

MAINE STATE LEGISLATURE

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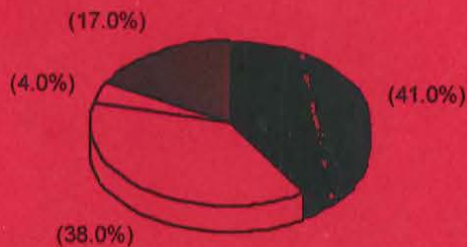
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REPORT OF THE MAINE STATE REVENUE FORECASTING COMMITTEE

February 1997

General Fund Revenues FY 1998



■ Sales Tax □ Ind Inc Tax
□ Corp Inc Tax ■ Other

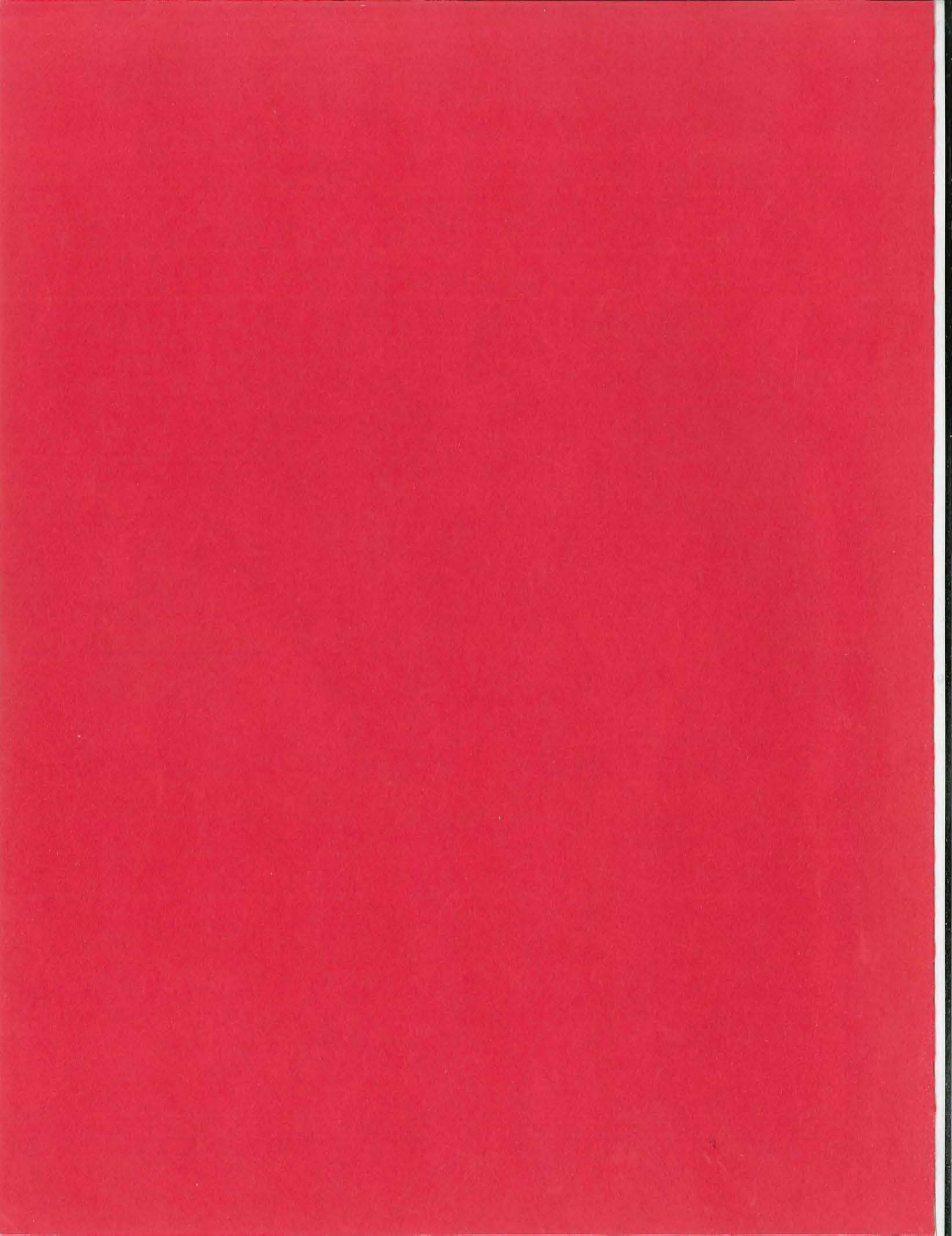
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REPORT OF THE MAINE STATE
REVENUE FORECASTING COMMITTEE

- I. EXECUTIVE SUMMARY
- II. OVERVIEW
 - A. Background of the Revenue Forecasting Committee
 - B. Methodology
 - C. Underlying Assumptions
 - 1. Current Tax Law
 - 2. Consensus Economic Forecasting Commission
- III. FY 1997 REVENUE REPROJECTIONS
 - A. General Fund
 - B. Highway Fund
- IV. FY 1998 THROUGH FY 2001 REVENUE PROJECTIONS
 - A. General Fund
 - B. Highway Fund
- V. CONCLUSION

I. EXECUTIVE SUMMARY

This report summarizes the Maine State Revenue Forecasting Committee's projections of General and Highway Fund revenues for FY 1998 through FY 2001 as well as reprojections for FY 1997. As Tables 1 and 2 show in greater detail:

- General Fund Revenues are expected to grow by 1.1% over the upcoming biennium, increasing from \$3.565 billion in FY96/FY97 to \$3.605 billion in FY98/FY99.
- General Fund revenues will grow to \$3.750 billion in the subsequent biennium which is a 4% increase.
- Highway Fund Revenues are forecast to experience a 9.9% decrease through the 98/99 biennium, falling from \$476.5 million in the current biennium to \$429.5 million, before growing 4.1% to \$447 million in the 2000/2001 biennium.
- The original FY 97 budget for General Fund Revenues has been reprojected upward by \$9.7 million (a 0.5% change) and the original Highway Fund budget for FY 97 remains virtually unchanged with a minor upward revision of \$750,000.

Overall, the modest pace of revenue growth forecast here is a direct reflection of the slow economic recovery being experienced in this state and the tax cuts put in place by the 117th Maine Legislature. As the cover graph illustrates, 79% of total General Fund Revenues are derived from two tax lines, the Sales and Use Tax and the Individual Income Tax. The performance of the Sales and Use Tax is tied directly to economic activity in the State. With wage and salary employment growth forecast to average 1.0% annual growth through the biennium and nominal personal income increases expected to be 5.0% annually, it is not surprising that sales tax revenue growth will be lackluster. In addition, Individual Income Tax revenues are effectively capped, starting in FY98, at \$676,230,000. All natural revenue growth in this line, which is projected to increase 5% annually, will be placed in a revenue targeting fund and will then be used to lower individual income tax rates. Since Individual Income Tax collections are expected to remain above the \$676 million cap through the forecast period, the cap mechanism will constrain General Fund tax revenue growth from this line to 0%.

Two-thirds of Highway Fund Revenues are derived from Fuel Taxes which are projected to see very stable 1.2% annual increases through the forecast period. The volatility of the smaller Highway Fund revenue lines, however, is significant enough to cause overall Highway Fund growth to be very uneven, showing a 3.9% decline in FY98 before registering positive growth of 1.1%, 3.1% and 0.9% in subsequent years.

During our review and reprojected of FY97 General Fund revenues, some Committee members felt that our Corporate Income Tax forecast was too low. As of our early December meeting, Corporate Income Taxes were nearly \$16 million above budget YTD October. Given the highly volatile nature of this revenue source and the fact that December is typically one of the largest refund months, the Committee adopted an upward reprojected of only \$7 million and agreed to reconvene in February to reconsider the FY97 projection of this line.

TABLE 1

GENERAL FUND REVENUE SUMMARY
FY96 - FY01

REVENUE SOURCE	ACTUAL FY96	BUDGET FY97	FY97 REVISION	REVISED FY97	FY98	FY99	FY00	FY01
Sales and Use Tax	624,041,216	682,356,818	0	682,356,818	738,298,995	767,830,955	798,544,193	830,485,961
Gross Receipts Tax	68,460,826	45,851,380	0	45,851,380	0	0	0	0
Individual Income Tax	674,507,957	676,301,555	13,200,000	689,501,555	676,230,000	676,230,000	676,230,000	676,230,000
Corporate Income Tax	67,344,662	63,547,000	7,164,200	70,711,200	74,246,760	77,959,098	81,857,053	85,949,906
Cigarette and Tobacco Tax	47,601,709	44,822,299	1,500,000	46,322,299	44,890,210	43,503,205	42,159,825	40,858,660
Public Utilities Tax	28,853,169	27,120,629	1,129,371	28,250,000	28,475,000	28,925,000	29,375,000	29,750,000
Insurance Companies Tax	35,518,538	38,061,754	(2,000,000)	36,061,754	35,663,000	35,312,000	34,964,000	34,619,000
Estate Tax	12,379,606	11,978,281	0	11,978,281	12,397,521	12,831,434	13,280,534	13,745,353
Property Tax - Unorganized Territories	9,135,576	10,135,313	(935,313)	9,200,000	10,290,909	10,622,772	11,025,325	11,337,655
Income from Investments	8,512,311	3,329,000	1,500,000	4,829,000	(1,000,000)	(800,000)	(600,000)	(400,000)
Transfer from Liquor Commission	21,446,967	20,504,971	0	20,504,971	21,199,678	21,397,879	21,397,879	21,397,879
Transfer from Lottery Commission	37,736,554	47,155,266	(9,792,991)	37,362,275	37,887,870	40,362,981	40,362,981	40,362,981
Sub-Total Other Revenues (below)	130,861,669	117,369,649	(2,055,194)	115,314,455	105,493,238	106,726,089	107,855,028	108,826,021
Real Estate Transfer Tax	6,901,703	8,263,373	(600,000)	7,663,373	4,977,431	5,126,754	5,280,556	5,438,973
Dairy Farm Stabilization Tax	2,866,816	3,600,000	(3,000,000)	600,000	0	0	0	0
Harness Racing Pari-Mutuels	616,374	1,289,990	(689,990)	600,000	600,000	600,000	600,000	600,000
Inland Fish and Wildlife	12,742,429	16,068,514	(879,994)	15,188,520	15,297,943	15,566,365	15,566,365	15,566,365
Judicial Fines	19,538,007	20,664,000	0	20,664,000	21,077,280	21,498,826	21,928,803	22,367,379
Human Services	17,985,417	9,138,246	524,300	9,662,546	9,956,000	9,956,000	10,941,600	10,941,600
Mental Health, Mental Retardation, SAS	14,608,500	10,481,428	1,065,490	11,546,918	10,175,800	10,673,800	10,987,800	11,357,800
Banking Licenses and Fees	5,127,270	3,300,000	1,200,000	4,500,000	4,261,000	4,261,000	4,261,000	4,261,000
Fines - Prof & Financial Regulation	137,800	0	325,000	325,000	50,000	50,000	50,000	50,000
Other Revenues	50,337,353	44,564,098	0	44,564,098	39,097,784	38,993,344	38,238,904	38,242,904
TOTAL GENERAL FUND REVENUES	1,766,400,760	1,788,533,915	9,710,073	1,798,243,988	1,784,073,181	1,820,901,413	1,856,451,818	1,893,163,416

TOTAL BIENNIAL GF REVENUES	3,564,644,748	3,604,974,594	3,749,615,234
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*****TOTAL GF WITHOUT TAX CAP	1,788,964,381	9,710,073	1,798,674,454	1,832,271,803	1,903,293,066	1,976,622,829	2,053,473,038
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HIGHWAY FUND REVENUE SUMMARY
FY96 - FY01

REVENUE SOURCE	ACTUAL FY96	BUDGET FY97	FY97 REVISION	REVISED FY97	FY98	FY99	FY00	FY01
Fuel Taxes	144,383,103	144,451,978	0	144,451,978	146,135,554	147,860,834	149,608,646	151,379,318
Motor Vehicle Registration & Fees	61,953,854	56,556,495	750,000	57,306,495	56,556,495	57,028,952	61,908,962	62,088,962
Inspection Fees	1,720,389	1,630,034	0	1,630,034	1,740,312	1,740,312	1,740,312	1,740,312
Other Revenues	46,157,572	18,909,425	0	18,909,425	9,209,169	9,279,620	9,279,620	9,279,620
TOTAL HIGHWAY FUND REVENUES	254,214,918	221,547,932	750,000	222,297,932	213,641,530	215,909,718	222,537,540	224,488,212

TOTAL BIENNIAL HF REVENUES	476,512,850	429,551,248	447,025,752
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TABLE 2

GENERAL FUND REVENUE GROWTH
FY97-FY01

REVENUE SOURCE	GROWTH FY97	GROWTH FY98	GROWTH FY99	GROWTH FY00	GROWTH FY01
Sales and Use Tax	9.3%	8.2%	4.0%	4.0%	4.0%
Gross Receipts Tax	-33.0%	-100.0%			
Individual Income Tax	2.2%	-1.9%	0.0%	0.0%	0.0%
Corporate Income Tax	5.0%	5.0%	5.0%	5.0%	5.0%
Cigarette and Tobacco Tax	-2.7%	-3.1%	-3.1%	-3.1%	-3.1%
Public Utilities Tax	-2.1%	0.8%	1.6%	1.6%	1.3%
Insurance Companies Tax	1.5%	-1.1%	-1.0%	-1.0%	-1.0%
Estate Tax	-3.2%	3.5%	3.5%	3.5%	3.5%
Property Tax - Unorganized Territories	0.7%	11.9%	3.2%	3.8%	2.8%
Income from Investments	-43.3%	-120.7%	-20.0%	-25.0%	-33.3%
Transfer from Liquor Commission	-4.4%	3.4%	0.9%	0.0%	0.0%
Transfer from Lottery Commission	-1.0%	1.4%	6.5%	0.0%	0.0%
Sub-Total Other Revenues (below)	-11.9%	-8.5%	1.2%	1.1%	0.9%
Real Estate Transfer Tax	11.0%	-35.0%	3.0%	3.0%	3.0%
Dairy Farm Stabilization Tax	-79.1%	-100.0%			
Harness Racing Pari-Mutuels	-2.7%	0.0%	0.0%	0.0%	0.0%
Inland Fish and Wildlife	19.2%	0.7%	1.8%	0.0%	0.0%
Judicial Fines	5.8%	2.0%	2.0%	2.0%	2.0%
Human Services	-46.3%	3.0%	0.0%	9.9%	0.0%
Mental Health, Mental Retardation, SAS	-21.0%	-11.9%	4.9%	2.9%	3.4%
Banking Licenses and Fees	-12.2%	-5.3%	0.0%	0.0%	0.0%
Fines - Prof & Financial Regulation	135.8%	-84.6%	0.0%	0.0%	0.0%
Other Revenues	-11.5%	-12.3%	-0.3%	-1.9%	0.0%
TOTAL GENERAL FUND GROWTH	1.8%	-0.8%	2.1%	2.0%	2.0%

TOTAL BIENNIAL GF REVENUE GROWTH	1.1%	4.0%
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*****TOTAL GF WITHOUT TAX CAP	1.9%	3.9%	3.9%	3.9%
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HIGHWAY FUND REVENUE GROWTH
FY97 - FY01

REVENUE SOURCE	GROWTH FY97	GROWTH FY98	GROWTH FY99	GROWTH FY00	GROWTH FY01
Fuel Taxes	0.0%	1.2%	1.2%	1.2%	1.2%
Motor Vehicle Registration & Fees	-7.5%	-1.3%	0.8%	8.6%	0.3%
Inspection Fees	-5.3%	6.8%	0.0%	0.0%	0.0%
Other Revenues	-59.0%	-51.3%	0.8%	0.0%	0.0%
TOTAL HIGHWAY FUND GROWTH	-12.6%	-3.9%	1.1%	3.1%	0.9%

TOTAL BIENNIAL HF REVENUE GROWTH	-9.9%	4.1%
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II. OVERVIEW

A. Background of the Revenue Forecasting Committee

The Revenue Forecasting Committee was established by Governor John R. McKernan, Jr. on May 25, 1992 by Executive Order 14 FY91/92 in order to provide the Governor, the Legislature, and the State Budget Officer with an analysis and recommendations related to the projection of General Fund and Highway Fund revenue. Its creation was in response to a recommendation by the Special Commission on Government Restructuring. Committee membership includes the State Budget Officer, the State Tax Assessor, the State Economist, the Director of the Office of Fiscal and Program Review, and an economist on the faculty of the University of Maine System selected by the Chancellor.

The original Executive Order calls upon the Revenue Forecasting Committee to submit recommendations for State revenue projections for the upcoming fiscal biennium, as well as adjustments to current biennium General Fund and Highway Fund revenue estimates. In accomplishing its task, the Committee is directed to utilize the economic assumptions developed by the Consensus Economic Forecasting Commission.

In 1995, PL 1995, c. 368 enacted in statute the Consensus Economic forecasting Commission and the Revenue Forecast Committee, adopting both the structure and the intent of the original Executive Order.

B. Methodology

Both the General Fund and the Highway Fund revenue projections are actually an aggregation of several individual revenue line forecasts. There are over two dozen revenue lines which comprise total General Fund revenue and a half dozen components which sum to total Highway Fund revenues. Since each of these individual revenue lines is distinctly different in terms of size (and thus relative importance to total revenue) and factors that influence growth (such as tax law, economic growth, interest rates, size of lottery jackpot, number of patrolmen, etc.), the Committee uses different approaches for evaluating various revenue line forecasts.

In order to ensure that the Committee's review process is as efficient and effective as possible, it divides its revenue line review into three parts:

- Major revenue lines directly tied to economic activity
- Major revenue lines tied to other "non-economic" factors
- Minor revenue lines

In general, major revenue lines directly tied to economic activity are forecast using econometric equations. These equations define a mathematical relationship between historical revenue growth and relevant economic trends, then project revenue growth based on the defined relationship and expected future performance of the economic

variable chosen. For example, revenues derived from the collection of individual income tax are very closely tied to growth in Maine personal income. Thus, an equation is estimated that defines income tax revenue in terms of personal income, then the forecast of personal income growth in Maine is used to estimate future income tax collections. The Revenue Forecasting Committee then reviews the equation, the underlying economic assumptions and the overall revenue forecast level to ensure that they are logical and plausible given our knowledge of current economic conditions and revenue growth. It is the Committee's understanding, and truly the spirit of "consensus forecasting", that model results need not be blindly accepted and should be closely examined.

Both the major revenue lines tied to other "non-economic" factors and the minor revenue lines are generally prepared by the department or agency responsible for collecting the particular revenue stream. Their experience with and expertise in tracking revenue growth is used in place of an equation to project future revenue activity. For example, the level of participation in Maine's lottery is not easily or clearly tied to any particular economic indicator, like income or employment. Revenue derived from lottery ticket sales can, however, be projected based on past lottery sales and the likelihood of a large jackpot occurring within a twelve month period. Therefore, the Department of Finance and Administrative Services reviews past lottery trends and estimates the lottery's revenue performance over the upcoming biennium. Additional factors which are reviewed by the Committee include the projected Cost of Goods Sold and Administrative Expense to arrive at an estimated Net Profit to be transferred to the General Fund. The Revenue Forecasting Committee then reviews their forecast to ensure that their logic is sound and to ensure that this particular line forecast is consistent with expectations for other revenue lines.

C. Underlying Assumptions

1. Current Tax Law

The Revenue Forecasting Committee bases all revenue projections on current tax law. The Committee does not attempt to second-guess how the law may be changed during the upcoming biennium.

In this particular forecast, the use of "Current Tax Law" has two implications:

Gross Receipts Tax

The repeal of the Gross Receipts Tax (often referred to as the Nursing Home Tax) by PL 1995, c.368 Part E, effectively eliminates over \$25 million annually from General Fund Revenue collections starting in FY97.

Income Tax Cap

Beginning in FY 1998, all individual income tax revenues collected in excess of \$676,230,000 must be deposited into the Revenue Targeting Fund. (36 MRSA subsection 5111-B was enacted by PL 1995, c. 368 Part VV and established this Revenue Targeting Fund.) Monies from the Fund will be used to reduce individual income tax rates. This mechanism, commonly referred to as the "Income Tax Cap", will remain in place until such time that a cumulative tax rate reduction of 20% of the 1994 rates has been achieved. In order to determine the likelihood of the "Cap" being exceeded, the Revenue Forecasting Committee prepared the forecast of Individual Income Tax Revenues in the usual manner. The Committee projects that in each of the four fiscal years from 1998-2001 the Cap will be exceeded and all natural growth in individual income tax collections brought about by growth in total personal income would put an estimated \$48 million into the Fund during FY98 and an incremental \$35-\$40 million annually thereafter.

2. Consensus Economic Forecasting Commission

As directed by the originating Executive Order and the subsequent statute, the Committee closely examined the economic assumptions developed by the Consensus Economic Forecasting Commission. Economic assumptions were used by the Committee in two ways. First, projected employment, income and inflation changes were used directly in the sales and income tax revenue estimating models maintained and operated by the Bureau of Taxation. Second, Committee members assessed revenue trends predicted by models and by other agencies against economic expectations offered by the Consensus Economic Forecasting Commission.

The Consensus Economic Forecasting Commission met in early September to prepare the economic assumptions that would become the basis of the Revenue Committee's current biennial revenue projections. Given that Maine's economic well being is so highly dependent on national economic activity, the Commission started its forecast review by examining national economic trends and projections. After reviewing a number of outlooks, they concluded that growth over the upcoming 5 years would be modest, at best, but a recession was unlikely. The Commission also concluded that inflation would be kept in check over the

foreseeable future and would not rise above the 3.5% threshold that triggers the indexing of Maine's individual income tax.

The majority of the Commission's deliberations focused on the current condition of and outlook for the Maine economy. A review of Maine's economic indicators raised many questions. The data were giving very mixed messages as to Maine's current situation which made the outlook less clear. On the positive side, the national outlook was for continued expansion, which bodes well for Maine as we tend to track U.S. economic performance quite closely. There was also a good deal of evidence that the southern and coastal counties were experiencing a fairly strong recovery and tight labor market conditions were beginning to develop. Sales, individual income and corporate income taxes were all up and retail sales continued to grow. On the flip side, bankruptcy filings had been climbing, those qualifying for food stamps remained at near-peak levels and, most puzzling, wage and salary employment had been declining since the beginning of 1996. Based on the knowledge that employment figures are subject to year-end revisions and that Maine traditionally tracks the national economy, the Commission decided that it was highly unlikely that Maine was entering a recession. Recognizing that the employment figures would have to show a significant turnaround if year-end numbers were going to show positive growth, the group predicted an extremely slow +0.2% increase for 1996 with a slightly faster pace thereafter.

The Revenue Forecasting Committee directly adopted the Economic Commission's forecast of income and employment growth and inflation and incorporated these assumptions into our revenue forecasting models. Thus, the economic growth assumptions underlying these revenue projections are as follows:

TABLE 3

UNDERLYING ECONOMIC ASSUMPTIONS

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
ME Wage & Salary Employment	0.7%	1.0%	1.2%	1.0%	1.0%
ME Personal Income (Nominal)	5.0%	5.0%	5.0%	5.0%	5.0%
U.S. Consumer Price Index	3.0%	3.0%	3.0%	3.0%	3.0%

The members of the Consensus Economic Forecast Commission are listed below:

Charles Colgan, Chair - Muskie Institute

Leon Bein - KeyBank
John Davulis - CMP

Michael Donihue - Colby
Robert McMahon - USM

III. FY 1997 REVENUE REPROJECTIONS

A. General Fund

The Committee recommends that FY 1997 General Fund revenues be reprojected to \$1,798,243,988 which is an upward revision of \$9.7 million. As TABLE 4 shows, a number of individual revenue lines were revised either upward or downward by over a million dollars. While the Committee is recommending several changes to various line items, the FY 1997 General Fund Reprojection is only one half of one percent (0.5%) higher than the original FY 1997 Budget figure of \$1,788,533,915.

The four line items to undergo the most significant dollar value revisions are Individual Income Tax receipts, reprojected upward by \$13.2 million, Corporate Income Tax receipts, revised upward by \$7.2 million, Transfer From Lottery Commission, revised downward by \$9.8 million, and the Dairy Farm Stabilization tax, revised downward by \$3 million.

Individual Income Tax (+ \$13.2 million):

According to the Bureau of Taxation, Individual Income Tax receipts in FY 1996 were 5% above budget and fiscal year-to-date October 1996 figures indicated a continuation of this trend with tax receipts being \$6.6 million (or 3%) above budget. With the recent performance of this revenue source as compared to the original budget and an outlook for growth in Maine Personal Income that remained virtually unchanged, the Committee recommends that the \$13.2 million upward revision in FY 1997 Individual Income Tax projections be adopted.

Corporate Income Tax (+ \$7.2 million):

Corporate Income Tax receipts during FY 1996 were also significantly above original budget levels. In addition, Fiscal 97 year-to-date October Corporate Income Tax revenues are \$15.9 million above the original FY 1997 budget. Noting the highly volatile

nature of this revenue stream and recognizing that December is one of the largest Corporate Income Tax refund months, the Committee decided that this tax line should be reprojected upward by \$7.2 million at this time, bringing this annual revenue projection to a base level of slightly over \$70 million. The Committee also decided to reexamine this revenue line in February to determine if the December refund activity had significantly reduced the current overage.

Transfer From Lottery Commission (- \$9.8 million):

During Fiscal 1996, the transfer into the General Fund from the Lottery Commission was \$8.4 million below expectations. This 18% underage, along with FY97 year to date October performance which is 15% below budget, has led the Revenue Forecasting Committee to accept the Director of the Lottery Commission's suggested downward revision of \$9.8 million in this line.

Dairy Farm Stabilization Tax (- \$3.0 million):

The Dairy Farm Stabilization Tax (included in the "Other Revenue" line below in Table 2) is a very volatile revenue stream that is entirely dependent on the price of milk. The tax is structured in such a way that when the price of milk is \$16.50 per hundred weight or above, no tax is collected. If the price is \$16.00 - \$16.49 per hundred weight, a tax of 1 cent per quart is levied. The tax increases to a maximum of 6 cents per quart as the price of milk falls to \$14 or below. As of October, 1997, milk prices had remained above the \$16.50 mark, thus no tax had been collected for FY97. Recognizing that the price of milk might fall below the threshold at some point during the year, the Revenue Forecasting Committee decided to revise the original forecast of \$3.6 million downward by \$3 million.

TABLE 4

**SUMMARY OF GENERAL FUND
REVENUE REPROJECTIONS - FY 97**

	Original FY97 <u>Budget</u>	FY97 <u>Reprojections</u>	Upward (+)/ Downward (-) <u>Revision</u>
Sales and Use Tax	\$682,356,818	\$682,356,818	0
Gross Receipts Tax	45,851,380	45,851,380	0
Individual Income Tax	676,301,555	689,501,555	13,200,000
Income Tax	63,547,000	70,711,200	7,164,200
Cigarette and Tobacco Tax	44,822,299	46,322,299	1,500,000
Public Utilities Tax	27,120,629	28,250,000	1,129,371
Insurance Companies Tax	38,061,754	36,061,754	-2,000,000
Inheritance and Estate Tax	11,978,281	11,978,281	0
Property Tax - Unorg. Terr.	10,135,313	9,200,000	-935,313
Income From Investments	3,329,000	4,829,000	1,500,000
Transfer from Liquor	20,504,971	20,504,971	0
Transfer from Lottery	47,155,266	37,362,275	-9,792,991
Other Revenues	<u>117,369,649</u>	<u>115,314,455</u>	<u>-2,055,194</u>
Total	\$1,788,533,915	\$1,798,243,988	\$9,710,073

B. Highway Fund

The Committee recommends that the FY 1997 Highway Fund revenues be reprojected to \$222,297,932. As Table 5 highlights, this level is \$750,000 higher than the original Highway Fund estimate for FY 1997 of \$221,547,932. This minor three tenths of one percent (+ 0.3%) change recognizes the fact that Maine's participation in the International Registration Program has brought in more revenue than had originally been anticipated.

TABLE 5

**SUMMARY OF HIGHWAY FUND
REVENUE REPROJECTIONS - FY97**

	Original FY97 <u>Budget</u>	FY97 <u>Reprojections</u>	Upward (+)/ Downward (-) <u>Revision</u>
Fuel Taxes	\$144,451,978	\$144,451,978	0
Motor Vehicle Reg. & Fees	56,556,495	57,306,495	750,000
Inspection Fees	1,630,034	1,630,034	0
Other	<u>18,909,425</u>	<u>18,909,425</u>	<u>0</u>
Total	\$221,547,932	\$222,297,932	\$750,000

IV. FY 1998 THROUGH FY 2001 REVENUE PROJECTIONS

A. General Fund

The Revenue Forecasting Committee estimates that Maine General Fund Revenues will total \$1.799 billion in FY97, will fall by 0.8% through FY98 reflecting the significant tax cuts that were enacted by the 117th Maine Legislature, and will grow by approximately 2% annually through the remainder of the forecast period. As the cover graph illustrates, 79% of all General Fund Revenues are derived from two sources, Sales and Use Taxes and Individual Income Taxes. Because of this, overall General Fund revenue growth is driven primarily by the performance of these two lines. The Forecast detail has been provided in Tables 1 and 2. A description of the primary factors influencing the growth of the major General Fund revenue sources is provided below:

Sales and Use Tax

Sales and Use Taxes represent 41% of total General Fund revenue collections. This tax line is estimated at \$682 million during FY97, and is expected to grow by 8.2% in FY98 and 4% annually through the remainder of the forecast period. The rapid growth in FY98 is due to the fact that, with the repeal of the gross receipts tax on nursing homes, the remaining portion of the gross receipts tax, which was a tax on class A restaurants, automatically reverted back to a sales tax. Therefore, in FY98 the Gross Receipts line shown in Table 1 goes to zero and the \$45 million associated with class A restaurants is folded into the Sales and Use Tax line. The underlying growth in this tax line is 4%, as sales tax collections track economic activity very closely. With projected total personal income growth of 5% and an estimated elasticity of 0.8 (An elasticity of 0.8 means that a 1% change in total personal incomes brings about a 0.8% change in Sales taxes), the Committee adopted the 4% growth in Sales Taxes.

Individual Income Tax

The Individual Income Tax represents 38% of total General Fund Revenues. As was mentioned in the "Current Law" section of this report, the 117th Maine Legislature established a Revenue Targeting Fund that essentially caps Individual Income Tax Revenues at \$676,230,000 starting in FY98. Thus, the Committee's job was simply to determine if this cap would be exceeded in each of the forecast years. Given the historical relationship between personal income growth in Maine and Income Tax collections, which is estimated to have an elasticity of 1 (An elasticity of 1 means that a 1% change in personal income brings about a 1% change in Income Taxes), the Committee determined that the natural growth in Individual Income Taxes due to economic growth would be 5% per year. This means that the cap will be exceeded in each of the forecast years and those monies will accrue to the revenue targeting fund rather than to the General Fund. The end result is that the General Fund will experience a zero percent annual increase over the upcoming biennia from this revenue source. Table 1 also shows what Total General Fund Revenue growth would have been in the absence to the tax cap (see Total GF Without Tax Cap line in Table 1).

Corporate Income Tax

Maine's Corporate Income Taxes, which represent 4% of Total General Fund Revenues, are the most volatile of all major revenue sources, making them the most difficult to forecast. There is no clear tie between the growth of any particular economic indicator, such as employment, income, national corporate profits, and growth in Corporate Income Tax collections in Maine. Growth in any one year is determined by the performance of a very few large companies, the timing of audit assessments and investment tax credits, and the use of Maine's net operating loss 3-year carryback provision that allows a company which suffers a loss following profitable years to reach back into their past tax payments and receive a refund based on the current losses. This can create a huge snap-back effect, dramatically altering the path of growth in this revenue line. At the suggestion of the State Tax Assessor, the Committee adopted a 5% annual growth in Corporate Income Taxes, knowing that the actual revenues derived from this source may well take wild swings around this base forecast.

Cigarette and Tobacco Tax

The Cigarette and Tobacco Tax, which is expected to bring in \$46 million during FY97, is projected to see annual declines in the vicinity of 3% through FY2001, reflecting the national movement away from smoking and the diminished Canadian sales brought about by the Canadian border taxes currently being levied.

Public Utilities Tax

This revenue source is predominantly driven by the Telecommunications Personal Property Tax. Revenues from this source are expected to experience some very modest increases through FY2001.

Insurance Companies Tax

The Insurance Companies Tax is a tax on Insurance premiums that contribute approximately \$35 million annually to the General Fund. Revenues derived from this source are expected to experience a very slow downward trend due to the increase in managed care. HMOs are not currently taxed under this, thus the rapid increase in HMO's is balancing the rapid rise in healthcare costs, producing no new revenues from insurance companies.

Estate Tax

Estate Taxes are entirely dependent on the timing and relative wealth of Maine residents who pass away. It is impossible to predict so the 3.5% annual increase in this revenue line, recommended by the Bureau of Taxation, was adopted by the Committee

Property Tax - Unorganized Territories

The forecast of property taxes from the unorganized territories is based on budgeted expenditures prepared by the Department of Audit. Annual increases in the vicinity of 3% are anticipated through the forecast period.

Income From Investments

Over the past few years, the Income From Investments has provided a few (less than 10) million dollars each year to the General Fund. Basically, the State borrowed money through a Tax Anticipation Note, and invested that money throughout the year, benefiting on the arbitrage. With the great improvement in the State of Maine's cash flow position, there is an expectation that a TAN may not have to be issued in FY98, thus the interest earnings from those monies would disappear.

Transfer From the Liquor Commission

This revenue source has been very stable and has contributed in the vicinity of \$21 million per year to the General Fund. This trend is forecast to continue through the foreseeable future.

Transfer From the Lottery Commission

Revenues collected from lottery operations in Maine grew at a fairly rapid pace during the early nineties before stalling in 1995. With the creation of major competing games in neighboring states and the natural dropoff in interest with the current mix of games that

Maine offers, lottery revenues have declined in the past two years. The Lottery Commission is planning to make some changes to their current offerings, providing better jackpots and more lower-tier prizes, in an effort to increase overall revenues. The expected result of this is 1.4% and 6.5% increases during FY98 and FY99.

B. Highway Fund

As Tables 1 and 2 show, the Revenue Forecasting Committee estimates that Highway Fund revenues will total \$222 million during FY97 and will show a slight increase to \$224 million by FY2001. Though the revenues derived from Fuel Taxes represent 69% of total Highway Fund Revenues and are forecast to grow by a stable 1.2% annually through FY2001, the other Highway Fund revenue sources are expected to experience some rather volatile swings, altering the growth path of Total Highway Funds. The uneven growth in Motor Vehicle Registration Fees is due primarily to the transition from a 4-year registration cycle to a 6-year registration. The decline in the Other Revenue line is primarily due to changes in the reimbursement from the Maine Turnpike Authority to the Department of Transportation.

V. CONCLUSION

The Maine Economy is experiencing a slow recovery. This, in turn, is causing the underlying growth in State Tax Revenues to be modest. Additionally, the significant tax cuts enacted by the 117th Maine Legislature have further dampened growth rates by constraining growth in one of the largest revenue lines, Individual Income Taxes, to 0%. The end result is a forecast of General Fund Revenues that increases at a 2% annual rate. Since inflation is expected to increase by at least 3% annually, real revenue growth in Maine will be negative for 5 consecutive years.

Highway Fund Revenues are projected to decline in FY97 and FY98 before resuming a slow growth path in FY99.