TESTIMONY
OF
MICHAEL J. ALLEN, ASSOCIATE COMMISSIONER FOR TAX POLICY
DEPARTMENT OF ADMINISTRATIVE & FINANCIAL SERVICES

Before the Joint Standing Committee on Appropriations and Financial Affairs

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August 1, 2020 REVENUE FORECASTING COMMITTEE REPORT

Senator Breen, Representative Gattine, and Members of the Joint Standing Committee on Appropriations and Financial Affairs – good morning, I am Michael Allen, Associate Commissioner for Tax Policy in the Department of Administrative and Financial Services and the current Chair of the Revenue Forecasting Committee (RFC). Before I begin summarizing the revenue forecast, I would like the other members of the RFC that are attending remotely to introduce themselves.

The Revenue Forecasting Committee (RFC) has concluded a rare "off-cycle" update of its most recent revenue forecast (March 1, 2020) in order to incorporate the new economic forecast released by the Consensus Economic Forecasting Commission (CEFC) on July 1, 2020 and to provide the Governor and Legislature with a revenue forecast that reflects the impact of the COVID-19 pandemic.

In its August 2020 update, the RFC has revised General Fund (GF) revenue estimates downward by $527.8 million for FY21 and by $883.2 million for the FY22/23 biennium. The forecasted rate of year-over-year growth for General Fund revenue in FY21 is now -10.8%, followed by growth of 5.6% in FY22 and 3.4% for FY23. In addition, Highway Fund revenues are being reduced by $30.8 million in FY21 and $30.5 million in the FY22/23 biennium.

General Fund Summary

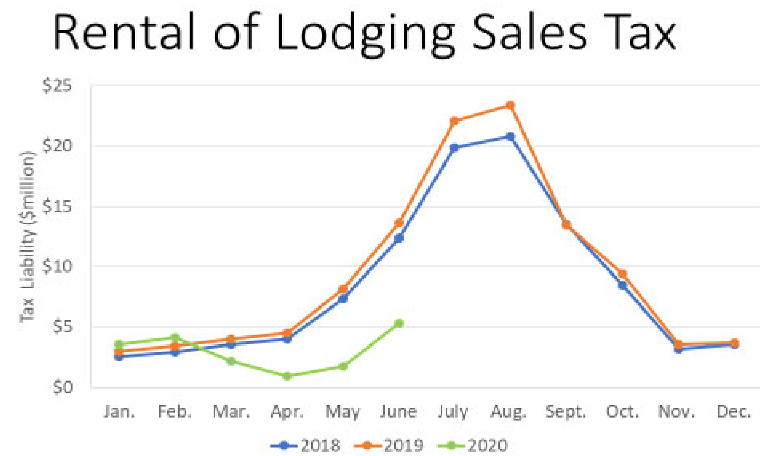
	FY20 Actual	FY21	FY22	FY23
Current Forecast	$3,969,343,702	$4,070,279,515	$4,174,531,432	$4,317,597,709
Annual % Growth	3.1%	2.5%	2.6%	3.4%
Net Increase (Decrease)		($527,809,542)	($433,731,150)	($449,465,768)
Revised Forecast	$3,969,343,702	$3,542,469,974	$3,740,800,282	$3,868,131,941
Annual % Growth	3.1%	-10.8%	5.6%	3.4%

The table below is a summary of changes made by the CEFC to the key economic variables that were used by the Maine Revenue Services' Office of Tax Policy (OTP) in the development of their sales and use tax and individual income tax forecast recommendations to the RFC. The CEFC forecast is always a key input for the RFC and that is certainly the case in the August revenue forecast. State Economist Amanda Rector is here today and before I discuss the revenue forecast Amanda will summarize for the committee the July CEFC report and the key assumptions behind that forecast.

Calendar Years	2019	2020	2021	2022	2023	2024	2025
Wage & Salary Employment (Annual Percentage Change)							
CEFC Forecast 02/2020	0.9	0.5	0.2	0.1	0.0	0.0	0.0
CEFC Forecast 07/2020	0.9	-8.0	4.0	2.0	0.0	0.0	0.0
Personal Income (Annual Percentage Change)							
CEFC Forecast 02/2020	4.7	4.1	4.0	3.7	3.5	3.5	3.5
CEFC Forecast 07/2020	4.6	3.9	-1.2	3.7	3.5	3.6	3.6
Wage and Salary Income (Annual Percentage Change)							
CEFC Forecast 02/2020	4.5	4.1	3.7	3.4	3.2	3.2	3.2
CEFC Forecast 07/2020	4.6	-5.0	2.0	3.0	3.0	3.0	3.0
CPI (Annual Percentage Change)							
CEFC Forecast 02/2020	1.8	1.9	2.0	2.0	2.0	2.0	2.0
CEFC Forecast 07/2020	1.8	0.9	1.5	1.7	2.0	2.0	2.0

Almost 95% (-$498.3 million) of -$527.8 million reprojection in FY21 by the RFC is from sales and use and individual income taxes, and 100% of the FY22 and FY23 net reductions are attributable to these two revenue lines. In both cases, swift and unprecedented stimulus from the federal government and the Federal Reserve System has helped to moderate the initial impact on State revenues of the historic COVID-19 recession during the final quarter of FY20. While the CEFC assumes that Congress will provide an additional $1 trillion of stimulus during CY20, the temporary nature of that stimulus and a weak recovery for the Maine economy leads to significant ongoing reductions in the State's two largest sources of GF revenue.

In the case of the sales and use tax line approximately 60% of the $238 million reduction in FY21 is attributable to taxable prepared foods and lodging. Lodging sales are assumed to be down year-over-year by 50% during the third-quarter of CY20, the height of the summer tourism season. Lodging sales are assumed to improve slowly over the remainder of CY20 and are not expected to generate the same level of tax revenue as CY19 until CY22.



CY 2019 liability = $112.3 million

Share of total CY 2019 sales & use tax = 7.3%

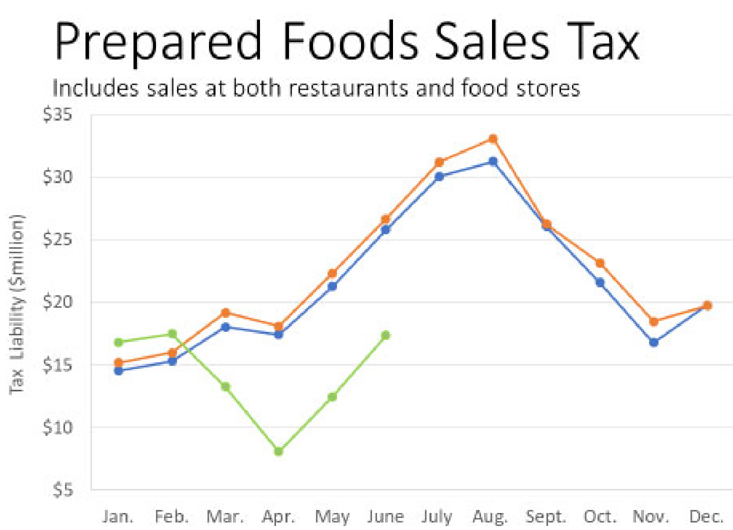
CY 2019 Share of Taxable Sales by Quarter:

1	9.3%
2	23.4%
3	52.5%
4	14.8%

YoY Growth, 2020

July 19 – Feb.20	Mar.	April	May	June	April – June
10.0%	-45.6%	-80.2%	-78.5%	-60.5% to -61.3%	-69.5% to -69.9%

Prepared food sales, mostly restaurant sales, are projected to perform better than lodging, but are assumed to be down approximately 30% year-over-year during the third-quarter of CY20. Like lodging, prepared food sales are assumed to slowly improve and not get back to the same level of tax revenue as CY19 until CY22.



CY 2019 liability = $269.4 million

Share of total CY 2019 sales & use tax = 17.5%

CY 2019 Share of Taxable Sales by Quarter:

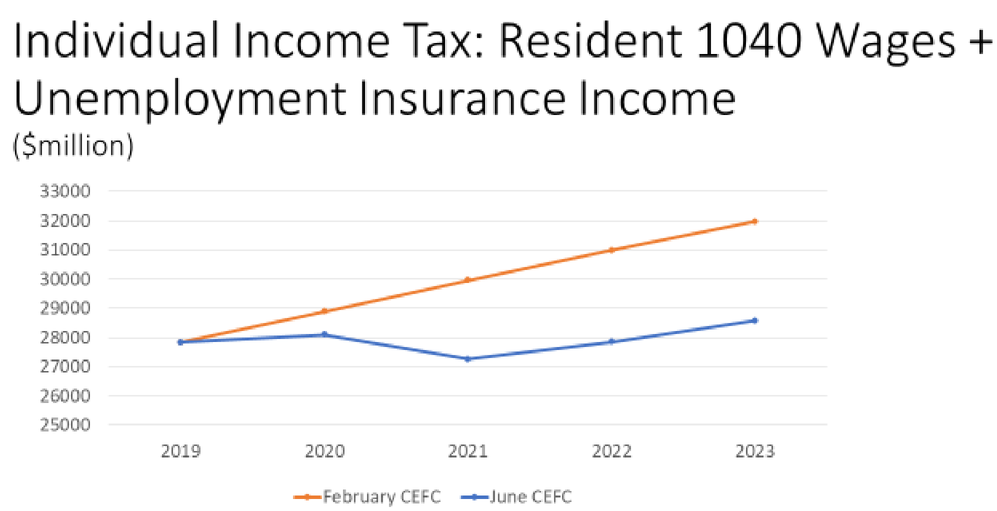
1	18.7%
2	24.9%
3	33.6%
4	22.8%

YoY Growth, 2020

July 19 – Feb.20	Mar.	April	May	June	April – June
5.4%	-30.9%	-55.2%	-44.1%	-35.9% to -33.9%	-43.8% to -43.0%

These key assumptions by the RFC about lodging and prepared food sales are consistent with the CEFC's employment forecast for the leisure and hospitality industry. The gradual improvement in both sales categories, representing 25% of total sales tax revenue in a typical year, is the primary reason for the lower decrease in sales tax revenue of $152 million in FY22 and $131.3 million in FY23. One bright note on sales tax is the additional tax revenue the State is collecting because of several recent law changes that require remote sellers to collect and remit sales tax on sales delivered into Maine.

75% of the adjustments to individual income tax revenue is primarily the result of the CEFC's assumption of combined wage and salary and unemployment insurance (UI) benefits growth over the forecast period. The CEFC forecast assumes that the initial enhanced UI benefits that were part of the CARES Act, and a continuation of those benefits at some reduced level in the next federal stimulus package will almost offset the reduction in wages and salaries during CY20. After CY20 the CEFC assumes that UI benefits will fall back to normal levels and growth as unemployment declines, but wage and salary growth will be weaker than their previous forecast. These assumptions result in a growing gap between the February and July CEFC forecast for the combined level of wage and salary and UI benefits, which has a significant impact on individual income tax liability.



	2020	2021	2022	2023
June wages relative to Feb.	-8.7%	-10.2%	-10.5%	-10.7%
June wages + UI relative to Feb.	-2.7%	-9%	-10.1%	-10.6%
Unemployment rate forecast	8%	5.7%	4.3%	3.7%

Other key factors impacting the individual income tax forecast are; (1) the reversal of the FY20 accruals for final and estimated payments in FY21, (2) a larger decrease in capital gains realizations than the March forecast, and (3) a reduction in IRA income in tax year 2020 due to federal tax law changes.

The COVID-19 pandemic has had an impact on our society not seen for 100 years, and an unprecedented impact on the global, U.S., and Maine economies. Public health officials are grappling with spread of the virus and are gaining an understanding of this deadly disease daily. Simultaneously, economists are trying to understand the ramifications of an almost complete shutdown of the world economy and a subsequent phased re-opening. Simply, there's no playbook for forecasting a modern economy during a worldwide pandemic. The recent economic forecast and this revenue forecast represent the two-forecasting committee's best attempts at forecasting Maine's economy and State revenues over the current and next three calendar years. Both committees will meet jointly for our annual retreat in mid to late September to review both forecasts, discuss incoming economic and revenue data, and will no doubt share ideas on how the next forecasting exercise can be improved. On the heels of the retreat will be the November 1st report of the CEFC and the December 1st report of the RFC. Given the numerous uncertainties expressed by both committees, there's a high probability that significant changes, positive or negative, may take place in the next forecasting exercise.

That concludes my summary of the August RFC meeting. We welcome any questions you may have.