



State of Maryland Board of Revenue Estimates

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Director, Bureau of
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December 15, 1998

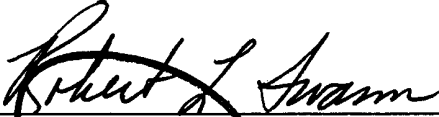
Honorable Parris N. Glendening
Governor of Maryland
State House
Annapolis, Maryland 21401

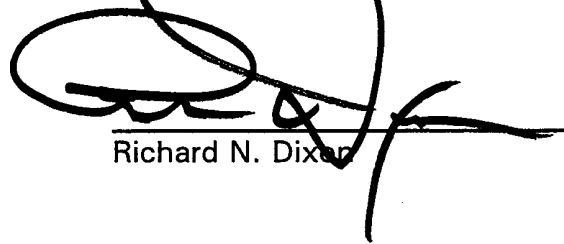
Dear Governor Glendening:

In compliance with Section 6-106(b) of the State Finance and Procurement Article of the Annotated Code of Maryland, the Board of Revenue Estimates has prepared and herewith submits to you new estimates of State revenues for the fiscal years ended June 30, 1999 and June 30, 2000, 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,


Robert L. Swann, Chairman


Richard N. Dixon


Frederick W. Puddester

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Executive Summary

The State Finance and Procurement Article of the Annotated Code of Maryland, Section 6-106(b), requires the Board of Revenue Estimates to review and report to the Governor on state revenue prospects for fiscal years 1999 and 2000. This review is based on existing state laws and the current economic outlook.

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

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

The outlook for the economy has changed quite dramatically in recent months. In the late summer, projections were pessimistic as the financial problems affecting the Asian economies spread to Russia and Latin America. Concerned with the effects on corporate profits, investors sold off, and the stock market dropped 19% between July 15 and August 31. Consumer confidence followed, tumbling for four straight months. By September, most national forecasters were placing the odds of recession at between 30% and 50%.

Recent forecasts have improved, as the economy has demonstrated remarkable resiliency. The stock market has bounced back, regaining its previous peak, consumer spending has remained buoyant and consumer confidence increased in November for the first time since June. Falling interest rates will support investment, housing and consumer spending, making a recession unlikely, although employment and income growth are expected to slow. In addition, it is believed that the economic effects of the Year 2000 problem will not be significant. Although some have predicted a substantial negative impact, the majority of economists believe that GDP growth will be reduced by only a fraction of a percentage point.

These national trends are expected to apply to Maryland as well. Personal income growth is expected to slow from the 5.7% gain in 1997 to 5.25% in 1998, and to 4.8% in both 1999 and 2000. Employment growth is expected to slow from 2.4% in 1998 to 1.2% in 1999 and 1.4% in 2000, reflecting both a slower rate of overall economic growth and a continued tight labor market in Maryland, particularly in several sectors which have been among the best-performing.

The Board expects total general fund revenues of \$8,171.4 million in fiscal 1999 after accounting for the phased-in income tax reduction, an increase of 1.5% over fiscal year 1998. This estimate reflects an upward revision of \$195.1 million over the March estimate. Fiscal year 2000 general fund revenues are estimated at \$8,422.6 million, an increase of 3.1%.

The fiscal year 1999 personal income tax estimate has been increased by \$105.1 million over the official estimate. Extremely strong growth in nonwage income (bonuses, stock options and capital gains) continues to push revenue growth up much faster than underlying wage gains would suggest. The level of

capital gains realizations has more than tripled during the past four years, bolstered by strong stock market appreciation, increased stock ownership among households and the cut in the federal capital gains tax rate. The estimate assumes that capital gains realizations will drop back during tax year 1999, reflecting the fact that a large portion of 1997 and 1998 capital gains realizations were induced by the change in the tax rate. For tax years 2000-2003, capital gains realizations are expected to rise 11.7% per year, consistent with the historical average. Baseline personal income tax revenues will increase 5.5% and 4.5% in fiscal year 1999 and 2000, respectively. However, the state income tax cut will lower revenues substantially. After accounting for all tax changes, personal income taxes will drop by 1.2% in fiscal year 1999 before rising by 5.6% in fiscal year 2000.

Sales and use tax revenues seem to have recovered from a relatively slow fiscal year 1998. Through the first four months of fiscal year 1999, revenues have increased by 4.7% compared to 3.2% growth for all of fiscal year 1998. Revenues for the full fiscal year are expected to grow by 4.6%, supported in part by: higher than usual state and federal income tax refunds, which are generally spent; continued consumer and business expenditures on computer hardware and software; a healthy housing market; and ongoing growth in communications services. Revenue growth is expected to moderate to 3.9% in fiscal year 2000.

Nationally, corporate profits have been quite weak, falling over the last six months. In contrast, Maryland corporate income tax revenues have shown solid growth in early fiscal year 1999. In part, this growth reflects changes in tax law which made banks subject to the corporate income tax rather than the franchise tax and expanded the tax base for local telephone companies. Due to recent trends, the fiscal year 1999 corporate income tax forecast has been revised upward by \$34.3 million to \$283.0 million. Although current receipts match this estimate, the direction of revenues can change quickly and sizably. Should the outlook for U.S. corporate profits worsen relative to the Board's forecast, revenues could be weaker than anticipated.

The fiscal year 1999 lottery general fund revenue estimate has been revised downward by \$19.1 million to \$357.2 million. This estimate is based on a projected sales decline of 1.7% for the full year, although sales through the first four months are down 4%. Through October, only Keno has shown an increase in sales, and instant ticket sales are flat. Sales would have to increase by 2.1% in the remaining eight months of the fiscal year to meet this estimate. The Lottery Agency is making adjustments to several games, including Cash-in-Hand, the Big Game, Keno and instant tickets, that are expected to boost sales and revenues.

Tobacco excise tax revenues are estimated at \$121.9 million in fiscal year 1999. This estimate accounts for the estimated cigarette price increase of 50 cents per pack as a result of the recent settlement between the tobacco industry and the states but does not include monies the state will receive as its portion of the settlement. When the size and timing of these payments are finalized, the Board will report to the Governor.

Investment income is projected to total \$68.1 million in fiscal year 1999, a reduction of \$3.9 million from the official estimate. Fund balances are high, which is expected to offset the impact of declining interest rates on earnings. Hospital patient recoveries are expected to be \$47.9 million higher than the previous estimate, due almost entirely to a shift to fiscal year 1999 of funds expected to have been received in fiscal year 1998. Miscellaneous revenues have been revised upward by \$15.7 million for fiscal year 1999. Half of that increase results from an unanticipated rise in unclaimed property revenue.



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The Board of Revenue Estimates thanks the following participants of the Business Advisory Panel for their assistance.

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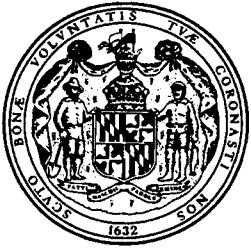
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The Board of Revenue Estimates thanks the following members of the Revenue Monitoring Committee for their assistance.

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The U.S. Economy

After nearly eight years of expansion, the national economy appears to be slowing down. Negative fallout from the global economic crisis has caused most analysts to downgrade expectations for growth in U.S. real domestic product (GDP) to 1.5%-2.5% in 1999 after three successive years of well over 3%. While most economists now believe the U.S. will avoid a recession in 1999, it remains a possibility. Whether the U.S. can avoid a recession within the next two years will depend on aggressive consumer spending and improvement in the Asian economies, with its attendant effects on the financial situation in other countries throughout the world.

The early effects of the Asia crisis were neutral for the U.S. economy. As investors sought a safe haven for their investments, capital flowed into U.S. treasuries, lowering interest rates. Falling interest rates reduced the cost of capital, providing support to home sales and business investment. At the same time, the global flight to quality increased the demand for the U.S. dollar, pushing up its value. The appreciation of the dollar held down import costs and inflation. These positives were partially offset by weakening exports, the downside to the appreciating dollar.

By mid-1998, as the financial problems in Asia worsened, spread to Russia and threatened Latin America, the negative effects prevailed. Exports dropped, widening the trade deficit, and the slide in overseas sales cut into corporate profitability. The combination of lower corporate profits and turmoil overseas caused equity markets to tumble. Stocks, as measured by the S&P 500, lost 18% of their value between mid-July and late September, slicing \$1.5 trillion from household wealth. Stocks have since bounced back, recovering most of their earlier decline.

Growth in the U.S. economy has decelerated. The pace of job creation slowed to 165,000 per month in the July to September quarter, down from 250,000 during the first half of 1998 and 300,000 during 1997. The drop in equity markets and recent volatility did undercut consumer confidence (Figure 1), although confidence has since rebounded with the market.

Responding to the weakening economy and global crisis, the Federal Reserve cut the federal funds rate three times since September. Although the recent performance of the stock market and resilience of employment growth and consumer spending will make the Fed more cautious in easing interest rates further, most analysts expect the federal funds rate to drop another 25 basis points to 4.5% by mid-1999.

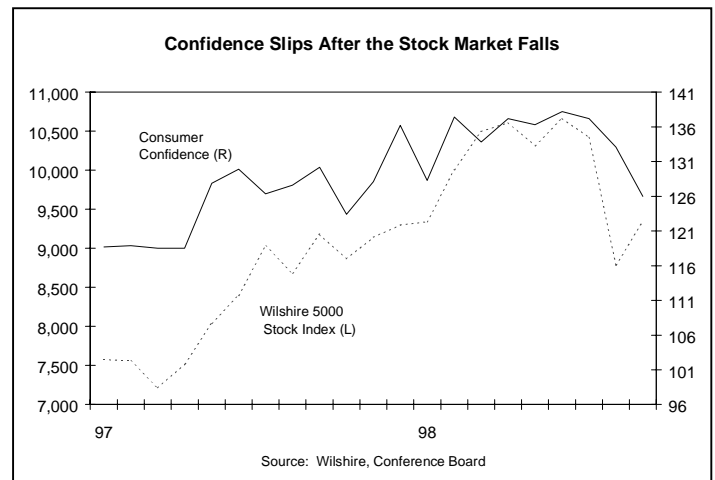


Figure 1

On the global front, Japan's passage of banking reform legislation has fostered hope that the country will begin to deal with the huge volume of bad loans (estimated at 15% of Japanese GDP) crippling its economy. Japan is mired in its worst recession since the end of World War II. Real GDP contracted 5.3% in the first quarter of 1998, after falling 1.5% in the previous quarter. The unemployment rate is at a post war high. Consumers and business have been unwilling to spend and invest, despite interest rates of just one-half percent, reflecting the lack of confidence in policymakers' ability to solve the economic

problems. Japan is the major market for the rest of Asia, accounting for 12% of the exports from Korea, 17% from Thailand and 29% from Indonesia, so improvement in the Japanese economy is crucial to stabilizing the other Asian economies. While the recent reform legislation is seen as a step in the right direction, follow through action, lacking in previous reform attempts, is essential.

At this point, the most likely outcome is that the U.S. economy will escape recession. However, growth will slow substantially, due to the deteriorating trade balance and an expected slowdown in consumer spending. Growth in real GDP is expected to fall from 5.5% in the first quarter of 1998 to about 1% in the first half of 1999. These factors will lead to cutbacks in employment in manufacturing and retail trade. Ongoing volatility in financial markets will take its toll on employment in the financial services sector. In total, job growth will slow from the 2.6% pace averaged during the past five years to 1.2% in 1999 and 1.3% in 2000.

The performance of consumer spending is critical. Real consumer spending, on average, increased a robust 3.5% per year during the past five years. Spending has been sustained by steady job and income growth, low interest rates, low inflation and the huge appreciation in the stock market—the wealth effect. The theory of the wealth effect suggests that consumers consider all income when making saving and spending decisions. To the extent that saving goals can be reached through appreciation of existing assets, consumers can spend a larger share of current income. Most measures of the wealth effect indicate that consumers spend between three and seven cents of each dollar of additional wealth over a two-year period. Household net wealth increased by \$3 trillion between the first quarter of 1995 and the first quarter of 1998, spurring \$90-\$121 billion in additional spending.

Recent gyrations in the stock market may restrain consumer spending. Absent significant inflows from investment income, consumers will bring spending and income back into balance. However, lower interest rates will cushion the decline in consumer spending. Mortgage refinancing will free up cash for other spending, while the low rates will keep debt service payments down. Real consumer spending will continue to grow, although at a slower rate, decelerating to 2.7% in 1999 and 2.4% in 2000.

Low interest rates continue to improve housing affordability, already at an all-time high (Figure 2). Housing starts will reach a record level this year for the third straight year. Sales of existing homes are also robust. Low interest rates, solid job and income growth, moderate prices and rising demand for second homes, fueled by both the strong stock market and the aging population, have all propelled housing activity. Although interest rates are expected to remain low through 2000, housing activity will begin to cool off, as the weaker economy takes its toll. Housing starts will drop back from 1.378 million units in 1998 to 1.333 million units in 1999 and 1.365 million units in 2000.

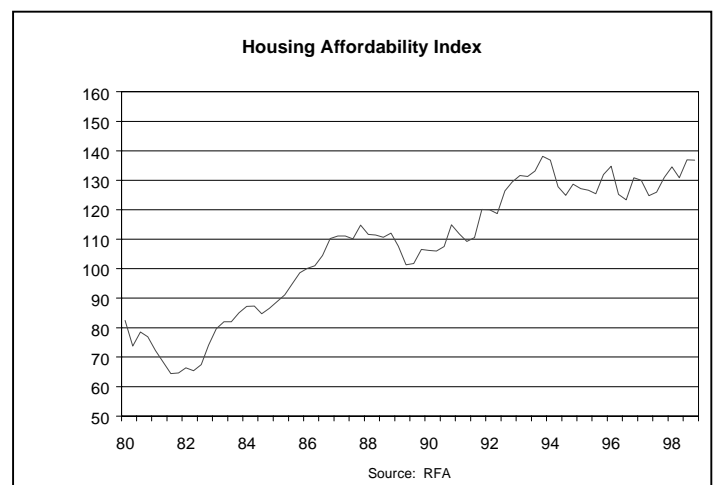


Figure 2

Investment spending will also slow, a direct result of overcapacity and falling profits. Tighter lending standards by banks will also limit access to capital. However, the continued search for productivity enhancements and the need to replace or update computer equipment to avoid Year 2000 compliance problems will cushion the decline. Growth in real investment in producers' durable equipment is projected to drop from 12.5% in 1998 to 4.1% in 1999 and 4.8% in 2000.

Federal fiscal year 1998 closed with a surplus of \$70 billion, the first year in the black in 29 years. The surplus was the result of both lower than anticipated spending (low inflation and a healthy economy held down entitlement outlays) and higher than expected revenue collections, particularly the personal income tax. After passing several continuing resolutions to extend operations, Congress managed to pass a budget for fiscal year 1999 on October 21. Lack of agreement between the President and the Republican Congress limited action; tax cuts were smaller than the Republicans had hoped for, as were the spending increases sought by the President. Despite the improved fiscal condition, the discretionary spending caps and the limiting effects of divided government will keep the growth of federal spending in check. Real federal spending is projected to decrease by 1.4% in 1998, before rising 0.6% in 1999 and 0.3% in 2000.

Net trade has been a substantial drag on growth in 1998 and will continue to be so in 1999 and 2000. After rising at an average annual rate of 10.2% between 1994 and 1997, exports will manage only a 0.5% increase in 1998. Exports are projected to improve as global economies stabilize, rising 1.8% in 1999 and 7.6% in 2000. The strong dollar and relative health of the U.S. consumer market is drawing in imports at a 10.4% pace this year, but growth will slow along with consumer spending. Imports are projected to rise 6.7% in 1999 and 5.5% in 2000.

Projections for the U.S. economy can be found in Table 1.

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

	1994	1995	1996	1997	1998	1999	2000
Real GDP (Billion \$92 chained)	6,610.7	6,761.8	6,994.8	7,269.8	7,536.6	7,671.7	7,855.7
Change	3.5%	2.3%	3.4%	3.9%	3.7%	1.8%	2.4%
Federal Funds Rate - %	4.20	5.84	5.30	5.46	5.38	4.50	4.86
Yield on 30 Year Treasury Bond - %	7.37	6.88	6.70	6.61	5.58	5.12	5.89
CPI - Change	2.6%	2.8%	2.9%	2.3%	1.6%	2.2%	2.5%
Housing Starts (Million Units)	1.446	1.361	1.470	1.479	1.378	1.333	1.365
Change	11.9%	-5.9%	8.0%	0.6%	-6.9%	-3.3%	2.4%
Light Vehicle Sales (Million Units)	15.0	14.7	15.0	15.0	15.2	14.6	15.1
Change	8.3%	-2.0%	2.2%	-0.3%	1.0%	-3.6%	3.4%
Corporate Profits After Tax (Billion \$)	348.5	424.7	454.1	488.3	481.5	485.9	504.2
Change	16.1%	21.9%	6.9%	7.5%	-1.4%	0.9%	3.8%
Total NonAgricultural Employment (Millions)	114.1	117.2	119.6	122.7	125.7	127.2	128.8
Change	3.1%	2.7%	2.1%	2.6%	2.5%	1.2%	1.3%
Unemployment Rate - %	6.1	5.6	5.4	5.0	4.5	4.9	5.2
Total Personal Income (Billion \$)	5,757.9	6,072.1	6,425.2	6,784.0	7,131.7	7,471.5	7,856.2
Change	5.1%	5.5%	5.8%	5.6%	5.1%	4.8%	5.2%

Sources: Regional Financial Associates, Inc., Standard and Poor's DRI

The Maryland Economy

Maryland's economy added 60,000 jobs in 1997, an increase of 2.6%, the strongest showing of the decade. Job growth remained robust in the first quarter of 1998, but preliminary information suggests that the pace decelerated during the April – September period (Figure 3).

Growth is expected to slow in 1999 consistent with the national economy. Maryland's low share of manufacturing (7% of total employment compared to 16% nationally) holds down the state's exposure to weakening exports. However, it is very likely that service exports (for which there are no data) provide a significant source of exports for the state, given Maryland's service-oriented job base. In addition, fallout from financial market turmoil will be more severe in Maryland. Finance sector employment accounts for 6.0% of the total in Maryland, slightly higher than the U.S. average, and job growth in the brokerage industry has supplied a greater proportion of the new jobs in the state than is the case for the nation as a whole. Both the share of households that own stock as well as the level of stock holdings in Maryland are higher than the U.S. average, consistent with the state's high per capita wealth. Thus, Maryland may be more vulnerable to a downturn driven by financial market problems.

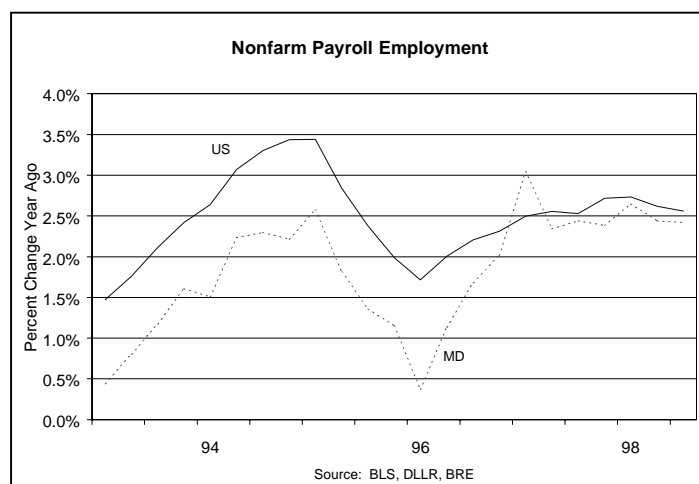


Figure 3

While the Maryland and national economies will experience slower growth in the coming year, both are expected to avoid recession. Weakness will be most pronounced in manufacturing, finance and retail trade. Employment gains will remain strong in construction, business services and some segments of transportation. The following section summarizes the recent performance and outlook by sector.

Government

With the advent of the first federal budget surplus since the Nixon Administration, the threat of significant government downsizing has receded. Although federal employment declined 1.8% in 1997, modest growth occurred in the last quarter of 1997 and the first quarter of 1998, the first expansion since the fourth quarter of 1995. State government employment declined by 2.3%, partially as a result of early retirement legislation enacted in 1996, but has resumed growing in the first quarter of 1998 and modest growth is expected to continue through next year. Local government, the only government sector that has grown every quarter since 1995, increased another 3.0% in 1997.

The recent decline in federal employment would have had a greater impact on Maryland had it not been for the consolidation of a number of naval facilities at the Patuxent River Naval Air Station in St. Mary's County and the Naval Surface Warfare Center in Charles County. An estimated 5,470 jobs were transferred to these locations from out-of-state, along with an additional 1,547 contractor positions. These transfers are virtually complete. Base realignment activities are still affecting the state, however, through the closure of Fort Ritchie in Washington County.

The immediate impact of the Fort Ritchie closure will be much more significant for the local areas than the state, since most of the jobs have been transferred to Fort Detrick in Frederick County. In the long term, however, both the local area and the state could benefit substantially. Since the base was a military communications center, with 26 miles of fiber-optic cable already installed, it is being promoted as the ideal location for high-tech businesses. The community anticipates that within ten years, most or all of the 2,300 lost jobs will be replaced with well-paying high-tech jobs. The International Masonry Institute has already established its national training center at the site.

With the Census Bureau located in Maryland, the decennial Census will temporarily boost federal employment in 2000. Employment levels are expected to rise by 3,000 in 2000, pushing up federal employment growth to 2.6% for the year.

Manufacturing

The state's defense dependent manufacturers should get a boost from the recently approved fiscal 1999 federal budget. Appropriations for procurement are 8% higher than 1998 levels, generally to modernize weapons. This represents the first real increase in procurement spending in 13 years, and analysts expect this trend to continue for several years. Lockheed Martin, based in Bethesda, will receive funding for several major contracts, including \$771 million for the F-22 fighter. Northrop Grumman, which makes the advanced radar system for this aircraft at its Linthicum plant, is a significant beneficiary of the budget bill, as modernizing forces requires high tech equipment such as that produced by Northrop.

Following the collapse of the merger between Lockheed and Northrop, Northrop announced a restructuring plan that would eliminate 2,100 jobs over the next two years, about 500 of which will be from the Linthicum facility. Maryland's defense industry is not just downsizing, however. Middle River Aircraft Systems is planning to add 250 jobs by 2001. Total employment at Middle River will reach 1,450, compared to 600 in 1996.

General Motors has not yet determined the status of the Broening Highway plant, which employs more than 3,000. The plant is old and less efficient than newer GM plants. State and local government officials met with company executives in October to discuss the plant's future. Offers of tax incentives are likely as the state attempts to hold on to this important employer. So far, GM has made no promises beyond 2000.

The strong dollar has undermined the competitiveness of domestic steel producers, who face severe competition from Russia and Asia. Alleging that foreign producers are attempting to boost their exports by undercharging for their product, domestic steel producers recently joined together to file a dumping suit against these suppliers. In other developments, Bethlehem Steel won the bidding war to acquire Lukens, a Pennsylvania-based steel company. This will result in the closing of the Sparrow's Point plate mill.

On the positive side, Bethlehem Ship's fortunes have turned around rapidly. In late 1997, Veritas Capital purchased BethShip's repair and conversion facility at Sparrows Point from parent Bethlehem Steel. Renamed Baltimore Marine Industries, the shipyard's employment increased from 25 to approximately 600.

Ciena has been one of Maryland's high-tech success stories. Ciena's technology increases the capacity of fiber optic lines, a valuable alternative to adding expensive new capacity. Employment at the Linthicum-based Ciena increased dramatically over the past two years, and currently totals more than 1,200. The company ran into problems in the late summer, however, when AT&T decided not to buy Ciena's equipment, sending its stock price plummeting. The stock price drop and uncertain sales outlook undermined the planned acquisition of Ciena by Telltabs.

The Kelly-Springfield Tire facility in Cumberland will close by mid-1999, eliminating 330 jobs. Alcoa announced a reduction in aluminum production at the Eastalco Works in Frederick, resulting in the loss of up to 150 jobs. Sea Witch International will move its seafood processing operation from Easton to Delaware along with 40 jobs. At the same time, a number of smaller firms have expanded operations. These include Nurad Technologies, a microwave antenna manufacturer located in Baltimore City, and aluminum products maker Alcore, which will expand its operations in Harford County. Pulse Electronics recently doubled the size of its facility and plans to increase its payroll from 300 to 500 workers in the next three years.

Construction

Construction employment growth in 1997 was the strongest of the 1990s at 5.2%. Virtually every segment of the construction sector showed growth last year, led by electrical contractors with a gain of more than 12%. Though still increasing through the beginning of 1998, the rate of employment growth has moderated. Two factors could slow growth further: a continuing labor shortage and a reduction in credit available to commercial developers.

Strong commercial and residential construction markets have resulted in a labor shortage, the major factor constraining strong employment growth. This shortage is expected to persist due to the hot residential market and ongoing commercial activity. Planned projects include up to five hotels in Baltimore, a hotel and convention center in Annapolis and the Arundel Mills mall. School construction will increase as well, since funding from the state has risen from \$144 million in fiscal 1998 to \$218 million in fiscal 1999, a 51% increase.

Office vacancy rates, which are at their lowest levels since the mid-1980s in both the Baltimore and Washington areas, have continued trending downward in the first half of 1998. Absorption in the central Maryland market is at its highest rate in ten years. The tightening supply has resulted in almost as much completed office space construction in the Baltimore metropolitan area in the first half of 1998 as in all of last year. Although industrial vacancy rates are relatively high, construction of industrial space continues.

Residential construction is likely to increase as well, with 17% more residential permits issued in the first eight months of 1998 compared to the same period in 1997. Near-record low interest rates and high housing affordability should sustain this trend. To the extent that the state's Smart Growth policies reduce the development of new housing, they should also increase demand for renovation work, as should the fact that sales of existing homes are relatively high.

Transportation

Employment in the transportation sector increased by 2,200 jobs or 3.5% in 1997. At the Baltimore Washington International Airport (BWI), passenger traffic increased 5% to 14.2 million passengers, marking the third straight year of robust gains (Figure 4). Through the first seven months of 1998, traffic continued to improve, rising a further 3.9%. Even better, the share of originating and departing traffic is also up, at almost 90% of all passengers. Originating and departing traffic – passengers that begin and end their flight at BWI rather than just transfer to another plane – more fully utilizes the airport’s amenities, like shopping, rental cars and parking, than does transient traffic.

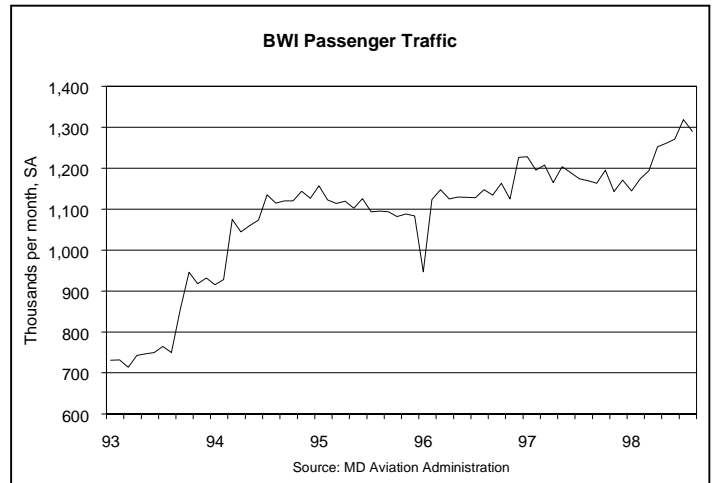


Figure 4

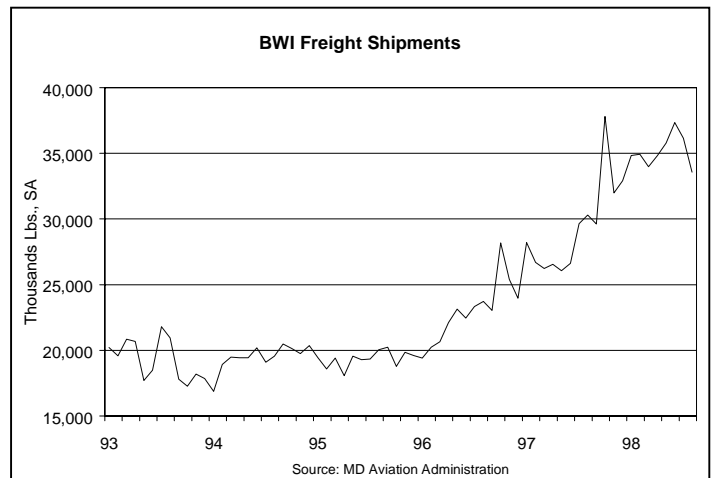
Since its arrival in 1993, Southwest Air has been instrumental in transforming BWI into the area’s leading low fare airport. Southwest operates seven gates at BWI with 50 flights each day, and accounts for about two million BWI passengers annually. Southwest is interested in expanding its operations at BWI and is negotiating with the Maryland Aviation Administration to add 10 more gates. These additional gates should translate into another 100 flights per day, since Southwest’s goal is 10 flights per day per gate. Further evidence of Southwest’s commitment to expand is the establishment of a crew base at the airport. The 200-pilot base is Southwest’s sixth in the nation. At its other crew base airports, Southwest supports 100 to 170 flights per day.

USAirways, BWI’s largest gateholder with 20 gates, has struggled in recent years. In mid-1998, USAir launched MetroJet, a low-cost service designed to compete with Southwest. This move will continue to bolster BWI’s reputation as the region’s low cost airport. A recent survey by the Maryland Aviation Administration found that passengers are traveling 50 miles or more to use BWI, a clear response to lower fares.

Business at the new William Donald Schaefer International terminal is growing, although excess capacity remains an issue. The Maryland Aviation Administration continues to aggressively market the terminal to new carriers. Long term, the availability of international flights will help Maryland compete for jobs. Given the globalization of the economy, firms need ready access to international travel.

Cargo has also expanded strongly at BWI (Figure 5). Since most cargo planes fly at night, they provide a secondary market for the airport. With plans underway for a mid-field cargo terminal, extra capacity will be available to support further growth.

Problems in overseas markets are adversely affecting the Port. The bulk of Maryland’s exports go to Latin America and Western Europe, rather than Asia, but the drop in demand is still measurable. Should the international financial crisis



13 Figure 5

spread to Latin America, problems at the Port would be intensified. In the meantime, demand from Latin America remains healthy, and in fact, some freight originally intended for Asian markets has been diverted to Latin America where demand is stronger and financing still available.

In addition to world trade conditions, the Port of Baltimore continues to struggle with competitiveness issues. As the price of truck and rail freight has fallen, Baltimore's inland location has become a liability instead of a benefit. Port officials have addressed the concern by targeting cargo that can still benefit from the inland location. One example is automobile freight, since ship travel is better than road travel for avoiding dents and dings. Given that the Baltimore-Washington market is the third largest consumer market in the country, shippers of goods destined for the local market will continue to land in Baltimore. Cost containment is also important. To the extent that the longer, more costly trip up the Chesapeake and Delaware Canal can be offset by reasonable costs at the Port and for overland travel, the Port will be better able to compete. To this end, a successful division of Conrail is vital to the long term health of the Port, because it will increase the number of rail routes and keep rates competitive.

The National Surface Transportation Board approved the division of Conrail between CSX and Norfolk Southern in June and the companies took control in August. At this point, the two rail lines are still negotiating with labor unions, merging technology and planning routes. The measured pace of implementation in part reflects the reality of a complicated merger; in addition, both companies want to avoid repeating the huge problems that crippled Union Pacific and Southern Pacific following their 1997 merger.

Progress is visible. Norfolk Southern opened a sales office in Baltimore in September, is discussing options with the Department of Transportation for on-dock facilities at the Port, and has almost completed an engineering study on improvements to track and tunnels in Baltimore that will allow for heavier rail cars and double stacking. CSX is going forward with improvements at the Virginia Avenue Tunnel in the District of Columbia which will remove a serious bottleneck and has committed several hundred million dollars for track improvements in the Midwest. These improvements will increase the efficient flow of traffic and ultimately benefit Maryland customers. CSX has also taken steps to increase traffic through Cumberland, although the closure of the Kelly-Springfield plant and reduction in output of the Eastalco plant will reduce business from two of its major customers.

Communications and Public Utilities

In theory, the local telephone market has been open to competition for several years. In practice, however, moving from a monopoly environment to competition is complicated and progress has been slow. The 1996 Telecommunications Act provided three ways for long-distance carriers to enter the local market: resell existing Bell Atlantic service, lease Bell Atlantic network access or construct new facilities. Constructing a network like Bell Atlantic's would cost several hundred billion dollars, so building a competing infrastructure is unlikely. The Public Service Commission has set the terms under which providers can buy access to the local lines. In July, the PSC ruled that Bell Atlantic could charge other companies \$14.50 per loop (a line from a Bell Atlantic switch to a customer) for access to its network. The PSC rates are an attempt to fairly compensate Bell Atlantic for the costs incurred in constructing its system, while also fostering competition. MCI WorldCom and AT&T, however, have disputed the fairness of the charge and have asked the PSC to reconsider.

Meanwhile, demand for new telecommunications services is skyrocketing. Falling prices have increased the affordability of wireless phones. More than 41% of U.S. households have at least one wireless device (phone or pager), according to data from the Personal Communications Industry Association.

BGE and Pepco called off their planned merger in late 1997, explaining that the regulator-imposed conditions would undermine profitability. With deregulation moving forward, other local utilities have considered mergers. DelMarva Power and Light merged with Atlantic Energy to form Conectiv. The planned union of Allegheny Energy and Pittsburgh-based DQE, which would create the nation's 10th largest utility, is on the rocks, however. Following a termination letter from DQE, Allegheny Energy has filed a federal lawsuit attempting to move forward with the merger.

The PSC has issued orders opening up the local electric market by July 1, 2000. State legislators have been reviewing the tax structure in order to make any changes necessary to accommodate deregulation, while the PSC has been studying filings related to the issue of stranded costs. Unexpectedly high costs in several states that have implemented deregulation, including California and Massachusetts, have led to a consumer backlash in those states. The General Assembly has expressed concerns over the implications of stranded costs, and suggested that the state may move more slowly toward implementing deregulation in order to more fully consider these issues.

Utilities have traditionally been among the state's largest and most stable employers. With competition on the horizon, employment levels have dropped as utilities move to cut costs to better face competition. With further consolidation and cost cutting on the horizon, employment levels are unlikely to increase.

Finance, Insurance and Real Estate

Although employment in financial services grew 1.7% in 1997, the growth was not evenly distributed across the industry. Banking continued a long-term decline while mortgage companies and brokerages have grown very strongly, at 11.1% and 9.3%, respectively. The insurance and real estate sectors experienced modest growth. These trends continued through the first quarter of 1998, the latest period for which reliable data are available. Average wage growth in this industry has been the best in the state at 10.1%, nearly twice the statewide average, driven largely by the 28.3% growth in average wages at brokerages.

The recent stock market downturn could have a substantial impact on this industry. Securities firms on Wall Street have begun to announce widespread layoffs, starting with Merrill Lynch announcing plans to eliminate over 5% of its jobs. Those firms, if any, which avoid layoffs will almost certainly reduce employee bonuses, which had been a major factor behind the rapidly increasing wages. In Maryland, BT Alex. Brown has already shed some positions and analysts expect the parent company, Bankers Trust Corporation, to eliminate between 900 and 1,800 jobs. The impact of such a reduction on the 1,500 Baltimore-area positions of BT Alex. Brown is currently uncertain. The outlook for BT Alex. Brown is further clouded by the likely purchase of Bankers Trust by Deutsche Bank AG which, according to some analysts, could result in the consolidation of all of Bankers Trust's operations in New York City.

Legg Mason executives have indicated that layoffs are not contemplated at this time; T. Rowe Price officials have indicated that they do not expect "significant" layoffs in their investment management division, but would not comment on the employment situation in the brokerage and investment banking divisions. Recent turmoil in the stock market has not slowed T. Rowe Price's hiring for technical positions. In addition, their planned expansion into some banking services (such as selling certificates of deposits) should provide some employment growth. In the longer term, the possible privatization of social security would be a substantial benefit to all investment firms.

The economic troubles affecting the investment industry may have a beneficial impact on the mortgage industry. Interest rates are at a 30-year low, encouraging both home purchases and refinancing.

While the frequency of bank mergers appears to be slowing down, several mid-sized Baltimore banks are expanding their number of branches, and a number of small, community-based banks have started up. Despite these developments, banking employment is expected to continue to slide.

The insurance and real estate segments of the industry may be facing similar futures, involving mergers and increased competition. Through the first two-thirds of 1998, eight local real estate brokers in Maryland have been bought by larger competitors. The merger of USF&G and the St. Paul Cos. has put 2,000 insurance jobs at risk. It is expected that most of the eliminated positions will be in the Baltimore offices, which employ 2,800 people. Baltimore has become the headquarters, however, of Sierra Military Health Services, which provides health care to about 600,000 individuals in a 13-state region. Their operations brought 300 new jobs to Baltimore and eight other locations throughout the state.

Employment prospects in these two industry segments may be depressed, particularly for agents, through the increasing use of the Internet for insurance and real estate transactions. Insurance agents may be further affected by mergers such as that between Citicorp and the Travelers Group. Such consolidations may have a large impact on the entire financial sector.

Retail Trade

The retail sector continued to expand through the beginning of 1998, although growth is expected to slow going forward. While retailing has generally been strong for several years, it may be more susceptible to economic concerns than many other sectors. The consumer confidence index, after a record high in June, declined for three consecutive months to its lowest level in 18 months. Consumer confidence has a direct effect on consumer spending, and is unlikely to regain its previous peak as long as worries over the international economic situation and the stock market persist. Despite these concerns, retailers are expecting growth in the range of 4% to 4.5% during the coming holiday season.

In Baltimore, the Hard Rock Café and Planet Hollywood, which helped spur restaurant and drinking establishment employment to 1% growth in 1997, have been joined by the ESPN Zone. The Bubba Gump Shrimp Company is also planning to build a floating restaurant nearby, and Rainforest Café expects to open a restaurant in the Towson Town Center.

Shopping centers experienced a good year in 1997, with an estimated 3,300 jobs created, according to press accounts. The openings of Prime Retail's Prime Outlets at Hagerstown, ultimately to include over 100 outlet stores, as well as several Target stores bode well for 1998. In the longer term, the planned 1.4 million square foot Arundel Mills mall is expected to encourage further retail development in the BWI area, and Abe Pollin, along with Earvin "Magic" Johnson, is converting the old Capital Center in Prince George's County into an upscale retail and entertainment center.

Tourism has done well, with tourist trips to the state increasing by 6% in 1997. Travel to the Eastern Shore increased by 9.7%. Baltimore is increasingly becoming known as a center for tourism, now the 20th most visited city in the country. Tourist trips to central Maryland increased by 7.5% and are expected to continue to increase due to the favorable publicity generated by the well-received Ravens' stadium as well as the exposure given to Baltimore on Monday Night Football, hosted weekly from the ESPN Zone. The newly expanded Baltimore Convention Center exceeded expectations in its first year, and admissions and spending at the National Aquarium continued to grow. The Maryland Science Center had record-breaking attendance in the first half of 1998. Despite these recent achievements, the possibility of a decline in tourism-related expenditures exists if businesses or consumers should reduce travel as a result of the current economic uncertainty.

Services

Business services added almost 18,000 new jobs in 1997. Composed of personnel supply services, computer and data processing services, and various building cleaning and security services, the sector posted a growth rate of 10.6%. Although personnel supply services, also known as temporary help firms, account for about one-quarter of total business services, they provided more than one-half of the new jobs.

Over the past few years, personnel supply firms have diversified. Once primarily suppliers of clerical workers, personnel supply firms now provide employees in legal, accounting, computer services and other professional occupations. According to Manpower, Inc., about 15% of temporary employees are technical workers, compared to 1% to 2% only five years ago. The evolution has also occurred on the demand side. Many businesses view temporary assignments as a way to “audition” or try out new workers before hiring them permanently. Some businesses staff a portion of their workforce with temporary workers year round, due to the added flexibility this provides. Similarly, many temporary employees use their work time to explore career options before taking a permanent job. A recent survey by the National Association of Temporary and Staffing Services showed that almost 75% of temporary workers moved on to permanent assignments, 18% of which were with their temporary employers.



Figure 6

Historically, businesses cut back on their temporary help work force before laying off permanent workers. Thus, hiring activity in the temporary help arena may provide insight into future employment prospects. Manpower, Inc.'s most recent quarterly survey, conducted in August 1998, showed that businesses still had strong hiring plans for the upcoming quarter. Although recent data on employment levels in Maryland are not available, employment at temporary help firms has weakened considerably nationally, dropping in four of the past seven months (Figure 6).

Computer and data processing services added 3,600 jobs in 1997, an increase of 8.1% over prior year levels. Competition for computer experts is fierce, and widespread anecdotal evidence suggests that job growth is limited by the lack of workers. These employees are needed to fix Year 2000 computer problems as well as maintain and develop corporate networks and software systems. Demand is also strong at internet service firms, which provide server management, network security, webpage content and design. Notable developments in the area include Digex's decision to remain in Maryland. The company recently broke ground on a new headquarters in Beltsville. Usinternetworking, a start-up company located in Annapolis, plans to expand by 1,000 employees over the next eighteen months.

The rebound in the office market has spurred demand for various building services, including maintenance and cleaning, equipment rental (such as photocopiers and office furniture), mailing and security services. Another expanding “back office” industry is telemarketing. In recent activity, American Trust Bank opened a customer service call center in Cumberland that will employ 100 when fully staffed; Metris, a Minneapolis-based credit card company is considering plans to double the size of its 500-employee call center in White Marsh; Comcast Online Communications Inc. opened a call center in White

Marsh; and Unitel expanded in Frostburg. Partially offsetting these gains, MCI Telecommunications will close its Linthicum office, moving the 665 jobs to its other facilities in Hunt Valley and Atlanta.

Health services added 3,600 jobs in 1997, an increase of 1.9%. Trends remained unchanged from the past few years: tradeoffs between advances in technology which increase the cost of care, and cost containment pressures as businesses rein in their health care costs. Demand for lower cost treatment has cut hospital stays and redirected patients to outpatient clinics.

Lower hospital admissions make it difficult for some hospitals to stay afloat. According to the Maryland Hospital Association, one-half of the largest hospital systems in the state had bed-occupancy rates of less than 60%; admissions are on the rise in only 18 of the 50 largest hospitals; patient days have dropped by 25% during the past five years. Reflecting the financial realities, hospital employment has been stagnant for the past three years. Hospitals are also facing labor problems. A shortage of nurses has existed for several years. In addition, hospitals must compete with hotels and others for labor to fill non-skilled positions.

Developments in Maryland are indicative of the various approaches toward consolidation, reorganization and strategic combination. Helix merged with Medlantic Healthcare, while Northwest Health System and Sinai Health System combined operations into the newly formed LifeBridge Health. The University of Maryland Medical System and Maryland General Health Systems are negotiating a union aimed at creating a strategic relationship between UMMS and community-based physicians. Similarly, Mercy Medical Center and North Arundel Health System joined to create a regional health care network. Johns Hopkins is expanding both downtown and in Columbia and Baltimore County. Hopkins is also renovating hospital facilities as outpatient facilities and inpatient rehab units.

Health maintenance organizations are also grappling with financial problems. The area's largest doctor group, Doctors Health, is waging a legal battle to keep NYLCare Health Plan from canceling a multimillion dollar arrangement in which Doctors Health provided care to Medicare patients under NYLCare's HMO. Claiming that reimbursement rates are below costs, Prudential HealthCare, United HealthCare and Aetna U.S. Healthcare also announced that they will no longer serve the Medicare market. Despite the aggressive shift towards managed care, the next few years will see a shakeout in the market as unprofitable providers are forced out of business.

Offsetting the declines in hospital employment is the continued expansion of the home health care industry, which has doubled in size over the past seven years. Demographics and cost containment pressures will continue to propel expansion in this industry.

Biotech

1997 was an exciting year for Maryland-based biotechnology firms. MedImmune turned profitable thanks to growing sales of its main drugs, RespiGam, CytoGam and Synagis. Digene received permission from the Federal Drug Administration to begin testing its new product, a test to detect the presence of a life-threatening virus in organ-transplant or AIDS patients. News that EntreMed's process of using compounds to block the growth of new blood vessels was successful in eradicating tumors in mice created a media storm as excitement spread about a possible cure for cancer. Although probably years away from market, EntreMed's research is extraordinarily encouraging.

Interest in gene therapy continues to grow. Gene therapy will increase in use and attractiveness for several reasons: it promises to offer significant medical treatment for illnesses for which there are no drugs or cures; technological advances in delivery methods will improve the safety and effectiveness of

gene therapy; and the convenience and impact on quality of life are considered greater with gene therapy than drugs. Maryland-based Human Genome Sciences and Genetic Therapy are national leaders in this field.

Given the financial realities of the industry, where firms operate for years with no income as they research and test new drugs, firms need some source of financial support. These crucial links take many forms: licensing products to pharmaceutical companies; strategic alliances with other biotechs or pharmaceutical companies; and outright mergers. The recent stock market tumble complicates the financing problem as investors have pulled back from supporting new public offerings. Osiris Therapeutic was forced to back away from its plan to launch an IPO when the market crashed, choosing to continue its partnership with Novartis Phara AG, a European drug manufacturer. Continued market turmoil may stall expansion for biotechnology (and other research-oriented technology firms) if it limits the access to capital.

Agriculture, Forestry and Fisheries

The state's agricultural and fishery industries were better off in 1998 than 1997, although 1998 has still been a difficult year because of drought conditions. The Governor has requested disaster relief from the federal government for farmers in 17 counties in central and Southern Maryland and on the Eastern Shore. Losses of corn and soybeans in some areas have reached as high as 50%. Despite the drought, corn production is expected to be 12% higher than last year, although August prices were over 18% lower than last year. Soybean production for 1998 is down by almost 20%, as are prices.

Poultry producers may be dramatically affected by Russia's economic troubles. More than 10% of the state's agricultural exports (25% of poultry exports) are exported to that country. Poultry sales to Russia declined by nearly 50% in the first few weeks of the crisis.

There has not been a recurrence of the *Pfiesteria* outbreak that caused a substantial decline in sales of Maryland seafood last year. Commercial crab landings through August, however, were only 60% of the last eight years' average. Oyster harvests were a bright spot in 1998, increasing by over 33%.

The difficulties in the agricultural sector will not have a material impact on the state's economy since agricultural, forestry and fisheries account for less than 1% of gross state product. Income in the farm industry should recover in 1999, barring a repeat of the extreme weather conditions experienced in large parts of the state.

In total, Maryland employment is expected to increase by 2.4% in 1998, 1.2% in 1999 and 1.4% in 2000. The forecast for the Maryland economy can be found in Table 2.

Table 2
Forecast of the Maryland Economy

CALENDAR YEAR	1993	1994	1995	1996	1997	1998	1999	2000
Total Personal Income (Million \$)	120,033	126,278	131,291	138,173	146,059	153,723	161,053	168,811
Change	3.97%	5.20%	3.97%	5.24%	5.71%	5.25%	4.77%	4.82%
Wages and Salaries	61,940	64,797	67,725	71,142	76,368	81,623	85,848	90,282
Change	3.13%	4.61%	4.52%	5.04%	7.35%	6.88%	5.18%	5.17%
Proprietors' Income	6,994	7,030	7,473	7,914	8,192	8,646	8,999	9,366
Change	7.96%	0.51%	6.30%	5.90%	3.52%	5.54%	4.09%	4.07%
Dividends, Interest, and Rent	19,710	21,102	22,597	24,417	25,325	25,834	26,586	27,768
Change	3.35%	7.06%	7.08%	8.06%	3.72%	2.01%	2.91%	4.44%
Transfer Payments	17,198	18,712	18,993	20,178	21,441	22,362	23,633	24,767
Change	5.70%	8.81%	1.50%	6.24%	6.26%	4.30%	5.68%	4.80%
Total NonFarm Employment (Thousands)	2,102.3	2,145.7	2,182.7	2,211.2	2,267.5	2,321.7	2,350.1	2,382.2
Change	1.01%	2.06%	1.72%	1.31%	2.55%	2.39%	1.22%	1.37%
Unemployment Rate (%)	6.2	5.1	5.1	4.9	5.1	4.7	5.1	5.2
Housing Starts (Thousands)	30.28	28.53	27.16	25.47	25.06	28.65	27.74	28.28
Change	-4.38%	-5.80%	-4.78%	-6.21%	-1.63%	14.33%	-3.17%	1.94%

Table 3
SELECTED REVENUES
FISCAL YEARS 1998 - 2000

	GENERAL FUND			SPECIAL FUND			TOTAL		
	Fiscal Year 1998 Actual	Fiscal Year 1999 Revised Estimate	Fiscal Year 2000 Estimate	Fiscal Year 1998 Actual	Fiscal Year 1999 Revised Estimate	Fiscal Year 2000 Estimate	Fiscal Year 1998 Actual	Fiscal Year 1999 Revised Estimate	Fiscal Year 2000 Estimate
INCOME TAXES									
Personal Corporation	4,156,142	4,106,130	4,336,200				4,156,142	4,106,130	4,336,200
	268,630	282,964	264,828	82,946	87,724	81,678	351,576	370,688	346,506
Total	4,424,772	4,389,094	4,601,028	75,129	87,724	81,678	4,507,718	4,476,818	4,682,706
SALES AND USE TAXES									
	2,161,152	2,260,384	2,349,203				2,161,152	2,260,384	2,349,203
STATE LOTTERY RECEIPTS									
	362,515	357,175	367,227	45,840	44,907	45,304	408,355	402,082	412,531
TRANSPORTATION REVENUES									
Motor Vehicle Fuel Tax	10,911	11,081	11,174	600,475	612,419	617,326	611,386	623,500	628,500
Motor Vehicle Licenses, Fees				276,793	287,097	276,889	276,793	287,097	276,889
Motor Vehicle Titling Tax				494,231	507,000	493,000	494,231	507,000	493,000
Mass Transit Fees				95,528	95,000	95,000	95,528	95,000	95,000
Maryland Port Fees				63,312	66,000	66,000	63,312	66,000	66,000
State Aviation Fees				89,963	110,000	103,000	89,963	110,000	103,000
Board of Public Works Transfer				21,000			21,000		
Total	10,911	11,081	11,174	1,641,302	1,677,516	1,651,215	1,652,213	1,688,597	1,662,389
PROPERTY TAXES, FRANCHISES, ETC.									
State Real and Personal Property Tax				242,180	246,353	251,218	242,180	246,353	251,218
Property Transfer Tax				81,075	85,348	83,601	81,075	85,348	83,601
Corporation Franchises and Filing Fees	177,319	169,601	175,658				177,319	169,601	175,658
State Tobacco Tax	128,272	121,864	117,355				128,272	121,864	117,355
Tax on Insurance Companies	172,662	181,660	186,682				172,662	181,660	186,682
Alcoholic Beverages Excises	23,939	24,331	24,475				23,939	24,331	24,475
Death Taxes	127,832	125,092	135,419				127,832	125,092	135,419
Clerks of the Court	38,926	41,398	40,947				38,926	41,398	40,947
District Courts	66,084	65,316	67,149				66,084	65,316	67,149
Hospital Patient Recoveries	64,402	152,683	101,260				64,402	152,683	101,260
Interest on Investments	76,807	68,057	57,000				76,807	68,057	57,000
Miscellaneous Fees, Other Receipts	215,747	203,696	188,069	10,933	9,000	7,000	87,740	77,057	64,000
Transfers	0	0	0						
Total	1,091,990	1,153,698	1,094,014						
GRAND TOTAL	8,051,340	8,171,432	8,422,646						

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

Table 4
MARYLAND GENERAL FUND REVENUES
FISCAL YEARS 1996 - 2000

Thousands \$	1996 Actual	FY 1997 Actual	FY 1998 Actual	FY 1999			2000 Estimate
				Official Estimate	Revised Estimate	Difference	
INCOME TAXES:							
Personal Corporation	3,483,863 252,338	3,767,237 265,987	4,156,142 268,630	4,001,070 248,701	4,106,130 282,964	105,060 34,264	4,336,200 264,828
Total	3,736,200	4,033,223	4,424,772	4,249,770	4,389,094	139,324	4,601,028
SALES AND USE TAXES	2,000,295	2,093,821	2,161,152	2,244,633	2,260,384	15,752	2,349,203
STATE LOTTERY	369,768	356,002	362,515	376,287	357,175	(19,112)	367,227
FRANCHISES, EXCISES, LICENSES, FEES:							
Business Franchise Taxes	189,197	192,006	177,319	169,353	169,601	248	175,658
Tax on Insurance Companies	165,786	165,805	172,662	182,306	181,660	(646)	186,682
Insurance Licenses and Fees	15,092	12,276	12,584	12,506	12,890	384	0
Death Taxes	110,598	104,149	127,832	125,172	125,092	(80)	135,419
Property Transfer Tax	6,341	6,503	0		0		0
Tobacco Tax	132,279	130,162	128,272	122,844	121,864	(980)	117,355
Alcoholic Beverages Excise Tax	23,337	23,377	23,939	23,271	24,331	1,060	24,475
Motor Vehicle Fuel Tax	10,583	10,738	10,911	11,000	11,081	81	11,174
District Courts	63,149	66,977	66,084	71,217	65,316	(5,901)	67,149
Clerks of the Court	35,039	35,081	38,926	36,084	41,398	5,314	40,947
Hospital Patient Recoveries	108,197	126,770	64,402	104,766	152,683	47,917	101,260
Interest on Investments	41,066	62,668	76,807	72,000	68,057	(3,943)	57,000
Miscellaneous	188,582	197,775	203,163	175,156	190,806	15,650	188,069
Total	1,104,742	1,134,288	1,102,900	1,105,674	1,164,778	59,104	1,105,188
GRAND TOTAL	7,211,005	7,617,333	8,051,340	7,976,364	8,171,432	195,068	8,422,646

Personal Income Tax

Net personal income tax revenues rose 10.3% in fiscal year 1998, after surging 8.1% in the prior year. This extremely strong performance reflects healthy job and wage growth, combined with extraordinary growth in capital gains, stock options and bonus income. Early data for fiscal year 1999 suggests that withholding may be slowing slightly, but capital gains realizations are likely to reach new highs.

Employer withholding accounts for more than 80% of gross personal income tax receipts and generally tracks the overall growth in wages and salaries in the state. Withholding has decelerated during the first quarter of fiscal year 1999, consistent with slower job growth and softer wage gains. Withholding is projected to rise by 5.5% during fiscal year 1999, down a bit from the 8.2% pace of 1998. In fiscal year 2000, withholding is projected to decelerate to 5.1%, as job growth slows.

Although income taxes generally follow wage growth fairly closely, revenue collections during the past two years were considerably higher than the 5.5% rise in total personal income would have suggested. Very strong growth in nonwage income, including capital gains, business income, bonuses and stock options, fueled tax collections.

Tight labor markets and the desire to hold down base expenditures, like wages, has led business to increasingly use bonuses as a way to recruit and retain workers. Similarly, the use of stock options has risen in popularity, especially at technology firms. These forms of compensation do not permanently increase the wage base and may be transitory. Since they are often tied to performance, in a slower economy, bonuses and options can drop quickly.

The level of capital gains realizations has more than tripled since 1994, rising 23% in tax year 1995, 54% in tax year 1996 and 51% in 1997. Based on the performance of the stock market and current collection trends, 1998 capital gains are expected to increase again. The increases are attributable to several factors: extraordinary appreciation in stock values, growth in the number of households that own equities, a shift among households from direct ownership of stocks to mutual funds and the change in the federal capital gains tax rate.

In tax year 1999, capital gains are projected to fall by 23.6%, before rising by 11.7% in 2000. The decline reflects the fact that a significant portion of the 1997 and 1998 realizations were induced or “unlocked” by the cut in the federal tax rate for capital gains. Once sold, those assets are unavailable to boost realizations in future years. The projected drop in realizations reflects only a portion of the additional gains induced by the law change. Stimulated by the lower tax rates, realizations will remain on a permanently higher path than expected before the tax cut.

Although capital gains account for less than 10% of taxable income, they contributed an estimated 40% of the growth in income tax receipts last year. At current levels, every 10% change in capital gains realizations changes total state and local tax collections by about \$48 million. Realizations can be volatile; since 1990, the annual change has ranged from -34% to +51%. The forecast of capital gains realizations is the most uncertain part of the revenue estimate and a correction in stock prices or gains higher than forecasted could materially affect the growth in actual tax receipts.

Various federal tax changes passed in mid-1997 will flow through and affect Maryland collections. In general, the expansion of Individual Retirement Accounts, deductions for education expenses and various small business provisions will decrease state revenues, slowly at first, but by material amounts in

later years. In total, these changes will reduce state and local revenues by \$13.6 million in fiscal year 1999 and \$13.4 million in 2000.

In addition, the 1998 Maryland General Assembly passed several laws affecting income taxes. First, the state income tax cut, scheduled to be phased in at a rate of 2% per year over five years, was accelerated. The tax cut for 1998 was increased to 5%, with tax year 1999's reduction increased to 6%. The retroactive 1998 reduction will increase refunds and lower final payments in the spring of 1999, decreasing fiscal year 1999 receipts by \$173.4 million. The first half year of the 6% cut in tax year 1999 will cut another \$132.7 million from fiscal year 1999 receipts. The state also instituted a refundable earned income credit for certain low income households and a deduction for payments to the Maryland prepaid college tuition program. These changes will lower receipts by \$16.3 million in fiscal year 1999 and \$18 million in fiscal year 2000.

Baseline state and local income tax collections will rise by 5.4% in fiscal year 1999 and 4.5% in 2000. After adjusting for state and federal tax changes, the general fund share of the income tax is expected to total \$4,106.1 million in fiscal year 1999, a decline of 1.2% from the previous year. During fiscal year 2000, general fund income tax receipts are expected to increase 5.6% to \$4,336.2 million. Forecasts for the individual income tax by component are shown in Table 5.

Table 5
Personal Income Tax
Fiscal Years 1997 - 2000

\$ Thousands	1997 Actual	1998 Actual	1999 Revised Estimate	2000 Estimate
Gross Receipts (State & Local)				
Withholding	5,352,821	5,791,358	6,110,255	6,420,846
Estimated Payments	897,385	1,060,315	1,121,300	1,178,463
Payments with Final Returns*	424,893	535,213	531,846	512,997
Fiduciary	30,437	52,358	53,160	55,798
Total Gross Receipts	<u>6,705,537</u>	<u>7,439,244</u>	<u>7,816,561</u>	<u>8,168,104</u>
Refunds	845,603	892,008	914,542	955,884
Baseline Net Receipts	5,859,934	6,547,236	6,902,019	7,212,220
Revenue Loss from Federal Tax Act **		15,030	13,612	13,362
Net Receipts, State and Local	<u>5,859,934</u>	<u>6,532,206</u>	<u>6,888,407</u>	<u>7,198,858</u>
Local Reserve Account	2,091,737	2,333,091	2,458,803	2,569,635
Income Tax Check Offs	961	972	1,000	1,000
Net Receipts	<u>3,767,237</u>	<u>4,198,143</u>	<u>4,428,604</u>	<u>4,628,223</u>
State Tax Cut		42,000	306,128	274,024
Other Income Tax Legislation***			16,347	18,000
Net General Fund	<u>3,767,237</u>	<u>4,156,143</u>	<u>4,106,130</u>	<u>4,336,200</u>

* Includes undistributed

** Does not include induced capital gains receipts, which are included in gross receipts

*** Includes the refundable earned income credit and subtraction for higher education investment contracts, among others

Corporation Income Tax

Corporate profit growth weakened in mid-1998, after eight years of robust growth. Struggling overseas economies have resulted in slower demand and falling prices. At the same time, production costs are rising, further pinching profit margins. Tight labor markets have pushed up the wage bill, and fringe benefit costs are also on the upswing. The traditional cure for narrowing profit margins, higher prices, is proving difficult to implement due to stiff price competition both at home as competitors look to expand market share, and abroad due to the strong U.S. dollar.

Maryland's corporate tax collections have followed the strong national profit performance, almost doubling over the past six years. Although profits are the principal driver of corporate tax receipts, the two series do not move in lockstep. This is the result of several factors, including the ability of corporations to carry losses back or forward and the fact that fiscal year receipts include payments related to several different tax years (estimated payments, audit adjustments, refunds, final payments and the like).

Also, multi-state corporations tend to make estimated tax payments based largely on the prior year's performance. This is not surprising given the complexities of tax law and the complications that arise from the different apportionment formulas operating in various states. The net effect of these factors increases the volatility of Maryland's corporate tax collections. When the trend in profits changes, corporations may be due refunds. While the recent deterioration in U.S. corporate profits would suggest weakness in Maryland tax receipts, such a trend is not yet evident in recent collections. In part, changes in tax law that have increased corporate tax liability are obscuring underlying trends.

First, legislation enacted in 1995 made banks subject to the corporate income tax rather than the franchise tax. This shift, effective for tax year 1998, adds an estimated \$5.6 million to receipts in fiscal year 1998 and will add \$15.1 million to receipts in fiscal years 1999 and 2000. In general, bank receipts have been hard to predict. While industry profitability has been good, the performance of Maryland's tax base has been less so. A major reason for this is the evolving structure of financial institutions. After years of mergers, acquisitions and consolidations, banking in the state is now dominated by a small number of large banks — Crestar, NationsBank and First Union — which are headquartered elsewhere. For tax purposes, net income is apportioned based on the ratio of gross receipts derived from business done in Maryland to gross receipts from all sources during the taxable year. For certain financial products, like loans, some services must be provided in the state for the related gross receipts to be considered income in Maryland. Without in-state facilities, some income related to these services is now apportioned to other states.

The second law change which increased revenues is the telecommunication tax reform, enacted by the 1997 General Assembly. Beginning in tax year 1998, all income of local telephone companies will be subject to the corporate income tax. Utilities will be allowed a non-refundable income tax credit equal to 60% of State, county and municipal property tax paid on certain specified real property. These changes are expected to generate \$15.7 million beginning in fiscal year 1999.

The federal Taxpayer Relief Act of 1997 included a number of provisions that will flow through to Maryland corporate receipts. These measures simplify pension calculations, raise revenues from certain financial products, close loopholes and affect the tax treatment of foreign enterprises. The net effect of these items on Maryland corporate receipts is slight, increasing collections by \$1-\$2 million per year.

Finally, fiscal year 1999 receipts will be boosted by \$17.2 million in nonrecurring payments, related to a large capital gain and a significant audit settlement. In sum, general fund corporate income taxes are projected to total \$283.0 million in fiscal year 1999 and \$264.8 million in fiscal year 2000. Table 6 contains the forecast for Maryland corporate tax collections.

Table 6
Maryland Corporate Income Tax Revenues
Fiscal Years 1997 - 2000

\$ Thousands	1997 Actual	1998 Actual	1999 Revised Estimate	2000 Estimate
Gross Receipts	411,110	429,773	413,409	406,692
Refunds	63,059	83,798	73,500	89,000
Net Receipts before Leg. Changes	348,051	345,976	339,909	317,692
Financial Institutions *		5,600	15,100	15,100
Telecommunication Reform **			15,679	13,715
Net Receipts	348,051	351,576	370,688	346,507
Transportation Trust Fund	37,291	37,669	39,717	37,126
Department of Transportation	44,773	45,277	48,007	44,552
Net to General Fund	265,987	263,030	282,964	264,828

* Effective January 1, 1998, banks are subject to corporate income tax; FY98 is half-year effect.

** Effective January 1, 1998, the subtraction modification for telecommunication companies is repealed, subjecting all net income to the corporate tax.

Sales and Use Tax

For forecasting and analytic purposes, sales and use tax receipts are broken down into six components: consumer spending, construction, capital goods (consisting of store and office equipment, machinery and equipment, containers and miscellaneous manufacturing), utilities, assessment collections and refunds.

Total sales and use tax revenue grew by 3.2% in fiscal year 1998. All categories contributed to the gain, with sales of capital goods particularly strong. Revenue growth in fiscal years 1999 and 2000 is expected to accelerate slightly due to a continued strong economy, a record low savings rate and increasing consumer debt.

Receipts from sales of consumer goods increased by 2.9% in fiscal year 1998. The continued strength of the stock market and the resulting impact of the wealth effect supported consumer confidence, which reached record highs during the second half of fiscal year 1998. The wealth effect, or higher consumption expenditures from current income made possible by increases in net wealth, has bolstered consumer spending for several years. Real net worth per household grew by 8% in 1997, and is expected to nearly double that growth rate in 1998. Consumer credit increased throughout the fiscal year, also fueling growth in consumer expenditures, although the rate of growth was generally declining. Revenues from the consumer component would have been stronger but for the reenactment of the sales tax exemption for snack foods. Without this change, revenues would have been about \$14 million higher in fiscal 1998, resulting in a growth rate of 3.9% for the year.

Growth of revenues from sales of consumer goods in fiscal year 1999 will be supported by a number of factors, including the continuation of several significant trends which began in the latter half of fiscal year 1998. Record low interest rates have led to a surge of mortgage refinancing, which should result in an increase in consumption expenditures for those households. Consumer debt has grown at an accelerating rate since May 1998. With the rebound of the stock market from its mid-year downturn, consumer confidence has recovered somewhat, although not to its summer peak. These factors will all sustain the current level of consumer spending into fiscal year 2000.

In addition, state and federal income tax refunds for tax year 1998 should be larger than normal. The impact of the state income tax reduction was not fully accounted for through withholding changes, nor was the impact of the federal \$400 tax credit per child. Since a large portion of income tax refunds usually are spent, this will provide a boost to tax receipts in the second half of fiscal year 1999.

Revenues from the consumer sales tax category will also rise because of the recent increase in cigarette prices resulting from the tobacco industry's settlement with the states. The two largest cigarette manufacturers have raised wholesale cigarette prices by 45 cents per pack; the retail price has increased by an estimated 50 cents per pack. Even though the total number of packs sold will decline, the net impact on sales tax revenues is a positive estimated increase of \$3.0 million in fiscal year 1999 and \$4.7 million in fiscal year 2000. Total revenues from sales of consumer goods are expected to increase by 5.0% in fiscal year 1999 and 4.3% in fiscal year 2000.

Tax receipts from purchases of construction-related materials grew by 1.5% in fiscal year 1998 following a strong 1997. Non-residential construction activity was strong, aided by the completion of the Ravens' football stadium, several retail projects and substantial new office space in the Baltimore metropolitan area, but residential construction was weak, with housing starts declining by 8%. Construction activity is expected to remain relatively stable throughout fiscal year 1999, however. Housing starts have

picked up, increasing by 10% in 1998. Renovation expenditures were at an all-time high at the start of the fiscal year, and over 1.4 million square feet of office space was under construction in the Baltimore metropolitan area, compared with 914,100 square feet completed in all of 1997. Total construction activity is expected to result in revenue growth of 2.4% and 3.4% in fiscal years 1999 and 2000, respectively.

The capital goods sector posted solid growth in fiscal year 1998, with an increase of 8.3% following a 7.2% gain in fiscal year 1997. Businesses have continued to invest in information processing and other high-technology equipment, partially in response to the Year 2000 problem. Expenditures on producers' durable equipment increased by almost 11.5%, the second highest growth rate since 1985. A phased-in elimination of the tax on all tangible personal property used in a production activity will dampen revenue growth until fiscal year 2001, when the exemption is fully effective. Based on actual claims received, the expected cost of this exemption has been halved to \$5 million in fiscal year 1999, \$10 million in fiscal year 2000, and \$15 million in fiscal year 2001. Expenditures on computer equipment have increased at an average annual rate of almost 15% in the 1990s; 1998 was another strong year, with an increase of 15.9%. Demand is expected to remain high, and while falling prices are expected to moderate revenue growth, anecdotal information suggests computer prices may now be stabilizing. Total revenue growth from sales taxes on capital goods is estimated at 7.7% in fiscal year 1999, before slowing to 1.1% in fiscal year 2000.

Tax receipts from utilities increased by just under 1% in fiscal year 1998. Slightly over half of this revenue comes from nonresidential gas and electricity sales and is significantly affected by weather conditions. A warm winter followed by a relatively cool summer resulted in a drop in these revenues of almost 6.7%. Imminent deregulation has forced utilities to keep costs and prices down; these competitive pressures will increase as deregulation occurs. Sales of communication services, which account for the remainder of this sector's revenues, are further broken down into cellular services and all other communications services. Revenues from both categories grew briskly in fiscal year 1998, cellular services by 13% and other communications services by 8.7%. Strong growth from these two revenue sources is expected to continue, resulting in a total increase in revenue from utilities of 5.2% and 5.0% in fiscal years 1999 and 2000, respectively.

Assessment collections remained relatively low in fiscal year 1998, because of the early retirement of several experienced auditors in the Compliance Division of the Comptroller's Office. This problem is expected to work itself out over the next several years, and assessments are expected to revert to the historic norm.

After adjustments for legislative changes, assessments and refunds, sales and use tax receipts are projected to increase by 4.6% in fiscal year 1999 and 3.9% in fiscal 2000. Detailed projections are shown in Table 7.

Table 7
Sales and Use Tax
Fiscal Years 1997 - 2000

\$ Thousands	1997 Actual	1998 Actual	1999 Revised Estimate	2000 Estimate
Consumer	1,409,483	1,450,918	1,523,573	1,588,630
Construction	304,868	309,503	317,050	327,955
Capital Goods	225,313	243,921	262,814	265,640
Utilities	148,709	150,082	157,908	165,805
Net Collections	<u>2,088,373</u>	<u>2,154,425</u>	<u>2,261,344</u>	<u>2,348,030</u>
Assessments	15,592	20,331	16,000	18,784
Refunds	(10,144)	(13,604)	(16,960)	(17,611)
Total	<u><u>2,093,821</u></u>	<u><u>2,161,152</u></u>	<u><u>2,260,384</u></u>	<u><u>2,349,203</u></u>

State Lottery

Lottery sales increased 2.7% in fiscal year 1998 after declining the previous year. This recovery may be short-lived, as sales through the first four months of fiscal 1999 are down 4.0% and only one game, Keno, has shown any increase in sales.

Pick 3 sales lost 1.4% in fiscal year 1998. Except for fiscal years 1995 and 1996, sales have declined every year since 1990, with an average annual decline over that period of 2.4%. Through the first four months of this fiscal year, sales were down 8.5%. Pick 4 sales have performed better in this decade, with only two years of modest decline. Nonetheless, sales are down 2.0% this year after an increase of 6.7% in fiscal year 1998. The Pick 4 sales falloff may be due in part to the fact that payouts were higher than statistically expected last year, which may have caused a temporary increase in sales. Pick 3 sales are expected to continue to fall, while Pick 4 sales are expected to remain relatively flat.

After a 12% decline in fiscal year 1997 due in part to the conversion to a new computer system, instant ticket sales were flat in fiscal year 1998 and have declined slightly through the first four months of fiscal year 1999. The instant games may have the most potential for growth; however, some efforts taken to increase sales have caused administrative problems which, in turn, may have hampered any potential sales increase. For example, an instant game used to be run until the entire stock of tickets was sold. The Lottery Agency is now removing those games which don't sell well long before all tickets are sold. This may maintain players' interest, but the number of games sold throughout the year (approaching 40) has caused frustrations for lottery agents. An increase in the commission paid to lottery agents for each instant ticket sold to 5% effective October 1 may help sales. Sales of instant tickets, which the agency is positioning as an entertainment purchase, are expected to resume modest growth in the second half of fiscal year 1999 and throughout fiscal year 2000.

Keno has been the sole bright spot; sales increased by 9.3% in fiscal year 1998, and by an even faster 11.0% so far in fiscal year 1999. The growth is attributable to additional outlets and continued enhancements to the game. This robust growth is expected to continue for the foreseeable future.

Performance of the jackpot games, Lotto, Cash-in-Hand, and the Big Game, has not been promising. Lotto sales increased by almost 9% in fiscal year 1998, but are down over 35% through the first four months of fiscal year 1999. The comparison to fiscal year 1998 is somewhat misleading as there were a number of jackpots over \$10 million in 1998, and none so far this fiscal year. A jackpot of \$10 million or more generally results in large sales increases. The multi-state Big Game has underperformed expectations throughout its existence. Sales declined by 4.0% in fiscal year 1998, although this comparison is again misleading, since the Big Game only ran for ten months in fiscal year 1997. The Big Game has not had an opportunity to establish itself in the minds of the game-playing public, as its jackpots have been consistently and substantially below those of its competitor, PowerBall. The Big Game also has yet to have a large sales-enhancing jackpot in fiscal year 1999, which is \$50 million for this game. Changes planned for January should result in higher jackpots and therefore higher sales, which are down 6.8% through the first four months of fiscal year 1999.

Cash-in-Hand, the new lotto-type game which rewards winners with a lump-sum payout of \$500,000, replaced Match 5 halfway through fiscal year 1998. Sales totaled \$13.9 million in fiscal 1998. Assuming sales of roughly \$2 million per month continue, Cash-in-Hand sales will reach \$27.9 million in fiscal year 1999.

As shown in Table 8, total lottery sales are expected to reach \$1,052.3 million in fiscal 1999 and \$1,068.5 million in fiscal 2000. After the deduction of agent earnings, administrative expenses, prizes and Stadium Authority revenues, net receipts of \$357.2 million and \$367.2 million are projected for fiscal years 1999 and 2000, respectively.

Table 8
Lottery Sales and Revenues by Game
Fiscal Years 1997 - 2000
\$ Millions

	Sales				Revenues			
	Actual 1997	Actual 1998	Estimated		Actual 1997	Actual 1998	Estimated	
			1999	2000			1999	2000
Pick 3	338.7	333.8	317.1	309.2	143.8	145.6	129.4	126.3
Pick 4	168.4	179.7	177.9	177.9	73.1	69.1	74.4	74.8
Lotto	66.4	72.3	58.1	57.7	27.1	29.3	24.3	24.1
Match 5	36.1	17.9	--	--	12.5	6.9	--	--
Cash-in-Hand	--	13.9	27.9	29.3	--	6.7	13.5	14.1
Instant	160.1	160.4	163.6	171.7	47.8	50.4	50.7	51.5
Keno	234.2	256.0	276.5	290.3	72.6	77.4	84.0	87.0
Big Game	37.5	36.0	31.2	32.3	15.5	14.7	12.9	13.3
Total	1,041.5	1,070.0	1,052.3	1,068.5	392.5	400.2	389.2	391.2
Less: Stadium Authority Revenue					31.5	32.6	32.0	24.0
Transfer to Horse Racing Fund					5.0	5.0	0.0	0.0
General Fund Revenue					356.0	362.5	357.2	367.2

Business Franchise Taxes

The franchise tax on public service companies — local and long distance telephone, and gas and electric utilities — is levied on gross receipts, which means that revenues change with usage. Computer modems and fax machines have raised the demand for telephone lines and usage. Demand for traditional telephone service generally rises with the growth in income. Although overall usage is higher, competition among the major long distance carriers has led to significant price discounting, thereby dampening the growth in receipts and tax revenues. In the longer term, deregulation will permit greater competition in the telecommunications industry, which is expected to keep downward pressure on price.

Revenues from the tax on gas and electric companies are affected by the exploitation of Section 8-406(b) of the Tax-General Article, which provides utilities with a \$3 per ton credit against the tax for each ton of Maryland-mined coal purchased (in excess of the amount purchased in 1986). Although this coal is not used by Maryland utilities, one utility is purchasing and re-selling the coal to an out-of-state utility. The Attorney General has ruled that reselling is allowable for credit purposes. The credit reduced revenues during the prior three fiscal years by about \$6 million annually. This estimate assumes that the cost of the credit will remain at \$6 million during fiscal years 1999 and 2000.

It should be noted that the opportunity for expanded use of the credit exists. If all Maryland-mined coal were resold by state utilities, the credit would lower receipts by \$10.5 million. It is also unclear whether the Attorney General's ruling would allow the same coal tonnage to be resold multiple times between utilities, or would allow non-electric utilities to broker coal purchases and claim the franchise tax credit.

Tax revenues are also being affected by the emergence of natural gas re-sellers in the market who sell directly to end-users. Gas marketers purchase low cost gas for delivery through the local utility pipelines. The marketers bill the customer for the gas, and the utility bills the customer only for transportation costs. The Department of Assessments and Taxation estimates that a significant amount of the natural gas purchased by large customers in Maryland is marketed. Since the Public Service Commission does not regulate re-sellers, they are not subject to the gross receipts tax. This is the likely cause of the slippage in franchise taxes from gas utilities in recent years. Likewise, the coming deregulation of the electric industry has the potential for substantially higher tax revenue erosion. The estimate assumes that the loss in revenue due to brokering of gas and electricity reaches \$8 million by fiscal year 2000.

In addition to these factors, fiscal year 1998 receipts were also held down by the unusually warm winter. The unseasonably mild weather has continued through the fall, further curtailing receipts. The weak demand domestically, combined with plummeting demand from the recession-plagued Asian economies, have resulted in high stocks of natural gas and heating oil and low prices. Electricity prices have also been held in check due to the competition with natural gas and heating oil and as deregulation begins to affect pricing decisions. As a result, even with a return to more normal temperatures this winter, low prices are likely to result in only sluggish growth in gross receipts taxes.

Effective for tax year 1998, banks are subject to the corporate income tax rather than the franchise tax. Thus, only finance companies and savings and loan institutions still pay the financial institutions franchise tax. Revenue from finance companies is cyclical, depending on loan demand for sales and refinancings of homes, autos and other similar items.

Revenue from savings and loans has declined precipitously in recent years and is expected to continue to drop because the industry is gradually disappearing. Congress has considered legislation that would eliminate federally chartered savings and loan institutions, requiring them to convert to banks. Many in-state institutions have already done so, and others have merged with out-of-state financial institutions. The \$10 million in franchise tax expected from finance companies and savings and loans will be partly offset by an estimated \$4 million in refunds related to prior year returns for banks.

Deposits at savings and loan associations are also taxed at a rate of 0.013%. Revenue from this tax was originally intended to finance the cost of state regulation of these entities. Although there no longer are any state chartered and regulated institutions, the tax remains in place. Revenues have fallen over the years, commensurate with the decline in the number and size of the savings and loan institutions in the state.

Revenue from corporate filing fees are expected to hold steady, with modest increases offset by the ongoing shift to types of business structures (partnership, subchapter S and limited liability companies) that are not subject to these fees. Table 9 contains the forecast details for the business franchise taxes.

Table 9
Fiscal Years 1997 - 2000

\$ Thousands	1997 Actual	1998 Actual	1999 Revised Estimate	2000 Estimate
Public Service Company Franchise Tax	145,601	146,494	148,842	155,003
Franchise Tax on Net Earnings of Financial Institutions	31,781	16,709	6,916	6,926
Tax on Deposits of Savings and Loans	1,539	1,480	1,332	1,199
Filing Fees				
Domestic Corporations	10,799	10,415	10,329	10,279
Foreign Corporations	2,287	2,222	2,182	2,252
Total	<u>192,006</u>	<u>177,319</u>	<u>169,601</u>	<u>175,658</u>

Insurance Company Revenues

Taxes on insurance premiums resumed growth in fiscal year 1998 after a stagnant fiscal year 1997. The 4% growth in 1998 reflects steep rate hikes by some of the state's largest insurers, who have taken advantage of a stronger market and a relaxation of the state's regulatory climate to rebuild reserves after years of nominal rate hikes and costly natural disasters. Revenue gains will be muted by the ongoing movement of large firms toward self-insuring workers' compensation funds and the growing importance of health maintenance organizations, which are not subject to the tax.

Strong premium increases are expected again in fiscal year 1999 before moderating slightly in fiscal year 2000. Revenue growth is expected to mirror these changes, increasing by 5.2% and 2.8% in fiscal years 1999 and 2000, respectively.

License and fee revenues increased by 2.5% in fiscal year 1998, and are expected to continue that growth in fiscal year 1999. Because of legislative action taken in 1998, these revenues will be credited to a special fund instead of the general fund beginning in fiscal year 2000.

Fiscal Years 1997 - 2000

\$ Thousands	1997 Actual	1998 Actual	1999 Revised Estimate	2000 Estimate
Premiums Tax	165,805	172,662	181,660	186,682
Licenses and Fees	12,276	12,584	12,890	0
Total	178,081	185,246	194,549	186,682

Death Taxes

Death tax collections depend on the number and value of estates settled during the fiscal year. Revenues rebounded in fiscal year 1998 after a weak 1997. More than twice as many large estates were settled in fiscal year 1998 than in fiscal year 1997--there were 25 estates with an estate tax liability of \$0.5 million or more, compared to only 11 in fiscal year 1997 and 19 in fiscal 1996. The value of estates is affected by real estate conditions and the performance of stock and bond markets. Since a significant portion of the average estate's value is in corporate equities, estate values have been pushed up in recent years.

During the first four months of fiscal year 1999 estate tax revenues have declined by 14%. Only five large estates have closed during this period, compared to eight during the same period last year. Full year revenues are expected to decline slightly as the number of large estates returns to historical levels.

Federal tax reform will nip estate tax receipts. Beginning with tax year 1998, the effective unified estate tax exemption will rise from the current \$600,000, reaching \$1.0 million by 2007. The increased exemption will shave \$0.9 million from estate tax collections in fiscal years 1999 and 2000.

Fiscal Years 1997 - 2000

\$ Thousands	1997 Actual	1998 Actual	1999 Revised Estimate	2000 Estimate
Collateral Inheritance Tax	47,114	48,786	51,248	55,406
Direct Inheritance Tax	18,178	19,161	20,428	23,095
Tax on Commissions *	112	90	20	0
Maryland Estate Tax	36,857	58,747	52,597	56,118
Interest and Penalty	<u>1,888</u>	<u>1,048</u>	<u>800</u>	<u>800</u>
TOTAL	104,149	127,832	125,092	135,419

* The Tax on Commissions was abolished by the 1989 General Assembly.

Tobacco and Alcoholic Beverage Excise Taxes

Tobacco excise tax revenues are affected by decreasing demand caused by health considerations. The larger than usual decline in revenues in fiscal year 1999 is attributable to the recent settlement between the states and the tobacco industry. Prices have risen by an estimated 50 cents per pack price to pay for the agreement. Consumption is expected to decline by 4.9% in fiscal year 1999 and by 3.7% in fiscal year 2000 before resuming the more modest trend decline.

Reversing the recent trend of declining sales, alcoholic beverage excise taxes increased by 2.4% in fiscal year 1998. Modest growth is expected to continue in fiscal years 1999 and 2000.

Fiscal Years 1997 - 2000

Tobacco Tax

\$ Thousands	1997 Actual	1998 Actual	1999 Revised Estimate	2000 Estimate
Tobacco Tax	130,162	128,272	121,864	117,355

Alcoholic Beverages Excise Tax

\$ Thousands	1997 Actual	1998 Actual	1999 Revised Estimate	2000 Estimate
Tax on Distilled Spirits	10,975	11,244	11,200	11,200
Tax on Wine	3,722	3,865	4,019	4,120
Tax on Beer	8,680	8,829	9,112	9,155
Total	23,377	23,939	24,331	24,475

Hospital Patient Recoveries

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

In general, hospital recoveries are expected to rise moderately. Declining populations at State hospitals will result in a reduction of billable days, which will partially offset small rate increases.

A new billing system in fiscal year 1996 temporarily delayed billing activity. As a result, approximately \$11.7 million in disproportionate share revenues attributable to that year were recorded in fiscal year 1997. In fiscal year 1998, billing delays related to the introduction of managed care program for Medicaid patients pushed approximately \$49.2 million in disproportionate share receipts into fiscal year 1999.

The federal Balanced Budget Act of 1997 significantly cut into the availability of disproportionate share revenues. Revenues received under this program are scheduled to decline each year through fiscal year 2003, when they will total only \$12.8 million.

Fiscal Years 1997 - 2000

\$ Thousands	1997 Actual	1998 Actual	1999 Revised Estimate	2000 Estimate
Medicaid	40,387	44,465	43,180	43,937
Medicare	3,270	3,247	3,975	3,831
Insurance and Sponsors	8,117	7,695	7,369	7,492
	51,774	55,407	54,523	55,260
Medicaid Cost Settlement	1,935			
Disproportionate Share				
Current year	61,331	8,995	49,000	46,000
Billings from prior year	11,730		49,160	
Total	126,770	64,402	152,683	101,260

Clerks of the Court

Mortgage activity rebounded in fiscal year 1998, spurred by the lowest interest rates in 25 years. Mortgage originations for new sales and refinancings rose by 63%, the sharpest increase since 1992. Home sales have remained quite strong in the early months of fiscal year 1999, thanks to a steady economy and excellent affordability. In addition, high consumer debt burdens will continue to propel growth in home equity loans. These loans have been marketed as a way for homeowners to consolidate debt and to benefit from an income tax deduction. Based on the added mortgage activity, the commissions and recording fees collected by the Clerks of the Court are expected to grow by 6.4% in fiscal year 1999. Revenues will dip in fiscal year 2000, as the housing market cools off.

District Courts

District court revenues, primarily traffic fines and fees, dropped 1.3% in fiscal year 1998. The decline was partly attributable to a shift in responsibility for certain court activities from the state to certain local governments. The approximately \$3 million in fees associated with these functions are now collected by those localities as well.

District court receipts vary widely from year to year since they are affected by driving patterns, weather and the extent to which judges enforce or forgive fees and fines. Revenue is expected to decline 1.2% in fiscal year 1999 and increase 2.8% in 2000. While a higher speed limit on portions of the interstate highway has the potential to result in fewer motorists being issued speeding tickets, in practice, stricter enforcement of the new limits has kept revenue stable.

Fiscal Years 1997 - 2000

\$ Thousands	1997 Actual	1998 Actual	1999 Revised Estimate	2000 Estimate
Clerks of the Court	35,081	38,926	41,398	40,947
District Courts	66,977	66,084	65,316	67,149

Table 10
Miscellaneous Revenues
Fiscal Years 1997-2000

\$ Thousands	1997 Actual	1998 Actual	1999 Revised Estimate	2000 Estimate
Franchise Taxes				
Expedited Fee Revenue	1,184	1,389	1,400	1,450
Domestic Recording Fees	2,939	3,495	3,500	3,525
Foreign Recording Fees	272	215	225	240
Organization & Capitalization Fee	588	631	600	600
Interest & Penalty	1,387	2,540	750	750
Transportation (GF share of filing fees, license tags)	6,238	8,598	8,845	8,678
Horse Racing	2,216	0	0	1,174
PSC Filing Fees	10,793	10,437	11,036	11,469
Excess Fees of Office	15,340	17,987	18,000	18,500
Legislature	637	436	252	331
Workers' Compensation	15,690	14,580	15,000	15,100
Public Defender	1,358	1,125	1,300	1,500
Attorney General	14,459	15,584	15,000	15,500
Executive & Administrative Control	5,940	2,154	539	555
Budget & Fiscal Administration	1,071	1,881	1,083	957
General Services	122	38	40	40
Agriculture	281	297	246	246
Health & Mental Hygiene	9,322	14,949	7,919	7,502
Human Resources	3,158	2,161	3,830	3,830
Labor, Licensing & Regulation				
Div. of Financial Reg.	3,565	4,891	3,345	6,060
Div. of Labor & Industry	1,110	1,160	1,400	1,400
Div. of Occup. & Prof. Lic.	6,204	5,832	5,107	5,243
Public Safety & MD State Police	6,981	7,713	9,212	9,303
Public Education	18,478	23,768	20,474	21,454
Environment	533	217	333	197
Juvenile Justice	877	866	699	574
Unclaimed Property	22,216	25,495	32,500	25,000
Alcoholic Beverage Licenses	506	490	320	490
Local Income Tax Reimbursement	10,800	12,000	12,450	12,450
MDIF	5,000	0	0	0
MAIF Penalties	9,620	12,896	10,500	9,200
Dedicated Purpose Account Transfer	11,600	0	0	0
Miscellaneous Revenues and Transfers	7,291	9,338	5,000	5,000
Total	197,775	203,163	190,906	188,319

Transportation Revenues

Titling tax receipts increased in fiscal year 1998 for the seventh consecutive year, rising 2.8%. Vehicle demand was supported by a healthy economy, low interest rates, and lucrative manufacturers' incentive programs. The number of vehicles sold increased 0.8% and the average tax increased as well, reflecting the continued popularity of expensive luxury and multipurpose vehicles. In addition, the rising use of leasing has boosted the number of vehicle sales and pushed up the average price paid. Consumers are often able to lease a more expensive vehicle than they could afford to buy. Since the titling tax is paid on the price of the vehicle, higher prices have pumped up total receipts.

Revenue is expected to rise 2.6% to \$507 million in fiscal year 1999 before declining to \$493 million in fiscal year 2000. The economy is expected to slow over this period, putting downward pressure on vehicle sales, and recent data suggest that the popularity of leasing may be cooling. Even so, revenues will still benefit for several years as current leases expire, causing lessees to lease again or purchase a vehicle. Additionally, favorable interest rates, incentives and flat prices will increase affordability, somewhat offsetting the negative pressures.

Titling tax receipts are very cyclical, and thus difficult to project. Other transportation revenues generally follow changes in the underlying demographics of the population and, as a result, exhibit more moderate trends. Motor fuel consumption increased by 1.7% in fiscal year 1998 as gasoline prices fell. Fuel prices remain quite low, spurring an expected increase of 2.0% in gasoline consumption in fiscal year 1999. By 2000, prices will begin to recover, dampening demand and holding fuel tax revenues to a 0.8% increase. Revisions to other transportation revenues reflect recent trends in collection activity.

Table 11 contains the detailed forecast for transportation revenues.

Table 11
Maryland Motor Vehicle User Revenues
Fiscal Years 1997 - 2000

\$ Thousands	1997 Actual	1998 Actual	1999 Revised Estimate	2000 Estimate
Motor Vehicle Administration				
Registrations	162,470	164,446	169,500	165,700
Licenses	11,879	15,309	16,800	17,100
Medevac Surcharge	32,017	31,229	32,197	31,489
Miscellaneous Motor Vehicle Fees	48,562	53,741	53,600	51,200
Vehicle Emission Inspection Fees	16,614	12,067	15,000	11,400
Security Interest Filing Fees				
Special Funds	5,153	2,860	2,940	2,879
General Funds	4,220	4,290	4,410	4,319
General Funds - Baltimore City		2,383	2,450	2,399
Hauling Fees	5,825	5,269	5,400	5,000
Learners and New Drivers Licenses	7,302	6,856	7,300	7,400
Special License Tags				
Special Funds	350	350	380	380
General Funds	1,366	1,336	1,460	1,510
DOT	279	305	310	310
Chesapeake Bay Tags - MDOT	475	393	350	300
Chesapeake Bay Tags - GF		588	525	450
Titling Tax	480,980	494,231	507,000	493,000
	<u>777,492</u>	<u>795,656</u>	<u>819,622</u>	<u>794,836</u>
Motor Vehicle Fuel Tax	601,308	611,386	623,500	628,500
Road Tax	13,842	14,939	15,300	15,400
Decals	351	286	300	300
Permits	109	92	0	0
	<u>615,610</u>	<u>626,703</u>	<u>639,100</u>	<u>644,200</u>
TOTAL	<u><u>1,393,102</u></u>	<u><u>1,422,359</u></u>	<u><u>1,458,722</u></u>	<u><u>1,439,036</u></u>

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. Real gross domestic product is expected to expand at an average annual rate of 2.6% per year during the 1999 - 2003 period. This rate is consistent with the consensus forecast of the economy's potential growth rate, which represents the sum of the expected growth in the labor force, capital stock and increases in their productivity.

As discussed in the economic outlook, beginning in 1999, Maryland's economy is expected to slow down from the robust rate registered in 1997-98 to a more sustainable pace. Employment is expected to increase an average 1.5% per year between 1999 - 2003, very similar to the 1.4% rate anticipated for the nation. Consumer price inflation is projected to escalate only mildly, for an average annual increase of 2.8% during the next five years. Coupled with modest employment growth, Maryland personal income is expected to increase an average of 5.0% per year between 1999-2003. Table 12 contains the economic indicators for the long-term forecast.

Revenue growth will be moderate between 2001 - 2003. Baseline income tax revenue will generally track the gains in income. Actual tax collections will grow more slowly, however, because of the phased-in income tax cut. In addition, the revenue losses associated with the federal tax changes will increase each year, further dampening income tax growth.

Underlying growth in the sales tax base is projected at 4.2%. This is below the growth in personal income, because an increasing share of spending is on services, mail-order sales and Internet sales, which are largely untaxed.

Lottery sales are expected to increase by about 1.5% per year. The general fund share of lottery revenues will rise in the out years, when the amount of revenues transferred to the Stadium Authority drops from \$32 million in fiscal year 1999 to \$24 million in fiscal year 2000, before sliding to \$14 million by fiscal year 2003.

In total, general fund revenues are expected to increase by 3.7%, 3.5% and 4.2% in 2001, 2002 and 2003, respectively. Table 13 displays the five year revenue forecast.

Table 12
Long Term Economic Forecast
Primary Indicators

CALENDAR YEAR	1997	1998	1999	2000	2001	2002	2003
U.S. Real GDP (Billion \$92 Chained)	7,269.8	7,536.6	7,671.7	7,855.7	8,089.0	8,296.5	8,493.0
% Change	3.93%	3.67%	1.79%	2.40%	2.97%	2.56%	2.37%
U.S. Total NonFarm Employment (Millions)	122.7	125.7	127.2	128.8	131.0	132.8	134.7
% Change	2.58%	2.50%	1.17%	1.26%	1.72%	1.39%	1.37%
U.S. Total Personal Income (Billion \$)	6,784.0	7,131.7	7,471.5	7,856.2	8,295.6	8,785.2	9,273.5
% Change	5.58%	5.13%	4.76%	5.15%	5.59%	5.90%	5.56%
CPI - % Change	2.3	1.6	2.2	2.5	2.8	3.1	2.9
U.S. 30 Year Treasury Bond Yield	6.61	5.58	5.12	5.89	6.71	6.63	5.94
MD Total NonFarm Employment (Thousands)	2,267.5	2,321.7	2,350.1	2,382.2	2,423.0	2,463.4	2,497.9
% Change	2.55%	2.39%	1.22%	1.37%	1.71%	1.67%	1.40%
MD Total Personal Income (Million \$)	146,059	153,723	161,053	168,811	177,572	186,500	196,086
% Change	5.71%	5.25%	4.77%	4.82%	5.19%	5.03%	5.14%

Sources: U.S. Forecast: Standard and Poor's DRI, Regional Financial Associates, Inc.
MD Forecast: Bureau of Revenue Estimates

Table 13
MARYLAND GENERAL FUND REVENUES
FISCAL YEARS 1997 - 2003

Thousands \$	1998 Actual	1999 Estimate	2000 Estimate	2001 Estimate	2002 Estimate	2003 Estimate
INCOME TAXES						
Personal	4,156,142	4,106,130	4,336,200	4,518,443	4,666,596	4,881,302
Corporation	268,630	282,964	264,828	282,045	306,577	331,845
Total	4,424,772	4,389,094	4,601,028	4,800,488	4,973,173	5,213,148
SALES AND USE TAXES	2,161,152	2,260,384	2,349,203	2,437,829	2,539,444	2,648,763
STATE LOTTERY	362,515	357,175	367,227	381,275	391,294	399,403
FRANCHISES, EXCISES, LICENSES, FEES	1,102,900	1,164,778	1,105,188	1,113,593	1,131,738	1,149,797
GRAND TOTAL	8,051,340	8,171,432	8,422,646	8,733,185	9,035,649	9,411,110