

MAINE STATE LEGISLATURE

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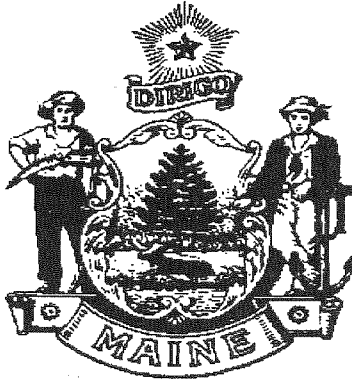


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THE MAINE ECONOMY:
Year-End Review and Outlook
1998

Maine State Planning Office
March 1999



**MAINE STATE PLANNING OFFICE
184 STATE STREET
AUGUSTA, MAINE 04333**

The Maine State Planning Office maintains several economic databases and other informational resources which may be of interest to the reader; most of these materials can be found on our WEB page. For details on information not found at our WEB site, call Galen Rose at (207) 287-1478.

In particular, we maintain a graphical database called MaineGraph which is a menu-driven file with eighty graphs and associated data on the Maine and national economies. Two versions, one requiring Excel and the other requiring Lotus 123, are available on the World Wide Web. To access these, go to our homepage at -

www.state.me.us/spo

- and click on "The Maine Economy." For those having neither Excel nor Lotus 123, a condensed version of MaineGraph is available from the Portland Newspapers at -

<http://www.mainebusiness.com/bigpic/maingraf/maingraf.htm>

This year-end report on the Maine economy reviews State economic performance during 1998, outlines the near-term economic outlook for Maine, New England, and the nation, identifies some of the issues we expect will prove important in Maine's economic performance during the next few years, and highlights ten key State economic events of the past year.

Among the conclusions detailed in this report are:

- Maine economic performance in 1998 was the best in a decade, with virtually all major indicators describing improvement over a strong 1997. The prime mover was a spectacular national economy which turned in a second straight year of 3.9% real growth, the best since 1984.
- During 1998, the number of Maine payroll jobs expanded by 15,900, more than in any year since 1988.
- The major economic events in the State during the year included extraordinarily strong State government revenues, a spate of large corporate mergers, a catastrophic ice storm, huge Y2K investments, and further expansion of call center businesses.
- The Maine economic outlook calls for continued steady growth, with coastal and southern I-95 corridor counties outperforming the balance of the State. Over the next few years, Maine payroll employment growth is expected to average about 1.5% per year. The major dampers on Maine economic performance continue to be slow population growth and ongoing structural shifts in employment patterns from higher wage paying industries to lower paying industries.

We hope that you will find this report useful and informative, and encourage you to call us with any comments or questions you may have.

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Table of Contents

The Maine Economy in 1998	2
The Ten Most Significant Economic Events in Maine in 1998	7
The U.S. and New England Outlook	10
Maine Economic Outlook	11
Issues For The Future	12

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The Maine Economy in 1998

OVERVIEW

In 1998, the Maine economy turned in one of its finest performances ever. Riding the tide of a surging national economy (Real GDP growth of 3.9%, same as 1997 and otherwise best since 1984), many Maine economic measures broke recent records.

Oddly, while jobs were plentiful, spending very strong, construction booming, and consumer confidence soaring, Maine personal income growth was weaker than last year. Clearly, stock market gains, which are not counted as income in the Federal stats, had a great deal to do with this. Also, given the continued decline in interest rates, mortgage refinancing activity was robust, freeing cash which also gave a lift to consumers. And, the data suggest that Maine consumers financed some of their increased spending by taking on more debt.

The table on this page compares performance in 1998 versus 1997 of a selection of Maine economic measures. Of the eighteen indicators shown, only personal income and help-wanted advertising failed to show improvement in 1998. However, a strong fourth quarter and the inevitable data revisions may correct the apparent weakness in personal income, and help-wanted advertising grew by 13.4%; less than the 27.4% of last year, but still qualifying as excellent growth.

EMPLOYMENT

Payroll employment growth in 1998, at 2.9%, was the best in a decade. Employment in the Services group grew almost twice as fast as total employment, and accounted for over half of all new jobs during the year. Retail and Wholesale Trade accounted for another quarter of total new jobs. The Construction sector had the fastest job growth at 6.5%, over twice the growth rate of total employment. As expected, manufacturing continued its long-term employment decline, losing 900 jobs.

Regionally, job markets were strongest in the south-coast and mid-coast counties, somewhat weaker in the central counties (Androscoggin, Kennebec, and Penobscot), and weakest in the "rim" counties, the natural-resource based counties which border Canada. This is a pattern which has persisted for the past several decades. All Counties had lower unemployment rates in 1998 except Oxford, where the rate edged up from 5.6% to 6%.

CONSTRUCTION

The dollar value of construction contracts increased an amazing 44.7% in 1998, dwarfing the previous year's strong 16.5% growth. Much of this growth traces to the non-building sector, but residential construction was also robust with a 17.3% gain on top of a 6.9% increase the previous year.

Maine Economic Performance Summary; 1997-1998

	Annual %Chg. 1996-97	Annual %Chg. 1997-98
<u>General Economic Growth:</u>		
Personal Income (3Qtrs '98)	5.0%	4.2%
Consumer Retail Sales	3.5%	8.9%
General Fund Revenues (Cal. Yr.)	6.3%	8.3%
<u>Employment:</u>		
Payroll Employment (revised)	2.1%	2.9%
Residents Employed (prelim.)	-1.5%	0.8%
Unemployed Persons (prelim.)	4.5%	-19.6%
Unemployment Rate (prelim.)	.3% pts	-1.1% pts.
Help-wanted Advertising	27.4%	13.4%
<u>Construction:</u>		
Total Construction Contract Award	16.5%	44.7%
Residential Construction Contract	6.9%	17.3%
Housing Permits	-4.1%	21.0%
<u>Banking:</u>		
Bank Deposits (thru 3qtrs)	1.2%	4.4%
Bank Non-performing Loans (3qtrs)	3.2%	-14.6%
Bankruptcies	37.7%	7.2%
<u>Social Assistance:</u>		
AFDC Caseload	-11.4%	-12.6%
Food Stamps Caseload	-6.0%	-3.6%
<u>Prices:</u>		
Mortgage Rates (30-year fixed)	-0.2 pts.	-0.8 pts.
Gasoline Prices	4.0%	-14.6%

TAXABLE RETAIL SALES

The 8.9% growth in Consumer Sales last year was the best in a decade, and the double digit growth of the Building Supply and General Merchandise sectors was the best since 1987. Also, Restaurant/Lodging sales growth, at 7.6%, was the highest since 1988.

There were some regional surprises, too. Two of the top three regions in terms of sales growth were the Eastern Maine District (mostly Hancock and Washington Counties), at 10%, and the Androscoggin District, at 9.1%. The third fast-growing area was the Mid-Coast, at 9.8%. All eight regions experienced greater sales growth in 1998 than in the previous year.

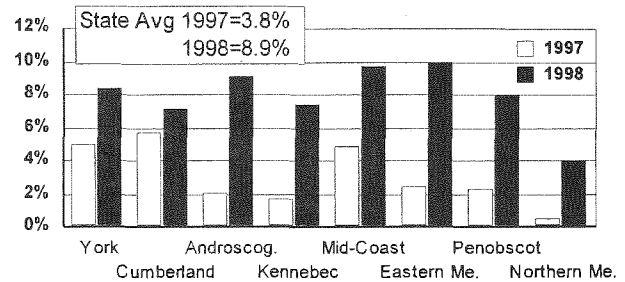
**MAINE PAYROLL EMPLOYMENT
JOB CHANGE BETWEEN 1997 AND 1998**

	JOBS CHG.	PCT. CHG.
TOTAL	15,900	2.9%
SERVICES	9,100	5.7%
RETAIL	2,900	2.6%
CONSTRUCTION	1,500	6.5%
FINANCE/INSURANCE/R.ESTATE	1,300	4.6%
WHOLESALE	800	3.0%
GOVERNMENT	700	0.7%
TRANSPORT/PUBLIC UTILITIES	500	1.9%
MANUFACTURING	-900	-1.0%

**UNEMPLOYMENT RATES OF MAINE COUNTIES
ANNUAL AVERAGES**

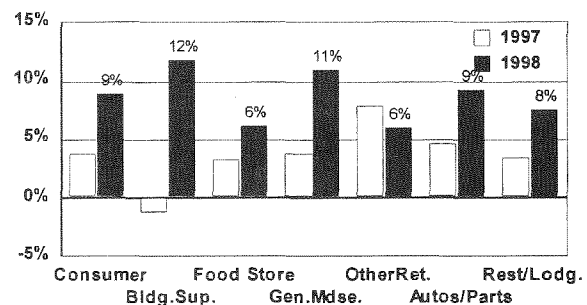
	1997	1998
MAINE	5.4	4.3
CUMBERLAND	2.9	2.4
YORK	3.8	3.1
SAGadahoc	4.0	3.1
KNOX	4.2	3.2
LINCOLN	4.0	3.3
PENOBSCOT	5.8	4.4
ANDROSCOGGIN	5.8	4.7
HANCOCK	5.9	5.0
WALDO	6.1	5.0
KENNEBEC	5.9	5.1
OXFORD	5.6	6.0
PISCATAQUIS	8.1	6.2
FRANKLIN	8.0	6.7
AROOSTOOK	9.5	7.0
SOMERSET	9.1	7.2
WASHINGTON	11.0	9.3

**Consumer Retail Sales Growth 1997-98
Maine Economic Districts**



Note: The Economic Districts are larger than the counties from which they sometimes borrow a name.

**Taxable Retail Sales Growth 1997-98
by Store-Type Group**

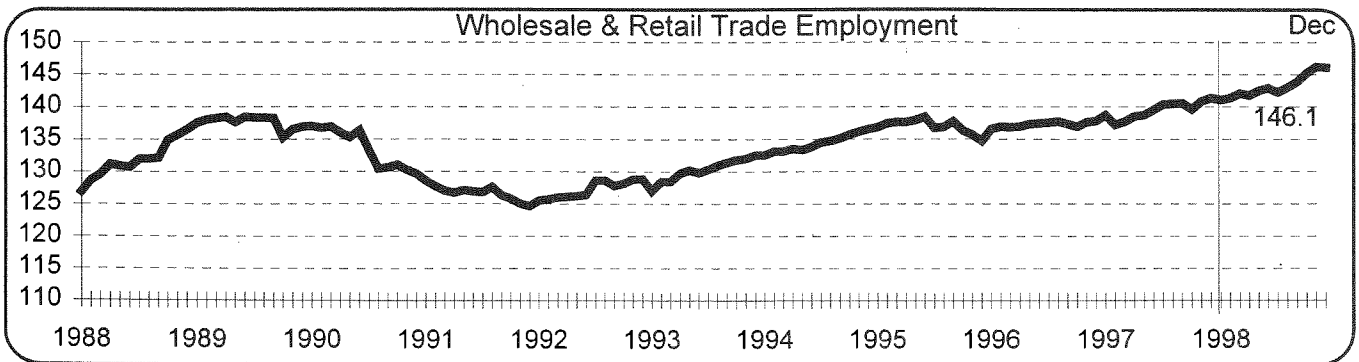
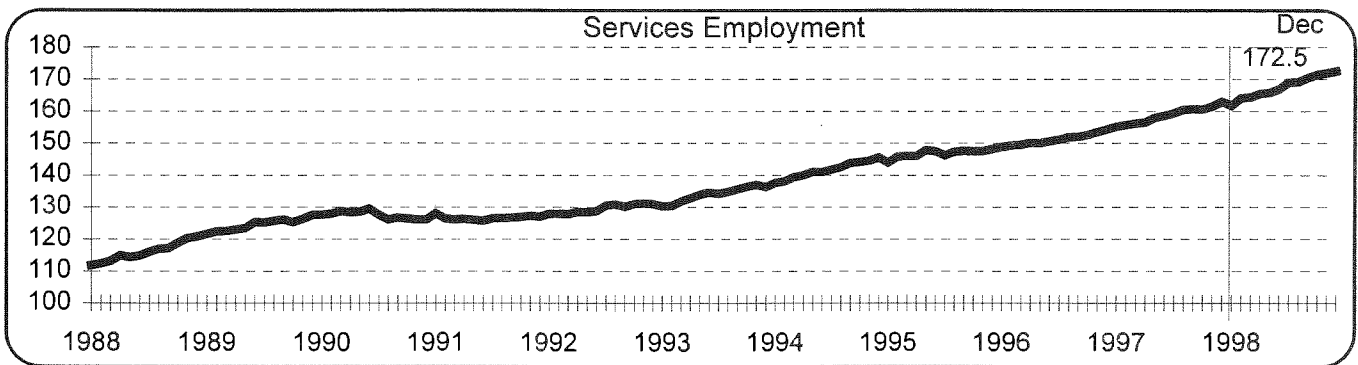
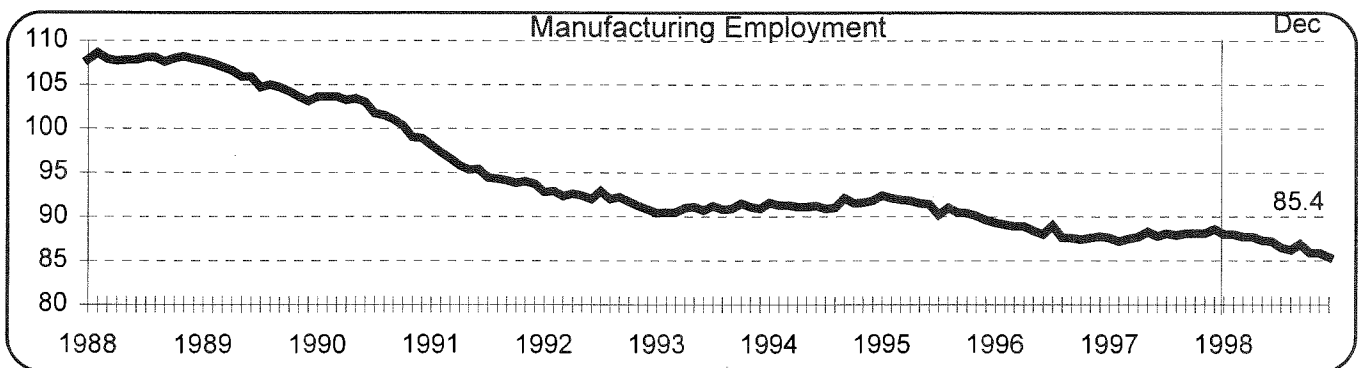
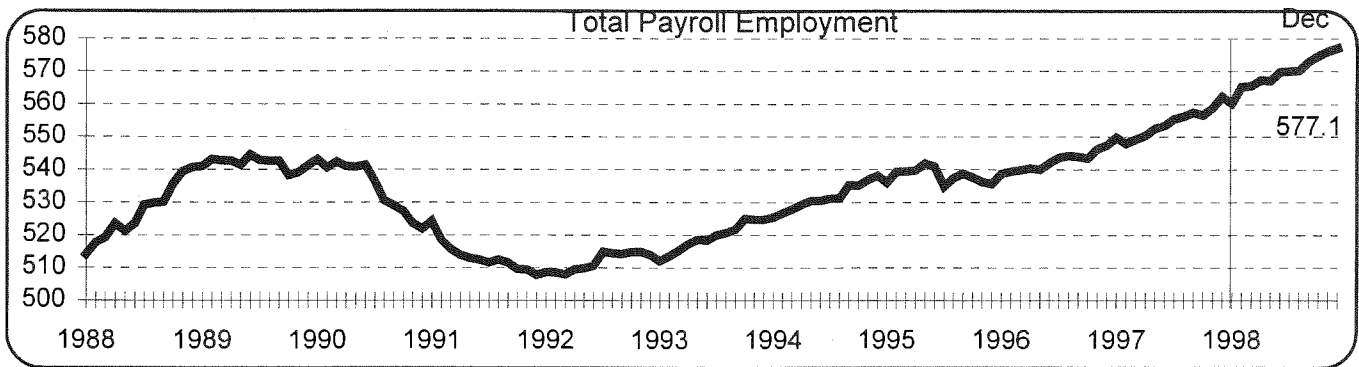


SUMMARY

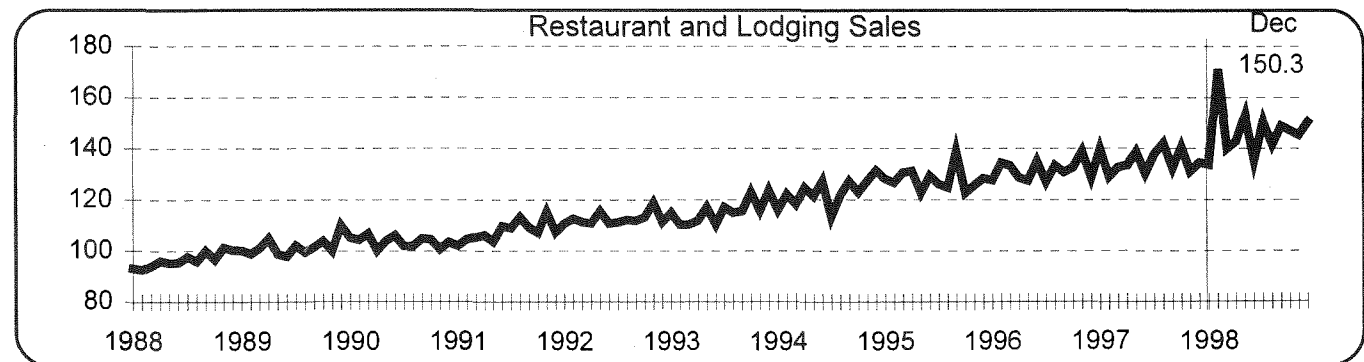
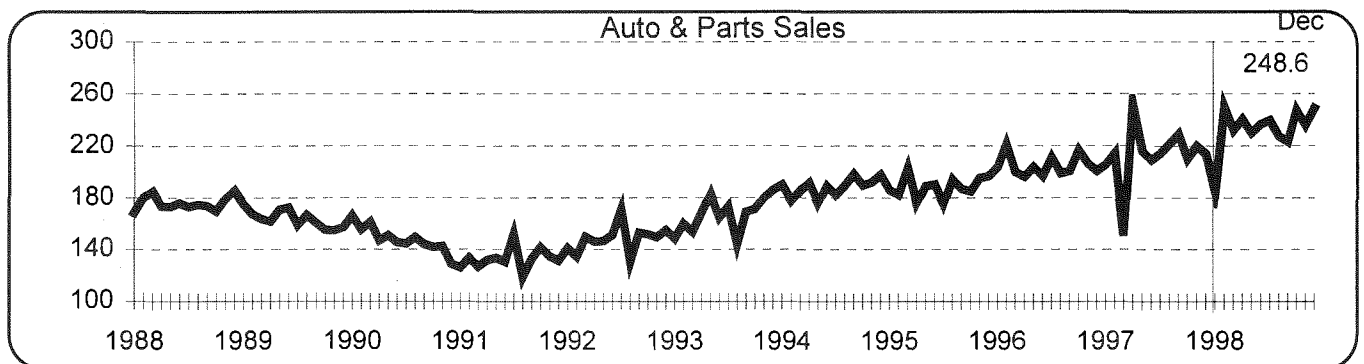
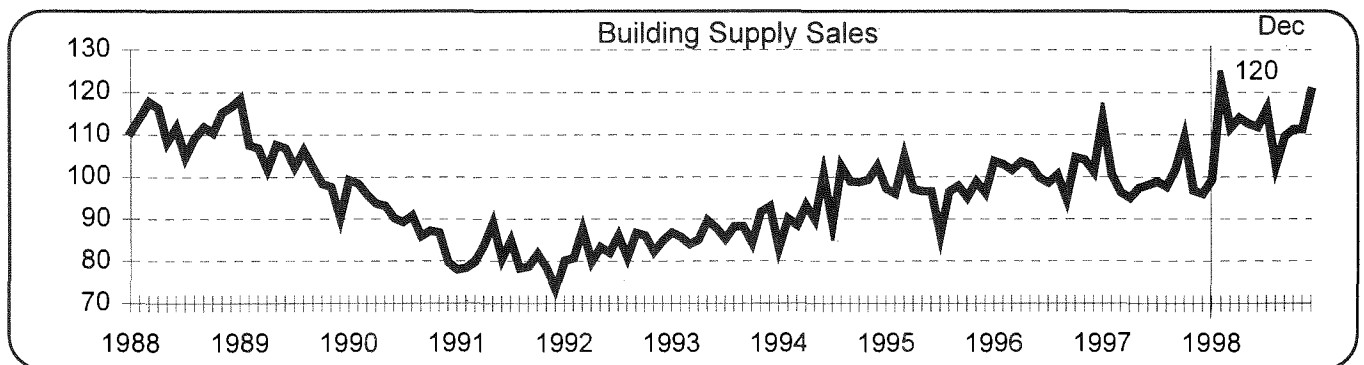
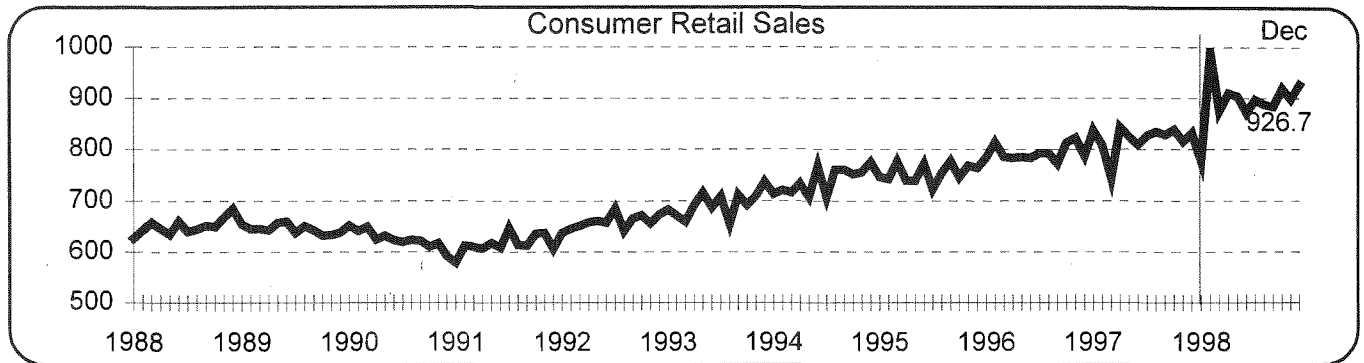
US economic performance in 1998 was outstanding, built on the strong fundamentals of low inflation, trend-breaking productivity gains, rapid job growth and a soaring stock market. Fortunately, the Maine economy was along for the ride, charting the best performance since the booming 1980's. Indicative of this strength, Maine General Fund tax revenues rose 8.3% during calendar year 1998, on the heels of exceptional 6.3% growth in '97. As illustrated by rapid employment growth in call centers (2000-plus jobs) and business services (11.5%), Maine is definitely charging into the Information Age on all cylinders. This speaks very well for the State's adaptable, dependable, educated work force and promises a bright future for the people of Maine.

The Maine Economy in 1998

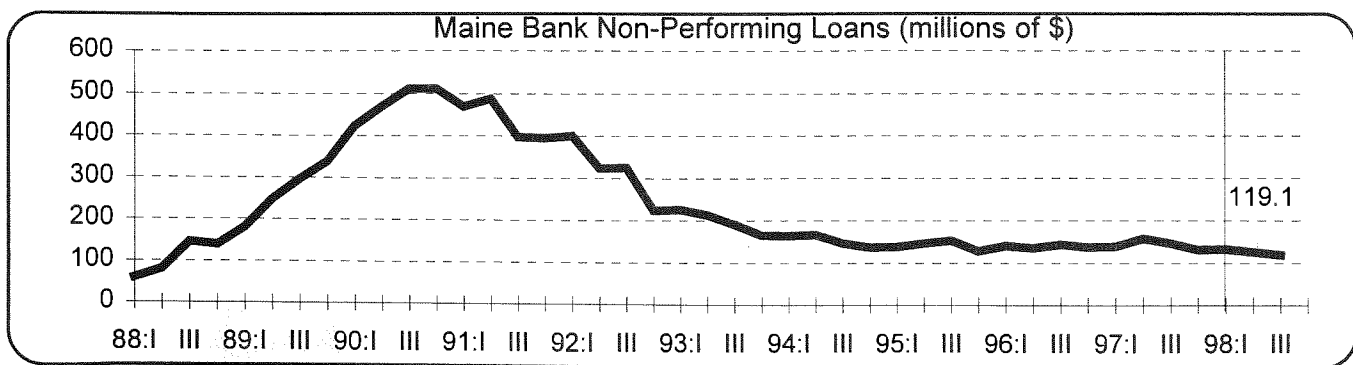
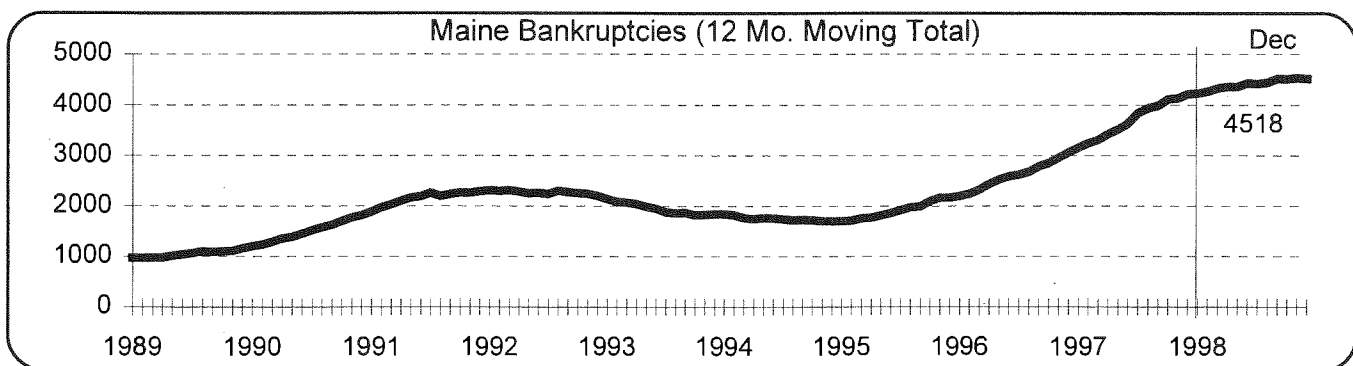
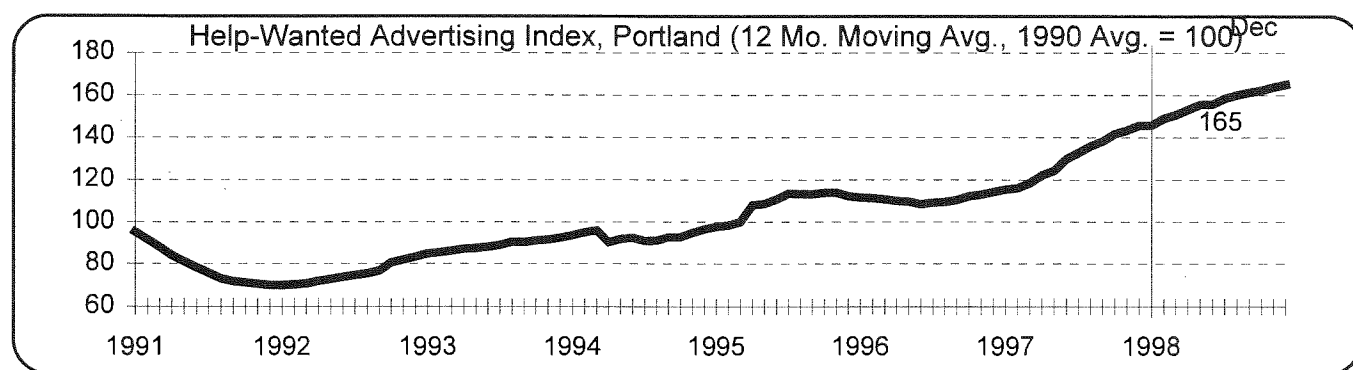
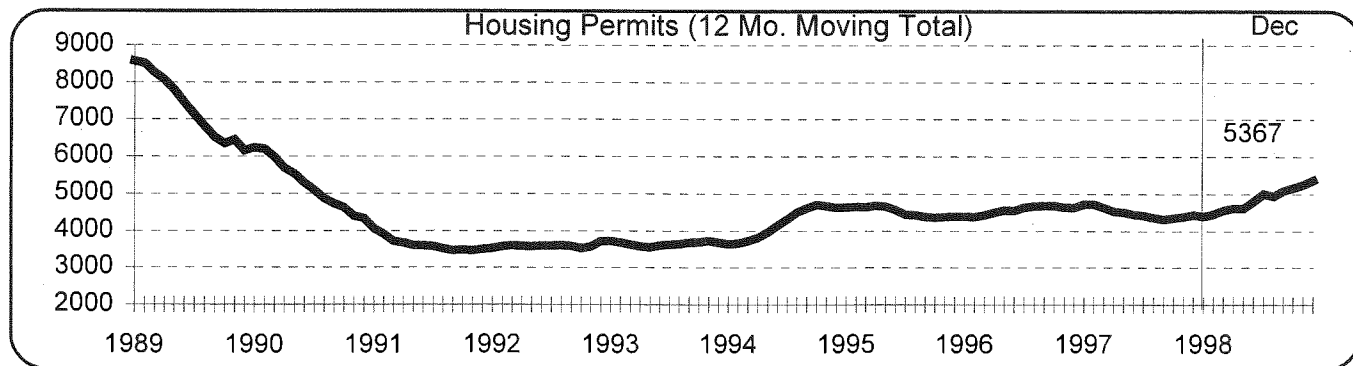
Maine Payroll Employment (seasonally adjusted 1,000's)



Maine Taxable Consumer Sales (seasonally adjusted mil.\$)



Miscellaneous Economic Indicators



The Ten Most Significant Economic Events in Maine in 1998

It seems to be standard practice for year-end publications to carry a 'Top Ten' list. Not wishing to be outdone, we include herewith our own top ten, in no particular order.

Bug Bucks, or How Many Programmers Does It Take...

The good news is that the Y2K problem generated an investment spurt in the State in 1998. The bad news is that it's not over yet (more on this in ISSUES FOR THE FUTURE). In reality, Maine and the rest of the nation appear to be well prepared to weather this storm — although the final costs to Maine businesses will likely be several times greater than those associated with the Ice Storm of '98. The State of Maine has spent nearly \$15 million to ensure that the state pension checks arrive on time, prisons continue to function, auto registrations remain consistent, and the instant lottery can still pick a winner. Estimates of the increased spending incurred by Maine businesses already run into the hundreds of millions of dollars with additional dollars for testing and bug fixing likely to continue into the next millennium.

Whatever Floats Your Boat

They say that "a rising tide lifts all boats" and the US economy looked like a tsunami during 1998 as it provided a life boat for economies around the world. Maine was no exception as employment boomed, retail sales in the State grew at the fastest rate in over a decade, personal income posted impressive gains, and state tax revenues exceeded even the wildest expectations of officials in Augusta. Several factors contributed to the economic success story of 1998, but perhaps most importantly was the so-called 'wealth effect.' Direct estimates of household wealth in Maine do not exist, but nationally household wealth surged to almost six times the level of disposable personal income last year. The run-up in stock prices was chiefly responsible. Economists estimate that consumer spending tends to rise 5 cents for every dollar that stock market wealth rises, and 8 cents for every dollar it falls. The wealth effect in 1999 may function somewhat differently, as most economic forecasters are predicting a slowdown in consumer spending relative to 1998. Of course, slowdowns (which never materialized) were expected in 1997 and 1998, too.

Win Some... Lose Some

A study of the Maine Dept. of Economic & Community Development's list of major new industries and expansions for 1998 and The Maine Dept. of Labor's mass layoff list yielded no real surprises; manufacturing jobs continue to fade and services jobs continue to increase.

On the downside, there were 77 layoff events reported to Labor's Dislocated Worker Unit (DWU). Nearly two-thirds of these involved manufacturers, which accounted for 80% of all affected workers. All 12 events involving 100 or more workers were reported by manufacturers. While not all layoffs are reported to the DWU, nearly all events involving 20 or more workers are reported. All told, reported layoffs in 1998 totaled 3,822 workers, an increase of about 800 over 1997.

On the positive side of the ledger, new industries and major expansions (events involving expansions of 20 or more workers or investments of \$500,000 or more) created 4,200 jobs, an 83% increase over the 2,300 created in 1997. Nearly 1,600 of the new jobs in 1998 were in manufacturing, but call centers (8 events) accounted for 2,065 new jobs, or nearly half of the total. Fortunately, all of the new or expanding call centers were located in counties where jobless rates were above the State average; the largest events involved Oxford (500 jobs), Wilton (400 jobs), Loring (350 jobs), and Presque Isle (300 jobs). The emergence of this industry on the Maine scene has been a tremendous boon to the economy as the call centers provide jobs paying above-average wages with benefits - as the slide in manufacturing jobs continues to erase so many of Maine's best jobs. Of course, the majority of new job generation in Maine as in the rest of the nation, in any year, occurs in the smaller enterprises.

And Then There Was One

At least ten Maine businesses merged with out-of-state firms in 1998. In four instances, the merged firms will be headquartered in Maine. In four other instances, the headquarters will be elsewhere. One merger, that between Fairchild Semiconductor and Samsung Electronics' Power Device Division, will create a third Maine firm with revenues exceeding one billion dollars a year. (UNUM and Hannaford Brothers are the other two Maine firms with revenues over one billion dollars.) The principal reasons for the mergers are the economies of scale which can be achieved and the elimination of redundant staff and operations. A contributing reason is the need for firms to grow large enough that they won't be targets for hostile takeovers.

Timber Tremors

Purchases of 4,291 square miles of Maine woodland (equivalent to an area sixty-five and one half miles square, or more than twice the land area of Delaware) were announced in 1998. Out-of-state land and timber companies were the buyers of 4,002 square miles. The Nature Conservancy was the purchaser of the remaining 289 square miles. Transfers of this magnitude are worrisome for four reasons. First is the potential negative environmental impact if the new owners fail to follow the best forest practices. Second is the adverse effect of a possible wood shortage on Maine's paper and wood products industries should the new owners use the land for something other than growing trees. Third is the environmental damage which could be done should the new owners choose to exploit the recreational potential of some of Maine's most remote and pristine natural areas and not do it carefully. And, fourth is the pressure on other large land owners to do likewise if the new owners develop the recreational value of their lands.

Who Turned Out the Lights?

That's the question thousands of Mainers were asking beginning on January 8th last year as the Ice Storm of 1998 hit the state. As the new year began, weather conditions developed which resulted in a massive ice storm which spread across parts of upper New York, crippling Montreal, and moving across New Hampshire and into Central Maine. At its peak, Central Maine Power Company reported 275,000 customers without power. Many of those customers had to wait for over a week for power to be restored, and as temperatures fell Governor King called out the National Guard to help people in need of transportation and protect against falling power lines and tree limbs. Line crews came from as far away as the mid-Atlantic states to help get the lights back on in Maine. The Governor hosted a lobster bake for them this past summer to show the appreciation all Mainers felt for their efforts.

The economic impact on the State was sizable. The Federal Emergency Management Agency expects between \$45 and \$47 million to be paid out to state agencies, municipalities, and individuals in disaster claims. Additional estimates reported to FEMA put the toll at over \$320 million including damage to forests, electricity companies, Red Cross and Salvation Army relief efforts, cable television, and telephone repairs. The Ice Storm of 1998 will undoubtedly go down in history as one of the most significant natural disasters of the century - at least in our part of the world - and the stories of how we survived will be told for generations to come.

Who Makes Your Electricity?

Come March 2000 this will very likely be the question your friends are asking you. In 1997 the Maine state legislature passed landmark legislation joining with states across the country in deregulating the generation of electricity. This means that companies like Central Maine Power Co. and Bangor Hydroelectric will no longer be in the business of generating electricity, but will merely deliver the electricity to your home. The electricity that runs your appliances will be generated by some other company that is competing with companies from across the country for your business much the way long-distance telephone companies compete for your business today.

During 1998 Central Maine Power Company entered into a contract with Florida Power and Light Company to sell all of its generating assets for \$846 million — roughly 3 times their book value. This looked to be a great deal for CMP customers as it would provide the funds to pay down the stranded costs associated with moving to a competitive market for electricity generation and result in an immediate reduction in rates of up to 10%. Late last year, however, FPL went to court seeking to be released from its contractual obligations claiming that recent Federal Energy Regulatory Commission rulings represented unanticipated changes in the regulatory environment which substantially reduced the value of CMP's assets. The Public Utilities Commission, the Maine Attorney General, and the Public Advocate's Office have filed briefs in support of CMP in the case. In the mean time, while ten other states move ahead, the transition to a competitive market for electric power generation in Maine is on hold putting at risk the mandated target date of March 2000.

Pennies From Heaven?

The budget proposed by Governor King in January 1997 projected fiscal year 1998 revenues of \$2.45 billion. When the books were closed, actual revenues were \$215 million, or 8.8% higher. For the past two years, the tax revenue stream has consistently foiled the best efforts of those responsible for projecting revenues. Historically, annual growth in State revenues has correlated quite well with total personal income. Over the past two-plus fiscal years, however, revenues from the sales and personal income taxes, in particular, have grown much faster than personal income. Nearly all states, as well as the Federal government, have been enjoying sizable surpluses. Some of the "excess" revenues can be explained by capital gains from the robust stock market, which are not counted as income in the Federal income stats, some by strong mortgage refinancing activity and increasing consumer debt loads (which both increase household cash flow for consumption), but at this point the existing data is not sufficiently detailed to explain

such strong tax revenues in an era of moderate personal income growth. We expect to be able to explain this mystery about the time it becomes history. Oh yes, and "excessive" general fund revenue growth triggered an automatic reduction of Maine's basic 6% tax rate to 5.5% on October 1, 1998. And, if 1999 revenues prove to be as strong as '98 revenues, the trigger could once again be tripped, bringing sales tax rates back to 5%.

Bond To Run

Voters in the November 3, 1998 election approved issuing \$20 million in bonds "to improve the Maine economy by supporting innovative research and development by businesses and non-profit and educational institutions in the fields of biotechnology, computers and other information technology, aquaculture and marine technology, forestry and agriculture and advanced materials." Since Maine is currently at or near the bottom in R&D spending, this marks a huge step forward and Governor King hopes to keep this level of investment up throughout his tenure, recognizing that long-term commitment is necessary. Voters approved issuing another \$7,000,000 in bonds to construct water pollution control facilities and drinking water system improvements addressing public health threats; to provide funds for the cleanup of tire stockpiles; and to investigate, clean up and mitigate threats to the public health and environment from hazardous substances discharges.

Sea Sick

While it's virtually impossible to estimate the economic consequences, Maine's fishing industry encountered a number of serious problems in 1998 which may have long-term economic effects. On the bright side, Maine gained the respect of Washington in management of lobsters and was allowed to try our own approach to species management. On the down side, cod stocks off the coast of Maine and in the Georges Bank have reached such low levels that a complete ban is proposed by the Feds; hearings are underway. The health of species also became a major issue as sick lobsters began turning up in traps. As the year ended, a virus, formerly seen further south along the Atlantic coast, was affecting Maine salmon aquaculture. The debate over whether Atlantic salmon should be classified as an endangered species continues, creating uncertainty for the future of aquaculture development, since sites are usually near the mouths of the rivers in question. And, the expiration of the offshore drilling ban for oil and gas exploration on Georges Bank adds to the level of uncertainty as the year ends.

The U.S. and New England Outlook

National & New England Economies: Settling In

As the decade of the nineties draws toward a close, one can almost hear the US economy sigh. Like the warm feeling of a full belly after a delicious meal, this is, first, a sigh of contentment as the economy enjoys a record-breaking period of growth. For 3 years running, Gross Domestic Product growth has been in excess of 3.5%. Unemployment, which has continued its slow descent to 4.5% in 98, is now at its lowest level in 28 years. The stock market is high, interest rates are low. Incomes have been rising at a decent pace, consumers have become increasingly confident, and the great American pastime - shopping - appears to be enjoying even greater popularity. In fact, consumers were so active in 1998 that retail activity significantly outpaced growth in disposable income (4.9% versus 3.1%) and the national savings rate went negative for the first time since the Great Depression! The American sigh is, second, a sigh of relief. As the international "flu" season seems to be winding down, it appears that the US has been able to avoid the dreaded disease that has plagued countries around the globe. In addition, the domestic scandals that have tied Washington in knots for the past year are, at least for the time being, over.

As the US rises from the bountiful table of the 90s, it is expected to move more slowly, with GDP forecast to be a full percentage point lower in 1999 (closer to 2.5%) before settling into a 2% pace in the new decade. Payroll employment growth will also slow from 2.5% in 1998 to the 1.5% range in 99, and continue to decelerate to 1% thereafter. Relatively slow population growth is expected to limit our ability to generate jobs. As Figure 1 shows, inflation is expected to be a non-factor.

The New England economy absolutely struggled through the first part of the decade, but has finally emerged as a stronger, more well-balanced economy. As Figure 2 illustrates, the New England region suffered a much deeper recession than the US as a whole, and was not able to fully recover its devastating job losses until 1997. Nowhere was the term "jobless recovery" more fitting than in New England. Whereas the northern tier states of Maine, New Hampshire and Vermont began their ascent in 1992 and hit their previous record employment levels a full year or two before the region as a whole, southern New England truly staggered along. Massachusetts finally began making real steps forward in 1996 and has enjoyed 3 strong years. Connecticut and Rhode Island recoveries have been not only delayed, but less robust.

While employment growth in Massachusetts is expected to slow to 1.5% in '99, it will continue to lead and, because of its sheer size, propel the region. The high tech job base in the Bay State has allowed the area to flourish in recent years and will continue to be a driving force in the future. Labor force

shortages in these particular industries along with tight labor markets overall will constrain growth rates over the next several years.

Unlike the late 80s, when overbuilding, overspending, and over-dependence on defense spending were the norm, the late 90s show a New England economy resting on a much stronger foundation. The region's dominance in high tech jobs and concentration in rapidly growing industries bode well for both job and income growth in the years ahead. Despite the area's painful economic upheaval a few short years ago, New England remains one of the wealthiest regions in the country and should enjoy its share of economic growth in the years ahead.

Fig. 1

Real U.S. Gross Domestic Product and Consumer Price Index

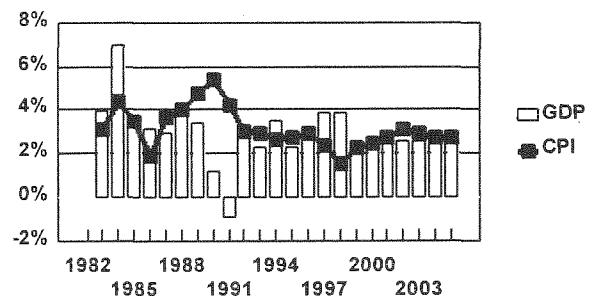
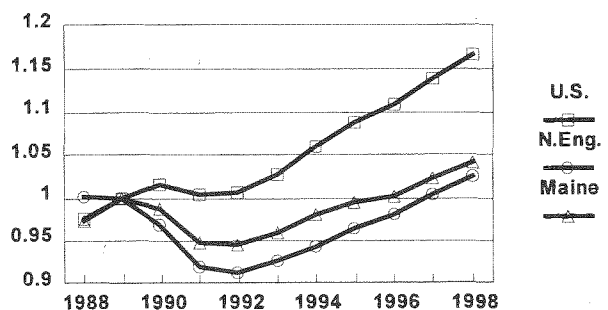


Fig. 2

The Expansion Measured by Payroll Employment (1989=1.00)



The Maine Economy: Where do we go from here?

By virtually all measures, 1998 proved to be an exceptional year for Maine. Employment grew at a 2.9% clip, unemployment continued its descent towards 4%, housing activity picked up, retail sales grew a strong 8.9%, and State tax revenue collections skyrocketed - again! The fact that Maine has not experienced this type of growth since 1988 and 1989 (the period of phenomenal growth that ended in the deepest regional recession in decades), leads immediately to the question "Where do we go from here?"

While there are certainly some areas of concern and a decent amount of risk surrounding the outlook, there is no downturn forecast for the near future. In addition, the consensus is that even if some national or international event sent our economy into a tailspin, the downward spiral would be neither as deep nor as devastating as the recession of 1990 and 1991. While the late 80s was marked by a speculative building boom that ultimately ended and crippled the region's financial institutions, and a run-up in both defense spending and consumer spending that ended abruptly, growth in the 90s has been at a much more sustainable rate and has been spread in a more sound manner across various industries. As the 90s draw to a close, the economy stands on a surer foundation.

Barring any major macro-economic upheaval, the State Planning Office is projecting that Maine's economy will continue to grow, albeit at a modest rate. Both the pace and the geographic dispersion of economic activity will be greatly influenced by population growth. The mass out-migration from Maine during the first half of this decade coupled with a birthrate that slowed to a crawl, led to a dramatic slowdown in population growth from a 10% increase in the eighties to an abysmal 2% showing during the nineties. As employment growth resumed in 1992 and hit the pre-recession peak in 1996, Maine started to feel the pinch of tight labor markets. As Figure 1 illustrates, by September 1998, three-quarters of Maine's coastal communities and the lower half of the I-95 corridor communities had unemployment rates below 4%. These are tight labor market conditions that, ultimately, limit our ability to grow.

The good news on the labor market front is that the vast majority of all population gains this decade have accrued to the southern and mid-coastal counties (see Figure 2) which, if it continues, should offer some relief in these regions and allow some growth going forward. On the down side, Figure 3 shows that, statewide, we are near our record high participation rate, which means it will become increasingly difficult to entice more of the population into the labor market.

[Continued on page 13]

Fig. 1

*Unemployment Rate (11/98)
by Labor Market Area*

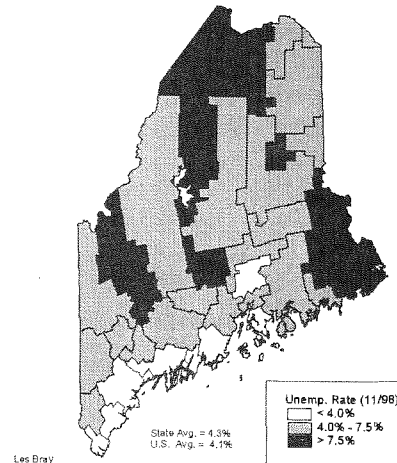


Fig. 2

Population Change 1990-97

Maine Counties

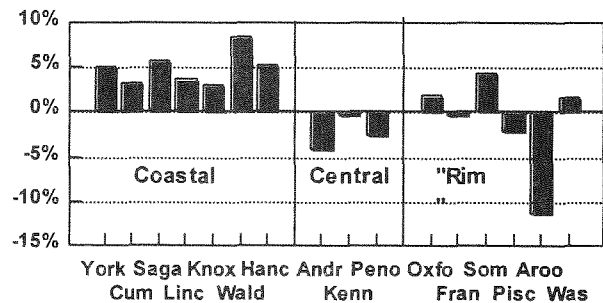
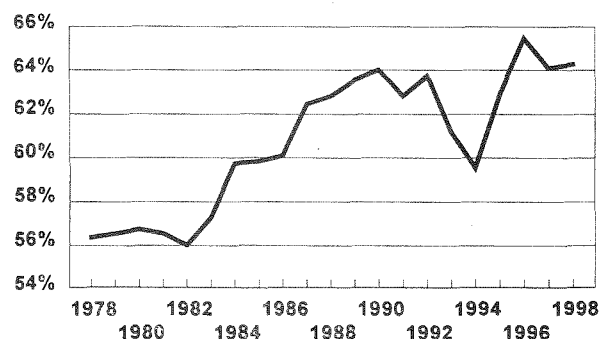


Fig. 3

Maine Employment Participation Rate

(Residents Employed as a % of Pop. 16 & Over)



ISSUES FOR THE FUTURE

Below, we outline four issues which we believe will play major roles in Maine's near-term economic future.

Worldwide Economic Uncertainties

1998 was a remarkable year for the US economy. Despite being hit by the political crisis in Washington, the meltdown of the Asian tiger economies, the collapse of the Russian economy, and a late-year 'correction' on Wall Street, the US ended the year in terrific economic shape. Unemployment in December stood at its lowest level in 30 years. Real economic growth in both 1997 and 1998 was 3.9 percent, well above the government's benchmark potential output growth rate of 2.4 percent. And consumer price inflation was a meager 1.6 percent. How long can this economic miracle go on?

There is no doubt that the US and Maine economies have benefited from the recent investment spending boom, particularly in the area of computing and telecommunications. Indeed the Labor Department announced that worker productivity grew by a healthy 2.5 percent in 1998, hinting that the US economy may be breaking out of a 25-year slump as productivity posted its third year of above-trend growth. Higher worker productivity enables firms to increase both profits and wages without raising prices. But despite all the good economic news there are some worrisome uncertainties as we close out the 20th century. The following are just a few of the more obvious causes for concern for the months ahead.

Domestically, the negative household savings rates of late 1998 are not sustainable. When Americans wake up from their spending euphoria and begin to replenish their savings, the resulting slowdown in consumption will make the economy more vulnerable to domestic and foreign shocks.

Huge worldwide declines in prices for commodities such as oil have helped enormously to keep U.S. inflation at remarkably low levels despite a hot economy; but the bottom may not be far off.

And, the currency crises in Asia, South America and Russia are exerting tremendous destabilizing pressures upon the world and US economies. For example, currency devaluations in these regions have led to record breaking U.S. trade deficits. Consumer spending in this country cannot forever keep both the U.S. and our trading partners' economies afloat.

In short, while there seems to be some very good evidence that the era of the "New Economy" has arrived - an era of long-term low inflation, high productivity, and continuous and rapid technological advance - there is also plenty of evidence that economic imbalances and the occasional recession will inhabit this new world, too.

Sprawl

Sprawl - and its antidote, smart growth - is suddenly on everyone's radar screen. The costs associated with sprawling development patterns — environmental, economic and social — are being felt across the nation and in all Maine towns, whether they're struggling to hang onto population and jobs or struggling to accommodate their influx. The early consensus on what to do in Maine has centered upon two broad themes; the need for non-regulatory approaches, and the need to rethink many State programs which often, in unintended ways, promote or subsidize sprawl. The evolving policies being talked about in meeting places around the State will, in a fundamental way, change how we allocate scarce public resources. Two examples of this are the recent changes to regulations regarding school construction funding and changed priorities for land acquisition. The ultimate aim of these public and private actions promoting more efficient land use is to reduce public costs, create more livable cities, preserve working rural landscapes, and protect the environment.

Y2K

If Maine businesses have their way, perhaps the biggest nonevent of 1999 will occur at midnight on December 31st. Hundreds of people across the State are literally working around the clock on the so-called "Y2K problem." Y2K, as most folks know by now, stands for the Year 2000 and the "problem" is that most of the programs which run computers around the world were, until very recently, written decades ago when the year 2000 seemed like the stuff of science fiction movies. Back then, computers were relatively simple machines and memory was expensive and in short supply. To make computer code more efficient, programmers lopped off the first two digits of the year so 1999 would be treated simply as 99 by computer programs. When the year 2000 arrives, no one is quite sure how some computer programs will respond if left unchecked. It may seem like an esoteric problem, but computers use dates to handle everything from traffic on the Maine turnpike to production at pulp and paper mills across the State. Some people, claiming that January 1, 2000 may look like January 9, 1998 when the ice storm turned off power throughout much of Maine, are stockpiling cash, food, fuel, and flashlights in preparation. The Federal Reserve is taking no chances and is prepared to have lots of extra cash on hand should people decide to head to their local ATMs at the end of December.

Maine businesses and other organizations have already spent hundreds of millions on the problem, and worldwide costs are likely to approach \$1 trillion. While this spending can be seen as technology upgrading, for the most part it will not increase

productivity and is unlikely to help long-term growth prospects. Spending on Y2K fixes carries with it an opportunity cost of forgone investment spending in other areas. So while Maine is currently enjoying a short-term economic boost from increased investment spending, there will be long-term repercussions in terms of lost opportunities for growth.

East-West Highway

In the spring of 1998, the 118th Legislature commissioned yet another East-West Highway Study, marking the Golden Anniversary of the examination of this concept. While the past half century has seen numerous and voluminous studies, no clear answer has emerged. One thing that is clear is that this idea will not go away. Further, it has become crystal clear that there are as many passionate opinions on this topic as there are black flies on a humid afternoon in June! Ardent backers of this proposal claim that construction of an east-west highway is absolutely critical for preventing the "Other Maine" from plunging into the abyss. Opponents refer to the proposed highway with such eloquent terms as a "scar across Maine."

So how will this study be different? Well... This time a thorough examination of the potential net economic benefits will take place. Five thousand businesses from the Maritimes to Ontario and Maine to New York will be surveyed in an effort to fully understand how and if this new highway would be used. Two thousand tourists will be surveyed. Two analogous highway build-outs will be examined. Regional economic impacts will be estimated along the proposed routes. A thorough analysis of the current and planned infrastructure, the current and projected economic conditions, and the major commodity flows and trading patterns in the Maritimes, Quebec and Ontario will take place.

While no one knows what this study will show, the hope is that an objective rigorous analysis of this proposal will bring forth a wealth of information from which solid, well grounded policy and investment decisions can be made. Stay tuned! It promises to be a wild ride!

Natural Gas Projects

During 1998, the construction of the Portland Natural Gas Transportation System (PNGTS) project moved into full swing. The construction period benefits of the \$400 million project began flowing late in 1997 and will continue into 1999 as project details are completed. Although the project was managed and operated by experienced pipeline construction companies, many Maine based subcontractors and workers worked on the project creating significant economic impacts in the western and southern parts of the State. The final welds were completed in February 1999 with the gas flowing shortly thereafter.

In the meantime, the Maritimes & Northeast (M&NE) project received all of its final Federal and State certificates and approvals during 1998, setting the stage to begin construction early in 1999. Late project changes, however, have dimmed the prospects for the widest possible access to gas in eastern and northern Maine areas. This situation is ameliorated by plans of Local Distribution Companies (LDC) to pick up gas from the mainline to serve nearby businesses and communities, and possibly some of the larger users. Scheduled delivery from this project continues to be late fall 1999.

In addition to the significant progress realized by the pipeline projects, the Maine Public Utilities Commission (MPUC) issued franchises for two new local distribution companies to serve designated energy markets.

The big surprise in natural gas development in 1998 was the beginning of construction on two natural gas fired power projects, plus announced plans for substantial additional capacity that may get built in Maine locations. These projects will provide more than enough capacity to replace Maine's share of Maine Yankee Atomic Power Plant.

And, retail competition for natural gas is just over the horizon as recent MPUC actions ensure that Maine energy consumers soon will be able to shop for natural gas supplies and services.

MAINE ECONOMIC OUTLOOK - Continued

Overall, wage and salary employment in Maine is forecast to grow at an annual rate of 1.5% over the next several years with the majority of all job gains accruing to the southern coastal and I-95 corridor regions. Business, medical and recreational services employment will continue to lead the sectoral growth (rising 3.2% annually), followed by Finance, Insurance and Real Estate growing at a 2% clip and retail trade increasing 1.1% annually. Together, these industry groups are expected to provide 85% of all new jobs in Maine.

The outlook for Maine's manufacturing sector is a bit less robust as 10 of the state's 19 manufacturing categories are expected to experience ongoing employment losses leading to an overall outlook for manufacturing of slow decline. A number of our mainstay industries, namely pulp and paper, electric and non-electrical equipment, and lumber and wood should experience some employment growth through the period. It should also be noted that, despite employment declines, productivity increases continue across many of Maine's industries which is actually a better measure of the overall health of those sectors. In fact, the productivity growth in Maine will help push annual gross state product growth towards 2% per year.

THE MAINE ECONOMY:
Year-End Review and Outlook
1998

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