Maine Revenue & Spending Primer 2008

MECEP
Maine Center for Economic Policy

Kurt Wise

MECEP

The mission of the Maine Center for Economic Policy is to advance public policy solutions to help Maine people prosper in a strong, fair, and sustainable economy. MECEP is an independent, nonpartisan research organization and one of thirty state groups funded through the State Fiscal Analysis Initiative. The SFAI is funded by the Ford, Charles Stewart Mott, Annie E. Casey, Stoneman Family, Public Welfare, and Kellogg Foundations, and the Open Society Institute.

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EXECUTIVE SUMMARY

The purpose of the primer is to provide a simple overview of Maine's revenue and expenditures at the municipal, county and state levels in order to assist policymakers and taxpayers in their decision making on tax and budget issues. Here are some highlights from the 2008 primer, using the most up-to-date data available:

- The total state operating budget included over $2.3 billion in funding from the federal government in 2008. In Maine over one-third (36%) of all state revenue comes from the federal government. Another 24% comes from the individual income tax, 15% from sales tax, and less than 1% from property tax.

- Municipal revenue comes from the property tax (53%), state revenue sharing (32%) and excise taxes, permits, fees, and other revenue (15%).

- In the 2008 total state operating budget, K-12 education with teacher retirement accounts for 22% of spending and Health and Human Services with mental health services included accounts for 47%.

- In the state-only General Fund, spending on K-12 education with teacher retirement takes up a far larger percentage of spending at 39% of the total. General Fund expenditures on Health, Mental Health and Human Services accounted for 32% of the total.

- In the 2006-2007 school year, per-pupil costs were $8,439 for elementary students and $9,519 for secondary students. These figures represent inflation adjusted cost increases of 13% and 11 % respectively over per-pupil expenses in the 2003-2004 school year.

- Overall state spending has not outpaced our statewide growth in personal income. Growth in Maine's Highway, General, and Other State Funds has remained relatively constant over the last decade as a percentage of Maine's total personal income. The growth in spending that has occurred has been due primarily to increases in the state's expenditure of federal dollars allocated to the state. State General Fund spending actually has declined slightly relative to personal income over the last five years.

- Among all states, Maine ranks 15th for personal income tax and 9th for property tax per capita. Maine ranks 15th on "own source revenue" per capita, which includes fees and other methods of collecting revenues, and which therefore is a better measure for assessing the real tax burden each state places on its residents. At $5,968 per capita in own source revenue, Maine is lower than Vermont, Rhode Island, Massachusetts and Connecticut and just 3% (or $165) above the U.S. average.

- Relative to other states Maine does very well with its "debt burden." Per capita tax-supported debt is $606 versus the national median of $787.

- Maine's lowest-income households have the highest effective tax rate, contributing 14.6% of their total income to state taxes. By comparison, Maine's wealthiest households contribute 9.0% of total income. Low-income households pay the highest percentage of their income in property, sales, and excise taxes relative to all other Maine households.

INTRODUCTION

We must continually make decisions about what public goods and services we want and how much we are willing to pay for them. We face trade-offs for each decision. A desire for quality education for our children may require higher taxes. A desire for lower taxes may result in lost services or fewer public investments which that foregone revenue would support. Understanding these trade-offs is important because Maine people experience the effects of such trade-offs each day.

Fiscal decisions at one level of government may also affect other levels. For example, making state investments in MaineCare brings in a two-to-one match of federal dollars. Making state investments in K-12 education may lower property taxes in some communities. State investments in research and development or in infrastructure can generate new business activity and strengthen state and local tax bases.

Five principles for improving Maine's tax system.

- **TARGET RELIEF** to those with the least ability to pay.
- **BENEFIT THE MAJORITY** of Mainers.
- **PROVIDE ADEQUATE REVENUE** for programs.
- **EXPORT** taxes out-of-state when possible.
- **STRIKE A BALANCE** between business and residents.

Our public budgets reflect our collective social and economic values and priorities. In this way they are "moral documents" as well as fiscal ones and deserve careful reflection and informed discussion. It is wishful thinking that we can achieve full consensus on public budgets. But it is reasonable to think that we can achieve budgets with compromises that best reflect our collective priorities. This includes creating a revenue system that is sustainable and predictable over the long term, which provides adequate funds to pay for Mainer's priorities and does so without overburdening taxpayers and businesses.

REVENUE AND EXPENDITURES

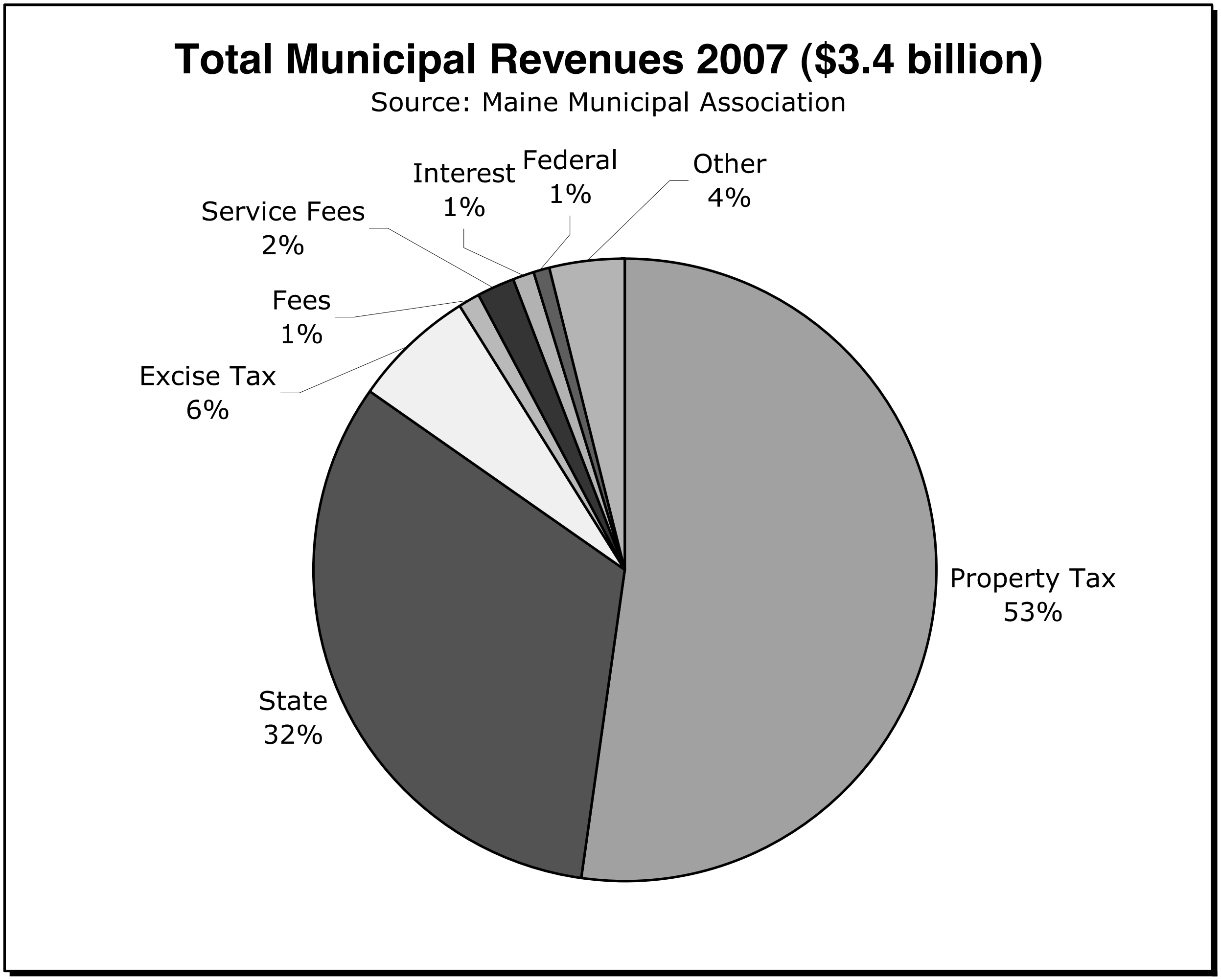
Municipal Government

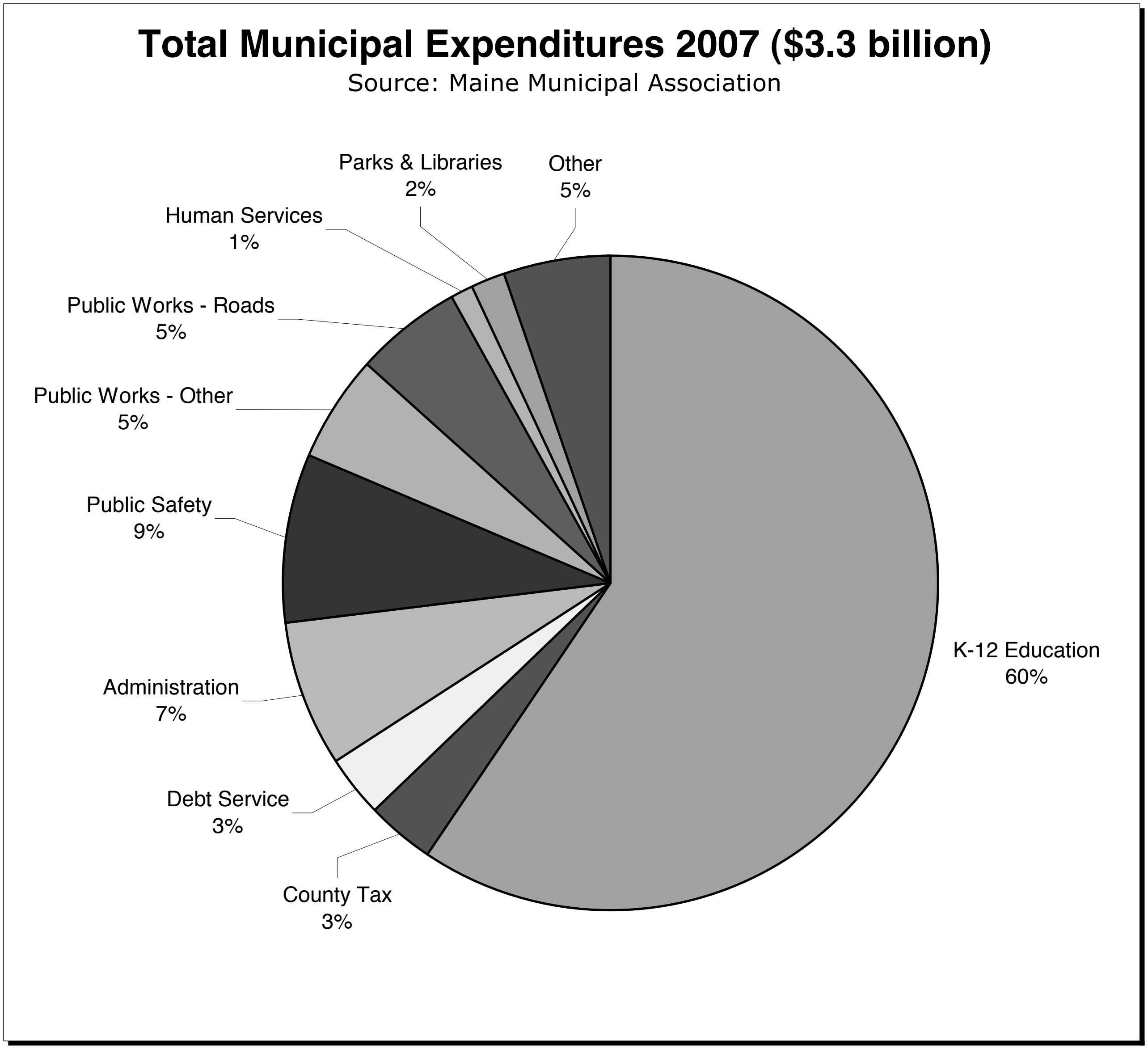
Municipalities depend heavily on property taxes for revenue. According to the Maine Municipal Association's (MMA) 2007 Fiscal Survey Report and Analysis, over $1.8 billion of the estimated total $3.4 billion raised by Maine municipalities comes from local property taxes.

The state is the next largest source of revenue for municipalities. The state distributes approximately $1.1 billion (primarily income and sales tax revenue) to municipalities. This is mainly in the form of **General Purpose Aid to Education** (the state is committed to pay for 55% of K-12 education, though it has yet to reach this goal), municipal revenue sharing, and reimbursement which the state pays to municipalities on behalf of eligible resident property owners through the Homestead Exemption. Automobile excise fees account for another 6% of total municipal revenue and the remaining 9% is split between several other fees, interest, and a very small federal contribution.

Municipalities spent approximately $2 billion in state and local revenue on K-12 education in 2007, which accounts for 60% of all municipal revenue. The remaining 40% of revenue must cover all other expenses, including libraries, parks, code enforcement, municipal employees, debt service, public works, public safety, capital expenditures and county taxes. The rising costs of inputs like fuel and the high price tags associated with the maintenance and replacement of Maine's aging infrastructure (e.g. sewers and roads) have put continued pressure on municipal budgets in recent years.

(See charts on pp. 5 & 6)


Total Municipal Revenues 2007 ($3.4 billion)
Source: Maine Municipal Association
Interest 1%
Federal 1%
Other 4%
Service Fees 2%
Fees 1%
Excise Tax 6%
Property Tax 53%
State 32%


Total Municipal Expenditures 2007 ($3.3 billion)
Source: Maine Municipal Association
Parks & Libraries 2%
Other 5%
Human Services 1%
Public Works - Roads 5%
Public Works - Other 5%
Public Safety 9%
Administration 7%
Debt Service 3%
County Tax 3%
K-12 Education 60%

County Government

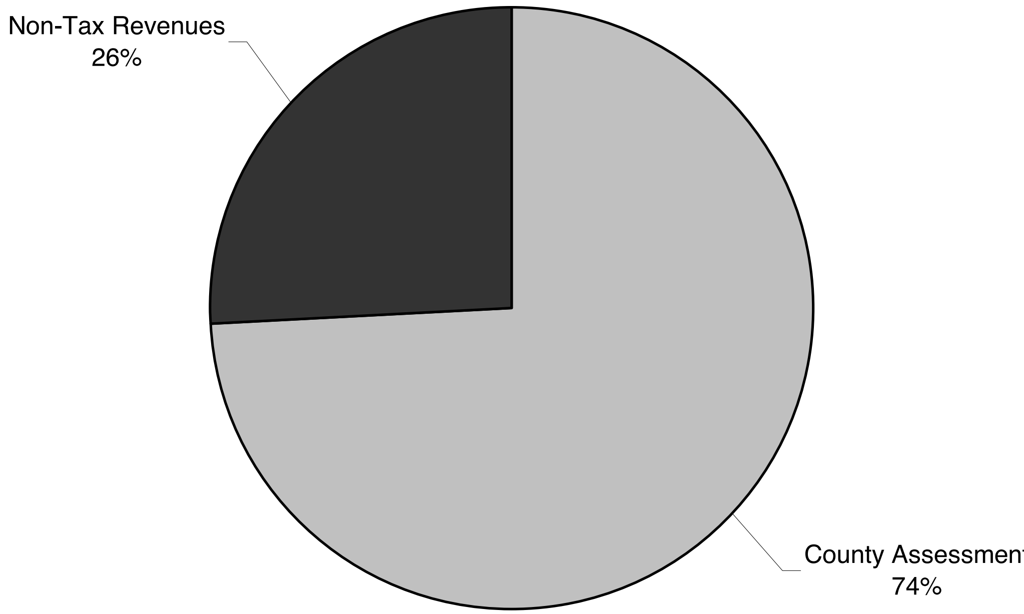
Maine’s sixteen counties account for a very small share of revenue and expenditures in Maine. In 2004, the most recent year for which data have been assembled, Maine counties in aggregate collected an estimated $134 million in revenue. Three-quarters of that came from the county assessment paid for by local property taxes assessed through the municipalities. The other quarter was non-tax revenue and was comprised of state and federal funds, deed fees, probate fees, jail fees, contractual fees, and surplus.

Over half of this revenue (52%) is spent on corrections and the county sheriff departments. The other half funds services such as the registries of deeds, the registries of probate, and the district attorneys’ offices.

(See charts on pp. 8 & 9)

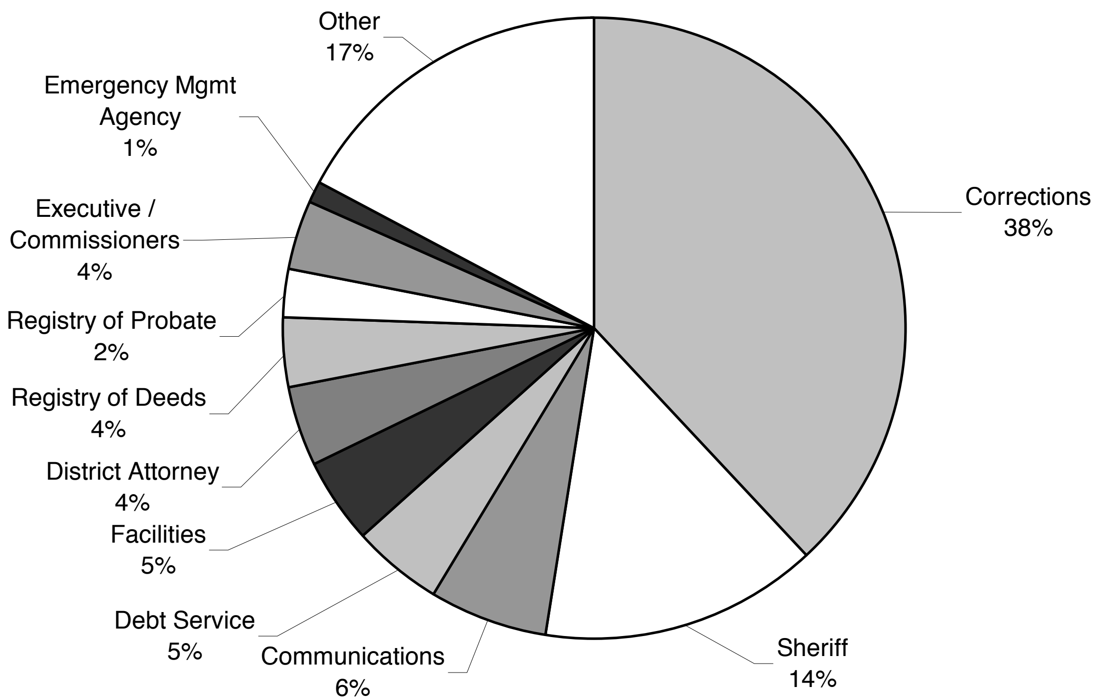
Total County Revenue 2004 ($134 million)

Source: Robert Devlin, Kennebec County and Maine State Planning Office



Total County Expenditures 2004 ($134 million)

Source: Robert Devlin, Kennebec County and Maine State Planning Office



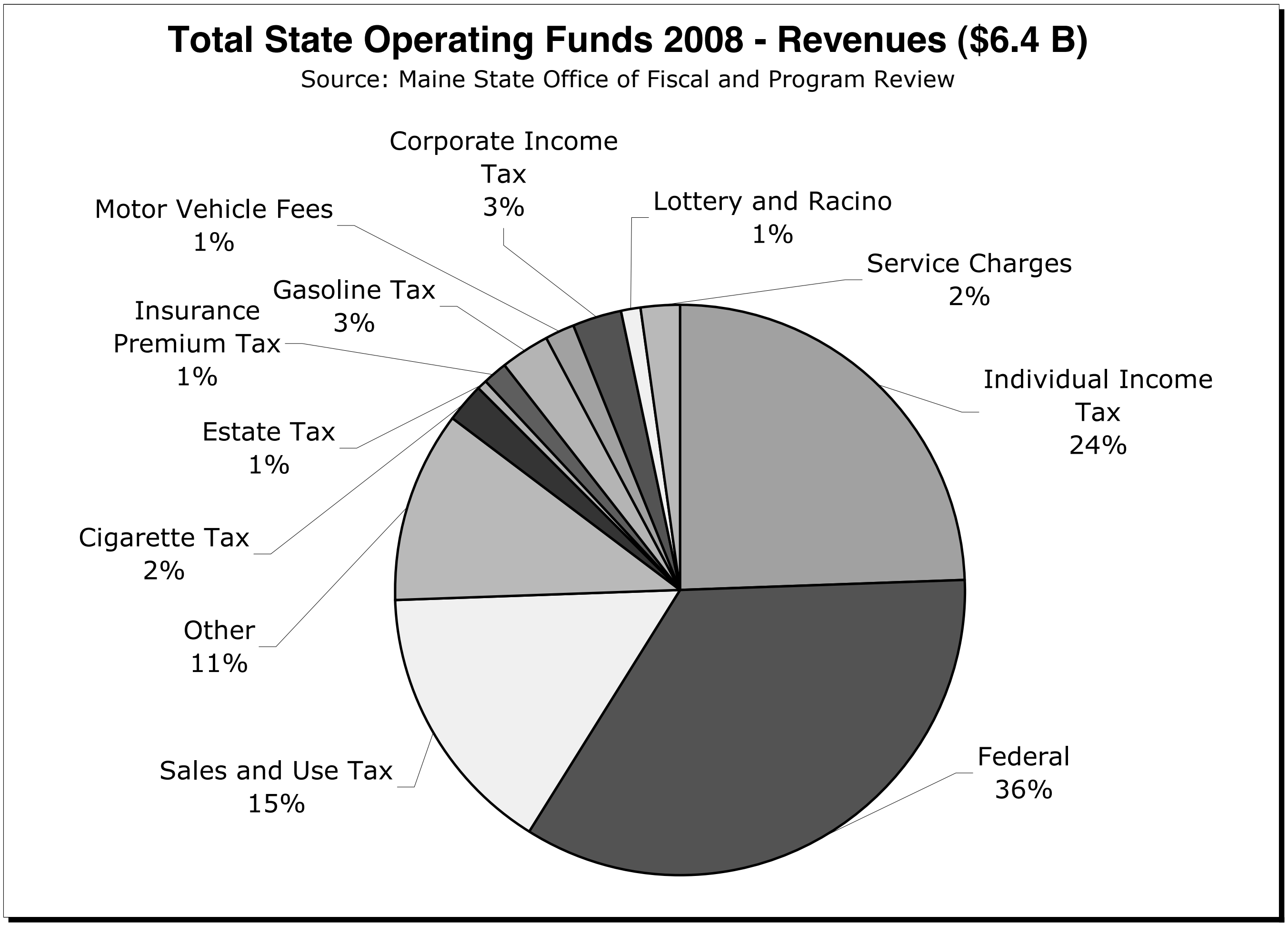
State Government

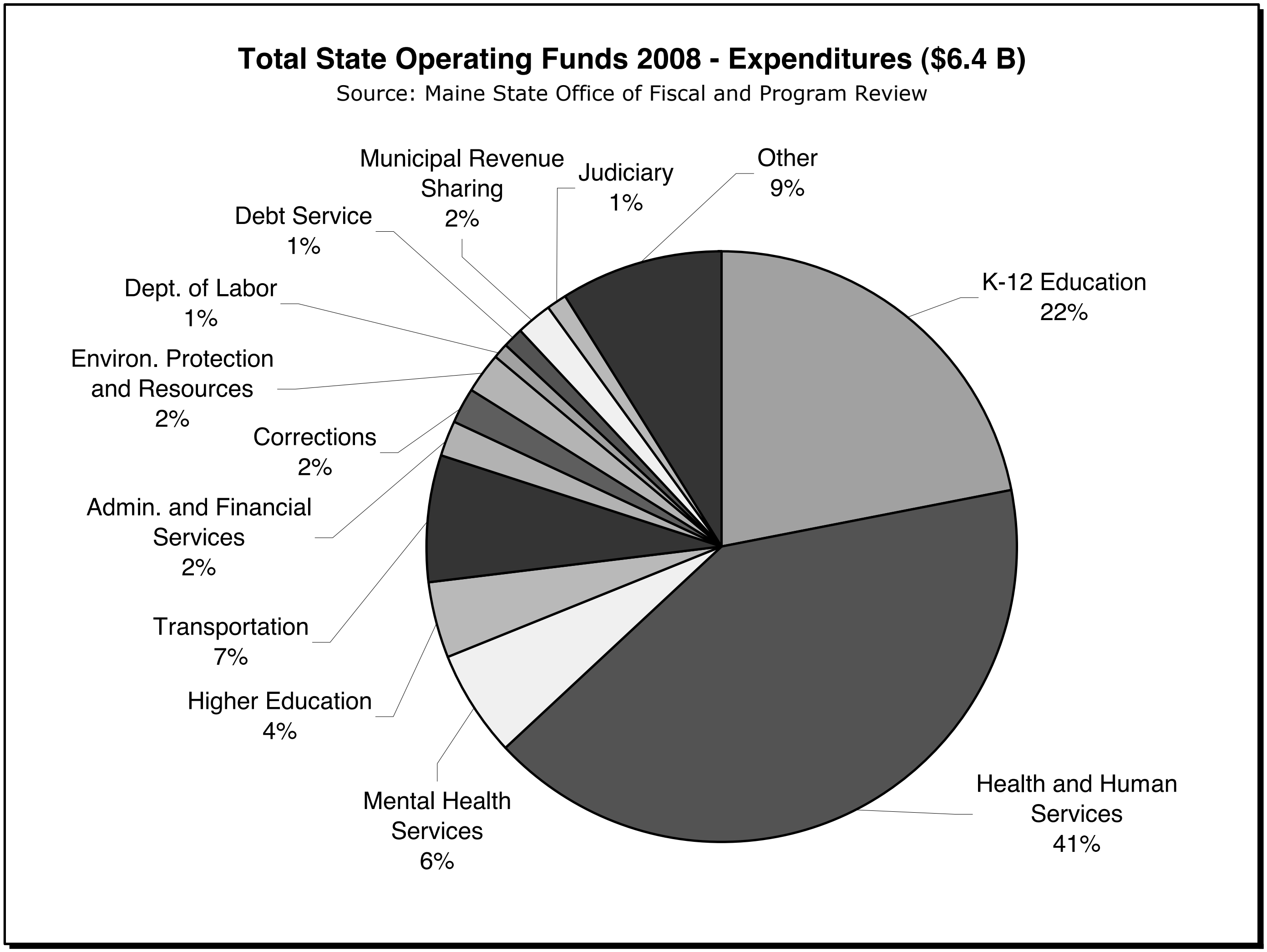
State government raises revenue through taxes, fees, and program transfers. Unlike local and county government, property taxes play a small role in generating state revenues. In fact, property taxes account for less than 1% of total state revenue and include only taxes collected from the unorganized territories to pay for municipal-like services which the state provides in those areas.

The three principal revenue sources for state government are the individual income tax (24% in 2008), sales tax (15%), and the federal government (36%). Combined, they account for $4.8 billion in revenue, or three-quarters of the $6.37 billion in total revenues collected by the state in 2008. The remaining revenue comes from a number of taxes and fees that individually account for 1-3% of total revenue. Some of these include the corporate income tax, gasoline tax, insurance premium tax, cigarette tax, and motor vehicle fees.

Two key areas account for well over half of all state expenditures: K-12 education with teacher retirement (22%) and Health and Human Services with mental health services (47%). The remaining expenditures include transportation (7%), higher education (4%) and a number of other programs within labor, corrections, and the environment. Because of the wide range of services, state revenues and expenditures are broken down into four major operating funds: the **General Fund**, **Highway Fund**, **Other Special Revenue Fund**, and the **Federal Expenditure Fund**, each of which we examine separately in the sections that follow.

(See charts on pp. 11 & 12)


Total State Operating Funds 2008 - Revenues ($6.4 B)
Source: Maine State Office of Fiscal and Program Review
Corporate Income Tax 3%
Lottery and Racino 1%
Motor Vehicle Fees 1%
Service Charges 2%
Gasoline Tax 3%
Insurance Premium Tax 1%
Individual Income Tax 24%
Estate Tax 1%
Cigarette Tax 2%
Other 11%
Sales and Use Tax 15%
Federal 36%


Total State Operating Funds 2008 - Expenditures ($6.4 B)
Source: Maine State Office of Fiscal and Program Review
Municipal Revenue Sharing 2%
Judiciary 1%
Other 9%
Debt Service 1%
Dept. of Labor 1%
K-12 Education 22%
Environ. Protection and Resources 2%
Corrections 2%
Admin. and Financial Services 2%
Transportation 7%
Higher Education 4%
Mental Health Services 6%
Health and Human Services 41%

The General Fund

The **General Fund** supports the general functions of state government. Over 80% of General Fund revenue comes from individual income and sales taxes – approximately $2.6 billion in fiscal year 2008.

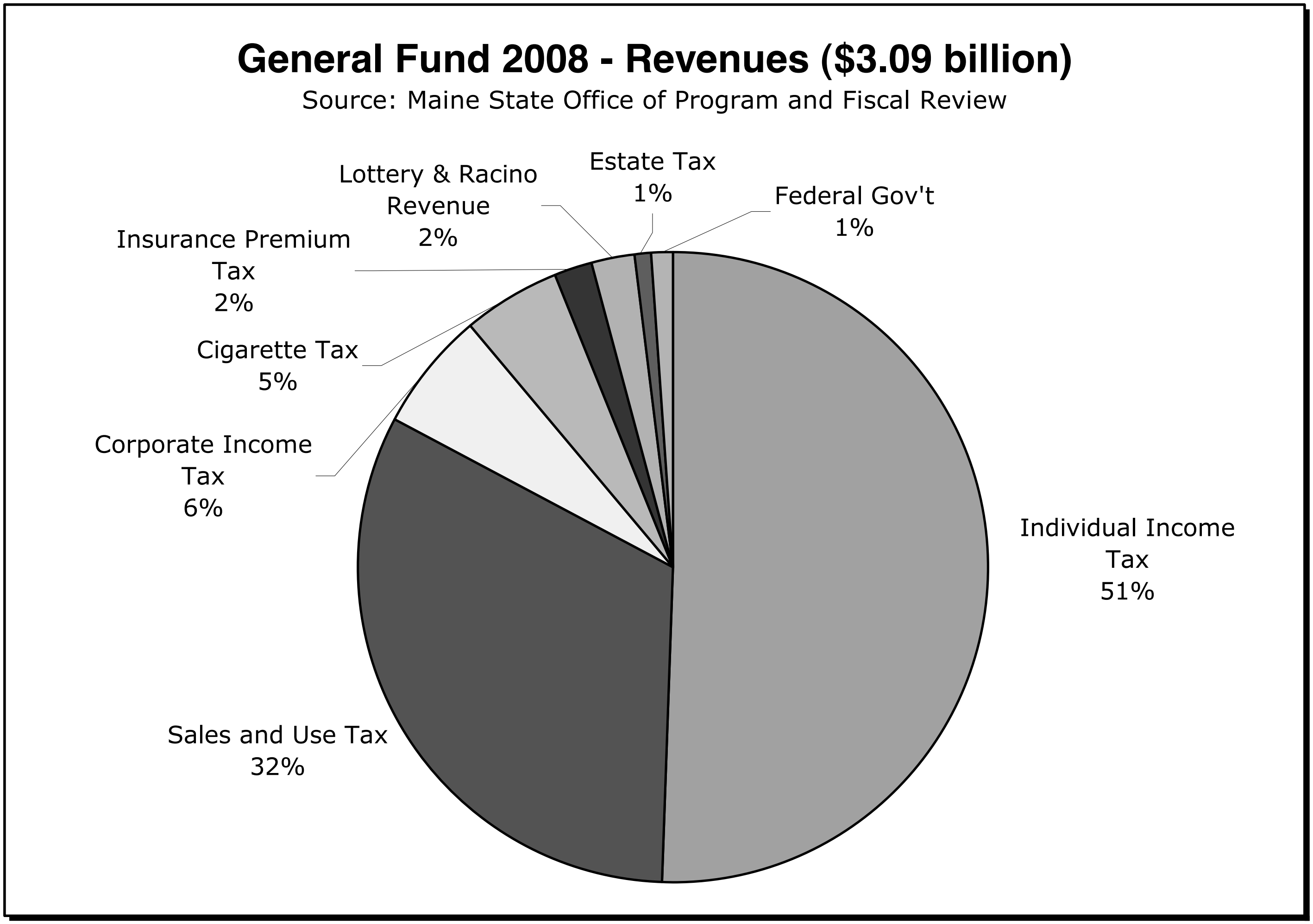
The biggest expenditures from this fund are for K-12 education and health care. **General Purpose Aid for Local Schools** (31%) combined with **Teacher Retirement** (6%) make up over one-third of the General Fund budget. This results in part from the 2004 referendum when voters committed the state to fund 55% of K-12 education. The state currently pays over half of local K-12 education costs and has committed to reaching the 55% goal by 2011. Whether to increase funding to this level in the 2010-2011 biennium budget will be decided in the 2009 legislative session.

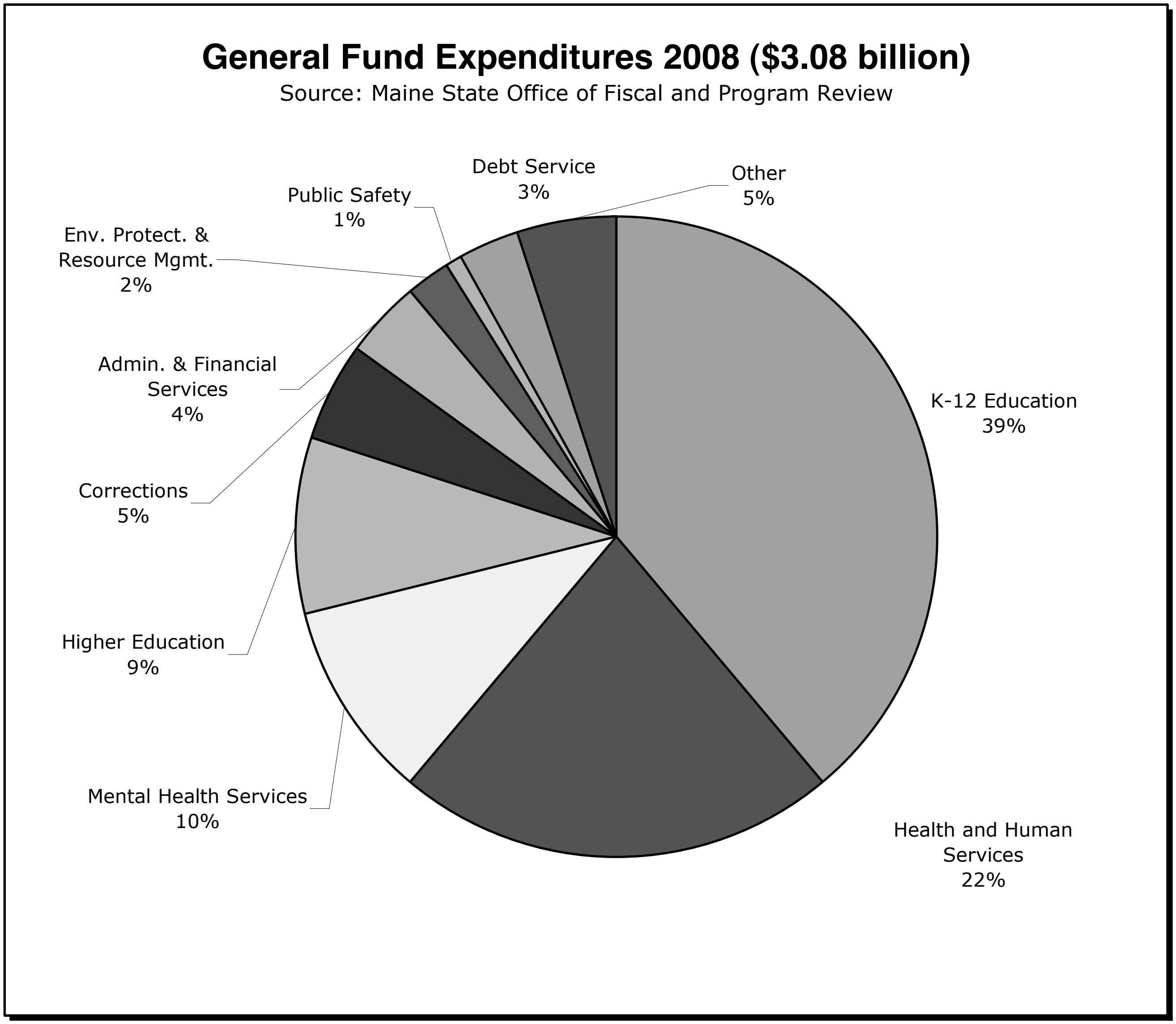
Health and Human Services (22%) and **Mental Health Services** (10%) combined make up another third of the General Fund budget, and primarily cover Medicaid (also called MaineCare) payments to providers. **Higher Education** accounts for 9% of General Fund expenditures, and **Corrections** for 5%. Less than 4% of General Fund expenditures go to cover administration and financial service costs.

Looking at funding not by specific department or program area, but instead by broad descriptive categories, we see that **Personal Services** (salaries and benefits for state employees) accounted for less than 14% of General Fund expenditures in fiscal year 2008, or approximately $426 million.

The remaining expenditures include tax relief and reimbursement programs such as the state earned income tax credit, homestead exemption, and the property tax and rent rebate program which collectively account for 1.1% of General Fund expenditures. Debt service accounts for another 2.7% of expenditures.

(See charts on pp. 14 & 15)


General Fund 2008 - Revenues ($3.09 billion)
Source: Maine State Office of Program and Fiscal Review
Lottery & Racino Revenue 2%
Estate Tax 1%
Federal Gov't 1%
Insurance Premium Tax 2%
Cigarette Tax 5%
Corporate Income Tax 6%
Individual Income Tax 51%
Sales and Use Tax 32%


General Fund Expenditures 2008 ($3.08 billion)
Source: Maine State Office of Fiscal and Program Review
Debt Service 3%
Other 5%
Public Safety 1%
Env. Protect. & Resource Mgmt. 2%
Admin. & Financial Services 4%
Corrections 5%
Higher Education 9%
Mental Health Services 10%
K-12 Education 39%
Health and Human Services 22%

The Highway Fund

The **Highway Fund** is primarily supported by fuel taxes. The state gasoline tax supplies the bulk of these funds (55%). This tax was enacted in 1923 and has been increased periodically to keep up with the rising cost of goods and services. As enacted in 2003, the gas tax is now automatically adjusted each year for inflation. It is currently at 28.4 cents per gallon.[1] However, as fuel efficiency increases there are many more miles being driven on Maine roads that do not result in increased fuel tax revenue, and thus the cost of road repairs is rising much faster than gas tax revenue.

Another 14% of the Highway Fund comes from a special fuels tax. These fuels include diesel, propane or butane. The remaining revenue comes primarily from motor vehicle license fees.

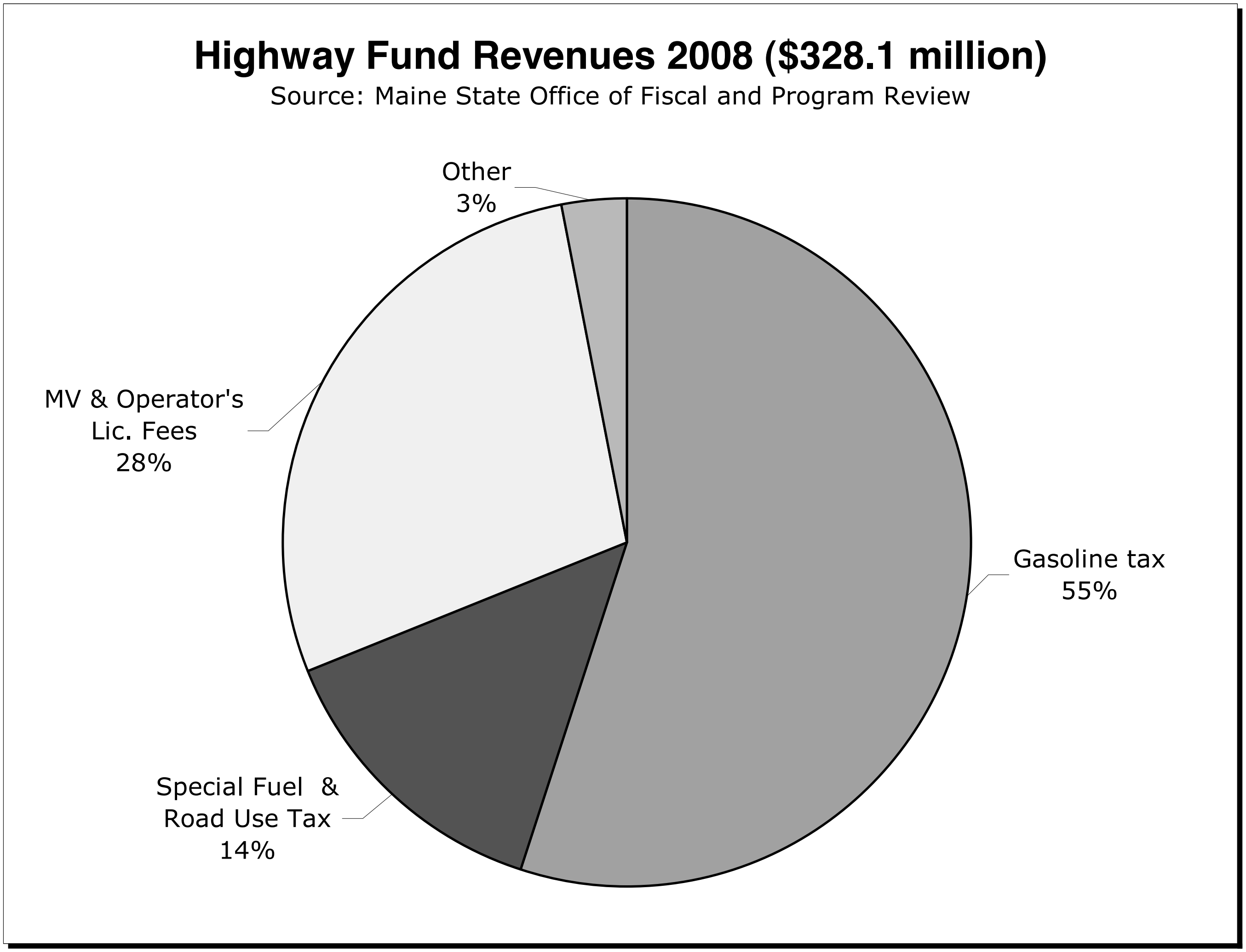
Almost three-quarters of the Highway Fund is spent on road projects – improvements and maintenance that includes assistance to local governments for transportation projects. The remaining revenue is split between administration, planning, public safety and debt service. The Department of Transportation is the primary user of this fund (79%). The other 21% is used by the Secretary of State (10%) to administer motor vehicle and operator licensing, Public Safety (10%), and Administrative and Financial Services (1%).

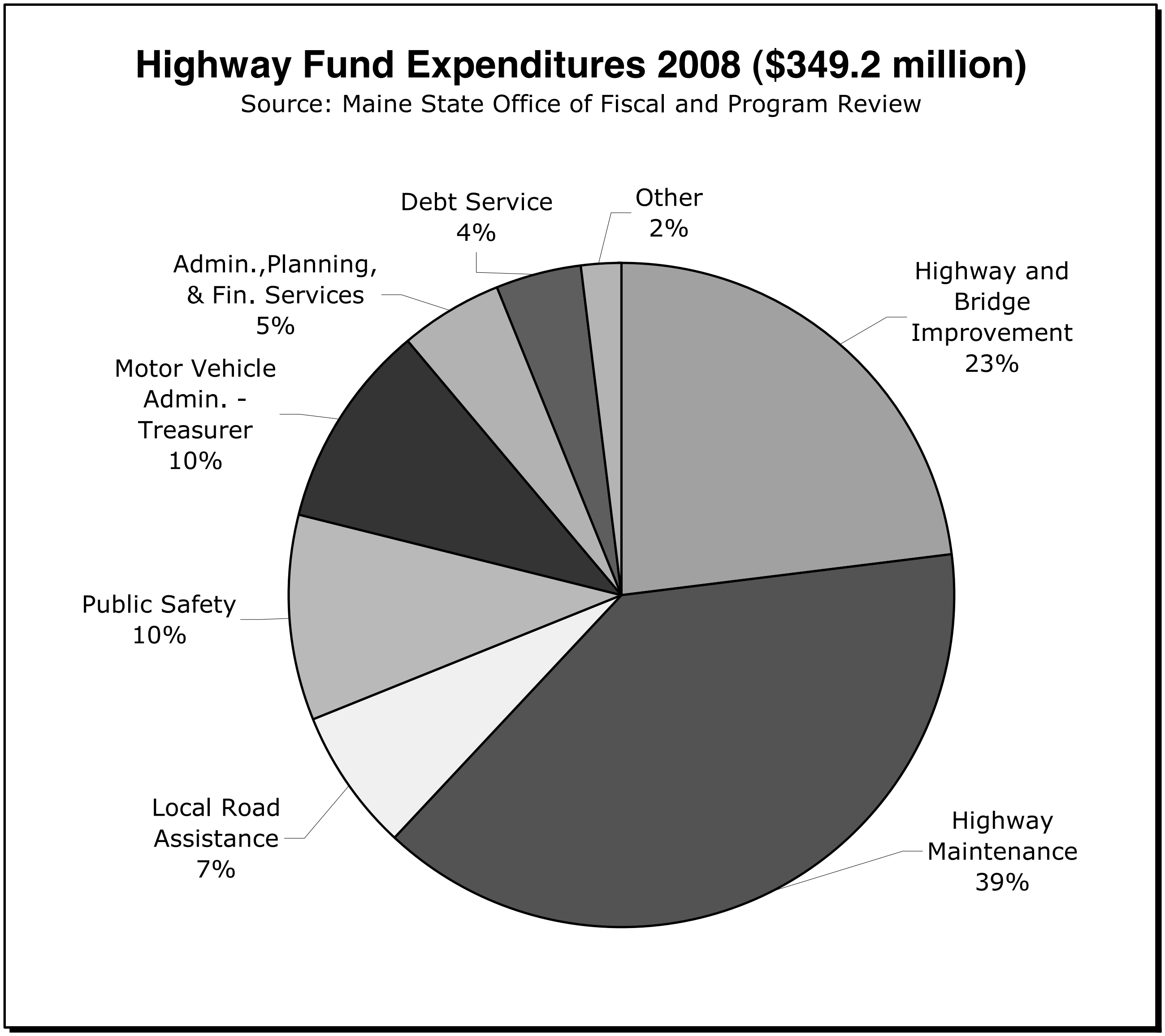
In addition to these funds there is federal money for transportation. In 2008, the Maine Department of Transportation spent an additional $156 million on transportation projects from Maine's Federal Funds account.

As can be the case with any of the funds in a given year – and as is the case in 2008 for the Highway Fund - sometimes "booked" expenditures exceed "booked" revenues. Unspent balances carried over from the prior year are *not* included in the revenue totals but do offset what otherwise appears to be deficit spending. In fact, revenues match expenditures.

(See charts on pp. 17 & 18)

[1] Maine Revenue Services: http://www.maine.gov/revenue/fueltax/fueltaxrates.htm


Highway Fund Revenues 2008 ($328.1 million)
Source: Maine State Office of Fiscal and Program Review
Other
3%
MV & Operator's
Lic. Fees
28%
Gasoline tax
55%
Special Fuel &
Road Use Tax
14%

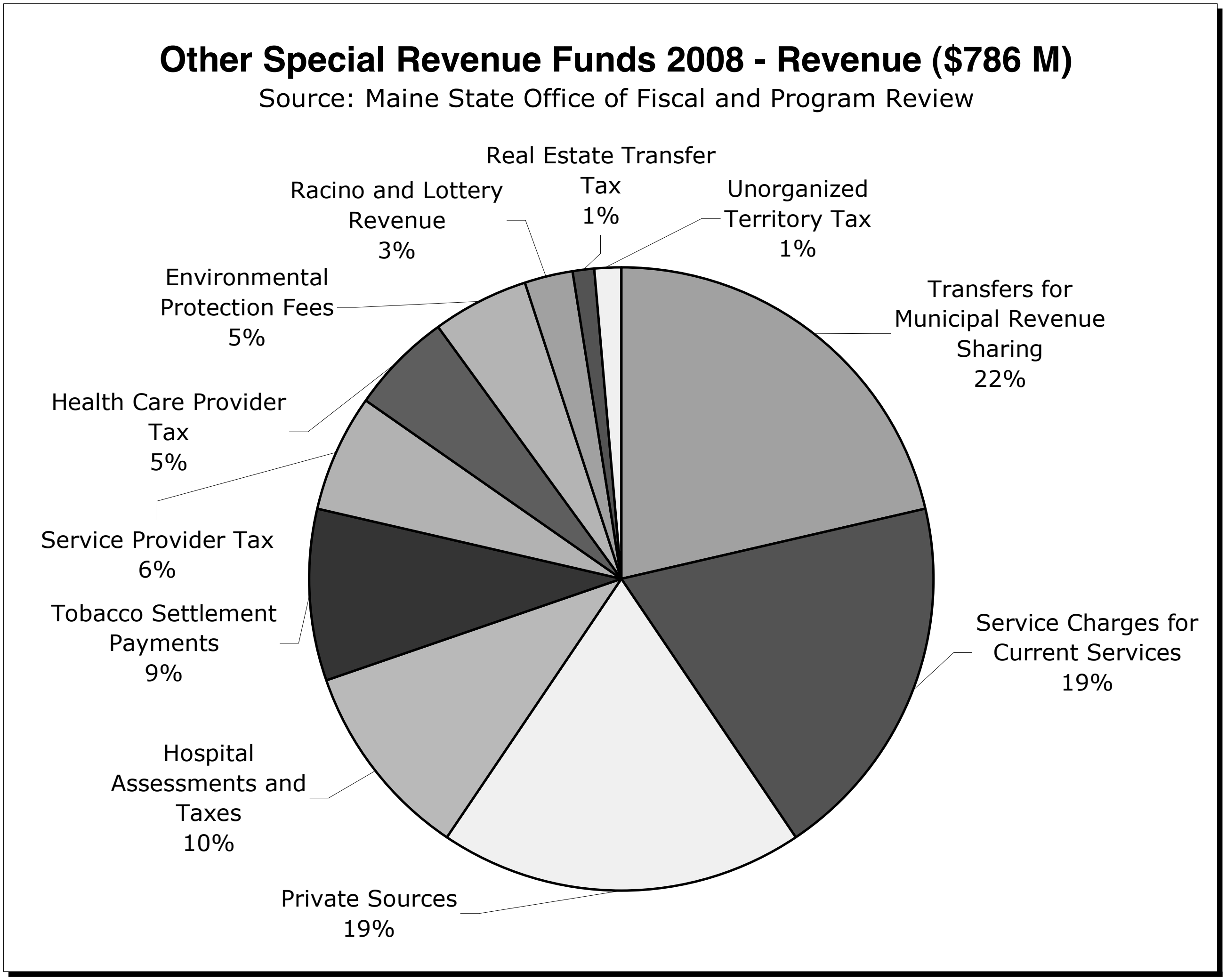

Highway Fund Expenditures 2008 ($349.2 million)
Source: Maine State Office of Fiscal and Program Review
Debt Service
4%
Other
2%
Admin.,Planning,
& Fin. Services
5%
Highway and
Bridge
Improvement
23%
Motor Vehicle
Admin. -
Treasurer
10%
Public Safety
10%
Local Road
Assistance
7%
Highway
Maintenance
39%

Other Special Revenue Funds

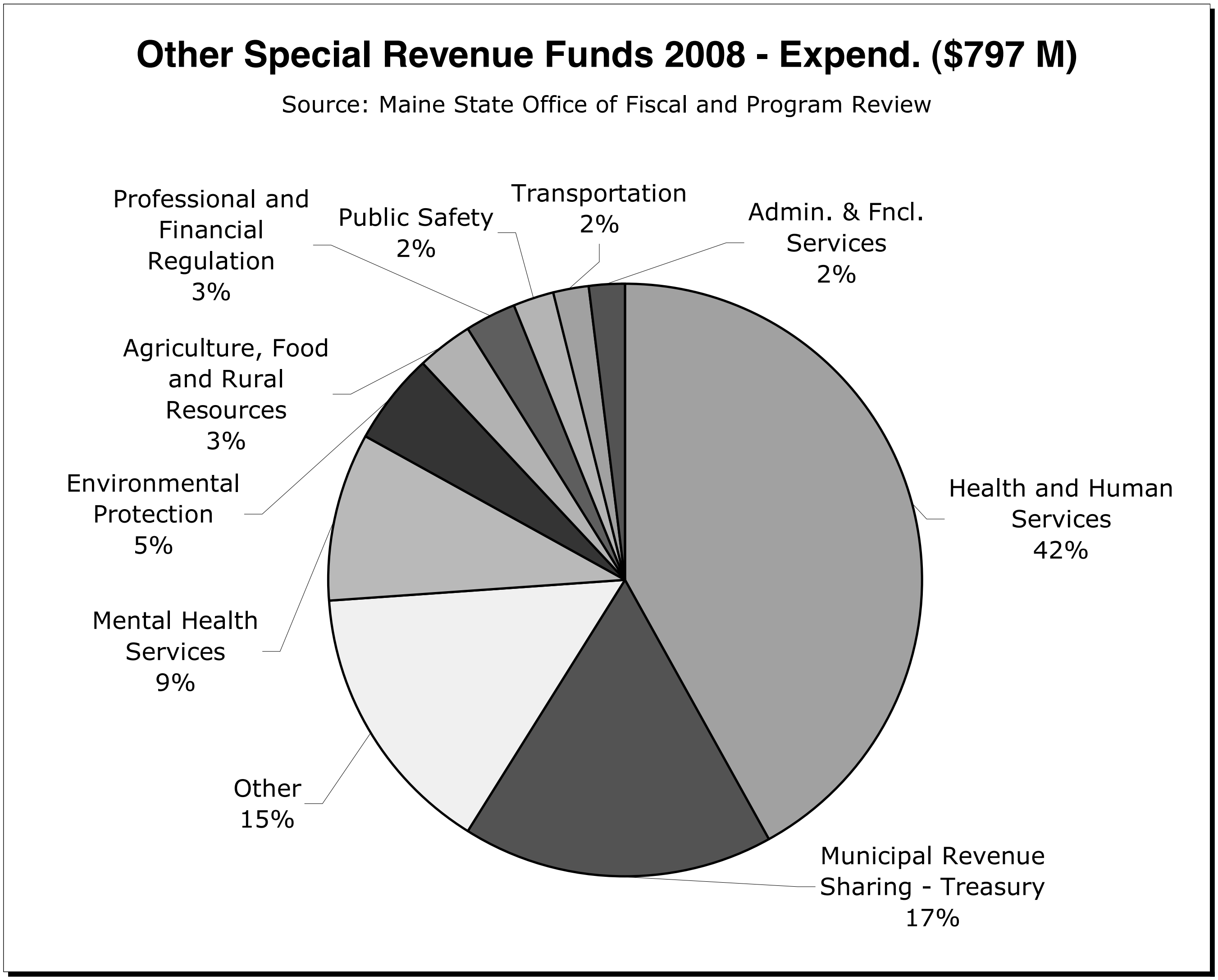
Other Special Revenue Funds expended $797 million in 2008, constituting less than 15% of the state's total operating budget. Dozens of commissions, departments, and individual programs are included within this catchall fund category, and revenues are derived from a wide variety of taxes, assessments, and fees. Major contributors to revenues include: Transfers for Municipal Revenue Sharing (22%) which derive from the State's General Fund; Service Charges (19%) for various services provided by government departments or agencies (rent or leases on state property, for example); Private Sources (19%) which primarily includes payments for child support; and Hospital Assessments (10%) which are used to offset unpaid medical expenses at Maine hospitals. The remainder is collected as fees from targeted industries for uses in those industries (e.g. real estate transfer tax, agricultural production fees, and oil handling fees). Other revenues include the payments collected as Maine's portion of the national settlement with the tobacco companies and are used for tobacco cessation and treatment programs through the **Fund for a Healthy Maine**.

By department, the biggest recipient of Other Special Funds is **Health and Human Services** (42%), which receives $335 million. These state dollars are a major portion of the total investment Maine makes in MaineCare, an investment that in total leverages an additional $2 billion annually in federal healthcare spending in Maine. This is spent primarily through the Medicaid (MaineCare) program on payments to health care providers.

(See charts on pp. 20 & 21)



Other Special Revenue Funds 2008 - Revenue ($786 M)
Source: Maine State Office of Fiscal and Program Review
Real Estate Transfer Tax 1%
Racino and Lottery Revenue 3%
Unorganized Territory Tax 1%
Environmental Protection Fees 5%
Transfers for Municipal Revenue Sharing 22%
Health Care Provider Tax 5%
Service Provider Tax 6%
Tobacco Settlement Payments 9%
Service Charges for Current Services 19%
Hospital Assessments and Taxes 10%
Private Sources 19%


Other Special Revenue Funds 2008 - Expend. ($797 M)
Source: Maine State Office of Fiscal and Program Review
Professional and Financial Regulation 3%
Public Safety 2%
Transportation 2%
Admin. & Fncl. Services 2%
Agriculture, Food and Rural Resources 3%
Environmental Protection 5%
Health and Human Services 42%
Mental Health Services 9%
Other 15%
Municipal Revenue Sharing - Treasury 17%

Federal Funds

Funding provided by the federal government supports over one third of all state spending in Maine. The overwhelming majority of this money (76%) pays Maine healthcare workers, hospitals, and nursing homes to provide care to Maine's elderly, disabled, and low-income populations. Most of this federally-funded healthcare spending occurs through the state's Medicaid program, MaineCare. The remaining 24% supports investments in transportation infrastructure (7%), education (8%), and smaller amounts in many other departments and programs.

Some of the federal dollars Maine receives are dispersed in the form of "block grants". Block grants typically are distributed as lump sum payments to states, often based on a formula that allocates federal dollars among the states. Each state then must administer the funded programs according to guidelines established at the federal level. Examples include Temporary Aid to Needy Families (or TANF) for which Maine received $78 million in 2008; the State Children's Health Insurance Program (SCHIP), funded at $15.5 million in the President's 2008 budget; the Women, Infants and Children program (WIC), funded at $15.2 million in the President's 2008 budget; and the Interstate Maintenance grant, from which Maine received $26.5 million in 2008.[2] While the state also may contribute dollars to these programs (or may be *required* to contribute some specified amount), the size of a block grant does not change based on state spending levels.

In contrast to the static funding structure associated with block grants, federal funding for Medicaid occurs through a "matching grant" structure. Based on a variety of state-specific factors (median state income, a state's population parameters, etc), the federal government matches each state's Medicaid-related outlays at varying rates. Maine enjoys one of the highest match rates; for every dollar Maine spends on eligible health care services the federal government matches that outlay with two additional dollars. There is no limit to the amount the federal government will match. Thus, unlike with block grants, Maine can increase the number of federal dollars entering the state economy through increased state spending on MaineCare services. In a period of slumping demand, this is one strategy for boosting the Maine economy using primarily federal dollars.
(See chart on pg. 23)

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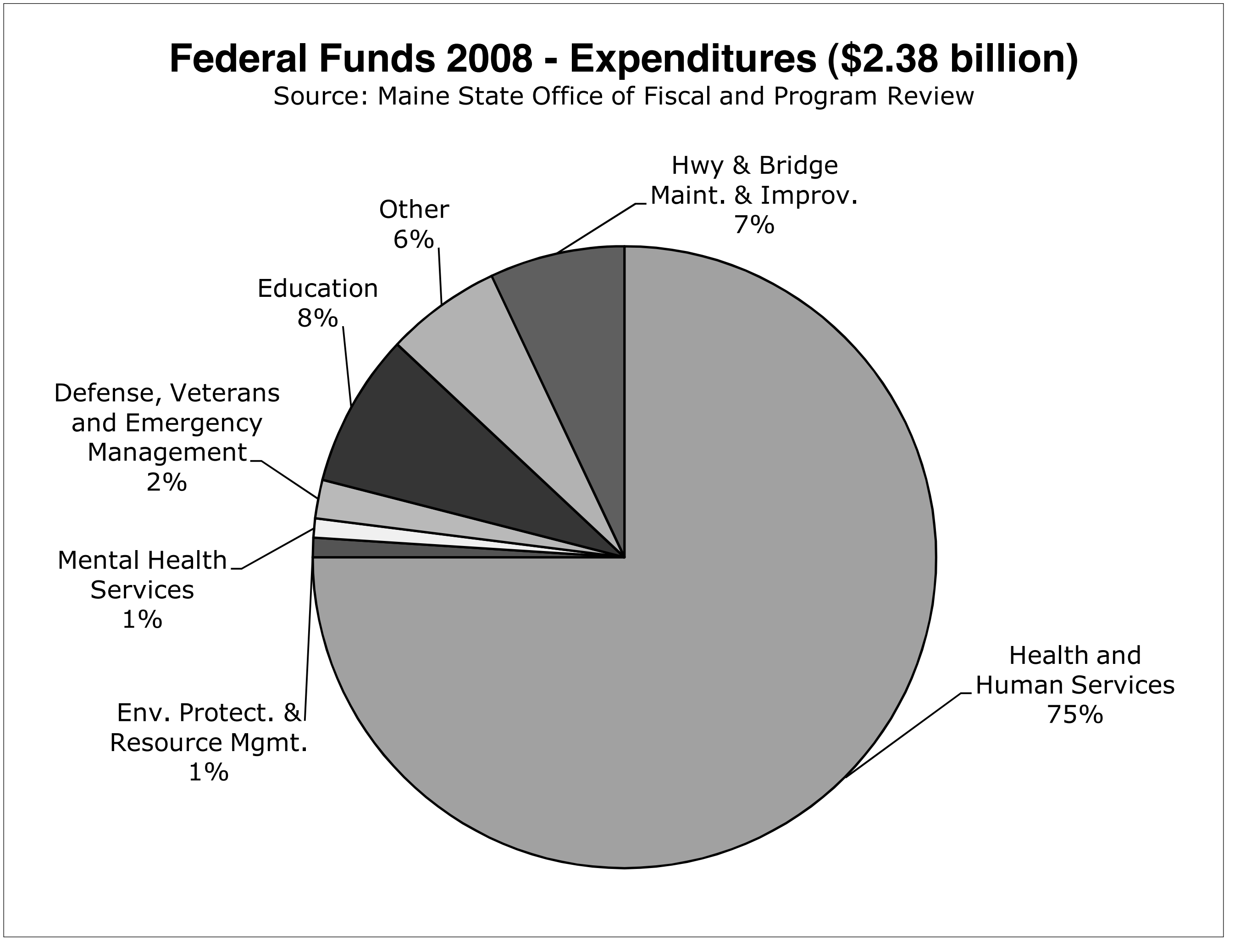
[2] Federal Funds Information for States: www.ffis.org


Federal Funds 2008 - Expenditures ($2.38 billion)
Source: Maine State Office of Fiscal and Program Review
Hwy & Bridge Maint. & Improv. 7%
Other 6%
Education 8%
Defense, Veterans and Emergency Management 2%
Mental Health Services 1%
Env. Protect. & Resource Mgmt. 1%
Health and Human Services 75%

TAXES AND FEES

Measures of Taxation

There are several methodologies used to measure the level of taxation, commonly called the "tax burden." Since some of these methodologies are considered "proprietary" and closed to public review, we are not always able to determine their accuracy. Many of these methodologies use assumptions that are based on political ideology as much as they are on theory. One solution is to simplify the process with a widely accepted, transparent measure that uses official government data, readily available from the U.S. Census Bureau and the US Bureau of Economic Analysis.

These data are commonly used to measure tax burden with a simple ratio of *state revenues* to *total state personal income* – with no other assumptions. Using this measure, Maine's total local and state taxes are 14% of total personal income. On a national scale this places us 4th highest in national rankings. However, this measure does not provide a complete picture. When considering all fees and other revenue collections *in addition to* taxes – a total referred to as "*own source revenue*" - Maine's rank drops to 7th in the nation as a percentage of total state personal income. Breaking the measure up by individual revenue sources we find that Maine ranks higher than most states on personal income tax (12th) and local property tax (3rd), but near the middle on corporate income tax (24th) and general sales tax (27th).

A better measure of the burden borne by the individual taxpayer, however, is the *per capita* tax burden. Considering "own source revenue" on a per capita basis, Maine ranks 14th among the states. At $5,968 per capita in own source revenue, Maine is lower than Vermont, Rhode Island, Massachusetts, and Connecticut and just 3% (or $165) above the U.S. average.

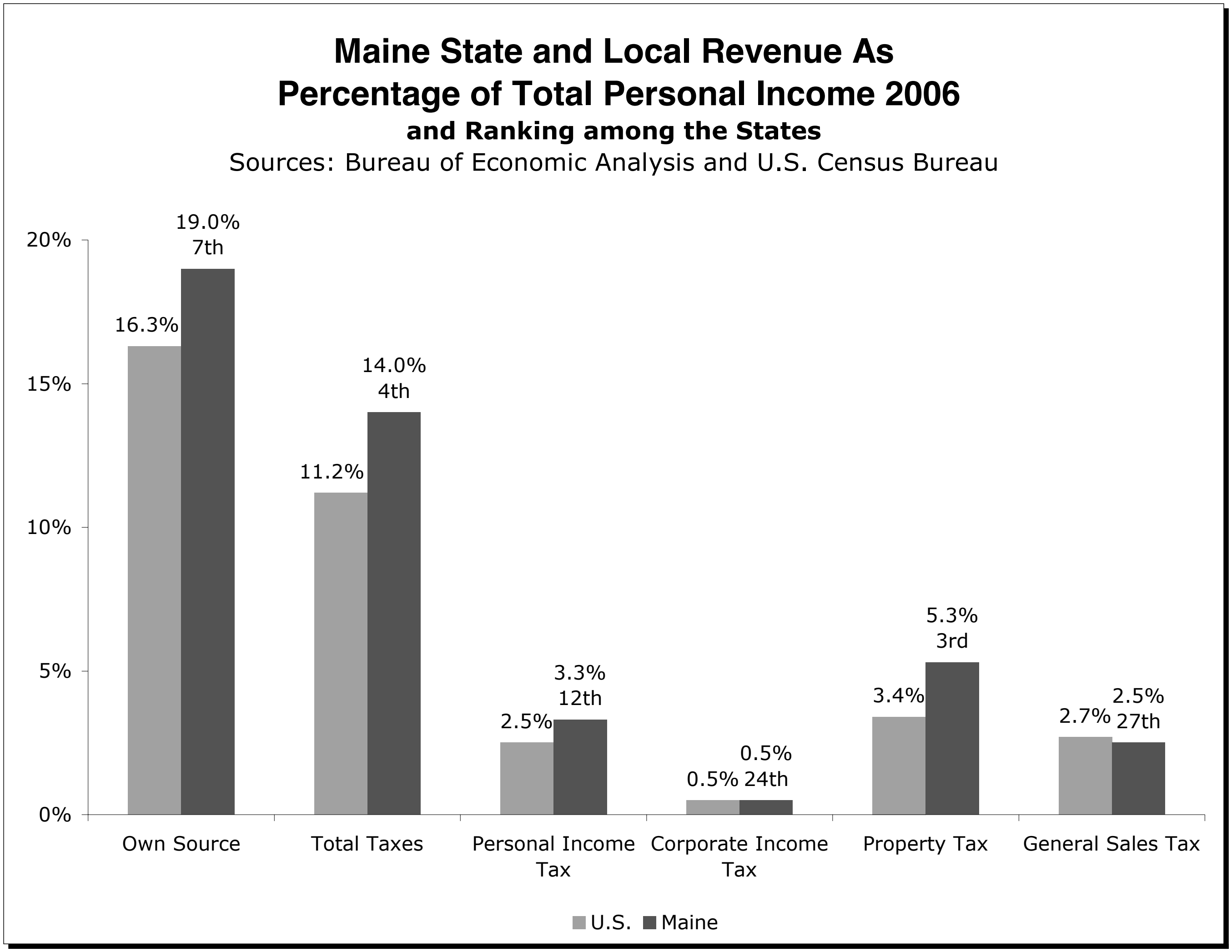
Something that neither the ratios of total state and local revenues to personal income nor per capita tell us, however, is how much of Maine's revenues are collected from non-residents. Because a high proportion of businesses and properties in Maine are owned by non-residents, there is good reason to expect that more of Maine's tax burden is "exported" than is the case in many other states.

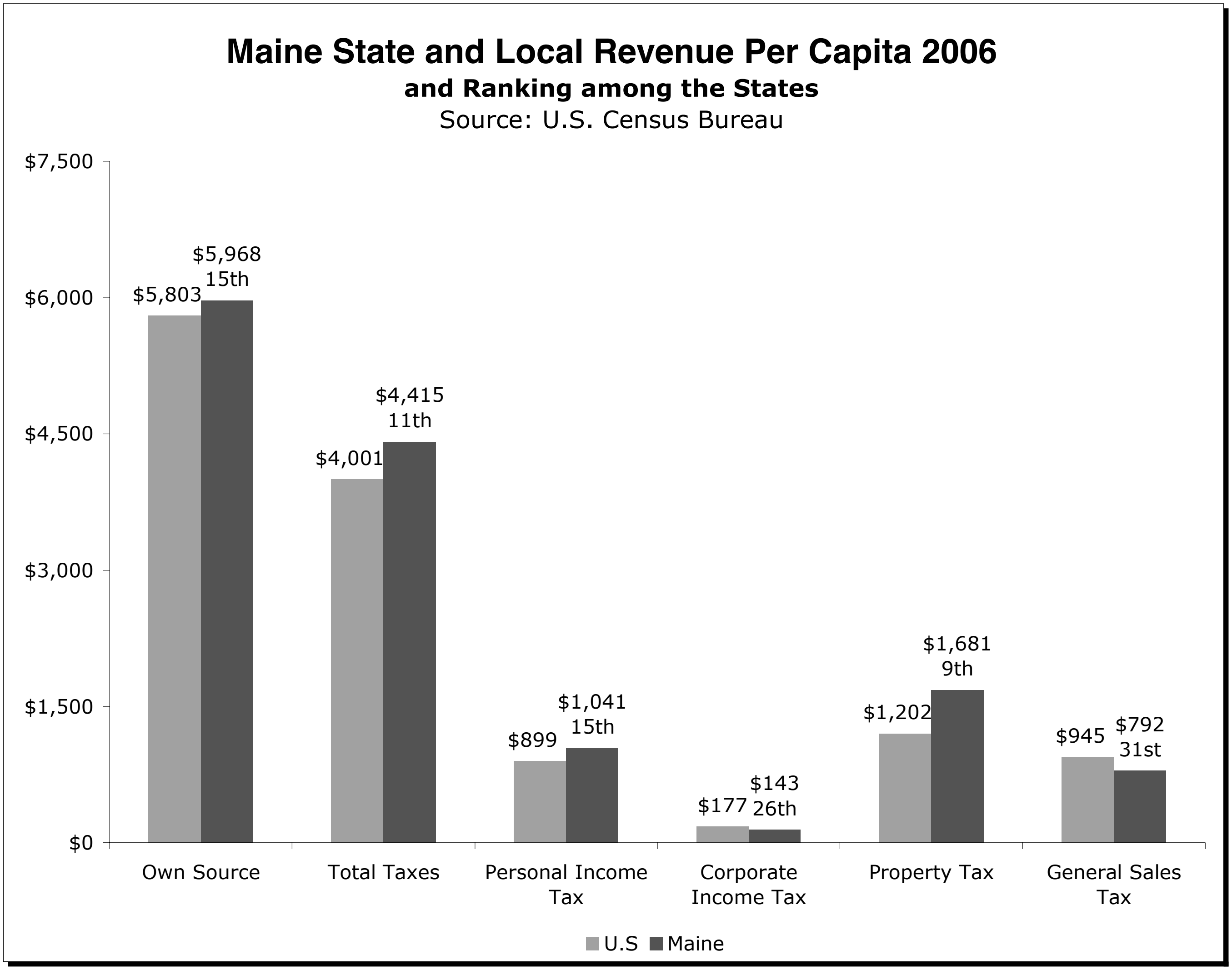
In addition, the Maine Municipal Association and the US Census Bureau have identified a widespread problem with "overcounting" of Maine property taxes in the Census numbers for 2006 and before. While the data to be published in spring of 2009 are expected to correct this error, the current numbers inflate the figures for property taxes (and hence the totals).

These two factors – the issue of property tax "overcounting" and the likelihood that Maine "exports" more of its taxes than do many other states – call into question the rankings noted above. In fact, it is very likely that Maine residents pay fewer taxes than current Census data suggest, and that Maine's "real" rankings therefore would be closer to the national average.

Nevertheless, what does it tell us if we rank 4th, 7th, or 27th? Not enough. Primarily, it tells us nothing about whether we are content with the goods and services we have chosen to purchase with public funds. Yet, some policymakers and commentators have suggested we should adopt a policy direction of lowering our tax burden based on these measures. This is an empty directive, devoid of context. Often this directive follows from claims that lowering our tax burden ranking will improve our business prospects. In fact, experts do not agree on how these measures affect business climate. They do agree, however, that other factors such as workforce quality, research and development, and infrastructure positively affect business climate. Therefore, policymakers should be cautious about directing policy based on these rankings, as it may lead to lowering investments in critical areas that have more potential to improve our overall economy than does lowering our tax burden.

(See charts on pp. 26 & 27)


Maine State and Local Revenue As
Percentage of Total Personal Income 2006
and Ranking among the States
Sources: Bureau of Economic Analysis and U.S. Census Bureau
20%
15%
10%
5%
0%
16.3%
19.0%
7th
11.2%
14.0%
4th
2.5%
3.3%
12th
0.5%
0.5%
24th
3.4%
5.3%
3rd
2.7%
2.5%
27th
Own Source
Total Taxes
Personal Income Tax
Corporate Income Tax
Property Tax
General Sales Tax
U.S.
Maine


Maine State and Local Revenue Per Capita 2006
and Ranking among the States
Source: U.S. Census Bureau
$7,500
$6,000
$4,500
$3,000
$1,500
$0
$5,803
$5,968
15th
$4,001
$4,415
11th
$899
$1,041
15th
$177
$143
26th
$1,202
$1,681
9th
$945
$792
31st
Own Source
Total Taxes
Personal Income Tax
Corporate Income Tax
Property Tax
General Sales Tax
U.S
Maine

Effective Tax Rates and Tax Shares

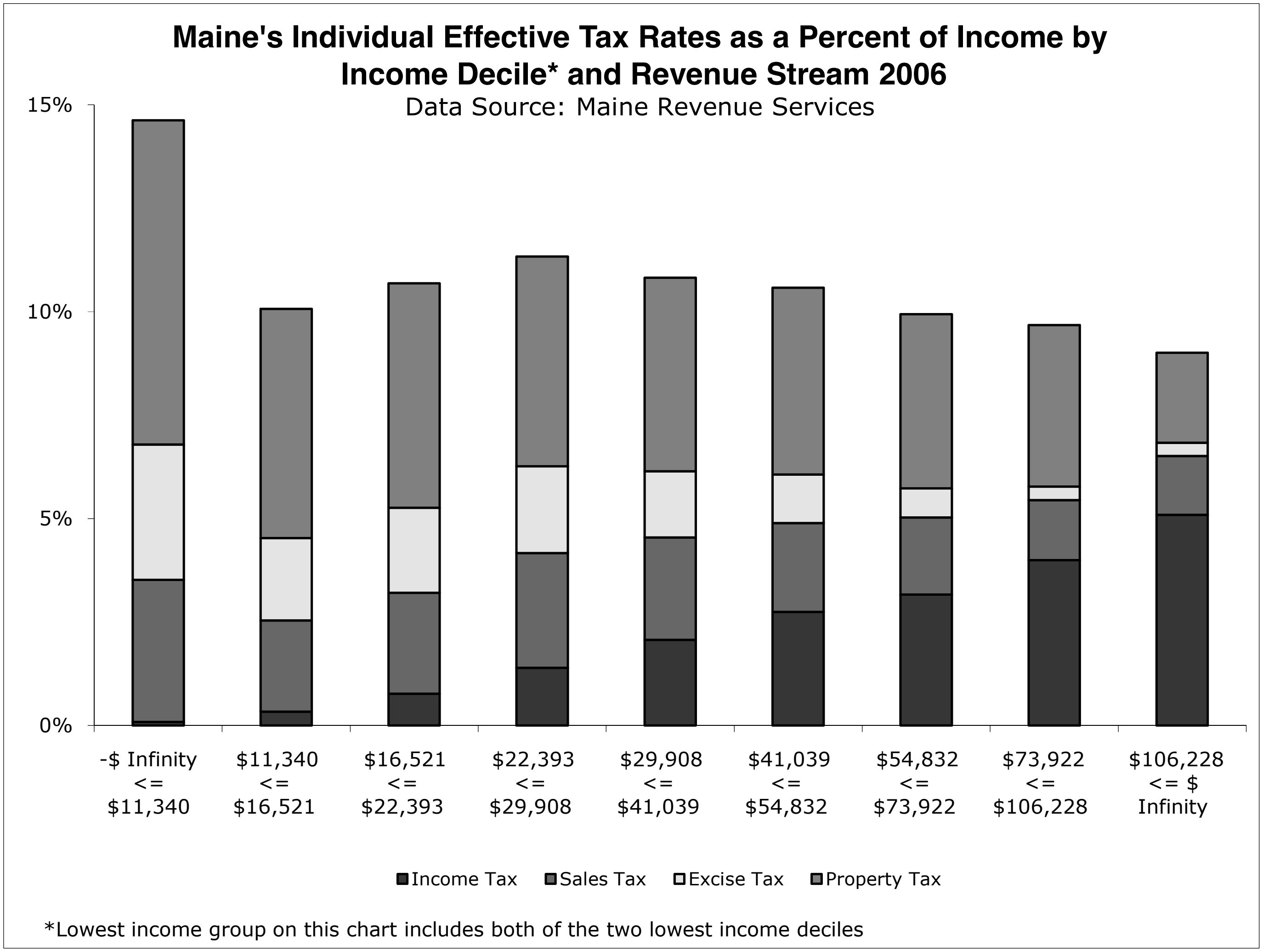
Over the last ten years the effective tax rate (taxes as percent of personal income) has remained relatively constant in Maine. A closer examination indicates, however, that while effective rates have remained relatively constant through time, the rate any individual household pays varies greatly based on income.

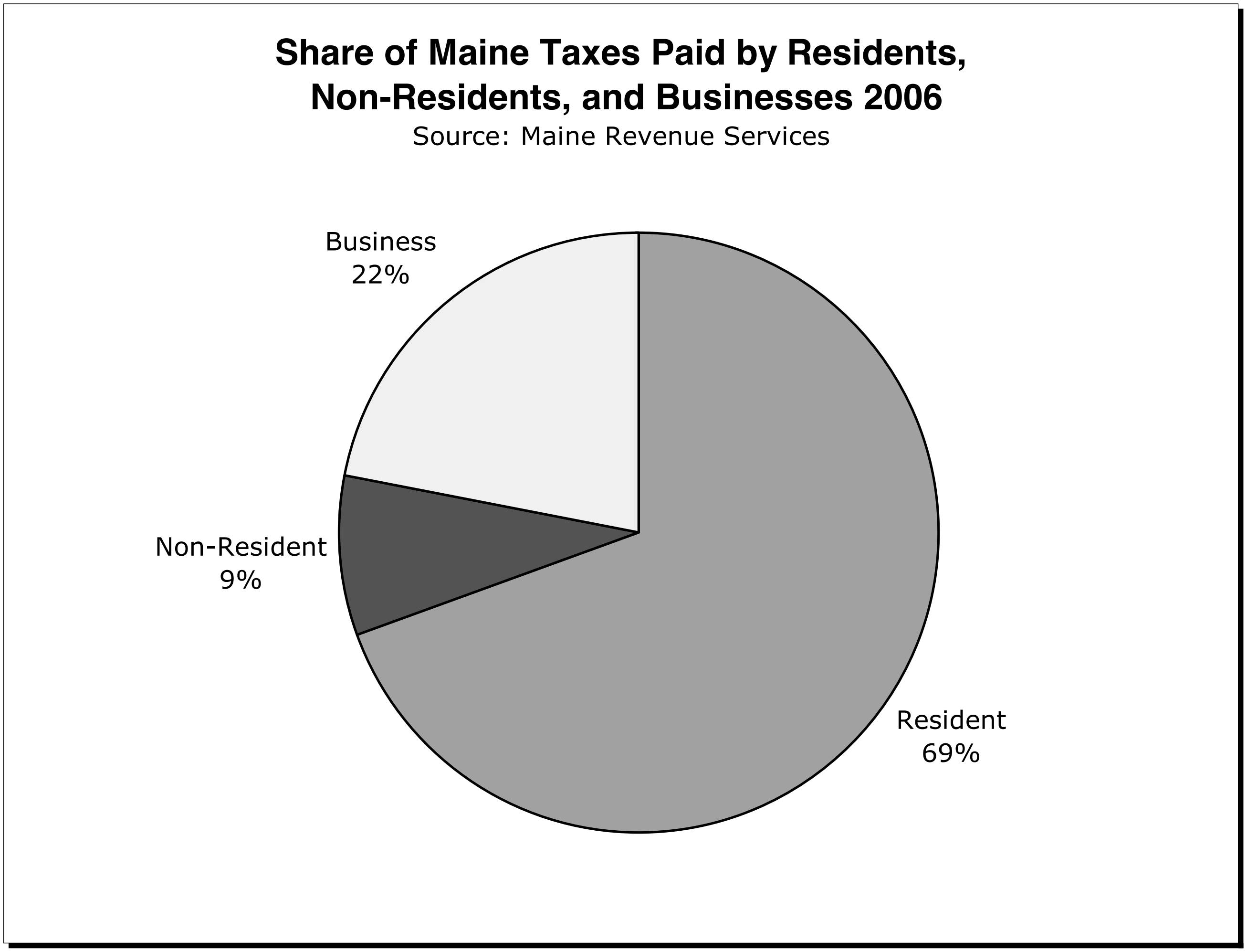
Maine's lowest-income households have the highest effective tax rate at 14.6%. By comparison, Maine's wealthiest households' effective rate is 9.0%. Breaking this down further by revenue streams, Maine's lowest-income households pay the highest percentage of their income in property, sales, and excise taxes relative to all other households. These three taxes are all **regressive**, meaning that they take proportionately more from low-income households than from high-income households. On the other hand, Maine's income tax is **progressive**, meaning that those with higher incomes pay a larger portion of their income toward this tax than do those with lower incomes.

Almost 70% of taxes in Maine are paid by individual residents. The other 30% are paid by businesses and non-residents, with businesses paying 22%. The overall mix among these three categories of taxpayers is also an important consideration for policymakers. A common policy objective around the country is to export as much of the tax burden as possible outside the state to non-residents who visit, vacation, and purchase goods and services while they are here. In considering how best to structure our state tax system it is important to strike a balance between the adequacy of revenues, the predictability of the revenue stream, and the fairness of the burden each household faces. Overall, there are five principles that should guide policymakers' efforts to improve Maine's tax system:

1. **TARGET RELIEF** to those with the least ability to pay.
2. **BENEFIT THE MAJORITY** of Mainers.
3. **PROVIDE ADEQUATE REVENUE** for programs.
4. **EXPORT** taxes out of state when possible.
5. **STRIKE A BALANCE** between business and residents.

(See charts on pp. 29 & 30)


Maine's Individual Effective Tax Rates as a Percent of Income by Income Decile* and Revenue Stream 2006
Data Source: Maine Revenue Services
15%
10%
5%
0%
-$ Infinity <= $11,340
$11,340 <= $16,521
$16,521 <= $22,393
$22,393 <= $29,908
$29,908 <= $41,039
$41,039 <= $54,832
$54,832 <= $73,922
$73,922 <= $106,228
$106,228 <= $ Infinity
Income Tax
Sales Tax
Excise Tax
Property Tax
*Lowest income group on this chart includes both of the two lowest income deciles


Share of Maine Taxes Paid by Residents, Non-Residents, and Businesses 2006
Source: Maine Revenue Services
Business
22%
Non-Resident
9%
Resident
69%

SPENDING TRENDS AND BIG TICKET ITEMS

Spending Trends

Total spending by Maine's state government has increased over the last ten years. According to the Office of Fiscal and Program Review, since 1999 the total average annual increase was 5.2%.[3] The General Fund grew at 4.1%, the Highway Fund at 4.7%, Federal Funds at 5.4%, and Other Special Revenue Funds at 8.6% annually. In the last five years, overall state spending has grown at an average annual rate of 2.9%, or very close to the underlying rate of inflation.

Is this too much? Is it not enough? The answers to these questions depend on several factors. First, the cost of goods and services increases over time. Health care and fuel costs increase at particularly rapid rates. Second, spending reflects policy decisions that are based on policy objectives. We must evaluate the outcomes to determine if we are satisfied with our expenditures and have made progress in meeting our objectives.

We may reasonably be concerned with whether the state is spending money at a rate faster than the rate at which taxpayers' income increases. One way to measure this is to compare spending to personal income. From 1997 to 2008, total spending as a percentage of total personal income in Maine has increased slightly from 14.15% to 14.90%. Looking at the individual funds, however, we see that much of that spending growth has occurred within the Federal Funds. Spending from the Highway Fund and the General Fund has remained relatively constant as a percentage of total personal income over this period. Overall, the spending of *state* dollars has NOT outpaced our statewide growth in personal income. In fact, for the last several years the overall ratio - as well as the ratios for most individual funds - has been decreasing.

Similarly, state and local effective tax rates have declined over the last decade. The trend of the last several years, in particular, has been one of decreasing effective tax rates.

(See charts on pp. 32, 33, & 34)

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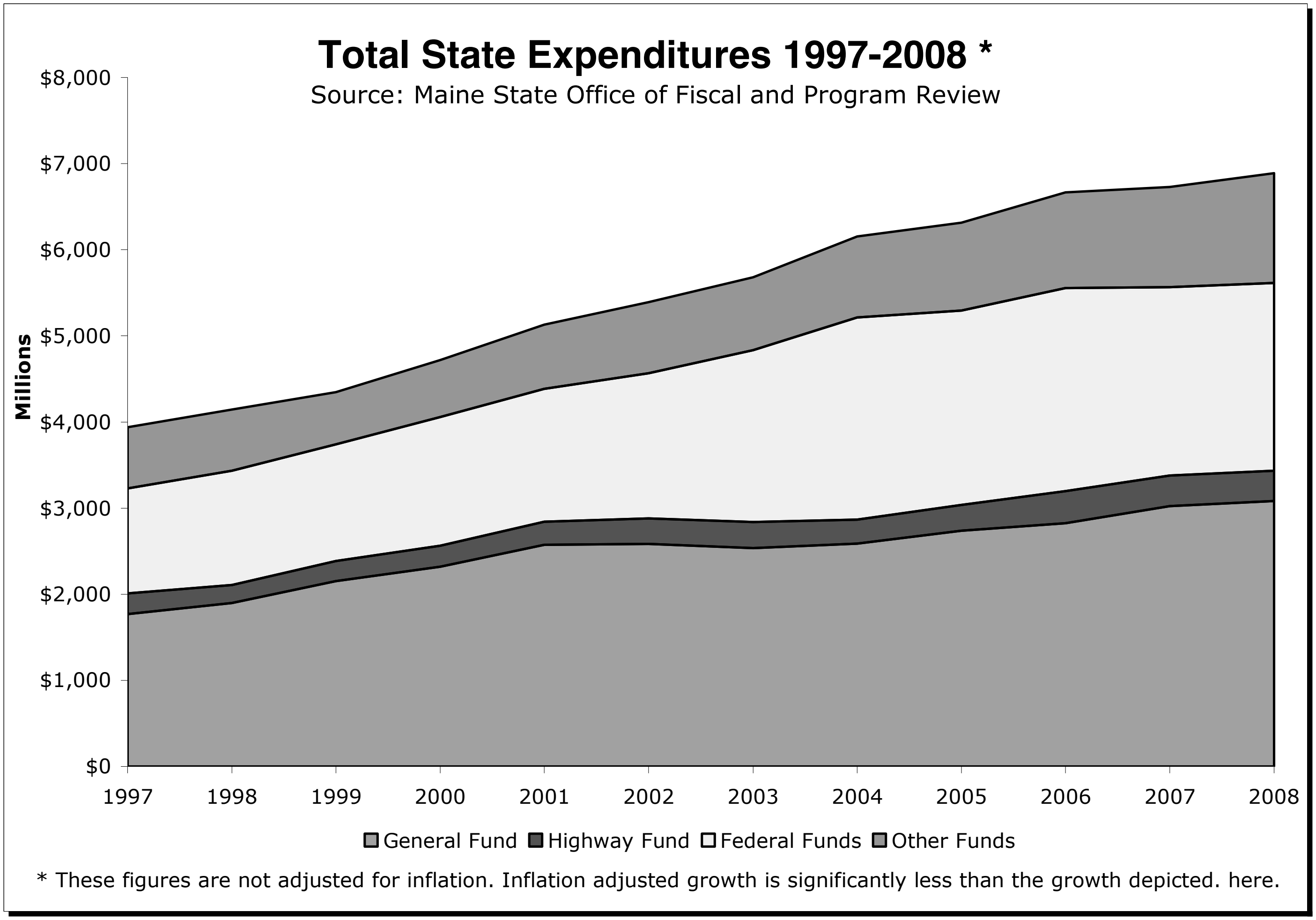
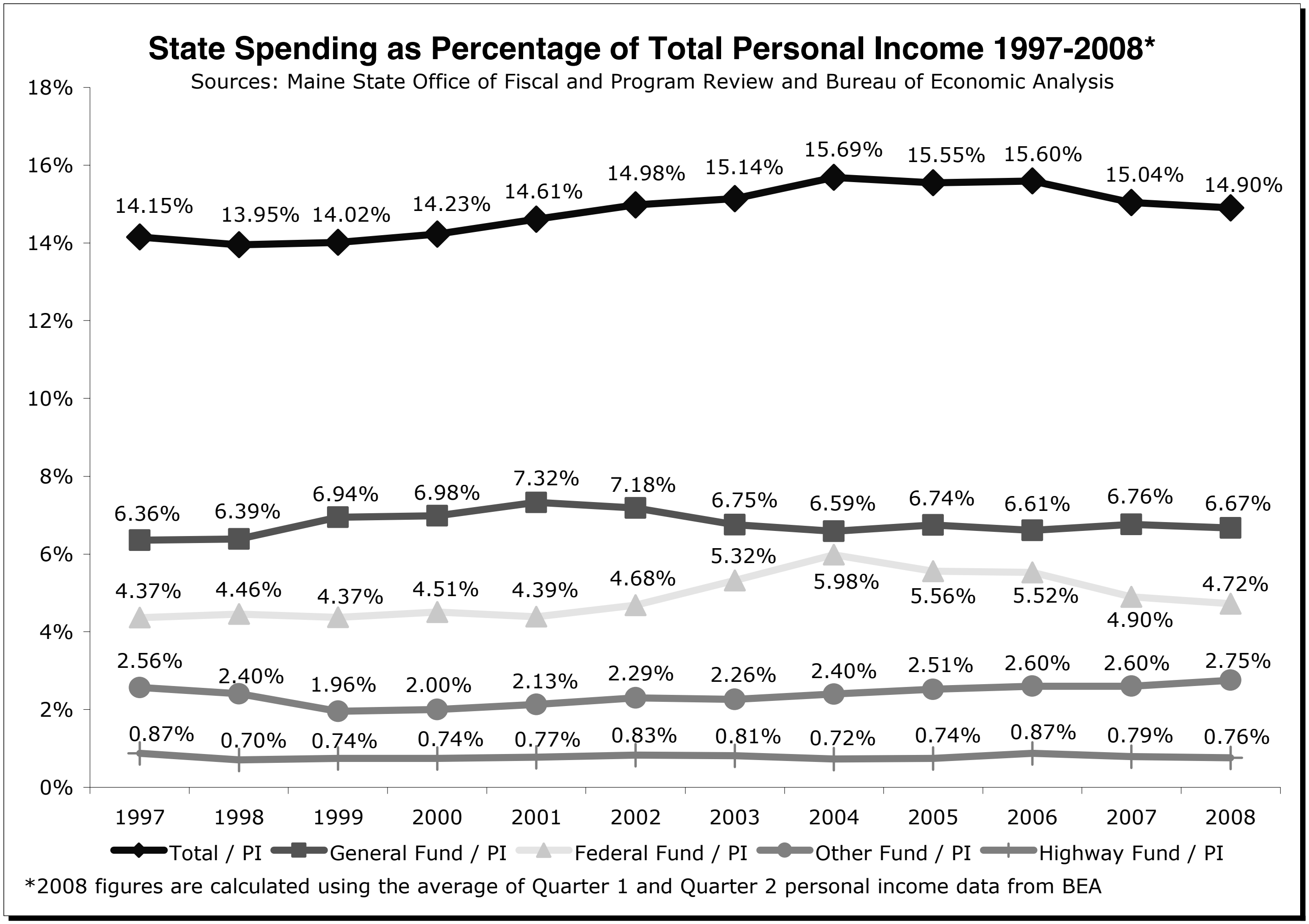
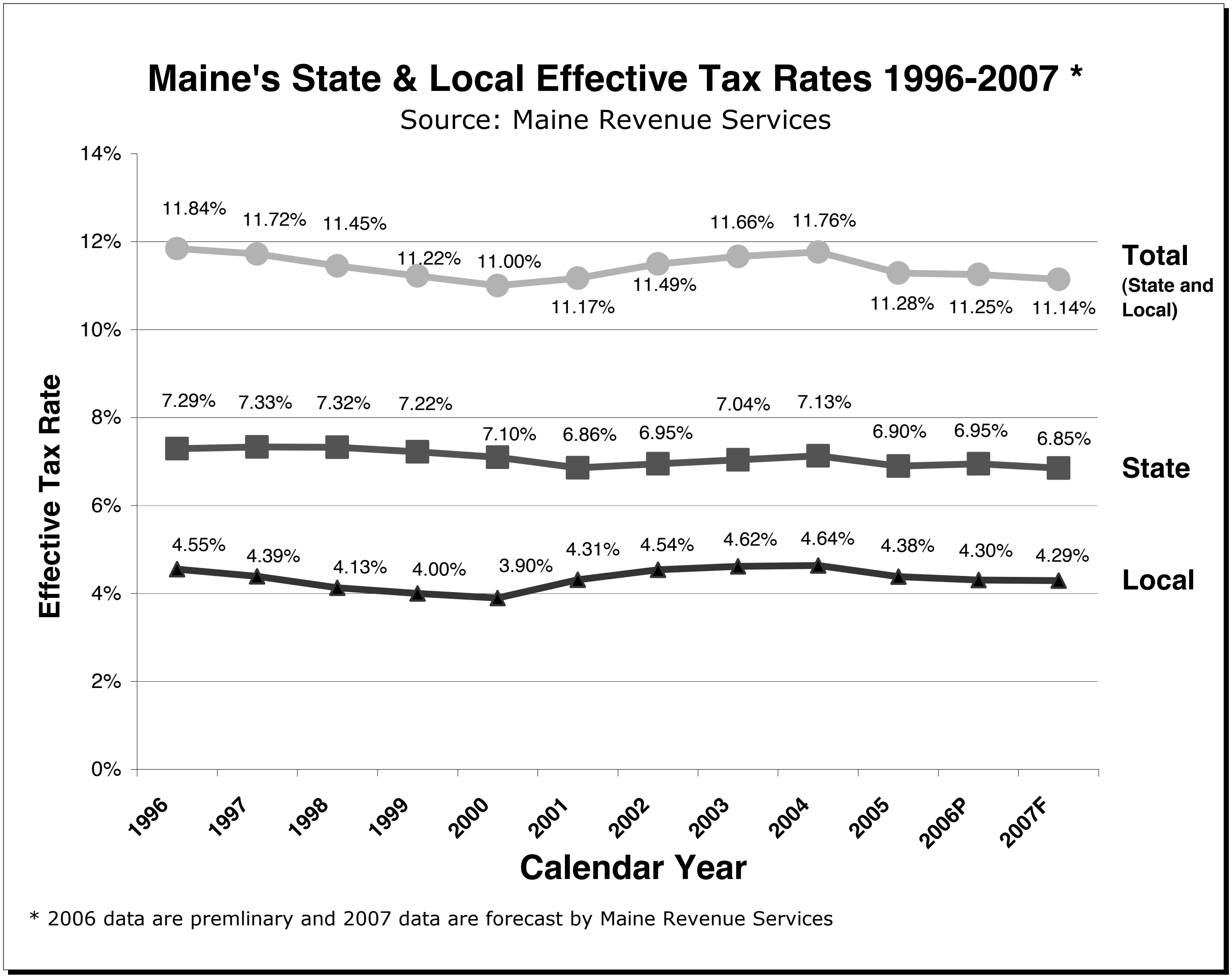
[3] Maine State Office of Fiscal and Program Review: http://www.maine.gov/legis/ofpr/total_state_budget/history/allfunds_history.htm


Total State Expenditures 1997-2008 *
Source: Maine State Office of Fiscal and Program Review
Millions
$8,000
$7,000
$6,000
$5,000
$4,000
$3,000
$2,000
$1,000
$0
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
General Fund
Highway Fund
Federal Funds
Other Funds
* These figures are not adjusted for inflation. Inflation adjusted growth is significantly less than the growth depicted. here.


State Spending as Percentage of Total Personal Income 1997-2008*
Sources: Maine State Office of Fiscal and Program Review and Bureau of Economic Analysis
18%
16%
14%
12%
10%
8%
6%
4%
2%
0%
14.15% 13.95% 14.02% 14.23% 14.61% 14.98% 15.14% 15.69% 15.55% 15.60% 15.04% 14.90%
6.36% 6.39% 6.94% 6.98% 7.32% 7.18% 6.75% 6.59% 6.74% 6.61% 6.76% 6.67%
4.37% 4.46% 4.37% 4.51% 4.39% 4.68% 5.32% 5.98% 5.56% 5.52% 4.90% 4.72%
2.56% 2.40% 1.96% 2.00% 2.13% 2.29% 2.26% 2.40% 2.51% 2.60% 2.60% 2.75%
0.87% 0.70% 0.74% 0.74% 0.77% 0.83% 0.81% 0.72% 0.74% 0.87% 0.79% 0.76%
1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008
Total / PI
General Fund / PI
Federal Fund / PI
Other Fund / PI
Highway Fund / PI
*2008 figures are calculated using the average of Quarter 1 and Quarter 2 personal income data from BEA


Maine's State & Local Effective Tax Rates 1996-2007 *
Source: Maine Revenue Services
14%
12%
10%
8%
6%
4%
2%
0%
Effective Tax Rate
11.84%
11.72%
11.45%
11.22%
11.00%
11.17%
11.49%
11.66%
11.76%
11.28%
11.25%
11.14%
Total
(State and Local)
7.29%
7.33%
7.32%
7.22%
7.10%
6.86%
6.95%
7.04%
7.13%
6.90%
6.95%
6.85%
State
4.55%
4.39%
4.13%
4.00%
3.90%
4.31%
4.54%
4.62%
4.64%
4.38%
4.30%
4.29%
Local
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006P
2007F
Calendar Year
* 2006 data are premlinary and 2007 data are forecast by Maine Revenue Services

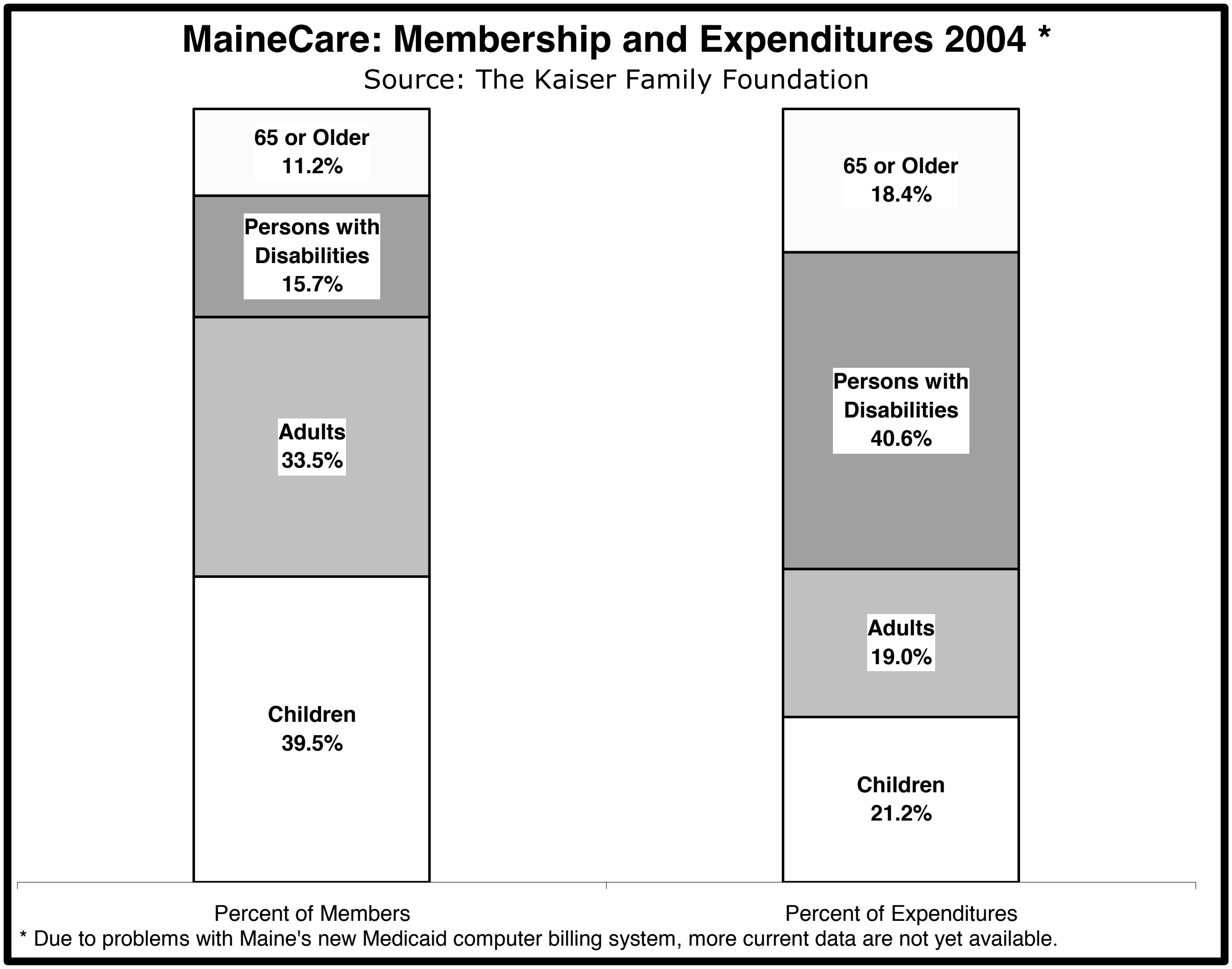
MaineCare

MaineCare is Maine's Medicaid program and is financed jointly by state and federal dollars. State MaineCare dollars act as seed dollars to attract a federal two-to-one match. For every $1 Maine spends on health care through MaineCare, the federal government adds an additional $2, boosting purchasing power and invigorating Maine's economy. These funds are used to cover the medical expenses of eligible low-income Maine people. In total, MaineCare receives over $2 billion in state and federal funding annually. The state's share – one-third of the $2 billion – represents approximately 13% of all state spending and is primarily split between the General Fund (80%) and Other Special Funds (20%).

Drawing on the most current data available for Maine (2004), we see that the majority of MaineCare recipients are children (39%) followed by adults (33%), people with disabilities (16%), and persons 65 or older (11%). Expenditures are distributed much differently. Almost 60% of MaineCare expenditures are used to provide health care and long-term care to the 27% of recipients with disabilities or who are 65 or older. The chronic nature of the conditions faced by these populations makes their care far more costly than that of other MaineCare enrollees. Children account for under 22% of expenditures and non-elderly adults account for under 20% of expenditures.

MaineCare dollars have supported the creation of many health care-related jobs in recent years. Health care has been one of the major growth sectors of Maine's economy, particularly in rural areas.

(See chart on p. 36)


MaineCare: Membership and Expenditures 2004 *
Source: The Kaiser Family Foundation
65 or Older
11.2%
Persons with
Disabilities
15.7%
Adults
33.5%
Children
39.5%
65 or Older
18.4%
Persons with
Disabilities
40.6%
Adults
19.0%
Children
21.2%
Percent of Members
Percent of Expenditures
* Due to problems with Maine's new Medicaid computer billing system, more current data are not yet available.

K-12 Education

Approximately $1.9 billion in state and local funds went to pay for K-12 education in fiscal year 2006 (more recent, detailed data are not available currently from Maine's Department of Education). Of these funds, 71% went to operate elementary and secondary schools. Elementary schools accounted for twice the amount of spending as secondary schools. Special education accounted for another 15% while the remaining 14% was divided among vocational training, loans, leases, transportation and other capital expenses. Administrative costs represented 9% and instruction 63% of total costs.

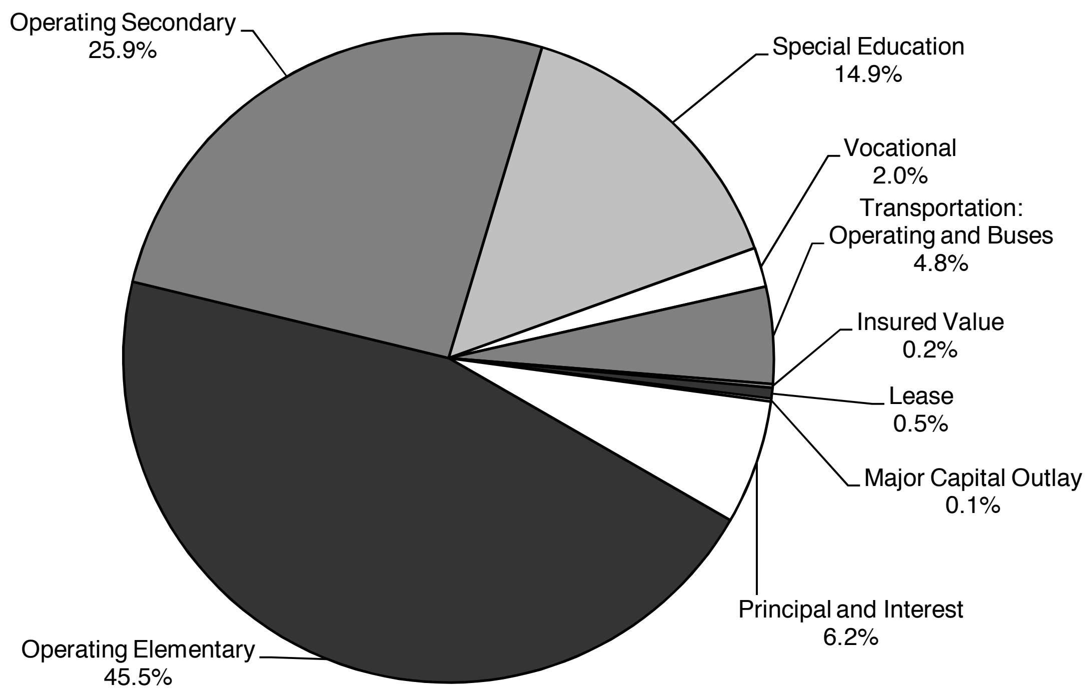
By a different measure, the Maine Department of Education reports that the state-wide average per-pupil-cost for the 2006-2007 school year was $8,439 for elementary students and $9,519 for secondary students. Adjusting for inflation, these figures represent real cost increases of 13% and 11 % respectively over per-pupil expenses in the 2003-2004 school year.* These averages include only *operating* costs. Costs associated with major capital outlays, debt service, transportation, and federal outlays are excluded.

(See chart on p. 38)

* Maine's Department of Education does not provide pre-2003-2004 data in a format that is fully cross-comparable with more current years. Inflation adjustment for these figures is performed using the Consumer Price Index.

State and Local K-12 Expenditures 2006 ($1.9 billion)

Source: Maine Department of Education



Note: More current data were not available at time of publication

DEBT IN MAINE

General Obligation Bonds

Maine's state government borrows money by issuing bonds. This allows the state to invest in, for example, land acquisition, small business investment, and public facility space and equipment. Borrowing allows payments to be spread out over a project's useful lifespan rather than paid upfront. This also ensures that all people benefiting from projects pay some portion of the cost through taxes over time.

The majority of Maine's tax supported debt (61%) consists of **General Obligation Bonds** that the state government backs with its "full faith and credit" to be repaid from General Fund revenue. These bonds must be approved by voters in general elections. Of the authorized General Obligation Bonds, about 11% of revenue goes to the Highway Fund and the remaining 89% goes to the General Fund. In addition to the $476 million in authorized and issued General Obligation Bonds, there also is approximately $225 million in authorized and yet-to-be authorized General Obligation Bonds that have yet to be issued.

Other types of bonds include Tax-Supported Certificates of Participation and Capital Lease bonds, both of which are secured with revenues from state-issued leases. GARVEE (or Grant Anticipation Revenue Vehicle) bonds are secured with the promise of revenues from future federal transportation grants. Maine Government Facilities Authority bonds are secured with revenues from tax supported agency budgets.

Relative to other states Maine does very well with its "debt burden." Tax-supported debt in Maine is $618 per capita versus the national median of $889.[4] As a percentage of total personal income, Maine's tax-supported debt is 1.9%, while the national median stands at 2.6%.[5] Maine's bond ratings from the three major bond houses – Moody's, Fitch, and Standard & Poor's – all remain very good.

(See chart on p. 40)

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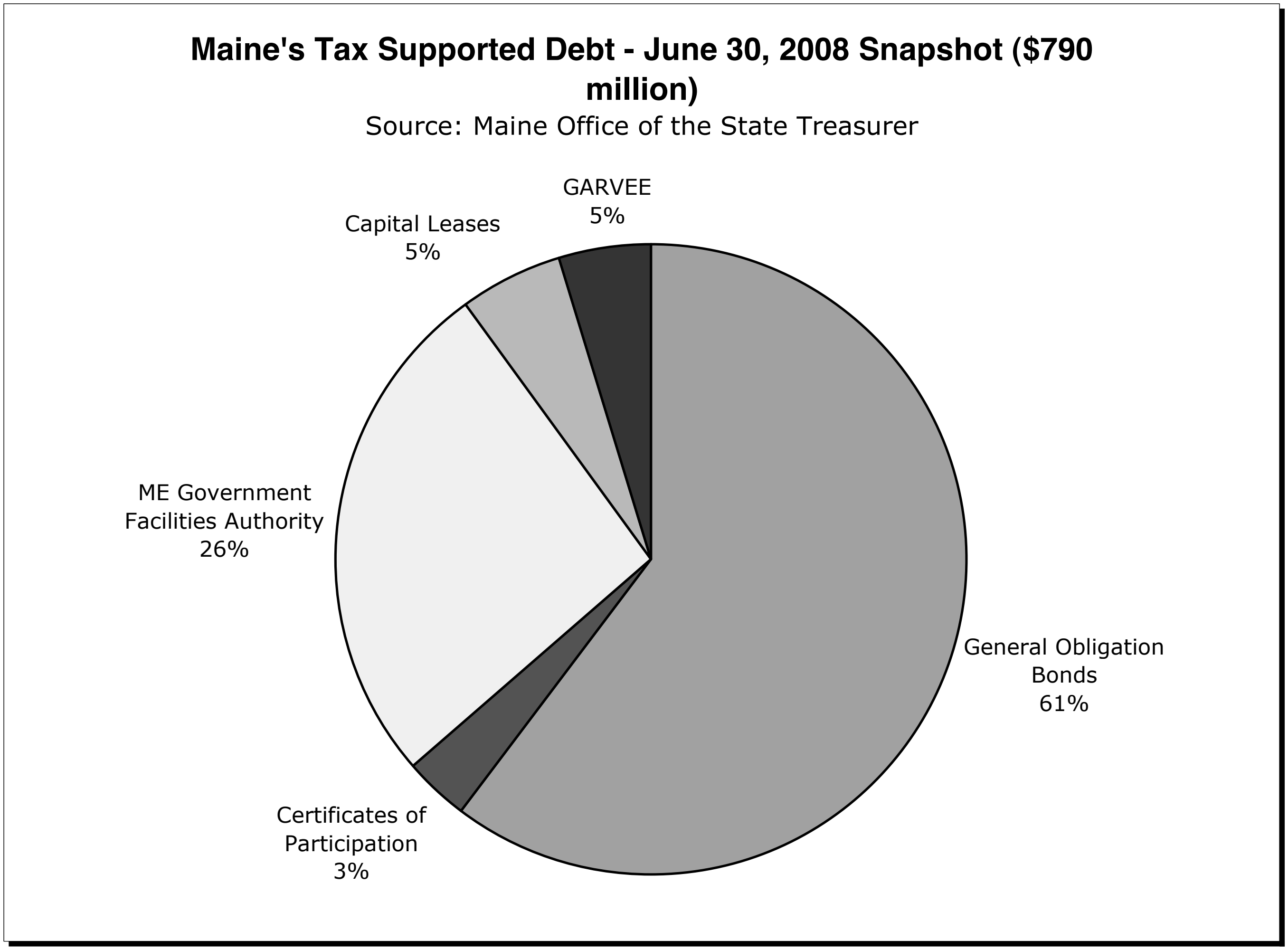
[4] Website of the Maine Office of The State Treasurer: http://maine.gov/treasurer/debts_bonds/debt_summary.html

[5] Ibid


Maine's Tax Supported Debt - June 30, 2008 Snapshot ($790 million)
Source: Maine Office of the State Treasurer
GARVEE
5%
Capital Leases
5%
ME Government
Facilities Authority
26%
General Obligation
Bonds
61%
Certificates of
Participation
3%

Moral Obligation Bonds

A **Moral Obligation Bond** is "a bond backed by the State's moral (but not legally enforceable) promise of payment." [6] Often it is backed by a specific revenue stream. If that revenue stream fails, the state government has no legal requirement to repay the loans, although it would look for other revenue to pay back the debt. Currently, Maine carries Moral Obligation Debt totaling $3.94 billion.

Maine has long been a leader in the nation in its innovative and extensive use of bonds for affordable housing (Maine State Housing Authority); economic development finance (Finance Authority of Maine); municipal improvements (Maine Municipal Bond Bank); hospital and university buildings (Maine Health and Higher Educational Facilities Authority) and student loans (Maine Education Loan Authority).

The state's four largest bond issuing agencies carry financial reserves significantly higher than those needed to satisfy bondholders, and Maine's Housing Authority and Municipal Bond Bank offerings are rated higher by Wall Street than many other moral obligation bonds.

In addition to the debt associated with General and Moral Obligation Bonds, Maine has a constitutional obligation to fund pensions for state employees and teachers. While amounts are set aside in each state budget to cover current retiree pension benefits, there are obligations incurred for future retirement benefits for which funds have not yet been set aside. This is commonly referred to as the **Unfunded Actuarial Liability**. By constitutional amendment passed in 1995, this account must be balanced by 2028 and as of June 30, 2008, the Treasurer's office reported that the anticipated amount is $2.6 billion.

In addition to pension liabilities, the state has incurred liabilities for retired employee health care costs. The 123rd Maine Legislature established investment and trust funds as well as a trustee structure to address the unfunded liability for retiree health benefits, which have historically been paid with current General Fund revenue and have not been prospectively funded.

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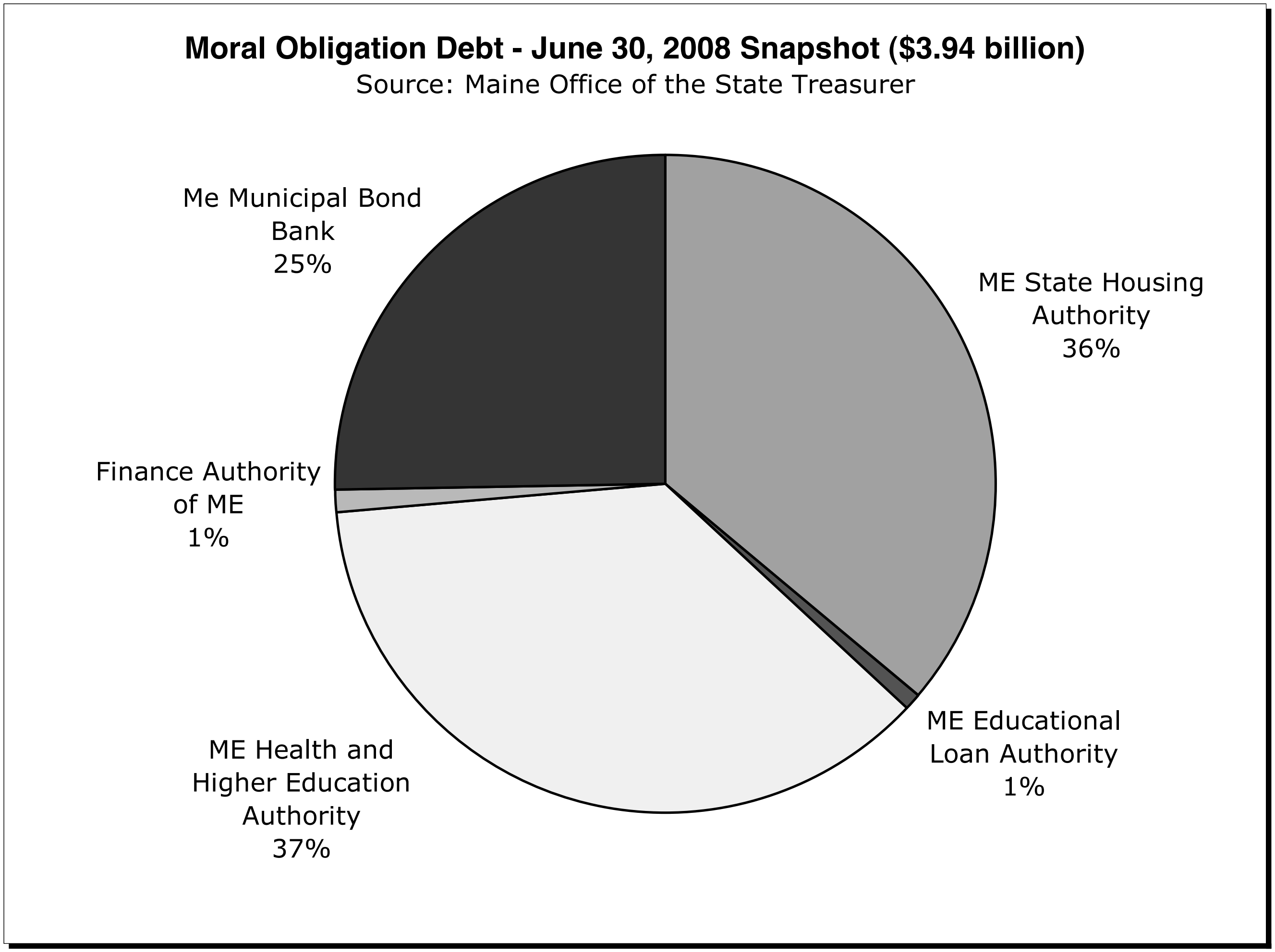
[6] Maine Office of The State Treasurer

An actuarial report commissioned by the State Comptroller's office identified that there would be $3.2 billion in unfunded retiree health care liabilities if a plan to "prepay" the balance is undertaken. Without any prepayment the liability would grow to $4.7 billion. The FY09 budget included an $80 million payment to begin prepayment. Starting in the next biennium (FY10-11), the trustees will identify an ongoing funding stream which the legislature can allocate on an annual basis to meet current and future retiree health obligations.

(See chart on p. 43)


Moral Obligation Debt - June 30, 2008 Snapshot ($3.94 billion)
Source: Maine Office of the State Treasurer
Me Municipal Bond Bank 25%
ME State Housing Authority 36%
Finance Authority of ME 1%
ME Educational Loan Authority 1%
ME Health and Higher Education Authority 37%

FISCAL POLICY ISSUES

Budget Shortfalls and Economic Stimulus

Based on estimates from early December 2008, the budget shortfall in the current fiscal year (FY2009 - ending June 30th, 2009) is projected to be $140 million. A shortfall of more than $800 million is projected for the 2010-2011 biennium. If the national economy deteriorates further than anticipated at the time these projections were made, either or both of these figures could grow.

How should the state respond to this challenge? By law, our state government cannot run a deficit. Unlike the federal government, which can and does run a deficit by borrowing money from global investors to cover ongoing operating expenses, the state must adjust its operating budget to ensure that expenditures do not exceed revenues in any given year.

While there are two sides to this equation – *expenditures* on the one hand and *revenues* on the other – the Governor's recent proposal to achieve budget balance for fiscal year 2009 makes only modest use of "rainy day" reserves and relies heavily on more spending cuts. Looking ahead to the larger shortfalls anticipated in 2010 and 2011, both the Governor and some legislators have expressed a similar reluctance to consider the other side of the equation: increased revenues (including use of all available "rainy day" reserves). There are important reasons why this budget cutting approach may be significantly less prudent than it at first appears.

First and foremost is the nature and severity of the current economic woes we face, both nationally and at the state level. Quarter by quarter the economic data reveal a steady slide into what looks to be the deepest recession the US has faced since the 1930s. While many factors have contributed to this decline, at its core the problem is now one of sharply decreased global and national demand. If consumers and businesses are not buying, there is no reason to produce more goods and services. This results in layoffs, reduced business investment, and a steady downward spiral in the economy. What appears prudent to each individual and business – a reduction in personal spending – has a cumulative effect that is disastrous for the economy as a whole.

As the renowned economist, John Maynard Keynes, first identified at the time of the Great Depression, in such circumstances the only entity capable both of acting for the common good rather than in the self-defeating interests of the individual and of generating a level of demand sufficient to restore the economy to good health is government. Simply put, the medicine an economy in recession needs can be supplied only by government, and the medicine required consists of large scale investments in projects and programs of many kinds, even if that spending adds significantly to short-term deficits.

While states cannot run annual deficits, the same general principal still holds true; in times of recession state governments best help their local economies by maintaining or increasing government spending, not by instituting spending cuts. States can achieve this goal in several ways; they can access and spend as many federal dollars as are available, they can increase state-funded infrastructure expenditures through bonded borrowing, and they can spend down reserves while raising more revenues.

Among the many distinguished economists advocating elements of this three-pronged approach are Nobel Prize winning economists Paul Krugman and Joseph Stiglitz, as well as Peter Orzag, current Director of the Congressional Budget Office. In a joint paper outlining their recommended state-level responses to the current economic downturn, Stiglitz and Orzag conclude that, "(a) reduction in government spending on goods and services is…likely to be more harmful to the economy in the short run than an increase in taxes(.)" [7] Drawing on basic economic theory, they directly refute the idea that cuts in either spending or taxes are the answer to our current woes, going on to explain that, "tax increases on higher-income families are the least damaging mechanism for closing state fiscal deficits in the short run." [8]

In short, Maine cannot cut its way to better near or long term economic health. Indeed, targeted revenue increases that help support ongoing state spending are very likely the most prudent approach for the near and longer term health of the Maine economy.

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[7] Center on Budget and Policy Priorities: http://www.cbpp.org/1-8-08sfp.htm; see also New York Times: http://www.nytimes.com/2008/12/29/opinion/29krugman.html?ref=opinion
[8] Ibid

Finally, it is worth noting that the large majority of the budget shortfall in both FY2009 and the 2010-2011 biennium results not from increased state spending meant to deliver upgraded, “gold-plated” services, but from basic price inflation in the national economy and - even more so - from a sharp decline in state revenues. Much of the problem results from the inability of Maine’s antiquated, insufficient, and unstable revenue structure (see below) to keep pace with basic inflation, let alone build up adequate “rainy day” reserves to help us through these inevitable economic downturns.

Nevertheless, attempts to address the current shortfalls have focused almost exclusively on further reductions in government functions and services. Absent an informed discussion about and thoughtful restructuring of the way Maine collects state revenues, we inevitably resign ourselves to additional rounds of future budget cuts. We must ask ourselves whether this indeed is the path we wish to choose. If it is not, we must consider alternatives to the status quo.

Streamlining Government

Given projected budget shortfalls, there is continued if not growing enthusiasm for achieving cost savings through government efficiencies. Such plans underpin the legislature’s adoption of plans to consolidate school administrative units and reorganize the county correctional system, and Governor Baldacci’s proposal to reorganize the environmental resource departments.

Policymakers should be both informed and cautious as they approach the task of finding “efficiencies” through streamlining or other means. Actual costs and savings in such proposals seldom turn out to agree with initial predictions. Broad cuts may adversely affect Maine’s goals of achieving universal health care, improving the economy, and protecting the environment.

Some officials are eager to compare Maine to other states in order to find areas of “overspending.” But this is not in itself a solution. Maine’s population, geography, and the regional economy in which Maine competes are different from other states with which we are often compared, such as rural states like Idaho or South Dakota. And ultimately, our spending patterns reflect what legislators - and the voters who elect them - have indicated they want in the form of public goods and services.

This is a complex topic. Institutional change is difficult for everyone. Efficiencies must be sought where feasible but the trade-offs should be made apparent and carefully considered. The idea that government functions and services can be maintained at current levels in the face of sharp funding decreases is one that requires special scrutiny.

Tax Reform and Tax Relief

"Tax reform" and "tax relief" are terms that often are used interchangeably but they have different meanings. Tax reform generally relates to a change in the overall structure of the revenue system and mix of taxes. It does not have to lead to lower taxes, although it could. A state may be very dependent on some taxes and fees and not so much on others. An example in Maine is the heavy dependence on property and income taxes as compared to sales taxes and user fees. Being too dependent on one stream of revenue places state finances at greater risk when softening occurs in that part of the economy. Just like an individual's investment portfolio, Maine should strive for balance and diversity so that when one revenue stream fluctuates the other revenue streams will provide ongoing stability.

Tax relief means lowering taxes for some Maine residents. Lower taxes for some can result by shifting taxes to other groups both in and out-of-state. Lower taxes can also result from spending cuts. Both tax reform and tax relief can and should be pursued at the same time.

Maine's overall tax system is antiquated and needs updating. Because it is unbalanced, it is subject to fluctuations in the economy that can lead to sharp revenue shortfalls. Specific reform measures for Maine that have been widely discussed include:

- **Broadening the sales tax base**
- **Adjusting the personal income tax brackets**

From this primer we see that some low and moderate-income families in Maine are paying a much higher proportion of their income in taxes than other households. We need to target relief to those families. Specific reform measures that would help achieve this end include:

- **Expanding the property tax "circuit breaker"**
- **Expanding the State Earned Income Tax Credit**
- **Raising the threshold of tax liability for those with the lowest incomes**
- **Exporting more taxes out-of-state**

Conclusion

Maine residents and businesses must engage in an informed discussion about government revenues and expenditures in order to realize a collective vision for Maine's future. To do so they must understand how state and local governments raise revenue, what different revenue streams pay for, and how those revenue streams interact. Understanding these factors will help them decide which services to invest in, how much taxation is required to pay for those services and whether the current mix of taxes is adequate, stable, and fair.

Spending cuts in one area may produce immediate savings in that line item, but can result in increased expenses in other areas of the budget or in higher costs down the road. For instance, keeping bonded indebtedness low by putting off needed repairs to vital roads and bridges may lead to far larger costs over the long term. Similarly, reductions in General Fund health spending may negatively impact public health over the long run and reduce federal matching funds in the near term. Likewise, increased spending for one service may result in a reduction in some other service, unless more revenue is generated.

We also must understand tax burden. Are we providing services at too great an expense for taxpayer incomes? Are we asking too much from those with the least income? If done thoughtfully, tax system reforms could help maintain good quality services while spreading the cost more equitably and efficiently across households and communities.

How best to secure adequate funding for our shared priorities and how we plan to distribute the costs for those public investments will be questions central to any responsible discussion of Maine's future. At the Maine Center of Economic Policy, we hope the information contained in this primer will help inform and guide that discussion.