



FISCAL NEWS

MONTHLY NEWSLETTER OF THE OFFICE OF FISCAL AND PROGRAM REVIEW

SEPTEMBER 2008

Volume 2 Number 9

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The Office of Fiscal and Program Review (OFPR) is a nonpartisan staff office of the Legislative Council providing budget, tax and general fiscal research and analysis for the Maine State Legislature.



Month In Review

The Administration released its estimates of the revenue shortfalls or “structural gaps” facing the General Fund and Highway Fund for the 2010-2011 biennium. The General Fund nor Highway Fund structural gap estimates (roughly \$500 million and \$350 million, respectively) do not yet reflect the likely downward revenue revisions that will occur as part of the fall forecasts that begins with the update of the economic forecast. The Consensus Economic Forecasting Commission will be meeting on October 16th to update the economic forecast and begin the fall revenue forecasting process.

General Fund and Highway Fund revenue were under budget in August and a preliminary look at September’s performance shows the trend continuing.

Cash pool balances continued to decline, falling even further behind historical balances as a result of policy changes and the cash flow problems with the Dirigo Health Fund.

While Maine has been feeling the indirect effects of the national credit market crisis, the crisis hit home directly this month as Maine’s attempt to sell \$50 million of revenue bonds for transportation projects was delayed due to the turmoil in the national financial markets. The Maine Municipal Bond Bank decided to wait out the turmoil.

Structural Gap Estimates

As required by statute (5 MRSA, §1665), the Administration released its estimates of the structural gaps facing the General Fund and Highway Fund for the upcoming 2010-2011 biennium that begins July 1, 2009. These estimates represent projections of expenditures based on current law and include reasonable growth reflecting inflation, local and national trends and program operations. The expenditure estimates are then compared to the most recent revenue forecast. This analysis is similar to the process used to develop the old “Current Services” appropriations and allocations, which was the starting point for the biennial budget prior to the 2008-2009 biennium.



Structural Gap Estimates —continued

As noted in the chart below, the current General Fund estimates represent a revenue shortfall for the next biennium of approximately 7.5% of estimated General Fund appropriations. This is higher than the estimates for the last biennium, but a much lower percentage of appropriations than those of the early 1990's or Governor's Baldacci's first term budgets. However, the estimates are not yet comparable until the revenue forecast is revised this fall. Given the current economic conditions, the 7.5% shortfall will likely increase when the December revenue forecast is released.

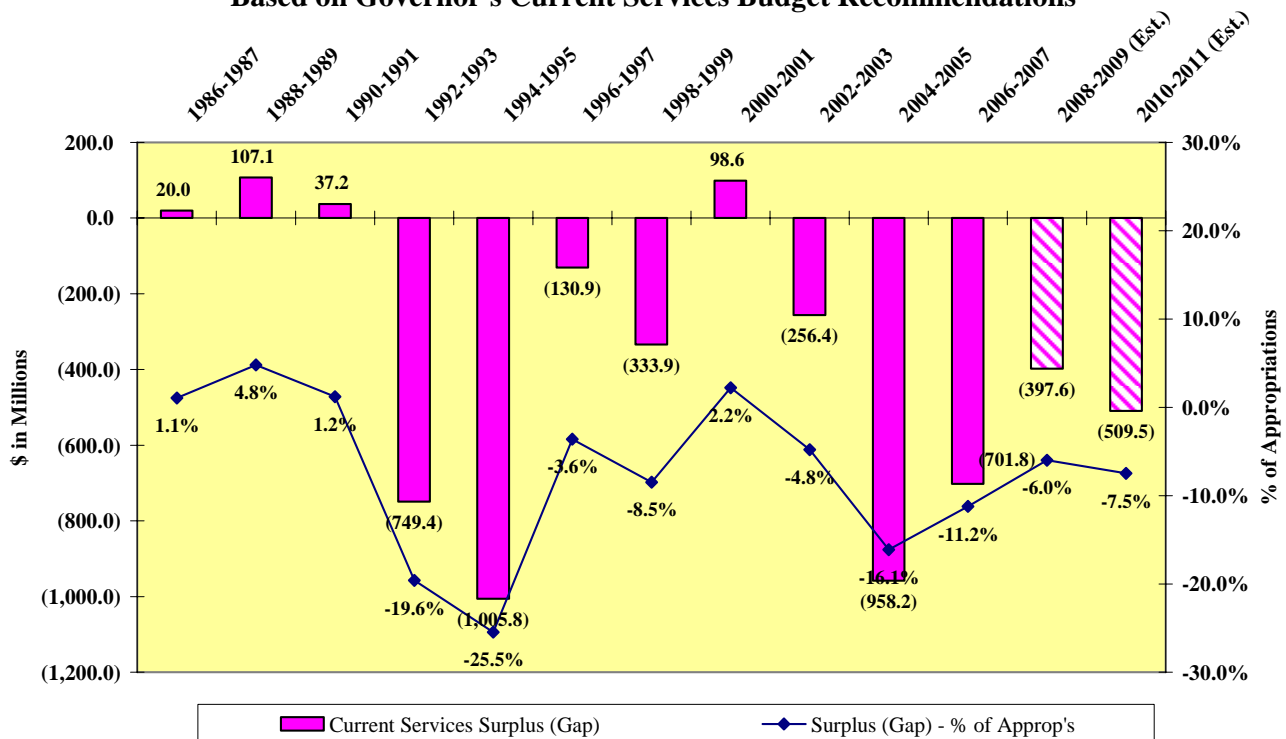
For the Highway Fund, the current estimate of the revenue shortfall is one of the most significant that this fund has faced (actual historical data is not available). At \$350 million, the revenue shortfall represents approximately 35% of estimated Highway Fund allocations. It is important to point out that the Administration's estimates do not reflect the full cost of meeting the goals established in PL 2007, c. 470, which established performance measures and goals for transportation infrastructure. In order to achieve those goals,

expenditures would have to increase by roughly \$150 million, increasing the structural gap estimate to around \$500 million, putting it in the same dollar range as the General Fund shortfall.

With the changes to the budget process beginning with the 2008-2009 biennium, these structural gap estimates based on a "Current Services" approach no longer represent an estimate of the budget starting point and have become more of a theoretical exercise. The modified flat-funded Baseline Budget appropriations and allocations will vary significantly from these estimates. Those baseline amounts will likely hide a number of tough budget decisions as inflationary pressures increase program operating costs and force program cut-backs to stay within the modified flat-funded starting point.

While the value of these estimates is somewhat diminished due to the change in the budget process, they provide a sense of the level of tough budget decisions that will need to be made for the 2010-2011 biennium.

**History of General Fund Structural Surpluses (Gaps)
Based on Governor's Current Services Budget Recommendations**





General Fund Revenue Update

Total General Fund Revenue - FY 2009 (\$'s in Millions)

	Budget	Actual	Var.	% Var.	Prior Year	% Growth
August	\$78.0	\$61.9	(\$16.1)	-20.6%	\$91.4	-32.3%
FYTD	\$315.2	\$309.2	(\$6.0)	-1.9%	\$314.6	-1.7%

General Fund revenue was under budget by \$16.1 million in August, resulting in a negative variance of \$6.0 million or 1.9% for the first 2 months of FY 2009. Revenue for the first 2 months was 1.7% below the same period in FY 2008.

The timing issue in the Individual Income Tax category identified last month, which produced a positive variance in July, was more than offset by the \$17.8 million negative variance in August, resulting in a \$9.6 million negative variance for the first 2 months of FY 2009. Roughly half of this negative variance was related to Circuitbreaker tax and rent refund payments exceeding projections. The increase in these payments appears to represent a timing issue, with more filings compared to prior years coming in the first month of the program year (August to July). Preliminary data for September payments show them below budget, offsetting much of the August variance. Other components of Individual Income Tax revenue in September were ahead of projections.

Sales Tax collections in August resulting from July taxable sales exceeded budgeted projections by \$3.2 million. This variance is largely attributable to the monthly distribution of budgeted revenue in this category. September Sales Tax revenue is coming in under budget. Given the current economic conditions, the negative variance in the Sales Tax line is expected to increase as we head into the heating season.

Some other areas of concern include the Real Estate Transfer Tax, Estate Tax and the Corporate Income Tax. Corporate Income Tax quarterly payments due in September came in well under budget.

With the sale of the Mainsail II commercial paper investment at cost, the reserve established to offset a potential investment was distributed to cash pool participants in September. The Income from Investments category showed a \$1.4 million positive variance in September as a result.

Highway Fund Revenue Update

Total Highway Fund Revenue - FY 2009 (\$'s in Millions)

	Budget	Actual	Var.	% Var.	Prior Year	% Growth
August	\$8.4	\$6.9	(\$1.5)	-18.3%	\$7.6	-9.8%
FYTD	\$35.3	\$32.1	(\$3.3)	-9.3%	\$33.4	-4.1%

Highway Fund revenue was under budget by \$1.5 million in August and \$3.3 million for the Fiscal Year-to-date. Highway Fund revenue continues to show negative growth at 4.1% for the first 2 months of FY 2009.

Fuel Taxes remain the largest contributor to the negative variance in the Highway Fund for the first 2 months of FY 2009 (\$1.9 million below budget), but Motor Vehicle Registration and Fees have also begun to show some weakness, falling \$0.9 million below budget for the first 2 months of FY 2009.

According to U.S. Department of Transportation data, Maine was 2nd behind Idaho in the percentage decline in the number of total vehicle-miles driven from June 2007 to June 2008. Maine's total vehicle-miles driven declined 7.0% over this period compared to the U. S total decline of 4.7%. This data explains much of the decline in Fuel Tax revenue despite indexing of the tax rate for inflation.



Cash Balances Update

Summary of Treasurer's Cash Pool		
August Average Daily Balances		
Millions of \$'s		
	2007	2008
General Fund (GF) Total	\$73.5	\$39.2
General Fund (GF) Detail:		
Budget Stabilization Fund	\$115.7	\$129.0
Reserve for Operating Capital	\$40.6	\$40.6
Tax Anticipation Notes	\$0.0	\$0.0
Internal Borrowing	\$78.4	\$60.0
Other General Fund Cash	(\$161.2)	(\$190.4)
Other Spec. Rev. - Interest to GF	\$78.4	\$110.8
Other State Funds - Interest to GF	\$5.6	(\$15.2)
Highway Fund	\$28.1	\$21.9
Other Spec. Rev. - Retaining Interest	\$82.1	\$73.6
Other State Funds	\$262.2	\$159.8
Independent Agency Funds	\$114.6	\$77.9
Total Cash Pool	\$644.5	\$467.9

Presented above is a comparison of the average balances of August 2007 and August 2008. The average total cash pool balance last month was \$467.9 million, which was \$176.6 million less than the \$644.5 million average for August 2007. The average balance in August for the 7 years from 2001 to 2007 was \$655.2 million.

There are a number of major contributors to the decline of the balances in the cash pool compared with August 2007. The weaker General Fund cash position represents roughly \$34 million. The State also shifted its investments of retiree health insurance funds, approximately \$100 million, from the cash pool to the Maine Public

Employees Retirement System. The University of Maine System has invested less of its excess cash balances in the cash pool (roughly \$34 million) as a result of a policy change that reduced the cash pool rate of return for independent agencies. And, Dirigo Health Fund's growing cash pool borrowing over this period represented a decline of approximately \$26 million in the average cash balance (see separate article).

Only the Other Special Revenue Funds, the "dedicated revenue" accounts, showed improvement over August average balances in 2007.



Dirigo Health Update

At the Appropriation and Financial Affairs Committee's September meeting, the State Controller and the Executive Director of the Dirigo Health Agency presented additional information regarding the status of the Dirigo Health Fund (DHF). They confirmed that in the fall of 2007, after reviewing the financial condition of the Dirigo Health Fund, the State Controller authorized the DHF to borrow from the State's cash pool in order to meet current obligations of the program. Specific accounting controls were also turned off, allowing the DHF to spend in excess of available cash.

While the looming cash flow problems faced by the Dirigo Health Program, primarily a result of the time-lag in collecting savings offset payment (SOP) assessments and the continued spend-down of the initial \$53 million General Fund transfer to the DHF, had been discussed in public meetings of the Dirigo Health Board and in presentations to the Legislature, the immediacy of the crisis that resulted in the November 2007 decision to borrow from the State cash pool had not. Subsequent discussions during the Second Session of the 123rd Legislature focused on longer term solutions and replacement of the SOP that resulted in enactment of PL 2007, c.629, "An Act to Continue Maine's Leadership in Covering the Uninsured."

While the enacted bill did address some of the DHF cash flow problems, it did not take effect until FY 2009. For FY 2008, the State Controller will be required to implement retroactive account journal entries to record offsets to the Dirigo Health Fund's FY 2008 deficit.

At their September meeting, the Appropriation and Financial Affairs Committee was also presented with an updated financial analysis of alternative impacts of the pending People's Veto of parts D, E, and F of Public Law 2007, c.629 (see Table below). The State Controller and Executive Director stated that if the People's Veto is successful, the Dirigo Health Program will continue to rely on the SOP as its primary revenue source and would need to address a financial shortfall in the range of \$14 to \$18 million. If the veto is not successful, they estimate the DHF will have sufficient resources to offset its outstanding liabilities by the close of FY 2009. The State Controller further indicated they would continue to allow the DHF to borrow from the cash pool up to a maximum of \$20 million and that a policy solution must be in place before the close of the current biennium on June 30, 2009.

Dirigo Health Agency FY 2009 Projections		
(\$'s millions)		
	Scenario 1	Scenario 2
	People's Veto Successful	People's Veto Unsuccessful
Revenue		
Fund for a Healthy Maine Allocation	\$5.0	\$5.0
General Fund Cash Advance	\$3.6	\$3.6
SOP 2	\$18.9	\$16.4
SOP 3	\$12.6	\$4.7
1.8% Claims Surcharge	\$0.0	\$16.5
Beverage Taxes	\$0.0	\$8.8
Employer/Employee Contributions	\$26.0	\$26.0
Membership Fees	\$0.8	\$0.8
Total Revenue	\$66.8	\$81.7
Expenses		
Agency Program Costs (subsidy)	\$30.2	\$30.2
Member Program Costs	\$26.0	\$26.0
Subtotal Dirigo Choice Coverage	\$56.1	\$56.1
Administration/Maine Quality Forum	\$3.9	\$3.9
MaineCare Costs	\$4.5	\$4.5
Total Expenses	\$64.5	\$64.5
Net Surplus (Deficit)	\$2.3	\$17.2
Beginning Balance	(\$16.5)	(\$16.5)
Ending Balance	(\$14.2)	\$0.7