Report of the

Maryland Board of Revenue Estimates

on

ESTIMATED MARYLAND REVENUES

FISCAL YEARS ENDING JUNE 30, 2004 AND JUNE 30, 2005

Submitted to

Robert L. Ehrlich, Jr.

December 17, 2003

State of Maryland
Board of Revenue Estimates

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December 17, 2003

Honorable Robert L. Ehrlich, Jr.
Governor of Maryland
State House
Annapolis, Maryland 21401

Dear Governor Ehrlich:

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, 2004 and June 30, 2005, 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

William Donald Schaefer, Chairman

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Executive Summary

By almost every measure Maryland's economy has demonstrated strong performance relative to the national economy over the past two years. In terms of employment growth, unemployment rates, personal income growth and more, Maryland has been at the top of the tables throughout the recession and stuttering recovery. Indeed, employment in Maryland did not decline during or after the recession, growing at 0.7% in recessionary 2001 and by 0.2% in 2002, while national employment was flat in 2001 and declined by 1.1% in 2002. Employment nationwide will drop again in 2003, by 0.3%, while employment in Maryland will accelerate to 0.4% growth. With solid national economic gains just around the corner, the State is poised for strong performance.

Growth in 2003, both nationally and in Maryland, has been hampered by the uncertainty leading up to the war in Iraq at the start of the year. Additionally, Maryland was hit by record snow at early in 2003 and by hurricane Isabel in September. With the international situation slightly more stable, employment growing again nationally, stunning 8.2% growth in gross domestic product in the third quarter and booming productivity growth and corporate profits, robustness has returned to the economy for the first time since the start of the recession in early 2001. Maryland's economy will employ over 2.5 million individuals in 2004, for growth of 1.3%, and will increase by an additional 1.9% in 2005. Personal income growth will bottom out in 2003 at 3.1%, and will increase by 4.6% in 2004 and 5.5% in 2005. Wage and salary income will increase from 2.9% growth in 2003 to 5.9% in 2005; dividend, interest and rent income and the residence adjustment (for Marylander's working out-of-State) will accelerate throughout the forecast period as well, although growth of transfer payments will decline slightly.

As the Maryland economy moves towards solid growth, revenues will recover. An estimated $9,943.7 million in general fund revenues is expected in fiscal year 2004, growth of 6.6% over fiscal year 2003. Baseline growth, after adjusting for legislative changes, is roughly 4.8%. Revenues will finally break the $10 billion level in fiscal year 2005, reaching $10,391.1 million (growth of 4.5%).

The individual income tax, which has declined for two consecutive years, will grow again as personal income recovers and as capital losses from the burst market bubble have largely been flushed from the system. Income tax withholding will grow by 6.8% in fiscal year 2004, boosted by local income tax rate increases and changes to State withholding. Baseline growth is a more reasonable 4.9%. Estimated income tax payments will grow again, by an estimated 5.4%, after two years of steep declines related to the unprecedented drop in capital gains. Individual income tax revenues will grow by 6.3% in fiscal year 2004 to $4,998.0 million (baseline growth is 4.9%). Revenues in fiscal year 2005 will increase by 6.1% to $5,304.4 million.

General fund corporate income tax revenues will grow by 10.2% in fiscal year 2004 and by 12.4% in 2005 as corporate profits will be growing at double-digit rates throughout the period. The estimates of $317.8 million and $357.1 million do not account for possible receipts arising from the Delaware holding company cases which are currently being contested. Should these ultimately be decided in the State's favor, a one-time windfall of perhaps $200 million will be received, with a much smaller ongoing revenue increase.

With a very strong start to fiscal year 2004, sales taxes are expected to grow by 5.5% to $2,846.0 million. Consumer spending will be driven by recent federal tax cuts and the probable last gasp of mortgage refinancing. Construction spending will be the other major contributor to growth, in part due to repair and rebuilding work after hurricane Isabel. Revenue growth will moderate to 3.4% in fiscal year 2005 as the impact of the one-time events in 2004 goes away.

Lottery sales slowed dramatically in fiscal year 2003. Growth is not expected to reach the 6.5% levels averaged from 1999 to 2002. Instead, growth will be a modest 2.4% in 2004, rising to 4.8% in 2005 with the introduction of a new game and mid-day Sunday draws for Pick 3 and Pick 4. Instant tickets and Keno will continue to be the strongest performers. Sales of Mega Millions will depend largely on how big the jackpots get; with the addition of Texas, a large new pool of players will enter the game, which increases both the dollars flowing through the game and also the chances of an early winner.

Insurance premium taxes will grow strongly again in fiscal year 2004 with one more year of large increases in premiums, although the market is already softening. Growth will level off at 3.0% in fiscal year 2005 with normal growth in premiums. The State's estate tax will decline in 2004, the second consecutive decline. District Court revenues will increase to $81.1 million as a result of increased court fees and other administrative changes. Revenues from the clerks of court, driven largely by recordation activity, will grow by over one-third in 2004 due to high levels of home sales coupled with a large numbers of mortgage refinancing. A large backlog has developed in many clerks' offices, which will cause several more months of strong growth from the housing activity over the summer.

Miscellaneous revenues will increase by nearly $18 million in fiscal year 2004, due largely to special funds received by the Department of Education becoming general fund revenue. Other legislative changes effective in fiscal 2004 also boost the miscellaneous revenues.

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Board of Revenue Estimates

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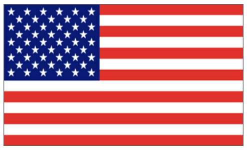
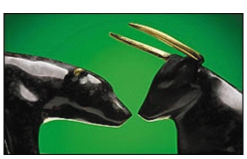


The U.S. Economy

For several months, most economic data have indicated the national economy is finally, though not certainly, headed towards a robust recovery. These emerging trends were validated by third quarter gross domestic product data that showed the economy growing at an annual rate of 8.2%, well above expectations of 6.0% growth. While that torrid pace will not be sustained, it does appear that the economy has found its footing. The sole question mark is whether employers will resume hiring–if more jobs are not forthcoming shortly, there is a good chance that the recovery will stall. All indications are, however, that employers will soon require additional help.

The resilience of the United States' economy is beyond question. If one had asked economists in early 2001 whether the economy could absorb a collapse of the market bubble, the most lethal terrorist attack in history, major corporate accounting scandals, and international instability and war, all inside of two years, and escape with only the mildest of recessions, the answer would have been a resounding collective "NO." As events transpired, however, the economy shrank by 1.6% at its nadir, in the second quarter of 2001–before the majority of the aforementioned events even occurred. This performance represents the smallest decline in a recession in the last fifty years (second-best was the 1969-70 recession, the longest recession in this period, but during which real GDP declined by 2.0% in the worst quarter).

A number of factors have offset the negative impact of events of the past two years, including substantial federal income tax reductions and business tax incentives, along with continuing record low interest rates. The federal tax changes would likely not have been as large, and interest rates possibly not have been as low, had the economy not been facing those troubles, but the fact remains that the recent recession was extraordinarily shallow and the turnaround was rather quick given events of the past two years. Particularly in light of the strong third-quarter performance, the economy seems ready to shake off the doldrums of the past two years and resume steady and stable, but not spectacular, growth.



The Current Situation

The economy has managed to perform as well as it has largely for the same reason several million jobs have been lost since the start of the recession–dramatic improvements in productivity. Productivity grew by more than 5% in 2002, and has been at or above 2% growth since 1996 (in contrast to the 1980-95 period, when productivity growth exceeded 2% only four times). Such strong growth has been a double-edged sword, allowing businesses to regain profitability after the recession but obviating the need for additional employees even in the face of increasing output, leading to the "job-loss" recovery.

Employment has trended downward throughout the recovery, which began in December 2001, in contrast to the early 1990s recession when employment was flat for twelve months before growing. In that recovery, employment reached its previous peak 23 months after the trough (see *Figure 1*). It had been thought that the performance after the previous recession–the "jobless recovery"–was an anomaly, as employment in post-war recoveries has generally increased concurrently with the resumption of growth. The jobless recovery may well prove to be unique; the current recovery is 22 months old, and employment remains less than 98% of the previous peak.

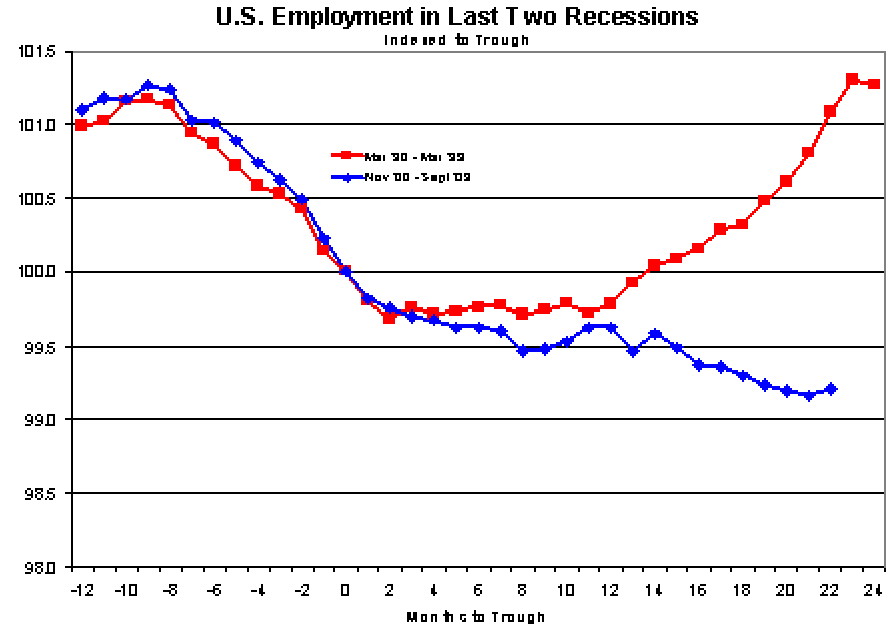


Figure 1 Source: Bureau of Labor Statistics

Aside from the dramatic continuing increases in productivity, a lack of business confidence may have been partly responsible for the lack of job growth. Business confidence clearly suffered in the run-up to the war in Iraq, dropping in one index from 100 in January to a low of 44 in late March before rebounding. While the war had a direct impact, it is likely that confidence has suffered greatly over the past two years due to the fact that many of the risks faced by businesses are unquantifiable. The difficulties of determining the probability of another massive terrorist attack on the West (perhaps with nuclear or biological weapons) or a wider war in the Middle East and concomitant disruption to oil supplies are of a much larger order of magnitude than the difficulties of measuring everyday business risks. The immense uncertainties almost certainly have precluded many businesses from taking on long-term costs, such as additional permanent employees.

Through the recession and into the first part of the recovery, businesses also avoided investment costs–in fact, the recent recession is the first that was caused by a drop in investment rather than consumer spending. After the massive increases in investment (and in the case of telecommunications equipment, overinvestment) through the second quarter of 2000, business investment suffered six consecutive quarters of decline. By the end of 2001, real investment expenditures stood barely above the levels reached at the end of 1997. Even though investment has grown in six of the seven quarters since then, it has recovered only 40% of the lost ground.

Two factors have driven the investment recovery–time and taxes. The useful economic life of information technology equipment has grown ever shorter, and now stands at about three years. Most of the equipment purchased for Y2K, which was generally responsible for the investment boom, has reached the end of its useful life and has begun to be replaced. Changes to federal tax law, including the recently expanded and extended bonus depreciation and increase in the limit for §179 expensing, have provided immense incentive for businesses to invest.

One additional factor that may be impeding the creation of new jobs is the recently-noted phenomenon of white-collar jobs moving overseas. While manufacturing jobs have been flowing towards low labor cost regions for some time, concern has arisen over the past year about service jobs, particularly well-paid service jobs, shifting to countries such as India with a large pool of highly-educated and motivated employees willing to work for a fraction of the compensation American employees demand. Some estimates indicate that, of the 2.7 million jobs lost since the peak of employment in February 2001, over one-third have moved overseas, and 20 percent of those are finance, information and professional service jobs.

Although the labor market has been shrinking and unemployment has risen about two percentage points from its low point in 2000, consumers have continued to drive economic growth. They have not, however, had to do more than their fair share over the past seven quarters, as they had in the several years prior. Private investment increased in five of the past seven quarters, and growth in government spending has been positive in all seven. About three-quarters of the growth in GDP since the start of 2002 is attributable to consumers, compared to 2000 and 2001, when consumers carried their weight and then some, providing about 190% of the growth in GDP, with other factors dragging growth down. Consumer spending has been boosted by successive waves of mortgage refinancing activity spurred by ever-lower mortgage rates, and by federal tax cuts.

In the early 1990s, the household debt service burden declined after the recession from about 12 percent of disposable income (1990 Q4) to about 10.8 percent (1992 Q4). The debt service burden reached an all-time high in the fourth quarter of 2001 (the end of the recession) at 13.6 percent, but has declined only 30 basis points through the second quarter of 2003 (see *Figure 2*). One sign that consumers are overextended is the increase in mortgage delinquencies–up over 20% since 2000 despite the record low mortgage rates over that period. The fact that consumers have not reduced their debt burden over the past two years does bring into question how much longer consumer spending can increase before a retrenchment. That concern may be mitigated, however, by the fact that some amount of the increase in total debt service represents new homeowners, brought into the market by the record low rates, who are simply transferring rental payments to mortgage payments. In many cases, monthly cash flow is unchanged, but their spending has been reclassified into debt service.

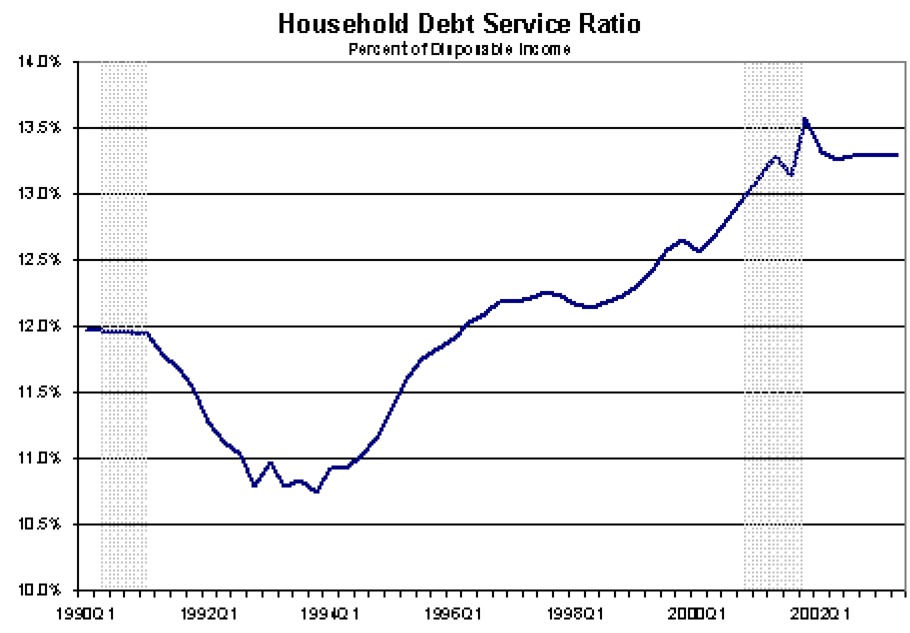


Figure 2 Source: Federal Reserve

The Outlook

November's employment report showed the fourth consecutive month of employment gains. While the gains have been admittedly modest to date, there are indications from recent employment reports and elsewhere that growth has resumed. Temporary employment agencies have been hiring–this is usually a sign of improving business conditions and a precursor to increases in permanent employment. Employment in other business services has also been rising, which similarly implies a generally strengthening business environment.

The release and revision of the third quarter gross domestic product data contains several other hints that stronger employment growth is imminent. Inventories have been drawn down three quarters in a row, subtracting an average of three-quarters of a percentage point of growth, most likely a result of producers underestimating the strength of final demand. As production increases to build inventories up again, demand for labor will increase. Furthermore, the very strong increase in investment–the highest growth rate in more than five years–will lead to a lower marginal return on capital, tilting the advantage towards labor.

The falling dollar has provided some small comfort to America's manufacturers, who have shed almost 2 million jobs between 2000 and 2002. While the benefits of a lower dollar (down roughly 10% from its early 2002 peak) are not evident overnight, lower prices on American products will help to boost exports, supporting manufacturers and their employees, and will also help to reduce the seemingly ever-increasing trade deficit.

The heavy doses of both monetary and fiscal stimulus will continue to do their work. While much of the third quarter GDP surprise was related to the child credit checks distributed by the IRS, taxpayers will benefit on an ongoing basis from the reduction in the income tax rates. The refinancing boom may be at an end, but automobile manufacturers are still able to entice buyers with zero percent loans since their borrowing costs are so low.

The trends that led to the strong third quarter performance will continue, and economic growth will likely be boosted by the resumption in the growth of government spending. Over the next several quarters profits will continue to grow, as will investment. Employment does seem set to increase, with many economists calling for average monthly increases of 200,000 jobs or more. The unemployment rate will come down, but slowly, as workers

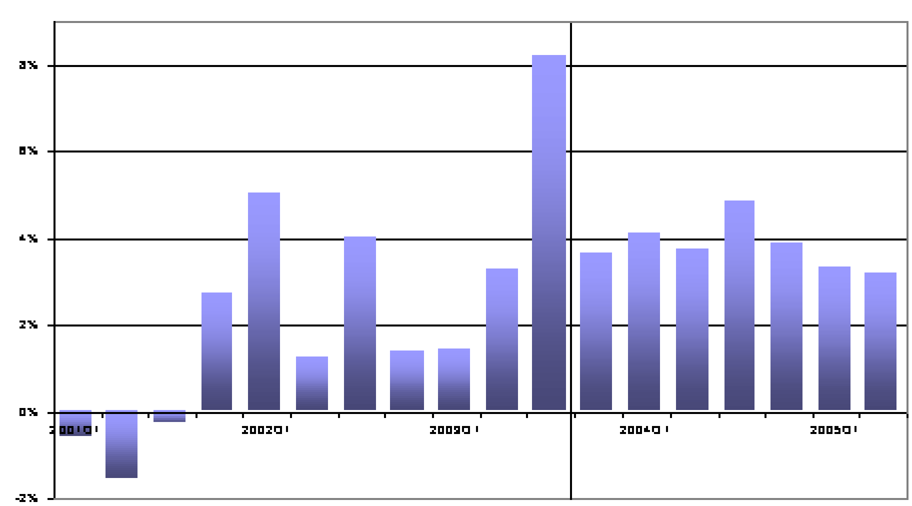


Figure 3 Source: Global Insight

are drawn back into the labor force. There are downside risks even if employment does pick up, notably a slowdown in home and vehicle purchases, but the economy will grow at annualized rates between 3% and 4% for the next several quarters (see Figure 3).

Table 1

Forecast of the U.S. Economy

Primary Indicators

	1999	2000	2001	2002	2003	2004	2005
Real Gross Domestic Product ($ billions)	9,274.3	9,824.7	10,082.2	10,446.3	10,924.6	11,580.1	12,210.6
	5.6%	*5.9%*	*2.6%*	*3.6%*	*4.6%*	*6.0%*	*5.4%*
Federal Funds Rate (%)	4.97	6.24	3.89	1.67	1.13	1.07	1.86
10-Year Treasury Bond Yield (%)	5.64	6.03	5.02	4.61	4.04	4.83	5.47
Consumer Price Index (%Δ from prior year)	2.2%	3.4%	2.8%	1.6%	2.3%	1.4%	1.9%
Housing Starts (thousands of units)	1,647.2	1,573.3	1,601.2	1,710.9	1,792.0	1,722.1	1,612.4
	1.6%	*-4.5%*	*1.8%*	*6.9%*	*4.7%*	*-3.9%*	*-6.4%*
Light Vehicle Sales (thousands of units)	16,899.6	17,359.4	17,113.6	16,778.2	16,558.1	17,019.5	17,220.9
	8.9%	*2.7%*	*-1.4%*	*-2.0%*	*-1.3%*	*2.8%*	*1.2%*
Corporate Profits after Tax ($ in billions)	514.3	523.0	470.9	451.9	513.2	575.6	734.4
	6.6%	*1.7%*	*-10.0%*	*-4.0%*	*13.6%*	*12.2%*	*27.6%*
Total Non-Agricultural Employment (thousands)	128,994.0	131,790.4	131,829.9	130,375.8	130,008.8	131,490.5	134,394.6
	2.4%	*2.2%*	*0.0%*	*-1.1%*	*-0.3%*	*1.1%*	*2.2%*
Unemployment Rate (%)	4.2	4.0	4.8	5.8	6.0	6.0	5.8
Total Personal Income ($ in billions)	7,786.5	8,406.6	8,685.3	8,922.2	9,209.7	9,685.2	10,222.8
	4.9%	*8.0%*	*3.3%*	*2.7%*	*3.2%*	*5.2%*	*5.6%*

Sources: Global Insight, November 2003
Bureau of Revenue Estimates, December 2003

The Maryland Economy

Although it is relatively small and cannot remain apart from national and global economic currents, Maryland's economy has performed well through the recent recession and period of slow growth. Despite a number of extraordinary events beginning with the terrorist attacks of September 11, including the anthrax scare, sniper attacks, a historic snowstorm, war with Iraq and most recently hurricane Isabel, the economy of the State has demonstrated its resiliency. While national employment growth declined by 1.1% in 2002 following a stagnant 2001, Maryland employment eked out 0.2% growth, down from 0.7% in 2001. Similarly, unemployment increased only 0.3 percentage points last year, while national unemployment increased by a full percentage point. Personal income in Maryland grew by 3.8% in 2002 and wages and salaries grew by 3.1%, both figures substantially higher than the national growth rates of 2.7% and 0.9%, respectively. By nearly all measures, Maryland's economy continues to outperform the national economy.

But strong relative performance does not hide the fact that Maryland's economy suffered its worst year since 1992, when employment declined by 0.9%. Personal income growth was lower than at any time since 1992, while wage and salary growth was tied for worst in the 11-year period. Personal bankruptcies increased only slightly in 2002, by 0.4%, but reached an all-time high almost 130% above the level of ten years before. These figures indicate that Maryland's economy has suffered setbacks over the past eighteen months, but it is poised for strong growth as the national economy shakes off the current doldrums.

The recent Maryland Business Climate Survey, taken by the Maryland Business Research Partnership midway through the year, indicated that 60% of Maryland businesses are expecting to increase employment over the coming twelve months, up from 45% at the end of 2002. Further, the percentage of firms who reported that labor market conditions have impeded their business has fallen to 24%, down from 31% in 2002 and 44% in 1999, when the economy was booming. Despite the loosening labor market, there have been some indications that the labor market is tightening again, with a slight uptick in the percentage of businesses experiencing worker shortages. The unemployment rate has declined from its August high of 4.6% to 4.1% in October, where it started the year.

Though many sectors will not experience employment growth until 2005, the declines are generally moderating. Maryland's economy as a whole has come through the recession in relatively robust fashion. Employment did not decline over any calendar year, hitting a nadir of 0.2% in 2002. Signs of acceleration appeared in late Spring of 2003, and the year will finish with growth of 0.7%. As the national recovery hits full stride in 2004, Maryland employment growth will reach 1.3%. In 2005, every sector of the State's economy will be growing greater than 1.0% with the exceptions of cyclical construction, troubled manufacturing and fiscally-straitjacketed government. Employment will increase by 1.9%, robust growth certainly, but still a far cry from the 2.5% rates achieved in the late 1990s.

The growth rate of personal income will bottom out at 3.1% in 2003 before accelerating to 4.6% in 2004 as wages and salaries recover, interest rates increase marginally and companies increase dividend payouts in response to the 2003 federal income tax changes. Growth will further accelerate to 5.5% in 2005. Wage and salary income will be accelerating throughout this period. Growth was a weak 3.1% in 2002 as employment growth was stagnant–those who held jobs saw about 3% growth in wages. With accelerating employment and labor receiving a greater share of profits from productivity gains, wage and salary income will accelerate to 4.4% growth in 2004 and 5.9% in 2005. The following discussion details prospects for Maryland's economy by industry sector for the coming years.

Construction

Maryland's construction sector struggled through a difficult 2002, growing at just 0.5%–the worst year since a flat 1993. Troubles have continued into 2003, as the record snowfall in the winter and a cold, wet spring led to two months of employment declines of 1.5% or more. Nationally, the largest decline thus far in 2003 was 0.6% from January to February–the only month this sector has contracted. By contrast, the construction sector has declined in four months this year in Maryland, and through August was still below December 2002 levels. The sector is expected to finish the year with a 0.6% decrease in employment in 2003. While it is still too early to tell, it is possible that reconstruction after the impact of Hurricane Isabel may provide a modest boost–the hurricane caused an estimated $4 billion to $6 billion damage statewide.

The construction industry will recover through 2004 due in part to several large ongoing public projects, including the Woodrow Wilson Bridge and the $1.8 billion expansion at BWI Airport. Other, smaller public projects are continuing despite the State's fiscal problems, which have affected the State's capital budget much less than its operating budget. Private sector construction, which is currently stagnant, will also strengthen in 2004, leading to a 1.6% increase in employment.

The office market rebounded in the first half of the year in much of the State. The area around the BWI Airport is the strongest market, with a vacancy rate of just over 10% in the first six months of the year. The BWI area and Annapolis markets will likely remain the most competitive for the foreseeable future as a result of national security and high-tech tenants wanting to be in close proximity to Fort Meade and the airport. Howard County continues to suffer the fallout from the fiber-optics bust with a vacancy rate in excess of 20%. Montgomery County's biotech space shows relatively elevated vacancies as well, although federal government activity has helped support the market. Overall, the vacancy rate in the county was 12.4%. Only 182,000 square feet of office space were added to the Baltimore market in the first half of this year, more than offset by absorption of over 600,000 square feet.

There should be slow but steady improvement in the office market in and around Baltimore City. The Inner Harbor redevelopment is nearing an end, but activity has moved to the periphery of the Harbor area with construction activity underway or planned on both sides of the harbor, including Morgan Stanley's new processing center and a new office building in Federal Hill. While there are 1.3 million square feet of office space under construction citywide, most of which is speculative, low rates as compared to the District of Columbia will help the market absorb this space and should lead to a slowly declining vacancy rate over the next several quarters.

The industrial market around the Port has tightened over the past three quarters, and will be supported by the price advantages enjoyed over most nearby markets. The Cecil and

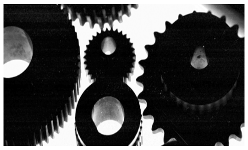
Harford county industrial markets have been hard-hit due to several large companies vacating over a half-million square feet of space, sending vacancy rates to 84% (in a still developing market) and 31%, respectively. Other areas are doing somewhat better; the overall industrial vacancy rate in the greater Baltimore region is just over 17%. But with several dozen buildings offering at least 100,000 square feet of bulk distribution space, the vacancy rate will not come down substantially until the economy and retail demand pick up. Thus, the addition of measurable amounts of new industrial space is likely several years off. The Hagerstown market is slightly better off; FedEx Ground is adding a central distribution hub in the area that will be active by 2006. In Hagerstown as well, a broadly improving economy will boost the industrial market.

The National Harbor in Prince George's County is one of the largest planned private development projects in the State. Plans call for a conference center, a 2,000 room hotel, office and retail space, and a marina. To date, only minor grading, excavation and shoreline stabilization work has begun, but the National Harbor will help sustain the construction industry over the next several years in addition to providing a new focal point for Maryland's broader economy in the coming years. Similarly, the Cordish Co.'s work at the former Capital Centre site will provide a locus for high-end retail in Prince George's County upon its imminent opening; in the meantime, dozens of construction jobs have been supported by the $82 million project.

The residential market has continued to surge with 30-year mortgage rates still hovering around 6%. Activity has been strong throughout most parts of the State, including Baltimore City, where 260 units in West Baltimore's Heritage Crossing (on land where two recently demolished high-rise public housing units stood) have sold out. Also on the west side, though aimed at a different demographic, the Centerpoint development is nearing completion. The project includes 400 luxury apartments, 35,000 square feet of retail space, and crucially, 415 parking spaces. A developer has recently been selected for Stadium Place, at the Memorial Stadium site, which among other facilities will include a 110-unit apartment complex. The mixed-use Park Place development on West Street in Annapolis will include a hotel, two Class A office buildings, 200 condominiums and 50,000 square feet of office space, scheduled for completion by the end of 2005.

In Prince George's County, the opening of two new Metrorail stations by the end of next year has caused a bout of residential and mixed-use development. In all, over 1,700 residences and a ten-story apartment building are planned, along with almost 1.5 million square feet of commercial and retail space. Low interest rates and a growing population have exacerbated the ever-present tension between pressures to develop and pressures to conserve, or at least grow slowly. Carroll County, Maryland's fastest-growing, has imposed a moratorium on new residential development that has not received final planning approval. Cecil County has faced similar issues, particularly with the troubled on-again, off-again development of the Bainbridge site. In fact, these counties are the anomaly; the long-term problem for residential builders is likely not to be the inevitable rise in interest rates, but the impending shortage of developable land. Land prices in Howard County reflect a sizable premium for scarcity; the county may be completely built out in about ten years. Montgomery is likely to follow in another ten.

Despite the long-term issues, residential construction will tide the sector over in the near-term. Following a flat 2003, the construction sector will rebound strongly with 2.2% growth in 2004 before rising interest rates take their toll, particularly on the residential market, and lead to a 1.0% decline in 2005.



Manufacturing

The manufacturing sector in Maryland has continued to decline, following national trends (see *Figure 3*). Old-line manufacturers are suffering. In addition to the previously announced closing of the Black and Decker plant in Easton, which eliminated the remainig 800 jobs, several other plant closing announcements came in 2003. General Motors has finalized plans to close the Broening Highway plant that makes Chevrolet Astro/GMC Safari vans. The plant, the 7th largest manufacturing employer in the Baltimore area, will close in 2005, taking with it 1,300 jobs. The world's largest automaker cut production at the plant substantially this year, reacting to a drop off in demand for the outdated vehicle—it has not been redesigned in twenty years. The closing is an ominous indicator for the remaining 50 employees of Johnson Controls at its Belcamp (Howard County) plant, who make seats for the Astro-Safari. In February, Johnson Controls sold the foam production operations at Belcamp to Woodbridge Foam Corp. which closed the plant, putting about 100 individuals out of work.

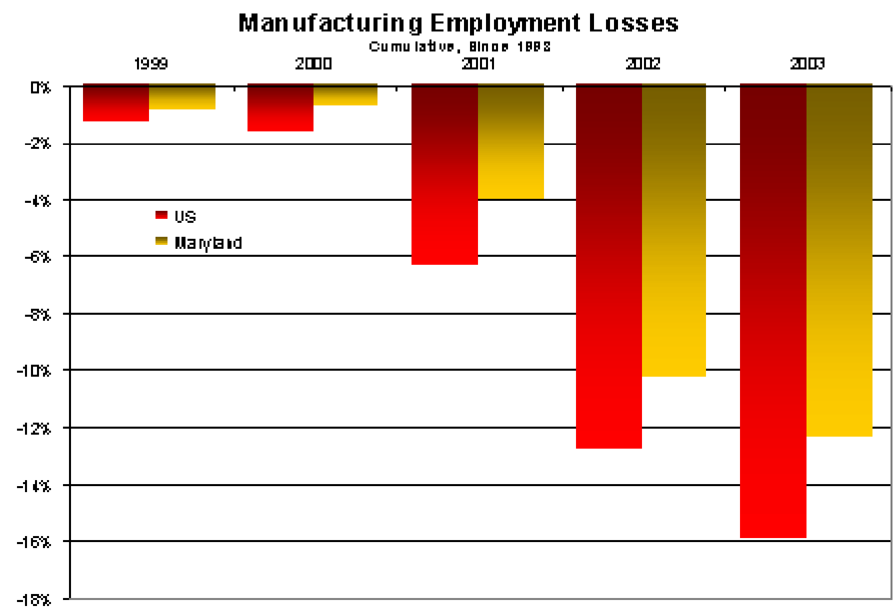


Figure 4

Baltimore Marine Industries, the region's 25th largest manufacturer, filed for Chapter 11 bankruptcy protection and laid off 200 workers after the mobilization for war in Iraq left no Navy ships in BMI's docks. International Steel Group completed its takeover of Bethlehem Steel. At least 490 employees accepted buyout offers from the company. Although the Sparrows Point mill eliminated 1,000 jobs, about one third of the workforce, it is unlikely that Bethlehem Steel could have survived bankruptcy on its own. The ISG purchase is expected to preserve over 2,000 jobs.

Smaller manufacturers have been losing jobs as well. Renaissance-Mark, the 7th largest printer in the Baltimore area, closed its label-printing operation in Baltimore County with a loss of 123 jobs. Clarke American, another major printer, closed its 30-year-old check printing operations in Timonium, putting 57 people out of work. Another 250 people in Baltimore City lost their jobs when glassmaker Carr Lowry filed for bankruptcy liquidation in July. Carr Lowry, which specialized in perfume bottles, was the last of the City's glassmakers. The industry was once eclipsed only by garment and canning industries in terms of City employment. Baltimore Air Coil, an industrial cooling and heat transfer equipment manufacturer, announced that it would lay off 150 people in Jessup, transferring those jobs to

Delaware and Illinois. Nevamar announced that it would close its laminate counter top production facility in Odenton, leaving 360 people jobless. Qualex, a division of Eastman Kodak, closed a photo processing plant in Gaithersburg that had employed 82 people, and Rock-Tenn, a maker of store displays, is also closing its Maryland operations, at the cost of 70 jobs.

One of the few pieces of “good” news is the billions of dollars in funding for new Defense and Homeland Security programs that are beginning to flow down into Maryland companies, and not just those near the National Security Agency and BWI Airport. Hunt Valley based AAI is producing unmanned aerial vehicles for the army, and recently received a $15 million contract to support their vehicles. Middle River Aircraft Systems in Baltimore was recently given a six-year, $80 million contract with Pratt & Whitney, while Cecil County’s ATK Elkton has received a contract to support a missile defense system procurement, for which Lockheed Martin and Northrop Grumman are competing. The increase in federal defense spending has led to a large number of contracts for Northrop Grumman’s Electronic Systems division in Linthicum, including a major role in the Army’s Future Combat System program, which will provide communications links between manned and unmanned ground and air forces. The division’s third quarter sales were up 16%, and profit more than doubled. Sparta, a systems engineering company for whom the Department of Defense is a major customer, will be doubling its 60-strong Columbia workforce over the next several years. Due to the nationwide reach of many of these companies, many if not most of these contracts will be fulfilled at least partly outside Maryland, but many will use Maryland facilities and resources.

High-tech manufacturers have started to recover somewhat from the bubble hangover, however the road to profitability has been paved with job cuts. Ciena Corp. increased its customer base by 10% this year while transforming itself from a manufacturing company to a service company. The company cut 650 positions in March, and may be letting another 75 go by the end of the year. Corvis reduced its workforce by another 200 people, but the fiber optic communications industry is expected to turn around in 2005, and Corvis has been making strategic investments to take advantage of that turn-around.

The manufacturing sector will decline by 2.6% in 2003, an improvement over the steep 6.5% decline in 2002. Job losses will decelerate in 2004, due in part to the depreciating dollar, falling to only 0.6%, before marginal growth occurs in 2005. But since manufacturing constitutes less than 6.5% of employment in Maryland compared to 11.7% of jobs nationwide, continuing woes in this sector will have a proportionately smaller impact on the State’s economy.

Trade, Transportation, and Utilities

Retail and wholesale trade is very important to the Maryland economy, providing 15.7% of the jobs in the State. The recession has taken its toll, with two straight years of declining employment. This year will break the trend, largely due to expectations of a nationwide 5.7% increase in holiday sales, the largest increase since 1999. Last year’s holiday sales were up 2.2%, the smallest increase in at least ten years. Holiday sales are very important to the retail sector, as 25% or more of most retailers’ revenue comes from the last two months of the calendar year. Since Maryland's economy has outperformed the national economy, holiday sales in the State may well be better than the national figures.

Employment in Maryland's retail sector declined by 0.5% in 2002 as consumers were buffeted by domestic economic concerns, lingering worries after September 11 and, towards the end of the year, impending war with Iraq. But income in Maryland remained relatively strong, and job losses in the State were marginal compared to the rest of the country, leaving consumers in good shape to resume spending. One of the State's prime retail-related businesses, the real estate investment trust Prime Retail, found the going too difficult, however, and has recently sold itself to a New Jersey-based real estate company. The retail landscape has stabilized after several years of upheaval saw Ames, Caldor, and Montgomery Wards closing stores across the State with the loss of thousands of jobs. Early this year K-Mart closed several stores in Maryland, on top of several closed in late 2002, and bankrupt Today's Man closed its remaining 24 stores, including six in the Baltimore-Washington area.

But many retailers and shopping centers are thriving. Chains searching for or opening new locations in Baltimore alone include the Outback Steakhouse, the Olive Garden, Starbucks, Caribou Coffee, DuClaw Brewing Company and both Giant and Safeway. Candy Express will house a chocolate factory and museum at the new Lockwood Place on Pratt Street. Much retail activity remains focused at and around Arundel Mills mall, which had over 14 million visitors in 2002. Those planning to move into the area include Wal-Mart, Circuit City, Staples, a second Exxon station, and TGI Friday's. Additional retail space will be provided in the area with the development of 86,000 square foot Arundel Village, to be anchored by a Safeway. Hampstead-based Jos. A. Bank posted one record performance after another, and is one of the fastest-growing retailers in the country.

The next round of upheaval in the retail sector is likely to come in the grocery market. Largely in response to K-Mart's bankruptcy, Fleming Cos., which supplied K-Mart with food products, declared bankruptcy and closed its distribution center in North East, Maryland. Maryland's largest grocer, Giant, is owned by the world's third largest grocery retailer, Royal Ahold. Ahold lost over $5 billion in 2002, and is not expecting significant improvement in 2003, primarily due to accounting irregularities at its Columbia, Maryland-based US Foodservice. Ahold's problems will increase in coming years, along with other grocers in the State, as the already competitive market becomes even more competitive with Wal-Mart's probably inevitable entry.

In just ten years Wal-Mart went from no grocery operations to becoming the largest grocer in the U.S. It is only a matter of time before Wal-Mart overcomes its hesitation to pay the high land costs in central Maryland and begins to compete directly with Giant and Safeway. Wal-Mart currently has only three grocery stores in Maryland (two in Salisbury and one in Oakland), but it has many others within 15 miles of Maryland's borders in Delaware, Pennsylvania, Virginia and West Virginia. Wal-Mart is already the 15th largest employer in the State and the 8th largest private employer. Many grocery stores anchor neighborhood strip malls, locations too small for a Wal-Mart Supercenter. If these grocery locations become vacant, the other stores in the mall will suffer from the lack of traffic. Maryland's high household income may partially insulate chains that emphasize quality and selection (Wal-Mart's weaknesses) over price (Wal-Mart's strength) but certainly Wal-Mart will change the grocery business landscape. The threat from low-paying, non-union Wal-Mart, which employs about half as many workers as the stores it displaces, is likely to affect negotiations between the United Food and Commercial Workers Union and the three large grocery chains that have contracts expiring in 2004: Giant, Safeway and Superfresh.

Over the past several years Prince George's County's efforts to attract retailers have begun to show results. Construction continues at Simon Property Group's Bowie Town Center, and The Cordish Company's Boulevard at the Capital Centre in Landover is slated to open soon. The Boulevard will have 490,000 square feet of retail space and provide 750 jobs. However, just a mile away, there has been no movement on Lerner Enterprise's 110-acre former Landover Mall, which the owner is trying to convert to a mixed-use development including office, medical and retail space. The only retail activity at the site is Sears, which continues to operate despite being attached to the defunct mall. A few miles north on the Beltway, however, Ikea opened a new 340,000 square foot, 450-employee store north of College Park.

Ikea will also open a new distribution center in Perryville in 2004 with 300 employees. Also in 2004, Macy's will begin construction on a new store at Shoppingtown Wheaton (formerly Wheaton Plaza), where the Australian owner, Westfield Holdings, is adding 100,000 square feet of additional retail space, an expansion of almost 10%. The new space will open in 2005.

Maryland's role as a regional distribution center for the mid-Atlantic continues to grow. In addition to the Ikea warehouse, FedEx is planning to open a 400-employee package distribution center near Hagerstown in 2006. These gains are partially offset by losses of the Fleming Cos. Warehouse in Northeast and closure of a Davidson Supply Co. distribution center in Laurel. The Laurel facility employed 80 people, distributing beauty supplies made by Alberto-Culver, such as VO5, Paul Mitchell, and Matrix.

While the outlook for the retail sector is generally good, there are several downside risks. Retail sales were propped up by tax rebates in the late summer, as well as through home refinancing. Neither of these factors is sustainable over the long term. Unless total employment picks up significantly, retail spending is likely to moderate during the next year. Retail employment is expected to will grow slightly in 2003 before declining a marginal amount in 2004. Modest growth is expected again in 2005. The wholesale sector will decline this year, and will be essentially flat in 2004 before returning to slow growth in 2005 as the new distribution centers become fully operative.

BWI Airport is once again seeing steady growth, with passenger volumes increasing about 10% over a year ago; 2002 traffic was only about 3% below the level of 2000, much better than the double-digit declines at most other airports. Southwest Airlines, one of the few making money, consolidated its position as BWI's largest carrier, with traffic increasing by 6.8%. Discount airline AirTran has begun service to BWI airport and already achieved a distant second place, measured by number of passengers, beating out integrated carriers American, Delta, and United. International traffic is up 23% at BWI with the return of Aer Lingus and Air Jamaica. That figure does not include the recent military R&R flights to and from Iraq, which have brought a significant amount of traffic through the international and domestic terminals.

Construction continues to expand BWI's capacity. New gates are being added and existing gate areas remodeled in the domestic flight areas, primarily to support Southwest Airlines, which will fill out most of the 31 new gates scheduled to be completed in 2005. The airport opened 3,200 new parking spaces with another 5,400 parking spaces to be added in the spring, along with expansion of the parking space locator equipment. A new rental car facility has opened, and work will begin soon to make the main concourse 10 feet wider. The current expansion project will be completed in 2006.

BWI's biggest competitor for freight is Dulles International Airport, and in 2002 BWI gained ground on Dulles. Excluding mail, BWI cargo increased 22% in 2002 to 526.4 million pounds, compared to 670.3 million pounds (a 5.5% increase) at Dulles.

The Port of Baltimore moved over 7 million tons of cargo in fiscal year 2003, a record amount. The Port also signed a new 10-year, renewable agreement that calls for over 28,000 Mercedes-Benz vehicles to be shipped to the US through Baltimore annually. The Port also opened a new 100,000 square foot protective shed, allowing an additional 100,000 tons of paper to be shipped through the Port each year. The shed has no internal columns to interfere with cargo movement, abuts the pier on one side and encloses a railroad siding on the other. The Port is working to repair minor damage caused by Hurricane Isabel and to finish another adjacent 300,000 square foot shed by 2005.

The Port still faces some long-term challenges, notably a lack of room for expansion on property currently owned by the Port. There are 3,000 acres of suitable land around the Port, but that land is not owned by the State. Access to and from the Port may also become a bottleneck. The Chesapeake and Delaware Canal remains at 35 feet. Even if plans to dredge to 40 feet are resumed, there are few nearby places left to deposit dredge spoil. Land access is a problem as well, as rail lines owned by CSX do not allow for double stacking of containers, and the single-track Howard Street Tunnel is running at capacity. About $2 billion would be needed to meet the rail needs in the Baltimore area, but there has been no serious effort to address this need.

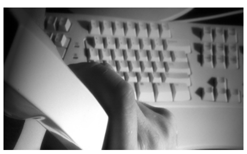
It has been a difficult year for electric utility companies. The year started out with record-setting cold weather in January followed by a series of snowstorms that led the Governor to declare a week-long state of emergency in February. Thunderstorms throughout the summer left thousands of customers without power for several days, but that paled in comparison to the numbers who lost power during a succession of storms, including Hurricane Isabel, in late September. The thunderstorms and winds knocked out power to as many as 80% of the companies' customers. In some places power was not restored for more than a week. In addition to tens of millions of dollars in emergency repair costs, utilities lost money on sales of electricity customers could not consume. One notable success was realized, however, with the PJM Interconnect's protection of Maryland's electric utilities from the blackouts that raced around Lake Erie in August, when cascade failures knocked out power in much of the northeastern U.S. and southeastern Canada for several days.

BGE did manage to turn a profit for its parent Constellation Energy in the quarter that included Isabel, although storm losses cut that profit in half. Allegheny Energy has not been so fortunate; its auditors are questioning whether it can continue as a going concern. Allegheny continues to struggle with losses from its merchant energy and trading businesses that have been devastated by falling demand and electric prices and by substantial increases in natural gas prices. In addition, Allegheny is in technical default on some of its credit agreements since it is not current with its financial reporting.

Also hurt by its dependence on its merchant energy business is Mirant, the company that operates most of the generating plants formerly owned by Pepco. Mirant filed for bankruptcy on July 14, jeopardizing the long-term, low-cost power supply agreements negotiated by Pepco as part of the sale of the power plants. On October 27, Pepco and Mirant announced that they had come to an agreement to restructure the contracts. If approved by the bankruptcy court in Texas, the new agreement will not lead to increases in rates paid by Pepco customers in Maryland. Pepco itself continues to be profitable, even after factoring in expenses related to the Mirant bankruptcy, cancellation of power units for Conectiv Energy, and Isabel.

WGL Holdings, parent company of Washington Gas Light, reported record profits for the fiscal year ended September 30, 2003. Profits resulted from the cold winter weather, higher rates, and an increased customer base. The company's non-utility businesses posted a small profit. Dominion Resources, Inc. began receiving shipments of liquified natural gas at its Dominion Cove Point facility this summer. Dominion can store five billion cubic feet (BCF) in its four tanks and can transmit one BCF per day. A fifth tank, twice the size of the existing tanks, is under construction and should be ready in early 2005. Dominion Cove Point is one of only four LNG terminals in the US, and the largest of the three on the East Coast. With natural gas demand expected to increase by 20% annually, prices will remain high and Dominion's facilities can be expected to remain busy.

Employment in the transportation and utility sector will decline slightly in 2003, but the decline will slow in 2004 as airlines continue to recover from September 11 and as utilities adjust further to deregulation and high natural gas prices. Growth will resume in 2005.



Information Services

The information services sector was actually Maryland's worst-performing sector in 2002, with a staggering 8.8% decline, worse even than manufacturing. The decline is largely the hangover from the massive overinvestment in telecommunications equipment and services during the stock market bubble. Further trouble has come from call centers, a number of which are in Baltimore County and Baltimore City. AT&T closed a Hunt Valley call center, affecting about 150 employees, and Bally Total Fitness laid off 200 employees from their Towson office, most of whom worked in a call center. These layoffs were prior to the imposition of the federal government's "Do Not Call" registry–other call centers may be adversely affected by the Do Not Call list, though the magnitude of the impact is an open question. On the other hand, Morgan Stanley's plans for a processing center in Fells Point, including a call center, continue apace, and C.R. Dynamics & Associates has opened a Baltimore call center to operate Maryland's tourism call center.

Verizon has entered Maryland's long-distance telecommunications market, opening a $1.4 billion market to the company, while AT&T has entered the local telecommunications market for business service in Baltimore and residential service in Baltimore and the Washington, D.C. suburbs. Verizon, which recently averted a strike by its over 6,000 employees in the State (and 79,000 workers overall), is active on several fronts. The company opened 160,000 high-speed Internet access lines on the Eastern Shore, and Verizon Wireless is now competing with Nextel for walkie-talkie services. Verizon suffered a setback, however, when it was required by the State to reduce the access fees it charges to other telecommunications firms by almost $20 million; that decision has been appealed to the Court of Special Appeals. Verizon Wireless will soon be facing increased competition now that cellular phone numbers have become portable; while opportunities for growth for all companies exist because the ties that bind customers to their competitors are loosened, they also stand to lose their own current customers. Verizon offered an early retirement plan in 2003 which reduced its workforce by 9.5%.

Supporting growth over the long term, Verizon, SBC, and BellSouth have agreed on a basic infrastructure for migrating their copper wire communications systems to fiber optics. Barring any unforseen change in federal regulations, Verizon is expecting to invest heavily in this conversion over the next decade. The move by the three largest of the four "Baby Bell" companies is designed to help them recapture some of the business they are losing to competitive local exchange carriers and the expanding capabilities of cable television networks.

USinternetworking is recovering from its bout with Chapter 11 bankruptcy, and is now grossing over $100 million annually. The company has shed about 1,000 employees over the past several years, and is now down to about 435, but is again expanding, having recently purchased a Georgia company. Market analysts expect USi to be one of the application service providers to survive the industry shakeout. A number of software firms in the State are targeting new niches in national security products–Bluefire Security, SafeNet, Sourcefire and Intellitactics, which is moving its headquarters from Ontario to Bethesda, are among the Maryland companies seeking to earn their keep from the federal government. The possibility of large-scale disaster, as evidenced by September 11, spurred the creation of Evergreen Assurance, established last year by the founder of USinternetworking. The 35-employee company provides emergency backup support and disaster recovery for clients' e-mail and other vital information systems. The recent blackout in the Northeast put their system to the test, which it passed by transferring Forbes.com's e-mail systems from New York to Cincinnati. The company, which started with five clients, recently signed a contract with the International Monetary Fund.

Wireless Internet access may be another growth market for information services companies. Baltimore recently announced plans to provide a free wireless-fidelity, or wi-fi, network in the Inner Harbor. Baltimore-based firms are supplying the project--Accelacom is providing the broadband access and wi-fi link, while Legal Technology Solutions is building the portal. Two start-ups, Port Networks and Onedor, are also building wireless networks in the City. Verizon may become active in that market locally; the company plans to establish 1,000 wi-fi "hotspots" nationwide. The technology won't be used just to access the Internet. Barcoding, a 50-employee Baltimore company that provides equipment for bar code inventory systems, has spun off Wireless Builders, which will provide integrated wireless inventory systems.

Although a large number of start-ups have come on the scene, their presence is the epitome of the "creative destruction" that has affected the information services sector since the dot-com bubble. As companies, large and small, laid off workers or went out of business over the past two years, many formerly high-flying tech executives and workers started their own companies. These micro-firms may amount to something in the future, from a macroeconomic standpoint, but they cannot offset the current job losses still afflicting the sector. The information services sector will suffer further job losses of 4.7% in 2003, before a rebound of 1.8% in 2004. The information services sector, however, is the smallest major industry in Maryland, so its troubles will have only a minimal impact on the State's economy.

Financial Services

Maryland’s financial services sector is currently stagnant, coming off of 1.3% growth in 2002. Bank mergers have resulted in job losses this year–between the purchase of Allfirst by M&T Bank and of F&M Bancorp by Mercantile Bankshares, 1,000 Maryland jobs or more will be lost. On a much larger scale, Bank of America recently announced the purchase of FleetBoston Financial, which will create the second-largest bank in the country. Bank of America is Maryland’s largest bank, but since FleetBoston has no presence in the State, it is likely that few if any Maryland jobs will be affected.

Also not affecting Maryland jobs is the potential move of T. Rowe Price from downtown Baltimore–Price may be following the St. Paul Cos., which is all but certain to move its 700 area jobs from the City for Baltimore County. T. Rowe Price is considering consolidating its activities, and 1,000 city jobs, in Owings Mills, where its 72-acre campus is only half developed. Should the company make the move it would be a blow to Baltimore’s downtown business district. The company has weathered the market downturn, and through June 30 had nearly regained its 2000 peak of assets under management. The firm has started several new mutual funds, and while revenues have been down in 2003, earnings are up.

While losing a $20 million copyright lawsuit may have dimmed its record performance in the third quarter, Legg Mason posted its highest earnings per share and reached a new high for assets under management. Both of these firms are very well positioned for the future, particularly if they can avoid association with the nascent mutual fund scandal which is already causing outflows from several mutual fund companies who have been charged with wrongdoing. Both companies have apparently received a subpoena from the Securities and Exchange Commission regarding the practices at issue, but there is no indication that either firm has behaved improperly.

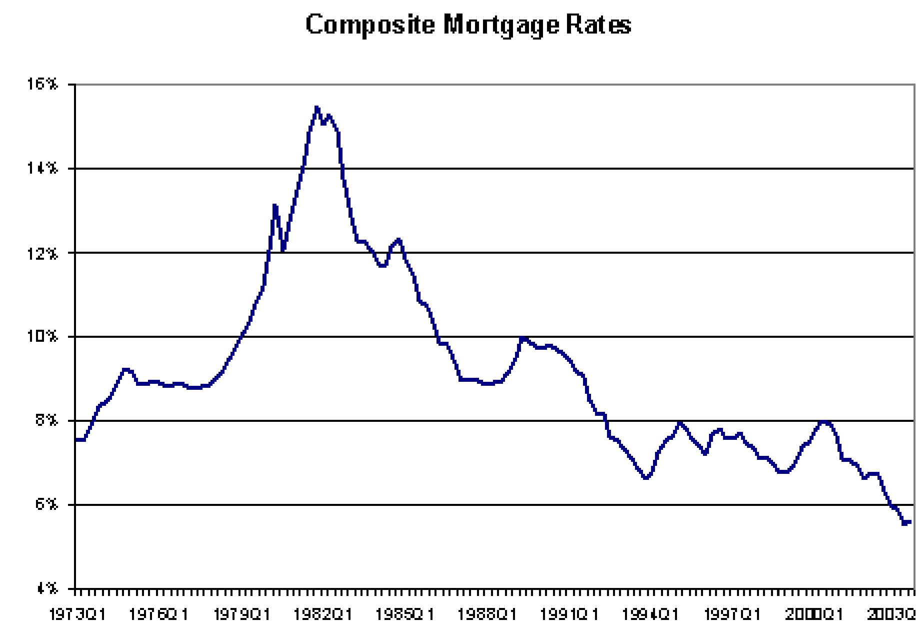


Figure 5 Source: Federal Housing Finance Board

The real estate sector has benefitted greatly from record low interest rates, and commercial real estate firms are expanding. The Staubach Company, a commercial real estate firm founded by Roger Staubach, has established a Baltimore office to serve the northeastern region; Baltimore County-focused MacKenzie has opened an office in the city as well. Corridor RF&S Real Estate has added four vice presidents and established a new multi-family property division, and plans to add brokers to its Bethesda office in the near future.

The mortgage refinancing boom is coming to a close as rates begin to creep up; at a minimum, mortgage banking will no longer be supporting growth and it may turn to a drag on growth through 2004. A renewed bull market will support a number of companies in the State, including both large and small mutual fund companies, but increasing efficiencies through the banking mergers will result in a flat 2003 for the finance sector. The following year will see a modest improvement, to 0.7% growth, followed by 1.6% growth in 2005.

Professional and Business Services

The professional and business service sector is Maryland's largest service industry, and the second largest overall, behind government. This sector has experienced a dramatic turnaround over the past few years–from 1996 to 2000, average annual growth in this sector was 5.9%, leading Maryland to four consecutive years of employment growth at or above 2.5%. The sector slowed to 0.7% growth in 2001, and declined by 0.7% in 2002 as profitability declined and businesses cut back on spending.

As with much of Maryland's economy, federal government spending lends a great deal of support to this sector. The federal government spent $13.5 billion in the Washington, D.C. area on high-technology services in 2001, five times the amount spent in Silicon Valley. This spending can only have grown by 2003. Businesses in Montgomery and Anne Arundel counties, and increasingly in Frederick, Howard and elsewhere, are benefitting from these federal expenditures. Science Applications International Corporation, or SAIC, epitomizes the high-end of the business service sector. They provide the federal government with services of all sorts, including electronic eavesdropping for the National Security Agency, destroying chemical weapons for Aberdeen Proving Grounds, running a research program for the National Cancer Institute in Frederick, and disposing of contraband for the Transportation Security Agency. The company receives about two-thirds of its business from the federal government, but also receives business from the State. SAIC was called upon to evaluate the electronic voting machines and systems provided by another contractor to Maryland, and it runs the State's electronic procurement system. The company has 33 locations in the State, and employs about 14,000 in the Washington, D.C. metropolitan area.

Most firms in this sector are much smaller than SAIC, and most benefit to a much lesser extent from federal spending. For those whose primary clients are other businesses, the last two years have been difficult. ADnational Directory Advertising, a 23-employee firm based in Columbia, recently filed for bankruptcy after having purchased advertising space for which its business clients could not pay. W.B. Doner, once the largest advertising agency in Baltimore, closed its local office in August and consolidated its local accounts to its Detroit office, resulting in the loss of 75 jobs. Carton Donofrio Partners had planned to relocate its Baltimore headquarters towards the end of this year, but required about 40% less space as it had let go about 40% of its 75 employees. The advertising business, as with many in this sector, will bounce back now that business profitability and business confidence have returned.

The accounting sector has largely recovered from the shocks of the Enron and other auditing scandals, though there has been a spate of mergers and other reshufflings. The 50-person Towson firm of Grabush, Newman has been bought by Smart and Associates, Philadelphia's fifth largest accountant, and national player Clifton Gunderson recently purchased Harford County's largest accountant, Coughlin & Mann Chartered. Meanwhile, KPMG has sold off its dispute advisory service to Annapolis-based FTI as part of the ongoing restructuring of the Big Four accounting firms. FTI, a bankruptcy and litigation consulting firm, has made several acquisitions recently and is looking to expand as far afield as Europe. Protiviti, a risk management firm founded by former Arthur Andersen employees, has moved its local Columbia office into new space which will allow it to double its employees in the near future.

The professional and business services industry is showing some signs of recovery currently, and will eke out modest growth of 0.6% in 2003. Respectable growth of 2.1% will be realized in 2004 and strong growth of 3.9% will be reached in 2005 as businesses loosen spending. That heady growth, however, will still be well under the performance of the late 1990s.

Education and Health Services

Maryland's second-largest service industry is education and health, which has shown more consistent, robust growth over the past decade than any other sector of the State's economy. In only four of the last eleven years has employment growth been less than 3.0%, and this sector grew by 3.4% in recessionary 2001 and 3.5% in slow-growth 2002. Although beset by such troubles as labor shortages, attendant costs and the State's budget problems, this sector is likely to continue its record of relatively strong, relatively stable growth.

The biotechnology industry is moving closer to actually becoming the long-promised industry of the future. The National Institutes of Health provide a locus of growth in Montgomery County, although the 2004 federal budget contained surprisingly small increases in funding. Growth will continue, in part due to a grant of $200 million from the Bill and Melinda Gates foundation. The NIH will also provide for growth in the east side of Baltimore with an $800 million research park funded by a number of partners. The park, which will take five years to complete, will contain an incubator for emerging biotech companies and the Johns Hopkins medical school along with about 1,000 employees, as well as residential and retail space. On the other side of the City, the University of Maryland-Baltimore has plans for six research buildings, the first of which should be completed by the end of 2004. Negotiations about joint marketing of these research parks are underway; should the negotiations bear fruit, the synergy created by the two parks will allow Baltimore to consolidate its position as a global leader in biomedical research.

Other biotechnology incubators and research centers are thriving, including the Shady Grove Life Sciences Center in Montgomery County and one hosted by the University of Maryland, Baltimore County. The Center for Advanced Research in Biotechnology, a joint operation of the University of Maryland Biotechnology Institute and the National Institute of Standards and Technology, is moving ahead with a $50 million 140,000 square foot building to house an expansion of the Center for Advanced Research in Biotechnology, a teaching and research facility. The 165,000 square foot UMBC facility is home to many life science and information technology startups; it has had little difficulty both in moving successful companies into the real world and in filling the vacant space left by those moving up. The center recently received a $400,000 grant from the State to expand and renovate its facilities.

The Howard Hughes Medical Institute will add a $25 million addition to its Chevy Chase headquarters that will house up to 110 new workers, though the addition may take up to two years to complete. But that the expansion has reached serious stages of planning demonstrates that the institute is committed to keeping its headquarters in Montgomery County, after quietly locating a new $500 million, 500 employee research facility in Loudoun County across the Potomac. Not all tech centers are booming–Baltimore's Emerging Technology Center at the Can Company and the Bard Life Sciences Laboratory are having difficulties in finding start-ups to promote, but they are currently the exceptions. While incubators and the biotechnology industry itself do not yet provide sizable numbers of jobs in the State, they are laying the groundwork for a prosperous future.

Some hospitals and other health care providers have, for a variety of reasons, experienced difficulties of late. Sierra Military Health Services, which has provided health services to military personnel and their families in 13 east coast states and the District of Columbia, recently lost its sole contract, with the Department of Defense. The future of the company, which signed a 10-year lease one year ago, and its 550 Baltimore area employees is uncertain; the company has protested the procurement. Rockville-based Mid-Atlantic Medical Services, or MAMSI, has announced that it will be purchased by UnitedHealth Group of Minneapolis. UnitedHealth's local HMO will be merged into MAMSI, potentially putting some administrative jobs at risk.

St. Agnes HealthCare cut services and reduced expenditures in light of an adverse decision on rates by the Health Services Cost Review Commission (HSCRC); the Prince George's Hospital Center and its operator, Dimensions Healthcare System, will apparently receive a $5 million subsidy from the county immediately and a further $25 million over the next four years to stave off bankruptcy, again after an adverse decision on rates by the HSCRC. Magellan Health Services has been in Chapter 11 bankruptcy since March, but should complete its reorganization by the end of the fourth quarter saving the jobs of its approximately 1,500 Maryland employees. Not all State decisions were bad for hospitals, however; six Baltimore-area hospitals received over $3 million for expansion projects from the State's fiscal year 2004 capital budget.

The nursing crisis in the health care sector is being addressed with innovative approaches. Several community colleges and other higher education institutions across the State have established relationships with nearby hospitals to help students learn while accomplishing needed nursing tasks under a program funded by the HSCRC. Filling nursing positions isn't the only problem facing health care managers, however. Doctors in Maryland, and the mid-Atlantic region generally, are underpaid compared to national figures due to lower reimbursement rates and higher malpractice insurance and other overhead costs. Only larger problems in New Jersey and Pennsylvania have kept the focus from the problems of Maryland's doctors. A growing shortage of pharmacists has led the University of Maryland School of pharmacy to enroll its largest class ever, midway through its five-year effort to raise enrollment by 20%, though the impact of expanded enrollment obviously won't be seen in the market for several years.

Businesses providing educational services have also had some difficulties. Sylvan Learning Systems was expected by many to add 1,800 jobs in Baltimore City between 2000 and mid-2005, and in the process, to convert part of $4 million in loans from the City and State to grants, and to maintain the remainder at below-market rates. To date, only 150 new jobs have been created. At formerly-related eSylvan, an Internet tutoring service, 17 positions were eliminated early in the year, nearly one-third of the workforce. While education services provided over the Internet may not be flourishing yet, one of the most traditional of for-profit educational services has been—trade schools. Driven by increasing demand for real estate, allied health and computer skills programs, 44 new schools have opened in Maryland and 310 new programs have been approved by the Maryland Higher Education Commission over the past five years. While the growth in this field may slow as the economy recovers and prospective students find jobs, demand for continuing education and retraining in a dynamic economy will help support continued expansion.

While many of the businesses in this sector are experiencing turbulence, high demand for both education and health services and relatively high salaries in many jobs in the health sector will keep this industry among the top performers in Maryland's economy, with growth of 2.6% this year and 2.4% and 3.3% in the following two years.

Leisure and Hospitality Services

Maryland's hospitality industry has recovered from the steep drop in travel after September 11 much more quickly than that of the nation. Most visitors arrive by car, so the drop in air travel did not affect the State's tourism as much. Coupled with a weak economy, day-long and weekend trips by car from nearby, densely populated regions kept this industry growing. This year employment in the industry will grow by 2.2%, somewhat below the 3.0% growth of 2002–second only to the education and health services industry.

While hotel occupancy rates in Maryland have followed the generally stagnant national trends over the past year, room rates have increased all but one month in the last 14. Luxury hotelier Four Seasons is planning on opening a 200 room hotel in the Inner Harbor, the former Archer Daniels Midland grain silo at Locust Point will be converted to hotel/condominium/office space, and Marriott is building a 225-room hotel in Bethesda. Business travel continues to support growth around BWI Airport, and tourist attractions at Baltimore's Inner Harbor—the National Aquarium, the Science Center, the Power Plant and others—continue to attract. A new visitors center at the harbor will open shortly. The Baltimore Development Corporation recently recommended Robert Johnson's proposal to build a 750-room Hilton to serve as Baltimore's convention headquarters hotel, though a competing group would still like to participate in the hotel's construction. The National Harbor project in Prince George's County will, when complete, provide numerous tourist/travel attractions, including a convention center, a 2,000 room hotel, and an amusement park.

Policymakers have recently discussed the possibility of placing slot machines at locations other than racetracks. Such a decision could boost tourism overall, and could provide help to such areas of the State as Rocky Gap and Cambridge, though any progress in this area will not occur until after the next session of the General Assembly, if then. Maryland's wealth, central location and proximity to Washington will continue to drive growth in this sector, regardless of the outcome of the slots debate. The leisure and hospitality services sector will grow by 4.9% in 2004, topping Maryland's charts, before decelerating to a still robust 3.4% growth rate in 2005.

Government

Aside from directly supporting tens of thousands of jobs in manufacturing, information services, professional services and health services, federal, state and local governments employ over 460,000 individuals in the State (not to mention several tens of thousands who commute to their government jobs in Virginia or the District). While the government sector has provided a source of stable growth over the past five years, government jobs are will be much harder to come by for the next several years as all levels of government are experiencing fiscal difficulties.

Federal government employment growth was strong in 2002, rising at 1.2% as a result of increased activity at Ft. Meade, Ft. Detrick, Aberdeen Proving Grounds and elsewhere. The National Security Agency is Maryland's largest employer, a position it is unlikely to relinquish any time in the near future. Several developing trends may moderate growth of federal government employment, however. The Bush Administration has shown interest in outsourcing federal jobs. Should outsourcing or privatization be implemented at agencies based in Maryland, presumably much of the impact on employment would be a shift of jobs from one sector to another, though the number of Maryland jobs (and possibly associated pay) could be reduced. An off-and-on trend of moving federal agencies away from the Washington, D.C. metropolitan area would reduce Maryland employment; that trend could accelerate in the event of another major terrorist attack in the region. Finally, the federal government's budget deficit seems likely to impose a restraint on federal employment, perhaps not immediately but possibly over the next several years, although whether Congress and the Administration (or any administration) will respond to budgetary pressures is unclear. Federal government employment will decline by 0.7% this year before essentially leveling off at 0.1% growth next year before returning to growth at a rate of 0.4% in 2005.

State employment will not grow during the next few years. A hiring freeze has been in effect since October 2001; the freeze was strengthened by the incoming Ehrlich Administration in January 2003. While some positions are being filled on a case-by-case basis, the number of vacancies statewide would be growing were it not for recently implemented position reductions. The General Assembly eliminated 131.5 positions during the 2003 session, and the Board of Public Works abolished 962 more in July (including 82.5 filled positions) along with 72.5 contractual positions. The Department of Budget and Management had until December 1 to eliminate another 715 positions, vacant or not. Given that State budget pressures are unlikely to ease until fiscal year 2008 (perhaps sooner, if funding requirements for education aid under the Thornton plan are altered), the number of individuals directly employed by the State will decline in the near future.

Local governments have it better than the State, but only barely. They will be receiving a fresh influx of funds due to the increased education aid from the State, and most counties are benefitting from the real estate boom via increased property taxes. But other aid from the State has been curtailed, and local income taxes, particularly in wealthier jurisdictions, have followed the same course as State income taxes. While teachers and school administrators will continue to be hired, other local government jobs will increase marginally, if at all. State and local government employment will grow in 2003 by 2.0%, before slowing to very modest growth of 0.5% in 2004 and 2005 as the full impact of the State's fiscal problems works its way down to the counties. All the growth will be at the local level, with the State losing 0.5% of its jobs the next two years. Local government growth will be almost solely due to growth in education-related employment.

Agriculture

The worst news on the agricultural front is that Tyson Foods announced in April that it was closing its Berlin processing plant. The plant, which employed 650 people and could process one million chickens a week, will be closed by the end of the year. Meanwhile, broiler chicken production continues to climb, with 292.9 million birds produced in 2002, up from 288.0 in 2001.

After three years of drought, the weather made an about face in 2003 and dumped 52.9 inches of precipitation at BWI Airport through mid-October, more than double that of the year before and 18.5 inches more than normal. Tropical Storm Isabel seems to have done little damage to crops, although some corn crops were affected. Crop harvesting has been slowed by the wet weather and slow growing conditions. Soybean production is expected to be 40% above the 2002 harvest of 10.8 million bushels, and corn will be up 62%. Barley yields are down to 61 bushels/acre from record 2002 levels of 82 bushels/acre. Acreage harvested is down as well, resulting in production of 2.4 million bushels, down 27% from 2002. Wheat production is down 55% due to declines in both yield and harvested acres.

Fruit crops are small in Maryland (32.0 million pounds of apples and 7.0 million pounds of peaches), and are under threat from the brown marmorated stink bug. The stink bug, first spotted in the U.S. in Pennsylvania two years ago, has been found in Washington County. The cosmetic appeal of fruit is ruined by the bug (“cat-facing”), and soybeans are another favorite meal. Adding insult to injury, the malodorous bugs frequently invade homes as the weather turns colder.

Tobacco production has been declining since 1994 and is now 2.1 million pounds, about 16% of its 1994 level, and only 4.6% of the record high level of 46 million pounds in 1946. Prices have also been declining since 2000, and the number and length of tobacco auctions has been shortened considerably. Production and prices are expected to continue to fall in the upcoming years, as farmers have responded to market pressures and the State’s tobacco buyout program.

Fin fish harvests were up in weight, but mixed in revenue. Rockfish harvest in 2002 was 1.9 million pounds, up from 1.0 million, with dockside value climbing from $1.7 million to $3.2 million. The weight of other fin fish was also up from 6.6 million pounds to 10.6 million pounds, although revenue was down from $6.6 million to $3.5 million. The Blue Crab harvest improved modestly in 2002, to 25.0 million pounds from 24.5 million in 2001. The harvest is expected to be lower in 2003, due in part to the heavy rains in the Chesapeake Bay watershed that have reduced the salinity of the Bay. One of the three remaining crab-picking houses in Crisfield, Byrd’s Seafood, closed this year because there was an insufficient supply of crabs.

According to The National Research Council, part of the National Academy of Sciences, the oyster population in the Bay is less than 1% of what it was in the 1870s. Several factors have led to this decline, but by far the biggest is disease. Pollution, overharvesting, and declining salinity of the Bay have also contributed to the decline. The outlook for 2003 is not good, as disease continues to devastate the oyster population and unusually high rainfall in the Chesapeake watershed has led to a further reduction in salinity in the Bay. There has been a corresponding drop seen in commercial harvests. As recently as 1981 the oyster harvest exceeded 2.5 million bushels. In its fourth consecutive year of decline, the harvest in 2002 was a scant 94,000 bushels. The steep drop in supply has nearly tripled prices from $8/bushel in 1981 to $23/bushel in 2002. Maryland, along with other states and the federal government, is looking at ways to restore the oyster population, both by promoting the native oyster species and by introducing disease-resistant non-native species. The State Board of Public Works recently approved a test program of introducing sterile, disease-resistant Asian oysters into three Bay tributaries. Even if successful, sizable oyster harvests remain some time off.

According to the Bureau of Economic Analysis, farm income declined by 9.3% in Maryland in 2002, more than double the national decline of 4.6%.

Table 2
Forecast of the Maryland Economy

	1999	2000	2001	2002	2003	2004	2005
Total Non-Agricultural Employment (thousands)	2,386.2	2,449.8	2,467.2	2,472.6	2,482.6	2,513.9	2,562.0
	2.7%	*2.7%*	*0.7%*	*0.2%*	*0.4%*	*1.3%*	*1.9%*
Total Personal Income ($ in millions)	167,360	180,941	190,015	197,156	203,515	212,614	224,309
	5.6%	*8.1%*	*5.0%*	*3.8%*	*3.1%*	*4.6%*	*5.5%*
Wages and Salaries	87,125	93,927	98,803	101,863	104,811	109,376	115,863
	6.8%	*7.8%*	*5.2%*	*3.1%*	*2.9%*	*4.4%*	*5.9%*
Proprietors' Income	9,621	10,206	10,611	11,134	11,836	12,537	13,263
	13.5%	*6.1%*	*4.0%*	*4.9%*	*6.3%*	*5.9%*	*5.8%*
Dividends, Interest and Rent	31,441	34,481	35,378	35,900	36,083	37,314	38,676
	1.4%	*9.7%*	*2.6%*	*1.5%*	*0.5%*	*3.4%*	*3.7%*
Residence Adjustment	17,582	19,571	20,534	20,931	21,521	22,465	23,800
	6.5%	*11.3%*	*4.9%*	*1.9%*	*2.8%*	*4.4%*	*5.9%*
Transfer Payments	16,926	17,740	19,257	21,053	22,448	23,646	25,003
	4.2%	*4.8%*	*8.6%*	*9.3%*	*6.6%*	*5.3%*	*5.7%*
Capital Gains	9,313	11,294	5,365	3,890	4,084	4,493	4,942
	19.1%	*21.3%*	*-52.5%*	*-27.5%*	*5.0%*	*10.0%*	*10.0%*
Unemployment Rate (%)	3.6	3.8	4.0	4.3	4.5	4.2	4.1
Housing Starts (units)	30,207	30,014	29,831	29,786	29,973	28,326	28,122
	-6.5%	*-0.6%*	*-0.6%*	*-0.2%*	*0.6%*	*-5.5%*	*-0.7%*

Bureau of Revenue Estimates, December 2003

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 RESI, and by national consulting firms Global Insight and Ecomomy.com.

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 2003 through 2005. 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 2003 - 2005

$ Thousands	GENERAL FUND			SPECIAL FUND			TOTAL		
	Fiscal Year 2003 Actual	Fiscal Year 2004 Revised Estimate	Fiscal Year 2005 Estimate	Fiscal Year 2003 Actual	Fiscal Year 2004 Revised Estimate	Fiscal Year 2005 Estimate	Fiscal Year 2003 Actual	Fiscal Year 2004 Revised Estimate	Fiscal Year 2005 Estimate
INCOME TAXES									
Personal	4,703,738	4,997,954	5,304,354				4,703,738	4,997,954	5,304,354
Corporation	288,274	317,796	357,058	91,034	100,357	112,755	379,308	418,153	469,813
Total	4,992,012	5,315,750	5,661,412	91,034	100,357	112,755	5,083,046	5,416,107	5,774,167
SALES AND USE TAXES	2,697,061	2,845,977	2,943,669	23,102	23,644	24,826	2,720,163	2,869,621	2,968,495
STATE LOTTERY RECEIPTS	422,945	418,786	439,911	79,102	72,919	74,509	502,047	491,705	514,420
TRANSPORTATION REVENUES									
Motor Vehicle Fuel Tax	12,520	12,773	13,110	703,564	722,327	741,090	716,084	735,100	754,200
Motor Vehicle Licenses, Fees				376,498	384,271	391,971	376,498	384,271	391,971
Motor Vehicle Titling Tax				669,253	704,000	728,000	669,253	704,000	728,000
Maryland Transit Fees				98,237	106,000	110,000	98,237	106,000	110,000
Maryland Port Fees				91,901	89,000	89,000	91,901	89,000	89,000
Maryland Aviation Fees				109,706	164,000	137,000	109,706	164,000	137,000
Total	12,520	12,773	13,110	2,049,159	2,169,598	2,197,061	2,061,679	2,182,371	2,210,171
PROPERTY TAXES, FRANCHISES, ETC.									
State Real and Personal Property Tax				285,955	471,746	512,865			
Property Transfer Tax				140,908	158,094	132,797			
Business Franchises and Filing Fees	143,364	188,233	193,329						
State Tobacco Tax	199,201	269,096	264,256						
Tax on Insurance Companies	228,476	252,684	260,249						
Alcoholic Beverages Excises	25,651	26,439	26,737						
Death Taxes	142,311	117,284	123,650						
Clerks of the Court	51,573	57,033	43,677						
District Courts	71,573	81,075	79,367						
Hospital Patient Recoveries	73,681	76,616	77,127						
Interest on Investments	31,901	27,101	48,022						
Miscellaneous Fees, Other Receipts	224,751	254,820	216,601		--- See Notes ---			--- See Notes ---	
Total	1,192,482	1,350,381	1,333,015						
Total Current Revenues	9,317,020	9,943,667	10,391,117						
Transfers	12,119							--- See Notes ---	
GRAND TOTAL	9,329,140	9,943,667	10,391,117		--- See Notes ---				

Notes: Includes all general fund revenues, all Transportation revenues and selected special fund taxes. Additional federal recoveries were received in fiscal year 2003 and will be received in 2004. Fiscal year 2003 revenues include approximately $58.2 million in heritage structure rehabilitation tax credits, $52.6 million of which were against general fund revenue sources. The credit is expected to reduce fiscal year 2004 revenues by $52.9 million ($48.5 million general fund) and fiscal year 2005 revenues by $32.7 million ($30.0 million general fund).
In conjunction with Appendix B of the Fiscal Year 2005 Budget Book, this table will comprise the official estimate of total state revenues.

Table 4

Maryland General Fund Revenues

Fiscal Years 2001 - 2005

$ Thousands	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004 Official Estimate[1]	FY 2004 Revised Estimate	FY 2004 Difference	2005 Estimate
INCOME TAXES:							
Personal	5,133,726	4,771,649	4,703,738	5,061,039	4,997,954	(63,085)	5,304,354
Corporation	374,397	273,235	288,274	330,773	317,796	(12,977)	357,058
Total	5,508,123	5,044,884	4,992,012	5,391,812	5,315,750	(76,062)	5,661,412
SALES AND USE TAXES	2,626,775	2,642,477	2,697,061	2,829,379	2,845,977	16,598	2,943,669
STATE LOTTERY	385,045	414,063	422,945	450,732	418,786	(31,946)	439,911
FRANCHISES, EXCISES, LICENSES, FEES:							
Business Franchise Taxes	169,008	145,180	143,364	217,446	188,233	(29,213)	193,329
Tax on Insurance Companies	190,397	193,718	228,476	229,181	252,684	23,503	260,249
Death Taxes	168,803	184,725	142,311	136,884	117,284	(19,600)	123,650
Tobacco Tax	205,636	209,887	199,201	275,566	269,096	(6,470)	264,256
Alcoholic Beverages Excise Tax	24,522	25,747	25,651	26,598	26,439	(159)	26,737
Motor Vehicle Fuel Tax	11,984	12,266	12,520	12,611	12,773	162	13,110
District Courts	69,606	72,592	71,573	74,456	81,075	6,619	79,367
Clerks of the Court	39,534	42,634	51,573	44,881	57,033	12,152	43,677
Hospital Patient Recoveries	66,221	97,788	73,681	76,427	76,616	189	77,127
Interest on Investments	140,588	71,510	31,901	45,576	27,101	(18,475)	48,022
Miscellaneous	196,191	198,598	224,751	223,932	254,820	30,888	216,601
Total	1,282,490	1,254,644	1,205,002	1,363,558	1,363,154	(404)	1,346,125
Total Current Revenues	9,802,433	9,356,068	9,317,020	10,035,481	9,943,667	(91,814)	10,391,117
GAAP Transfer / Other Transfers	--	119,465	12,119	--	--	--	--
Tax Amnesty	--	28,509	--	--	--	--	--
GRAND TOTAL	9,802,433	9,504,042	9,329,140	10,035,481	9,943,667	(91,814)	10,391,117

[1] The official estimates for the income taxes have been adjusted for the heritage structure rehabilitation tax credit; the grand total is unchanged.

Individual Income Tax

The individual income tax suffered its second consecutive year of decline in fiscal year 2003, falling 1.4% after the 7.1% decline in fiscal year 2002. In both years, the revenue declines were a result of steeply dropping capital gains and very modest employment growth during and after the recession (as well as the final steps of the phased-in 10% income tax cut). The direct impact of the capital gains slump was much less in fiscal year 2003 than the year before, as the drop was only an estimated 27% from a base less than half that of the prior year. Tax year 2002 revenues from capital gains, which are subject to income tax the same as any other dollar of taxable income, were under $200 million, about one-third of the level just two years prior.

As productivity and profits improved dramatically throughout 2003 and continue to increase in 2004, businesses will be in position to resume hiring and increase compensation. As the economy improves, income tax withholding will grow by an estimated 6.8% in fiscal year 2004 and 6.2% in 2005. While growth is fundamentally driven by accelerating income—wage and salary growth will average 3.4% during fiscal year 2004, up from 2.9% in 2003, and will accelerate further to 5.4% in 2005—changes to the State and local income taxes will boost withholding.

A number of actions were taken by the 2003 General Assembly to improve compliance with existing tax laws, including withholding income tax from sales of real estate by nonresidents, eliminating the effect of graduated rates on withholding, limiting the number of withholding exemptions for delinquent taxpayers, and withholding taxes on certain winnings at racetracks. In addition, six counties increased their local income tax rate for tax year 2004, including Montgomery, Howard and Prince George's, some of Maryland's largest and wealthiest counties. These rate increases will result in 4.85% growth in local revenues for the tax year, over and above expected income growth, and will increase withholding by about 1.75 percentage points in tax year 2004 and each year thereafter. After accounting for these changes, baseline withholding growth in fiscal year 2004 will be about 4.9%, rising to 5.2% in fiscal year 2005.

While the stock markets will finish 2003 with sizable gains, the first since 1999, revenues are not expected to be dramatically affected since gains must generally be realized before taxes are paid, and because there are no doubt many taxpayers with carryforward losses to offset any gains they may have actually achieved in 2003. Following declines of 52.5% and an estimated 27.5% in calendar years 2001 and 2002, capital gains will increase by 5% in 2003, supported in large part by gains from the booming real estate market, and by 10% in 2004. In addition, as the economy accelerates, other non-wage related income from which taxes are not withheld will grow more strongly. As a result, estimated income tax payments will actually grow again in fiscal year 2004, by 5.4% (4.6% after adjusting for legislative changes to the safe harbor requirements), strengthening to 6.7% growth in 2005.

Final payments, which in fiscal year 2004 generally reflect activity in calendar year 2003, will increase by 6.0%, reflecting more than anything else very low estimated payments throughout 2003, which most taxpayers would have based on tax year 2002 liability. Similarly, before accounting for the heritage structure rehabilitation tax credit, refunds will grow by 3.9%, a rate which is low by recent standards (and an amount boosted by increasing amounts of refundable earned income credits).

The heritage structure rehabilitation tax credit is expected to have a continuing impact on the income tax. Since the credit is capped for commercial projects for both tax years 2003 and 2004, there is a finite amount of credits which can be claimed under the current program (plus credits for residential projects, which are uncapped but relatively minor). Analysis of tax returns indicates that there is approximately $120 million of credits which have or will be certified and which will be claimed on tax returns in the future. Based on historical relationships, an estimated $52.9 million of credits will be claimed in fiscal year 2004, dropping to $32.7 million in fiscal year 2005. Again, based on analysis of tax returns, it is expected that 65% of these amounts will be claimed against the individual income tax, with the remainder reducing corporate income tax revenues (although the credit can also be claimed against the insurance premium tax). Credits under the existing program may reduce revenues through fiscal year 2010, although the bulk of the outstanding $120 million will be claimed by fiscal year 2007.

Recent federal income tax changes will modestly reduce revenues in fiscal year 2005. While the State is automatically decoupled from the increases in §179 expensing for tax year 2003, they will affect Maryland income taxes in tax year 2004 in the absence of legislative action. After accounting for all legislative changes and natural growth in programs such as the refundable earned income credit, State general fund income tax revenues will total $4,998.0 million in fiscal year 2004, growth of 6.3% (baseline growth of 4.9%). In fiscal year 2005, general fund revenues will reach $5,304.4 million, exceeding for the first time fiscal year 2001 levels. Growth in that year will be 6.1%, boosted slightly by a decline in heritage structure rehabilitation credits.

Table 5

Individual Income Tax Revenues

Fiscal Years 2002 - 2005

($ in thousands)

	2002 Actual[1]	2003 Actual	2004 Revised Estimate	2005 Estimate
Gross Receipts (State & Local)				
Withholding	7,201,092	7,413,434	7,916,001	8,383,015
Estimated Payments	1,066,751	991,133	1,044,641	1,114,957
Payments with Final Returns	757,058	701,829	743,728	829,630
Fiduciary	69,140	40,015	37,011	41,542
Gross Receipts	9,094,041	9,146,411	9,741,381	10,369,143
Refunds	(1,418,378)	(1,552,801)	(1,622,890)	(1,660,170)
Net Receipts, State & Local	7,675,663	7,593,610	8,118,491	8,708,973
Local Reserve Account	(2,902,770)	(2,888,316)	(3,119,537)	(3,403,619)
Income Tax Check-offs	(1,244)	(1,555)	(1,000)	(1,000)
Net General Fund	4,771,650	4,703,738	4,997,954	5,304,354

[1] Excludes $26,678,789 from the 2001 tax amnesty.

Corporate Income Tax

Corporate income taxes are one of the most volatile revenue sources. The volatility is due to two factors: inherent volatility in corporate profits, and tax-related issues including the timing of tax years, the use of filing extensions and perhaps most importantly, the ability to carry forward net operating losses, which can be substantial. Corporate profits were dramatically affected by the 2001 recession – arguably, the decline in profits indirectly led to the recession, which was the first brought on by a decline in investment rather than consumption. Before-tax profits declined by 14.3% in calendar year 2001, and by 0.7% in 2002. With dramatic increases in productivity and a generally improving economic picture, profits are expected to increase by 15.8% in 2003, with double-digit growth for the next two years. While the growth in profits will ultimately lead to increases in corporate income tax collections, the large losses in 2001 mean that many companies are likely to be offsetting these gains for some time.

Volatility of this revenue source was on display in 2003 when net receipts, which had increased by 34% through November (*excluding* extraordinary payments), finished the year up only 4.9% (excluding the impact of the heritage structure rehabilitation tax credits). In fiscal year 2004, gross receipts are expected to increase by 4.8% to $561.0 million, although baseline growth will be a stronger 8.9%. In 2005, as profit growth slows slightly, gross receipts will slow to 7.5% growth. In fiscal year 2004, refunds will remain near the peak reached in 2003 as a result of an estimated $18.5 million of heritage structure rehabilitation credits claimed against the corporate income tax, and also due to net operating loss carryforwards. But refunds will decline, and will decline further in fiscal year 2005 as the losses work their way through the system and only $11.4 million of rehabilitation tax credits are claimed against the corporate income tax.

With 24% of the corporate income tax distributed to the Transportation Trust Fund, the corporate income tax will contribute $317.8 million to the general fund in fiscal year 2004, an increase of 10.2% over 2003. With the reduction in heritage credits claimed in 2005 and other refunds, net receipts and general fund revenues will increase by 12.4%. These estimates do not include any revenue related to the Delaware holding company issue. The Comptroller's Office won two cases before the Court of Appeals; the Supreme Court has denied *certiorari* in both cases. The final outcome is not certain, however, since the Court of Appeals remanded the cases to the Tax Court. Ultimately, the State stands to gain a one-time windfall of perhaps $200 million and ongoing revenues in the range of several tens of millions (these figures are subject to a great deal of uncertainty).

Table 6

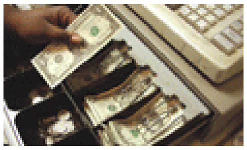
Corporate Income Tax Revenues

Fiscal Years 2002 - 2005

($ in thousands)

	2002 Actual[1]	2003 Actual	2004 Revised Estimate	2005 Estimate
Gross Receipts	502,605	535,240	560,968	603,041
Refunds	(144,854)	(155,933)	(142,815)	(133,228)
Net Receipts	357,751	379,307	418,153	469,813
Transportation Trust Fund[2]	(38,342)	(91,034)	(100,357)	(112,755)
Department of Transportation	(46,174)	0	0	0
Net General Fund	273,235	288,274	317,796	357,058

[1] Excludes $2,651,289 of general fund corporate income tax revenue from the 2001 tax amnesty.
[2] The distribution to the Transportation Trust Fund was simplified by the 2002 General Assembly.



Sales and Use Taxes

Sales taxes, over 28% of general fund revenues, will recover strongly as a result of the improving economy, increases in disposable income due to recent federal tax cuts, and growing business expenditures. The majority of sales taxes are paid by consumers, who have helped maintain revenue growth over the past two years with continued spending fueled by mortgage refinancing and tax cuts. But the other three segments of the sales tax—taxes collected from construction-related sales, from sales of capital goods, and from utility sales to industrial and commercial users—have not fared well over the past two years and have weighed down growth. Sales tax revenues rebounded from a very weak 2002 to 2.1% growth in fiscal year 2003—still well below the average rate of 5.4% for fiscal years 1994 to 2001. Helped by extraordinarily strong growth in the early part of the year, all segments will contribute to 5.5% growth in fiscal year 2004 before tapering off to 3.4% growth in 2005. Revenues will total $2,846.0 million and $2,943.7 million, respectively.

In fiscal year 2004, revenues collected from consumer sales (69.0% of total sales taxes) will grow by an estimated 5.2% as the full impact of the May 2003 federal income tax reductions flows into Marylanders' wallets. Through the first third of the fiscal year, revenues increased by a very strong 6.6%. Income growth alone does not explain this growth. Spending was clearly boosted by advanced payment of the increased child tax credit—checks for $400 per child under seventeen were sent to Maryland parents in mid-summer, adding an estimated $422 million to disposable income in the State.

The other major component of the 2003 federal income tax cut—reducing all marginal rates except the highest and lowest by 2 percentage points (the top rate of 38.6% was lowered to 35%, and the 10% rate was left unchanged)— will support growth throughout the remainder of the fiscal year. Most employees saw the new rates reflected in lower withholding starting in the summer; since the tax cut was retroactive to January 1, federal income tax refunds in April 2004 will be larger as well. The federal rate reductions will increase disposable income by an estimated $1.1 billion. All told, these income tax changes are expected to add $37.5 million to Maryland sales tax revenues in fiscal year 2004.

Growth will moderate through the remainder of the year resulting in $1,963.5 million in consumer sales taxes, an increase of 5.2% over fiscal year 2003 (although baseline growth will be about 4.7% as a result of revenue lost during last February's snowstorm). In 2005, the federal tax cuts will continue but they will not add to growth, and the mortgage refinancing boom will be long over. Growth in incomes will be the primary driver of revenue growth, which will slow to 3.7% with revenues reaching $2,036.1 million.

Sales tax revenues from construction-related sales, the second-largest sales tax category, declined by 1.3% in fiscal year 2003, primarily as a result of the cold, wet winter and spring. Revenues will rebound strongly in fiscal year 2004 to growth of 8.1%. As with consumer-related revenues, growth through the first third of the year has been exceptionally strong. July and August revenues grew by 8.0%, a result of an increase in housing starts and a doubling-up of projects due to the bad weather in the first half of 2003. September and October revenues were up a stunning 15.1%, which can only be attributed to spending at hardware stores in preparation for hurricane Isabel and repair and rebuilding work afterwards. These revenues will slow to a still strong 5.5% the rest of the year, resulting in $415.6 million (8.0% growth). Growth will slow to 1.2% in 2005 as spending on public infrastructure and housing starts slow, and, with the end of the refinancing boom, home improvement spending falls off. Construction-related revenues will amount to $420.5 million in that year.

Spending on capital goods (including consumer expenditures on computer hardware and software) has declined two years in a row (9.2% and 3.8% in fiscal years 2002 and 2003) as business investment plummeted and computer spending was hit by a falloff after the inflated expenditures leading up to Y2K and by continuing declines in prices. Revenues are down marginally through the first four months of fiscal year 2004, but growth should resume as business investment posts solid gains throughout the year, and finally regains levels achieved in 2000. Growth will reach 3.8% for the year, bringing revenues to $254.5 million. Stable growth will continue in fiscal year 2005 as revenues climb to $263.2 million.

As with sales tax revenues from expenditures on capital goods, revenues from sales of utilities (including cellular telephone service) have suffered from the precipitous drop in business investment, which hit telecommunications investment particularly hard. In fiscal year 2003, these revenues increased by 1.9%, with little help from the telecommunications component which was nearly flat. In 2004, as spending on telecommunications equipment picks up again, spending on cellular service remains near double-digit growth, and energy prices (particularly natural gas and therefore electricity) remain at relatively high levels, sales taxes from utility sales will rise by 4.5% to $234.9 million in fiscal year 2004. Continued double-digit increases in cellular telephone service and a marginal slowdown in energy proces will result in growth of 5.3% in fiscal year 2005, to $247.3 million.

Sales tax assessments will rise as the Comptroller's Office has hired more auditors and collectors, and several special compliance projects have begun, notably one matching sales of alcoholic beverages by bars to records of sales to the bars by wholesalers. Refunds will decline from levels of the recent past, which were boosted by a sales tax credit that expired several years ago; by now, almost all of the outstanding credits will have been claimed. Sales taxes on rental cars, 45% of which are distributed to the Transportation Trust Fund, have rebounded from the decline in travel following the September 11 terrorist attacks. This distribution will reach $23.6 million in fiscal year 2004, and will grow by 5.0% in 2005 to $24.8 million.

Accounting for these adjustments, general fund revenues from the sales tax will reach $2,846.0 million in fiscal year 2004, growing by 5.5%. Growth will slow in 2005 as many of the factors that caused a burst of growth in 2004 will not recur. General fund revenues will total $2,943.7 million in that year.

Table 7
Sales and Use Tax Revenues
Fiscal Years 2002 - 2005
($ in thousands)

	2002 Actual	2003 Actual[1]	2004 Revised Estimate[1]	2005 Estimate[1]
Consumer	1,813,665	1,865,740	1,963,472	2,036,074
Construction	389,689	384,521	415,616	420,467
Capital Goods	254,680	245,127	254,495	263,193
Utilities	220,455	224,693	234,893	247,279
Net Collections	2,678,489	2,720,081	2,868,476	2,967,013
Assessments	21,184	17,160	19,989	21,042
Refunds	(21,748)	(17,078)	(18,844)	(19,560)
Transportation Trust	(35,447)	(23,102)	(23,644)	(24,826)
Total General Fund	2,642,477	2,697,061	2,845,977	2,943,669

[1] Major components Include pro rata share of approximately $11 million for both fiscal years 2003 and 2004 for the reductions in the vendor discount from the Budget Reconciliation and Financing Act (BRFA) of 2002, and $2.3 million in fiscal year 2004 and $3.4 million in fiscal year 2005 for changes from the 2003 BRFA.

Lottery

The Maryland lottery had another year of record sales in 2003–the fourth in a row–and the sixth consecutive year of growth. But sales growth declined markedly to just 1.3% following three years with average annual growth of 6.5%. Lottery revenues grew by only 0.7% as agent compensation, costs of administration and prize payouts all grew more strongly than sales. General fund revenues, however, grew by 2.1% as a result of a $4.3 million reduction in the transfer to the Stadium Authority and the one-time transfer of $2.2 million for horse racing in fiscal year 2002.

Sales will increase again in fiscal year 2004, by about 2.4%, although 0.7 percentage points of that growth will come about as a result of a new game and the addition of mid-day Sunday draws for Pick 3 and Pick 4. Hurricane Isabel put a damper on growth in the early part of the year (1.3% through November), resulting in the direct loss of approximately $5 million in sales and destroying the businesses of four large lottery agents including the largest; the second half of the year will be better than the first. Despite another year of sales increases and falling administrative expenses, revenues will decline by 1.0% in 2004 due to a 4.3% increase in prize payouts, which have exceeded statistical expectations and/or last year's experience for many games through the first five months of the fiscal year.

Pick 3 sales declined by 3.3% in 2003, resuming a long-term trend (2002 was the only year sales increased since 1996). Several promotions have been run in an effort to boost sales of what used to be the lottery's most popular game but which has now fallen to third place, behind Keno and instant tickets. Revenues grew by 16.0% last year due in large part to the lowest prize ratio in the history of the game. The game will continue to decline in 2004–the baseline drop will be 3.5%, although the net drop will only be 2.9% when mid-day Sunday draws are introduced in the spring. Sales would be expected to fall by 1.5% in fiscal year 2005, but a full year of the mid-day draws (increasing the weekly number of draws from 13 to 14) will result in sales growth of 1.1%. Revenues will decline by 13.6% in 2004 as prize payouts return to normal, and will increase at a modest 1.0% in 2005.

Pick 4 sales increased by 1.1% in 2003, the second year in a row of growth under 1.5%. Prize payouts were higher than expected, rebounding from a particularly low 2002 (from 43% of sales to 51.25%–prize payouts should average 49.5%), resulting in a 15.8% drop in revenues. Baseline sales growth the next two years is estimated at 0.75% and 1.0%, and the addition of mid-day Sunday draws will raise growth to 1.4% and 4.2%. Prizes have been low through the first five months of the year, and though they will return to expected levels for the remainder of the year, that extra lift, as well as the decline from 2003's high level, will result in revenue growth of 13.1% in 2004. A full year of normal prize payouts will result in a revenue decline of 2.0% in 2005.

Sales of Keno, the lottery's largest game, grew by a seemingly strong 6.1% in 2003. But this rate of growth was more than three percentage points lower than that of four of the past five years. One possible reason for the slowing growth is that opportunities to place new monitors are increasingly rare. Revenues increased by 8.4% in 2003, with the extra lift coming largely from a change regarding the administrative costs of the games. Sales growth will slow further to 2.5% in 2004 following a lackluster summer; the game was also hard-hit by Isabel.

Growth is only 1.7% through the first five months of the year–this will improve, particularly in March when promotions are planned for the millionth Keno draw. Sales growth will improve in 2005 to 5.0%. Revenues will increase by 0.6% in 2004, improving with normal prize payouts to 8.1% in 2005, when Keno will become the first lottery game to exceed $400 million in sales.

Instant ticket sales demonstrated the same pattern as Keno, although even more so. After four consecutive years of double-digit growth averaging 16.9%, sales slowed to just 5.8% growth in 2003. Revenues actually declined by 8.0% as operating expenses increased with the addition of higher-cost (to both the agency and players) tickets. The game is one of the few strong performers through November, with sales growth of 9.7%. The full year is expected to see an increase of 7.5%, with revenues increasing by 7.0%. Fiscal year 2005 will see a further slowing to a still respectable 5.0% sales growth, although revenues will increase by 9.1%.

Lotto, Bonus Match 5 and Mega Millions will contribute less than 10% of the lottery's sales in fiscal year 2004. Lotto sales, which finished 2003 at less than half the level of just five years prior, will drop by 7.5% in both fiscal years 2004 and 2005. High payouts in 2004 will lead to a revenue decline of 14.3%, followed by a 3.1% decline in 2005 with a return to statistically expected prize levels. Fiscal year 2003 was the first full year of Match 5 sales following a four-year hiatus (the game was reintroduced midway through 2002). Sales for the year were 41.1% lower than 1997 sales; had the game been in existence the entire time, that would equate to an 8.5% average annual decline. Modest growth is expected this year and next, although revenues will decline by 9.4% in 2004 before increasing by 3.0% in 2005. Mega Millions finished 2003 on a high note, with the $183 million cash-value jackpot the largest ever won by a Maryland resident. But sales declined by 11.2% from 2002 levels as a result of only that one large jackpot combined with several in the latter half of the year in competing Powerball. The recent addition of Texas to the Mega Millions roster may help the game reach ever-higher jackpots, which will boost sales. But the forecast includes modest growth of 5.0% for this year and a flat 2005, with revenues generally following.

In the ongoing effort to spur sales, the Cash-in-Hand game was discontinued and a new game will debut in the spring. "Instant Win" will be unveiled in March, and will reach $500,000 in weekly sales by the end of the year. Total sales in 2004 are expected to be $6.0 million, and will stay at roughly that level for annual revenues of $25.0 million in 2005. Revenues will total $1.5 million in 2004 and about $8.25 million in 2005. A number of other promotions and changes are planned for the ongoing games, and several news games are under consideration for introduction in the latter part of fiscal year 2005. One planned improvement that will not occur is the international lotto game that had been under development–the game has apparently fallen victim to disputes over the war with Iraq. Nonetheless, total lottery sales will reach $1,354.5 million in fiscal year 2004, an increase of 2.4%, and will rise by 4.8% in fiscal year 2005 to $1,420.1 million. General fund revenues will decline by 1.0% in 2004 to $418.8 million, but will increase by 5.0% in 2005 to $439.9 million.

Table 8
Lottery Sales and Revenues by Game
Fiscal Years 2002 - 2005
($ in millions)

	Sales				Revenues[1]			
	2002 Actual	2003 Actual	Estimated 2004	Estimated 2005	2002 Actual	2003 Actual	Estimated 2004	Estimated 2005
Pick 3	306.9	296.7	288.2	291.4	119.7	138.9	120.0	121.2
Pick 4	201.4	203.7	206.5	215.2	93.8	79.2	89.6	87.8
Lotto	37.7	34.2	31.6	29.2	14.5	13.8	11.8	11.4
Cash-in-Hand & Instant Win	18.2	3.2	6.0	25.0	6.5	1.3	1.5	8.3
Instant	299.2	316.7	340.4	357.4	69.9	64.3	68.8	75.1
Keno	355.7	377.4	386.9	406.2	103.4	112.1	112.8	121.9
Match 5	8.3	21.3	22.3	23.0	2.4	7.2	6.5	6.7
Mega Millions	77.9	69.2	72.6	72.6	31.8	28.2	29.8	29.5
Let It Ride	1.3	0.0	0.0	0.0	0.5	0.0	0.0	0.0
Total	1,306.6	1,322.2	1,354.5	1,420.1	442.5	444.9	440.8	461.9
Less Stadium Authority Revenue					(26.2)	(21.9)	(22.0)	(22.0)
Transfer to Horse Racing					(2.2)	0.0	0.0	0.0
General Fund Revenue					414.1	422.9	418.8	439.9

[1]Special fund revenues (the Lottery Agency's operating expenses) of $50.3 million in 2002 and $51.9 million in 2003 are not included in revenues; these revenues, generally proportional to sales by game, are expected to be $50.9 million in 2004 and $52.5 million in 2005.

Figures may not sum to totals due to rounding.

Business Franchise Taxes

Maryland's business franchise taxes have been subject to more change over the past several years than any other revenue source. With the deregulation of the electric industry, the public service company franchise (gross receipts) tax was changed from a flat 2% of gross receipts to a 2% tax on the cost of distribution and a consumption tax of 0.062 cents per kilowatt hour (0.402 cents per therm of natural gas). These changes were effective beginning in tax year 2000. The next year, the financial institution franchise tax was repealed (with the tax base made subject to the corporate income tax). Refunds for this tax, however, will likely continue to be paid for several years. The tax on deposits of savings and loans was repealed at the same time. A 2% tax on gross receipts also applies to telecommunications companies.

Revenues from the gross receipts tax declined by $10.7 million in 2003 largely as a result of timing issues, although the recently declining prices of telecommunications services also played a role. In fiscal year 2004, timing issues aside, revenues from electric utilities will grow slightly, while declining revenues from telecommunications companies will offset much of that increase. Due to a recent Internal Revenue Service decision, refunds of the financial institution franchise tax will spike to $2.1 million before dwindling away over the next several years. Fiscal year 2005 will see a continuation of these trends, with lower growth in revenues from the electric utilities.

In fiscal year 2003, $14.6 million in general fund revenue was collected from the $100 filing fee charged to corporate entities doing business in Maryland (the fee was $25 for a small number of other business entities). The 2003 General Assembly increased the filing fee to $300 and applied it to noncorporate entities (except partnerships and sole proprietorships, which do not have to register with the Department of Assessments and Taxation). This change is expected to result in an additional $35.0 million, somewhat less than estimated at the time the bill was passed. Increasing economic activity will increase the number of filers, resulting in 8.7% revenue growth in fiscal year 2005.

All told, franchise taxes and filing fees will generate $188.2 million in fiscal year 2004, with most of the increase attributable to the change to filing fees. Modest 2.7% growth in fiscal year 2005 will result in $193.3 million.

Table 9

Business Franchise Tax Revenues

Fiscal Years 2002 - 2005

($ in thousands)

	2002 Actual	2003 Actual	2004 Revised Estimate	2005 Estimate
Public Service Company Franchise Tax	140,895	130,142	140,683	139,879
Financial Institution Franchise Tax	(9,658)	(1,409)	(2,100)	(500)
Tax on Deposits of Savings and Loans	13	0	0	0
Filing Fees	13,930	14,631	49,650	53,950
Total	145,180	143,364	188,233	193,329

Insurance Premium Tax

The insurance premium tax is levied at the rate of 2% of premiums collected by insurance companies. Revenues are somewhat cyclical as the industry tends to be more competitive in prosperous years, and raises premiums in years following major losses. From the early 1990s to fiscal year 2002, revenues generally grew about 3% annually. In fiscal year 2003, revenues increased by 17.9%, with premiums rising as insurers tried to maintain profitability in the face of declining portfolio values and significant underwriting losses, including those related to September 11.

Premium growth has peaked at 14% in calendar year 2002 and is now decelerating; calendar year 2003 will see premiums rise an estimated 11%, still well above rates of 2% to 6% seen throughout the 1990s. Despite substantial property damage in the State due to hurricane Isabel, Maryland premiums will not rise as the losses were not outside expectations of catastrophic loss when insurers calculated rates.

Insurance premium revenues will reach a new high in fiscal year 2004 at $252.7 million, growing by 10.6% over fiscal year 2003 (although baseline growth is lower due to heritage structure rehabilitation tax credits taken against the tax in 2003). Growth will slow further as the market softens substantially in 2005, and revenues will increase to $260.2 million.

Table 10
Insurance Premium Tax Revenues
Fiscal Years 2002 - 2005
($ in thousands)

	2002 Actual	2003 Actual	2004 Revised Estimate	2005 Estimate
Premium Tax	193,718	228,476	252,684	260,249

Death Taxes

Revenues from Maryland's inheritance and estate taxes declined by 23.0% in fiscal year 2003, and are now down $42.4 million from the peak achieved in fiscal year 2002. The drop is largely due to the collapse of the stock market bubble, which had a substantial negative impact on estates of all sizes, particularly those subject to the estate tax. The increase in the federal unified credit also played a role in the estate tax revenue decline (Maryland decoupled from the federal provisions phasing out the State estate tax credit, ensuring that the tax would continue, but for administrative simplicity, did not decouple from the unified credit increase). Collateral inheritance taxes also posted poor performance in 2003 as a result of the market drop, although a small part of the decline was due to the repeal of the tax for inheritances from siblings.

Growth in estate tax revenue, or lack thereof, depends almost entirely on large estates-those with a tax liability of $500,000 or more. From fiscal year 2000 to 2003, these large estates comprised over 50% of revenues-in fiscal year 2002, reflecting the peak of the market bubble, these estates contributed just under two-thirds of total estate tax revenue. Although not predictable with any degree of precision, the number of large estates almost certainly will fall in fiscal year 2004 from the 37 in 2003, which itself was lower than the 2002 figure of 42 (the number of very large estates dropped from 24 to 14 in those two years). Total revenues will decline as well, from $95.7 million to $74.3 million. Modest growth will resume in 2005 as the stock markets will likely have continued reasonable growth, and with the recent surge in real estate markets-these factors will cause estate sizes to grow, and will push more estates into taxable status. For decedents dying in 2005 and later, a quirk in Maryland’s decoupling law will result in a circular calculation to determine the State estate tax. This provision will result in an ongoing revenue loss of roughly 10% of estate tax revenues beginning in fiscal year 2006.

Inheritance taxes will generally follow the pattern of estate taxes, although not to the same extremes. Revenues will decline by 7.8% in 2004 to $42.9 million, although part of that loss is due to ever-declining revenues from the repealed direct inheritance tax. In fiscal year 2005, inheritance taxes will increase by a modest 2.2% to $43.9 million.

Table 11

Death Tax Revenues

Fiscal Years 2002 - 2005

($ in thousands)

	2002 Actual	2003 Actual	2004 Revised Estimate	2005 Estimate
Collateral Inheritance Tax	47,797	45,204	42,340	43,660
Direct Inheritance Tax	2,786	1,416	600	240
Estate Tax	134,142	95,691	74,344	79,750
Total	184,725	142,311	117,284	123,650

Alcohol and Tobacco Excise Taxes

With the cigarette tax increasing from 66 cents per pack to $1.00 per pack on June 1, 2002, revenues increased by 33.8% to $272.6 million in fiscal year 2003. Since $80.5 million was dedicated to a special fund, however, general fund revenues declined by $10.7 million. In fiscal year 2004, all cigarette tax revenues are credited to the general fund. Consumption is expected to decline by 0.7% in fiscal year 2004, following the 11.6% decline induced by the tax increase last year. An estimated 264.2 million tax stamps will be sold, resulting in $262.0 million for the general fund. The long-term trend of declining sales will continue in 2005, and revenues will decline by 2.0% to $256.8 million.

The 15% tax on other tobacco products was instituted in fiscal year 2001, raising $5.8 million in the first year. Two consecutive years of $350,000 growth (6%) followed. Through the first four months of fiscal year 2004, however, growth is 13.2%. For the full fiscal year, revenues will total $7.1 million, growth of 9.3%. Growth of 5.6% will resume in fiscal year 2005, resulting in general fund revenues of $7.5 million.

The excise tax on distilled spirits has grown an average of 0.3% since 1993, but the growth has been anything but steady. Six of the last ten years have seen a decline, while 1992 showed a 7.1% increase. Strong growth in the first part of fiscal year 2004 (5.9%) leads to expectations of stronger than trend growth; the full fiscal year will see 3.2% growth, or revenues of $12.6 million. Growth will decelerate towards trend in fiscal year 2005 to 1.0%, leading to revenues of $12.7 million. After reaching a historic peak of $9.3 million in fiscal year 2002, excise tax revenues on beer declined by 2.6% in 2003. This revenue source has also been up and down over the past ten years, from a 3.7% increase in fiscal year 2001 to a 3.1% decline in 1995. Growth will resume in 2004 at 1.7% resulting in revenues of $9.2 million, and will slow to 0.6% in 2005 for revenues of $9.3 million. Wine excise tax revenues have increased an average of 2.3% for the past ten years, but growth has been much stronger the last several. Revenues will increase by 5.3% in fiscal year 2004 to $4.6 million, and will slow to 2.6% growth in 2005. All together, alcoholic beverage excise tax revenues will total $26.4 million in fiscal year 2004 and $26.7 million in fiscal year 2005.

Table 12
Excise Tax Revenues
Fiscal Years 2002 - 2005
($ in thousands)

	2002 Actual	2003 Actual	2004 Revised Estimate	2005 Estimate
Cigarette Tax	203,730	272,634	261,996	256,756
Other Tobacco Products Tax	6,158	6,498	7,100	7,500
Total Tobacco Taxes	209,887	279,132	269,096	264,256
General Fund	209,887	199,201	269,096	264,256
Special Fund	0	80,524	0	0
Distilled Spirits Tax	12,250	12,223	12,623	12,749
Wine Tax	4,197	4,371	4,601	4,722
Beer Tax	9,300	9,057	9,215	9,266
Total Alcoholic Beverages Tax	25,747	25,651	26,439	26,737

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 estimates are based on projections of use and reimbursement rates. Changes to the reimbursement rates for nursing homes and facilities for the developmentally disabled will boost revenues from Medicaid, but these increases will be more than offset by the end of reimbursement to the State for those confined to institutions by the courts but who are not receiving ongoing treatment. The increase in disproportionate share revenues is due to a change in the reimbursement rate by the federal government, and offsets declines in the other components.

There had been indications that revenues for both fiscal year 2004 and 2005 could be approximately $8 million higher due to recommended changes to the reimbursement rates to be claimed by the State, but at this time it is not clear that this revenue increase will occur. Hospital patient recoveries will result in $76.6 million of general fund revenues in fiscal year 2004, increasing slightly to $77.1 million in 2005.

Table 13
Hospital Patient Recoveries
Fiscal Years 2002 - 2005
($ in thousands)

	2002 Actual	2003 Actual	2004 Revised Estimate	2005 Estimate
Medicaid	53,142	52,903	47,143	47,134
Medicare	16,792	2,170	1,746	1,793
Insurance and Sponsors	7,850	8,251	6,989	7,151
	77,784	63,325	55,878	56,078
Disproportionate Share	20,004	10,356	20,738	21,049
Total	97,788	73,681	76,616	77,127

Court Revenues

Revenues from the clerks of the circuit courts include recordation tax commissions, recording fees, and other miscellaneous fees that are largely related to the strength of the housing market. Although mortgage rates are at their lowest levels in many years, a large number of the transactions have been refinancings, which are exempt from recordation and transfer taxes. But the housing boom was so great over the summer of 2003 that processing of transactions in many clerks' offices has backed up. Through the first four months of fiscal year 2004, revenues from the clerks are up 41.9%. Growth will slow in the second half of the fiscal year as the backlog is worked off, mortgage rates rise slightly and current activity falls. For the full year, revenues of $57.0 million are anticipated, growth of 10.6%. Revenues will decline by 23.4% in fiscal year 2005 as the housing market cools further.

Revenues from the District Court of Maryland come primarily from traffic fines and court fees, which vary with driving patterns, enforcement activities and the weather. They are also affected by the extent to which drivers contest citations and judges impose or forgive fines and fees. Revenues from the District Court fell 1.4% in fiscal year 2003, partly due to severe winter weather. Fiscal year 2004 revenues will grow by 13.3% to $81.1 million as a result of fee increases and other administrative changes, before falling off by 2.1% in fiscal year 2005 to $79.4 million.

Table 14
General Fund Court Revenues
Fiscal Years 2002 - 2005
($ in thousands)

	2002 Actual	2003 Actual	2004 Revised Estimate	2005 Estimate
Clerks of the Court	42,634	51,573	57,033	43,677
District Court	72,592	71,573	81,075	79,367

Interest Earnings

The State's interest earnings are dependent on two factors—balances and rates. Neither has been in the State's favor of late, as the fiscal crisis has reduced the general fund and many other balances, and rates have continued to decline. Currently, the State is earning 1.28%, a rate not expected to rise appreciably for the remainder of the year. Several actions were taken by the 2003 General Assembly to increase interest earnings, including accelerating the due date for employer withholding, which was expected to increase earnings by about $7.5 million. The actual revenue increase from this change will be less, as at the time the bill was passed rates were expected to average 3.5% during fiscal year 2004, but low rates have continued longer than expected. For the entire fiscal year, the three-month Treasury bill is expected to be just above 1.0%.

Rates will rise to roughly 2.4% in fiscal year 2005 and the actions taken to increase interest earnings will be in effect for a full year, but declining balances will mitigate the rise in earnings. General fund interest earnings will reach $27.1 million in fiscal year 2004 and will climb to $48.0 million in fiscal year 2005.

Table 15
Total Interest Earnings
Fiscal Years 2002 - 2005
($ in thousands)

	2002 Actual	2003 Actual	2004 Revised Estimate	2005 Estimate
Interest Earnings	71,510	31,901	27,101	48,022

Miscellaneous Revenues

Miscellaneous revenues covers a wide variety of revenue sources, from vending machine proceeds in the 5th Regiment Armory in Baltimore City to unclaimed property that is turned over to the State. Because there is such a wide variety of revenues, there are frequently one-time effects and often many law changes that affect these revenues.

The biggest changes in miscellaneous revenues have been and continue to be due to law changes:

- Most collections of the Public Service Commission and Workers' Compensation Commission are special fund revenues, effective in fiscal year 2003;
- The holding period for unclaimed property has been shortened from five years to four in fiscal year 2003 and from four years to three in 2004;
- The switch to biennial professional licenses still causes fluctuation in revenue from the Department of Labor, Licensing and Regulation;
- Reimbursement of teachers' retirement costs will be returning to the general fund after being diverted to the Transitional Education Fund since fiscal year 2001;
- Fee increases have raised revenue collected by the State Department of Assessments and Taxation and the Vital Statistics Administration in the Department of Health and Mental Hygiene; and
- Excess fees of office will decline as estate and inheritance taxes decline.

Other fluctuations in revenue are not directly related to legislative changes, but are due to changes in the way agencies operate or other events.

- The Motor Vehicle Administration has increased the amount of money it collects in uninsured motorist penalties by stepping up enforcement activities and through more efficient operations–these activities will continue in fiscal year 2004;
- An unusually high number of unpresented checks increased the Treasurer's Office revenues in fiscal year 2003 (included in Financial and Revenue Administration);
- Large settlements with financial analysts in fiscal year 2004 increased the Attorney General's revenue above normal levels; and
- Most of the Department of General Services' fiscal year 2003 increase represents the sale of the buffer strip around Deep Creek Lake to adjoining property owners.

Overall, miscellaneous revenues are expected to increase in fiscal year 2004 to 254.8 million, and then decline in 2005 to $216.6 million. Almost all of the decline is due to the end of the acceleration in unclaimed property remissions, the biennial cycle of professional and business licenses, and a return to more normal recoveries by the Attorney General.

Table 16

Miscellaneous Revenues

Fiscal Years 2002 - 2005

($ in thousands)

	2002 Actual	2003 Actual	2004 Revised Estimate	2005 Estimate
Recording, Organization & Capitalization Fees	3,890	4,200	7,850	7,860
Transportation - Filing Fees & License Tags	9,835	10,054	10,452	10,729
PSC Fines, Citations and Filing Fees*	12,587	(38)	60	60
Excess Fees of Office	8,454	8,458	4,800	4,800
Legislature	375	315	275	300
Workers' Compensation*	18,985	7,462	55	55
Public Defender	1,214	2,790	1,200	1,500
Attorney General	20,291	20,353	24,554	19,500
Executive & Administrative Control	6,259	3,086	3,325	4,276
Financial & Revenue Administration	7,868	14,359	7,925	7,925
Budget & Fiscal Administration	1,181	2,097	1,374	1,269
General Services	192	3,012	1,445	945
Natural Resources	1,251	617	582	582
Agriculture	309	316	317	317
Health & Mental Hygiene	8,620	8,136	14,181	14,970
Human Resources	3,181	2,327	2,183	2,173
Labor, Licensing & Regulation	17,395	14,381	18,601	12,956
Public Safety & MD State Police	10,544	10,743	10,719	10,777
Public Education	2,957	3,457	31,021	32,022
Housing and Community Development	631	747	690	764
Environment	429	443	287	513
Juvenile Services	439	483	402	300
Unclaimed Property	31,374	71,714	65,000	35,000
Alcoholic Beverage Licenses	622	636	1,192	1,192
Local Income Tax Reimbursement	12,879	12,454	13,145	12,522
Uninsured Motorist Penalty Fees	14,420	29,338	30,185	30,294
Miscellaneous Revenues and Transfers	2,404	4,930	3,000	3,000
Total	198,586	236,870	254,820	216,601

* Public Service Commission filing fees and Workers Compensation revenue sources are now special funds.

Transportation Revenues

With extra spending fueled by federal income tax reductions, continuing consumer incentives needed to move vehicles off the lots and a slower-growing though now sizable share of the market held by sport utility vehicles, titling tax revenues are expected to grow by 5.2% in fiscal year 2004, more than twice the 2.9% growth rate in 2003. Growth will moderate to 3.4% in fiscal year 2005, with revenues reaching $728 million.

After 1.9% growth in fiscal year 2003, motor vehicle fuel tax revenues will increase by 2.7% in fiscal year 2004 as general economic activity accelerates and as individuals, with higher income gains, travel more. Growth in fiscal year 2005 will remain at essentially the same level, with total revenues reaching $738.9 million.

All other transportation-related revenues are expected to continue relatively stable growth, including the sales tax on rental vehicles. For six months in fiscal year 2002 100% of these revenues were distributed to the Transportation Trust Fund; the distribution reverted at the start of fiscal year 2003 to the prior level of 45% of revenues. After a slump in the baseline in 2002 resulting from reduced travel after September 11, fiscal years 2004 and 2005 should see accelerating growth of 2.3% and 5.0%.

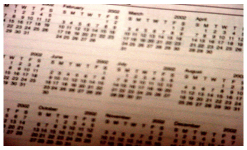
Table 17

Maryland Motor Vehicle User Revenues

Fiscal Years 2002 - 2005

($ in thousands)

	2002 Actual	2003 Actual	2004 Revised Estimate	2005 Estimate
Motor Vehicle Administration				
Registrations	185,048	188,024	192,100	195,900
Licenses	33,101	37,617	38,200	38,900
Med-Evac Surcharge	48,699	50,509	50,063	52,066
Miscellaneous Motor Vehicle Fees	88,417	82,684	85,700	86,800
Vehicle Emission Inspection Fees	4,758	4,856	4,900	4,900
Security Interest Filing Fees				
Special Funds	3,539	3,598	3,738	3,835
General Funds	5,309	5,396	5,607	5,753
General Funds - Baltimore City	2,950	2,998	3,115	3,196
Hauling Fees	7,784	7,739	8,000	8,000
Special License Tags				
Special Funds	380	380	380	380
General Funds	1,576	1,660	1,730	1,780
DOT	405	409	415	420
Chesapeake Bay/Ag Tags - MDOT	865	682	775	770
Titling Tax	650,210	669,253	704,000	728,000
Sales Tax on Rental Vehicles				
MDOT-Rental Vehicles	35,222	23,102	23,644	24,826
MVA - Clean Fuel Vehicle Credit	225	0	0	0
	1,068,488	1,078,907	1,122,367	1,155,526
Motor Vehicle Fuel Tax	688,611	701,507	720,200	738,900
Road Tax	14,814	14,485	14,900	15,300
Decals	109	92	0	0
	703,534	716,084	735,100	754,200
Total	1,772,022	1,794,991	1,857,467	1,909,726



Five Year Forecast

These estimates are based on a trend scenario for the U.S. and Maryland economies. A trend scenario does not attempt to forecast cyclical economic patterns, but projects the average growth that the economy is likely to register based on the fundamental factors affecting the economy.

As discussed in the economic outlook, the State's economy will recover from this period of uncertainty poised for solid growth. Maryland will continue to outperform the nation, as it generally has since the early 1990s. Revenue growth, however, will not return to the same levels experienced throughout the latter half of the 1990s, since capital gains do not look to recover at any time in the near future and the economy is unlikely to reach the sustained level of superior performance it reached in the late 1990s.

Over the long term, the individual income tax will grow at roughly the rate of personal income growth. Sales taxes generally grow slightly slower; while there is concern about remote sales affecting the sales tax base, there is no indication as yet that remote sales will translate into a several hundred million dollar revenue loss. Thus, over the next five years, about three-quarters of general fund revenues can be expected to grow slightly slower than the growth of personal income.

Corporate income taxes will experience several years of strong growth due to three years of double-digit increases in corporate profits. The State has won the most recent round in its fight against Delaware holding companies, but the dispute will continue as the cases have been remanded to the Tax Court Perhaps two hundred million dollars are at stake for past tax years for companies currently identified by the Comptroller as having holding companies; on an ongoing basis, several tens of millions of dollars could be at stake. As there is no indication when this issue will be resolved, this forecast does not include any revenues from Delaware holding companies.

Lottery sales growth will be moderate, as will revenues. Death taxes should resume growth, although they are unlikely to reach the levels achieved in fiscal year 2002 for some time. Starting in fiscal year 2006, estate tax revenues will be reduced by an oddity in Maryland law decoupling the State estate tax from federal law changes. Heritage structure rehabilitation tax credits under the current program yet to be claimed will cost $120 million through fiscal year 2010 or so, although the bulk of these credits will be claimed by fiscal year 2007.

Table 18

Long Term Economic Forecast

Primary Indicators

CALENDAR YEAR	2001	2002	2003	2004	2005	2006	2007
U.S. GDP (billion $ 96 chained)	9,214.5	9,439.9	9,715.9	10,137.9	10,498.5	10,871.3	11,259.1
% change	*0.2%*	*2.4%*	*2.9%*	*4.3%*	*3.6%*	*3.6%*	*3.6%*
U.S. Total Non-Farm Employment (millions)	131.8	130.4	130.0	131.5	134.4	136.9	139.3
% change	*0.0%*	*-1.1%*	*-0.3%*	*1.1%*	*2.2%*	*1.9%*	*1.8%*
U.S. Personal Income (billion $)	8,685.3	8,922.2	9,209.7	6,985.2	10,222.8	10,817.5	11,470.8
% change	*3.3%*	*2.7%*	*3.2%*	*-24.2%*	*46.3%*	*5.8%*	*6.0%*
CPI - % Change	2.8%	1.6%	2.3%	1.4%	1.9%	2.0%	2.2%
U.S. 10-Year Treasury Bond Yield (%)	5.02%	4.61%	4.04%	4.83%	5.47%	5.53%	5.78%
Md. Total Non-Farm Employment (millions)	2,469.6	2,472.6	2,482.8	2,513.9	2,562.0	2,611.3	2,655.7
% change	*0.8%*	*0.1%*	*0.4%*	*1.3%*	*1.9%*	*1.9%*	*1.7%*
Md. Total Personal Income (million $)	189,142	197,156	203,290	212,614	224,309	236,197	247,535
% change	*4.9%*	*4.2%*	*3.1%*	*4.6%*	*5.5%*	*5.3%*	*4.8%*

Table 19

Maryland General Fund Revenues

Fiscal Years 2007-2008

($ in thousands)

	2003 Actual	2004 Estimate	2005 Estimate	2006 Estimate	2007 Estimate	2008 Estimate
Income Taxes						
Individual	4,703,738	4,997,954	5,304,354	5,576,744	5,843,975	6,117,081
Corporation	288,274	317,796	357,058	395,602	418,575	437,280
TOTAL	4,992,012	5,315,750	5,661,412	5,972,346	6,262,550	6,554,361
Sales and Use Taxes	2,697,061	2,845,977	2,943,669	3,053,060	3,172,780	3,281,437
State Lottery	422,945	418,786	439,911	446,510	453,207	460,005
Franchise, Excise, License, Fee	1,173,101	1,336,053	1,298,103	1,302,602	1,321,958	1,343,260
Interest on Investments	31,901	27,101	48,022	55,000	56,650	58,350
TOTAL CURRENT REVENUES	9,317,020	9,943,667	10,391,117	10,829,518	11,267,145	11,697,413