Budget Overview

122nd Legislature

1st Regular and 1st Special Sessions

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Maine State Legislature

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I. Introduction

This document is intended to provide an overview of the major budget and fiscal decisions of the 122nd Legislature during its 1st Regular and 1st Special Sessions. All amounts are presented in millions of dollars with the exception of Appendix A. As a result of rounding, the detail may not add to the totals. Throughout the document, fiscal years are abbreviated to FY05, FY06 and FY07, which correspond to the fiscal years ending June 30, 2005, June 30 2006 and June 30, 2007, respectively. Additional detailed analyses of the budget and numerous historical analyses are being updated by the Office of Fiscal and Program Review (OFPR) and are or will be available from OFPR. Many of these analyses including this report are or will be posted to OFPR's web page: http://www.maine.gov/legis/ofpr/.

II. General Fund Structural Gap – 2006-2007 Biennium

Base Revenue Forecast vs. Governor's Recommendations

At the start of the 122nd Legislature, December 1, 2004, the Legislature was facing a sizeable structural gap or shortfall of baseline revenue estimates established by the Revenue Forecasting Committee (RFC) compared to General Fund current services recommendations. Table II-A below summarizes the General Fund structural gap prior to Legislative actions of the 122nd Legislature and based on the Governor's recommendations for current services appropriations. The Governor's current services appropriations were corrected and adjusted in a March 2005 change package. Those adjustments are reflected in the table. In order to balance the budget solely with reductions of appropriations, an 11.2% reduction of total current services appropriations would have been required over the biennium.

Table II-A General Fund 2006-2007 Structural Gap
Millions of $'s

	FY06	FY07	Biennium
Base Revenue Estimates - December 2004	$2,719.1	$2,828.6	$5,547.8
Current Services Appropriations	$3,038.9	$3,210.7	$6,249.6
General Fund "Current Services" Surplus (Shortfall)	($319.7)	($382.1)	($701.8)
Surplus (Shortfall) as a % of Appropriations	-10.5%	-11.9%	-11.2%

Items not included and other considerations

The Governor's current services recommendations did not include several items that would have affected the estimate of the General Fund structural gap.

- **FMAP Change** - The Governor's current services recommendations did not factor in a reduction in the Federal Medical Assistance Percentage (FMAP), which increased the state share for the MaineCare/Medicaid program. The FMAP for Maine changed from 64.89% in federal fiscal year 2005 to 62.90% for federal fiscal year 2006. This matching rate change would have added an additional $34.2 million in FY06 and $46.5 million in FY07, assuming no further reductions for federal fiscal year 2007 (based on preliminary estimates, Maine's federal fiscal year 2007 FMAP may drop by approximately 1 percentage point more).

- **School Funding Initiated Bill Approved by Voters –** The Maine Municipal Association's citizen-initiated bill was approved in a run-off election in November 2004. Although inoperative until 45 days after the start of the 122nd Legislature (mid-January), the initiated bill would have called for an immediate increase in the State's share of K-12 education to 55% and resulted in an additional General Fund cost of $167.1 million in FY06 and $131.0 million in FY07 over previous estimates of General Purpose Aid for Local Schools program costs prior to the 122nd Legislature's changes. These additional costs were also not factored into the structural gap estimates above. (See discussion of Property Tax Reform below and in Appendix B.)

- **Available FY05 Ending Balance –** The December 2004 Revenue Forecasting Committee revision for FY05 increased the General Fund ending balance by $71.9 million to $82.6 million. This amount was not factored in as a resource to offset the 2006-2007 shortfall. In the Governor's original budget submission, it appeared that the whole balance was designated for funding the current year (FY05) shortfalls.

III. Tax Reform – Property Tax Reform

With the approval by the voters of the Maine Municipal Association's (MMA's) initiated bill (see above) and with other tax reform and spending limit initiatives waiting in the wings, the Governor and legislative leadership undertook a very aggressive schedule to implement a property tax reform proposal that included spending limitations at the state, county and municipal levels of government and several other initiatives designed to produce property tax relief. The Governor's proposals also included enhancements of several property tax relief programs. A special select committee, the Joint Select Committee on Property Tax Reform, was established with direction to conclude its work by mid-January 2005.

The enacted version of the property tax reform plan included: a more rapid increase in the State's share of school funding (but not the immediate increase to 55% as called for in MMA's initiated bill); an expansion of the Circuit Breaker program; an increase in the Homestead Exemption program with reduced reimbursement to municipalities; a change to revenue sharing to distribute more to municipalities with disproportionate tax burdens; and the implementation of spending limits for the State, counties and municipalities. Appendix B provides more information regarding tax reform during the 122nd Legislature, including other tax reform initiatives that were considered during the 1st Special Session.

IV. Addressing Current Year (FY05) Funding Issues

The Emergency FY05 or "EFY05" Budget Bill (PL 2005, c. 3) was enacted in early February as a unanimous Appropriations Committee report. That EFY05 Budget Bill addressed several current year funding needs, the largest being MaineCare funding shortfalls. In addition to the adjustments made in the EFY05 Budget Bill, the "Current Services" or Part 1 Budget Bill (PL 2005, c. 12 – a divided committee report enacted as a non-emergency) and the "New and Expanded Programs" or Part 2 Budget Bill (PL 2005, c. 386 – unanimous committee vote and enacted as an emergency) also provided additional funding and made adjustments to FY05. Table IV-A below provides a summary of these FY05 adjustments.

Table IV-A Summary of FY05 General Fund Adjustments

Increase (Decrease) to General Fund Balance - Millions of $'s

	FY05
Budgeted Ending Balance - Prior to 122nd Legislature	$82.6
Spending/Decreases to Balance	
MaineCare/Medicaid Shortfall - EFY05 Budget	($52.0)
BETR and Circuit Breaker Shortfalls	($12.8)
Child Welfare Services Shortfall	($10.2)
Other Health and Human Services Shortfalls	($3.1)
Salary Plan Transfer (for Collective Bargaining)	($5.0)
Maine Clean Elections Fund Transfer	($2.4)
Reserve for Future Funding Needs	($16.4)
Eliminate Intergovernmental Transfer (Portland, Barron Center)	($2.5)
Other Miscellaneous Spending/Reductions to Balance	($8.2)
Savings/Increases to Balance	
March and June 2005 Revenue Forecasting Committee Revisions	$29.8
Health and Human Services Billing Revenue Accrual	$11.5
MaineCare Reductions - Nursing Facilities	$3.2
Lapsed General Purpose Aid for Local Schools Savings	$2.3
Debt Service Savings	$2.5
Other Miscellaneous Savings/Increases to Balance	$7.8
Budgeted Ending Balance - After 122nd Legislature, 1st Special	$27.1

V. Summary of General Fund 2006-2007 Budget Adjustments

The table below and the narratives that follow summarize the adjustments that were made during the 1st Regular and 1st Special Sessions of the 122nd Legislature to offset the General Fund structural gap for the 2006-2007 biennium.

Table V-A Summary of 2006-2007 General Fund Adjustments

Millions of $'s

	FY06	FY07	Biennium
FY05 Balance Remaining after FY05 Commitments	**$27.1**		**$27.1**
Transfers and Adjustment to Balance			
Reserve for Future Needs from FY05	$16.4	$0.0	$16.4
Transfers to Retirement Allowance Fund	($41.9)	$0.0	($41.9)
Working Capital Advance from Other Special Revenue Funds	$42.5	($42.6)	($0.1)
Transfers from Other Special Revenue Funds	$18.3	$10.6	$28.9
Transfer from Fund for a Healthy Maine	$0.4	$4.6	$5.0
Other Transfers and Adjustments to Balance	$5.6	$0.8	$6.3
Subtotal - Transfers and Adjustments to Balance	**$41.2**	**($26.6)**	**$14.7**
Revenue Adjustments			
Revenue Forecasting Committee Revenue Revisions	$4.5	$13.6	$18.1
BETR Shifted to Revenue, 90% FY07 Reimbursement	($73.5)	($68.1)	($141.6)
Circuit Breaker Benefit Expansions & Reprojections	($15.1)	($17.4)	($32.5)
Cigarette and Tobacco Products Tax Increases	$53.3	$72.7	$126.0
Partial Non-conformity with Recent Federal Tax Changes	$3.1	$9.5	$12.5
Corporate Income Tax Apportionment Change	$5.3	$4.2	$9.5
Casual Rental of Living Quarters	$3.9	$4.7	$8.6
Other Tax and Fee Changes General Fund - Gross Amount	$13.4	$20.9	$34.3
Net (Increase) Decrease to Revenue Sharing	$5.9	$10.2	$16.1
Fine Revenue - Increased Fines and Collection Efforts	$5.3	$6.2	$11.5
Other Legislative Adjustments to Revenue	$18.0	$14.7	$32.8
Subtotal - Net Increase (Decrease) of Revenue	**$24.2**	**$71.1**	**$95.2**
Total Increase (Decrease) to Resources	**$92.5**	**$44.5**	**$137.0**
Appropriation Adjustments			
Retirement Amortization Change & Related Deappropriations	($107.9)	($69.4)	($177.3)
Adjustment for BETR Deappropriations Shifted to Revenue	($78.1)	($82.9)	($161.0)
Health Insurance Statewide Deappropriations	($4.9)	($11.7)	($16.6)
Other Statewide Deappropriations	($9.8)	($14.0)	($23.8)
Net MaineCare/Medicaid Adjustments	$4.6	($69.4)	($64.8)
Higher Education Adjustments	($7.8)	($19.2)	($27.0)
Net Other Appropriation Adjustments	($24.2)	($75.0)	($99.2)
Net Appropriations (Deappropriations)	**($228.2)**	**($341.6)**	**($569.8)**
Net Increase (Decrease) to General Fund Balance	**$320.8**	**$386.1**	**$706.9**

With the addition of the FY05 budgeted balance forward of $27.1 million, the 122nd Legislature made net adjustments of $706.9 million to offset the $701.8 million 2006-2007 General Fund structural gap. These actions left a budgeted ending balance projected for the end of FY07 of $5.0 million (Note: the budgeted ending balance at the close of FY06 was only $1.0 million).

Transfers and Adjustments

Transfers and Adjustments to Balance include a $41.9 million transfer in FY06 to the Maine State Retirement System. Originally, this amount was budgeted to be transferred as a prepayment toward future unfunded actuarial liability payments beyond the 2006-2007 biennium. In the end, it was used to hold down the appropriations for Teachers' Retirement that were partially restored with the replacement of the Pension Cost Reduction Bonding initiative by PL 2005, c. 457. The 122nd Legislature, like some of its predecessors, also looked for available balances in Other Special Revenue Funds and included budgeted transfers totaling $33.9 million including $5.0 million from the Fund for a Healthy Maine. The largest single adjustment in this group, although it nets to a very small amount over the biennium, is the working capital advance of $42.5 million in FY06 from Other Special Revenue Fund cash pool balance. This adjustment was necessary as part of the final deliberations on the "Part 3" Budget or Pension Cost Reduction Bond Replacement budget to keep the General Fund in balance for FY06. That advance is budgeted to be repaid with interest on the first day of FY07.

Revenue Forecasting Committee Revisions

The baseline forecast for the 2006-2007 biennium at the start of the 122nd Legislature, the December 2004 Revenue Forecasting Committee Forecast, reflected a decrease from FY05 to FY06. This decrease was largely due to some substantial one-time revenue enhancements that the 121st Legislature used to address its structural gap for the 2004-2005 biennium. The largest initiatives that created this decline between these fiscal years were the privatization or lease of the wholesale liquor business and the delays in conformity with federal tax changes.

The Revenue Forecasting Committee met twice during the sessions and made revisions to the baseline forecast. The first was the statutory update due by March 1st. While the economic forecast was not revised at the interim meeting of the Consensus Economic Forecasting Commission in its February 1st report, the Revenue Forecasting Committee did revise the forecast upward in all years by some modest amounts. The largest effect was adjusted to reflect an omission in the December Forecast of a component of individual income tax revenue for tax years beginning on or after 2006. In early June, the RFC met again at the call of the State Budget Officer to address the additional revenue resulting from a positive "April Surprise", allowing the Revenue Forecasting Committee to revise the Individual Income Tax forecast upward by $70.0 million. After factoring in some negative variances in other tax sources, the net FY05 revenue adjustment was $27.7 million upward. No adjustments were made beyond FY05 and the RFC urged caution in the commitment of the additional revenue due to a number of uncertainties surrounding the future revenue picture.

Legislative Revenue Changes

During the 2006-2007 biennium, the major initiatives reducing revenue were the change of the BETR program from an appropriation to a reduction of Individual Income Tax revenue beginning in FY06, and the increase in the Circuit Breaker program included in the Property Tax Reform initiatives (the Circuit Breaker program was also shifted from an appropriation to a reduction of individual income tax revenue in FY05 by the 121st Legislature). Excluding the net reductions to these 2 programs and the Revenue Forecasting Committee revisions, legislative initiatives of the 122nd Legislature increased revenue by $108.2 million in FY06 and $143.1 million in FY07. Of these amounts, tax and fees changes increased revenue by $79.0 million in FY06 and $111.9 million in FY07. Changes in certain taxes and fees, delaying an increase in the revenue sharing percentage and a one-time $5 million transfer from revenue sharing balances decreased revenue sharing by a total of $5.9 million in FY06 and $10.2 million in FY07. Several increases in fine amounts (seat belt violations and certain drug offenses) and additional collection efforts are budgeted to generate additional fine revenue of $5.3 million in FY06 and $6.2 million in FY07.

Adjustments to Current Services Appropriations

Over 80% of the net adjustments necessary to bring the budget into balance came from net deappropriations of nearly $570 million. Of the net change in appropriations over the biennium, over 31% or $177.3 million was related to retirement deappropriations and over 28% or $161.0 million was related to the BETR program, which was shifted from appropriations to revenue reductions as noted early. Another large portion of the deappropriations were numerous statewide deappropriations, which will be distributed as reductions to individual General Fund accounts by financial order approved by the Governor. Table V-B below provides a summary of these statewide deappropriations.

Table V-B Summary of 2006-2007 Statewide Depppropriations

General Fund Appropriations (Deappropriations) - Millions of $'s

	FY06	FY07	Biennium
Health Insurance Savings Initiatives	($4.9)	($11.7)	($16.6)
Retirement Amortization Change	($10.3)	($10.8)	($21.1)
5% All Other Reduction	($5.8)	($5.8)	($11.5)
Technology Review and Efficiencies	($1.2)	($3.8)	($4.9)
Other Efficiencies	($2.9)	($4.5)	($7.3)
Total Statewide Appropriations (Deappropriations)	**($25.0)**	**($36.6)**	**($61.5)**

OFPR has provided a historical analysis of General Fund appropriations focusing in on six major programs or program groups. These groups along with Personal Services expenditures (salaries, wages and fringe benefits) have in recent years accounted for approximately 85% of General Fund expenditures and appropriations. Provided below in Table V-C is a summary of these major categories and the adjustments made to these categories by the 122nd Legislature. Appendix A provides additional detail of the adjustments to these major categories. In addition, a separate analysis of the changes to MaineCare/Medicaid is provided in Appendix D. Net reductions to the appropriations to MaineCare/Medicaid programs were almost $65 million. This is significant in light of a $35.5 million payment to settle a legal suit with hospitals and significant shortfalls in appropriations for FY05.

Table V-C Summary of Appropriation Adjustments By Major Categories

General Fund Appropriations (Deappropriations) - Millions of $'s

Major Categories	**FY05**	**FY06**	**FY07**
General Purpose Aid for Local Schools	$0.0	$12.6	($19.2)
MaineCare/Medicaid	$44.2	$4.6	($69.4)
Higher Education	$0.0	($7.8)	($19.2)
Teachers' Retirement	$0.0	($97.7)	($59.4)
Tax Relief and Reimbursement	$10.6	($84.3)	($82.8)
Debt Service	$0.0	($4.0)	$1.3
Personal Services	($1.7)	($21.7)	($31.6)
Other - Non-Personal Services	$21.4	($30.0)	($61.3)
Total General Fund Appropriations	**$74.6**	**($228.2)**	**($341.6)**

VI. General Fund Appropriations Growth and Appropriations Limits

The property tax reform plan enacted by PL 2005, c. 2 established limits for the growth of appropriations during the 2006-2007 biennium. The limits on appropriations did not become effective until July 1, 2005. Table VI-A shows the calculations of the appropriation limit and the growth of General Fund appropriations. Sections 1 and 2 of Table IV-A show the method of calculating the appropriation limit amount. Although the growth of General Purpose Aid for Local Schools (GPA) is excluded from the limit until the State's share reaches the 55% goal, the calculation in the table is simplified by adding the growth of GPA to the base. This accomplishes the same intent as the temporary exclusion. See PL 2005, c. 2, Part A or Maine Revised Statutes, Title 5, Chapter 142 for the implementing language.

Section 3 of the Table IV-A compares the Appropriations limit with appropriations at different stages and with adjustments for the Business Equipment Tax Reimbursement (BETR) program changes. The Governor's Current Services appropriation recommendations exceeded the calculated appropriations limit by $143.3 million in FY06 and $190.6 million in FY07. After legislative adjustments to appropriations, the total approved appropriations through the 122nd Legislature's 1st Special Session were below the limit by $85.0 million in FY06 and $150.9 million in FY07. Many legislators had requested a comparison of total appropriations adjusted to add back BETR expenditures, which are now treated as reductions of revenue rather than appropriations. Even after adding back the estimated BETR expenditures, the adjusted amounts would be below the limit in both years.

Section 3 of Table IV-A also provides a look at the growth of appropriations without GPA appropriations. The growth of adjusted appropriations with estimated BETR expenditures added back in, but excluding GPA appropriations, shows negative growth from FY05 to FY06 and less than 1% growth between FY06 and FY07.

Table VI-A General Fund Appropriations Limit Calculations
Millions of $'s

1. GROWTH LIMITATION PERCENTAGE	**Base Amounts**	**FY 06**	**FY 07**
Average Real Personal Income Growth (but no greater than 2.75%)		2.58%	2.58%
Average Population Growth		0.53%	0.53%
Growth Limitation Factor when state is in the highest third of tax burden		**3.11%**	**3.11%**
2. APPROPRIATIONS LIMITS CALCULATION			
A. Total Appropriations times Growth Factor from #1 Above	$2,709.9	$2,794.0	$2,881.0
B. General Purpose Aid for Local Schools (GPA) Appropriations	$734.5	$836.1	$873.6
C. Growth of GPA Appropriations over FY05 Base Amount		$101.6	$139.1
D. Appropriations $ Limit (D = A + C)		$2,896	$3,020
3. COMPARISON OF APPROPRIATIONS TO APPROPRIATIONS LIMITS			
A. "Current Services" Appropriations (Governor's Recommendations)	$2,709.9	$3,038.9	$3,210.7
Annual % Change		12.1%	5.7%
Amount Over (Below) Appropriations Limitation		$143.3	$190.6
B. Total Actual Appropriations Through 1st Special Session	$2,784.5	$2,810.6	$2,869.2
Annual % Change		0.9%	2.1%
Amount Over (Below) Appropriations Limitation		($85.0)	($150.9)
C. Adjusted Appropriations (Adding Back Estimated BETR Payments)	$2,784.5	$2,884.1	$2,937.3
Annual % Change		3.6%	1.8%
Amount Over (Below) Appropriations Limitation		($11.5)	($82.8)
D. Adjusted Appropriations from C excluding GPA	$2,049.9	$2,048.0	$2,063.7
Annual % Change		-0.1%	0.8%

VII. 2008-2009 General Fund Structural Gap Projections

Table VII-A below summarizes OFPR's preliminary analysis of the General Fund structural gap for the 2008-2009 Biennium. The projections of appropriations presented in this analysis are preliminary based on an expedited review of appropriations growth. The Office of Fiscal and Program Review will be providing a more detailed analysis of the structural gap in the fall of 2005 prior to the start of the 2nd Regular Session of the 122nd Legislature.

Table VII-A General Fund 2008-2009 Structural Gap

Millions of $'s

Appropriations by Major Categories	FY05	FY06	FY07	FY08	FY09
General Purpose Aid for Local Schools	$734.5	$836.1	$873.6	$955.6	$1,015.8
MaineCare/Medicaid	$595.7	$621.8	$589.0	$705.7	$753.5
Higher Education	$241.3	$245.8	$246.9	$251.9	$256.9
Teachers' Retirement	$181.7	$152.2	$205.4	$219.2	$232.9
Tax Relief and Reimbursement	$115.6	$35.6	$42.6	$43.7	$44.7
Debt Service	$92.6	$111.6	$112.7	$107.0	$98.5
Personal Services	$397.5	$410.6	$421.3	$456.0	$474.7
Other - Non-Personal Services	$425.6	$396.9	$377.6	$418.8	$427.2
Total General Fund Appropriations	**$2,784.5**	**$2,810.6**	**$2,869.2**	**$3,157.8**	**$3,304.1**
Annual % Change		**0.9%**	**2.1%**	**10.1%**	**15.2%**
Total Appropriations excluding GPA	**$2,049.9**	**$1,974.5**	**$1,995.5**	**$2,202.2**	**$2,288.3**
Annual % Change		**-3.7%**	**1.1%**	**10.4%**	**14.7%**
General Fund Revenue					
December 2004 RFC Forecast	$2,723.6	$2,719.1	$2,828.6	$2,918.0	$3,022.8
March 2004 RFC Forecast	$2.0	$4.5	$13.6	$14.8	$18.3
June 2004 RFC Forecast	$27.7	$0.0	$0.0	$0.0	$0.0
Legislative Changes	$7.6	$19.6	$57.5	$31.1	$23.2
General Fund Revenue – Total	**$2,760.9**	**$2,743.3**	**$2,899.7**	**$2,963.9**	**$3,064.3**
Annual % Change		**-0.6%**	**5.7%**	**2.2%**	**5.7%**
Approximate Surplus (Shortfall) 2008-2009 Biennium				**($193.9)**	**($239.8)**
Approximate 2008-2009 Biennial Total				**($433.7)**	

This General Fund structural gap estimate reflects a significant improvement from OFPR's estimate provided in February 2005 based on the Governor's original budget submissions, when the 2008-2009 structural gap was estimated to be approximately $650 million. The 122nd Legislature's actions late in the 1st Special Session to replace the Pension Cost Reduction Bonding initiative with on-going reductions to appropriations and increases in revenue are the major reasons for the improved outlook, which now has the General Fund structural gap for the 2008-2009 biennium in the $400 to $450 million range.

Revenue growth through the 2008-2009 biennium is positive, unlike the negative growth between FY05 and FY06. On the appropriations side, the table shows significant growth in General Purpose Aid for Local Schools (GPA), Personal Services appropriations, MaineCare/Medicaid and in some of the "Other" appropriations (largely due to the size of FY07 one-time deappropriations). The growth of GPA, implemented as part of property tax reform, is a major contributor to the imbalance. The Personal Services appropriations growth is due primarily to the addition of collective bargaining for which no appropriations were provided in FY06 or FY07. The General Fund Salary Plan account, from which agencies can draw down funds for collective bargaining cost, was expected to receive a substantial transfer from excess equity in the Retiree Health Insurance Fund that would leave approximately $5 million to be absorbed within agency General Fund appropriation amounts.

The largest contributor to the 2008-2009 General Fund structural gap is MaineCare/Medicaid growth, which is projected to increase almost 20% between FY07 and FY08. The underfunding of FY07 FMAP costs by $10 million, the additional FMAP decrease projected for federal fiscal year 2007 and the early payment in FY06 of some FY07 hospital settlements are the primary reasons for this substantial increase. The assumption of the additional FMAP change, based on the preliminary data, adds approximately $50 million dollars to the difference between projected General Fund appropriations and General Fund revenue.

VIII. Highway Fund

2006-2007 Highway Fund Structural Gap

Like the General Fund, the Highway Fund was also facing a shortfall for each year of the 2006-2007 biennium. The Highway Fund shortfall, more moderate than the General Fund's, would have represented a 3.7% reduction of Highway Fund allocations to balance the Highway Fund budget. The table below summarizes the Highway Fund structural gap prior to Legislative actions of the 122nd Legislature and is based on the Governor's recommendations for current services allocations. The baseline forecast for the 2006-2007 Biennium reflected a modest increase from FY05 levels and no real disruptions. The indexing of fuel taxes since FY04 has significantly improved the resources available to the Highway Fund and has reduced the chronic structural gaps in the Highway Fund.

Table VIII-A Highway Fund Structural Gap - 2006-2007 Biennium
Millions of $'s

	FY06	FY07	Biennium
Base Revenue Estimates - December 2004	$330.4	$340.2	$670.6
Current Services Allocations - Governor's Recommendations	$343.7	$352.6	$696.4
Highway Fund "Current Services" Surplus (Shortfall)	($13.3)	($12.4)	($25.7)
Surplus (Shortfall) as a % of Current Services Allocations	-3.9%	-3.5%	-3.7%

122nd Legislature's Highway Fund Adjustments

Table VIII-B below summarizes the Highway Fund adjustments made by the 122nd Legislature through the 1st Special Session. Most of the larger adjustments necessary to bring the Highway Fund into balance were net downward adjustments to allocations. The Highway and Bridge Improvement program within the Department of Transportation, whose funding has been historically reduced and replaced by general obligation bonds, was reduced by a total of

$11.0 million during the 2006-2007 biennium. The other major Highway Fund deallocations emanate from the General Fund budget initiatives related to retirement and health insurance changes.

Highway Fund revenue was revised modestly downward in the March 2005 Highway Fund revenue revision. Legislative changes, the largest being the new gas tax exemption of gas purchases by state employees, decreased Highway Fund revenue by less than $2.5 million over the biennium.

In addition to the new gas tax exemption that contributed to the General Fund budget solution to replacing the Pension Cost Reduction Bonding initiative, the Highway Fund also contributed to the General Fund budget solution by transferring gas tax revenues of $0.1 million in each fiscal year to the newly created STAR Transportation Fund, by allocating $3.2 million and $3.4 million to reflect the transfer of the subsidy for the Maine State Ferry Service from the General Fund, by deallocating $0.2 million and $0.3 million from Highway Fund departments to reflect savings from gas tax exemptions and by deallocating a total of $1.0 million from Highway Fund departments in FY06 to maintain a balanced Highway Fund budget.

Table VIII-B Summary of 2006-2007 Highway Fund Adjustments

Millions of $'s

	FY06	**FY07**	**Biennium**
FY05 Balance Remaining after FY05 Commitments	$7.7		$7.7
Transfers and Adjustment to Balance			
Transfer from Health Insurance Fund	$0.0	$0.4	$0.4
Revenue Adjustments			
Revenue Forecasting Committee Revenue Revisions	($0.4)	($0.4)	($0.8)
Legislative Changes - New Gas Tax Exemptions and Transfers	($0.7)	($0.9)	($1.6)
Total Increase (Decrease) to Resources	$6.6	($0.8)	$5.8
Allocation Adjustments			
New Marine Highway Transportation (Ferries) Program	$3.2	$3.4	$6.5
Provides funds for Statewide Radio and Network System	$0.0	$0.5	$0.5
Reductions to Highway and Bridge Improvement Program	($3.7)	($7.3)	($11.0)
Retirement Amortization Change and Related Deallocations	($4.4)	($4.7)	($9.1)
Health Insurance Statewide Deallocations	($1.3)	($3.9)	($5.2)
Net Other Adjustments to Allocations	($0.9)	($1.7)	($2.6)
Net Highway Fund Allocations (Deallocations)	($7.1)	($13.8)	($20.9)
Net Increase (Decrease) to Highway Fund Balance	$13.8	$12.9	$26.7

IX. Fund for a Healthy Maine

The Fund for a Healthy Maine (FHM) receives funding primarily from the tobacco settlement agreement. However, beginning in FY07, FHM current services revenue assumptions include a significant increase of $9.9 million in the second year of the biennium to reflect the FHM's share of the proceeds from slot machines at commercial racetracks. The Governor's Current Services Budget did not allocate these funds; as a result this new budgeted revenue increases FHM balances for FY07. The Governor's recommendations for 2006-2007 (FHM) current services allocations are in aggregate essentially flat-funded from FY05 levels, with slight increases provided for "Personal Services" allocations offset by decreases in "All Other" allocations. Table IX-A below summarizes both the fund's status prior to legislative adjustments of the 122nd and the adjustments made during the 122nd Legislature's 1st Regular and 1st Special Sessions.

Table IX-A 2006-2007 Fund for a Healthy Maine (FHM) Summary

Millions of $'s

	FY06	FY07	Biennium
FY05 Budgeted Ending Balance	$2.7		$2.7
Base Revenue Estimates - December 2004	$48.8	$59.4	$108.2
Current Services Allocations - Governor's Recommendations	$49.5	$50.3	$99.8
FHM "Current Services" Surplus (Shortfall)	**$1.9**	**$9.1**	**$11.1**
Adjustment to FHM Allocations and Other Uses			
Transfers			
Transfer to General Fund	$0.4	$4.6	$5.0
FHM Allocation Adjustments			
Allocations for MaineCare FMAP Change	$0.4	$0.5	$0.9
Reductions to Several Programs to Offset General Fund Transfer	$0.0	($4.6)	($4.6)
Allocations for Drugs for the Elderly	$0.0	$9.8	$9.8
Net Allocations and Uses (Deallocations/Reductions in Uses)	**$0.8**	**$10.3**	**$11.1**

These Legislative adjustments include additional allocations for FHM programs that match Federal Medicaid dollars to offset the decrease in the 2006 Federal Medical Assistance Percentage (FMAP) that will take effect on October 1, 2005. In addition, the "Part 3" Budget included transfers of $5 million in FHM balances to the General Fund. A portion of the available balance for these transfers were created by FY07 deallocations of $4.6 million across a number of programs, with $3 million coming from the FHM's share of funding for the elderly low-cost drug program. The "Part 3" Budget also allocates $9.8 million of the FHM's share of proceeds from slot machines at commercial race tracks to be used for drug programs for the elderly and disabled, which commits nearly all of the budgeted resources of the Fund for a Healthy Maine. The estimated budgeted balance at the end of FY07 is less than $5,000.

X. General Obligation Bonds

No general obligation bond bills were enacted during the 1st Regular and 1st Special Sessions of the 122nd Legislature. The Joint Standing Committee on Appropriations and Financial Affairs had 22 Bond Bills remaining in committee that were carried over to the next session of the Legislature. In early February 2005, the Governor submitted a bond package that proposed total general obligation borrowing of approximately $197.4 million, which included $27.8 million of Highway Fund bonds. Table X-A below provides a summary of the substance of the Governor's bond package.

Table X-A Summary of Governor's Bond Package
$ in millions

LD #	Subject	Principal
997	National Guard Armory Improvements	$1.0
998	Transportation	$38.0
999	Higher Education Infrastructure	$12.0
1001	Environmental & Hospice	$17.5
1020	Economic Stimulation & Higher Education Promotion	$78.9
1035	Land for Maine's Future	$50.0
	Total Governor's Recommended Bond Package	$197.4

As of the printing of this report, negotiations between the major parties appear to have improved the chances that there will be bond issues for voter approval on the November 2005 ballot. The negotiated amount is less than the Governor's original package, $83 million compared to the $197.4 million, but the reduced amounts are distributed among most of the items in the Governor's original package.

XI. Fiscal Policy Decisions Affecting Local Governments

Each year in the early fall, the Office of Fiscal and Program Review updates a report of the major state funding disbursed to municipalities and counties. The 122nd Legislature implemented several initiatives that affect the amount of funding disbursed to municipalities and counties. Presented in Table XI-A are some of the major changes that will be reflected in that report. The table also includes some local governmental fee increases that generate additional local revenue, which are not included in OFPR's annual report. Most of the initiatives in this table happened late in the 1st Special Session in the "Part 3" Budget. The largest single item in this table is the increase of GPA. The amounts in the table reflect the increase of GPA over the increases proposed by the 121st Legislature. The amounts for some of the items in this table may be affected further by the distribution of certain statewide deappropriations.

Table XI-A Major Changes Affecting Municipalities and Counties

Decrease (Increase) of Municipal and County Funding - Millions of $'s

	FY05	FY06	FY07
Adjustments to Educational Funding			
Additional Funding for General Purpose Aid for Local Schools	$0.0	($28.9)	($34.8)
Lapse GPA Balances	$2.3	$0.0	$0.0
Delays Educational Efficiency Fund Transfers	$0.0	$0.0	$6.2
School Revolving Renovation Fund - Transfer to General Fund	$0.0	$5.9	$0.0
Delays phase-in of 100% Special Education Cost Reimbursement	$0.0	$0.0	$1.5
Capture Medicaid Savings Otherwise Accruing to School Units	$0.0	$0.0	$2.5
Reduces School Bus Subsidy	$0.0	$0.0	$3.2
Delays Start of Certain Capital Improvement Projects	$0.0	$0.0	$5.2
Adult Education Subsidy Changes	$0.0	($0.3)	($0.3)
Municipal Revenue Sharing			
One-time decrease in FY07	$0.0	$0.0	$5.0
Net Decrease (Increase) of Tax and Fee Changes	$0.1	$3.5	$7.7
Delay the increase to 5.2% until July 1, 2007	$0.0	$2.4	$2.5
Divert Local and Regional Efficiency Fund to General Fund	$0.0	$2.3	$2.5
Tax Reimbursement Programs			
Tree Growth Property Tax Reimbursement Delayed	$0.0	$5.4	$0.1
Veterans Tax Exemption Tax Reimbursement Delayed	$0.0	$0.9	$0.0
Homestead Tax Reimb.from 100% to 50% with $13,000 Exemption	$0.0	($0.1)	($0.2)
Homestead Mandate Reimbursement	$0.0	($0.1)	$0.0
County Jails			
Fees Charged to Counties for High-risk Prisoners ("Safe-keepers")	$0.0	$0.1	$0.1
Reduction of State Support	$0.0	$0.2	$0.1
Other Effects			
Reduce municipal share of park fee revenue	$0.0	$0.2	$0.2
General Assistance - Funded FY05 Shortfall	($1.0)	$0.0	$0.0
Transportation - Urban Rural Initiative Program - Net Adjustments	$0.0	$0.1	$0.5
Local Tax and Fee Changes			
Municipal Marriage Fees Increased	$0.0	N/A	N/A
County Fees Increased	$0.0	($1.7)	($2.2)

XII. Position Count Changes – All Funding Sources

Through the 1st Special Session of the 122nd Legislature, the General Fund realized a net reduction of approximately 63 positions. These reductions were achieved primarily through the following initiatives:

- Consolidation of Executive Branch information and technology services;
- Restructuring of the Child Welfare system and reduction of children in custody;
- Transferring funding responsibility from the General Fund to Other Special Revenue for various Department of Labor positions;
- Privatization of the current State-operated group homes for persons with mental retardation known as Freeport Towne Square; and
- Privatization of the Office of Advocacy in the Department of Health and Human Services.

The net increase of approximately 12 positions in the Highway Fund is due to a reorganization of programs and positions in the Department of Transportation. This same reorganization also resulted in the net decrease of 27 full-time positions from the Motor Transport Services program in the Highway Garage Fund, which is an internal service fund supported by user charges to Highway Fund programs within the Department of Transportation.

The net reduction to all funds was approximately 644 positions. However, 580 of those position eliminations are attributable to redefining positions in the Maine Military Authority as Limited Period and therefore eliminating the Legislative head-count.

Table XII-A Position Count Adjustments - By Fund
Net Increase (Decrease) in Legislative Count and FTE Count

Fund	Position Count
General Fund	(62.692)
Highway Fund	11.923
Other Special Revenue Funds	15.731
Federal Expenditures Fund	(9.654)
Federal Block Grant Funds	(4.000)
Other Funds	(595.538)
Net Increase (Decrease) of Position Counts - All Funds	(644.230)

XIII. Summary of Major Fiscal Policy Issues

A. Non-emergency Current Services Budget and Early Adjournment

The 1st Regular Session of the 122nd Legislature was adjourned before the end of March 2005 in order to be able to enact the Current Services or "Part 1" Budget (PL 2005, c. 12) as a non-emergency and have the 90-day effective date delay toll before the beginning of the biennium, July 1, 2005. This early adjournment procedure was first implemented by the 118th Legislature in 1997 and was designed to avoid a "shut-down" of state government as a result of failing to pass a budget before the start of a biennium, as occurred in 1991. In both cases, the 118th and the 122nd Legislature were immediately called back into special session and the items pending at the adjournment of the 1st Regular Session carried over to the 1st Special Session. For the 122nd Legislature, the non-emergency enactment resulted in the opportunity for a people's veto of a controversial pension borrowing initiative, which is discussed in the next section.

Early in the 1st Regular Session, the Property Tax Reform initiative, PL 2005, c. 2, was enacted as a non-emergency, yet had effective dates of July 1, 2005. The early adjournment of the 1st Regular Session addressed some retroactivity and effective date issues with that law.

B. Lottery Securitization vs. Pension Cost Reduction Bonds

The Governor's original budget proposals included a plan to "securitize" lottery revenue to generate additional revenue from the proceeds of the "securitization" of future lottery revenue. The net benefit to the General Fund was a $250 million revenue increase during the 2006-2007 biennium. The Governor tied this proposal with its $250 million infusion of additional resources to the ability to implement the property tax reform initiative enacted in early January 2005. This proposal proved unacceptable to the Legislature, which explored a new initiative with the intent of generating the same amount of net General Fund benefit during the 2006-2007 biennium.

That alternative proposal started out in negotiations as a means of prepaying retirement contributions to realize savings from a prepayment gain using the actuarial interest earnings assumptions. It expanded into a $447.2 million revenue bond initiative deemed "Pension Cost Reduction Bonds" that did not pledge the full faith and credit of the State. The debt was to be supported by the bundling and transfer of certain non-tax state revenue sources including: the lottery revenue; the revenue from a facility operating video slot machines at commercial racetracks (a "Racino"); and certain dedicated revenue of the Department of the Secretary of State.

The $447.2 million bonds were intended to provide a net payment of $410.0 million (after capitalization of FY06 and FY07 interest and other issuance costs) to the Maine State Retirement System near the beginning of FY06. The proceeds would have replaced the normal cost and unfunded actuarial liability (UAL) components of the retirement contributions for teachers, resulting in total biennial General Fund deappropriations of $358.6 million from Teachers' Retirement. With the extra savings above the $250 million, the Legislature proposed to make an additional transfer to the Retirement System of $41.9 million, which, when added to net proceeds after satisfying the 2006-2007 biennial liabilities, would have provided $120.0 million for the prepayment of future UAL payments.

This borrowing package proved controversial and because the Current Services or "Part 1" Budget (PL 2005, c. 12) was enacted as a non-emergency, it was subject to the possibility of a people's veto. A petition drive to gather the necessary signatures began shortly after passage. This petition effort was abandoned when the controversial borrowing package was eliminated by the enactment of the "Part 3" Budget, Public Law 2005, chapter 457, which started with department and agency proposals to reduce their budgets by 5%.

C. Retirement Unfunded Liability Amortization Schedule Change

Part of the 121st Legislature's solution to its $958.2 million General Fund structural gap for the 2004-2005 biennium was lengthening the amortization payment schedule of the Maine State Retirement System's unfunded actuarial liability (UAL) for state employees and teachers. The 121st legislature extended the amortization schedule out to the maximum length allowed by the Constitution of Maine, June 30, 2028. However, the 121st Legislature added a provision (see Public Law 2003, c. 20, Pt. NN) to revert back to the amortization schedule that would retire the UAL by June 30, 2019 at the beginning of the 2006-2007 biennium. The Governor's current services recommendations reflected double-digit growth in the cost of funding retirement contributions for retired teachers and state employees for the 2006-2007 biennium over the 2004-2005 biennium as a result of reverting back to the more aggressive amortization schedule.

Public Law 2005, c. 12, the Current Services Budget for the 2006-2007 biennium, repealed 5 MRSA §17151, sub-§3 that required the State to revert back to the shortened schedule, resulting in a permanent extension of the UAL amortization schedule. With the lengthened schedule, the projected UAL amount will continue to grow until the fiscal year ending June 30, 2015, when the growth of annual payments begins to reduce the UAL. The State uses a level percentage of salaries method in establishing the annual payments for the UAL.

D. Collective Bargaining Agreement Approved

The State reached agreement with most of its major bargaining units and the Legislature approved the cost elements of the agreement that included a 3% annual cost-of-living adjustment (COLA) effective July 1, 2005 and an additional 3% COLA effective July 1, 2006. The agreement also included an increase in the mileage reimbursement from $0.32 per mile to $0.38 per mile over several incremental changes with the final increase effective January 1, 2007. The estimated General Fund cost of the COLA's was $10.1 million in FY06 and $21.0 million in FY07. The additional Highway Fund costs were $3.7 million and $7.6 million in FY06 and FY07, respectively. No direct General Fund appropriations and Highway Fund allocations have been provided to offset the these additional costs. Transfers of the excess equity in the Retiree Health Insurance Fund to the General Fund and Highway Fund Salary

Plan accounts, which agencies can access to help fund the additional costs, have provided funding for most of these costs. Based on recent estimates of the excess equity, the projected General Fund costs to be absorbed by agencies total nearly $5.0 million on top of additional salary savings budgeted in the "Part 3" Budget. Highway Fund agencies are expected to absorb just under $1 million of the additional costs.

E. BETR Program Shifted from Appropriation to Revenue Reduction

The 122nd Legislature expanded on an idea implemented during the 121st Legislature and changed the method of funding Business Equipment Tax Reimbursement (BETR) benefits from General Fund appropriations to an offset to General Fund revenue under the individual income tax category. This statutorily directed accounting change does not change the amount of the benefits received by the beneficiaries of this tax program, but the shift generates General Fund savings equal to 5.1% of benefits in FY06 and FY07 as the reduction of individual income tax reduces the General Fund transfer to the Local Government Fund for state-municipal revenue sharing. This conversion from an appropriation item to an offset of revenue is the same as the change in funding for the Maine Residents Property Tax or "Circuit Breaker" program that was adopted by the 121st Legislature beginning in FY05.

These accounting changes were designed, in addition to the revenue sharing savings, to attempt to show a reduction in the State's tax burden, by recognizing these 2 major tax relief programs as revenue reductions rather than spending programs. The methodology used by the United States Department of Commerce, Bureau of Census, compares state and local tax burden based on tax revenue. Assuming Census does not change its methodology, these changes should reduce Maine's relative tax burden by a small amount as a percentage of personal income. The reduction of approximately $125 million of revenue is just under 0.3% of personal income and is not expected to change Maine's ranking, everything else unchanged.

F. FMAP Changes

As referenced a number of times in this summary, Maine's Federal Medical Assistance Percentage used to determine Federal matching Medicaid payments has been experiencing a decline in recent years (with the exception of the temporary federal fiscal relief in FY03 and FY04) culminating in an almost 2% point decline for the federal fiscal year 2006 FMAP effective October 1, 2005. Each state's FMAP is calculated as a three-year moving average of the State's per capita personal income relative to that of all other states. While the improved position of Maine's relative per capita personal income is a good economic sign, it has meant a reduction in the FMAP and, therefore, created the need to either increase state funding or reduce the costs of the MaineCare program. For the 2006-2007 biennium, the increased MaineCare appropriation provided in the Part 2 Budget (PL 2005, c. 386) to fund the FMAP decrease is more than $60 million, with another $10 million of the estimated impact unfunded (see PL 2005, c. 386, Section FF-2).

In addition, preliminary national estimates of per capita personal income suggest the federal fiscal year 2007 FMAP for Maine could decrease further. Absent any changes in the Federal funding formula in the interim, this will require an additional increase in state funding and/or reductions in state spending for the MaineCare/Medicaid program for FY07 and beyond. The preliminary estimate of the additional 2007 FMAP decline has not been addressed to date.

G. Medicaid Claims Management System (MECMS) – Implementation Issues

As discussed previously in this summary, during the 1st Regular and 1st Special Sessions of the 122nd Legislature, the MaineCare program required additional FY05 appropriations of $44.2 million to offset funding shortfalls. While a detailed analysis of the factors and trends that caused and may result from these shortfalls has not been completed, a significant portion is likely the result of Medicaid Claims Management System (MECMS) implementation problems.

MECMS, the replacement for MaineCare's outdated claims processing system, began "live" processing of MaineCare claims in late January of 2005, but was unable to make payments to a significant portion of MaineCare providers. As part of the now almost six-month long process of fixing the MECMS payment problems, the MaineCare program has been making interim payments to providers (i.e., estimated payments outside the claims processing system). As many of the MECMS problems have been addressed in recent months and previously unpaid claims have been paid through MECMS, MaineCare has also had to address the issue of provider overpayments (i.e., providers receiving both processed claim payments and interim payments for the same services provided).

While MaineCare has and will continue to move to reconcile these payments and collect any overpayments, the reconciliation process will carry over well into FY06. This timing and the resulting uncertainty about FY05 and FY06 budget assumptions, is compounded by the disruption in data collection and financial reporting during this period. An additional factor is the need to continue to meet federal Medicaid financial reporting requirements to ensure continued federal matching of MaineCare payments.

H. Highway Fund Support for Marine Highways (Ferry Service)

In the "Part 3" Budget, PL 2005, c. 457, Part GGG transfers the subsidy for the Maine Ferry Service from the General Fund to the Highway Fund, deappropriates the rest of General Fund appropriations for the Department of Transportation and allocates funding for these programs into the newly established State Transit, Aviation and Rail (STAR) Transportation Fund within the department. It also transfers certain General Fund (aeronautical fuel taxes), Highway Fund and Other Special Revenue Funds revenue to the new STAR Transportation Fund. The resulting net General Fund savings totaled $3.3 million annually in FY06 and FY07.

As part of the agreement to shift General Fund support for the ferry service to the Highway Fund, the "Part 3" Budget included adjustments to General Fund appropriations and Highway Fund allocations within the Department of Transportation so that Highway Fund bills would include, and the Committee on Transportation would review and have jurisdiction over, federal matching funds and other funding sources included in Department of Transportation's Highway Fund programs. Funding was also provided to the Bureau of the Budget for the additional programming costs of implementing this change for budget bill production.

I. Racino Expansion Vetoed

The Legislature enacted an expansion of the "Racino" authorization to allow a federally recognized Indian tribe in Maine to operate video slot machines at a tribal commercial track in Washington County. A "Racino" is a facility that has video slot machine terminals and is affiliated with a licensed commercial horseracing track. One facility in the City of Bangor is currently authorized to operate a commercial track slot machine facility by existing law. That facility has yet to begin slot machine operations. The Governor vetoed LD 1573, which first proposed the expansion of the Racino. The Legislature attempted a second time to enact this expansion. LD 1690 was the same as the enacted version of LD 1573, except that it was made contingent on a referendum vote. The Governor has not signed LD 1690, which would take effect unless vetoed by the Governor following the next meeting of the Legislature as provided by the Constitution of Maine.

J. Baxter Compensation Authority Funding

The estimated remaining cost of financial settlements for past abuses at the Governor Baxter School for the Deaf and its predecessor, the Maine School for the Deaf, is currently estimated to be $8.1 million. The awards or settlements have been heard and determined by a special authority created for this purpose, the Baxter Compensation Authority. In the EFY05 Budget, the Legislature designated a transfer from any unappropriated surplus in the General Fund at the close of FY05 up to $8.1 million as the next priority after other statutory year-end transfers. This priority designation of unappropriated surplus has been referred to as the "Cascade" as available unappropriated surplus flows into accounts to satisfy a list of designated initiatives in priority order.

Unsatisfied with the priority order and probability of full funding, the Legislature later appropriated $1.0 million toward the final settlement estimate and adjusted both the amount and the "Cascade" priority order for funding the remaining need of the Baxter Compensation Authority in the Part 2 Budget (PL 2005, c. 386, Part Z). The remaining $7.1 million needed after the $1.0 million appropriation was designated as the first priority transfer from the available unappropriated surplus before the year-end statutory transfers to the Budget Stabilization Fund, the Retirement Allowance Fund, the Reserve for General Fund Operating Capital, the State Contingent Account and the Loan Insurance Reserve Fund. Based on preliminary estimates of the positive General Fund revenue variance for FY05, the Baxter Compensation Authority is assured of receiving its full estimated funding need in FY06.