REPORT OF THE MAINE STATE REVENUE FORECASTING COMMITTEE

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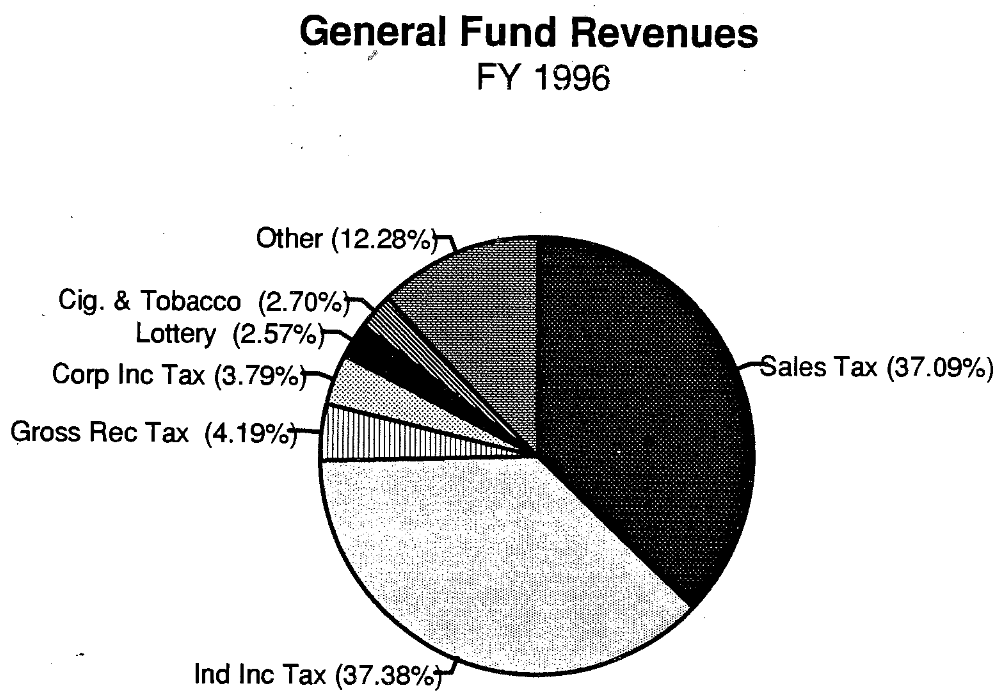

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I. EXECUTIVE SUMMARY

This report summarizes the Maine State Revenue Forecasting Committee's projections of General and Highway Fund revenues for FY 1996 and FY 1997 as well as reprojections for FY 1995. General Fund Revenues are expected to grow by 7% over the biennium, increasing from $1.658 billion in FY 95 to $1.774 billion in FY 97. Highway Fund Revenues are forecast to experience only a 1% increase through FY 97, growing from $215.4 million in the current fiscal year to $218.1 million by FY 97. The original FY 95 budget for Highway Fund Revenues has been reprojected upward by $5 million (a 2% change) and the original General Fund budget for FY 95 remains virtually unchanged.

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 region as a whole. As the cover graph illustrates, 75% of total General Fund Revenues are derived from two tax lines, the Sales and Use Tax and the Individual Income Tax. The performance of both of these tax lines is tied directly to economic activity in the State. With wage and salary employment growth forecast to average 1.5% through the biennium and nominal personal income growth expected to be 5.1% annually, it is not surprising that State General Fund Revenue growth will be lackluster.

Ninety-four percent of Highway Fund Revenues are derived from Fuel Taxes and Motor Vehicle Registrations, both of which are projected to see 1% average annual increases through the forecast period.

The Committee would like to express its concern over the possible implications of a recent Superior Court decision regarding the manufacturing sales and use tax (see Section II-C-1). If this decision is interpreted broadly by manufacturers throughout Maine, the State could experience a significant erosion of sales tax revenue in the future ($15 million annually). Our Committee will track this closely, but urges the Governor and the Legislature to jointly examine and, if necessary, clarify the current tax law concerning the manufacturing sales and use tax as it relates to the "integrated plant theory".

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 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.

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.

Both major revenue lines tied to other "non-economic" factors and 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 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.

The first has to do with a recent Superior Court decision which concluded that supplies used by a manufacturing concern in its pollution control facility are exempt from the manufacturing sales and use tax. This relatively narrow decision of the court, which the Bureau of Taxation has accepted, results in an estimated tax impact of $400,000 in FY 95, $1,600,000 in FY 96 and $500,000 in FY 97. Of further concern are the broader implications of the courts's reference to the "integrated plant theory" as it applies to materials, supplies and equipment used in manufacturing that are currently taxable. Although the Bureau of Taxation interprets the superior court decision on the more narrow grounds as described above, the committee is unsure how manufacturing taxpayers will interpret their individual liability. Members of the committee share a serious concern that the ultimate tax loss, which cannot be quantified at this time, could be as much as an additional $5 million annually in FY 96 and FY 97. The committee, in conjunction with the Bureau of Taxation, will monitor a sampling of manufacturing tax filers on a monthly basis in order to anticipate any negative revenue trends from companies possibly not paying the proper tax liability.

- Another concern of the committee relates to the future impact of this court decision. Indications from the Department of the Attorney General are that court cases will be pursued by manufacturers to expand the "integrated plant theory" to additional property related to the manufacturing process. If this occurs, which appears likely, the tax impact on an annual basis will be, conservatively, $15 million. The committee thinks the Governor and the Legislature should jointly examine the current tax law concerning the manufacturing sales and use tax as it relates to the "integrated plant theory" in order to clarify the current tax law.

The second issue of current law has to do with Tax Anticipation Notes (TAN). Maine State Government is authorized to issue temporary loans in anticipation of taxes levied for the fiscal year. Title 5, Section 150 of the Maine Revised Statutes Annotated provides the statutory framework for issuing TANs. Included in Section 150 is a requirement that the Treasurer of the State negotiate each TAN with the approval of the Governor and that the TAN be retired in the same fiscal year for which it was issued.

In Fiscal Year 1995 the debt service on the TAN will be approximately $181,125,000. In addition to helping to keep the "Treasurer's Cash-Pool" positive on a daily basis, the proceeds of the TAN are invested and estimated to generate $6,125,000 in FY 1995 as General Fund revenue for that fiscal year only. The interest payment on the TAN, payable around June 1995, is estimated to be $6,125,000. That amount was appropriated from the General Fund to the "Debt Service Treasury" program in order to retire the FY 1995 TAN.

The $6,125,000 in estimated General Fund revenue in the FY 95 from TAN earnings will not be available in FY 96 or FY 97 unless the 117th Legislature amends 5 MRSA subsection 150 again to replace the $30,000,000 statutory limit with the Constitutional limit for those fiscal years at or about $175,000,000 per year.

2. Consensus Economic Forecasting Commission

As directed by the originating Executive Order, 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, forecasted 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.

As was explained in the Methodology section of this report, in accepting or revising individual revenue line projections, the Committee goes through a process that includes review of the equation, review of the underlying economic assumptions, and review of the resulting forecast level to ensure that the forecast is logical and plausible given our knowledge of current economic conditions and past revenue growth patterns. 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. After reviewing the Individual Income Tax projections derived directly from the Consensus Economic Forecasting Commission's forecast of personal income growth in Maine, the Committee felt that the resulting forecast levels were somewhat implausible given past revenue growth patterns. Rather than making an ad hoc adjustment to the Individual Income Tax forecast, the Committee decided to adopt a personal income forecast that was slightly slower than that recommended by the Economic Commission. By taking this approach, the Revenue Committee was able to use a consistent income assumption through all of the various sales and income tax revenue estimating models.

The Committee did directly adopt the Economic Commission's forecast of employment growth and inflation. Thus, the economic growth assumptions underlying these revenue projections are as follows:

TABLE 1

UNDERLYING ECONOMIC ASSUMPTIONS

	1994	1995	1996	1997
Me. Wage & Salary Employment	1.4%	1.5%	1.5%	1.5%
Me. Personal Income (Nominal)	4.5%	5.2%	5.1%	5.1%
U.S. Consumer Price Index	2.7%	3.3%	3.4%	3.5%

III. FY 1995 REVENUE REPROJECTIONS

A. General Fund

The Committee recommends that FY 1995 General Fund revenues be reprojected to $1,657,808,661 which is an upward revision of $.5 million. As TABLE 2 shows, while several individual revenue lines were revised either upward or downward by over a million dollars, the net impact on total General Fund, - $+550,295, is a revision of less than one-tenth of one percent. Thus, while the Committee is recommending several changes to various line items, the FY 1995 General Fund Reprojection is virtually identical to the original FY 1995 Budget figure.

The only two line items to undergo significant dollar value revisions are Individual Income Tax receipts, reprojected downward by $11.8 million, and Corporate Income Tax receipts, revised upward by $12.1 million.

Individual Income Tax:

According to the Bureau of Taxation, Individual Income Tax receipts in FY 1994 were significantly below budget and fiscal year-to-date September 1994 figures indicated a continuation of this trend with tax receipts being $4.6 million below budget. With the recent performance of this revenue source as compared to the original budget and a new slightly slower outlook for growth in Maine Personal Income, the Committee recommends that the $11.8 million downward revision in FY 1995 Individual Income Tax projections be adopted.

Corporate Income Tax:

Corporate Income Tax receipts during FY 1994 were significantly above original budget levels. In addition, fiscal year-to-date September 1994 Corporate Income Tax revenues are $5.7 million above the original FY 1995 budget. Therefore, the Committee recommends that this tax line be reprojected upward by $12.1 million for FY 1995.

TABLE 2

SUMMARY OF GENERAL FUND REVENUE REPROJECTIONS FY 95

	Original FY95 Budget	FY95 Reprojections	Upward (+)/ Downward (-) Revision
Sales and Use Tax	$608,216,624	$609,500,000	$1,283,376
Gross Receipts Tax	67,208,328	68,483,193	1,274,865
Individual Income Tax	614,625,000	602,843,000	-11,782,000
Corporate Income Tax	53,830,664	65,927,400	12,096,736
Cigarette and Tobacco Tax	48,247,189	47,269,323	-977,866
Public Utilities Tax	24,725,000	26,083,035	1,358,035
Insurance Companies Tax	38,745,371	37,363,389	-1,381,982
Inheritance and Estate Tax	9,532,964	11,181,854	1,648,890
Property Tax - Unorg. Terr.	10,141,012	9,542,488	-598,524
Income From Investments	1,522,000	2,300,000	778,000
Transfer from Liquor	24,789,465	21,914,465	-2,875,000
Transfer from Lottery	42,589,432	42,589,432	0
Other Revenues	113,085,317	112,811,082	-274,235
Total	$1,657,258,366	$1,657,808,661	$550,295

B. Highway Fund

The Committee recommends that the FY 1995 Highway Fund revenues be reprojected to $215,350,134. As Table 3 highlights, this level is $5,110,253 higher than the original Highway Fund estimate for FY 1995.

TABLE 3

SUMMARY OF HIGHWAY FUND REVENUE REPROJECTIONS FY95

	Original FY95 Budget	FY95 Projections	Upward (+)/ Downward (-) Revision
Fuel Taxes	$136,160,855	$141,191,357	$5,030,502
Motor Vehicle Reg. & Fees	57,896,598	59,904,098	2,007,500
Inspection Fees	1,170,000	1,542,251	372,251
Fines	1,235,000	1,235,000	0
Turnpike Reimbursement	8,700,000	6,700,000	-2,000,000
Other	5,077,428	4,777,428	-300,000
Total	$210,239,881	$215,350,134	$5,110,253

This upward revision reflects a number of factors:

Fuel Taxes:

The original budget projection of fuel taxes appears to have underestimated the effects of the economic recovery as fiscal year-to-date September fuel tax collections are $2.6 million above budget. The Bureau of Taxation recommended, and the Revenue Forecast Committee accepted, an upward revision of $5.0 million to the original budget.

Motor Vehicle Registrations and Fees:

Given that FY 1994 motor vehicle registrations and fees grew at a very strong pace (12% increase over FY 1993) to a level of $58.7 million, it seemed highly unlikely that revenues would decline to $57.9 million in FY 1995, as the original budget suggested. Per the recommendation of the Secretary of State's office, the Revenue Committee reprojected 1995 at $59.9 million. This is a 1% increase over FY94, which is consistent with the 1% growth assumed for this revenue line in FY96 and FY97.

Turnpike Reimbursement:

According to the Maine Turnpike Authority, at their 1994 annual meeting, they made the decision to lower the amount transferred to the Maine Department of Transportation for FY95 from $8.7 million to $6.7 million. This decision was based on the fact that their own capital needs have increased significantly to cover expenditures on a new closed barrier system, electronic toll booths, bridge redecking and the purchase of 5 miles of highway.

IV. FY 1996 and FY 1997 REVENUE PROJECTIONS

A. General Fund

The Revenue Forecasting Committee estimates that Maine General Fund Revenues will total $1,706,328,429 in FY 1996 and $1,773,958,762 in FY 1997. As Table 4 shows, the FY 1996 General Fund forecast is 2.9% higher than the FY 1995 Reprojection. The reason for the projected modest performance in FY 1996 is the $1.6 million downward adjustment made to the Sales and Use Tax receipt line to account for the Champion Case and the current law assumption that no Tax Anticipation Note is issued. (These have been fully explained in Section II-C-1 of this report). The projected 4.1% growth in Sales and Use Tax for FY 1997 is due to the fact that the Champion adjustment to FY 97 is only $.5 million rather than the $1.6 million removed from the FY 96 base forecast.

TABLE 4

REVENUE FORECASTING COMMITTEE
GENERAL FUND REVENUE FORECAST
FY 1996 AND FY 1997

	FY 1995 Reprojection	FY 1996 Forecast	% Change	FY 1997 Forecast	% Change
Sales and Use Tax	$609,500,000	$632,800,000	3.8%	$658,800,000	4.1%
Individual Income Tax	602,843,000	637,819,000	5.8%	674,230,000	5.7%
Corporate Income Tax	65,927,400	64,719,900	-1.8%	63,547,000	-1.8%
Gross Receipts Tax	68,483,193	71,533,600	4.5%	74,678,947	4.4%
Cigarette & Tobacco Tax	47,269,323	46,028,837	-2.6%	44,822,299	-2.6%
Public Utilities Tax	26,083,035	26,596,695	2.0%	27,120,629	2.0%
Insurance Company Tax	37,363,389	37,571,908	0.6%	38,061,754	1.3%
Inheritance & Estate Tax	11,181,854	11,573,219	3.5%	11,978,281	3.5%
Property Tax Unorg. Terr.	9,542,488	9,944,814	4.2%	10,133,113	1.9%
Income From Investments	2,300,000	-4,000,000	-273.9%	-4,000,000	0.0%
Liquor Transfers	21,914,465	22,289,465	1.7%	22,289,465	0.0%
Lottery Transfers	42,589,432	43,867,115	3.0%	45,183,128	3.0%
Other Revenues	112,811,082	105,583,876	-6.4%	107,114,146	1.4%
Total	$1,657,808,661	$1,706,328,429	2.9%	$1,773,958,762	4.0%

The first four tax lines listed in Table 4 account for over 80% of total General Fund Revenue. A brief description of the factors driving growth in each of these major lines follows:

Individual Income Tax:

Revenues derived from Individual Income Tax collections are projected to grow by 5.8% in FY 96 and 5.7% in FY 97. Not surprisingly, this revenue line is directly tied to the forecast of Maine Personal Income, which is expected to grow at slightly over 5% annually through the biennium.

Corporate Income Tax:

Despite the fact that Corporate Income Tax revenues have been above budget in both FY 94 and, thus far, in FY 95, the forecast calls for a 1.8% decline in each of the upcoming two years. The projected declines are due to the Investment Tax Credit and the Jobs and Investment Tax Credit. The anticipated growth in tax credits combined with credit carry-forwards more than offset the expected growth in Corporate Income, thus lowering overall tax liability and, ultimately, lowering tax collections.

Gross Receipts Tax:

Over one-half of the Gross Receipts Tax is derived from restaurant sales, which tend to track personal income growth (forecast at slightly over 5% annually). The remainder of the Gross Receipts Tax is derived from nursing homes and tracks growth in inflation (forecast to grow 3.5% annually).

B. Highway Fund

The Revenue Forecasting Committee estimates that Highway Fund revenues will total $216,180,515 in FY 1996 and $218,147,446 in FY 1997. Though the revenues derived from Fuel Taxes and Motor Vehicle Registrations and Fees represent 94% of total Highway Fund Revenues and are each forecast to grow by 1% during FY 96, the projected decline in the Maine Turnpike Authority's reimbursement to the Maine Department of Transportation of $2,000,000 in FY 96 causes overall Highway Fund Revenue growth to remain, basically, at FY 1995 levels. As mentioned in Section III-B, the decline in Turnpike Reimbursement is due to increased capital needs of the Maine Turnpike Authority.

Total Highway Fund Revenue will grow at 1% for FY 1997 as the Turnpike Reimbursement level stabilizes at $4.7 million and Fuel Taxes and Motor Vehicle Registrations and Fees continue to grow at 1%.

Table 5 provides detail of the Highway Fund Revenue Forecast.

TABLE 5

REVENUE FORECASTING COMMITTEE
HIGHWAY FUND REVENUE FORECAST
FY 1996 AND FY 1997

	FY 1995 Reprojection	FY 1996 Forecast	% Change	FY 1997 Forecast	% Change
Fuel Taxes	$141,191,357	$142,500,147	1%	$143,799,777	1%
Motor Vehicle Reg. & Fees	59,904,098	60,286,798	1%	60,876,482	1%
Inspection Fees	1,542,251	1,588,330	3%	1,592,034	0%
Fines	1,235,000	1,250,000	1%	1,250,000	0%
Turnpike Reimbursement	6,700,000	4,700,000	-30%	4,700,000	0%
Other	4,777,428	5,855,240	23%	5,929,153	1%
Total	$215,350,134	$216,180,515	0%	$218,147,446	1%

V. CONCLUSION

The Maine Economy is experiencing a very slow recovery. This, in turn, is causing the underlying growth in the State Tax Revenues to be modest. The underlying growth in the State's General Fund is projected to average 3.5% through the upcoming biennium.

Highway Fund Revenues are projected to grow at a very slow pace, 0% in FY 1996 and 1% in FY 1997, reflecting a significant decrease in the size of the transfer from the Maine Turnpike Authority to the General Fund and slow economic growth.