Report of the
Maryland Board of Revenue
Estimates
on

# ESTIMATED MARYLAND REVENUES

Fiscal Years Ending
June 30, 2001
and
June 30, 2002

Submitted to
Governor Parris N. Glendening
December 14, 2000

State of Maryland
# Board of Revenue Estimates

Louis L. Goldstein Treasury Building, P. O. Box 466
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December 14, 2000

Honorable Parris N. Glendening
Governor of Maryland
State House
Annapolis, Maryland 21401

Dear Governor Glendening:

In compliance with Section 6-106(b) of the State Finance and Procurement Article of the Annotated Code of Maryland, the Board of Revenue Estimates has prepared and herewith submits to you new estimates of State revenues for the fiscal years ended June 30, 2001 and June 30, 2002, based upon current laws and administrative practices. These estimates are set forth in the accompanying Report on Estimated State Revenues. As in the past, the estimates represent the collective efforts of each of the Board members and their staffs.

The Board will continue its study of economic and revenue trends and will report to you any significant changes that may affect Maryland's revenues.

Respectfully yours,

William Donald Schaefer, Chairman

Richard N. Dixon

T. Eloise Foster

T. Eloise Foster

## Executive Summary

Maryland's economy has been very strong over the last several years, with employment growth averaging 2.5% since 1997 and growth in personal income averaging about 6% over that period, and unemployment hitting a record low of 3.0% early in 2000. Although Maryland had generally grown more slowly than the United States over most of the 1990s, the situation reverted in 1998 to that prior to the last recession, with Maryland once again growing faster than the country. The economic outlook calls for Maryland to continue to grow near or above the national averages in employment and income over the next several years. In contrast to the State's position in the early 1990s, a federal government surplus is now benefitting the economy. If federal pursestrings should happen to tighten over the next several years, however, a lessened dependence on federal employment and spending will cushion the State from a repeat of the impact of federal cutbacks at the beginning of the decade.

While the economy will slow over the next two years from its torrid pace of the last three, performance will still be strong. At this point, the labor market remains tight but inflation seems to be at bay, and growth in wage and salary income looks to continue. There are potential risks, notably a sharp spike in or sustained higher levels of energy prices, as well as the impact of the stock market decline since March, which may or may not be over. Either of these could cause consumers to further cut back their spending, which has been one of the driving forces of the economy over the past few years.

General fund revenue growth will slow along with the economy, and will be further constrained by the increasing income tax reduction, which will be fully implemented in tax year 2002 (fiscal year 2003), and the repeal of the direct inheritance tax. Despite these changes and the tax-free week in fiscal year 2002 (sales of clothing and footwear under $100 will be exempt the week of August 10), general fund revenues are expected to increase by 4.6% in fiscal year 2001 and 2.9% in fiscal year 2002. In addition to lower general fund revenues due to the repeal of the direct inheritance tax, tobacco tax revenues are expected to continue to decline as people quit smoking, hospital patient recoveries will decline due to a change in federal law, business franchise tax revenues will decline due to a variety of law changes and miscellaneous revenues will decline because of law changes and the fact that roughly $18 million of one-time receipts were received in fiscal year 2000. Nonetheless, strong growth in the income and sales taxes and continued high interest earnings will result in a net revenue increase of $428 million over fiscal year 2000. As the economy slows in fiscal year 2002 and the remainder of the income tax reduction becomes effective, growth will slow to $278 million.

The Board is cognizant of the slowing economy and the risks mentioned above. We are also aware of the current situation in neighboring states, particularly with regard to slowdowns in sales tax and withholding collections. To date, Maryland revenues have performed as expected and have not reflected declines apparently experienced in some other states. While the experience of other states provides a note of caution, we believe Maryland is well-positioned for the next several years and revenue growth will continue.

State of Maryland
# Board of Revenue Estimates

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## The U.S. Economy

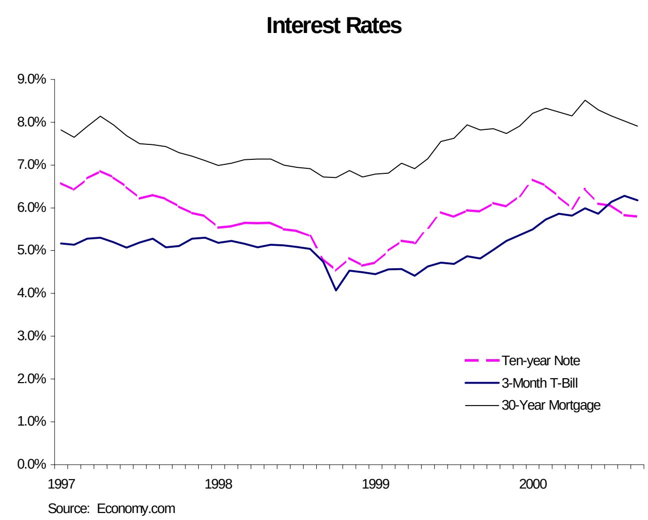
The economy continues to surprise analysts on the upside. The current expansion, which began in April 1991, is almost ten years old and has lasted much longer than most expected. In fact, this expansion is the longest on record, now surpassing the Vietnam-era boom of 106 months by over 10 months. According to the National Bureau of Economic Research (NBER), the official statistician of business cycles, the U.S. economy has been in expansion for much of the last twenty-five years. Economic growth shows no signs of stopping in the near term.

Current forecasts for the national economy show the expansion extending at least for the next several years. According to the Blue Chip Economic Forecast of 50 business economists in the fall, there is about a 16% probability that the economy will enter recession in the next twelve months and a 29% possibility that the expansion will end in the next twenty-four months. Other macroeconomic forecasters like DRI and WEFA also see an expanding economy through 2002.

In addition to duration, this expansion continues to impress analysts by its solid growth, especially late in the business cycle. This time last year, analysts were expecting economic growth to slow following increases of over 4% in each of the three previous years. Despite six increases in the Federal Funds rate beginning in June 1999, the economy surged ahead in the fourth quarter and again in the first and second quarters of this year. Stronger than expected growth has prompted analysts to revise their forecasts upward for 2000 to an above trend rate. Even the Congressional Budget Office and the Federal Reserve moved their forecast for between 4% and 5% for the period. Forecasts for 2001 and 2002 have also been adjusted higher but still show a significant slowing in economic growth compared with previous years of extraordinary performance.

*Current Conditions*

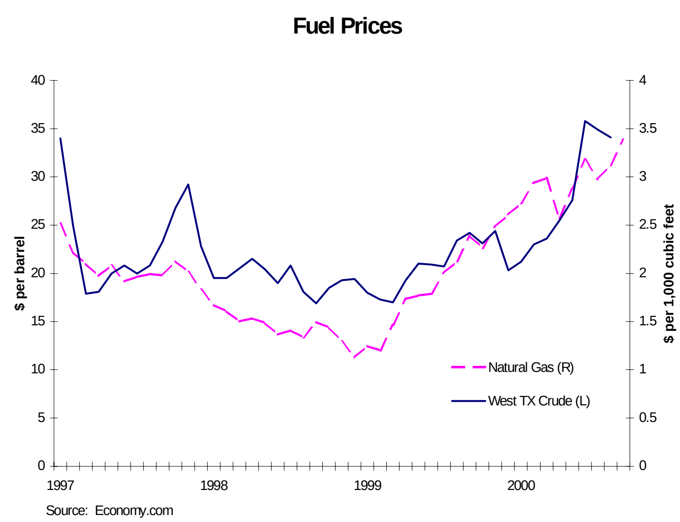
Although the economy expanded over 4% in the first three quarters of 2000, the current economic environment is much different than at this time last year. First, continued increases in the Federal Funds Rate this year to 6.50% and a rise in mortgage rates from a low of 6.75% in 1998 to over 8% this year has dampened demand for housing and consumer durables. Residential construction, which rose 8.3% in 1998 and 6.4% in 1999, declined about 2% for the first three quarters of 2000.



Durable goods spending actually fell in the second quarter following a surge in the first quarter. Although the Federal Reserve is not expected to raise rates in the near term, most analysts are unsure whether the Fed has finished its adjustment process. Recent economic data suggest that economic growth may be slowing sufficiently for the Fed to remain on hold and to perhaps reevaluate their restrictive bias.

Inflation, however, has risen sufficiently over the last year to put the Federal Reserve on alert and maintain a positive bias for monetary policy. Consumer prices are expected to increase 3.3% in 2000 compared with annual gains of 2.2% in 1999 and the thirty-four year low of 1.6% in 1998. A spike in energy prices has contributed to the rise. Energy prices rose 2.8% for the first nine months of the year compared with a 1.9% increase for all of 1999.

The jump in fuel oil prices this year is the second reason the economy is different from last year. Not only are fuel price increases lifting the price indices, but they are also affecting consumer spending. Owing to a re-unification of Middle East producers, West Texas Intermediate oil prices increased from about $15 per barrel towards the end of 1998 to a peak of $37 per barrel this year. The release of oil from the U.S. Strategic Oil Reserve this summer has temporarily dampened prices but is not expected to keep prices from remaining around $30 per barrel for the near future. The rise in oil prices this year has acted as a one-time tax roughly equal to about 1% of disposable income and has altered consumer spending. Oil prices are expected to remain high but are not expected to rise further. Some analysts suggest that prices at this level will have little sustained effect on spending.




An end to, or perhaps a pause in, the historic bull market has also had a dampening impact on consumer spending. So far this year, the NASDAQ stock index has declined by 25.9%, while the Dow Jones Industrial Average and the Standard and Poor's 500 Index have decreased 6.7% and 6.1% so far this year, respectively. Stocks generally grew through March, at which point investors began to reevaluate earnings prospects, especially for high-tech companies. Since much of the recent consumer spending has been driven by the accumulated wealth in the markets, the increasing volatility and declining returns have made consumers more cautious regarding future spending. This is reflected also in the latest consumer confidence surveys, which show deterioration in consumer confidence from the lofty levels reached in late 1999 and early 2000.

Despite the uncertainties surrounding the stock markets, consumer spending is expected to grow at a relatively respectable rate in 2001 and 2002. Personal consumption spending is forecast to rise about 3.0% over the next two years, about half the rate in either 1998 or 1999. The civilian unemployment rate remains the lowest in a generation and has supported personal income and consumption growth. A small decrease in employment growth may serve to dampen although not diminish consumers' spending.

*Risks to the Forecast*

Several risks are apparent to the forecast entering the new year. First, gains in materials' costs, especially fuel oil are crucial to the forecast for inflation. Continued increases in energy, or other commodity costs, will result in higher product prices. To the extent that business owners anticipate higher costs, inflationary expectations will also increase. The Federal Reserve will fight hard to prevent the re-emergence of inflation by raising rates and reducing credit. Many economists believe that fuel oil prices will remain around $30 a barrel or perhaps slightly lower in the forecast period, and prices aside from energy seem to be contained.

Another concern is the decline of equity values since March, and the possibility that they may continue to fall, or simply stagnate. Should this occur it would remove one of the supports for consumer spending and at the very least dampen consumer expectations for future spending. Lastly is a fear that Chairman Greenspan cited in his Humphrey-Hawkins testimony this summer that the productivity gains the economy has enjoyed over the last several years wane, putting pressure on firms to raise prices to compensate for rising resource costs. This would likely increase inflation and reduce real growth.

The economy continues to surprise analysts both by the length of the business expansion and by its robust economic growth. Increases in interest rates in addition to rising inflation and uncertain financial markets make it unlikely that the economy will continue to exceed growth expectations in the future, especially given the age of this business cycle. Although most analysts don't expect a significant slowdown, they do anticipate a reduction in activity compared with previous years. Risks aside, a slower pace of economic activity more in line with the economy's potential of 3.0 to 3.5% is the most likely case for 2001 and 2002.

Table 1
**Forecast of the U.S. Economy**
**Primary Indicators**

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|---|---|---|
| Real GDP (Billion $96 chained) | 7,543.8 | 7,813.1 | 8,159.5 | 8,515.7 | 8,875.8 | 9,333.4 | 9,643.8 | 9,996.1 |
| % Change | 6.9% | 3.6% | 4.4% | 4.4% | 4.2% | 5.2% | 3.3% | 3.7% |
| Federal Funds Rate - % | 5.84 | 5.30 | 5.46 | 5.35 | 4.97 | 6.24 | 6.50 | 6.40 |
| Yield on 10 Year Treasury Bond - % | 7.59 | 6.44 | 6.35 | 5.26 | 5.64 | 6.10 | 6.26 | 6.65 |
| CPI - % Change | 2.8% | 2.9% | 2.3% | 1.6% | 2.2% | 3.3% | 2.5% | 2.5% |
| Housing Starts (Million Units) | 1.360 | 1.47 | 1.47 | 1.62 | 1.68 | 1.59 | 1.43 | 1.44 |
| % Change | 5.3% | 8.1% | 0.0% | 10.2% | 3.7% | -5.4% | -10.1% | 0.7% |
| Light Vehicle Sales (Million Units) | 14.8 | 15.0 | 15.1 | 15.4 | 16.8 | 17.4 | 16.0 | 16.0 |
| % Change | 6.7% | 1.4% | 0.7% | 2.0% | 9.1% | 3.6% | -8.0% | 0.0% |
| Corporate Profits Before Tax (Billion $) | 668.4 | 726.4 | 792.4 | 758.1 | 822.9 | 946.1 | 979.2 | 1,032.1 |
| % Change | 16.6% | 8.7% | 9.1% | -4.3% | 8.5% | 15.0% | 3.5% | 5.4% |
| Total NonAgricultural Employment (Millions) | 117.2 | 119.6 | 122.7 | 125.8 | 128.8 | 131.5 | 133.1 | 134.8 |
| % Change | 5.9% | 2.0% | 2.6% | 2.5% | 2.4% | 2.1% | 1.2% | 1.3% |
| Unemployment Rate - % | 5.6 | 5.4 | 4.9 | 4.5 | 4.2 | 4.0 | 4.3 | 4.8 |
| Total Personal Income (Billion $) | 6,200.9 | 6,547.4 | 6,937.0 | 7,391.0 | 7,789.7 | 8,300.6 | 8,824.2 | 9,372.8 |
| % Change | 5.3% | 5.6% | 6.0% | 6.5% | 5.4% | 6.6% | 6.3% | 6.2% |

Sources: Economy.com - November 2000

# The Maryland Economy

As always, national trends will strongly affect Maryland's economy. The past three years have been the best of the 1990s by any measure. Employment growth was over 2.5% for each of the last three years, unemployment hit an all-time low of 3.5% in 1999, and personal income growth averaged over 6%. In some respects, 2000 is more of the same, with unemployment bottoming out at 3.0% in February and March before rising to 3.5% in August. Even better news is that in 1999 Maryland once again outperformed the U.S. economy. Marginally higher job growth, unemployment of 3.5% compared to 4.2% nationally, and personal income growth of 6.1% compared to the national figure of 5.4% indicate that Maryland has one of the better-performing economies in the country.

Maryland will not escape the slowdown, however. Higher fuel prices and interest rates and a volatile, stagnant stock market will bring Maryland growth from outstanding to merely respectable. Overall non-agricultural employment will slow from 2.5% in 2000 to 1.6% in 2001, before rebounding to 1.9% in 2002. Government-sector employment is no longer a drag on the State's economy, and manufacturing employment will stop its long-term decline. While growth in the finance, insurance and real estate sector will slow dramatically in 2000 and 2001, construction and service employment will remain strong. Personal income growth will be sustained by a continuing tight labor market, remaining at 6.2% in 2000 and 2001 before dropping slightly to 5.9% in 2002.

## Government

Government employment has long been an important factor in Maryland's economy. In 1982, the government sector (federal, state and local) totaled nearly 23.5% of employment in Maryland, but was only 17.7% of national employment. In 1999, this sector was down to 18.4% of Maryland employment, and 15.7% nationally. Growth in the government sector in Maryland over this period was 0.6%, compared to employment growth in the State of 2.1%. Recent performance, however, has been more robust, averaging over 2% the last two years.

Each of the three components of government employment have played a different role in this relatively strong performance. The federal payroll, which declined every year from 1991 through 1997 due to the Republican revolution, the "re-invention" of government and military reductions, increased in 1998 and 1999, and will do so again through 2000. State government employment, which declined in the early 1990s as a result of the fiscal crisis, and, after a brief respite, in 1996 and 1997 due to an early retirement program, resumed growth in 1998 and grew very strongly in 1999 at roughly 4%, with the bulk of the growth in areas of policy concern, including higher education, public safety (including juvenile justice) and human resources. Local government employment increased substantially over the last half of the 1990s, primarily through the hiring of teachers. Growth has slowed in 2000, partially as a result of a shortage of qualified teachers.

The outlook for government employment may well be stronger than it has been at any point since the 1980s. The federal, State, and many county governments have sizeable surpluses. The federal budget surplus is currently projected by the Office of Budget and Management to grow from $124.4 billion in federal fiscal year 1999 to $255.0 billion in 2004. Although the surplus may or may not develop to that magnitude, it is clear that the relative restraint in federal spending in the mid-1990s is over. Moreover, given statements from the major party candidates for President, it seems likely that federal spending on both defense and health research will increase substantially. As Maryland is a leader in health research and has a disproportionately high share of defense-related employment, federal employment will no longer be a substantial drag on Maryland employment. The biggest benefit to Maryland through the improved fiscal standing of the federal government, however, will likely accrue to the private sector.

The one clear downside in the federal sector is one that was entirely expected. With the completion of the 2000 Census, particularly the data-gathering work, roughly 2,500 full-time equivalent positions will be lost from the headquarters of that operation in Suitland and around the State. Federal employment growth was boosted by approximately two percentage points in 2000 because of the Census, but employment will decline commensurately in 2001. Moderate growth is expected to resume in 2002.

While much of the increase in State and local spending that the nearly one billion dollar State surplus of fiscal year 1999 allowed has been directed toward one-time capital expenditures such as expanding schools, these expenditures will nevertheless lead to an increase in employment. Partly to keep class sizes down, seventy-one schools received funding for construction or relocatable classrooms in the fiscal year 2001 capital budget. There is currently a shortage of teachers in many parts of the State, but the enactment of legislation providing for bonuses, tax credits and low-cost mortgages for teachers may alleviate that shortage. State employment will continue to grow, although at a more modest rate than when emerging from the early retirement program.

**Manufacturing**

The manufacturing sector decreased 0.6% in 1999 and is expected to rise by a small amount in 2000. Thereafter, employment in this sector is anticipated to be unchanged. The manufacturing sector continues to be a tale of two diverse and differing subsectors. Core manufacturing, including GM and Bethlehem Steel, have not participated in the growth of employment that the Maryland economy has enjoyed over the last several years. However, an increase in productivity due to the incorporation of new technology has actually enhanced revenues at these facilities.

GM discontinued its third shift at the Broening Highway plant this year, resulting in lower employment, and the future remains uncertain. Last year, GM extended its commitment to produce Astro/Safari vans through 2001 at the Broening Highway plant. The Allison Transmission Plant in White Marsh is expected to begin operating in January 2001 and will be adding 400 new workers. In addition, Allison has announced a doubling of its capacity to total 800,000 square feet and 800 worker, although the expansion has been delayed until 2004.

Bethlehem Steel has also added a new cold sheet mill to the facility at Sparrow's Point, producing cold rolled sheets for metal construction and appliance industries. The new mill employs about 300 people. However, net new employment at Sparrows Point has been unchanged due to the announcement of a job cut of 300 in September. Bethlehem Steel now employs about 4,300 people.

Other manufacturing firms have reconfirmed their commitment to Maryland. Crown Cork & Seal Co. has leased more than 300,000 square feet of warehouse space, which will be used as a distribution center. Clorox has also recently finalized an agreement to employ an additional 200 to 300 people in Harford County and will lease 650,000 square feet of space for a Northeast distribution center. Domino Sugar will invest roughly $21 million to upgrade its Inner Harbor plant, adding an extra shift to its workforce.

Northrup/Grumman is to some extent representative of what's happening to the rest of the Maryland manufacturing sector. The Electronic Sensors and Systems Sector of Northrup/Grumman is located in Linthicum, taking advantage of Maryland's growing high-tech labor force. Grumman has recently won several major government contracts to supply radar, intercom and information systems. Although major manufacturers are reducing employment or, at best, holding steady, smaller high-tech firms are increasing employment.

Activity in the manufacturing sector includes new developments in the high-tech and biotech areas. Currently, there are about 113,000 workers employed in private-sector high-tech industries and according to a report by MdBio, Inc. more than 40,000 people are employed by Maryland's 244 bioscience companies. Corvis Corp., the Columbia fiber-optics equipment manufacturer, has recently expanded in the Howard county area, and Celera Genomics Group recently made headlines when it announced this summer that it had discovered how to map a human genome sequence. A European biotechnology company, Qiagen N.V., announced that the company would build a 190,000 square-foot facility in Germantown to accommodate 300 employees in 2002. Until and unless these high-technology and biotechnology companies come into their own, manufacturing in Maryland is unlikely to contribute to economic growth in the State.

### Construction

Employment growth in the construction sector increased at a rate of 6.6% in 1999, behind only the finance sector and more than double the rate of Maryland employment growth. A number of factors spurred this sector forward in 1999, including record low mortgage rates in 1998 and the early part of 1999 and an extremely tight market for office space, with low vacancy rates which haven't been seen since the mid-1980s.

*Commercial and Industrial Construction*

Commercial and industrial construction activity remains strong despite the rise in interest rates. Vacancy rates for office space in downtown Baltimore have increased slightly through mid-2000 to 10.4%, although the rate for class A office space has declined from 4.5% to 3.9% over the first six months of the year. Rental rates for class A space have exceeded $30 per square foot along Pratt Street and other downtown areas for the first time. The market is so tight that firms looking to expand are having to consider suburban locations. While some office development is planned, including at Light and Redwood Streets, at the Lockwood site on Pratt Street, and at the Power Plant, the downtown market is constrained by the lack of real estate available for development. There are only 557,000 square feet of office space currently under construction in the city, none of it in the central business district and none of it class A space. This amount will only increase available office space by 4%.

While there will not be much construction of office space in downtown Baltimore, there will be other construction activity in the city. A recent report indicated that the downtown area requires at least 3,500 additional parking spaces; this shortage is now a major concern of downtown employers. Currently, at least four parking garages are at various stages of planning, which are expected to add over 1,700 spaces by the end of 2001. A number of hotels for the city continue to be discussed, although not as many as at this time last year. The 750-room Marriott Waterfront Hotel in the Inner Harbor is about half complete, and may be finished by the end of the year. There is growing pressure to begin work on a hotel at a Pratt Street site near the convention center and Oriole Park. The City recently broached the idea of publicly funding the hotel so as to get work underway.

The tight office market in Baltimore and lack of parking have enhanced the building boom in the Baltimore-Washington International Airport (BWI) area. The office vacancy rate increased from 7% to 8.2% in the first half of 2000, but this is partly a result of the completion of 255,500 square feet of space, about three-quarters of which is class A space. An additional 230,000 square feet is currently under construction, all of which is class A. Industrial space is increasingly in demand, with much of the new construction in the State occurring in this area. Speculative construction of both office and industrial space continues, including the planned 612,000 square foot BWI Technology Park. New firms continue to move into the area, including high-tech and distribution companies.

The Maryland Aviation Administration recently announced a variety of improvements to BWI itself, including improving vehicular and pedestrian access to the airport, expanding the terminal by 243,000 square feet, building a 7,000 space parking garage, consolidating rental car activities to one facility, and potentially adding an intermodal transportation center. Along with the airport improvements, the influx of employers to the area and the opening of Arundel Mills Mall will result in a continuing development of shopping, eating and other establishments, transportation improvements, possibly even including an extension of light rail, and other ancillary development. Even if the construction sector in the rest of the State slows substantially, activity in this region will ensure continued employment growth over the next several years.

Activity will continue in other areas of the State as well. The Hagerstown area has a number of business and industrial parks under development. The area has recently been discovered as an ideal location for distribution centers. Staples, PetSmart and Lippincott publishers have already established distribution operations; a 300,000 speculative warehouse is now under construction. State officials are currently considering a plan to encourage speculative building to spur construction in the booming technology-oriented areas of the State. Work on the Woodrow Wilson Bridge has just begun. This project will cost upwards of $2 billion, and will help sustain the construction sector in the State through at least 2004.

*Residential Construction*

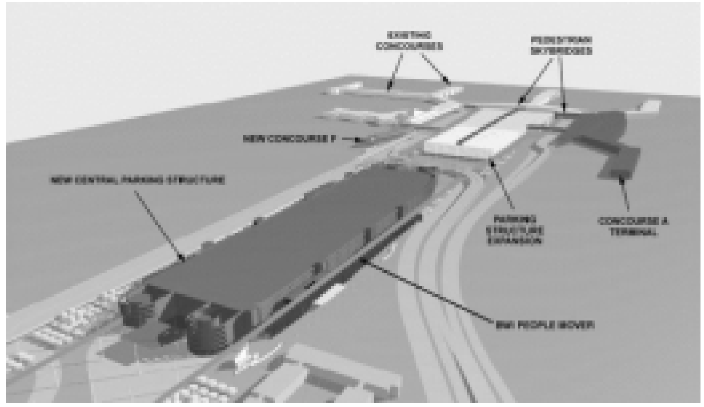
Although mortgage rates have increased to around 8% from their record lows near 6.5% over the past eighteen months, housing construction remains at relatively high levels. Housing starts, which increased by over 20% in 1998, declined by 0.9% in 1999 although single-family starts actually increased by 2.1%. Much of the new construction is in the luxury range, with homes of up to 24,000 square feet being built. With the economy showing some signs of slowing, reducing the likelihood of further interest rate hikes, housing starts are expected to remain at around 30,000 annually. It is possible that this sector will be less affected by interest rate changes than in the past since adjustable rate mortgages are now widely available.

Home improvement activities have also been very strong, with nationwide expenditures reaching record levels in real terms in 1999, 5% over the previous record. Homeowners are having difficulty finding available contractors, contractors are having difficulty finding available subcontractors, and subcontractors are having difficulty finding materials. In 1999, there was a severe shortage of drywall; this year, there is a severe shortage of brick. Further support of the strong home improvement activity is evidenced by the fact that Home Depot recently expanded the hours of operation at five of its Maryland stores to 24 hours a day. Although the construction sector is expected to slow from 6.6% growth in 1999 to 3.5% in 2002, it should remain one of the best performers in the Maryland economy over this period.

**Transportation**

Employment in the transportation sector grew by almost 5% in 1999, double the growth rate for the entire Maryland economy. So far this year employment growth has continued to be above average. Transportation employment is expected to grow about 2.3% in 2000 and slow thereafter. The strong growth in 1999 and 2000 is heavily influenced by developments at BWI which continue to enhance the airport's popularity compared with other airports in the region.

In August, BWI set the fourth consecutive monthly record for passengers traveling through the terminal, qualifying it as the nation's fastest growing airport and surpassing Dulles International Airport earlier in the year. A $1.8 billion capital expansion program will facilitate even more growth. The program includes expansion of the Southwest gates from 12 to 31 and the addition of Concourse F. A consolidated rental car facility and new parking spaces are also planned. When the expansion is complete, revenues are projected to double from about $150 million this year.



Proposed expansion of transportation facilities at BWI
Source: Maryland Aviation Administration

Southwest Airlines currently leads passenger traffic at BWI, followed by U.S. Airways. Together they provide about 80% of the service at the airport. By December, Southwest will operate 119 flights per day. New international service by Ghana Airways and Aer Lingus was initiated this year. The airport will also add to its cargo facilities over the coming year.

The joint acquisition of Conrail by CSX and Norfolk Southern has meant little additional traffic so far for Maryland and no additional employment. An expected pick-up in traffic this fall has failed to materialize, possibly due to a slowdown in manufacturing, especially for chemicals. Mild summer weather has also slowed demand. Recently, an increase in fuel costs has hurt the railroads, but long-term elevated prices could be beneficial for two reasons. First, transportation by rail is more fuel-efficient than by road, the major competitor, and second, a substitute fuel–coal–is best transported by rail.

The Port of Baltimore is the fourth largest on the East Coast and generates almost 145,000 direct and indirect maritime jobs. In September, the Port and ATC Logistics of Maryland opened the Masonville facility, which allows the Port to strengthen its market share in the Roll On/Roll Off (Ro-Ro) market. Its Ro-Ro share reached 46% of the East Coast market in 1999. It continues to dominate in the import of tractors and trucks and the export of automobiles. Baltimore also imports more wood pulp than any other U.S. port and growth in forest products soared 41% during the past year. This was highlighted by a decision by UPM-Kymmene and Mesta-Serla, both of Finland, who each decided to use the Port of Baltimore as their main destination for imported magazine-quality paper.

Several of the major challenges for the port include retaining its major shipping lines and keeping its labor costs under control. Technologically, the port is a leader and remains well ahead many of its nearby competitors. Last year, the Port of Baltimore handled almost

$20 billion worth of goods ranking it ninth in the U.S. in terms of value of cargo handled. Controversy exists as to whether the Chesapeake and Delaware Canal needs to be dredged to maintain the port's competitiveness; at least one shipping firm has suggested it may shift its business to Norfolk because of a delay in the federally-approved project.

**Utilities**

Deregulation has brought a tremendous amount of uncertainty and change to the utility sector. While these businesses may take advantage of deregulation and grow rapidly, there is certainly no guarantee that the Maryland-based companies will prosper; even if they do, with their market reach now nationwide, there is no guarantee that the Maryland economy will directly benefit. Nonetheless, the early signs are promising as Maryland firms seem to have joined the vanguard of deregulation despite a later start than was available to utilities in many other states.

Maryland's electric utilities have changed dramatically over the past year. Pepco has reached an agreement to sell almost all of its generating facilities, and BGE's have been transferred to Constellation Energy Group, which will shortly be separating from BGE. Similarly, Allegheny Energy has transferred its generating assets to its non-regulated affiliate, but at this point they plan to remain affiliated. Conectiv will continue to generate electricity, and has recently purchased 21 turbines. Their focus, however, is shifting to the "mid merit" market, which provides electricity for peak demand periods.

The utility aspect of these companies remains, in the form of a regulated distributor of electricity. These companies will also be brokers of electricity, whether or not they remain generators. They are all undertaking other energy management services such as maintenance and testing of generating and distribution systems and energy efficiency consulting. Further afield from electricity-related enterprises, BGE is a partner in Comfort Link, which opened its second chiller station in Baltimore, employing fifteen people. Pepco is partnering in a business-to-business procurement website and offering Internet access and local and long-distance telecommunications through its Starpower subsidiary. Conectiv and Allegheny Energy are also providing telecommunications and internet services through subsidiaries. Conectiv is a partner in Capstone Turbine, which manufactures turbines, and which has recently entered into a strategic alliance with a subsidiary of Allegheny Energy. In a similar vein, Washington Gas Light Company has reformed itself into WGL Holdings, which will still be regulated in its natural gas distribution. Its unregulated side will market natural gas and electricity, design and build heating, ventilating and air conditioning systems, provide consumer finance, and develop real estate.

Consolidation and competition will result in job losses in these areas, particularly in the aspects of this sector directly related to the old regulated businesses. These losses will be offset to a degree by the new ventures undertaken and supported by these companies. More importantly, the dynamism and efficiencies generated by these changes may have a substantial impact on the State in the longer term. These dramatic changes to the utility sector are expected to result in modest job losses in 2000 and 2001, before stabilizing in 2002.

The communications sector is likewise undergoing rapid change as a result of both deregulation and the Internet. The recent merger of Bell Atlantic and GTE into Verizon will have a tremendous impact on the operations of a long-time Maryland institution. Since a large amount of infrastructure and customer service needs will remain, and since neither Bell Atlantic nor GTE had major management operations in Maryland, the impact on Maryland employment should not be substantial. The Verizon strike, however, did have a modest impact on Maryland employment in August, with over 8,000 individuals on strike for nearly a month.

The convergence of telecommunications, cable, and Internet companies is continuing. The cable company Comcast added 250 jobs at its regional headquarters in Silver Spring this year, and will provide content to Web-On-Site, a Baltimore-based firm which places Internet kiosks in public areas. Verizon has also teamed with Web-On-Site to provide DSL service to Web-On-Site's outlets. Comcast is investing heavily in infrastructure throughout the State, as are many other communications firms. While the mergers and consolidations in this area make employment losses likely, the economic activity in this sector will be large, and will improve the performance of virtually all other segments of the economy.

**Retail**

In 1999, retail employment grew about 1.7% in Maryland compared with an increase of 2.5% for all sectors of the Maryland economy. Retail represents about 20% of total Maryland employment and is the second largest sector in the state. Employment is expected to grow about 2.5% in the retail sector in 2000, and will slow to 1.0% and 1.4% in 2001 and 2002. Acceleration in retail employment growth this year is partially attributed to the grand opening of the Arundel Mills Mall near BWI on November 17. When complete, the 1.4 million square foot mall is expected to employ over 3,000 people. The mall will be opening in two stages and is expected to house 15 to 18 anchor tenants and 200 specialty retail stores. It will be the biggest mall in the area, followed by the newly expanded Columbia Mall.

The long awaited Bowie Town Center has also opened this year after being converted from a closed mall. The "de-malling" or renovation of formerly closed and aging malls is also planned for Westview, Hunt Valley, North Plaza and Golden Ring Malls. Other stores continue to expand in this area including Kohl's and Lowe's which are remodeling some of their old stores. Of course, the largest retailers in the area continue to be Wal-Mart, Sears, Kmart, Target and J.C. Penney.

E-retailing continues to grow, especially for the smaller retailers. Internet shopping has totaled about $31 billion so far this year, including about $4.2 billion in September as reported by the NRF/Forrester Online Retail Index. E-retailing still represents a small portion of total national sales at about 2%. The future impact of the Internet on retailing is debatable. A number of smaller Internet retailers folded in March; most of the larger e-retailers are still losing money.

Some have speculated that when the bricks-and-mortar retailers start selling over the Internet, they would have a large advantage. This may or may not be the case–in April, Prime Retail, the owner of several outlet malls in the State and elsewhere, closed its on-line store after being unable to find a buyer. On the other hand, Giant Food has recently announced a partnership with Peapod, a top Internet grocer. Although there are many advantages to doing retail business over the Internet, companies are discovering there are disadvantages as well.

In an effort to boost retailers in the State, the General Assembly adopted a sales tax holiday, or "tax-free week." Maryland sales taxes will be suspended on the sale of clothing and footwear for the week of August 10 through August 16, 2001, if the taxable price of the item is less than $100. Maryland is one of several states to experiment with the sales tax holiday. Other states include New York, Florida and Texas.

**Finance, Insurance and Real Estate**

Employment in financial services grew 3.9% in 1999, well above the growth of total employment in Maryland. Growth is expected to slow significantly this year to 0.7% after several years of above average growth, and then remain below average.

Employment growth in 1998 and 1999 reflects the excellent financial conditions experienced nationwide up until early this year. Although the Federal Reserve began raising interest rates in June 1999, the economy continued to perform well and real GDP rose over 5.2% through June 2000. The Dow-Jones Industrial Average actually peaked at over 11,700 in-mid January. In this environment, financial firms were busy and apt to add to their staffs. Since January, the Federal Reserve has raised the Federal Funds Rate another percentage point and the DJIA has remained between 10,000 and 11,000. Home sales have slowed and consumers and businesses have become a bit more cautious.

The outlook for Maryland's financial sector includes a consolidated and slowing banking sector balanced by somewhat brighter prospects for nonbanking financial institutions given the national outlook for a stable Fed and less volatile financial markets. Banking mergers and consolidations continued in 2000, including the acquisition of Frederick County National Bank by Branch Bank and Trust. Patapsco Bancorp Inc. agreed to buy Northfield Bancorp Inc. in May and F & M National Corp. agreed to buy Community Bankshares of Maryland.

Many of these combinations have shifted jobs to the South, especially to Virginia and South Carolina. At best, employment has held steady in Maryland. The largest federally chartered banks in Maryland, *e.g.*, Allfirst and Mercantile, have remained solid and have tried to grow not only by expanding branches but increasing their breadth of services.

Some local banks have eliminated services to concentrate on their core businesses. For example, both Provident Bankshares and Carrollton Bank have phased out their mortgage business after reporting disappointing earnings. Also another sign of the times, many banks have announced buy-back programs to improve their balance sheets and competitive positions. Columbia Bankcorp, the holding company for The Columbia Bank, was one of the latest banks to announce a stock repurchase program.

On the other hand, nonbanking institutions and brokerages have done well and continue to expand their assets under management despite a not so positive market outlook. Legg Mason has moved to the U.S.F & G. building on Light Street to obtain more space for its operations, and continues to solidify its position in the business of retirement planning by acquiring small institutional money managers across the country. T. Rowe Price is expanding its service operations in Owings Mills and has doubled the size of its investment center downtown. Price is also awaiting permission to open a savings bank under the bank holding company name of the T. Rowe Price Group Inc. Combinations between regional brokerages and other nonbank financial institutions are likely, resulting in a blurring of the traditional banking boundaries and possibly reducing local employment as operations are consolidated.

Real estate had a banner year in 1999, including both residential and nonresidential activity. Wealth generated by the stock market and technology companies has been invested in luxury homes. Low vacancy rates and solid income growth have combined to encourage demand and raise property values. The large number of new and expanding businesses has generated a great deal of activity in the BWI area, the I-270 corridor and elsewhere.

**Services**

Service employment grew a robust 3.5% in 1999 and healthy growth is expected throughout the forecast period. Over one of every three jobs is a service job, and more than 40% of new jobs are in this sector. Business and health services are the two largest components of the service sector.

Business services include building maintenance, personnel services and computer and data processing services. Business services grew over 5.0% in 1999 and employment growth is expected to be robust. Technology-related services are providing much of the growth. USInternetworking, a provider of Internet-based business solutions based in Annapolis, is the fastest-growing publicly-held company in the State. Business service employment will be given a further boost by the contracting out of certain telecommunications and computer services by the National Security Agency (NSA). These roughly 1,000 positions will appear to be a net gain in Maryland employment, since positions at the NSA are not included in official employment statistics.

Employment in health services rose only 1.0% in 1999, including a small increase in hospital employment. The consolidation of local hospitals has put pressure on employment growth in Maryland, with many hospitals projecting operating losses for the year. Between last year's reimbursement rate rollback of 1%, a nursing shortage, and increasing pharmaceutical costs, hospitals have had to adapt and seek ways to become profitable. MedStar Health has taken over Georgetown University Medical Center's clinical operations and has cut its own physicians group and reduced its staff. MedStar, which operates four hospitals in Baltimore and two in Washington, is the fifteenth largest community-owned, not-for-profit health care system in the country. Harford hospitals have combined medical staffs in anticipation of opening the new Upper Chesapeake Medical facility, while St. Joseph's announced that it would trim its pediatric unit.

Some good things are happening in the medical field however. Some procedures such as laser eye surgery and reconstructive surgery have been growing rapidly. Also, Franklin Square Hospital Center plans to build a $10.3 million cancer center as part of a strategy to beef up its cancer research efforts, and Sinai Hospital expects to expand its ER-7 emergency center.

Educational services are doing very well. For example, Sylvan Venture will boost growth in the area by as many as 2,000 jobs by investing in companies dealing in internet solutions in the education and training marketplace. Tourism, another potential source of growth for the state, is also doing well with current growth of 3.5%. According to the Travel Industry Association of America, nearly 20 million visitors spent $6.5 billion in Maryland in 1998, and that figure is not expected to decline until the economy slows.

**Agriculture and Fisheries**

This sector of Maryland's economy has experienced more than its share of problems over the past few years. From record low commodity prices to *pfisteria* to drought, the news of the late 1990s has not been good. The tide seems to have turned in 2000, however. Early-season rains got the growing season off to a good start, and there has been no serious presence of *pfisteria* for two years. Despite improving conditions, some problems persist.

About 15.3 million pounds of crabs were landed through September 2000, a record low and a decline of 35% from the same period in 1999. Crab prices increased by over 25%, however, leading to a market value of $24.7 million, only 18% lower than the prior year. The oyster harvest has been relatively constant over the past few years at about 300,000 bushels, or 2.5 million pounds of meat valued at about $7 million. The commercial finfish catch has been relatively constant as well, at 15.7 million pounds in 1998 and 15.8 million pounds in 1999, although the market value increased from $8.6 million to $9.2 million. The rockfish catch, roughly 15% of the total fish catch but 40% of the market value, declined 8% in 1999, but the value increased by 12%.

Production of corn, soybean and tobacco may hit record levels in 2000 after a dismal 1999 in most areas of the State, although other grains are not doing as well. Unfortunately, prices for most agricultural products remain at low levels and, when adjusted for inflation, are at all-time low levels for a number of products. Tobacco is one of the few products not selling at relatively low prices, but tobacco clearly does not have a future in Maryland. The State is offering a buyout plan to tobacco farmers, funded with 5% of the money from the tobacco industry settlement. In many cases, farmers could make more from the buyout than from producing tobacco. The program will require an appropriation each year; even if it is not funded, tobacco will continue to decline. Current production in the State is about 25% of that from the early 1980s.

While income from the agricultural sector will certainly be higher in 2000 than in 1999, the benefit to the State will not be large as this sector accounts for less than 1% of gross state product. Gains in 2001 and 2002 are less likely, due to the excellent growing conditions for many crops in 2000.

Table 2

**Forecast of the Maryland Economy**

| CALENDAR YEAR | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|---|---|---|
| Total Personal Income (Million $) | 135,116 | 140,809 | 148,827 | 158,264 | 167,896 | 178,283 | 189,410 | 200,531 |
| % change | 4.1% | 4.2% | 5.7% | 6.3% | 6.1% | 6.2% | 6.2% | 5.9% |
| Total NonFarm Employment (Millions) | 2,182.4 | 2,211.9 | 2,266.5 | 2,323.2 | 2,381.8 | 2,441.5 | 2,481.5 | 2,528.0 |
| % change | 1.7% | 1.3% | 2.5% | 2.5% | 2.5% | 2.5% | 1.6% | 1.9% |
| Wages and Salaries | 67,776 | 71,144 | 76,241 | 81,622 | 87,126 | 93,116 | 99,272 | 105,189 |
| % change | 4.5% | 5.0% | 7.2% | 7.1% | 6.7% | 6.9% | 6.6% | 6.0% |
| Proprietors' Income | 7,721 | 7,788 | 8,140 | 8,814 | 9,508 | 10,185 | 10,812 | 11,409 |
| % change | 7.8% | 0.9% | 4.5% | 8.3% | 7.9% | 7.1% | 6.2% | 5.5% |
| Dividends, Interest, and Rent | 24,835 | 26,301 | 28,406 | 30,249 | 31,609 | 33,721 | 36,186 | 38,869 |
| % change | 5.5% | 5.9% | 8.0% | 6.5% | 4.5% | 6.7% | 7.3% | 7.4% |
| Transfer Payments | 14,372 | 15,280 | 15,924 | 16,338 | 16,959 | 18,089 | 19,405 | 20,661 |
| % change | 4.8% | 6.3% | 4.2% | 2.6% | 3.8% | 6.7% | 7.3% | 6.5% |
| Unemployment Rate (%) | 5.1 | 4.9 | 5.1 | 4.5 | 3.5 | 3.3 | 3.6 | 4.0 |
| Housng Starts (thousands) | 27.2 | 25.5 | 25.0 | 30.3 | 30.0 | 29.7 | 30.1 | 30.8 |
| % change | -4.7% | -6.1% | -2.0% | 21.1% | -0.9% | -1.1% | 1.5% | 2.4% |

## Maryland General Fund Revenues

In preparing these estimates, all of the State's revenue collecting agencies were consulted. In addition, the Board continued to rely on the Revenue Monitoring Committee, made up of key State staff with revenue estimating or collection responsibility or knowledge, which it had appointed in 1992. The Committee compared and considered alternative economic forecasts made by economists at the University of Maryland and Towson University and by the national consulting firms Standard & Poor's DRI and Economy.com (formerly Regional Financial Associates).

Additionally, the Board of Revenue Estimates considered the advice and recommendations of the Business Advisory Panel. The Panel, comprised of representatives from various sectors of the economy and regions of the State, was consulted on the economic outlook. The Board of Revenue Estimates has incorporated the advice of the Business Advisory Panel into the economic assumptions that underlie the revenue forecast.

Table 3 shows detail on general fund and selected special fund revenue sources for fiscal years 2000 through 2002. Table 4 provides further detail on general fund revenues. The following sections of this report provide detail on each of the State's general fund revenue sources.

Table 3

**Selected Revenues**

Fiscal Years 2000 - 2002

| $ Thousands | GENERAL FUND | | | SPECIAL FUND | | | TOTAL | | |
|---|---|---|---|---|---|---|---|---|---|
| | Fiscal Year 2000 Actual | Fiscal Year 2001 Revised Estimate | Fiscal Year 2002 Estimate | Fiscal Year 2000 Actual | Fiscal Year 2001 Revised Estimate | Fiscal Year 2002 Estimate | Fiscal Year 2000 Actual | Fiscal Year 2001 Revised Estimate | Fiscal Year 2002 Estimate |
| INCOME TAXES | | | | | | | | | |
| Personal | 4,746,341 | 5,065,999 | 5,282,803 | | | | 4,746,341 | 5,065,999 | 5,282,803 |
| Corporation | 319,454 | 349,033 | 341,032 | 95,418 | 98,952 | 105,348 | 414,872 | 447,985 | 446,380 |
| Total | 5,065,795 | 5,415,032 | 5,623,835 | 95,418 | 98,952 | 105,348 | 5,161,213 | 5,513,984 | 5,729,183 |
| SALES AND USE TAXES | 2,478,539 | 2,647,691 | 2,776,432 | 18,991 | 19,000 | 19,500 | 2,497,530 | 2,666,691 | 2,795,932 |
| STATE LOTTERY RECEIPTS | 367,763 | 383,403 | 384,307 | 45,080 | 46,121 | 50,117 | 412,843 | 429,524 | 434,424 |
| TRANSPORTATION REVENUES | | | | | | | | | |
| Motor Vehicle Fuel Tax | 11,275 | 11,299 | 11,720 | 620,311 | 626,901 | 649,980 | 631,586 | 638,200 | 661,700 |
| Motor Vehicle Licenses, Fees | | | | 323,765 | 321,266 | 322,602 | 323,765 | 321,266 | 322,602 |
| Motor Vehicle Titling Tax | | | | 604,482 | 622,000 | 625,000 | 604,482 | 622,000 | 625,000 |
| Mass Transit Fees | | | | 102,084 | 98,640 | 103,705 | 102,084 | 98,640 | 103,705 |
| Maryland Port Fees | | | | 74,498 | 75,513 | 76,536 | 74,498 | 75,513 | 76,536 |
| State Aviation Fees | | | | 135,327 | 130,139 | 121,160 | 135,327 | 130,139 | 121,160 |
| Total | 11,275 | 11,299 | 11,720 | 1,860,467 | 1,874,459 | 1,898,983 | 1,871,742 | 1,885,758 | 1,910,703 |
| PROPERTY TAXES, FRANCHISES, ETC. | | | | | | | | | |
| State Real and Personal Property Tax | | | | 252,014 | 258,721 | 266,574 | 252,014 | 258,721 | 266,574 |
| Property Transfer Tax | | | | 99,205 | 97,679 | 101,831 | 99,205 | 97,679 | 101,831 |
| Corporation Franchises and Filing Fees | 178,688 | 169,667 | 171,766 | | | | 178,688 | 169,667 | 171,766 |
| State Tobacco Tax | 210,012 | 194,984 | 187,757 | | | | 210,012 | 194,984 | 187,757 |
| Tax on Insurance Companies | 172,491 | 177,154 | 182,035 | | | | 172,491 | 177,154 | 182,035 |
| Alcoholic Beverages Excises | 24,399 | 24,678 | 24,963 | | | | 24,399 | 24,678 | 24,963 |
| Death Taxes | 157,039 | 142,362 | 133,229 | | | | 157,039 | 142,362 | 133,229 |
| Clerks of the Court | 37,713 | 39,472 | 39,024 | | | | 37,713 | 39,472 | 39,024 |
| District Courts | 70,349 | 72,150 | 73,936 | | | | 70,349 | 72,150 | 73,936 |
| Hospital Patient Recoveries | 102,113 | 71,145 | 66,361 | | | | 102,113 | 71,145 | 66,361 |
| Interest on Investments | 128,391 | 123,705 | 82,513 | | | | | | |
| Miscellaneous Fees, Other Receipts | 215,552 | 175,608 | 172,374 | | --- See Notes --- | | | --- See Notes --- | |
| Transfers | 0 | 0 | 0 | | | | | | |
| Total | 1,296,747 | 1,190,925 | 1,133,958 | | | | | | |
| | | | | | --- See Notes --- | | | --- See Notes --- | |
| GRAND TOTAL | 9,220,119 | 9,648,350 | 9,930,252 | | | | | | |

Notes: Includes all general fund revenues, all Transportation revenues and selected special fund taxes
In conjunction with Appendix B of the Fiscal Year 2000 Budget Book, this table comprises the official estimate of total state revenues

Table 4

**Maryland General Fund Revenues**

Fiscal Years 1998 - 2002

| $ Thousands | FY 1998 Actual | FY 1999 Actual | FY 2000 Actual | FY 2001 Official Estimate | FY 2001 Revised Estimate | FY 2001 Difference | 2002 Estimate |
|---|---|---|---|---|---|---|---|
| INCOME TAXES: | | | | | | | |
| Personal | 4,156,142 | 4,296,248 | 4,746,341 | 4,865,934 | 5,065,999 | 200,066 | 5,282,803 |
| Corporation | 268,630 | 306,050 | 319,454 | 337,432 | 349,033 | 11,601 | 341,032 |
| Total | 4,424,772 | 4,602,297 | 5,065,795 | 5,203,366 | 5,415,032 | 211,666 | 5,623,835 |
| SALES AND USE TAXES | 2,161,152 | 2,299,265 | 2,478,539 | 2,606,470 | 2,647,691 | 41,221 | 2,776,432 |
| STATE LOTTERY | 362,515 | 352,175 | 367,763 | 371,823 | 383,403 | 11,580 | 384,307 |
| FRANCHISES, EXCISES, LICENSES, FEES: | | | | | | | |
| Business Franchise Taxes | 177,319 | 173,571 | 178,688 | 170,905 | 169,667 | (1,238) | 171,766 |
| Tax on Insurance Companies | 172,662 | 177,788 | 172,491 | 191,173 | 177,154 | (14,019) | 182,035 |
| Insurance Licenses and Fees | 12,584 | 12,073 | -- | -- | -- | -- | -- |
| Death Taxes | 127,832 | 129,694 | 157,039 | 119,095 | 142,362 | 23,267 | 133,229 |
| Tobacco Tax | 128,272 | 128,915 | 210,012 | 195,533 | 194,984 | (549) | 187,757 |
| Alcoholic Beverages Excise Tax | 23,939 | 23,908 | 24,399 | 24,692 | 24,678 | (14) | 24,963 |
| Motor Vehicle Fuel Tax | 10,911 | 11,884 | 11,275 | 11,344 | 11,299 | (45) | 11,720 |
| District Courts | 66,084 | 71,079 | 70,349 | 74,900 | 72,150 | (2,750) | 73,936 |
| Clerks of the Court | 38,926 | 41,771 | 37,713 | 40,084 | 39,472 | (612) | 39,024 |
| Hospital Patient Recoveries | 64,402 | 159,212 | 102,113 | 63,483 | 71,145 | 7,662 | 66,361 |
| Interest on Investments | 76,807 | 104,711 | 128,391 | 88,597 | 123,705 | 35,108 | 82,513 |
| Miscellaneous | 203,163 | 236,023 | 215,552 | 163,939 | 175,608 | 11,669 | 172,374 |
| Total | 1,102,900 | 1,270,630 | 1,308,022 | 1,143,745 | 1,202,224 | 58,479 | 1,145,678 |
| GRAND TOTAL | 8,051,340 | 8,524,367 | 9,220,119 | 9,325,405 | 9,648,350 | 322,945 | 9,930,252 |

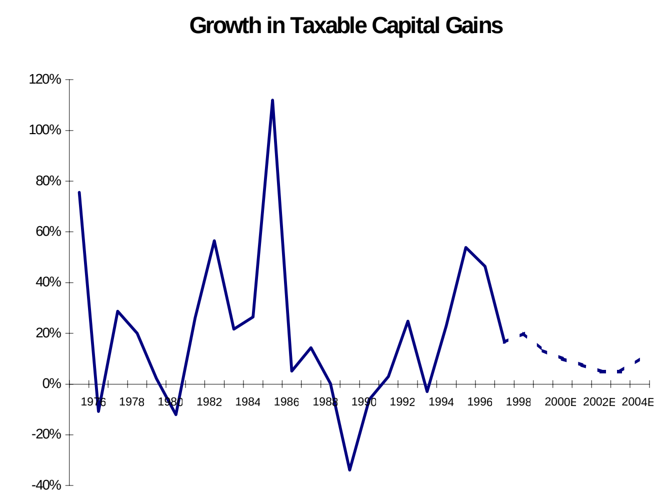
## Personal Income Tax

Net personal income tax revenues credited to the general fund increased by 10.5% in fiscal year 2000, after an increase of 3.4% in fiscal year 1999. As described below, the rate of growth in both years was affected by the 10% income tax reduction which was enacted in 1997. Growth is forecast to slow in fiscal years 2001 and 2002, to 6.7% and 4.3%, as the tax reduction continues to phase in and the State's economy slows. Baseline growth, however, is expected to grow at a relatively healthy 7.6% and 6.7% for those two years, a slowdown from the 10.9% average annual growth from 1998 through 2000, but well ahead of the 4.0% growth averaged for the remainder of the 1990s. In other words, as with the State's economy, when compared to the past three years this growth seems somewhat sluggish, but when looked at from a longer-term perspective growth remains robust.

Pre-tax reduction withholding receipts, which represent over 85% of net State and local income tax collections and are tied most directly to the economic health of the State, are expected to grow at 6.9% in fiscal year 2001 and 6.3% in 2002. Again, this is slower than the recent past, but still above the ten year annual average of 6.1% growth. Withholding is essentially a current indicator of what Maryland residents are earning, and generally reflects changes to wage and salary income. In recent years the relationship between wages and salaries and withholding has weakened slightly, because some types of stock options and bonuses are not included in the wage data but taxes are withheld from them. The Board forecasts wage and salary income growth to slow from 7.3% in fiscal year 2001 to 6.0% in fiscal year 2002.

Estimated income tax payments are expected to rise by 9.7% in fiscal year 2001, the first year with an increase below 10% since fiscal year 1996, and by 7.4% in fiscal year 2002. Estimated payments are largely related to taxable capital gains, which have become increasingly dominated by gains on stock investments. The income tax has performed much better than the estimates over the past four years, in large part because of the sizable increases in capital gains. Capital gains realizations are extremely volatile and have grown very strongly over recent years, increasing from $2.4 billion in 1995 to $7.8 billion in 1998.

Data from the Internal Revenue Service for 1999 will not be available until late Spring 2001, but early evidence leads the Board to estimate that capital gains will have increased by about 20% in 1999. Should that be the case, taxable gains will have risen 31% annually since 1995, and, given the recent performance of the stock



Source: Internal Revenue Service, Spring 2000 *SOI Bulletin* market, seem likely not to perform over the next few years as they have over the past few years. Capital gains are assumed to increase by 13.2% in 2000 (the 25-year annual average through 1998), 10% in 2001, and 7.5% in 2002.

The forecast of capital gains realizations is the most uncertain component of the revenue estimate. If gains should substantially exceed those estimated for any given year, it increases the likelihood that gains in succeeding years could be significantly lower than expected as the reservoir of unrealized gains shrinks.

A number of changes to the income tax have been enacted in recent years, including a refundable earned income credit, a subtraction for contributions to the State's prepaid tuition program, and a tuition tax credit for teachers. These and other recent State law changes reduce baseline collections by about $70 million in fiscal years 2001 and 2002. In addition, the Comptroller's Office began a refund offset program with the IRS in tax year 2000, capturing federal refunds for State and local income tax liabilities. This program generated $4 million in previously uncollected liabilities in fiscal year 2000. The offset program will be expanded beginning in fiscal year 2001, and should generate an incremental $6 million in receipts, $4 million of which will flow through to the general fund (the remainder represents local income tax liability).

The income tax reduction enacted in 1997 was initially to have reduced the State income tax by 2% each year from 1998 through 2002, at which point the reduction would be 10%. The tax reduction for 1998 was retroactively increased to 5%; the additional three percentage points of reduction for the first half of tax year 1998 affected final payments and refunds during the filing season for 1998, the last half of fiscal year 1999. Thus, fiscal year 1999 receipts were artificially depressed, resulting in an overstated growth rate for fiscal year 2000. Growth will slow from the 10.5% of 2000 to 6.7% and 4.3% in 2001 and 2002. The tax reduction, after a pause in tax year 2000, slows this growth as it increases to 8% in tax year 2001 and the full 10% in tax year 2002. After the tax reduction and other tax changes, general fund revenues are expected to total $5.1 billion in fiscal year 2001 and $5.3 billion in fiscal year 2002, as shown in Table 5.

Table 5

**Individual Income Tax Revenues**

Fiscal Years 1999 - 2002

($ in thousands)

| | 1999 Actual[1] | 2000 Actual[1] | 2001 Revised Estimate | 2002 Estimate |
|---|---|---|---|---|
| Gross Receipts (State & Local) | | | | |
| Withholding | 6,242,727 | 6,852,276 | 7,322,506 | 7,785,515 |
| Estimated Payments | 1,229,626 | 1,398,898 | 1,534,301 | 1,647,308 |
| Payments with Final Returns | 612,700 | 656,072 | 716,328 | 776,684 |
| Fiduciary | 52,308 | 67,406 | 80,763 | 89,968 |
| Total Gross Receipts | 8,137,361 | 8,974,652 | 9,653,899 | 10,299,476 |
| Refunds | (869,135) | (1,029,674) | (1,099,122) | (1,172,301) |
| Baseline Net Receipts | 7,268,226 | 7,944,978 | 8,554,777 | 9,127,175 |
| Loss from Federal Changes[2] | (13,610) | (13,560) | (15,990) | (19,600) |
| Net Receipts, State & Local | 7,254,616 | 7,931,418 | 8,538,787 | 9,107,575 |
| Local Reserve Account | (2,567,472) | (2,802,267) | (3,019,836) | (3,221,893) |
| Income Tax Check-offs | (1,064) | (1,073) | (1,000) | (1,000) |
| Net Receipts | 4,686,080 | 5,128,078 | 5,517,951 | 5,884,682 |
| State Tax Cut | (368,832) | (356,137) | (388,911) | (533,607) |
| Other Income Tax Legislation[3] | (21,000) | (25,600) | (63,041) | (68,273) |
| Net General Fund | 4,296,248 | 4,746,341 | 5,065,999 | 5,282,802 |

[1]For FY 1999 and 2000, the income tax components in the absence of the tax cut have been estimated and the estimated tax cut deducted to arrive at actual general fund revenues.

[2]Does not include induced capital gains receipts, which are included in gross receipts.

[3]Includes the refundable earned income credit and subtraction for higher education investment contracts, among others, as well as the refund offset program with the IRS.

## Corporate Income Tax Revenues

General fund revenues from the corporate income tax increased by 4.4% in fiscal year 2000, a substantial slowdown from the 13.9% growth of fiscal year 1999. Growth is expected to accelerate again in fiscal year 2001, however, to 9.3%, resulting in record high corporate income tax revenues of $349.0 million. This performance is certainly solid, and represents in part the strong growth of the economy over the past several years, but it also reflects the substantial changes that have been made to the corporate income tax over this time.

Since 1995, the corporate income tax base has been increased by almost 20% through the partial repeal of the financial institution franchise tax and the repeal of the subtraction for net income subject to the gross receipts tax which was available to telecommunications companies and public utilities. Although changes enacted in 2000 have a much smaller fiscal impact than the changes from other recent years, they include such important measures as the complete repeal of the financial institution franchise tax (an increase of $2.1 million in net receipts in fiscal year 2001, and $8.3 million in fiscal year 2002), and a tax credit for research and development (a loss of net receipts of $6 million annually beginning in fiscal year 2002). Additionally, the $3 per ton credit for Maryland-mined coal will be claimed against the corporate income tax for the first time beginning in fiscal year 2002, at approximately $2 million per year (although potential liability, if credits are claimed for all Maryland-mined coal, is up to $6 million).

Excluding these legislative changes, baseline growth in net receipts is estimated at 2.4% in fiscal year 2001 and a 2.7% decline in fiscal year 2002. Corporate profits are expected to tighten as a result of: a slowdown in consumer spending; the recent runup in interest rates; and increasing input prices, particularly for oil and to a lesser degree, wages and benefits. The impact on revenues of a slowing economy and lower corporate profits may be muted in Maryland, however, since manufacturing makes up only about 8% of its economy, half of the 16% nationwide. Thus, higher interest rates and energy prices may have less of an impact on Maryland corporations than in states with a stronger manufacturing base. Nonetheless, this revenue source will continue to remain volatile since corporations can carry back losses to lower their tax liability from past years.

Table 6
**Corporate Income Tax Revenues**
Fiscal Years 1999 - 2002
($ in thousands)

| | 1999 Actual | 2000 Actual | 2001 Revised Estimate | 2002 Estimate |
|---|---|---|---|---|
| Net Receipts before Leg. Changes | 368,868 | 375,741 | 384,842 | 372,319 |
| Financial Institutions | 21,000 | 21,000 | 21,000 | 21,000 |
| Telecommunications Reform | 11,600 | 16,000 | 16,800 | 17,640 |
| Electric Deregulation | 0 | 6,600 | 34,000 | 34,900 |
| 2000 Changes | 0 | 0 | 2,137 | 2,252 |
| Net Receipts | 401,468 | 419,341 | 458,779 | 448,111 |
| Transportation Trust Fund | 43,014 | 44,929 | 49,155 | 48,012 |
| Department of Transportation | 52,404 | 54,957 | 60,591 | 59,067 |
| Net to General Fund | 306,050 | 319,455 | 349,033 | 341,032 |

## Sales and Use Tax

For forecasting purposes, sales and use tax revenues are divided into six major components - consumer-related, construction-related, capital goods (store and office equipment, machinery and equipment, containers and miscellaneous manufacturing), utilities (including cellular phones), assessment collections and refunds.

Recent sales and use taxes have been very strong. In fiscal year 2000, revenues rose 8.6% following a 6.4% gain in fiscal 1999. A buoyant economy and rising consumer confidence and equity prices contributed to the rise in fiscal 2000 tax receipts. Real GDP growth averaged over 6% for the first three quarters of the fiscal year, including large gains in durable goods consumption and nonresidential fixed investment. This growth was uncharacteristically robust for this late in the business cycle. Growth was further enhanced by several legislative changes which increased Maryland disposable income, including the semi-annual property tax legislation (which resulted in one-time refunds from escrow accounts of mortgagees) and the federal income tax credit of $500 per child. Since early this year, however, consumer confidence has declined, the equity market has cooled and housing starts have declined from the high of 1.8 million units started in February to 1.5 million in October. As a result of this slowdown, sales and use tax revenues are expected to rise 6.8% in fiscal year 2001 and about 4.9% in 2002.

The consumer portion of the sales tax, about two-thirds of the total, grew by 7.0% in fiscal year 2000, the best performance since fiscal year 1993 when Maryland was emerging from the recession. Growth from this category is expected to soften to 6.3% in fiscal year 2001 and 3.7% in 2002, as income growth slows and consumer confidence recedes from its recent all-time highs. Growth would have been estimated at 4.0% in 2002 were it not for the tax-free week enacted in 2000. Sales of clothing and footwear under $100 will be exempt during the week of August 10, resulting in a revenue loss of $6.7 million.

Revenues attributable to the collection of taxes from the sale of construction supplies rose 9.4% in fiscal 2000 but are forecasted to increase 3.8% in fiscal 2001 and 4.8% in 2002. This is the second largest category of sales tax revenue providing about 15% of the total. The outlook for residential construction is sluggish, as mortgage rates are expected to hover around 8%, but nonresidential construction activity in the State is expected to remain relatively strong. Continued spending on State projects should help sustain the growth in this cyclical component.

The capital goods component has been driven by strong increases in spending on computers in recent years, averaging 8% to 10% over the last ten years. Capital goods growth is expected to slow over the next two fiscal years as hardware purchases slow and Maryland employment softens. The tax exemption for tangible personal property used in a production activity will be fully effective in fiscal year 2001, and will thus not restrain growth as it has over the past three years. This category is expected to surge 9.2% in fiscal 2001 and by 6.4% in 2002.

The utility segment of the sales tax has been the best-performing over the last two years, with growth of 11.8% in fiscal year 1999 and 18.7% in fiscal year 2000. Almost all of this growth is in the communications category, which comprise about two-thirds of total utility revenue. Spending on communications infrastructure, including upgrades to fiber-optic cable from copper wire and digital switching equipment rather than mechanical equipment, as well as sales of cellular phones and service, continue to support growth in this category. Even though revenue growth of the other one-third of this category is nearly flat, the utility sector is expected to grow at a 10.6% rate in fiscal year 2001 and 12.3% in fiscal year 2002.

Sales tax assessments are expected to remain at about $15 million in the forecast period, while refunds will fall from the 2000 level of $23.5 million, providing a boost to revenues. In addition, the Transportation Trust Fund will receive an estimated $19.0 million from its 45% share of the sales tax revenue from rental vehicles, increasing to $19.5 million in 2002.

After adjustments for legislative changes, assessment and refunds, sales and use tax receipts are expected to increase 6.8% in fiscal year 2001 to $2,648 million and 4.9% in fiscal year 2002 to $2,776 million as shown in Table 7.

Table 7
**Sales and Use Tax Revenues**
Fiscal Years 1999 - 2002
($ in thousands)

| | 1999 Actual | 2000 Actual | 2001 Revised Estimate | 2002 Estimate |
|---|---|---|---|---|
| Consumer | 1,535,849 | 1,659,505 | 1,763,463 | 1,828,578 |
| Construction | 332,668 | 363,905 | 377,630 | 395,671 |
| Capital Goods | 266,719 | 281,787 | 307,835 | 327,593 |
| Utilities | 167,652 | 199,030 | 220,112 | 247,284 |
| Net Collections | 2,302,888 | 2,504,227 | 2,669,040 | 2,799,126 |
| Assessments | 12,910 | 16,747 | 15,000 | 15,000 |
| Refunds | (16,532) | (23,453) | (17,349) | (18,194) |
| Transportation Trust Fund | 0 | (18,991) | (19,000) | (19,500) |
| Total General Fund | 2,299,266 | 2,478,530 | 2,647,691 | 2,776,342 |

## Lottery

Lottery sales increased a strong 8.6% in fiscal year 2000, the third consecutive annual increase and the best performance since fiscal year 1994. Even though sales grew 8.6%, total net revenue only increased by 2.0%. The weak revenue growth relative to the outstanding sales performance was due primarily to higher payouts than statistically expected for Pick 4 and the planned higher payouts for instant tickets as well as a full year of increased commissions on instant tickets for lottery vendors.

Pick 3 sales declined 1.5% in fiscal year 2000, continuing the pattern of decreasing annual sales, a pattern which is expected to continue. Pick 3 had the highest sales of any lottery game every year through 2000, but should be surpassed by Keno in fiscal year 2001. Revenue from Pick 3 decreased 6.8% in fiscal year 2000, but is expected to decline only 4.1% in 2001 and 3.6% in 2002. Pick 4 sales rose 6.1% in fiscal year 2000 but revenue decreased 4.8%. The estimates call for a revenue increase of 22.0% in Pick 4 in fiscal year 2001 as payouts return to normal levels, and a small increase of 1.9% in fiscal year 2002.

The instant lottery has been growing strongly over the last couple of years. A move to higher payout, higher priced games helped boost sales by 25.4% in fiscal year 2000. Sales through the first five months of fiscal year 2001 show continued double-digit growth on top of the strong 2000 performance; 10.0% growth is estimated for 2001, slowing to 8.0% in 2002. Although revenue was down in fiscal 1999 due in part to the rising commissions, revenue rose 12.3% in 2000 and is expected to post solid gains of 8.9% and 7.1% in fiscal years 2001 and 2002.

Keno sales increased almost 11% in fiscal year 2000 due to the full-year availability of Keno Bonus, which had been introduced on a trial basis in fiscal year 1999. Sales are expected to grow by 1.3% in 2001 before accelerating to 7.0% in 2002. Building on the success of Keno Bonus, the Lottery agency plans additional enhancements to Keno which will boost growth in 2002. Despite the relatively slow growth, Keno will become the largest lottery game this year. Revenue will be nearly flat in 2001, before resuming modest growth in line with sales in 2002.

The Big Game generated the highest sales of all jackpot games in fiscal year 2000, increasing 35.5% for the year on top of a 45.5% sales rise in fiscal year 1999. High jackpots in 1999 increased interest in the game, and the U.S. record high jackpot in the Spring of 2000 provided a large surge in sales. The odds of jackpots of that size are very low; therefore sales are expected to decline by 18% in fiscal year 2001 before resuming growth off of a lower base in fiscal year 2002. Revenue grew by 43.3% in 2000, but will decline by 21.6% in 2001.

Lotto and Cash in Hand each experienced sales declines of about 10% for fiscal year 2000. The Lottery anticipates replacing Cash in Hand by the end of fiscal year 2001, and plans to radically revise Lotto in the Fall of 2001. Modest growth of 5% for these two games is therefore expected in fiscal year 2002.

Total lottery sales are expected to reach $1,187 million in fiscal year 2001, for growth of 1.2%. After deductions for agent commissions, operating expenses and prizes, revenue is expected to total $405.4 million in fiscal year 2001. The transfer to the Stadium Authority, $22.0 million in fiscal year 2001, is expected to increase to $30.8 million in fiscal year 2002. Thus, despite total net revenue growth of 2.4%, general fund revenue is expected to rise by only 0.2% in fiscal year 2002 to $384.3 million. Table 8 shows the game-by-game detail on lottery sales and revenues.

Table 8

**Lottery Sales and Revenues by Game**

Fiscal Years 1999 - 2002

($ in millions)

| | Sales | | | | Revenues | | | |
|---|---|---|---|---|---|---|---|---|
| | 1999 Actual | 2000 Actual | Estimated 2001 | Estimated 2002 | 1999 Actual | 2000 Actual | Estimated 2001 | Estimated 2002 |
| Pick 3 | 316.4 | 311.6 | 306.1 | 298.5 | 143.2 | 133.5 | 128.1 | 123.6 |
| Pick 4 | 179.7 | 190.5 | 202.0 | 208.0 | 71.4 | 67.9 | 82.9 | 84.5 |
| Lotto | 48.2 | 43.3 | 38.9 | 40.9 | 19.5 | 17.1 | 15.2 | 15.8 |
| Cash-in-Hand | 26.3 | 23.6 | 22.4 | 23.5 | 9.2 | 8.5 | 7.8 | 8.1 |
| Instant | 177.0 | 221.9 | 244.1 | 263.6 | 44.2 | 49.6 | 54.0 | 57.9 |
| Keno | 280.3 | 311.0 | 315.2 | 337.3 | 84.4 | 93.8 | 93.6 | 98.7 |
| Big Game | 52.4 | 71.0 | 58.3 | 65.3 | 21.3 | 30.5 | 23.9 | 26.5 |
| Total | 1,080.3 | 1,172.9 | 1,186.9 | 1,226.6 | 393.1 | 401.0 | 405.4 | 415.1 |
| Less Stadium Authority Revenue | | | | | (32.0) | (23.3) | (22.0) | (30.8) |
| Transfer to Horse Racing Fund | | | | | (9.0) | (10.1) | – | – |
| General Fund Revenue | | | | | 352.2 | 367.8 | 383.4 | 384.3 |

## Business Franchise Taxes

Business franchise taxes, levied on telephone companies, public utilities, and until the end of tax year 2000 on some financial institutions, increased by 2.9% in fiscal year 2000. Due to substantial changes to the public service company franchise tax and the repeal of the financial institution and savings and loan association franchise taxes, however, receipts are expected to decline by 5.0% in fiscal year 2001 before increasing by 1.2% in fiscal year 2002.

Legislation enacted in 1999 radically changed the franchise tax on gas and electric companies, the largest piece of the franchise taxes. Beginning in tax year 2000, the public service company franchise tax is 2% of gross receipts derived from the transmission, distribution and delivery of electricity and natural gas in Maryland. In addition, a franchise tax of 0.062 cents for each kilowatt hour of electricity and 0.402 cents for each therm of natural gas delivered for final consumption in Maryland is levied. Although these changes have been in effect since the beginning of 2000, the actual revenue impact to date is still uncertain for several reasons, including the effect of provisions regarding the estimated payment safe harbor for the combination of franchise and corporate income tax payments. Overall, these changes are expected to reduce franchise tax revenues by $17.6 million in fiscal year 2001 and by $16.6 million in fiscal year 2002.

Revenue growth will be supported by the dramatic increase in energy prices and could potentially be enhanced if expectations of a cold winter in 2000-2001 following several years of relatively warm winter weather are realized.

The franchise tax on telephone companies remains at 2% of gross receipts, which means that revenues will change with usage. Increasing use of the Internet, either through higher-cost enhanced connections (ISDN and DSL) or through additional phone lines, will result in continued growth, and demand for traditional telephone service generally rises with income. These sources of growth will be offset to a degree by continued price competition between long-distance carriers, which reduces gross receipts and therefore tax revenues.

Beginning in tax year 1998, banks and certain other financial institutions were made subject to the corporate income tax rather than the financial institution franchise tax. Starting with tax year 2001, that franchise tax was repealed entirely, as was the savings and loan association franchise tax. Revenues for half of a tax year will be received in fiscal year 2001 for these two taxes, and an estimated $1 million of refunds will be paid out for the financial institution franchise tax in fiscal year 2002. Revenues from corporate filing fees are expected to continue a modest increase, although the ongoing shift to business structures that are not subject to these fees, including partnerships, subchapter S corporations, and limited liability companies, will restrain growth. Table 9 contains the forecast detail for the business franchise taxes.

Table 9
**Business Franchise Tax Revenues**
Fiscal Years 1999 - 2002
($ in thousands)

| | 1999 Actual | 2000 Actual | 2001 Revised Estimate | 2002 Estimate |
|---|---|---|---|---|
| Public Service Company Franchise Tax | 153,012 | 153,881 | 150,568 | 159,266 |
| Financial Institution Franchise Tax | 7,909 | 9,904 | 4,849 | (1,000) |
| Tax on Deposits of Savings and Loans | 1,437 | 1,365 | 750 | 0 |
| Filing Fees | 11,213 | 13,538 | 13,500 | 13,500 |
| Total | 173,571 | 178,688 | 169,667 | 171,766 |

## Insurance Premium Tax

Taxes on insurance premiums declined almost 3% in fiscal year 2000 to $172.5 million following gains of over 3% in the previous two fiscal years. According to the National Association of Insurance Commissioners (NAIC), Maryland has experienced a decline in premiums written in both life and workers compensation insurance in calendar year 1999. Property and casualty and accident and health insurance experienced small premium growth, but total premiums written in Maryland declined 1.3% in 1999, after a 2.4% rise in calendar 1998. This decline in total premiums was the first such overall decrease since a 3.8% decline in 1991. Modest revenue growth is forecast for fiscal years 2001 and 2002.

Fiscal year 1999 was the last year that license and fee revenue was credited to the general fund. SB 705 of 1998 established the Insurance Regulation Fund, into which most of the fees collected by the Maryland Insurance Administration are now deposited.

Table 10
**Insurance Premium Tax Revenues**
Fiscal Years 1999 - 2002
($ in thousands)

| | 1999 Actual | 2000 Actual | 2001 Revised Estimate | 2002 Estimate |
|---|---|---|---|---|
| Premium Tax | 177,788 | 172,491 | 177,154 | 182,035 |
| Licenses and Fees | 12,073 | 0 | 0 | 0 |
| General Fund Total | 189,861 | 172,491 | 177,154 | 182,035 |

## Death Taxes

Death tax collections depend on the number and value of estates settled during the fiscal year. Revenues grew 21% in fiscal year 2000 to $157.0 million despite State and federal law changes which reduced revenues by roughly $3 million. This revenue source is quite volatile since the death of several wealthy individuals (or a smaller number of very wealthy individuals) can have a substantial impact. Through November, 14 large estates (those with estate tax payments of $500,000 or more) have been settled, one more than through November of 1999. The estate tax payments from these estates totaled $22.2 million, almost $5 million less than the $27.1 million in net estate tax payments received from the 13 estates last year. Despite the 18% drop in payments received from large estates, net estate tax receipts are down only 10% on the year.

In addition to federal estate tax changes enacted in 1997 which increase the effective estate tax credit through 2007, the State has made significant changes to the inheritance tax over the past two years. Legislation enacted in 1999 reduced the tax rate for direct heirs from 1% to 0.9%, and reduced the rate for siblings from 10% to 5% over three years. In 2000, legislation was enacted which repealed the direct tax entirely and made siblings direct heirs. These changes will reduce inheritance tax revenues by an estimated $13.0 million in fiscal year 2001, and by $39.0 million in fiscal year 2002. Due to the interrelated nature of the inheritance tax and estate tax, however (inheritance taxes paid can be claimed as a credit against the estate tax), estate tax payments are expected to increase by $4.1 million in fiscal year 2001 and $14.3 million in fiscal year 2002. Table 11 shows the forecast detail for death tax collections.

Table 11
**Death Tax Revenues**
Fiscal Years 1999 - 2002
($ in thousands)

| | 1999 Actual | 2000 Actual | 2001 Revised Estimate | 2002 Estimate |
|---|---|---|---|---|
| Collateral Inheritance Tax | 48,018 | 55,893 | 47,219 | 42,573 |
| Direct Inheritance Tax | 22,022 | 23,077 | 16,631 | 0 |
| Tax on Commissions | 48 | 45 | 20 | 10 |
| Estate Tax | 58,573 | 77,380 | 77,702 | 89,801 |
| Interest and Penalty | 1,033 | 644 | 790 | 845 |
| Total | 129,694 | 157,039 | 142,362 | 133,229 |

## Tobacco and Alcoholic Beverage Excise Taxes

Tobacco tax revenues increased significantly as a result of the rise in the excise tax from 36¢ to 66¢ per pack on July 1, 1999 to $210.0 million in fiscal year 2000. Revenues were boosted $11.9 million by the "floor" tax, or tax on cigarettes in inventory. In response to the higher prices, resulting not only from the State tax increase but also from a federal excise tax increase of 10¢ per pack as well as price increases from manufacturers to help them pay for the 1998 tobacco settlement, cigarette sales in Maryland declined by 16% in fiscal year 2000. Excluding the floor tax, revenues are expected to decline by roughly 4% annually, to $190.2 million in fiscal year 2001 and $183.0 million in fiscal year 2002.

Beginning on July 1, 2001, excise tax revenues are supplemented by a 15% tax on the wholesale price of tobacco products other than cigarettes (cigars, chewing tobacco, pipe tobacco, *etc*.). The new tax has generated almost $1.7 million through one-third of the year; only $2.4 million was expected when the legislation was enacted. Based on these year-to-date collections, the other tobacco products tax is expected to generate $4.8 million in fiscal year 2001, and should remain flat in the out-years.

Alcoholic beverage tax revenues grew by 2.0% in fiscal 2000 after remaining nearly unchanged in fiscal 1999. Growth in 1998 and 2000 reversed the declines of most of the previous decade, bringing revenues to levels not seen since fiscal year 1992. Growth of about 2.0% is projected for fiscal years 2001 and 2002 to $24.7 million and $25.0 million, respectively.

Table 12
**Excise Tax Revenues**
Fiscal Years 1999 - 2002
($ in thousands)

| | 1999 Actual | 2000 Actual | 2001 Revised Estimate | 2002 Estimate |
|---|---|---|---|---|
| Cigarette Tax | 128,915 | 198,079 | 190,184 | 182,957 |
| Floor Tax on Inventories | – | 11,933 | – | – |
| Other Tobacco Products Tax | – | – | 4,800 | 4,800 |
| Total Tobacco Taxes | 128,915 | 210,012 | 194,984 | 187,757 |
| Distilled Spirits Tax | 11,157 | 11,464 | 11,594 | 11,725 |
| Wine Tax | 3,906 | 4,116 | 4,247 | 4,382 |
| Beer Tax | 8,845 | 8,818 | 8,837 | 8,855 |
| Total Alcoholic Beverages Tax | 23,908 | 24,399 | 24,678 | 24,963 |

## Hospital Patient Recoveries

Hospital patient recoveries are revenues received for services provided in State hospitals, paid by the patients, their sponsors or insurance and by the federal Medicaid and Medicare programs. These revenues are estimated by the Department of Health and Mental Hygiene based on projections of utilization and reimbursement rates.

Outside of disproportionate share payments, recoveries are expected to increase slightly in fiscal year 2001 and remain essentially stable. Population growth is expected in chronic care and nursing home facilities, while the population of psychiatric hospitals is expected to remain stable and that of developmentally disabled facilities should decline due to de-institutionalization. Slight increases in rates will offset the overall population decline.

The federal Balanced Budget Act of 1997 severely reduced the availability of disproportionate share payments, which are provided to state hospitals for uncompensated care. Revenues are expected to decline from $48.8 million in 2000 to $14.7 million in 2001 and $10.3 million in 2002, and under the current formula will continue to decline in the out-years.

Table 13
**Hospital Patient Recoveries**
Fiscal Years 1999 - 2002
($ in thousands)

| | 1999 Actual | 2000 Actual | 2001 Revised Estimate | 2002 Estimate |
|---|---|---|---|---|
| Medicaid | 41,507 | 44,111 | 45,060 | 44,617 |
| Medicare | 5,860 | 3,018 | 3,556 | 3,562 |
| Insurance and Sponsors | 7,294 | 6,169 | 7,829 | 7,882 |
| | 54,661 | 53,298 | 56,445 | 56,061 |
| Disproportionate Share Current Year | 55,391 | 48,814 | 14,700 | 10,300 |
| Billings from Prior Year | 49,160 | – | – | – |
| Total | 159,212 | 102,113 | 71,145 | 66,361 |

## Court Revenues

Clerks of the Court fees declined almost 5% to $37.7 million in fiscal year 2000 after increasing in each of the last three years. Court fees include recordation tax commissions, recording fees and other miscellaneous fees and are largely related to the strength of the housing market. Mortgage rates increased through 1999 and into 2000, but the increase was not large and rates now average about 8%. Owing to the stability in the mortgage market, revenue from the clerks of court are expected to rise about 4.7% in fiscal year 2001 but will decline slightly in 2002.

District Court revenues, primarily traffic fines and fees, declined about 1% in fiscal year 2000 following a 7.6% rise in fiscal year 1999. District Court fees vary from year to year since they are affected by driving patterns, weather, and the extent to which judges enforce or forgive fines and fees. Revenues are expected to rise 2.6% (roughly the ten-year annual average) in fiscal year 2001 to $72.2 million and 2.5% in 2002 to $73.9 million.

Table 14
**General Fund Court Revenues**
Fiscal Years 1999 - 2002
($ in thousands)

| | 1999 Actual | 2000 Actual | 2001 Revised Estimate | 2002 Estimate |
|---|---|---|---|---|
| Clerks of the Court | 41,771 | 37,713 | 39,472 | 39,024 |
| District Courts | 71,079 | 70,349 | 72,150 | 73,936 |

## Interest Earnings

General fund interest earnings reached $128.4 million in fiscal year 2000 due to several factors. The State Treasurer actively manages the State's accounts in order to earn the highest return possible without compromising safety. The large general fund surpluses over the last several years have increased the State's general fund balances, and balances have been building in the capital projects accounts for a variety of reasons including the fact that state agencies are having difficulty contracting capital projects.

The Treasurers' office is expected to earn $123.7 million in general fund interest in fiscal year 2001, declining to $82.5 million in fiscal year 2002. Total interest earnings are expected to reach $185.0 million in fiscal year 2001after peaking at $225 million in fiscal year 2000.

Table 15
**Total Interest Earnings**
Fiscal Years 1999 - 2002
($ in thousands)

| | 1999 Actual | 2000 Actual | 2001 Revised Estimate | 2002 Estimate |
|---|---|---|---|---|
| General Fund Interest Earnings | 104,711 | 128,391 | 123,705 | 82,513 |
| Other Interest Earnings | 90,337 | 97,035 | 61,295 | 47,487 |
| Total Interest Earnings | 195,048 | 225,426 | 185,000 | 130,000 |

## Miscellaneous Revenues

Miscellaneous revenues are expected to decline from $215.6 million in fiscal year 2000 to $175.6 million in fiscal year 2001, and $172.4 million in fiscal year 2002. Most of the decline is concentrated in four revenue sources. Excess fees of office are expected to decline by $4.8 million and $11.9 million in fiscal years 2001 and 2002, respectively, from revenues received in fiscal year 2000. The recent legislation that eliminated the inheritance tax for direct heirs and siblings will reduce Registers' commissions and thus reduce excess fees to the general fund.

In the Department of Health and Mental Hygiene, miscellaneous general fund revenues are forecast to decline by about $5 million from fiscal year 2000 levels, primarily due to reductions in receipts of the Office of the Secretary and the Medical Care Programs Administration. Miscellaneous revenues from the Division of Financial Regulation in the Department of Labor Licensing and Regulation are expected to fall slightly more than $11 million below the fiscal year 2000 actual due to one-time revenues received in fiscal year 2000.

Miscellaneous revenues from the Department of Education will fall by about $9 million from the fiscal year 2000 actual in fiscal years 2001 and 2002. Chapter 492, Acts of 2000, required that reimbursements of teachers' retirement costs now be credited to the Transitional Education Fund as special fund revenues.

Table 16
**Miscellaneous Revenues**
Fiscal Years 1999 - 2002
($ in thousands)

| | 1999 Actual | 2000 Actual | 2001 Revised Estimate | 2002 Estimate |
|---|---|---|---|---|
| Franchise Taxes | | | | |
| Expedited Fee Revenue | 1,508 | 1,579 | 0 | 0 |
| Recording Fees | 3,508 | 3,302 | 3,200 | 3,200 |
| Organization & Capitalization Fee | 608 | 560 | 631 | 625 |
| Interest & Penalty | 1,079 | 242 | 0 | 0 |
| Transportation | 8,497 | 9,669 | 9,380 | 9,881 |
| (GF share of filing fees, license tags) | | | | |
| Horse Racing | 0 | 0 | 0 | 0 |
| PSC Filing Fees | 10,829 | 11,350 | 11,912 | 13,367 |
| Excess Fees of Office | 17,659 | 20,125 | 15,283 | 8,191 |
| Legislature | 498 | 486 | 209 | 210 |
| Workers' Compensation | 16,775 | 16,235 | 19,615 | 18,505 |
| Public Defender | 1,010 | 1,678 | 1,700 | 1,800 |
| Attorney General | 17,551 | 22,083 | 18,000 | 18,000 |
| Subsequent Injury Fund | 12 | 54 | 12 | 12 |
| Executive & Administrative Control | 1,029 | 4,498 | 3,480 | 3,534 |
| Budget & Fiscal Administration | 835 | 841 | 1,655 | 675 |
| General Services | 594 | 30 | 38 | 38 |
| Agriculture | 296 | 299 | 286 | 295 |
| Health & Mental Hygiene | 22,718 | 12,319 | 6,831 | 7,157 |
| Human Resources | 3,029 | 1,625 | 1,255 | 1,255 |
| Labor, Licensing & Regulation | | | | |
| Office of the Secretary | 389 | 41 | 0 | 0 |
| Div. of Financial Reg. | 3,652 | 15,277 | 3,679 | 4,084 |
| Div. of Labor & Industry | 1,640 | 1,251 | 1,300 | 1,300 |
| Div. of Racing | 0 | 294 | 285 | 285 |
| Div. of Occup. & Prof. Lic. | 4,849 | 5,567 | 5,963 | 6,517 |
| Public Safety & MD State Police | 13,499 | 10,616 | 9,336 | 9,313 |
| Public Education | 28,215 | 10,735 | 1,727 | 1,787 |
| Housing and Community Development | 318 | 3,312 | 318 | 323 |
| Environment | 442 | 729 | 340 | 214 |
| Juvenile Justice | 832 | 301 | 291 | 301 |
| Unclaimed Property | 34,101 | 24,317 | 25,000 | 28,000 |
| Alcoholic Beverage Licenses | 460 | 585 | 550 | 550 |
| Local Income Tax Reimbursement | 9,848 | 11,100 | 11,300 | 11,500 |
| MDIF | 0 | 0 | 0 | 0 |
| Uninsured Motorist Penalty Fees | 13,747 | 13,202 | 12,034 | 11,455 |
| Miscellaneous Revenues and Transfers | 15,996 | 11,250 | 10,000 | 10,000 |
| Total | 236,023 | 215,552 | 175,608 | 172,374 |

## Transportation Revenues

Titling tax revenues rose almost 13% to $604.5 million in 2000, resulting in the ninth consecutive annual gain. The gain in titling tax revenues is consistent with the gain in vehicle sales, up 9.0% in calendar year 1999 and 3.6% in 2000, to a national level of 17.4 million units at a seasonally adjusted annual rate. Vehicle sales have been buoyed by a robust economy and very low unemployment rates, in addition to relatively low interest rates and generous incentives. The increase in taxes paid per vehicle continues to reflect a shift in sales mix to higher-end luxury and sport utility vehicles.

Revenue is expected to rise by about 3.0% in fiscal 2001 and 0.5% in 2002. A deceleration in growth is expected to be consistent with the forecast of a slowing local and national economy. Vehicle sales are expected to peak in calendar year 2000 and drop to about 16.0 million units by 2001. Price increases for new cars and trucks are expected to be less than the gain for the total consumer prices of between 2.5% and 3.0%.

Motor fuel taxes fell to $631.6 million in fiscal 2000 compared with $665.9 million recorded in fiscal 1999. Exceptional growth in fiscal 1999 and a decline in 2000 are the result of improper filing by motor fuel taxpayers in 1999. Some gasoline was accounted for twice and the tax was paid twice in 1999 creating significant refunds in fiscal years 2000 and 2001. The Department of Transportation currently estimates that about 144 million gallons of fuel was double-counted, yielding $33.8 million in tax revenue. About $10 million remains to be accounted for in fiscal 2001.

Before adjustment, gasoline consumption fell about 4.5% in fiscal year 2000 after increasing over 7.0% in fiscal year 1999. The increase for the two years combined is about 1.5% and in line with recent gains in gasoline consumption. Gasoline consumption rose 2.9% in fiscal year 1998. Gasoline prices rose 28.5% in 2000 and are expected to remain high, although further significant price gains are unlikely at this time. Motor fuel revenue is expected to rise 1.0% in fiscal year 2001 and 3.5% in fiscal year 2002 despite higher prices and a slowdown in economic growth.

Table 17
**Maryland Motor Vehicle User Revenues**
Fiscal Years 1999 - 2002
($ in thousands)

| | 1999 Actual | 2000 Actual | 2001 Revised Estimate | 2002 Estimate |
|---|---|---|---|---|
| Motor Vehicle Administration | | | | |
| Registrations | 173,532 | 173,425 | 178,700 | 180,100 |
| Licenses | 15,776 | 16,517 | 14,200 | 14,300 |
| Medevac Surcharge | 34,240 | 34,052 | 34,801 | 34,905 |
| Miscellaneous Motor Vehicle Fees | 58,620 | 64,791 | 68,900 | 70,000 |
| Vehicle Emission Inspection Fees | 15,710 | 15,856 | 4,300 | 3,700 |
| Security Interest Filing Fees | | | | |
| Special Funds | 3,013 | 3,379 | 3,270 | 3,282 |
| General Funds | 4,519 | 5,069 | 4,905 | 4,923 |
| General Funds - Baltimore City | 2,511 | 2,816 | 2,725 | 2,735 |
| Hauling Fees | 6,356 | 6,768 | 7,000 | 6,500 |
| Learners and New Drivers' Licenses | 7,944 | 8,150 | 8,500 | 8,600 |
| Special License Tags | | | | |
| Special Funds | 380 | 380 | 380 | 380 |
| General Funds | 1,437 | 1,784 | 1,105 | 1,585 |
| DOT | 379 | 23 | 785 | 410 |
| Chesapeake Bay Tags - MDOT | 386 | 424 | 430 | 425 |
| Titling Tax | 535,145 | 604,482 | 622,000 | 625,000 |
| Sales Tax on Rental Vehicles | 0 | 18,991 | 19,600 | 19,800 |
| | 859,948 | 956,907 | 971,601 | 676,645 |
| Motor Vehicle Fuel Tax | 665,870 | 631,586 | 638,200 | 661,700 |
| Road Tax | 14,021 | 14,532 | 14,900 | 15,200 |
| Decals | 277 | 265 | 100 | 0 |
| Permits | 93 | 97 | 0 | 0 |
| | 680,261 | 646,480 | 659,200 | 676,900 |
| Total | 1,540,209 | 1,603,387 | 1,624,801 | 1,653,545 |

## Five Year Forecast

These estimates are based on a trend forecast for the U.S. and Maryland economies. A trend scenario does not attempt to forecast cyclical economic patterns, but projects average economic growth based on fundamental economic factors such as demographics or structural changes in the economy. Real gross domestic product is expected to expand at an average annual rate of about 3.3% over the next five years, a full percentage point less than the average growth in the previous five years. Although real growth from 2001 to 2005 is less than the previous five year period it is above the average of about 2.5% achieved in the early 1990's when it was thought that potential GDP was much lower than it is today. The economy’s potential growth rate is the sum of expected growth in the labor force and the capital stock, in addition to productivity gains. Inflation, as measured by the increase in consumer prices, is anticipated to rise in the 2.0% to 2.5% range, higher than the 1.6% increase recorded at the low in 1998 and the national unemployment rate is expected to rise to average about 4.5% over the next five years compared with the annual average of 4.0% in calendar year 2000.

As discussed in the Maryland outlook, Maryland’s economy is expected to slow in slowing somewhat through 2002 before accelerating again, following the national economy. After growth of only 2.9% in fiscal year 2002, general fund revenue growth will accelerate beginning in fiscal year 2003, growing by 4.3%. The phased-in income tax reduction will be fully effective in fiscal year 2003, and will therefore no longer hold back revenue growth. Similarly, it is expected that the repeal of the direct inheritance tax will essentially be fully effective (the tax will still apply to any inheritances from decedents who died before July 1, 2000 on which it has not been paid, so a small amount of revenue may continue to be collected). Interest earnings should not decline substantially after fiscal year 2003, by which time it is expected that the balance drawdown will have ended.

Sales tax growth in the long run is expected to be slower than the growth in personal income, since an increasing share of expenditures are on non-taxable services. Lottery revenue is expected to grow at about 1.5% annually, and will of course be affected by changes in the Stadium Authority distribution. In total, general fund revenues are expected to increase by 4.3% in fiscal year 2003, 4.6% in 2004 and 4.8% in 2005 as shown in Table 19.

Table 18
**Long Term Economic Forecast**
**Primary Indicators**

| CALENDAR YEAR | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|
| U.S. Real GDP (Billion $96 chained) | 8,515.7 | 8,875.8 | 9,333.4 | 9,643.8 | 9,996.1 | 10,340.4 | 10,677.1 | 11,002.4 |
| % change | 4.4% | 4.2% | 5.2% | 3.3% | 3.7% | 3.4% | 3.3% | 3.0% |
| U.S. Total NonFarm Employment (Millions) | 125.9 | 128.8 | 131.5 | 133.1 | 134.8 | 136.5 | 138.3 | 140.1 |
| % change | 2.6% | 2.3% | 2.1% | 1.2% | 1.3% | 1.3% | 1.3% | 1.3% |
| U.S. Total Personal Income (Billion $) | 7,391.0 | 7,789.6 | 8,300.6 | 8,824.2 | 9,372.8 | 9,895.9 | 10,405.3 | 10,915.3 |
| % change | 6.5% | 5.4% | 6.6% | 6.3% | 6.2% | 5.6% | 5.1% | 4.9% |
| CPI - % Change | 1.6% | 2.2% | 3.3% | 2.5% | 2.5% | 2.4% | 2.3% | 2.3% |
| U.S. 10 Year Treasury Bond Yield | 5.26 | 5.64 | 6.10 | 6.26 | 6.65 | 6.31 | 6.16 | 5.91 |
| MD Total NonFarm Employment (Millions) | 2,323.2 | 2,381.8 | 2,441.5 | 2,481.5 | 2,528.0 | 2,577.1 | 2,624.5 | 2,673.7 |
| % change | 2.5% | 2.5% | 2.5% | 1.6% | 1.9% | 1.9% | 1.8% | 1.9% |
| MD Total Personal Income (Million $) | 158,264 | 167,896 | 178,283 | 189,410 | 200,531 | 211,847 | 223,581 | 235,830 |
| % change | 6.3% | 6.1% | 6.2% | 6.2% | 5.9% | 5.6% | 5.5% | 5.5% |

Sources: Economy.com, November 2000
Bureau of Revenue Estimates, December 2000

Table 19

**Maryland General Fund Revenues**

Fiscal Years 1999 - 2004

($ in thousands)

| | 2000 Actual | 2001 Estimate | 2002 Estimate | 2003 Estimate | 2004 Estimate | 2005 Estimate |
|---|---|---|---|---|---|---|
| INCOME TAXES: | | | | | | |
| Personal | 4,746,341 | 5,065,999 | 5,282,803 | 5,540,463 | 5,834,791 | 6,156,543 |
| Corporation | 319,454 | 349,033 | 341,032 | 356,091 | 376,147 | 389,014 |
| Total | 5,065,795 | 5,415,032 | 5,623,835 | 5,896,554 | 6,210,938 | 6,545,557 |
| SALES AND USE TAXES | 2,478,539 | 2,647,691 | 2,776,432 | 2,935,354 | 3,087,992 | 3,257,832 |
| STATE LOTTERY | 367,763 | 383,403 | 384,307 | 390,072 | 395,923 | 401,862 |
| FRANCHISES, EXCISES, LICENSES, FEES: | 1,179,631 | 1,078,519 | 1,063,165 | 1,061,206 | 1,061,373 | 1,067,275 |
| INTEREST ON INVESTMENTS | 128,391 | 123,705 | 82,513 | 75,000 | 75,000 | 75,000 |
| GRAND TOTAL | 9,220,119 | 9,648,350 | 9,930,252 | 10,358,186 | 10,831,226 | 11,347,525 |