

MAINE STATE LEGISLATURE

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THE MAINE ECONOMY:
Year-End Review and Outlook
2002

Maine State Planning Office
March 2003



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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.maine.gov/spo

- and click on "Economic and Census Data," then click on "Economics".

This year-end report on the Maine economy reviews State economic performance during 2002, 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:

- In the grip of a jobless recovery, the Maine economy made scant progress in 2002; most major indicators showed modest growth while job markets deteriorated.
- Maine payroll employment declined by 2,100 jobs (0.3%) in 2002; the manufacturing sector took the biggest hit, losing 6,600 jobs. Health services/education gained 4,000 jobs.
- The major economic events in the State during the year included the worsening of labor shortages in some sectors even as a long list of major layoffs was unfolding in others. Huge State government revenue shortfalls also grabbed headlines.
- The Maine economic outlook calls for a holding pattern through 2003, then slow but improving growth as the national economy gains traction.

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

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Acknowledgements

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The Maine Economy in 2002

OVERVIEW

It's been another jobless recovery. Following the 1991-92 recession, there was a period of several years where job growth in Maine and the U.S. was virtually nonexistent. The recession of 2001, which apparently ended during the fourth quarter of 2001, has led to the same type of recovery. While virtually all other major indicators of economic activity exhibited progress in Maine in 2002, payroll employment declined by -0.3%, or 2,100 jobs. As a result, the state's unemployment rate for the year was 4.4%, an increase of a half point over the previous year. This 4.4% rate was still well below the 5.8% national rate, however.

The very weak stock markets and the threat of - and now actual - war in Iraq has apparently put the nation's business leaders in a wait-and-see attitude. On the national front, expenditures for business capital equipment have been extremely weak and payroll employment declined about 1.1 million jobs (0.9%) for the year. However, thanks to the lowest interest rates in decades, consumers propped up the national and state economies, buying cars and houses and building materials at record - or near record - rates.

The table on this page compares performance in 2002 versus 2001 of a selection of Maine economic measures. Characteristic of a weak recovery, the measures show a mixed performance. Among the more important indicators, payroll employment was down for the year and personal income growth slowed some, yet retail sales were a bit stronger. Those low interest rates which spurred consumer spending also pushed up construction activity, especially in the residential sector. Housing permits were also extremely strong. Yet, while bank non-performing loans and bankruptcies declined in 2002, social assistance caseloads expanded.

EMPLOYMENT

The Maine Payroll Employment table on the facing page summarizes Maine's evolving employment structure by the new NAICS codes, (North American Industry Classification System). Much like the rest of the economy, it was a "some up, some down" year among the major industries. The Education and Health Services sector led all others in job growth with a gain of 4,000 (4.0%). Other major gains were in Government (900) and Other Services (600). The manufacturing sector, continuing a decades-long trend, (which also appears in the national data), lost 6,600 jobs. In percentage terms, the -8.8% decline was the largest in at least a generation. Other sectors with large job losses were Information (-600) and Construction (-600).

Maine's average unemployment rate in 2002 was 4.4%, up a half-point from the previous year, but still below the national rate of 5.8%. As shown in the Unemployment Rates Table on the facing

Maine Economic Performance Summary; 2001-2002

	Annual %Chg. <u>2001</u>	Annual %Chg. <u>2002*</u>
<u>General Economic Growth:</u>		
Personal Income (3Qtrs in 2002)	4.9%	4.0%
Total Taxable Retail Sales	2.1%	3.2%
General Fund Revenues (Cal. Yr.) (affected by tax rate changes)	0.6%	-0.9%
<u>Employment:</u>		
Payroll Employment	0.8%	-0.3%
Residents Employed	-1.2%	0.2%
Unemployed Persons	12.4%	3.5%
Unemployment Rate	0.4% pts.	0.5% pts.
<u>Construction:</u>		
Total Construction Contract Awards	-2.5%	8.3%
Residential Construction Contracts	-0.4%	23.6%
Housing Permits	1.6%	17.9%
<u>Banking:</u>		
Bank Deposits (thru 3qtrs)	4.4%	3.2%
Bank Non-performing Loans (3qtrs)	-2.1%	-9.1%
Bankruptcies	13.4%	-2.8%
<u>Social Assistance:</u>		
TANF (AFDC) Caseload	-7.8%	4.7%
Food Stamps Caseload	3.8%	6.6%
<u>Prices (ann. avgs.):</u>		
Mortgage Rates (30-year fixed)	-1.2 pts.	-0.5 pts.
Gasoline Prices	-0.8%	-0.5%

* 2002 data are preliminary

page, unemployment rates were higher in all counties except Hancock and Franklin in 2002. Continuing a long-standing pattern, unemployment rates tended to be lowest among the south-coast and mid-coast counties, a bit higher in the central counties, (Androscoggin, Kennebec and Penobscot), and highest in the rural counties around the outer rim of Maine.

MAINE PAYROLL EMPLOYMENT
JOB CHANGE BETWEEN 2001 AND 2002

	Jobs Chg.	Pct. Chg.
TOTAL	(2,100)	-0.3%
EDUC. & HEALTH SERVICES	4,000	4.0%
GOVERNMENT	900	0.9%
OTHER SERVICES	600	3.1%
LEISURE & HOSPITALITY	500	0.9%
TRADE, TRANSP., UTILS.	300	0.2%
NAT'L RESOUR. & MINING	(100)	-3.7%
FINANCIAL ACTIVITIES	(100)	-0.3%
PROF. & BUSINESS SERVS.	(400)	-0.8%
INFORMATION	(600)	-4.9%
CONSTRUCTION	(600)	-2.0%
MANUFACTURING	(6,600)	-8.8%

UNEMPLOYMENT RATES OF MAINE COUNTIES

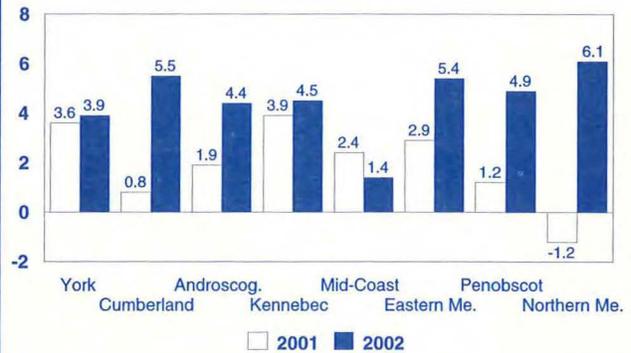
Annual Averages

	2001	2002
MAINE	3.9	4.4
CUMBERLAND	2.3	2.8
KNOX	2.8	3.0
LINCOLN	2.9	3.0
SAGadahoc	3.2	3.5
Kennebec	4.0	4.3
WALDO	4.1	4.3
ANDROSCOGGIN	4.0	4.3
HANCOCK	4.5	4.4
PENOBSCOT	4.1	4.5
YORK	3.6	4.6
AROOSTOOK	4.5	4.9
FRANKLIN	6.4	5.4
OXFORD	5.9	6.6
PISCATAQUIS	6.6	7.0
SOMERSET	7.6	8.4
WASHINGTON	8.1	8.8

TAXABLE RETAIL SALES

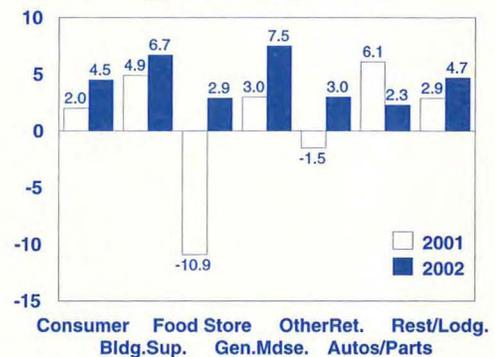
Maine Consumer Retail Sales increased by 4.5% in 2002, a major improvement over the 2.0% growth rate of 2001. In recent years, the auto and building supply sectors have been the major drivers of Maine sales growth, but the auto sector was actually weaker (up 2.3%) in 2002 than in the previous year (6.1%). Building Supply Sales (6.7%) were again very strong, however, while the General Merchandise sector (mostly department stores) was the top performer with 7.5% growth. Unlike the previous year, all categories had positive growth in 2002.

Consumer Retail Sales Growth 2001 & 2002
Maine Economic Districts (percent)



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

Taxable Retail Sales Growth 2001-2002
by Store-Type Group (percent)



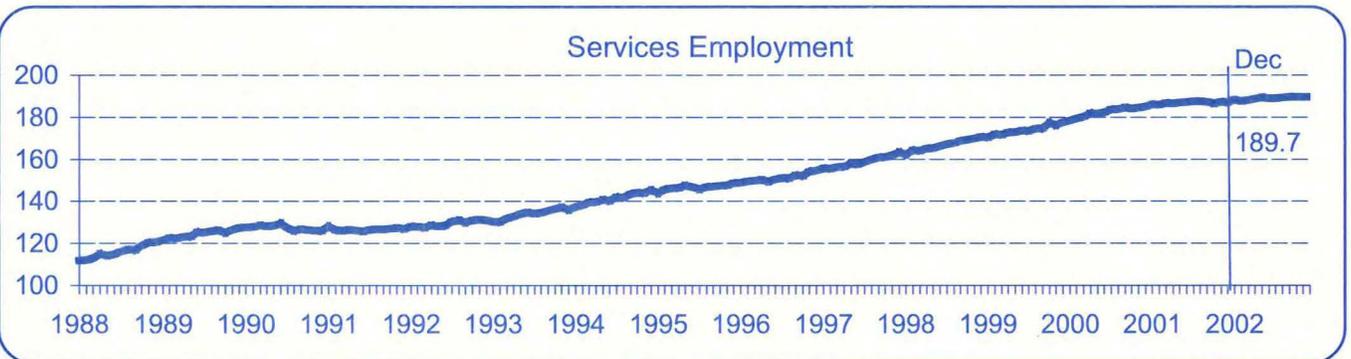
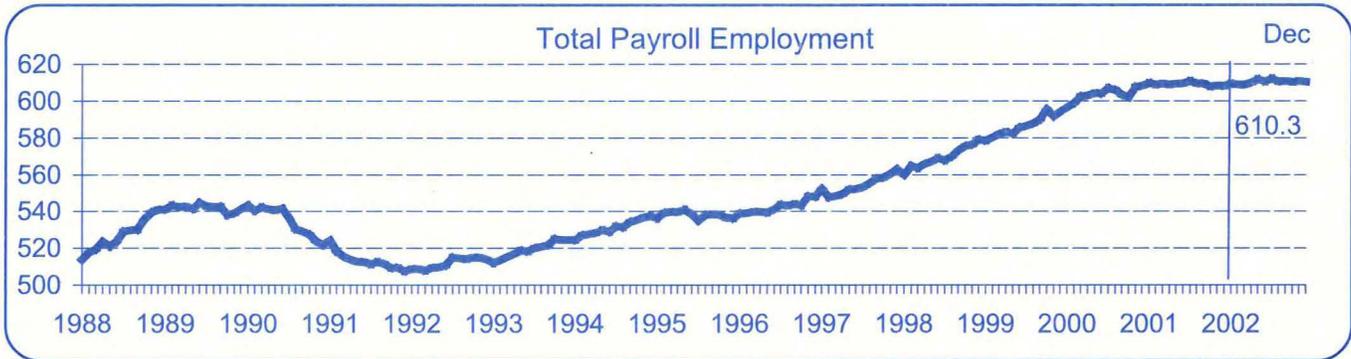
Regionally, the two Economic Summary Districts with the slowest growth in 2001, Cumberland and Northern Maine, had the fastest growth in 2002. The only District with sales growth below the State average in both of the past two years was the Androscoggin District. Sales growth in the Eastern Maine District (largely Hancock and Washington Counties) exceeded the State average in both years.

SUMMARY

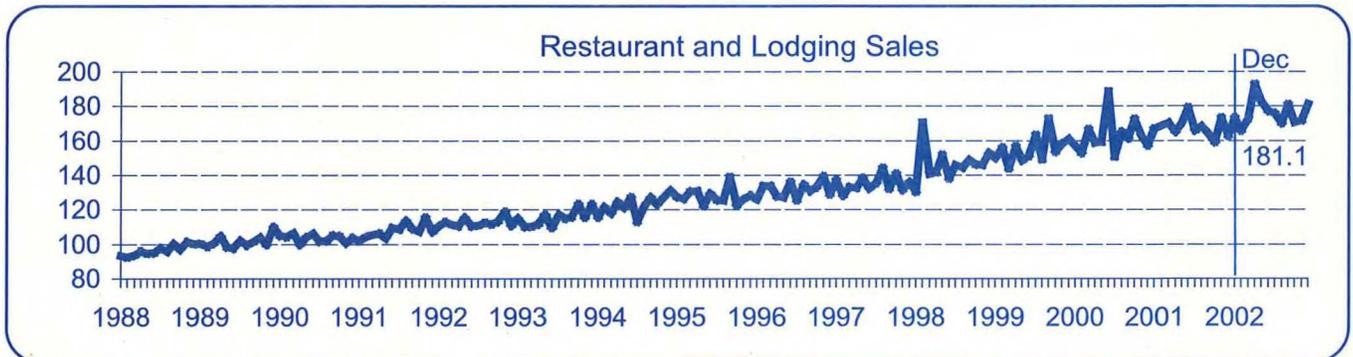
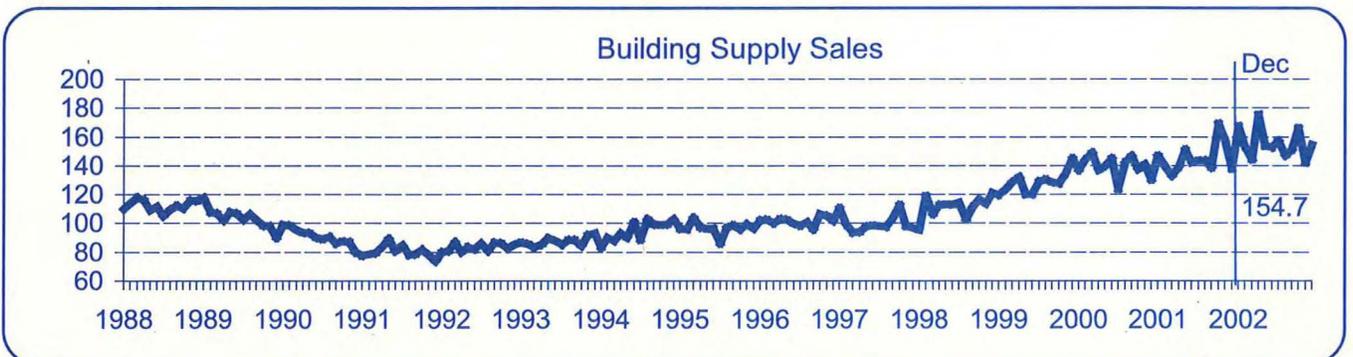
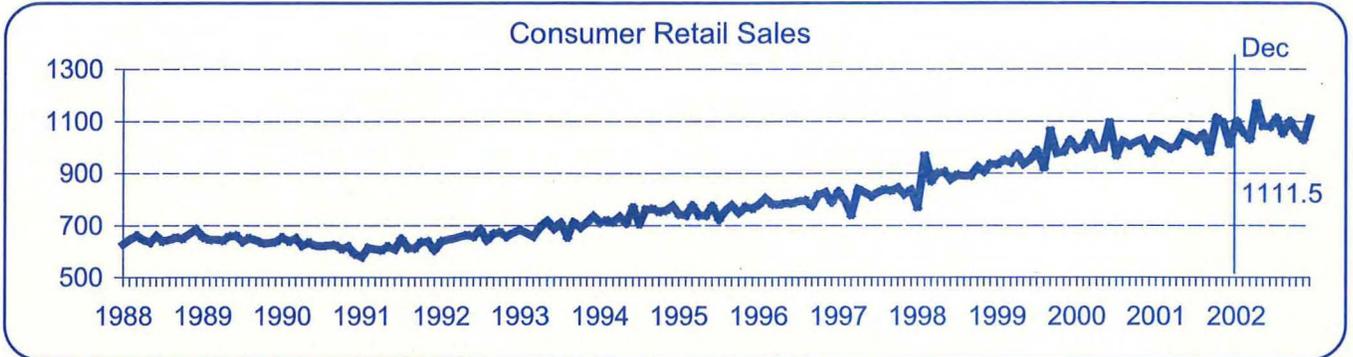
In the broadest terms, it appears that the national economy could get no traction in 2002, and the Maine economy was restrained as a result. Although U.S. real gross domestic product (GDP) grew at a 2.4% rate for the year, this was too slow to create job growth. Through the year, the major positives, low interest and inflation rates, barely outweighed the major negatives which included war fears, weak stock markets, and rising energy prices. However, all the forecasts we have seen for the current year call for stronger growth in both Maine and the nation (see the US and New England Outlook and Maine Economic Outlook).

The Maine Economy in 2002

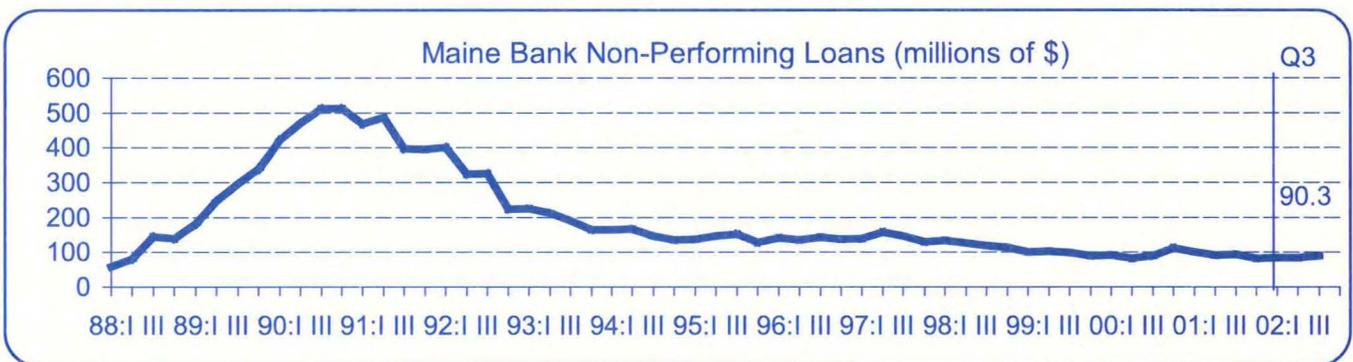
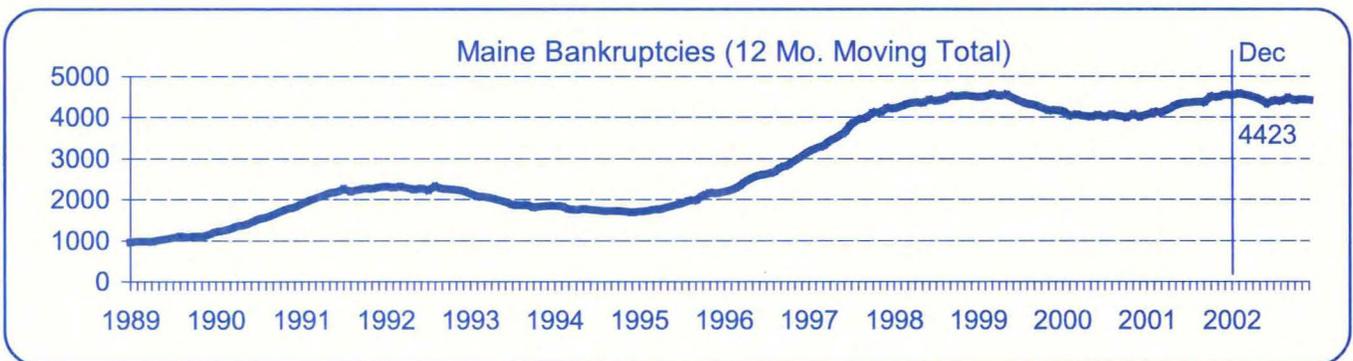
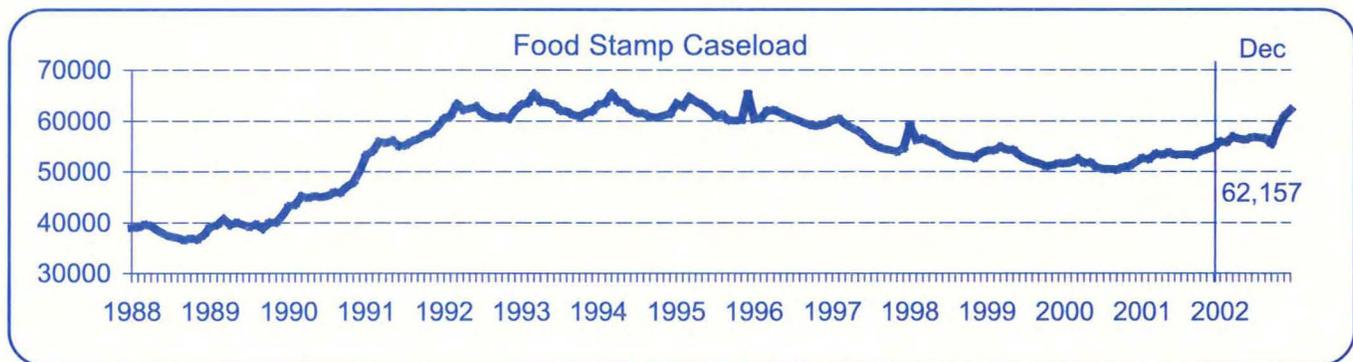
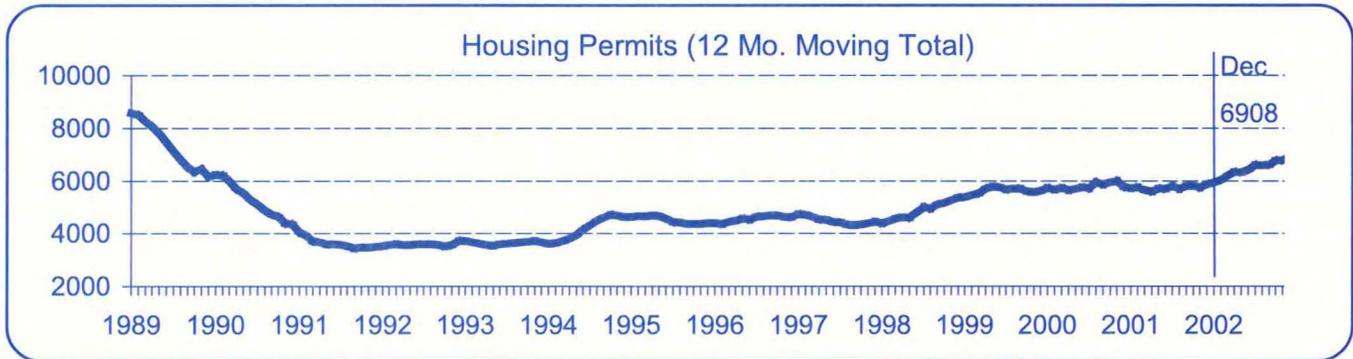
Maine Payroll Employment (seasonally adjusted 1,000's)



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



Miscellaneous Economic Indicators



The Ten Most Significant Economic Events in Maine in 2002

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.

Through the Roof!

Thanks largely to very low interest rates, both Maine and the nation enjoyed exceptionally strong residential construction and sales activity in 2002. In addition, the US set a record for mortgage refinancing volume, which helped fuel continued strength in consumer purchasing power. While we have no hard data for Maine refinancing, local bankers tell us that Mainers were very active as well.

Typical 30-year fixed mortgage rates in Maine, already low in 2001, declined by more than a point through 2002, to about 6.25% at year's end. As a result, the volume of Maine building permits rose 18% in '02, while residential construction contract awards increased by a whopping 24%. Data for the first 3 quarters of 2002 suggest an increase in the number of existing (not new) homes sold in Maine of 10%, to near 45,000. Prices appear to have increased about the same amount. Of course, these are statewide averages, so we can be certain that real estate sales and construction activity was even greater in coastal regions and, conversely, weaker inland.

An Unhealthy Situation

Health care coverage and costs continued to be problematic in 2002. Having promised during the election campaign to address health care issues, Governor Baldacci signed an executive order the day after his inauguration creating an Office of Health Care Policy and Finance which was charged with developing "... a comprehensive health policy and a plan to provide affordable, quality health care for every man, woman and child in the State of Maine."

During the year leading up to the Governor's action, the Kaiser Foundation reported employer-sponsored health insurance premiums in the U.S. rose an average thirteen percent between spring 2001 and spring 2002 – the largest increase since 1990. The Foundation further noted that premium increases varied widely: plans covering twenty-one percent of the workforce increased no more than five percent, while plans covering another third of the workforce increased over fifteen percent. The Maine Health Access Foundation found similar variations in recent Maine health insurance costs. Maine's larger companies face annual increases of eight to twenty percent in insurance premiums while the State's small businesses had an average forty-nine percent increase from 1999 to 2001 in managed care costs. According to the Kaiser Foundation, two thirds of all Americans are covered by employer sponsored plans while the

Maine Health Access Foundation says slightly fewer Mainers, three fifths, are covered by such plans.

In the spring of 2002, the Legislature passed "An Act to Address the Health Coverage Crisis for Maine's Small Businesses and Self-Employed Persons" which the Legislature hopes will provide quality health insurance and reduce costs for small business employees and the self-employed. Meanwhile, on Christmas Eve, a Federal appeals court ruled that Healthy Maine, a program extending Medicaid to cover prescription drugs for people with modest incomes who otherwise do not qualify for Medicaid, does not conform to Federal rules. And another State Government program to negotiate lower prices for all residents lacking insurance coverage for prescription drugs remained stalled in the Federal courts throughout 2002. Finally, although Congress and the President during 2002 discussed extending Medicare to cover prescription drugs, they failed to do so.

Corporate Scoundrels

Year 2002 (with spillover in both directions) may have been a record-setter for U.S. corporate scandals. Enron is reported to have overstated its profits by many hundreds of millions, leading to plummeting stock prices, dismissed employees, and bankruptcy. Prestigious Arthur Anderson, one of Enron's accounting, audit, and consulting firms, became the first U.S. accounting firm to be convicted of a felony and has gone out of business. Telecommunications giant WorldCom, announcing that it had overstated its earnings by several billion, filed the largest bankruptcy in U.S. history. The U.S. Department of Justice opened a criminal investigation of AOL's parent company, alleging overstatement of earnings. Cable TV company Adelphia filed for bankruptcy and is facing criminal investigations of its accounting and regulatory practices. Xerox, in a settlement with the SEC, paid a \$10 million fine (the largest ever imposed) in connection with allegedly overstating its earnings by billions. Global Crossing, hi-tech telecom star, filed for bankruptcy early in 2003. Investment banker Merrill Lynch, accused of giving "false advice," paid a \$100 million fine in a settlement with New York State. Even "it's a good thing" Martha Stewart has been suspected of financial misdealing in the form of insider trading.

Such scandals have led to shaken investor confidence in corporate financial reports, and in the integrity of corporate America in general. Besides the star corporations themselves, their support industries including brokerages, consultants, lawyers, banks, and accountants have been subject to suspicion, and sometimes investor lawsuits, criminal charges and convictions, and bankruptcies. Related poor corporate financial performance

The Maine Economy in 2002

and lack of investor confidence have undoubtedly been a factor (among others) in recent stock market investor losses.

Brand Name Pink Slips

The list of companies reporting mass layoffs to the State Department of Labor's Dislocated Worker Unit reads like a Who's Who of Maine industry, including such notables as LL Bean, BIW, DeLorme, C.F. Hathaway, and Great Northern Paper. In all, there were 28 layoff announcements which involved 50 or more jobs. The largest was Ames Department Stores, which closed all of its stores in Maine, laying off 1,012 workers. Sanmina – SCI, an electronics manufacturer in Augusta, had three different layoff announcements totaling nearly 600 jobs. C.F. Hathaway, a Waterville shirt manufacturer which had been struggling for many years finally closed its doors in 2002, costing 306 workers their jobs. And, Great Northern Paper of Millinocket laid off 200 workers in September, but only continued operation into early 2003 when it declared bankruptcy.

Help Wanted!

Population growth has always been considered a major engine for economic growth. Without a growing pool of working age individuals, the labor supply is quickly exhausted and firms seeking to expand or locate begin to look elsewhere. Maine's out-migration of youth and younger adults has stunted the potential for economic growth. One "solution" for companies in Maine, especially for those in the natural resource and tourism/hospitality sectors, has been to turn to migrant workers. Each year up to 20,000 come to work in Maine, many from offshore, though their contribution and their presence goes largely unnoticed. The situation took on new meaning this year when 14 migrant workers were killed in a tragic accident on a bridge in the Northern Maine Woods. The public became aware of the issues surrounding our dependence on migrant workers to fill some of the toughest and lowest paid jobs.

These aren't the only sectors of the economy experiencing labor shortages. Migrant workers fill all sorts of jobs in Maine and are working in all regions of the state, though the number reaches a peak during the summer and early fall. Maine also has a shortage of math and science teachers, scientists, metal workers and welders, health care providers, and other specialty skills. Migrants fill many of these positions. Nurses from Canada working in Maine hospitals, high tech workers from Taiwan in a semiconductor plant, researchers in the university system and in Maine laboratories from all over the world are among those that fill critical needs in the State's workforce.

Because of the State's reliance on alien workers, especially for short term seasonal jobs where timing is critical, Maine employers are facing new challenges in the aftermath of Sept. 11, 2001. The already difficult procedure for obtaining workers has be-

come more so as the nation looks with greater scrutiny at each person crossing our borders. The Immigration and Naturalization Service was recently transferred to the new Homeland Security Department, raising the specter of increased delays in worker processing.

So Call ME!...

The Maine Department of Economic and Community Development's "Major Business Expansions/Investments" list for 2002 listed 49 projects throughout the State which met their criteria of at least 10 new jobs or \$500,000 or more invested. The list demonstrates that despite the failure of Envisionet in 2001, the call center business is alive and well in Maine. Of the ten largest expansions, in terms of jobs created, one-half were call center operations, including ICT Group, Live Bridge, MBNA, and Microdyne. The largest projects involved Microdyne expansions in Augusta and Orono which were expected to involve 800 new jobs. Three of the projects on the list involved relocations from other states, including Saint-Gobian BIT (Brunswick), a composite materials manufacturer formerly of Texas. George W's loss is our gain!

New Kids on the Block

Somali natives that were resettled to the southeast US after a violent civil war in their own country have been moving north to Maine in record numbers, first to Portland and then to Lewiston, in search of a place to feel safe and for a better life and better job opportunities. Their arrival raises the level of discussion about racial and cultural diversity, economic development, and infrastructure.

Although Lewiston had been losing population, had a high housing vacancy rate, was in need of growth and generally welcomed the new arrivals, the rate with which they came raised a new set of issues about the capacity of Maine communities of all sizes to respond to sudden changes. Unlike Portland, where a much more diverse population exists and more services are in place to address special needs, differences of race, religion, culture, dietary customs and needs, and language barriers were new challenges to Lewiston. A lagging economy in the region led some local residents struggling with their own economic uncertainty to question the capacity of the economy to assimilate more workers and the cost to taxpayers of providing transitional services for so many. These fears were exacerbated and tensions in the community fueled by outside influences, some even from outside the State who have come to hold protest rallies or to create incidents with Somali residents. The highly publicized controversy drew the attention of the entire state and beyond. Mainers can anticipate more Somali families to arrive and more of Maine's communities to become home to Somalis and other diverse populations.

[see "Top Ten Events - continued" on page 13]

The U.S. and New England Outlook

A Whole Lot of Ifs

Since 2000, the US business cycle has been in a very odd period, with an exceptionally mild recession and a recovery that hasn't felt at all like a recovery. In fact, of late it seems that the best descriptors of national activity are oxymorons such as "growth recession" and "jobless recovery", leaving the public, business and policymakers confused and anxious. Real Gross Domestic Product grew at a tepid 2.4% in 2002 (Figure 1), payroll employment actually fell by 0.9%, and unemployment rose a full percentage point to 5.8%. Although inflation has been a non-issue and interest rates have been at historic lows, there has still not been much bounce to this rebound!

Throughout this malaise, the consumer has continued to do his part, almost elevating consumption to a patriotic activity. As interest rates plummeted to 30-year lows, housing activity soared through 2002 in both new and existing home sales. A tidal wave of mortgage refinancings combined with 0% financing and other automobile incentives kept car sales from tumbling through a period in which sharp decline would have been expected. Despite the recession, consumption of durables only slowed to 6% in 2001 before accelerating to 7.4% in 2002. With the threat of war looming larger and oil prices continuing to rise, both the ability and willingness of American consumers to continue the spending spree are now in doubt.

As the consumer retracts, our hopes for continued growth rest on business investment, federal outlays, and a recovery in export activity. American business has been battered by three waves of stock market decline (Figure 2). The first major blow came in early 2000 as the bottom fell out of technology stocks. The terrorist attacks of September 11, 2001 sent the market into another spiral. And as 2002 got underway, a series of corporate financing scandals rocked markets once more. The precipitous drop in the stock market has not only dampened any hoped-for resurgence in business investment, it has also wreaked havoc on capital gains and, ultimately, on the tax collections of virtually every state, sending state government budgets into turmoil. Federal expenditures on homeland security and the build up to war have pumped up economic vitality, and the proposed stimulus package should further buoy GDP growth. A reprieve in the value of the dollar is expected to reverse the export slide, further strengthening the economic indicators and helping to avoid a double-dip.

The outlook for continued economic expansion through the forecast period (Figure 1), however, rests on the assumptions that conflict with Iraq will be settled quickly and decisively and real oil prices will not spike further (Figure 3). Absent a protracted conflict, real GDP growth is forecast to accelerate through 2004 and inflation will remain below 3%. Oil price pressure is expected

[see "US & New England Outlook - continued" on page 13]

Fig. 1

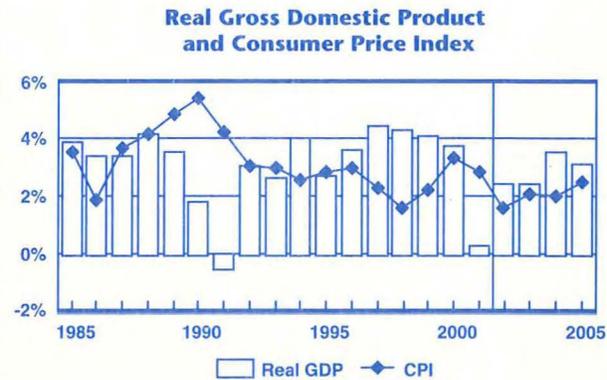


Fig. 2

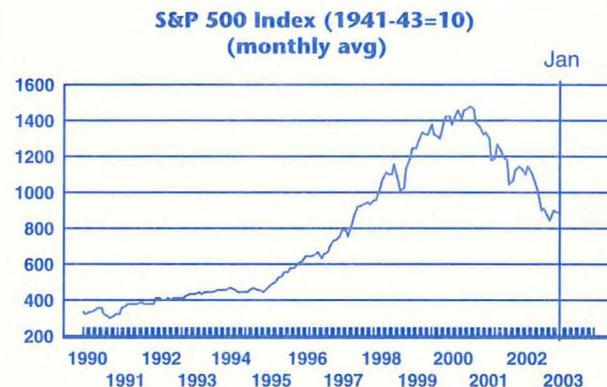
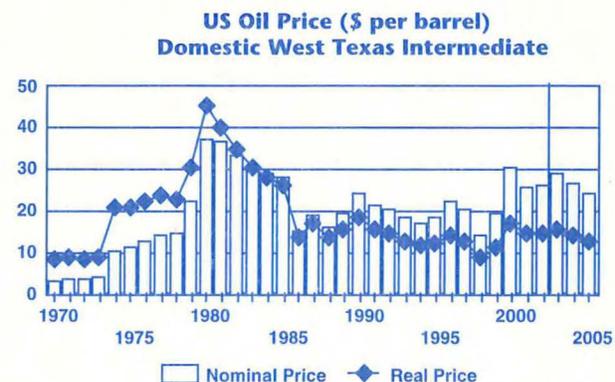


Fig. 3



Maine's Economy—Holding On

The Maine economy has been holding on for dear life. Following several years of fairly vibrant growth in the 3% range, the state's employment increases slowed to 1% in 2001 and actually declined 0.3% in 2002 (Figure 1). Meanwhile, as layoff announcements became more frequent, the state's jobless rate started to tick upward from its 2000 low of 3.5% to the current 4.5% level, and income growth slowed markedly from 7% in 2000 to an estimated 3% for 2002 (Figure 2).

While it may be cold comfort, it is interesting to note that even in our period of weakness, Maine's economic growth has, for the most part, outpaced that of both the nation and the region. National employment growth over the period slowed from the 2.5% level, to 0.2% in 2001 and negative 0.9% in 2002. With the nation experiencing deeper job cuts than Maine, unemployment spiked to 6%, a full 1.5 percentage points above the Pine Tree State. And for the first time in over a decade, Maine's income gains outpaced the nation's in 2001 and hit the national average in 2002.

The primary reason for Maine's relative "vibrancy" appears to be that our economy is far less invested in the technology sector which has been ravaged through the stock market adjustment, taking its toll on technology-dependent regions like New England and on the nation as a whole.

Going forward, Maine's ability to outpace the nation is, unfortunately, expected to be short-lived. As the technology sector gets back on its feet, it will once again become a dynamic force propelling knowledge-based economies across the US. In addition, as Figure 3 highlights, Maine's loss of manufacturing has been accelerating of late. This trend, combined with the fact that Maine does not have a concentration in the "high-flying" industries, will constrain income growth. Meanwhile, national income gains will accelerate through 2005, making it difficult for Maine to close the income gap.

Maine's employment will start to grow once more in 2004 at a sluggish 0.8% clip, only 1/3 the rate of increase enjoyed in the late nineties (Figure 1). Not surprisingly, all job gains will be in the non-manufacturing sector, led by retail trade, health and other services. Manufacturing employment is projected to continue its descent through the period, though the pace of decline will abate from -7% in 2003 to -3.2% in 2005. Further erosion in manufacturing employment will also constrain income gains through the period.

It appears that Maine will be in a bit of a holding pattern through 2003 until the US economy can get enough traction to pull states out of their malaise. Overall, as long as a protracted war is avoided, Maine's growth should resume in 2004 at a slow but steady gait.

Fig. 1

ME Wage & Salary Empl. Forecast

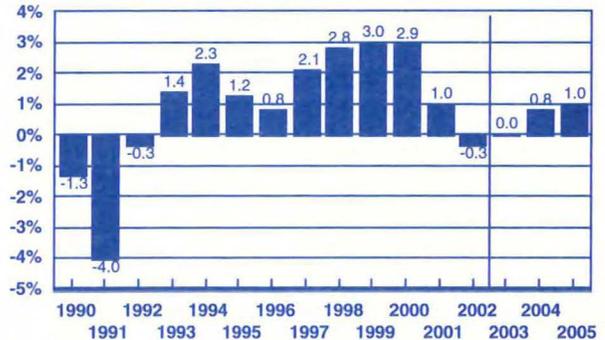


Fig. 2

Personal Income Growth; ME & US

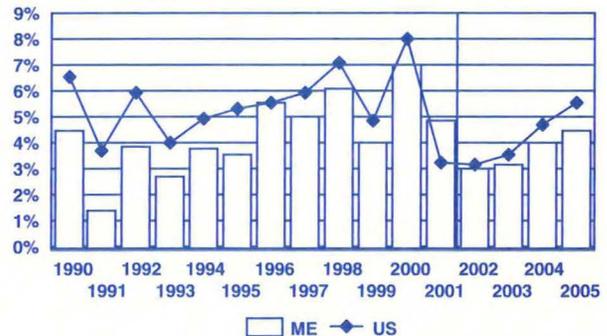
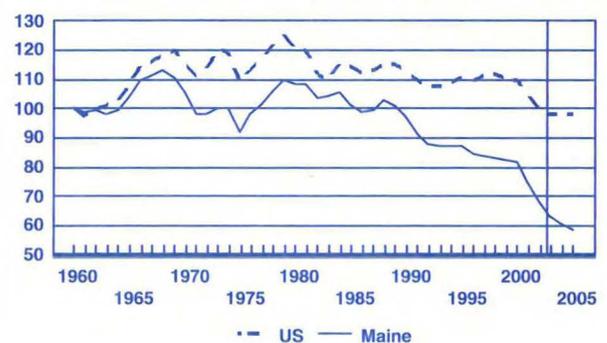


Fig. 3

Index of ME & US Mfg. Employment (1960=100)



ISSUES FOR THE FUTURE

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

Achieving Governmental Efficiency

Maine's population continues to move outward from traditional centers and inward from more remote rural areas. These shifts have yielded a growth in communities in the middle that has been accompanied by accelerated service needs.

To meet the demands of new growth, local taxes have been rising more rapidly in fast growing towns than elsewhere. Since 1984, their local tax commitment increased by 270% compared to slightly less than 175% (unadjusted) in regional centers and in towns with little or no growth. Rising property values have accompanied the growth in local spending, placing great stress on traditional land uses, which have become extreme along the coast, and forcing many elderly and working families off the property that they have worked for generations.

Even at this pace the local growth in spending by fast growing towns actually covered only a portion of their costs. The increase in local taxes would have been far greater without state and federal subsidies. These communities have received a disproportionate share of state and federal assistance in the form of new schools, new and upgraded roads, public facilities, etc., while schools were closed and other investments and services cut back in the most urban and most rural communities. Many of Maine's fast growing communities are caught in an upward spiral of taxes and higher costs where growth and affluence has also meant displacement and loss for traditional occupations and long time families.

Since we began to analyze the costs of sprawl and began to put new policies in place that will reduce the extent to which State dollars and policies contribute to and subsidize sprawl and ultimately increase the costs of government, the way Maine invests is being challenged. Though it is the major factor, sprawl is not the only cause of rising costs of governmental services. Item by item comparisons of expenditures indicate that all levels of government are faced with rising costs over which individual governmental units have little control and which will require major structural change to bring them back in line, the largest being insurance of all types- health benefits, workers' compensation, property and liability insurance. Public frustration is rising, as evidenced by the number of citizen referenda to reduce taxes, especially the property tax. In a time of budget shortfalls greater scrutiny of spending policies, renewed and concerted efforts to gain control of the cost of insurance and other runaway costs, and opportunities for communities to share rather than replicate programs and services from town to town must all be part of the mix to achieve tax stability.

Demographic Trends Seen as Constraining Maine's Future

The Maine Leadership Consortium in 2002 underwrote a report on the State's youth population. The report presented statistics on youth out migration and declining birth rates and assessed the problems they pose. "Maine," said the report, "is beginning to experience a youth labor shortage and, by all indications it is only the leading edge of a large empty abyss, the full effects of which will only be felt when the baby boom reaches retirement. ... This labor shortage now felt at the entry-level, will gradually move up through the job market as this young cohort ages." About education, the report said, "Public school enrollments today are falling; ... Maine communities will soon be faced with hard issues, including consolidation of schools and districts, underutilized school facilities and a greater financial burden. ... The long-term health of the University of Maine System is also dependent upon enrollment numbers." Concerning social and cultural life, the report said, "The identity and values of any region are a reflection of its residents—their experiences, origins, values and population. The young baby-boomers that moved to Maine in the 1970s and 1980s injected new ideas and shifted the cultural norms of the state even as they absorbed traditional Yankee values. Conversely, young out-migrants today will drain away something as they go."

In April 2002, former Attorney General James Tierney gave the University of Maine TIAA/CREF Distinguished Honors Graduate Lecture entitled "Diversity in Maine: an Opportunity" and later developed the same theme before The Institute for Civic Leadership. His central point was that to hold and attract young people we must increase racial and ethnic diversity which are sources of excitement and energy for the young.

Also in 2002, the Governor's Economic Development Conference addressed demographic concerns by focusing on human capital issues and including a workshop on ways to curb the loss of youth and talent from Maine.

At his inauguration, Governor Baldacci addressed youth out-migration saying, "I propose to hold a Youth Summit that will bring together some of our youngest public servants, students and entrepreneurs to examine why young people are leaving our state and what we can do to bring them back. ... I want this summit to lead to a permanent Working Group on Maine Youth that will advise my administration on ways to keep young people in Maine and bring those who have left back to our state."

While Tierney urged greater diversity, controversy erupted in Lewiston over the migration of Somalis from the U.S. south. When a neo-Nazi group called for expulsion of the Somalis, Governor Baldacci responded in his inaugural speech, saying, "I want to make it very clear, in case there is any question: Maine

is a lot of things, but it is not nor will it ever be a haven or a headquarters for hate groups and racist organizations. These groups do not reflect the principles and values of Maine, and I urge all Mainers to firmly embrace diversity and tolerance and oppose bigotry and hatred.” Two days later the Governor attended several meetings intended to foster tolerance and the day after that told a diversity rally in Lewiston, “We stand united as one Maine.”

Knowledge-based Economy

Like it or not, the underlying forces of free trade and free flows of capital that define the process of globalization are filtering into all regions of the world, including Maine, and wreaking havoc with old line manufacturing industries. As evidenced in the newspaper headlines of the day, these forces are causing repeated economic dislocations.

Capital investments are increasingly being drawn to human capital in the “new,” post-industrial economy because human capital investments generate the highest productivity, hence the greatest marginal rates of return on those investments.

In the era of rising prominence of human capital, Maine’s abundant natural and lifestyle amenities become important advantages that can draw in new, smaller scale capital investments which are seeking the highest level of productivity from a smaller scale, knowledge-intensive workforce.

To be competitive in the knowledge-based economy, firms and organizations, both public and private, profit and non-profit, will need to seek out strategies that continually invest in upgrading the skills of their workforce. In the knowledge-based economy it also becomes increasingly important to embrace the natural innovation that exists in the younger members of the workforce.

Maine decision-makers must learn to better understand and embrace the State’s inherent advantages in the knowledge-based economy. Spreading that understanding to all segments of society would allow Maine to accelerate internal and external investments in human capital, thus enabling a prosperous future for our home State.

State Government Deficits

Maine State Government’s budget was awash in red ink through FY 2003, and as we look out over the planning horizon, the red hues continue to color our view. The 3 rounds of downward revenue reprojections over the past year have blown open a budget gap for the FY 2004/2005 biennium to an estimated \$1 billion which is roughly 17% of the total biennial budget. While cold comfort, a January 2003 National Conference of State Legislatures’ survey shows Maine is certainly not alone and is

certainly not in the worst position relative to other states. In fact, of the 39 states that responded, Maine fell squarely in the middle of the pack. These budget shortfalls are believed to be the worst fiscal conditions seen in states in 50 years. The primary reasons for these sobering conditions are twofold: 1) On the revenue side, the sharp drop-off in the stock market caused income tax revenues to disappear, decimating the revenues that states had come to enjoy and count on during the unprecedented market run-up of the late 90s. 2) On the expense side, healthcare costs have soared, driving Medicaid expenses to spiral out of control. Adding insult to injury, unfunded federal mandates in the educational arena (such as special education and No Child Left Behind) have pushed costs down to the state and local levels, putting further pressure on budgets. Unfortunately, the red tide is not expected to turn in the near future, though a sustained run in the market and Federal restructuring of Medicaid programs could offer some relief to those trying to close state budget gaps to meet their constitutional requirements for a balanced budget.

Tax Reform: An idea whose time has come!

Over the past year, the cry for tax reform has reached fever pitch. The Institute for a Strong Maine Economy’s report, “No Place to Hide”, helped focus the gubernatorial debates on this topic through the spring and summer. By fall, Speaker of the House Mike Saxl had assembled an impressive Council to come up with a comprehensive reform package. And as Maine voters headed to the polls in November, they were asked to sign not 1, not 2, but 3 citizens’ initiatives to put tax reform on the ballot in 2003. One of those initiatives, put forward by the Maine Municipal Association (MMA), collected more than enough signatures to ensure its place on the November 2003 ballot. The MMA proposal would transfer over \$200 million of school funding costs from the municipalities to the State. While this isn’t really a true tax reform proposal, if passed, it certainly would force the State to reconfigure its system to free up monies which could be spent on the K-12 system, and would, in theory, offer relief to property tax payers. Perhaps the greatest attribute of the MMA proposal is that it holds both the Administration’s and the Legislature’s feet to the fire, because if no real effort is made in responding to the public outcry for reform, the people will have a chance to force reform through the referendum process. By all counts, both the Legislative and Executive branches seem to be taking this very seriously, providing hope that this long elusive reform may actually move from dream to reality. Governor Baldacci has steadfastly pledged to balance the biennial budget without tax increases, and has promised a comprehensive tax reform package as soon as his budget is passed and his economic development and healthcare initiatives are well underway. The Legislature has committed to work independently and with the Administration to move reform forward. Perhaps this truly is an idea whose time has now come.

The US and New England Outlook - continued

to diminish through the forecast period. Should the US experience a prolonged military conflict or a major oil supply disruption, the forecast could change considerably.

Like the US, New England has struggled over the past 3 years. Given that the regional economy is highly dependent on the technology sector, New England suffered a particularly hard blow when this sector went into a deep retraction. In addition, state governments throughout the region were hard hit by the tremendous loss of income tax revenues derived from capital gains. According to the Federal Reserve's March 5, 2003 Beige Book, economic activity in the First District – Boston – remains sluggish across all sectors including retail, manufacturing, commercial real estate and technology services. In fact, those surveyed painted a regional outlook that was fairly bleak, as the report says: "The outlook is highly uncertain and virtually no contacts are making plans based on expectations of an upturn". Unless the US economy picks up a head of steam in the very near future, it will be extremely difficult for the New England economy to demonstrate any more than meager gains in the next couple of years.

Top Ten Events - continued

Playing HopKotch

On February 6, 2002, the Maine Supreme Judicial Court affirmed an appeal of a Workers' Compensation Board decision that allowed compensation in some circumstances for injury claims that combined the effects of older injuries with newer on-the-job injuries. It was widely feared that this ruling, known as the "Kotch decision," would lead to large increases in worker's compensation insurance rates. The matter was taken up by the Legislature, which passed a revision to the Worker's Compensation Statute (MRSA 39-A, Sec. 213). This revision preserved some of the eligibilities affirmed in the Kotch decision. Subsequent rates, however, have shown no significant increase due to this provision.

What Recovery?

Oddly enough, one of the ten most significant economic events in Maine in 2002 was a sort of non-event; that is the lack of a solid recovery. While it hasn't been officially announced, the past recession apparently ended in the third quarter of 2001. Yet, national economic growth in 2002 was only 2.4% (real gross

domestic product), too low to even maintain employment levels. This malaise was reflected in the Maine economy, where most economic measures experienced some growth, yet employment declined by 2,100.

Some analysts blame the tepid national economic growth on weak stock markets and war fears, while others suggest that the excesses of the bubble years – huge private sector debts, industrial overcapacity, low savings rates, massive current account deficits – are more important. This debate may be settled soon, as the war fears will likely be behind us by mid to late spring, which should inject some life into the stock markets. If the bubble year excesses are truly more significant factors, then the national and State economies may remain stagnant for another year or two, possibly longer.

Red Tide in Augusta

When the tides turned on Maine State Tax Revenues, they turned quickly – and they turned red! While slowing economic conditions beginning in 2000 and the fallout of September 11, 2001 both caused revenue growth to slow from the torrid pace of the late 90s, the real hit to revenues came in the April 15th, 2002 tax filings. As Maine taxpayers settled their accounts with the State on that date, we began to fully understand the extent of the capital losses that Maine's wealthier individuals and s-corporations had endured through the prior year. The drop-off in capital gains was not unexpected. In fact, in December of 2001, the State's Revenue Forecasting Committee had re-projected capital gains to fall by 23%, exceeding the Federal Government's forecast of a 19% decline. At the time, it appeared that Maine's Committee was being overly pessimistic. As it turned out, capital gains fell 69%, stripping \$130-million from General Fund Revenues and sending the state's budget into disarray. As the months unfolded following our unpleasant "April Surprise", revenues continued to weaken, further opening the gap. In August 2002, revenues were officially reforecast downward by \$148 million for FY 2003 (which runs from July 2002- June 2003). By the end of 2002, with the threat of war with Iraq looming large and layoff notices in Maine's companies becoming more frequent, the State's revenue projections for FY 2003 were again cut \$44 million and in March 2003, pared an additional \$17 million. Although current revenue estimates are decidedly conservative, forecasters and policymakers alike are holding their collective breath to see if April will gift us with another surprise

THE MAINE ECONOMY:
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2002

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