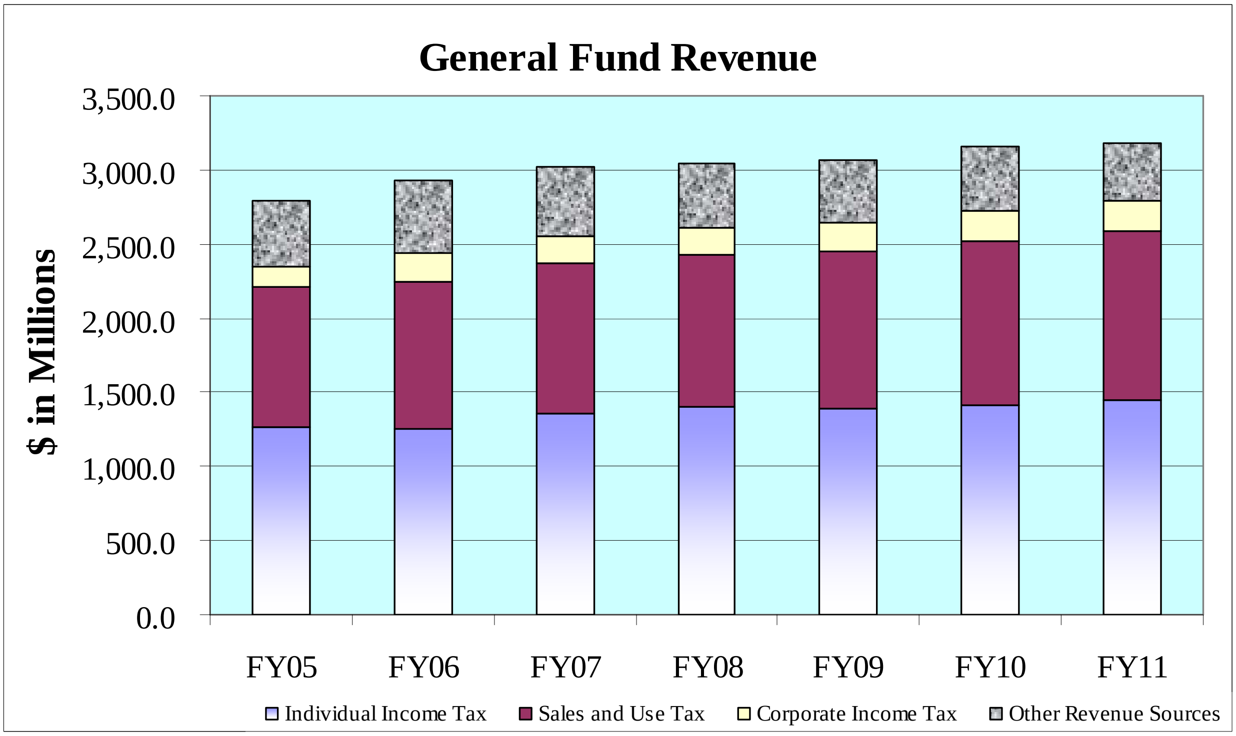
REPORT OF THE MAINE STATE REVENUE FORECASTING COMMITTEE

March 2008



Jerome Gerard, Chair
Acting State Tax Assessor

Dr. James Breece
University of Maine System

Marc Cyr
Office of Fiscal & Program Review

Grant Pennoyer, Director
Office of Fiscal & Program Review

Catherine Reilly
State Economist

Ellen Jane Schneiter
State Budget Officer

Report of the Maine State Revenue Forecasting Committee
March 2008 Forecast

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I. INTRODUCTION AND BACKGROUND TO REVENUE FORECAST

This report represents the conclusion to the winter forecast for the March 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 revenue forecasts through the fiscal year ending June 30, 2011. This forecast also reflects all legislative changes through the 1st Regular Session of the 123rd Legislature and incorporates the revised economic forecast presented by the Consensus Economic Forecasting Commission (CEFC) for its February 1st reporting deadline. The RFC met on February 25th to deliberate and discuss the recommendations of Maine Revenue Services and other revenue analyses.

A. Economic Forecast Update

The March 2008 revenue update began with the winter economic forecast in January. The Consensus Economic Forecasting Commission (CEFC) met on January 22nd to review and update its November 2007 forecast. Based on economic data available through the end of calendar year 2007, the CEFC reduced projections of employment growth and income growth with the greatest reductions in calendar year 2008. The inflation forecast was also lowered for each year of the forecast period. 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 November 2007 and February 2008 Economic Forecasts

Calendar Years	2007	2008	2009	2010	2011
• Wage & Salary Employment (Annual Percentage Change)					
> Consensus 11/2007	0.5	0.3	0.6	0.7	0.7
> Consensus 2/2008	0.5	0.0	0.6	0.7	0.6
Difference	0.0	-0.3	0.0	0.0	-0.1
• Personal Income (Annual Percentage Change)					
> Consensus 11/2007	4.9	4.4	4.5	4.5	4.6
> Consensus 2/2008	5.1	3.5	4.1	4.2	4.1
Difference	0.2	-0.9	-0.4	-0.3	-0.5
• Consumer Price Index (Annual Percentage Change)					
> Consensus 11/2007	2.8	2.5	2.5	2.5	2.5
> Consensus 2/2008	2.8	2.3	2.1	2.1	2.2
Difference	0.0	-0.2	-0.4	-0.4	-0.3

The downward revisions in this revenue forecast for the General Fund and the Highway Fund are driven primarily by the rapidly deteriorating economic picture reflected in this economic forecast. In the quarter, since the last meeting of the CEFC, the extent and the economic effects of the subprime mortgage crisis continued to worsen. In the short time between the conclusion of the economic forecast and the time when Maine Revenue Services was establishing the other economic variables used in this forecast (see next sections), the economic picture continued to worsen. The national forecasts by the major forecasting firms became much more pessimistic. To the extent that the core economic values do not completely reflect the most recent economic data, there is some additional downward risk in the economic and revenue forecasts presented in this report.

B. Capital Gains Forecast

A major variable that is not included in the economic forecast 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 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. That report was provided to the Legislature through the RFC's December 2007 report in Appendix G. Table I-B on page 3 summarizes the current assumptions. The differences from the assumptions included in the December 2007 report are:

- 2006 projections (note they are still projections due to filing extensions that will change the data) have been decreased from 24.4% growth to 16.0% growth as a result of additional data from the IRS;

- 2007 projections have been decreased from 10% growth to 8% growth based on the weak performance of the stock market during the final months of 2007; and

The forecast for tax years 2008 through 2011 retain the assumption of a 15% decline per year. This decline is required to bring assumed capital gains liability back to its historical average of approximately 6% of total tax liability for Maine residents by the end of the forecast period (see far right column in Table I-B below). This assumption pulls roughly $30 million per year out of the individual income tax liability. Beginning in 2001, it took only 2 years and a drop of 54.3% in 2001 to get to the longer term percentage of tax liability. The RFC assumes that this decline will happen gradually over 4 years, thereby reducing the extent of the risk to the forecast by a major downward correction in the markets. This assumption will require adjustment each forecast as new federal data becomes available.

Table I-B
Maine Resident - Net Capital Gains

Tax Year	Capital Gains Realizations ($ Millions)	Capital Gains Realizations Annual % Change	Capital Gains Tax Liability ($ Millions)	Capital Gains Tax Liability Annual % Change	Capital Gains % of Resident Tax Liability
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*	$2,273.6	16.0%	$161.1	17.6%	12.5%
2007*	$2,455.5	8.0%	$175.8	9.1%	13.0%
2008*	$2,087.2	-15.0%	$145.2	-17.4%	10.7%
2009*	$1,774.1	-15.0%	$120.7	-16.9%	8.7%
2010*	$1,508.0	-15.0%	$99.5	-17.6%	7.0%
2011*	$1,281.8	-15.0%	$86.1	-13.4%	5.9%

* Represents Projections

C. Corporate Profits

A major variable of the tax models that drives the corporate income tax forecast is corporate profitability. Again, this forecast is not part of the CEFC economic forecast. The RFC used Global Insight's February 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 December 2007 forecast and the current national forecast, which calls for a 4.2% increase in calendar year 2007, then a significant decline in profitability in calendar year 2008 (-14.8%), a rebound in 2009 and then slight decline 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, payroll and property. Maine's apportionment formula was modified during the 123rd Legislature, 1st Regular Session to be based solely on sales effective for beginning in 2007 tax years.

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

	2006	2007	2008	2009	2010	2011
December 2007 Forecast	14.3%	4.8%	-2.1%	3.3%	-0.5%	-0.1%
March 2008 Forecast	14.3%	4.2%	-14.8%	20.9%	-0.1%	0.7%

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' February 2008 US economic forecast, the RFC used the assumption that oil prices, which are currently in the $90 per barrel range and have spiked above the $100 per barrel mark, averaged out to $72.18 for calendar year 2007. The assumption is that oil prices will stay in roughly the $75 per barrel range for the remainder of the forecast period. This is roughly $10 per barrel higher than the March 2007 forecast's assumptions. The difference between this forecast and the December 2007 forecast is a slight increase in calendar year 2007 and a 2008 average that is roughly $3 per barrel higher.

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

	2006	2007	2008	2009	2010	2011
December 2007 Forecast	$66.12	$72.15	$75.66	$74.33	$74.02	$73.42
March 2008 Forecast	$66.12	$72.18	$78.53	$74.33	$74.02	$73.42

E. Legislative Changes

The RFC bases the revenue forecast on current law. This forecast includes all legislative changes through the 123rd Legislature's 1st Regular Session. The budgeted amounts in the tables in Appendices A through D do not reflect changes that may have been enacted during the 2nd Regular Session, which began on January 2, 2008. As of this writing, there was only one significant revenue impact in legislation enacted during the 2nd Regular Session. That law was actually enacted at the end of the 1st Regular Session, but was not signed by the Governor. It became law during the early part of the 2nd Regular Session without the Governor's signature when it was not returned to the Legislature. LD 1790, PL 2007, c. 470, sets aside 7.5% of the excise taxes on gasoline and special fuels and dedicates that portion of the tax that would otherwise accrue to the Highway Fund. This reduction to budgeted Highway Fund revenue is not reflected in the tables in this report, but the Office of Fiscal and Program Review has reported the additional effect of this legislation on the available balance of budgeted revenue to the Highway Fund.

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 February 25th to support the forecast recommendations for the major tax categories.

A. General Fund

For the **General Fund,** revenues were revised downward by $94.8 million over the 2008-2009 biennium, $26.9 million in FY 2008 and $67.9 million in FY 2009. This revision comes one quarter after the December 2007 revenue revision which included a similar downward revision of $95.2 million over the current biennium. Of the $94.8 million adjustment to the General Fund revenue for the current biennium, roughly $75 million is associated with the major tax lines that produce the vast majority of General Fund revenue. These changes to General Fund tax receipts are a reflection of a deteriorating national economy that has been significantly impacted by a tightening in credit markets as the correction in the residential housing market continues to unfold, and high volatile energy prices that are putting considerable stress on low and middle income households, particularly here in Maine. Taken together, these two factors are limiting household borrowing and drawing disposable income away from taxable goods and services and toward non-taxable energy products. This forecast represents a continuation of the recognition of this further squeeze on disposable income, even taking into account the federal economic stimulus package. As a result, tax lines associated with consumption, such as the sales tax and cigarette excise tax are now projected to be lower in this biennium by $29.5 million and $5.6 million, respectively.

Table II-A - General Fund Summary

	FY07 Actual	FY08	FY09	FY10	FY11
Current Forecast	$3,019,595,389	$3,067,920,438	$3,136,529,661	$3,206,392,774	$3,236,866,340
Annual % Growth	3.0%	1.6%	2.2%	2.2%	1.0%
Net Increase (Decrease)		($26,870,994)	($67,910,570)	($65,977,780)	($73,965,529)
Revised Forecast	$3,019,595,389	$3,041,049,444	$3,068,619,091	$3,140,414,994	$3,162,900,811
Annual % Growth	3.0%	0.7%	0.9%	2.3%	0.7%
Summary of Revenue Revisions by Major Revenue Category					
Sales and Use Tax		($6,827,961)	($22,731,976)	($35,583,027)	($44,045,075)
Individual Income Tax		($421,000)	($18,092,000)	($14,835,000)	($13,122,000)
Corporate Income Tax		($12,430,000)	($10,814,298)	($1,045,313)	($2,070,000)
Cigarette and Tobacco Tax		($2,920,000)	($2,680,000)	($1,094,958)	($1,452,319)
Estate Tax		($695,929)	($1,184,791)	($527,510)	($606,439)
Income from Investments		$50,447	$0	$0	$0
Transfer to Municipal Rev. Sharing		$1,003,627	$2,633,552	$2,676,094	$3,080,328
Transfer from Lottery Commission		($1,000,000)	$1,000,000	$1,000,000	$1,000,000
Other Revenues		($3,630,178)	($16,041,057)	($16,568,066)	($16,750,024)
Total Revisions - Increase (Decrease)		**($26,870,994)**	**($67,910,570)**	**($65,977,780)**	**($73,965,529)**

The slowing national economy is also beginning to affect corporate profitability. Unlike the previous revenue forecast, this forecast is now based on a national economy that will experience extremely slow growth at best and a mild recession at worst during this calendar year. As a result, corporate profits are estimated to decline by 14.8% in 2008, which translates into a reduction in corporate income tax receipts of approximately $23.2 million in the 2008-2009 biennium.

While the individual income tax is not expected to deviate much from the previous forecast in this fiscal year, the forecast for FY09 and beyond is reduced substantially because of the much lower projection of income growth during 2008 by the CEFC. While Maine has not been as dramatically affected by the sub-prime mortgage crisis as some other states, for the first time since the December 2006 forecast, the RFC projects a reduction in the Real Estate Transfer Tax totaling $7.3 million for the 2008-2009 biennium.

The majority of the remaining $12.3 million of net reductions to the General Fund forecast for this biennium is related to revenue collections by the Department of Health and Human Services (DHHS). Of the total $15.0 million reductions to Targeted Case Management revenue of DHHS, $12.2 million of this change is associated with the federal Medicaid rule changes.

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

B. Highway Fund

For the **Highway Fund**, revenues were projected lower by $2.3 million in FY08 and $2.0 million in FY 2009. High oil prices, which had been expected to return to more normal (lower) levels sooner than what is now expected, lower Fuel Taxes revenue by decreasing demand for diesel fuel and gasoline. 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

	FY07 Actual	FY08	FY09	FY10	FY11
Current Forecast	$330,821,083	$328,637,877	$339,173,861	$343,978,189	$348,933,780
Annual % Growth	1.3%	-0.7%	3.2%	1.4%	1.4%
Net Increase (Decrease)		($2,280,838)	($1,981,227)	$2,989,937	$2,024,366
Revised Forecast	$330,821,083	$326,357,039	$337,192,634	$346,968,126	$350,958,146
Annual % Growth	1.3%	-1.3%	3.3%	2.9%	1.1%
Summary of Revenue Revisions by Major Revenue Category					
Fuel Taxes		($240,727)	($901,973)	$3,135,254	$1,991,262
Motor Vehicle Registration & Fees		($1,816,583)	($700,000)	$234,241	$412,968
Inspection Fees		$35,000	($15,000)	($15,000)	($15,000)
Fines, Forfeits and Penalties		($223,190)	($223,190)	($223,190)	($223,190)
Other Revenues		($35,338)	($141,064)	($141,368)	($141,674)
Total Revisions - Increase (Decrease)		**($2,280,838)**	**($1,981,227)**	**$2,989,937**	**$2,024,366**

The RFC also lowered motor vehicle registration fees and title fees. While some of this is not consumption-driven and is related to competition for long-term trailer registrations and some problems with receipts from municipalities, the bulk of the changes reflect declining motor vehicle sales. 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 was revised downward slightly due to a small downward adjustment in interest earnings to reflect lower balances in the fund and an adjustment in FY08 to reflect the effect of winter weather and some FY08 changes to assumptions for slot machine revenue. The total change to Fund for a Healthy Maine revenue during the 2008-2009 biennium is less than $0.1million. See Appendix C for the additional explanations of the changes summarized below.

Table II-C - Fund for a Healthy Maine Summary

	FY07 Actual	FY08	FY09	FY10	FY11
Current Forecast	$50,950,512	$61,353,071	$65,626,578	$70,567,505	$69,667,817
Annual % Growth	8.6%	20.4%	7.0%	7.5%	-1.3%
Net Increase (Decrease)		($78,318)	($12,000)	($12,000)	($12,000)
Revised Forecast	$50,950,512	$61,274,753	$65,614,578	$70,555,505	$69,655,817
Annual % Growth	8.6%	20.3%	7.1%	7.5%	-1.3%
Summary of Revenue Revisions by Major Revenue Category					
Racino Revenue		($66,318)	$0	$0	$0
Income from Investments		($12,000)	($12,000)	($12,000)	($12,000)
Total Revisions - Increase (Decrease)		**($78,318)**	**($12,000)**	**($12,000)**	**($12,000)**

D. MaineCare Dedicated Revenue Taxes

In aggregate, **Medicaid/MaineCare Dedicated Revenue Taxes** were revised upward on a net basis by $1.0 million for the 2008-2009 biennium. These adjustments are based on updated trends with an additional quarter of actual experience and, within the Hospital Tax, a delay in the receipt of a tax payment between FY08 and FY09.

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

	FY07 Actual	FY08	FY09	FY10	FY11
Current Forecast	$125,704,185	$129,627,152	$131,380,798	$133,178,281	$135,020,703
Annual % Growth	6.4%	3.1%	1.4%	1.4%	1.4%
Net Increase (Decrease)		($346,130)	$1,342,884	$517,145	$530,074
Revised Forecast	$125,704,185	$129,281,022	$132,723,682	$133,695,426	$135,550,777
Annual % Growth	6.4%	2.8%	2.7%	0.7%	1.4%
Summary of Revenue Revisions by Major Revenue Category					
Nursing Facility Tax		$1,391,679	$1,426,471	$1,462,133	$1,498,686
Residential Treatment Facilities Tax		($280,201)	($287,206)	($294,386)	($301,745)
Hospital Tax *		($838,355)	$838,355	$0	$0
Service Provider Tax (PNMIs)		($619,253)	($634,736)	($650,602)	($666,867)
Total Revisions - Increase (Decrease)		**($346,130)**	**$1,342,884**	**$517,145**	**$530,074**

III. CONCLUSIONS

The additional General Fund and Highway Fund downward revisions of this revenue forecast, just one quarter after the December 2007 revisions represent a significant challenge for the Governor and the Legislature. The rapidly changing economic picture and its immediate effect on consumption-related tax revenue has dropped budgeted General Fund revenue by a total of $64.6 million in FY 2008 in these 2 forecasts, with effectively only a quarter left in the fiscal year to make the necessary adjustments to bring the budget back into balance. The back-to-back reductions of the December 2007 and March 2008 forecasts total $189.9 million for the General Fund and $21.1 million for the Highway Fund in the current biennium, both represent reductions of roughly 3.0%.

As noted earlier, this revenue forecast is driven largely by the deteriorating national economy. The RFC is once again expressing its concerns about the substantial amount of economic risk that still surrounds this forecast. In the short time frame since the January meeting of the CEFC, most national economic forecasts, including the models upon which the CEFC forecast was based, have been updated with much more pessimistic outlooks. While some of the economic variables, primarily corporate profitability and oil prices not established within the CEFC economic forecast, reflect the more pessimistic forecasts, some of the core components of the economic forecast underlying this revenue forecast may not have captured recent events, leaving a greater potential for downside risks when the forecast is revised again later this fall.