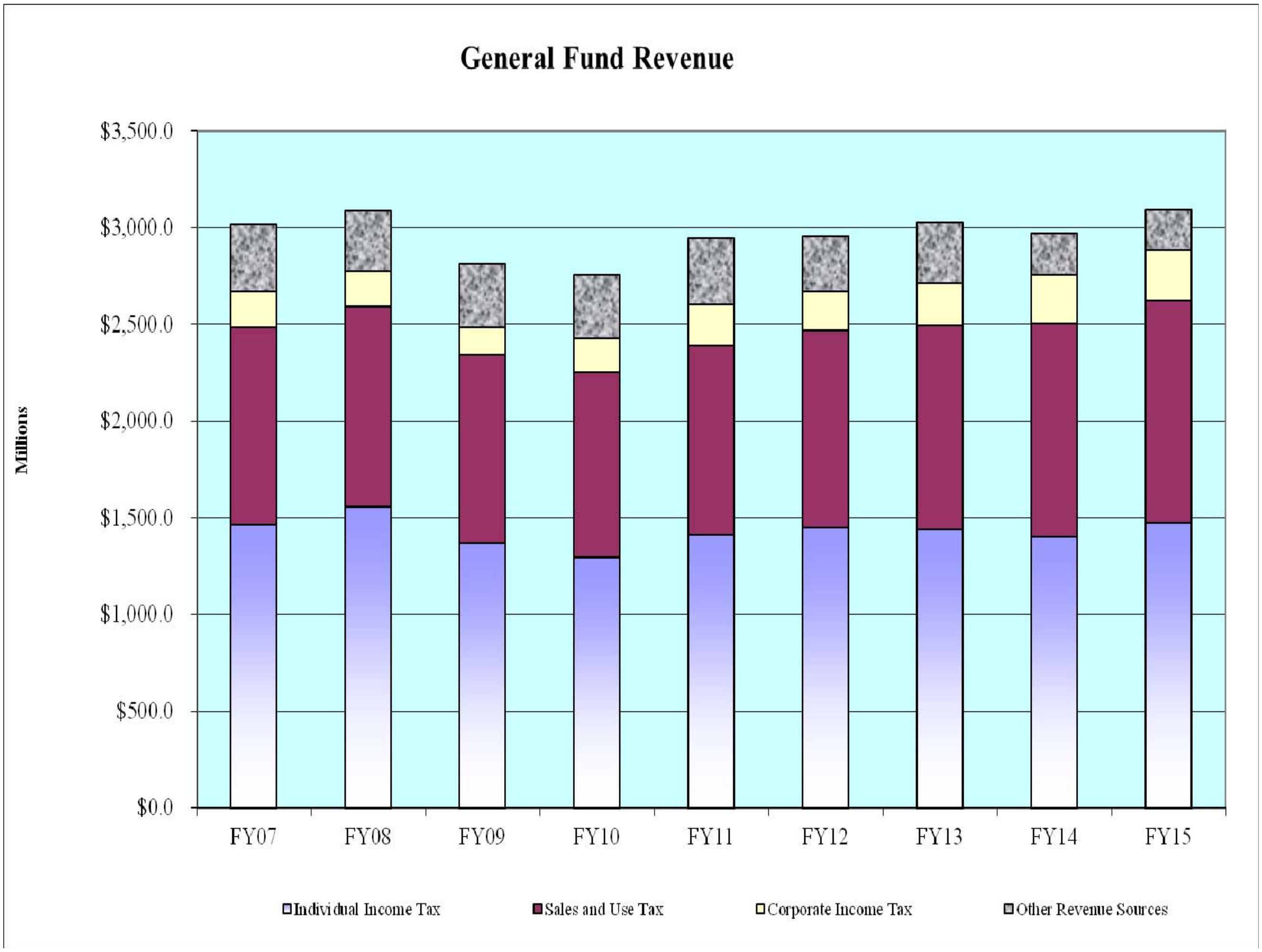
REPORT OF THE MAINE STATE REVENUE FORECASTING COMMITTEE

March 2012



Jerome Gerard, Chair
State Tax Assessor

Dr. James Breece
University of Maine System

Marc Cyr
Office of Fiscal & Program Review

Dawna Lopatosky
State Budget Officer

Grant Pennoyer, Director
Office of Fiscal & Program Review

Amanda Rector
State Economist

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Introduction

The Revenue Forecasting Committee (RFC) met on February 22, 2012 to review and update the current revenue forecast to comply with this year's statutory reporting date of March 1st. The RFC has revised its revenue projections through the fiscal year ending June 30, 2015 for the General Fund, Highway Fund, Fund for a Healthy Maine and Medicaid Dedicated Revenue Taxes.

Economic Forecast

This mid-session update of the revenue forecast began with a review and update of the economic forecast statutorily due this year by February 1st. That economic forecast was developed by the Consensus Economic Forecasting Commission (CEFC) at its meeting on January 26, 2012. The key elements of the review were an examination of how well the macroeconomic data has "tracked" forecast values, and the consistency of revenue collections with the revised revenue forecast based on the November 2011 CEFC baseline and revision in other macroeconomic forecasts for Maine.

Given the short period of time that has passed since the last CEFC meeting in October, there were only minor deviations of actual macroeconomic data from the forecast values, and the November 2011 forecast trends generally remain within the center of alternative macroeconomic outlooks. One area of some potential concern is in income growth, where preliminary estimates from the Bureau of Economic Analysis indicate that total personal income in Maine grew by 3.1% and wage-and-salary income grew 1.4% year-over-year for the first three quarters of 2011. These growth rates are substantially below the growth rates indicated by preliminary data from the Maine Department of Labor, and are lower than the growth rates indicated by changes in income tax withholding receipts from Maine Revenue Services.

Apart from the uncertainty around the growth in personal income and its components, there were few significant changes in most economic indicators, observed actual economic performance or other economic forecasts. As a result, the CEFC has left the November 2011 forecast in place without change. The principle risks to the forecast are the depths and longevity of the continuing economic crisis in Europe, prospects for global economic growth, and uncertainty in energy markets.

A copy of the February 2012 report of the CEFC and other economic information providing the basis for this revenue forecast is included in Appendix E.

Summary of Revenue Forecast

The economic variables in the CEFC forecast play an important role in the revenue forecast. Maine Revenue Services' tax models use the CEFC economic variables to help project revenue from the major taxes. While the CEFC did not adjust the projections of the growth rates of the major economic variables, the RFC reviewed the 2011 performance of the variables within the economic forecast and factored in recent performance of the major taxes. These "technical" adjustments to the tax models established a lower base to which the same growth rates were applied, resulting in lower projections for the major taxes throughout the forecast. Data related to non-tax revenue lines were provided by a number of different state agencies and reviewed by staff in the Office of Fiscal and Program Review and the Bureau of the Budget to come up with consensus recommendations. The RFC reviewed Maine Revenue Services' and other staff recommendations at its meeting on February 22nd and made some adjustments to those recommendations. The following tables and narratives highlight the final changes to each of the major funds and revenue sources accepted by the RFC as part of its March 2012 update to the revenue forecast. More detail on each of the funds and revenue sources is provided in the various appendices.

General Fund Summary

	FY11 Actual	FY12	FY13	FY14	FY15
Current Forecast	$2,944,956,756	$2,956,274,105	$3,030,290,073	$2,974,144,855	$3,094,637,875
Annual % Growth	6.9%	0.4%	2.5%	-1.9%	4.1%
Net Increase (Decrease)		($4,918,512)	($8,063,997)	($15,412,823)	($15,973,942)
Revised Forecast	$2,944,956,756	$2,951,355,593	$3,022,226,076	$2,958,732,032	$3,078,663,933
Annual % Growth	6.9%	0.2%	2.4%	-2.1%	4.1%

General Fund revenue estimates (also refer to Appendix A and other background materials in Appendix F and Appendix G) are being revised downward by $4.9 million in FY12 and $8.1 million in FY13, resulting in a total decrease of budgeted revenue for the 2012-2013 biennium of $13.0 million. For the next biennium, the downward revisions to revenue estimates exceed $15 million per year and total $31.4 million for the 2014-2015 biennium.

Income and sales taxes, those taxes affecting revenue sharing, represent the major downward adjustment in this General Fund revenue forecast update. The gross effect of these downward revisions for the 2012-2013 biennium are $31.9 million. After netting out the offsetting effects of the reductions to Transfers for Municipal Revenue Sharing, the net downward revisions from these taxes are $30.0 million. The net downward revisions from income and sales taxes during the 2014-2015 biennium total $34.6 million.

Partially offsetting the income and sales tax effects is the recommended revision to the estate tax collections. Improvements to household net worth and actual tax year 2010 liability result in upward revisions to the Estate Tax estimates of $5.1 million in FY12 and $6.7 million in FY13. The annual impacts beginning in FY14 are roughly half the impact as a result of enacted Estate Tax changes.

Some of the more significant positive adjustments in the General Fund revisions during the 2012-2013 biennium in addition to the Estate Tax changes include:

- $5.7 million in FY12 to recognize the one-time General Fund share of the recently announced national settlement with the major banks on mortgage foreclosures;
- $2.8 million during the biennium from Casino and Racino Revenue, largely the result of one-time licensing fees (the impact during the 2014-2015 of the adjustment in this category are negative);
- $0.6 million from payments from the Liquor Sales and Operation based on better than expected performance of profit sharing under the existing contract with Maine Beverage Company, LLC;
- $0.8 million from other liquor taxes and license fees;
- $0.7 million from new projections of the General Fund components of the municipal cost component affecting transfers to the General Fund from the Unorganized Territory Fund; and
- $2.2 million from the net effect of an update to the forecast affecting the Milk Handling Fee and the transfers out to the Maine Milk Pool.

Some of the more significant negative adjustments in the General Fund revisions during the 2012-2013 biennium include:

- $3.2 million in Fines, Forfeits and Penalties primarily from a continuing decline of traffic and other violations filed in the Court system;
- $2.0 million from higher than projected payments under the Business Equipment Tax Reimbursement (BETR) program; and
- $1.8 million from recent policy changes within the Department of Health and Human Services related to billing MaineCare for state employee-provided targeted case management services.

Highway Fund Summary

	FY11 Actual	FY12	FY13	FY14	FY15
Current Forecast	$311,351,155	$317,934,731	$318,875,750	$321,134,813	$323,195,894
Annual % Growth	0.1%	2.1%	0.3%	0.7%	0.6%
Net Increase (Decrease)		$258,594	$904,091	$1,723,216	$1,856,257
Revised Forecast	$311,351,155	$318,193,325	$319,779,841	$322,858,029	$325,052,151
Annual % Growth	0.1%	2.2%	0.5%	1.0%	0.7%

Highway Fund revenue estimates (also refer to Appendices B, F and G) are revised upward by $0.3 million in FY12 and $0.9 million in FY13 for a total increase of $1.2 million for the 2012-2103 biennium. The upward revisions to projections for the 2014-2015 biennium net to $3.6 million.

Most of the net change in this upward revision to Highway Fund revenue is driven by improvements in Bureau of Motor Vehicles revenue primarily from Long-term Trailer Registration Fees ($2.0 million for the 2012-2013 biennium) and Title Fees ($1.6 million). These positive effects are partially offset by projected declines Operator License Fee revenue ($1.4 million).

Projections for Fuel Taxes have been problematic lately, particularly for the Gasoline Tax. Although overall the broader category of Fuel Taxes has been performing close to budget, strength in the collections of the Special Fuel and Road Use Taxes category offset general weakness in Gasoline Tax collections due to recent price spikes. The December 2011 forecast was revised upward based on the underlying assumption of lower gasoline prices. That assumption has proven false and at least for the short-term, gasoline prices are expected to climb higher. As a result, the RFC further lowered projections for the Gasoline Tax in FY12 by an additional $1.0 million above initial recommendations, which called for offsetting adjustments within the Fuel Taxes category between Special Fuel and Road Use Taxes and Gasoline Tax.

Fines, Forfeits and Penalties revenue is revised downward by $0.1 million annually as the Highway Fund is also feeling the effects of decline in the number of infractions filed with the Courts. Higher than projected transfers from the Municipal Excise Tax Reimbursement Fund result in a one-time increase in FY12 of $0.4 million.

Fund for a Healthy Maine Summary

	FY11 Actual	FY12	FY13	FY14	FY15
Current Forecast	$54,386,707	$54,528,138	$53,979,634	$54,274,733	$53,865,302
Annual % Growth	-5.5%	0.3%	-1.0%	0.5%	-0.8%
Net Increase (Decrease)		($520)	($1,293)	($104,618)	($109,843)
Revised Forecast	$54,386,707	$54,527,618	$53,978,341	$54,170,115	$53,755,459
Annual % Growth	-5.5%	0.3%	-1.0%	0.4%	-0.8%

For the Fund for a Healthy Maine (FHM), the adjustments in this forecast are very small during the 2012-2013 biennium. The assumptions related to the tobacco settlement payments remain unchanged and there are no new developments in the pending legal proceedings that affect these payments. The only changes during the 2012-2013 biennium represent some minor reductions to interest earnings assumptions on balances in the fund. These continue into the 2014-2015 biennium. Also during the 2014-2015 biennium, the effects of the changes to the Bangor Casino revenue estimates begin to affect the FHM after the $4.5 million cap on the FHM share of the Bangor Casino revenue ends after FY13.

Medicaid/MaineCare Dedicated Revenue Taxes Summary

	FY11 Actual	FY12	FY13	FY14	FY15
Current Forecast	$148,021,777	$151,846,694	$154,373,049	$154,373,049	$154,373,049
Annual % Growth	5.7%	2.6%	1.7%	0.0%	0.0%
Net Increase (Decrease)		($396,444)	$0	$0	$0
Revised Forecast	$148,021,777	$151,450,250	$154,373,049	$154,373,049	$154,373,049
Annual % Growth	5.7%	2.3%	1.9%	0.0%	0.0%

Medicaid/MaineCare Dedicated Revenue Taxes revenue estimates (also refer to Appendices D and F) are revised downward on a one-time basis in FY 12 by $0.4 million based on FY11 payments and actual payments to date.

Conclusion

The RFC felt that it had to make “off-model” adjustments to the tax model results to factor in the recent developments related to fuel prices, primarily gasoline prices. The significant impact of high fuel prices on other consumer expenditures represents the greatest short-term risk to this forecast. These risks increased shortly after the CEFC met in late January. While national forecasts have become more stable, these national forecasts include scenarios that introduce various other risk factors to the modest economic growth we are experiencing. Some of these alternative forecasts reflect another recession, referred to as a “double-dip recession.” As we have noted in past forecasts, we are still in an era with high forecasting risk. Some of the most concerning risk factors include the potential for substantial increases in energy prices, uncertainty over the stability of future petroleum supplies and the threat to global economic growth posed by instability in Euro-zone financial markets. Higher than anticipated energy prices would reduce growth in consumer spending on non-energy items, and could negatively impact income and employment. Major disruptions in international petroleum shipments could affect not only energy prices, but also contribute to a slowdown in overall economic activity that would negatively impact income tax as well as sales tax revenues. The financial crisis in the Euro-zone could, if not successfully resolved, reduce prospects for economic growth globally and threaten the health of US financial markets and the demand for US exports. Finally, pending decisions on the extension of federal tax reductions, previously extended through the end of 2012, could significantly affect taxpayer behavior, particularly with respect to upper income taxpayers facing significant changes in the treatment of bonus income, exercising stock options and capital gains after tax year 2012.