

*Report of the*  
**Maryland Board of Revenue Estimates**  
*on*

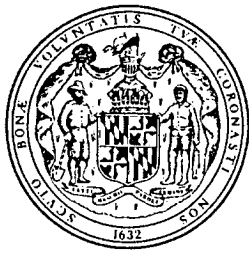
**ESTIMATED  
MARYLAND  
REVENUES**

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**FISCAL YEARS ENDING JUNE 30, 2002 AND JUNE 30, 2003**

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*Submitted to*  
Governor Parris N. Glendening  
December 13, 2001



# State of Maryland Board of Revenue Estimates

Louis L. Goldstein Treasury Building, P. O. Box 466  
Annapolis, Maryland 21404-0466  
E-Mail: bre@comp.state.md.us

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William Donald Schaefer  
State Comptroller

Richard N. Dixon  
State Treasurer

T. Eloise Foster  
Secretary, Department of  
Budget and Management

Executive Secretary:  
David F. Roose  
Director, Bureau of  
Revenue Estimates

December 13, 2001

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, 2002 and June 30, 2003, based upon current laws and administrative practices. These estimates are set forth in the accompanying Report on Estimated State Revenues. As in the past, the estimates represent the collective efforts of each of the Board members and their staffs.

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

Respectfully yours,

William Donald Schaefer, Chairman

Richard N. Dixon

T. Eloise Foster

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## Executive Summary

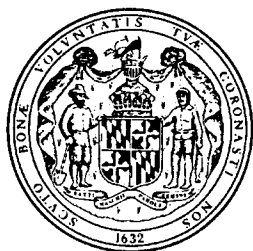
Maryland's economy performed exceptionally well through the end of fiscal year 2001. As the national economy slowed towards the end of calendar year 2000 and entered a recession now dated to March 2001, Maryland's economy continued to create jobs, income and wealth. At the start of the recession, Maryland unemployment stood at 3.6%; three months later, at the end of the fiscal year, it was at 3.5%. By most economic and revenue measures, the nationwide economic difficulties were not apparent in Maryland in mid-2001.

Economic and revenue slowdown appeared in Maryland around the time of the terrorist attacks on September 11. To be sure, the slowdown was underway and would have deepened had it not been for the attacks. The uncertainty, economic and otherwise, occasioned by the events of September 11 served to exacerbate the difficulties, however. Unemployment has increased to 4.4%, and employment growth is nonexistent.

National economic recovery won't occur until mid-2002. Maryland's economy is well-positioned to weather the recession, but will nonetheless slow dramatically. Employment growth of 2.7% in 2000 is forecast to slow to 1.0% in 2001 before a flat 2002 as the economy bottoms out. Personal income growth is expected to slow from 6.8% in 2000 to 3.6% in 2002, before accelerating again to 5.0% in 2003. Wage and salary income will follow the same general pattern.

General fund revenue growth will slow along with the economy, and will be hampered by several other factors. The final step of the phased-in income tax reduction occurs in tax year 2002, holding back revenue growth. The tax-free week reduced sales tax collections by \$5.1 million in fiscal year 2002, and interest earnings will fall as rates have dropped by nearly 50%. Overall, general fund revenues will actually decline by 1.9% in fiscal year 2002. This drop will be ameliorated by two factors—the tax amnesty in September and October 2001 resulted in \$28.5 million of general fund revenue, and \$119.5 million of surplus will be transferred from the local income tax reserve account. After accounting for amnesty and transfer funds, general fund revenues will only decline by 0.4% in 2002, or \$42.6 million.

In fiscal year 2003, when the economy recovers and the income tax reduction is fully effective, general fund revenues will increase to \$9,787.3 million, or 0.4%. Excluding the one-time amnesty and transfer funds, general fund revenue growth is estimated at 1.8%.



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**PELL RUDMAN**

Mr. Lee McDaniel  
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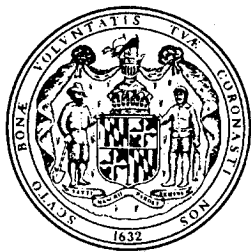
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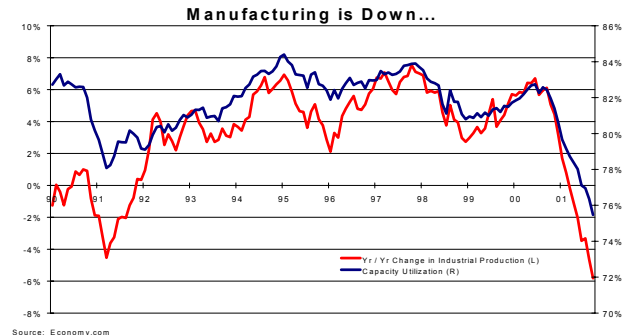
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## The U.S. Economy

After exactly ten years, the longest economic expansion in United States economic history is over. The National Bureau of Economic Research announced in November that economic activity peaked in March 2001, at which point the economy began to contract. Real gross domestic product has stagnated, declining at a 1.1% annual rate in the third quarter, following a scant 0.3% increase in the second quarter. Unemployment has increased 1.3 percentage points since its trough of 3.6% in October of 2000, and is currently at levels not maintained since early 1998. Expectations had generally been that the national economy would flirt with mild recession, but would recover in the first half of 2002. Events of September 11 have changed the outlook considerably, particularly for specific industries. It now appears that recovery will be delayed until mid-2002.

### The Current Situation

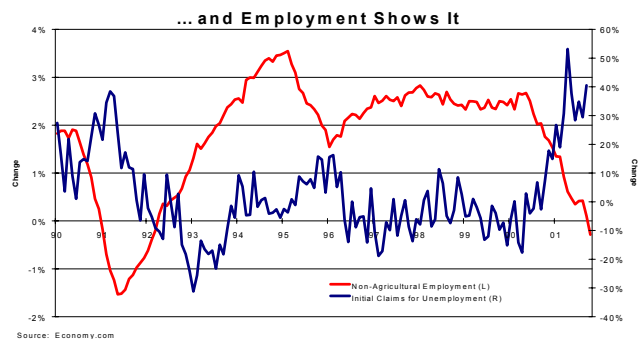
The slowdown was abrupt. Through most of 2000, it seemed that the economy was fundamentally strong despite the burst of the dot-com bubble. Real GDP grew at a 5.7% annual rate in the second quarter of 2000, and finished the year 4.1% above 1999 levels. The Y2K disaster never materialized, but cautionary slowdowns in production led to a shortage of inventories in 2000. Strong sales growth and the inventory shortfall led producers to increase production—the Federal Reserve's index of industrial production increased by 5.6% in 2000, the third-best performance of the last two decades. Inventories built up quickly, just as the market bubble collapsed and consumers reined in spending. As a result, manufacturing contracted sharply in 2001, with year-over-year declines in the industrial production index in each month from March through the present. In January, capacity utilization fell below 80% for the first time since March of 1992, and since December it has experienced four of the seven largest monthly declines in the 140 months since 1990.



The impact of excess inventories was closely followed by a dramatic decline in nonresidential investment. Through most of the 1990s, annual growth in nonresidential investment hovered around 10%. This growth was driven by investment in computer hardware, which approached 60% growth in the first quarter of 1996 and stayed above 40% for most of the rest of the decade, and by investment in software, which grew at

annual rates between 10% and 30% for almost the entire decade. Phenomenal growth in these sectors has come back to earth, with declines of nearly 12% in hardware investment and 1.6% in software investment in the third quarter, the first declines in over ten years and 23 years, respectively. In the second quarter, business investment declined for the first time in over nine years; in the third quarter, year-over-year growth in every category of investment was negative. Corporate profits have taken a nosedive, declining at an annual rate of 20% in the second quarter of 2001. The markets have responded to these factors, with the NASDAQ falling over 40% from its peak in January through September 10, and the Standard and Poors' 500 falling over 20% during the same period. These declines are, of course, following the 51% and 14% declines from their respective peaks in 2000.

Employment data show the slowdown clearly. So clearly, in fact, that year-over-year seasonally adjusted employment growth has accelerated in only one month since May of 2000, and has slowed from growth of 2.7% in that month to a decline of 0.3% in October. For the first three quarters of 2001, mass layoff events (50 or more initial claims for unemployment benefits in a five week period from one establishment, with at least 50 workers separated for more than 30 days) averaged 33% higher than from 1996 through the third quarter of 2000. Initial claims for unemployment benefits have risen steadily since April 2000, and have now reached levels not seen since early 1992.



Consumers, who have sustained the economy's growth over the past two years, have reacted to the increasing job uncertainty and declining markets as would be expected. Beginning in September of 2000, when it may have dawned on most investors that the NASDAQ would not see 5000 again for quite some time, consumer confidence plunged from record highs to its lowest level in five years. Despite the worsening news over the course of 2001 and the growing lack of confidence, consumers continued to spend albeit with growth at slower rates. Growth in consumer spending in the third quarter was the slowest since the first quarter of 1993. Consumers have continued to purchase homes, however, with home sales hitting record levels in the first quarter of 2001 and housing starts coming only slightly off their ten-year high from the end of 1998.

A number of factors have helped to sustain consumer spending at levels above what might be expected from consumer confidence data. The Federal Reserve has reduced interest rates eleven times in 2001 by a total of 425 basis points. Lower interest rates have certainly helped support the housing market and spurred the surge

in refinancings, providing cash for consumers to spend. Also providing cash is the federal government, which mailed out \$300 or \$600 checks to most taxpayers through the summer. Steep declines in gasoline and other energy prices over the past six months also have eased pressure on consumers.

## **The Outlook**

The events of September 11 have clearly had an impact on the economy. The economy was contracting before September 11; the recession will now be magnified. The consensus on September 10 was for growth in real GDP of about 1.5% in 2001 and between 2.4% and 2.7% in 2002. Forecasts of major economic consulting firms in the weeks after the attacks called for 2001 GDP growth of just over 1.0%, and growth next year of about 1.5%. Upon reflection, the forecasts for next year are declining; Economy.com now calls for growth of 1.2% in 2002, and DRI-WEFA forecasts a marginally better 1.3% growth.

The attacks have had an impact on the economy, but the impact is relatively modest when looking at the heights from which the economy has fallen. Transportation and tourism-related sectors have obviously had their fortunes most affected by the terrorist attack, along with the insurance industry and others in the financial sector. Unsurprisingly, employment growth will slow with GDP. Rather than decline in the second and third quarters of 2001 before increasing again in the third quarter, it is now expected that employment will decline through the first quarter of 2002 before resuming growth at a more moderate level than had been expected for the balance of the year. The unemployment rate will increase further in 2002 from the current 5.7%, reaching levels not seen since 1994.

The Federal Reserve acted quickly after September 11, cutting rates by 50 basis points the morning the stock markets reopened. While the indices fell sharply the first few days the markets were open, they had generally regained their pre-attack levels a month later, with the Standard and Poor's 500 exceeding its pre-attack level of 1,092 on October 11. Long-term confidence in the American economy seems to be undiminished. Mortgage rates have continued their decline, and look to remain at or near record lows throughout the forecast period. With the stock market perhaps bottoming out, housing prices holding steady or increasing, and low interest rates, the stage will be set for a recovery once inventories are worked through and business investment starts growing again.

The federal government's response to September 11 will be a significant positive force on the economy, and will help to offset the weaker activity of consumers. Talk of the lock-box and surpluses is no more; the only issues of importance are protecting the country at home and abroad and keeping the economy moving forward. Already, the government has provided \$40 billion in support for the airline industry. Subsidies for other affected sectors including the Post Office are a possibility, as are increased unemployment benefits for employees affected by these events. Broad tax breaks for



corporations are under discussion, as are additional tax benefits for individuals. While the passage of a broad economic stimulus package by the end of the year if at all is not the certainty it once appeared; any such package will provide a boost on top of the fiscal stimulus already in the pipeline. As many of the provisions would no doubt be effective almost immediately, they will take effect at about the same time that the rate reductions the Fed initiated in January take hold.

The success to date of the war in Afghanistan and the lack of further terrorist activity, including the cessation of the anthrax attacks, leave the economy poised to bounce back in 2003. Great uncertainty remains, however, both at home and abroad.

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

CALENDAR YEAR	1997	1998	1999	2000	2001	2002	2003
Real GDP (Billion \$96 chained)	8,159.4 4.4%	8,508.9 4.3%	8,856.5 4.1%	9,224.0 4.1%	9,324.9 1.1%	9,389.4 0.7%	9,809.1 4.5%
Federal Funds Rate - %	5.46	5.35	4.97	6.24	3.90	2.99	5.13
Yield on 10-Year Treasury Bond - %	6.35	5.26	5.64	6.03	4.96	5.12	5.79
CPI	160.6 2.3%	163.1 1.5%	166.7 2.2%	172.3 3.4%	177.4 3.0%	180.5 1.8%	184.6 2.2%
Housing Starts (Thousands Units)	1,475 0.4%	1,621 9.9%	1,647 1.6%	1,574 -4.4%	1,583 0.6%	1,470 -7.2%	1,588 8.0%
Light Vehicle Sales (Thousands Units)	15,072 0.2%	15,417 2.3%	16,777 8.8%	17,241 2.8%	16,689 -3.2%	15,725 -5.8%	15,975 1.6%
Corporate Profits Before Tax (Billion \$)	792.4 9.1%	721.1 -9.0%	776.3 7.7%	845.4 8.9%	735.5 -13.0%	754.4 2.6%	850.3 12.7%
Total NonAgricultural Employment (Thousands)	122,676.2 2.6%	125,844.5 2.6%	128,900.5 2.4%	131,757.3 2.2%	132,266.0 0.4%	131,824.7 -0.3%	134,632.5 2.1%
Unemployment Rate - %	5.0	4.5	4.2	4.0	4.7	6.1	5.7
Total Personal Income (Billion \$)	6,937.0 6.0%	7,426.0 7.0%	7,777.3 4.7%	8,319.2 7.0%	8,739.0 5.0%	9,000.4 3.0%	9,464.0 5.2%

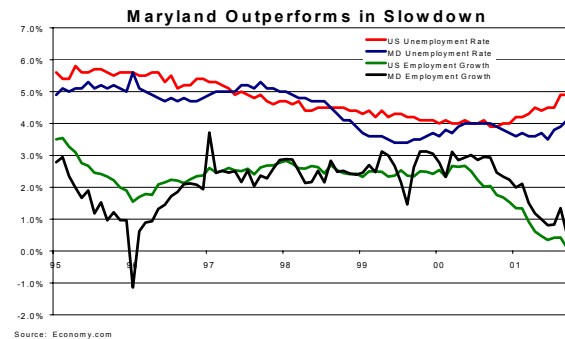
**Source:** Economy.com

## The Maryland Economy

Prior to September 11, Maryland's economy was holding up extremely well given the state of the national economy. Employment growth had slowed substantially, with a year-over-year change of 0.5% in September, down from a rate of 2.1% in February and 2.9% one year ago. Nonetheless, unemployment remains at historically low levels and, from October 2000 through July, was exhibiting a downward trend while U.S. unemployment was generally increasing. By most other measures, Maryland has outperformed the nation over the past twelve months, and looked to have much better near-term prospects than the country as a whole. While the terrorist attacks and their aftermath have lowered expectations for the State, they have not changed the fact that the State's economy is well positioned for the next two years and should continue to show strong performance relative to the rest of the country.

Maryland has performed better than the rest of the country for several reasons. The nationwide slowdown was led by the manufacturing sector, which is roughly half the size in Maryland that it is nationally, and Maryland manufacturers have fared better than their counterparts across the nation.

Employment in this sector was down 3.4% in September from year-ago levels, compared to a nationwide decline of 5.3%. Mass layoff data tell the same story. Although Maryland has 1.0% of manufacturing jobs in the nation, only four of the 1,546 mass layoffs nationwide in the first two quarters of 2001 were in Maryland—just 0.26%. The sector most at risk nationwide has been relatively secure in Maryland, and, as measured by job growth and unemployment, Marylanders generally have less cause for concern over the prospect of losing their jobs than other Americans.



Another reason for Marylanders to have more confidence about the economic situation is that Maryland is a high-income state, and almost certainly a high-wealth state as well. In every year from 1990 to 2000, Maryland had the sixth-highest per capita income in the nation. Maryland per capita income was 17.6% higher than the U.S. average in 1990 but was only 14.2% higher in 2000. Those figures, however, both reflect the disproportionate impact of the early 1990s recession on Maryland and mask strong income growth in Maryland since 1998, with Maryland improving its advantage over the nation by nearly one percentage point. Personal income grew at an annual

rate of 6.8% in the first quarter of 2001, compared to 6.1% nationwide. The disparity is even more striking when looking at wage and salary income; growth in Maryland was 8.5% in the first quarter, more than one full percentage point better than the 7.3% growth nationwide. The net effect is that Marylanders are much more likely to possess the wherewithal to withstand a job loss, at least for a short time, and therefore have much less reason to cut back on spending, which would further weaken the economy.

The labor market, which is still tight by historical standards, may provide further comfort to those Marylanders who fear losing their current jobs. Just a short while ago, the biggest problem facing many Maryland businesses was a severe labor shortage. In fact, in the third quarter of 2001, almost two-thirds of Maryland businesses responding to the Maryland Business Climate Survey of the Jacob France Center at the University of Baltimore reported labor shortages, down only slightly from year-ago levels. Thus, the modest slowdown in the labor market may turn out to be beneficial to many Maryland businesses.

September 11 has not as yet produced a significant change to this calculus. The slowdown had just reached Maryland over the summer, and while it will now be a more pronounced slowdown, it will not change the relative position of Maryland. In some respects, the State's advantage will increase, particularly as a result of increased federal expenditures. Located as it is near the nation's capital and in the midst of the Bos-Wash megalopolis, however, Maryland's current position could evaporate overnight if terrorists were to strike in the region again. The anthrax scare could have that effect if it were to resurface, as could another major terrorist attack affecting transportation links.

While the outlook is gloomier than it was before September 11, growth in employment is expected to continue in Maryland. Nonagricultural employment growth will slow from 2.7% in 2000 to 1.0% in 2001, further declining to a nadir of 0.0% in 2002. Employment growth will resume in 2003 at an estimated rate of 1.4%. The story is much the same with personal income, with growth slowing from 6.8% in 2000 to 3.6% in 2002 before accelerating to 5.0% in 2003. The recession seems likely to affect Maryland much less severely than that of the early 1990s.

## **Manufacturing**

Employment in Maryland's manufacturing sector continues to decline, with September 2001 manufacturing employment the lowest since January 1996. The short-term outlook continues this decline with decreases in employment through 2003. The long-term outlook is slightly better with small increases in employment in 2004 and 2005, however Maryland will continue to lag behind the nation in this sector.

General Motors continues to manufacture Astro/Safari vans at its Broening Highway plant, although at a production level lower than in 2000. Allison Transmission, a subsidiary of General Motors, announced an expansion of their new White Marsh facility six months before it opened. The 1000 Series automatic transmission is used in

commercial vehicles and heavy pickup trucks. When the expansion is completed, Allison will have invested \$423 million in the plant and employ 810 workers.

Bethlehem Steel's \$300 million cold rolling facility at the Sparrows Point mill opened in September 2000, but has been losing money. Bethlehem Steel filed for bankruptcy in October 15. On October 22, the US International Trade Commission ruled that 12 categories of steel products were being imported in such quantities that they are a substantial cause of serious injury to the domestic industry. The 12 categories included cast steel slabs and cold rolled steel, Sparrows Point's major products. The President has until February 19, 2002, to decide what remedies, if any, to impose. Sparrows Point will benefit if barriers to import of slabs and cold rolled steel are imposed, however existing inventories and declines in demand for durable goods will dampen the need for additional production in the short term. In the long term Sparrows Point must compete with domestic producers including smaller, non-union mills with lower labor costs. Federal aid requested by Bethlehem Steel and USX to assist their proposed merger is by no means certain.

Columbia-based W.R. Grace & Company also declared bankruptcy this year. On April 2 the company filed for Chapter 11 protection to shield its continuing operations after experiencing massive increases in asbestos-related claims. Despite the bankruptcy filing, employment is not expected to be affected as the company reported lower but still healthy profits from its ongoing operations. In Grantsville, Garrett County, ClosetMaid has opened a new 200,000 square foot manufacturing plant. By 2005 the company expects the facility to expand to 500,000 square feet, employing 800 people.

Also in Columbia, Corvis, an optical network equipment manufacturer, posted losses in 2001 and indicated it may trim its already reduced workforce of 1,270. The losses are due largely to an oversupply of optical cable and reduced demand for optical switching equipment in the unstable and overbuilt US telecommunications market. Overseas demand for optical network equipment, however, is not as soft as the US market and may help increase demand in the later half of 2002. Corvis has expanded operations in Europe, opening a sales office in Madrid. Also hurt by the sluggish market for telecommunications equipment is Britain-based Bookham Technology. Last year the company acquired the Columbia manufacturing plant formerly owned by Honeywell's Microelectronic & Technology Center.

After many years of money-losing research and small-scale production, Maryland's biotech research companies continue to be optimistic about their futures. Several claim to be about to turn the corner on profitability and begin manufacturing products. Rockville-based Human Genome Sciences will open a \$100 million, 360,000 square foot drug manufacturing plant on its I-270 Tech Corridor campus in 2003. Rockville-based Celera Genomics is also moving toward profitability and production, although the company will do its manufacturing in San Francisco where it is in the process of acquiring an existing pharmaceutical facility.

Other biotech companies are benefitting from the fear of further terrorist attacks. Profitable Rockville-based BioReliance recently won a contract with the federal government to produce large quantities of a smallpox vaccine. Gaithersburg-based Tetracore manufactures tests that can quickly identify biological agents such as anthrax. At least two Maryland companies are working on rapid diagnosis tests for pulmonary anthrax, the most deadly form of the disease in humans.

The Department of Defense awarded a 40-year \$200 billion contract to a consortium led by Bethesda-based Lockheed Martin to build the F-35 Joint Strike Fighter. Lockheed is scheduled to deliver the first 22 test aircraft in 2008. The contract will eventually include 3,000 planes, about 5% of which are for Britain's Royal Navy and Air Force. Lockheed developed its proposal with major involvement of Los Angeles-based Northrop Grumman and Britain's BAE Systems. Major manufacturing will be done in California, Texas, and Britain. In Maryland, Northrop Grumman's Linthicum-based Electronic Systems will be responsible for development and production of fire control radar and other electronic systems, which will occupy 400 to 600 employees.

Manufacturing employment is expected to decline from the high of 179,800 in 2000 to 168,300 in 2003, shrinking at rates of 2.6% and 1.0% in 2002 and 2003, respectively. While Maryland will have slightly less manufacturing employment in 2004 than it had in 1999, manufacturing employment in the US will have grown 2.8% in the same period.

## **Construction**

Maryland's construction sector continues to considerably outpace the State's economy as a whole. Following a sterling 1999, with employment growth of 6.1%, the industry posted 4.0% growth in 2000. While the pace of growth will slow, a continued backlog of projects, major public projects and low interest rates will keep this sector atop Maryland's economy.

During the next six years, construction of the new \$2.4 billion Wilson Bridge over the Potomac will keep many in the construction sector busy. According to the Federal Highway Administration, this project alone will directly create almost 19,000 jobs, although not all will be on-site. Already, over \$150 million of contracts have been let by the Maryland State Highway Administration. The estimated \$500 million contract for the bridge superstructure was advertised in August of 2001, with activity expected to begin in early 2002. Bids have been received for the approximately \$45 million contract for work on the interchange with Interstate 295 in Maryland, and an RFP will be issued in early 2002 for a \$75 million to \$90 million contract for the interchange with the National Harbor project. Other transportation-related projects will provide jobs in the construction sector through the forecast period, including an 8,400 space parking garage and 31 gate terminal at BWI, part of the airport's \$1.8 billion expansion.

Increasing vacancy rates in both office and industrial markets will be a drag on the construction sector. The vacancy rate in downtown Baltimore for class A office space has edged above 10%, and the rate in the BWI area for all office space increased from 7% at the end of 2000 to 9.5% six months later. The vacancy rate for the Baltimore metropolitan area as a whole stood at 11.2% in mid-2001, rising from a low of 8.6% at the end of 1999. In the Washington, D.C. metropolitan area, the market is tighter, but vacancy rates are increasing, having risen over one percentage point to 4.9% in the first two quarters of 2001. Available evidence indicates that much of the rise is due to the technology slowdown primarily affecting Northern Virginia, but Montgomery County as well. The Prince George's County market, though weaker than the rest of the metropolitan area, does continue to show improving conditions.

Some projects in Baltimore currently underway include the 170,000 square foot National Research and Training Institute for the Blind next door to the headquarters of the National Foundation of the Blind. When completed, the \$18 million project will provide over 60 jobs to the city. The Peabody Institute of the Johns Hopkins University is undertaking a \$24 million capital improvement program between now and the fall of 2003. In Anne Arundel County, the Anne Arundel Health System has completed its \$100 million facility on Jennifer Road, and vacated the downtown Annapolis hospital. The way is now open for the redevelopment of the hospital site into a planned residential/commercial facility.

The market for hotels in the State may not yet be sated, even in the wake of September 11. Construction is expected to begin shortly on two hotels on Redwood Street in Baltimore, a Marriott Residence Inn and a Hampton Inn. Hyatt Hotels & Resorts' interest in a convention hotel in Baltimore has lessened; Hyatt apparently wants to see how the new 750-room Marriott does before building a large hotel. Others' interest in a convention hotel is undiminished, however. Peter Angelos, the Mayor and the Baltimore Development Corporation remain convinced of the need for such a hotel. At the airport, construction has begun on a 131-room Hampton Inn & Suites next to Arundel Mills mall. The company constructing that hotel plans to build a second hotel near the mall, while Neema Equities is planning to build a 129-room Wingate Inn two miles north of the airport, as well as three or four more hotels between Baltimore and Philadelphia. While some of these projects may be delayed if tourism and travel remains depressed, in the absence of further terrorist attacks, they will likely not be cancelled.

Low interest rates have caused a continuation of the housing boom. Housing starts have been relatively steady 1998, when interest rates first reached a consistent 7%, and have maintained a level roughly 20% higher than the average of 1994 through 1997. Starts are expected to increase by 3% annually each year in 2001 through 2003, at which point they will be at their highest level since 1990, immediately prior to the last recession.

Clearly, a downside risk for construction is a continued deterioration of the economy. The State has embargoed \$133 million of PAYGO capital projects; it seems probable that additional cutbacks will occur in the course of resolving the State's impending budgetary problems. There are a large number of projects in the planning stages and underway, however, so the impact of any reduction by the State will not be felt for several years. As private businesses and institutions come under financial pressures as the slowdown continues, other projects may be eliminated as well. Nonetheless, construction employment is expected to increase by 1.8% in 2002 (by far the best performance of any sector) and by a further 1.9% in 2003.

## Transportation

No industry in Maryland has been more affected by the impact of the terrorist attacks than the transportation industry. Although there have been some offsetting factors, the impact is decidedly negative. The Baltimore-Washington International Airport (BWI), the nation's fastest growing, has long been thought of as one of the major drivers of the State's economy, supporting the development of a wide variety of business, industry and services in the region. Events of September 11 have slowed activity at the airport and its environs, but while the short-term impact may be severe, the airport's long-term prospects remain strong.

The most immediate impact of the terrorist attacks was the complete shutdown of aviation across the country. Parking and terminal facilities at BWI were completely shut down on September 12, and did not reopen until 11:00 am on the 13<sup>th</sup>. The first incoming flight did not arrive until 3:01 on the 13<sup>th</sup>, and the first departing flight did not leave until 4:25. The airport handles roughly 750 flights daily; therefore, nearly 1,500 flights were canceled between the 11<sup>th</sup> and the 13<sup>th</sup>, probably reducing the number of passengers passing through the airport by around 100,000. The cost of the closure on the State's economy has been estimated at \$20 million.

Flight schedules were restricted in the weeks following the attacks. Although Southwest Airlines resumed its full schedule just six days after the attacks, US Airways had only resumed 60% of its flights by that time. Resumption of the full schedule of flights did not occur until near the end of the month, but flights were generally only 50% full, rather than the usual load of 60% to 75%. The short-term impact would no doubt have been worse were it not for the three-week closure of and continued flight restrictions at Ronald Reagan National Airport. BWI, which had been on a pace for 21.4 million annual passengers through August, now forecasts 19.6 million passengers for the year, the same figure as 2000.

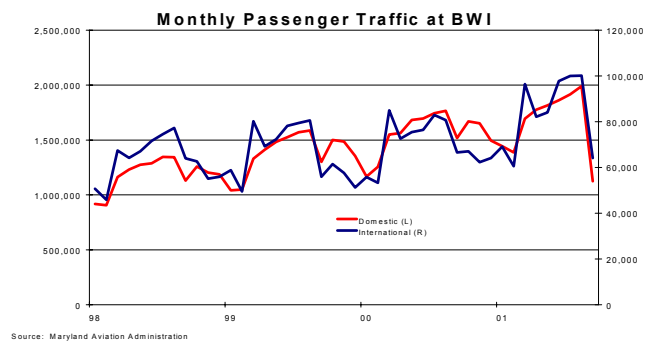
Just as personal travel was disrupted, so were other activities at the airport. Parking has become even more difficult, with construction underway for the expansion project, and now a Federal Aviation Administration requirement of a 300-foot setback from the terminal for parking. Thus, while the number of vehicles parked at the airport may be approaching pre-attack levels, revenue from parking has fallen off because



about 40% of the relatively high-cost short-term parking is off limits. Similarly, most of the airport's concessions are behind the security checkpoints. Sales will be reduced because those greeting and dropping off passengers will not be able to shop while they wait. This impact will be offset to a degree because passengers will spend more time at the airport due to increased security procedures. Several concessionaires are now opening earlier to provide service to those who arrive far earlier for morning flights than they used to.

In the wake of the attacks, US Airways announced that its MetroJet service, based at the airport with 44 daily flights to the northeast, midwest and Florida, would be discontinued as of December. Just before completing one year of service, Aer Lingus pulled out of BWI as part of a 25% reduction in their total flights. Elsewhere in the State, College Park Airport, Freeway Airport in Bowie, and Washington Executive Airport in Clinton remain closed by order of the National Security Council. These airports are a small fraction of the nearly three dozen private airports in Maryland. While they have been severely affected, there is no doubt that business has suffered at most if not all of the other airports in the State since September 11.

The news is not entirely bad, however. Southwest is continuing all of its flights, adding a new flight on October 8, and has not laid off a single employee. United has added three daily flights, one each to Los Angeles, San Francisco and Chicago, replacing some US Airways flights that had been discontinued. AirTran Airways started service from BWI in December with three flights each to Atlanta and Boston and one to Orlando, and expects to add up to five additional daily flights by March. Current expansion plans at the airport call for sixteen additional gates; airport officials report a waiting list for gates, and do not anticipate difficulty remaining at full capacity in the coming year. One gate will be used by a resurrected Pan American Airlines, which has undertaken three daily flights between Cumberland, Hagerstown and BWI.



The 358,800 square foot midfield cargo terminal at BWI opened in 2001, with Integrated Airline Services being the first to lease space and begin operating. Cargo passing through the airport actually increased by 5.1% in September over the prior September. Airport officials believe this reflects a move towards well-known carriers and airports, and the fact that BWI moved to its full flight schedule relatively quickly.

The Port of Baltimore has continued to grow, though not as dynamically as the airport. Over the past year, the port has signed agreements with seven major shipping companies, including Wallenius Wilhelmsen, Amports, and the Mediterranean Shipping Company. Wallenius Wilhelmsen will open a new roll-on/roll-off cargo hub processing 600,000 tons of cargo annually. Amports, headquartered at the Baltimore World Trade Center, processes about half of the 300,000 vehicles brought through the port annually, and will bring in over 200,000 additional Fords and Volvos by the end of a three-year deal. Amports has also reached new agreements with Mitsubishi and Volkswagen. The ten-year contract with the Mediterranean Shipping Company makes the port the first port of call from South America, and will bring in an additional 20,000 containers annually, supporting 250 jobs.

Following 3.2% growth in 2000, the transportation sector had been expected to slow along with the slowing economy; through September, the sector was nearly flat. As a result of the dramatic decline in travel, however, the sector is now expected to contract by 0.8% this year and by nearly that much next year, before resuming growth in 2003.

## **Utilities**

Deregulation of electric generation in Maryland continues to change the face of the industry. All but one of the large investor-owned utilities in the State are in the midst of major reorganizations, virtually divesting themselves of the unregulated electric generation business. Early in 2001 Pepco sold most of its electric generating plants to Atlanta-based Southern Energy, retaining only two small, oil-fired generators in the District of Columbia. Conectiv, which is in the process of merging with Pepco, sold most of its base load generating capacity to Minneapolis-based NRG Energy. The combined company will be the largest distribution utility in the mid-Atlantic region, but will own only smaller peak load plants.

Market forces are also shaping the industry. Allegany Power is also divesting generating plant. The generating company stock will be sold in the stock market, but the public offering has been delayed due to unfavorable market conditions. Constellation Energy Group had planned to spin off its regulated utility subsidiary BGE to its shareholders, but changed course on October 29 and decided to retain ownership. The company will have to pay over \$350 million to terminate divestiture-related contracts. The company's statement hinted there will probably be some layoffs where Constellation and BGE staff overlap. The company had previously canceled plans to merge with Pepco.

The Federal Energy Regulatory Commission (FERC) has proposed an order that would require the PJM Interconnect to merge with other interconnection groups in the northeast. Critics of the proposed rule fear that merging PJM, the nation's largest and most successful wholesale power market, will lead to higher prices and less reliable electric service in the region. If these predictions prove to be accurate, Maryland

commercial, industrial and residential customers will incur direct costs of higher electric prices and indirect costs of lost productivity if electric service is disrupted. FERC and its supporters claim the super-regional interconnection will aid competition, leading to cheaper, more efficient electricity which would benefit Maryland customers.

Companies in the telecommunications field are also beginning to restructure. AT&T is dividing its wireless, cable television, and traditional long-distance telephone services into separate companies. WorldCom has divided its operations into two groups: MCI Group including the residential long-distance market and WorldCom Group including data and international businesses. Sprint has also divided into two divisions: the PCS division including most of the wireless business and the FON division which includes most of the company's long distance services. Verizon Communications, the local exchange carrier for most of the State, has shown stable growth in Maryland. None of the major telecommunications carriers have major employment centers in the State, which will help to isolate Maryland from the turmoil in the industry.

Telephone companies also face competition from cable television companies. Many cable TV companies now offer Internet access, and are beginning to roll out voice telephone service that will compete with telephone carriers. The cable television system that serves Baltimore City has been sold to Philadelphia-based Comcast Cable Communications. Comcast has consolidated ownership of cable systems in nine central Maryland counties as well as the District of Columbia. Comcast has proposed a merger with AT&T Broadband, the nation's largest cable operator. As cable companies grow, it will become more economical to add telephone services, putting competitive pressure on telecommunications companies.

In turn, cable companies are facing competition from companies such as DC-based Starpower Communications. Starpower's operations headquarters are in Lanham. In addition, satellite providers such as DirecTV, Dish Network, and EchoStar compete with cable companies in the television and Internet services. General Motors has decided to sell its 30% interest in California-based Hughes Electronics to EchoStar. Hughes owns DirecTV which would be merged into the EchoStar satellite TV business. While a merger with either satellite system will likely result in job cuts, it is unclear what effect this may have on Hughes Electronics' Maryland operations. The merger also faces government review as it would combine the two largest satellite television providers.

Williams Gas Pipeline acquired the Cove Point liquid natural gas (LNG) terminal in Lusby from Columbia Energy in June 2000. Williams plans to add a fifth LNG storage tank at the facility that will increase storage by 50% above the current 2 billion cubic foot capacity. Williams is also constructing an interconnection between Cove Point and the company's existing Transco pipeline through Maryland. The facility currently connects with Columbia Gas, Dominion Transmission, and Washington Gas pipelines. Williams expects about 50 ships a year to call on the terminal during the first two years of

operation, and about 100 per year after that. When fully operational, Williams' employment in Maryland will increase by 25 to 30 employees.

Employment in this sector will not change dramatically. The distribution activities of the utilities may grow slightly, offset by reductions in the employment of Constellation Energy and the non-utility owners of Maryland electric generating plants. Most of the potential reductions in employment in the cable/satellite television and long distance telephone operations are expected to be outside Maryland as the State does not have large employment centers.

## **Retail**

Maryland is slightly more dependent on retail employment than other states with 18.1% of employment in the retail sector, compared with 17.6% for the entire U.S. Retail employment has slipped to the third largest sector of employment in Maryland, trailing the much larger service sector and the narrowly larger public sector. Employment is expected to increase slowly beginning in the second half of 2002.

During much of 2001, consumer spending kept the economy growing while other factors were tending toward recession. As the year wore on, announcements of layoffs by several major companies started to affect spending. Maryland was also hurt by decreases in tourism and business travel in the wake of the terrorist attacks. This suppressed employment and revenue in hotels, transportation, and tourism-related businesses, particularly in Anne Arundel, Montgomery and Prince George's counties.

Illinois-based Sears has announced plans to reduce its employment by 5,000. One quarter of these will come from the company's Hoffman Estates headquarters, and each store will lose an average of four salaried employees. There are about 18 Sears mall stores in Maryland. Sears also plans to change the format of its stores to compete more directly with stores like Wisconsin-based Kohl's and Minneapolis-based Target. These reductions will be more than offset by 150 new positions Sears will be adding in early 2002 to a new repair depot in Odenton.

Several years of work by Prince George's County to attract more retailers, especially mid- and high-end retailers and restaurants, are beginning to show results. The first new shopping center in Prince George's County in 20 years opened its first phase in October 2001 including Hecht's, Old Navy, and Sears. When the third phase opens in early 2002, Bowie Town Center will employ more than 1,300 people. Swedish furniture maker Ikea has announced plans to open a 340,000 square foot store by 2003 in the county. Located on 45 acres near the intersection of the Capital Beltway and U.S. Route 1 in College Park, the store will employ 450 people.

Ikea also hopes to begin construction before the end of the year on the first phase of a new 1.7 million square foot distribution center in Perryville. The facility will

be built in two phases of 850,000 square feet each. Construction on the second phase would begin in 2004, and when completed the center will employ 300 people.

Australian mall owner Westfield America expanded Montgomery Mall in Bethesda by 61,500 square feet, and is adding a 26,500 square foot Borders Books and Music store to the Annapolis mall. Minneapolis-based Target Stores is opening the first Metro-accessible Target in Maryland in the former Montgomery Ward's store in Westfield's Wheaton Plaza mall.

For one week in August the State waived sales tax on clothing with a taxable price of less than \$100. While there was an increase in retail sales that week, there do not appear to be any long-term benefits of the tax holiday. Much of the spending appears to have been transferred from other weeks. The effect of the program may have been muted because the District of Columbia had a similar tax-exempt week that included a wider variety of items.



Quality retail locations have been in short supply in the northeast, which has constrained growth. As stores such as Montgomery Wards and Ames close, other retailers are quickly acquiring those locations. Sales per square foot in Maryland continue to be about 50% higher than comparable stores in other parts of the US.

Overall, employment in the retail sector is expected to contract by 0.6% in 2001 and a further 0.3% in 2002, but will recover in the second half of 2002 and grow at a 0.8% rate in 2003.

#### Finance, Insurance and Real Estate

The finance, insurance and real estate sector has been affected by several developments over the past year, though none was particularly unexpected. First and foremost, the continued decline in the stock markets has taken a toll on earnings, morale and, in some cases, jobs. An ongoing process of mergers and restructuring brought about in part by the repeal of the Glass-Steagall Act continues apace, and the impact of service delivery through the Internet continues to evolve. Employment in the sector declined by 0.9% in 2000 following two years of nearly 3% growth.

T. Rowe Price, and Legg Mason, two of the largest employers in the State, exemplify all of these factors. Partly as a result of declining earnings in several quarters since the fourth quarter of 2000, T. Rowe Price has reduced its employment in Maryland

by 230 positions through layoffs and attrition, mostly in customer service and information technology areas. Price's assets under management fell by more than 20% in the third quarter alone. During the year, however, it has undertaken to manage Maryland's and Alaska's new Section 529 college investment plans, joined with Morningstar to provide online financial planning advice, and completed its acquisition of Rowe Price-Fleming International. In 2001, Legg Mason has purchased the Royce fund family, Barrett Associates and Private Capital Management, money managers for wealthy individuals, and has formed a joint venture with Delaware Investments to sell retirement plans to employers. Earnings have fallen throughout the year as well, due in part to the acquisitions, falling interest rates and the falling market, but Legg Mason appears to have avoided layoffs thus far.

Allfirst Financial, now the largest bank in the State, has decentralized control of many of its business lines, creating nine new divisions, and has created a corporate finance unit providing merger and acquisition and other corporate finance services to middle market businesses. BB&T, a North Carolina bank which has purchased several Maryland banks in recent years, bought F&M National, which had offices in the Washington area, and recently made an offer for Ferris, Baker Watts, one of the region's largest brokerages. Provident Bank has teamed up with Pivot, an Ohio-based company, to provide on-line insurance quotes, purchases and service, and Sandy Spring Bank has purchased the Chesapeake Insurance Group.

The threat of Internet-based financial services to bricks-and-mortar providers has diminished greatly over the past two years. While a number of Internet-only providers remain, they have generally been eclipsed as traditional businesses have either caught up in providing services through the Internet or teamed with Internet-based businesses. Consumers may yet move to the Internet for financial services, but there will not be a headlong rush to untested companies without a physical presence.

The insurance industry is another sector which will be directly and substantially affected by the terrorist attacks. Total losses have been estimated between \$30 billion and \$60 billion, the largest single-event loss ever. The industry, which was already experiencing difficulties due to the slowing economy and investment losses, employs over 20,000 individuals in Maryland. Two of the largest employers, the St. Paul Companies and Zurich Financial Services Group, which together have almost 10% of the industry's jobs in the State, are expecting over \$1 billion of combined losses.

Prior to September 11, the FIRE sector seemed likely to weather the economic slowdown in general, and the slumping stock market and declining interest rates in particular, without experiencing a contraction. Following September 11, however, the outlook is more pessimistic. Growth in 2001 is estimated at 1.3%, before declining by 0.5% in 2002.

## **Services**

Maryland's economy, as that of many states, is increasingly dominated by services. In 1990, service employment accounted for 28.7% of total employment in the State. Ten years later, services accounted for over 35% of Maryland employment. Although the service sector has jockeyed back and forth with construction as Maryland's fastest growing industry over the past six years, this sector has been a much more stable performer and has added over six times the jobs that the construction sector has. In fact, of the 280,000 jobs created in the State since 1990, over 236,000 of them have been created in the service sector.

### *Business Services*

The business services sector encompasses a diverse group of businesses, from temporary employment agencies to computer and data processing services to janitorial services. Employment in business services increased by an average of 5.3% annually in the three years to 2000. As much of this growth was driven by technology-related services, it may come as no surprise that this segment will contract slightly in 2001 and 2002. Although Maryland largely avoided fallout from the dot.com debacle, the State has not escaped entirely.

In some respects, Annapolis-based USinternetworking, an application service provider, exemplifies the Internet bubble. The company has yet to make a profit, having lost over a quarter of a billion dollars since its inception in 1998, and is struggling to stay out of bankruptcy. In one important respect, however, the company differs from most of its contemporaries—it is still in business. USi established a data center in Dublin, and is on the verge of finalizing a \$100 million investment. As a result of its woes, however, the company fired 450 people earlier in the year, and had an additional round of layoffs in September. The company, which at its peak had about 1,300 employees, is down to about 350 employees currently.

Aether Systems, headquartered in Owings Mills, faces similar problems. The company, a wireless communications software and systems provider, has laid off almost 500 employees this year, about 40% of its staff, and has postponed plans to build a new headquarters on the campus of the University of Maryland, Baltimore County. Earlier in the year, Bulkregister.com, the fourth-largest Internet domain registrar, fired its chief executive officer and 70% of its staff, 23 employees. Gr8, one of Baltimore's leading tech firms, once employed 85 people and, after asking its remaining 20 employees to work for free in March, now employs none. RewardsPlus, which provides employee benefits to large corporations through customized web sites, laid off 12% of its 225-strong workforce in July.

At the other end of the business services spectrum, a strike of commercial office janitors was partially resolved in August. Over 20,000 members of the Service Employees International Union in the region went on strike in June over low wages and benefits. The agreed-upon contract covers nearly 500 janitors who work in downtown Baltimore. They will receive employer-paid benefits, part-time workers will receive

some benefits, and the base pay has been increased from \$5.15 per hour to \$6.00 per hour.

### *Health Services*

Employment growth in health services has slowed to a crawl since 1998; this sector may be the only one still suffering from a severe labor shortage. The Maryland Hospital Association estimated unfilled demand for almost 3,700 positions in Maryland hospitals in 2000, including a shortfall of nearly 1,700 registered nurses. Maryland has a greater vacancy rate for both RNs and lab technicians than the rest of the country. The shortage has forced hospitals to raise salaries and offer bonuses and scholarships to attract and retain personnel. These steps and others have placed increasing pressure on hospital operating margins. Over one-third of hospitals in the State lost money last year; the average profit margin declined from 2.2% in the last quarter of 1999 to 1.6% in the last quarter of 2000. In what may be one tidbit of good news for the hospitals, nurses at several hospitals have rejected calls over the past year from the Service Employees International Union to unionize.

Hospitals and other health care providers will likely come under increasing financial pressure as the State's Medicaid debt continues to increase. Current estimates indicate a deficiency appropriation will be required from the State in fiscal year 2002 of \$173 million, and that an additional \$284 million will be required for fiscal year 2003. This shortfall is further compounded by a \$31 million combined deficit in mental health programs. The 14 hospitals in Baltimore City face the added burden of a roughly \$9 million payment in lieu of taxes agreed to with the city. Hospitals are trying to pass on that burden to insurers and patients; if they are successful, it will add to the burdens of some health insurers, who were recently penalized \$1.4 million by the State for failing to comply with claims payment regulations.

Outside of direct service provision, many health services businesses are prospering in the State. In the spring, Magellan Behavioral Health won a one-year contract with four renewals to provide employee assistance services to almost 350,000 federal employees, bringing total federal employees under their services to almost 3 million. In October, the United States Postal Service joined this contract, bringing another one million members into the fold. ViPS, a Baltimore-based information technology contractor for the healthcare industry, joined with Computer Sciences Corporation to support the National Institutes of Health National Information Technology Acquisitions and Assessment Center, under a ten-year \$19.5 billion contract. The company also won contracts to manage data for the Health Care Financing Administration and Horizon Blue Cross Blue Shield of New Jersey.



## Government

Employment in the public sector continues to grow in Maryland, although the proportion of public employment to private employment has been slipping. Public employment now stands at approximately 18.2% of all employment in the State, the second largest sector of the economy after services, and just slightly larger than the retail sector. The proportion of Maryland jobs in the public sector remains higher than the national average of 15.6%. Total growth in government employment is expected to be 1.4% for 2001, dipping to under 1% in 2002 and 2003.

Local government employment will continue to grow rapidly through 2001. Education accounts for roughly half of local government employment, and demand for teachers remains strong. The growth in local employment has been constrained by the inability to construct classrooms and hire qualified teachers as rapidly as they are needed. Growth in local government employment is expected to continue, but at a slower rate in 2002 and 2003. Direct intergovernmental transfers from the State to local governments amount to over \$3.5 billion annually; local governments will feel pressure on the budget as State tax revenues slow and the possibility of reduced transfers from the State increases. Higher property tax revenues will partially offset other losses, but not at a rate sufficient to avoid drags on employment growth.

Likewise, State employment has continued to grow, but growth will slow in the coming years. The fiscal year 2002 budget authorized 2,950 additional State positions to bring the total to 81,515. About 25% of these were to convert contractual positions to permanent positions. (Temporary contractual employees are not included in the count of authorized permanent positions but are counted as government employees in the economic statistics.) The position increases are primarily in public safety, higher education, transportation, and human resources. In the face of shrinking revenues the Governor has ordered a freeze on all non-security hiring effective October 17. At the time this report was written it was not clear how many unfilled positions exist in State government or how many additional employees may be hired during the year to increase security around the State. It is expected State employment will decline slightly through mid-2003 due to the hiring freeze.

After an expected 2.8% decline in 2001 as a result of the 2000 Census winding down operations, federal government employment in Maryland will grow again. Federal spending and employment are expected to balloon in the near future as a result of the war in Afghanistan and the anthrax scare. In addition to spending for security, military operations, and economic stimulus programs, the loss of any attempt to balance the budget will likely release a flood of other projects and programs. Just how these programs will affect Maryland will depend on how they are conducted, but a general increase in federal spending has historically been a boon for Maryland's economy. Prior to September 11, the forecast for federal employment growth in Maryland was 0.5% in 2001; growth of 1.0% is now likely. The growth of various security agencies, including Maryland's second largest employer, the National Security Agency, will drive

overall growth to a large extent, although employment at the NSA is not reported in the official statistics.

Government employment is expected to continue steady but slow growth through 2003, led by increases in federal and local employment. State employment is not expected to grow significantly during the next few years.

## **Agriculture**

The contribution of the Chesapeake Bay to the dinner tables of Americans continues to decline as pollution, over-harvesting, and disease all contribute to lower the volume of food taken from the Bay. Oyster harvests were down 18% in 2000 and are expected to decline further in 2001 and 2002 as MSX and Dermo continue to affect the oyster population. Oyster harvests are down 5% year-to-date through September. Crab catches are up slightly from 16.6 million pounds in 2000 to 17.2 million pounds in 2001. Hard shell crab prices are up about 5% from 2000, and soft shell prices up about 10%. Increased demand and the cost of importing crab from other parts of the country and southeast Asia has worked to keep prices climbing. Rockfish catches are way off in 2001 and far below Maryland's 2 million pound quota. Catches through the first three-quarters of the year were at 818,000 pounds, compared with 2.4 million pounds for the full year 2000. Catches of other fin fish remain fairly stable at between 15 and 16 million pounds.

Production of food and feed crops was generally down 5% - 10% from the near record high 2000 levels, but still above average. Prices for these crops are only slightly higher than the low 2000 levels. Not surprisingly, the biggest change is in tobacco, where the State buyout of tobacco farmers makes growing tobacco less profitable than not growing it. Yields per acre are down 3% from 2000, but total production is down 71%. The 2001 harvest was 2.4 million pounds, down from last year's 8.3 million pounds, and is now about 10% of what it was 20 years ago. Assuming the State continues to funnel 5% of the tobacco industry settlement into the buyout program and that revenues from the settlement remain as predicted, production is expected to continue to fall in the upcoming years.

Table 2  
Forecast of the Maryland Economy

	1997	1998	1999	2000	2001	2002	2003
Total Non-Farm Employment (000s)	2,267.4 2.5%	2,323.9 2.5%	2,385.8 2.7%	2,450.9 2.7%	2,474.3 1.0%	2,474.8 0.0%	2,509.3 1.4%
Total Personal Income (Million \$)	148,826 5.7%	158,492 6.5%	167,195 5.5%	178,506 6.8%	189,319 6.1%	196,223 3.6%	206,016 5.0%
Wages and Salaries	76,241 7.2%	81,660 7.1%	87,158 6.7%	93,992 7.8%	100,994 7.4%	105,098 4.1%	110,963 5.6%
Proprietors' Income	8,134 4.4%	8,470 4.1%	9,240 9.1%	9,743 5.4%	10,194 4.6%	10,523 3.2%	11,515 9.4%
Dividends, Interest, and Rent	28,434 8.1%	30,946 8.8%	30,632 -1.0%	32,192 5.1%	33,156 3.0%	33,721 1.7%	34,810 3.2%
Transfer Payments	15,925 4.2%	16,247 2.0%	16,913 4.1%	17,734 4.9%	19,167 8.1%	20,923 9.2%	21,264 1.6%
Unemployment Rate (%)	5.1	4.5	3.5	3.9	3.8	4.6	4.2
Housing Starts (units)	26,253 -1.8%	31,147 18.6%	29,357 -5.7%	30,358 3.4%	30,010 -1.1%	31,674 5.5%	33,780 6.6%

Bureau of Revenue Estimates, December 2001

## Maryland General Fund Revenues

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

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

In fiscal year 2002, there will be a transfer of \$119.5 million from the local income tax reserve account. This account currently has a surplus of \$134 million on the basis of generally accepted accounting principles. The surplus built up over the past three years, prior to which there was a deficit in the account. Essentially, distributions in excess of actual liability were made from the general fund to the reserve account. Also in fiscal year 2002, \$28.5 million of general fund revenue was received from the tax amnesty. These revenues are detailed in Appendix A.

Table 3 shows detail on general fund and selected special fund revenue sources for fiscal years 2001 through 2003. Table 4 provides further detail on general fund revenues. The following sections of this report provide detail on each of the State's general fund revenue sources.

Table 3  
**Selected Revenues**  
Fiscal Years 2001 - 2003

\$ Thousands	GENERAL FUND			SPECIAL FUND			TOTAL		
	Fiscal Year 2001 Actual	Fiscal Year 2002 Revised Estimate	Fiscal Year 2003 Estimate	Fiscal Year 2001 Actual	Fiscal Year 2002 Revised Estimate	Fiscal Year 2003 Estimate	Fiscal Year 2001 Actual	Fiscal Year 2002 Revised Estimate	Fiscal Year 2003 Estimate
	INCOME TAXES								
Personal	5,133,726	5,113,497	5,197,893				5,133,726	5,113,497	5,197,893
Corporation	374,397	245,212	302,370	52,778	34,323	42,489	427,175	279,535	344,859
Total	5,508,123	5,358,709	5,500,263	52,778	34,323	42,489	5,560,901	5,393,032	5,542,752
SALES AND USE TAXES	2,626,775	2,635,530	2,731,403	19,324	31,400	45,600	2,646,099	2,666,930	2,777,003
STATE LOTTERY RECEIPTS	385,045	396,745	403,345	22,000	28,400	28,500	407,045	425,145	431,845
TRANSPORTATION REVENUES									
Motor Vehicle Fuel Tax	11,984	11,983	12,076	674,990	674,915	683,824	686,974	686,898	695,900
Motor Vehicle Licenses, Fees				339,854	372,993	391,265	339,854	372,993	391,265
Motor Vehicle Titling Tax				612,779	594,000	612,000	612,779	594,000	612,000
Maryland Transit Fees				95,958	104,061	108,398	95,958	104,061	108,398
Maryland Port Fees				76,851	83,326	85,122	76,851	83,326	85,122
Maryland Aviation Fees				130,398	110,842	114,442	130,398	110,842	114,442
Total	11,984	11,983	12,076	1,930,830	1,940,137	1,995,051	1,942,814	1,952,120	2,007,127
PROPERTY TAXES, FRANCHISES, ETC.									
State Real and Personal Property Tax				257,100	269,714	283,198	257,100	269,714	283,198
Property Transfer Tax				102,946	97,097	97,461	102,946	97,097	97,461
Corporation Franchises and Filing Fees	169,008	157,390	168,609				169,008	157,390	168,609
State Tobacco Tax	205,636	203,643	199,873				205,636	203,643	199,873
Tax on Insurance Companies	190,397	192,662	197,105				190,397	192,662	197,105
Alcoholic Beverages Excises	24,522	25,108	24,997				24,522	25,108	24,997
Death Taxes	168,803	171,645	139,228				168,803	171,645	139,228
Clerks of the Court	39,534	40,196	38,619				39,534	40,196	38,619
District Courts	69,606	70,822	72,058				69,606	70,822	72,058
Hospital Patient Recoveries	66,221	87,691	63,886				66,221	87,691	63,886
Interest on Investments	140,588	72,623	70,259						
Miscellaneous Fees, Other Receipts	196,191	179,317	165,619						
Total	1,270,506	1,201,097	1,140,253						
<b>Total Current Revenues</b>	<b>9,802,433</b>	<b>9,604,064</b>	<b>9,787,340</b>						
GAAP Transfer	-	119,500	-						
Tax Amnesty	-	28,453	-						
<b>GRAND TOTAL</b>	<b>9,802,433</b>	<b>9,752,017</b>	<b>9,787,340</b>						

Notes: Includes all general fund revenues, all Transportation revenues and selected special fund taxes  
In conjunction with Appendix B of the Fiscal Year 2002 Budget Book, this table comprises the official estimate of total state revenues

Table 4  
**Maryland General Fund Revenues**  
 Fiscal Years 1999 - 2003

\$ Thousands	FY 2002						
	FY 1999 Actual	FY 2000 Actual	FY 2001 Actual	Official Estimate	Revised Estimate	Difference	2003 Estimate
<b>INCOME TAXES:</b>							
Personal	4,296,248	4,746,341	5,133,726	5,227,867	5,113,497	(114,370)	5,197,893
Corporation	306,050	319,454	374,397	341,297	245,212	(96,085)	302,370
Total	4,602,297	5,065,795	5,508,123	5,569,164	5,358,709	(210,455)	5,500,263
SALES AND USE TAXES	2,299,265	2,478,539	2,626,775	2,763,556	2,635,530	(128,026)	2,731,403
STATE LOTTERY	352,175	367,763	385,045	396,426	396,745	319	403,345
<b>FRANCHISES, EXCISES, LICENSES, FEES:</b>							
Business Franchise Taxes	173,571	178,688	169,008	171,766	157,390	(14,376)	168,609
Tax on Insurance Companies	177,788	172,491	190,397	182,035	192,662	10,627	197,105
Insurance Licenses and Fees	12,073	--	--	--	--	--	--
Death Taxes	129,694	157,039	168,803	133,229	171,645	38,416	139,228
Tobacco Tax	128,915	210,012	205,636	187,757	203,643	15,886	199,873
Alcoholic Beverages Excise Tax	23,908	24,399	24,522	24,963	25,108	145	24,997
Motor Vehicle Fuel Tax	11,884	11,275	11,984	11,720	11,983	263	12,076
District Courts	71,079	70,349	69,606	73,936	70,822	(3,114)	72,058
Clerks of the Court	41,771	37,713	39,534	39,024	40,196	1,172	38,619
Hospital Patient Recoveries	159,212	102,113	66,221	76,361	87,691	11,330	63,886
Interest on Investments	104,711	128,391	140,588	82,513	72,623	(9,890)	70,259
Miscellaneous	236,023	215,552	196,191	166,410	179,317	12,907	165,619
Total	1,270,630	1,308,022	1,282,490	1,149,714	1,213,080	63,366	1,152,329
<b>Total Current Revenues</b>	8,524,367	9,220,119	9,802,433	9,878,860	9,604,064	(274,796)	9,787,340
GAAP Transfer	--	--	--	--	119,500	119,500	--
Tax Amnesty	--	--	--	30,000	28,453	(1,547)	--
Total	--	--	--	30,000	28,453	(1,547)	--
<b>GRAND TOTAL</b>	8,524,367	9,220,119	9,802,433	9,908,860	9,752,017	(156,843)	9,787,340

## Personal Income Tax

General fund receipts from the individual income tax increased by 8.2% in fiscal year 2001, once again exceeding expectations. Without the continued phase in of the income tax reduction and some other tax changes, general fund receipts would have increased by 9.6%. The outlook is not as bright as recent performance, however, with growth in the baseline of only 1.6% in fiscal year 2002 as the recession takes its toll, and an increase of 3.1% in fiscal year 2003. Net general fund revenues will actually decline by 0.4% in fiscal year 2002 due to the final stage of the income tax reduction; revenues will increase by an estimated 1.7% in fiscal year 2003, by which point the income tax reduction will be fully effective.

One of the major factors that has driven income tax growth over the past several years is capital gains. From the period 1986 to 1994, realized capital gains declined by an annual average of 0.9%. In 1994, capital gains represented just 1.9% of personal income in Maryland. From 1994 to 1999 (the last year for which actual data is available), however, capital gains increased by an astounding 30.9% annually. Based on preliminary data from the Internal Revenue Service, Maryland capital gains are estimated to have increased a further 15% in tax year 2000. Over that time, capital gains as a share of personal income have more than tripled, to 6.0%. Approximately 10% of income tax revenues were generated by capital gains.

With the stock markets still down about 25% from their peak in March of 2000, growth in capital gains is expected to have come to a halt. Sales made over the past twenty months will have eroded the remaining unrealized gains, leaving much less to be realized over the next few years. No doubt many investors will have net losses for the first time in years. Realized capital gains are estimated to decline by 15% in 2001 and a further 5% in 2002 before stabilizing in 2003. This decline in capital gains will result in a reduction of income tax revenues of roughly \$80 million for tax year 2001 and a further \$100 million for tax year 2002 when compared to tax year 2000 levels.

There is already some indication that declining capital gains are eroding income tax revenues. Estimated payments for the third quarter of 2001 declined by almost 9%, or \$11 million from 2000 levels. Over the course of the fiscal year, it is expected that revenues from estimated payments, after adjusting for the income tax reduction, will decline by 3.1%. Slumping capital gains will also affect final and fiduciary payments, with declines of 4.1% and 10.4%, respectively, again after adjusting for the tax cut.

Income tax withholding, over 85% of net State and local income tax collections and the revenue source most directly reflecting the general economic condition of the State, will grow in 2002, but at only half the pace of 2001. As growth in wages and salaries slows from 7.4% in 2001 to 4.1% in 2002, withholding will slow. Pre-tax reduction growth is estimated at 4.1% in fiscal year 2002, increasing slightly to 5.6% in 2003. Withholding had grown at rates above 7% in many recent years; that level of growth is unlikely to be repeated any time in the next several years since it was boosted

to some degree by stock options and bonuses, many of which have gone the way of the dot-com stock.

There have been a number of State and federal tax changes enacted in recent years which affect the income tax. Foremost among them is the 10% reduction in State income taxes, which began in tax year 1998 and will be fully effective in tax year 2002. Other State tax changes include increasing the refundable earned income credit, and making the heritage structure rehabilitation tax credit refundable which, combined with smaller changes, will result in additional revenue losses of \$15 million in fiscal year 2002 and \$28 million in 2003. Federal income tax changes will increase revenues by \$3.4 million in fiscal year 2002 but reduce them by nearly \$30 million in fiscal year 2003 (see Appendix B).

Baseline growth for the income tax is estimated at 1.6% in fiscal year 2002, 3.1% in 2003 and 5.4% in 2004. After adjusting for the State tax reduction and other law changes, however, actual general fund income tax revenues are expected to decline by 0.4% in fiscal year 2002 to \$5,113.5 million. As the economy recovers and the decline in capital gains ebbs in 2003, income taxes will increase by 1.7% to \$5,197.9 million. More normal growth will resume in fiscal year 2004, at 5.0%.



Table 5  
**Individual Income Tax Revenues**  
 Fiscal Years 2000 - 2003  
 (\$ in thousands)

	<u>2000 Actual<sup>1</sup></u>	<u>2001 Actual<sup>1</sup></u>	<u>2002 Revised Estimate</u>	<u>2003 Estimate</u>
Gross Receipts (State & Local)				
Withholding	6,852,276	7,384,725	7,688,929	8,074,065
Estimated Payments	1,398,898	1,593,740	1,543,964	1,564,201
Payments with Final Returns	656,072	744,393	709,778	698,777
Fiduciary	67,406	86,675	77,679	76,579
<b>Total Gross Receipts</b>	<b>8,974,652</b>	<b>9,809,533</b>	<b>10,020,350</b>	<b>10,413,622</b>
Refunds	(1,029,674)	(1,144,943)	(1,212,290)	(1,253,534)
<b>Baseline Net Receipts</b>	<b>7,944,978</b>	<b>8,664,590</b>	<b>8,808,060</b>	<b>9,160,088</b>
Loss from Federal Changes <sup>2</sup>	(13,560)	(15,990)	(12,590)	(49,500)
<b>Net Receipts, State &amp; Local</b>	<b>7,931,418</b>	<b>8,648,600</b>	<b>8,795,470</b>	<b>9,110,588</b>
Local Reserve Account	(2,802,267)	(3,036,627)	(3,091,629)	(3,228,931)
Income Tax Check-offs	(1,073)	(1,088)	(1,000)	(1,000)
<b>Net Receipts</b>	<b>5,128,078</b>	<b>5,610,885</b>	<b>5,702,841</b>	<b>5,880,657</b>
State Tax Cut	(356,137)	(410,118)	(513,489)	(589,314)
Other Income Tax Legislation <sup>3</sup>	(25,600)	(67,041)	(75,855)	(93,450)
<b>Net General Fund</b>	<b>4,746,341</b>	<b>5,133,726</b>	<b>5,113,497</b>	<b>5,197,893</b>

<sup>1</sup>For FY 2000 and 2001, the income tax components in the absence of the tax cut have been estimated and the estimated tax cut deducted to arrive at actual general fund revenues.

<sup>2</sup>Does not include induced capital gains receipts, which are included in gross receipts.

<sup>3</sup>Includes the refundable earned income credit and heritage structure rehabilitation tax credit, newly refundable, among others.

## Corporate Income Tax Revenues

General fund revenues from the corporate income tax increased by a striking 17.2% in fiscal year 2001. In contrast, corporate profits declined 3.7% nationwide. While there is generally not a direct connection between current corporate profits and corporate income taxes because of the use of filing extensions and, more importantly, the ability to carry losses forward to future tax years and back to prior tax years, the performance of the Maryland corporate income tax in fiscal year 2001 was very unusual. It appears that many corporations simply overpaid their estimated taxes during fiscal year 2001. Through November, fiscal year-to-date corporate income tax refunds have grown 11% over fiscal year 2001's record level.

The refunding of overpayments made during fiscal year 2001 exacerbates the grim outlook for corporate profits, which are expected to decline by over 15% during fiscal year 2002. As a result, corporate income tax revenues are expected to drop by more than one-third in fiscal year 2002 before rebounding in 2003, although they will not exceed 2001 levels until fiscal year 2004. Table 6 details corporate income tax revenues and distributions. General fund receipts are expected to decline by 34.5% in fiscal year 2002 to \$245.2 million, and then increase by 23.3% to \$302.4 million in fiscal year 2003. The tax amnesty resulted in \$3.8 million of corporate income tax collections, \$2.7 million of which is general fund revenue in fiscal year 2002.

The corporate income tax base has been expanded in the past several years through the addition of telecommunications companies, financial institutions and, most recently, through the repeal of the subtraction modification for the net gross receipts of electric utilities. The impact of the tax changes accompanying electric deregulation has yet to be fully assessed, leading to more uncertainty in this already volatile revenue source.

Table 6  
**Corporate Income Tax Revenues**  
 Fiscal Years 2000 - 2003  
 (\$ in thousands)

	<u>2000 Actual</u>	<u>2001 Actual</u>	<u>2002 Revised Estimate</u>	<u>2003 Estimate</u>
Net Receipts before Leg. Changes	396,741	427,660	267,139	340,467
Telecommunications Reform	16,000	16,800	17,640	18,522
Electric Deregulation	6,600	46,000	34,900	36,500
Other Law Changes	0	2,137	673	1,073
 Net Receipts	 419,341	 492,597	 320,352	 396,562
Transportation Trust Fund	(44,929)	(52,778)	(34,323)	(42,489)
Department of Transportation	(54,957)	(65,423)	(40,816)	(51,703)
 Net to General Fund	 319,455	 374,396	 245,213	 302,370

## Sales and Use Tax

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

The first signs of the economic slowdown in Maryland revenues were in sales tax collections. In December 2000, net sales tax collections increased by 11.7%, with fiscal-year-to-date collections at 8.6% growth. From that point through the end of the fiscal year, year-to-date growth declined, finishing the year at only 6.0%. The last three months of the fiscal year were particularly weak compared to expectations. Unsurprisingly, weakness has continued into the current fiscal year. After accounting for tax changes (see below), year-to-date growth is only 1.0%. General fund sales tax collections are expected to continue to slow for several months, along with the economy, and grow by only 0.3% in fiscal year 2002 before accelerating to a 3.6% growth rate in fiscal year 2003.

The consumer portion of the sales tax, two-thirds of the total, grew by 6.1% in fiscal year 2001, slower growth than in fiscal 2000 but still very strong. The beating consumer confidence has taken from the sluggish stock market, the terrorist attacks and the recession which has now made its way to Maryland will result in growth of only 2.9% in fiscal year 2002. Growth would have been estimated at 3.2% had it not been for the tax-free week in August, which resulted in a revenue loss of \$5.1 million. As the economy recovers in mid-2002 into 2003, growth in this component of the sales tax is expected to increase to 4.4% for fiscal year 2003.

Sales tax revenues attributable to construction activity increased by 2.5% in fiscal year 2001. This portion of the sales tax, the second largest, is expected to remain nearly flat in fiscal year 2002 and to increase by 2.7% in fiscal year 2003. Every segment of these revenues will be under pressure in 2002. Housing starts are expected to decline by over 10%, and expenditures on home improvements will barely increase after two years of near double-digit growth. Business construction is estimated to fall slightly after increasing by 15% in 2001, and public construction is constrained by the State's fiscal condition. With the exception of home improvement expenditures, these factors will all show improvement in 2003.

The capital goods component was nearly flat in fiscal year 2001. Excluding 1991 and 1992, this category posted its worst year in the last twenty. With near record-low levels of capacity utilization and the accompanying decline in business investment, fiscal year 2002 is expected to be the worst ever for this category, declining 9.4%, before increasing by 4.9% in fiscal year 2003. Sales taxes from computer hardware and software sales to both businesses and consumers are included in this category; spending from both businesses and individuals is expected to decline in fiscal year

2002, due in large part to the continued drop in hardware prices, and also to the fact that computer users do not appear to upgrade as often as they have in the past.

Sales taxes from the utility component have increased at an annual average rate of over 15% for the last three years. Growth from this component has been almost entirely from the communications category, while growth from commercial and industrial utility sales has been almost flat. One large piece of the communications category, sales taxes from cellular phones and service, continues to grow, but receipts from sales of fiber-optic cable, digital switching equipment and other telecommunications infrastructure will fall as this sector of the economy recovers from tremendous amounts of excess capacity. This segment of sales tax revenues is expected to decline by 3.1% in fiscal year 2002 before increasing by a modest 3.0% in fiscal year 2003.

Sales tax assessments will be slightly lower than in past years due in part to the recent tax amnesty. That program cleared almost \$9 million of delinquent payments, which is now not available to be assessed. Refunds are expected to fall from the 2000 and 2001 level to \$17.4 million, more in line with historic levels. Legislation enacted in 2001 will transfer all of the sales tax collected from short-term vehicle rentals to the Transportation Trust Fund (TTF) starting January 1, 2002, rather than 45% of collections under prior law. The distribution to the TTF is therefore estimated at \$31.4 million in fiscal year 2002, and \$45.6 million in fiscal year 2003, when this provision is in effect for the entire year.

After adjustments for legislative changes, assessments, refunds and the TTF distribution, general fund sales and use tax receipts are expected to increase 0.3% in fiscal year 2002 to \$2,635.5 million, and by 3.6% in fiscal year 2003 to \$2,731.4 million as shown in Table 7.

Table 7  
**Sales and Use Tax Revenues**  
 Fiscal Years 2000 - 2003  
 (\$ in thousands)

	<u>2000 Actual</u>	<u>2001 Actual</u>	<u>2002 Revised Estimate</u>	<u>2003 Estimate</u>
Consumer	1,659,505	1,760,865	1,811,278	1,890,509
Construction	363,905	372,904	374,025	384,054
Capital Goods	281,787	282,805	256,349	269,012
Utilities	199,040	234,984	227,629	234,453
Net Collections	2,504,237	2,651,558	2,669,281	2,778,028
Assessments	16,747	17,500	15,000	17,000
Refunds	(23,453)	(22,960)	(17,350)	(18,025)
Transportation Trust Fund	(18,991)	(19,324)	(31,400)	(45,600)
Total General Fund	2,478,540	2,626,774	2,635,530	2,731,403

## Lottery

For the fourth straight year, lottery sales increased in fiscal year 2001, although at a rate about one-third as fast as the prior year. The amount of each dollar received by the State, however, continues to decline. In fiscal year 2001 it took an average of \$2.96 in sales to generate \$1 in State revenue, an increase of 4¢ since fiscal 2000. This change is due in large part to an increase in the commission rate for lottery agents. The lottery is expected to generate net revenues to \$425.1 million in fiscal 2002, a 4.1% increase over fiscal year 2001.

As expected, Pick 3 sales continued to decline in fiscal year 2001, with sales falling nearly 2% from the prior year. Just barely ahead of fast-growing Keno in sales in 2000, Pick 3 has now surrendered the first-place sales position. Pick 3 sales and revenues are expected to continue to decline, partially offset by increases in Pick 4. Net revenues from the two games are expected to drop in 2002 but remain constant at around \$205 million through fiscal year 2003. Stagnation in these games is of some concern as they are less volatile and provide better return (around 40%) to the State than other games.

The instant lottery games (scratch-off tickets) have shown strong growth of late, increasing by 25.4% in 2000 and 19.0% in 2001. While the recession through most of fiscal year 2002 may affect sales to a degree, growth through the first five months of fiscal year 2002 remains a respectable 17.8%. Instant games return about 20% of gross sales to the State, although revenue from certain instant lottery games is transferred to the Stadium Authority to meet debt service obligations.

Despite significantly slower growth in 2001, Keno managed to displace Pick 3 as the biggest seller among all the lottery games. The continued use of Keno Bonus and additional game enhancements, along with an expansion of the number of Keno outlets, will help sustain strong growth. Keno sales have picked up again, and are growing at a 10.9% rate through the first five months of fiscal year 2002.

The jackpot games, Lotto and The Big Game, are the most volatile games with regard to sales and revenues. As the jackpots grow, more people buy tickets. In the first four months sales and revenues of The Big Game tickets have increased about 20% over fiscal year 2001, while Lotto sales are down over 10% and revenues down nearly 5%. The Big Game revenues go to the Stadium Authority.

Let It Ride, which lost money in fiscal year 2001 due to high administrative expenses in the first few months, made a small profit before being discontinued in 2002. Cash-In-Hand paid out higher than average winnings in fiscal year 2001. The prizes are expected to return to normal levels in fiscal years 2002 and 2003.





## **Business Franchise Taxes**

Table 9 shows revenues from this category will be sharply lower in fiscal year 2002, primarily due to elimination of the financial institution franchise tax. Taxpayers who paid financial institutions franchise taxes through fiscal year 2001 (tax year 2000) are now subject to the corporate income tax. The financial institution franchise tax account will swing about \$14 million, from \$7.9 million of revenue in fiscal year 2001 to \$6.1 million of refunds in fiscal year 2002. Refunds will be paid as taxpayers carry back losses and deductions. These refunds will taper off in future years as the carry-back period expires. Pending litigation may also result in refunds in fiscal year 2002.

Concurrent with the elimination of the financial institutions franchise tax, the tax on deposits of savings and loan associations has been eliminated. As a result, little revenue will be received after fiscal year 2001.

### *Public Service Company Franchise Taxes*

Other franchise tax revenues have been dramatically affected by alteration of the tax statutes. The public service company franchise tax has been split into different categories. Extension of the Maryland mined coal credit and aggressive marketing of that credit by the Maryland coal industry has increased the amount of credit in fiscal year 2001 by \$4.9 million. Barring a significant increase in the amount of coal mined in Maryland, this credit has neared its limit.

Public service company franchise taxes are levied on two different transactions, on gross receipts and on energy delivered. Each of those categories is further divided by industry. Distribution utilities and telecommunications companies pay gross receipts taxes, and gas utilities and electric utilities pay excise taxes. Gross receipts taxes are a fairly predictable source of revenue, driven mostly by the number of customers and tariffs approved by the Public Service Commission. A more volatile component of the gross receipts tax is that collected on revenue from long distance telecommunications carriers. Revenues decline with prices, however as volume increases, so do revenues. The excise tax levied on utilities is more volatile, as it is levied on the number of kilowatt hours of electricity or therms of gas delivered. General economic conditions and weather affect energy consumption. Extreme weather and a strong economy both lead to increases in energy consumption and thus revenue increases. Mild weather and recession depress energy use and tax revenue. After adjusting for the Maryland mined coal credit, these revenues are expected to continue to increase as consumption increases.

A large part of the difference in public service company franchise tax collections between fiscal years 2000 and 2001 had to do with the uncertainty on the part of taxpayers as to their final tax liability. Taxpayers that underpaid estimated taxes were

subject to penalties. As a result, they paid more than they expected to owe in fiscal year 2000, and carried forward the resulting credit to 2001.

### *Filing Fees*

Without a significant change in statute or the economy, these revenues remain fairly stable, with slight growth over time. As there are no significant economic or statutory changes on the horizon, revenues in this category should remain fairly stable.

Table 9  
**Business Franchise Tax Revenues**  
 Fiscal Years 2000 - 2003  
 (\$ in thousands)

	<u>2000 Actual</u>	<u>2001 Actual</u>	<u>2002 Revised Estimate</u>	<u>2003 Estimate</u>
Public Service Company Franchise Tax	153,881	144,047	148,490	154,859
Financial Institution Franchise Tax	9,904	8,768	(6,100)	(1,250)
Tax on Deposits of Savings and Loans	1,365	1,591	250	0
Filing Fees	13,538	14,602	14,750	15,000
<b>Total</b>	<b>178,688</b>	<b>169,008</b>	<b>157,390</b>	<b>168,609</b>

## Insurance Premium Tax

Revenues from the 2% tax on insurance premiums took an unexpected decline in fiscal year 2000, but recovered to trend levels in fiscal year 2001. Pricing weakness in the insurance industry was the culprit for the decline in 2000. That weakness has generally disappeared, particularly after September 11. Premiums will be supported by the perceived increase in risk as well as the need to recoup losses from September 11 and investment losses in the industry over the past eighteen months.

Growth of 1.2% to \$192.7 million is expected in fiscal year 2002, increasing 2.3% to \$197.1 million in fiscal year 2003.

Table 10  
**Insurance Premium Tax Revenues**  
Fiscal Years 2000 - 2003  
(\$ in thousands)

	<u>2000 Actual</u>	<u>2001 Actual</u>	<u>2002 Revised Estimate</u>	<u>2003 Estimate</u>
Premium Tax	172,491	190,397	192,662	197,105

## Death Taxes

Death taxes are difficult to predict with any precision as they depend entirely on the number and value of estates settled during the fiscal year. A few taxpayers with large estates can radically affect revenues. This has happened a few times in the past several years, but not consistently enough to warrant building them into the estimates. Twenty large estates (estates with over \$500,000 of liability) have been settled in fiscal year 2002 through the end of November, paying \$43.2 million in tax. While that is only six more large estates than through the same period last year, it is almost double the revenue.

Several changes in State taxation have and will affect these tax revenues. Maryland has eliminated the inheritance tax for direct descendants and reclassified siblings as direct heirs effective in fiscal year 2001. This represents a loss of revenue from the inheritance taxes, but it increases the estate taxes since inheritance taxes paid can be claimed as a credit against the estate tax.

As the estate tax is tied closely with federal estate tax law, changes in federal tax law will flow through to Maryland. The Maryland estate tax is equal to the amount of the federal credit for State estate taxes. The federal credit, and thus the Maryland tax, will be reduced 25% in fiscal year 2002, 50% in fiscal year 2003, 75% in 2004, and will be eliminated in fiscal year 2005. In addition, the size of the estate subject to tax increases to \$1 million in fiscal years 2002 and 2003, and to \$1.5 million in fiscal year 2004.

Table 11  
**Death Tax Revenues**  
 Fiscal Years 2000 - 2003  
 (\$ in thousands)

	<u>2000 Actual</u>	<u>2001 Actual</u>	<u>2002 Revised Estimate</u>	<u>2003 Estimate</u>
Collateral Inheritance Tax	55,893	48,201	49,514	50,108
Direct Inheritance Tax	23,077	17,122	4,000	2,000
Tax on Commissions	45	29	10	10
Estate Tax	77,380	103,365	117,321	86,310
Interest and Penalty	644	86	800	800
Total	157,039	168,803	171,645	139,228

## Tobacco and Alcoholic Beverage Excise Taxes

Revenues from the tax on cigarettes increased in fiscal year 2001 by 0.9%, the first increase in revenue aside from tax rate increases since fiscal year 1982. It is expected that the long-term trend of declining cigarette consumption will return in fiscal year 2002, resulting in a revenue decline of 1.1%. The tax on other tobacco products generated \$5.8 million in its first year, well above expectations. Revenue is estimated at \$6.0 million in fiscal year 2002, and is expected to remain flat.

In the first four months of fiscal year 2002, the excise tax on beer has declined 2.2% from the year-ago figures, the largest drop since fiscal 1994. That decline has been more than offset, however, by large increases in distilled spirits and wine, 16.3% and 7.3%, respectively, perhaps the only positive revenue effect of recent events. These rates are not expected to hold through the entire year. If they did, the revenue increase in distilled spirits would be the largest since at least 1973, and on wine since 1992. Fiscal year 2002 is expected to finish with excise tax revenue on beer equal to the 2001 amounts, and with more modest increases of 4.0% for distilled spirits and 3.3% for wine.

In 2003, the revenue for sale of beer is expected to increase a more typical 0.8%. Revenue from wine and distilled spirits will come back into line with recent consumption trends. In total, there will be a slight decline in revenue in fiscal year 2003.

Table 12  
**Excise Tax Revenues**  
Fiscal Years 2000 - 2003  
(\$ in thousands)

	<u>2000 Actual</u>	<u>2001 Actual</u>	<u>2002 Revised Estimate</u>	<u>2003 Estimate</u>
Cigarette Tax	198,079	199,839	197,643	193,873
Floor Tax on Inventories	11,933	-	-	-
Other Tobacco Products Tax	-	5,797	6,000	6,000
<b>Total Tobacco Taxes</b>	<b>210,012</b>	<b>205,636</b>	<b>203,643</b>	<b>199,873</b>
Distilled Spirits Tax	11,464	11,435	11,892	11,630
Wine Tax	4,116	3,946	4,076	4,153
Beer Tax	8,818	9,140	9,140	9,214
<b>Total Alcoholic Beverages Tax</b>	<b>24,398</b>	<b>24,521</b>	<b>25,108</b>	<b>24,997</b>

## 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 revenue estimates are based on projections of utilization and reimbursement rates. Aside from disproportionate share payments, recoveries are expected to remain relatively stable. Slight increases in rates will offset small declines in population.

The federal Balanced Budget Act of 1997 reduced the formula for determining disproportionate share payments, which are provided to state hospitals for uncompensated care. The \$40 million decline in recoveries in 2001 is due largely to this reduction. The increase to an estimated \$32.5 million in fiscal year 2002 is attributable to two factors. The State has contracted with MAXIMUS to examine past reimbursements from the federal government to ensure the State has received the correct amounts. This contract will result in nearly \$12 million of one-time revenue. In addition, payments of nearly \$10 million had been expected to be received before the end of fiscal year 2001, but instead were received at the beginning of fiscal year 2002.

Table 13  
**Hospital Patient Recoveries**  
 Fiscal Years 2000 - 2003  
 (\$ in thousands)

	<u>2000 Actual</u>	<u>2001 Actual</u>	<u>2002 Revised Estimate</u>	<u>2003 Estimate</u>
Medicaid	44,111	47,891	44,631	43,037
Medicare	3,018	2,045	3,142	3,182
Insurance and Sponsors	6,169	7,704	7,418	7,429
	53,298	57,640	55,191	53,648
Disproportionate Share	48,814	8,463	32,500	10,238
	102,112	66,103	87,691	63,886
Total				

## Court Revenues

Revenue from the clerks of the circuit courts include recordation tax commissions, recording fees, and other miscellaneous fees that are largely related to the strength of the housing market. Although mortgage rates are at their lowest levels in five years, the majority of transactions have been refinancing which are exempt from recordation and transfer taxes.

District Court revenues are primarily from traffic fines and fees. These vary as driving patterns and enforcement efforts change. They are also affected by the extent to which citations are prosecuted and judges impose or forgive fines and fees.

Revenues from these sources, in the aggregate, are expected to remain relatively stable.

Table 14  
**General Fund Court Revenues**  
 Fiscal Years 2000 - 2003  
 (\$ in thousands)

	<u>2000 Actual</u>	<u>2001 Actual</u>	<u>2002 Revised Estimate</u>	<u>2003 Estimate</u>
Clerks of the Court	37,713	39,534	40,196	38,619
District Court	70,349	69,606	70,822	72,058

## Interest Earnings

Strong growth in interest earnings has been maintained over the past several years due to active money management by the Treasurer and increasing State revenues and balances. This growth will come to an end in fiscal year 2002, however, as revenue growth slows or declines and balances are drawn down. Compounding that situation is the sharp decline in interest rates. Rates for fiscal year 2002 are projected to average about 50% of fiscal year 2001 levels.

Table 15  
**Total Interest Earnings**  
Fiscal Years 2000 - 2003  
(\$ in thousands)

	<u>2000 Actual</u>	<u>2001 Actual</u>	<u>2002 Revised Estimate</u>	<u>2003 Estimate</u>
General Fund Interest Earnings	128,391	140,588	72,623	70,259



## Miscellaneous Revenues

Miscellaneous revenues are expected to decline by about 5% in fiscal year 2002 from \$201.3 million to \$179.3 million. In fiscal year 2003 miscellaneous revenue will further decline to \$165.6 million, a 7.6% decrease from 2002. Many revenue sources are facing modest declines as the economic situation deteriorates, although there are legislative and one-time items that have a significant effect on individual components of the total.

Unclaimed property revenue is running higher than expected in fiscal year 2002, but is expected to finish the year approximately \$7 million lower than fiscal year 2001 resulting from extraordinary receipts in that year that are not built into the forecast.

The next biggest change in miscellaneous revenues, amounting to about \$6 million in fiscal year 2002 and \$18 million in fiscal year 2003 are due to 2001 legislative changes that divert revenues that had previously gone to the general fund into the transportation trust fund to pay for mass transit service improvements. In fiscal year 2002, \$12 million from uninsured motorist penalty fees will be used for this purpose. Another \$6 million in 2003 comes from what was the general fund's share of revenue from filing fees and license tags.

Other revenue effects are from legislative or procedural changes, including the transfer of the reimbursement of teachers' retirement costs from the general fund to the Transitional Education Fund. Also in fiscal year 2001, expedited fee revenue collected by the State Department of Assessments and Taxation was credited to the Corporate Charter Computerization and Administration Fund instead of the general fund, and interest and penalties collected by the Department were credited to the same account as the underlying tax or fee.

Revenues for the Division of Financial Regulation and occupational and professional in the Department of Labor, Licensing and Regulation are cyclical, as many licenses are for a two-year period. Other large changes are due to one-time items. This is true of the Departments of Health and Mental Hygiene, Human Resources, and Housing and Community Development.

Table 16  
**Miscellaneous Revenues**  
 Fiscal Years 2000 - 2003  
 (\$ in thousands)

	<u>2000</u> <u>Actual</u>	<u>2001</u> <u>Actual</u>	<u>2002</u> <u>Revised</u> <u>Estimate</u>	<u>2003</u> <u>Estimate</u>
<b>Business Entity Fees</b>				
Expedited Fee Revenue	1,579	0	0	0
Recording Fees	3,302	3,305	3,300	3,350
Organization & Capitalization Fee	560	455	650	650
Interest & Penalty	242	1,403	0	0
<b>Transportation</b>				
(GF share of filing fees, license tags)	9,669	8,982	9,020	2,750
<b>PSC Filing Fees</b>				
Excess Fees of Office	11,350	11,762	12,986	13,209
Legislature	20,125	14,600	11,838	11,139
Workers' Compensation	486	414	210	228
Public Defender	16,235	20,291	18,633	20,657
Attorney General	1,678	1,652	1,800	1,800
Subsequent Injury Fund	22,083	21,396	17,800	18,200
Executive & Administrative Control	54	0	12	12
Financial & Revenue Administration	4,498	5,483	1,808	1,804
Budget & Fiscal Administration	8,897	6,602	6,735	6,870
General Services	841	1,738	1,171	1,184
Natural Resources	30	63	63	63
Agriculture	802	1,173	581	581
Health & Mental Hygiene	299	286	295	295
Human Resources	12,319	5,089	7,932	6,973
Labor, Licensing & Regulation	1,625	3,410	1,570	1,575
Office of the Secretary	41	0	0	0
Div. of Financial Reg.	15,277	4,968	10,074	6,018
Div. of Labor & Industry	1,251	1,322	1,400	1,500
Div. of Racing	294	323	290	260
Div. of Occup. & Prof. Lic.	5,567	4,867	6,075	5,870
Public Safety & MD State Police	10,616	10,835	9,668	9,566
Public Education	10,735	2,047	2,651	2,715
Housing and Community Development	3,312	1,386	397	674
Environment	729	402	213	350
Juvenile Justice	301	438	296	275
Unclaimed Property	24,317	36,965	30,000	32,000
Alcoholic Beverage Licenses	585	584	550	550
Local Income Tax Reimbursement	11,100	12,700	11,500	11,500
Uninsured Motorist Penalty Fees	13,202	12,861	6,800	0
Miscellaneous Revenues and Transfers	1,551	3,483	3,000	3,000
<b>Total</b>	<b>215,552</b>	<b>201,285</b>	<b>179,317</b>	<b>165,619</b>

## Transportation Revenues

Titling tax revenues increased by 1.4% in fiscal year 2001. Growth was not very strong, but vehicle sales remained at record high levels. Revenues are expected to decline by 3.0% in fiscal year 2002 as a result of the weaker economy. While sales through November have been very strong, the strength is due in large part to the zero percent financing that was broadly offered in October and November, and is still being offered by some manufacturers on some models. To an extent, this marketing effort is borrowing sales from the future. Sales are expected to decline in the second half of the fiscal year.

Motor fuel taxes increased by 6.5% in fiscal year 2001, which is very strong growth for this revenue source. Much of that increase is attributable to improper filing by motor fuel taxpayers in fiscal year 1999, which resulted in large refunds in fiscal year 2000. The growth from fiscal year 1999 to fiscal year 2001 is 1.0%, which is slightly under the historic average. Despite declining gas prices, gasoline consumption and therefore motor fuel tax revenues are expected to remain flat in fiscal year 2002 as concern over the terrorist attacks has reduced travel. Growth will resume at 1.4% in fiscal year 2003.

Many transportation-related revenues are now directed to a mass transit initiative, as shown in Table 17. Many of these revenues had been general fund revenues; the additional revenues from the sales tax on short-term vehicle rentals will again be general fund revenue in fiscal year 2007.

Table 17  
**Maryland Motor Vehicle User Revenues**  
 Fiscal Years 2000 - 2003  
 (\$ in thousands)

	<u>2000 Actual</u>	<u>2001 Actual</u>	<u>2002 Revised Estimate</u>	<u>2003 Estimate</u>
<b>Motor Vehicle Administration</b>				
Registrations	173,425	183,108	184,600	191,400
Licenses	16,517	13,535	17,800	22,800
Med-Evac Surcharge	34,052	37,212	48,593	49,565
Miscellaneous Motor Vehicle Fees	64,791	71,802	86,100	92,500
Vehicle Emission Inspection Fees	15,856	4,110	3,900	4,000
<b>Security Interest Filing Fees</b>				
Special Funds	3,379	3,346	3,240	3,300
General Funds	5,069	5,018	4,860	0
General Funds - Baltimore City	2,816	2,788	2,700	2,750
MDOT - Transit Initiative	0	0	0	4,950
Hauling Fees	6,768	7,374	7,500	7,500
Learners and New Drivers' Licenses	8,150	8,897	10,700	11,300
<b>Special License Tags</b>				
Special Funds	380	380	380	380
General Funds	1,784	1,153	1,460	0
DOT	23	742	610	600
Chesapeake Bay Tags - MDOT	424	389	550	375
MDOT - Transit Initiative	0	0	0	1,645
Titling Tax	604,482	612,779	594,000	612,000
<b>Sales Tax on Rental Vehicles</b>				
MDOT	18,991	19,324	19,500	19,700
MDOT - Transit Initiative	0	0	11,900	24,100
	<hr/> 956,907	<hr/> 971,957	<hr/> 998,393	<hr/> 1,048,865
Motor Vehicle Fuel Tax	631,586	672,495	672,495	681,300
Road Tax	14,532	14,403	14,403	14,600
Decals	265	76	0	0
Permits	97	0	0	0
	<hr/> <hr/> 646,480	<hr/> <hr/> 686,974	<hr/> <hr/> 686,898	<hr/> <hr/> 695,900

Total	1,603,387	1,658,931	1,685,291	1,744,765
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### **Five Year Forecast**

As discussed in the Maryland outlook, the State's economy is expected to slow considerably in fiscal year 2002 as the recession comes to Maryland. As growth picks up in 2003, revenues will recover, but will not approach trend levels of growth until fiscal year 2004. Revenue growth experienced in the late 1990s does not seem likely to recur, since much of it was a result of double-digit growth in capital gains. The bursting of the dot-com bubble and resulting market sell-off has reduced the stock of unrealized capital gains; historic levels of capital gains growth are therefore not expected until fiscal year 2005.

In fiscal year 2003, the phased-in income tax reduction will be fully implemented, and will no longer restrain growth. Other factors, however, notably including the effective repeal of the State estate tax, will hold back growth. On balance, however, the completion of the income tax reduction more than offsets the effects of the new changes.

Sales tax growth in the long run is expected to be slower than the growth in personal income since an increasing share of expenditures are on non-taxable services. Lottery revenue is expected to grow modestly, but general fund revenues will be affected by changes in the distribution to the Stadium Authority.

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

CALENDAR YEAR	1999	2000	2001	2002	2003	2004	2005	2006
U.S. Real GDP (Billion \$96 chained)	8,856.5	9,224.0	9,324.9	9,389.4	9,809.1	10,125.8	10,439.8	10,755.7
% change	4.0%	4.1%	1.1%	0.7%	4.5%	3.2%	3.1%	3.0%
U.S. Total NonFarm Employment (Millions)	128.9	131.8	132.3	131.8	134.6	137.2	138.8	140.6
% change	2.4%	2.2%	0.4%	-0.3%	2.1%	1.9%	1.2%	1.3%
U.S. Total Personal Income (Billion \$)	7,777.3	8,319.2	8,739.0	9,000.4	9,464.0	9,958	10,435	10,929
% change	5.2%	7.0%	5.0%	3.0%	5.2%	5.2%	4.8%	4.7%
CPI - % Change	2.2%	3.4%	3.0%	1.8%	2.2%	2.5%	2.4%	1.3%
U.S. 10 Year Treasury Bond Yield (%)	5.64	6.03	4.96	5.12	5.79	6.16	5.92	5.86
MD Total NonFarm Employment (Millions)	2,385.8	2,450.9	2,474.3	2,474.8	2,509.3	2,556.6	2,609.6	2,666.6
% change	2.7%	2.7%	1.0%	0.0%	1.4%	1.9%	2.1%	2.2%
MD Total Personal Income (Million \$)	167,195	178,506	189,319	196,223	206,016	217,732	230,183	243,609
% change	5.6%	6.8%	6.1%	3.6%	5.0%	5.7%	5.7%	5.8%

Table 19  
**Maryland General Fund Revenues**  
 Fiscal Years 2001-2006  
 (\$ in thousands)

	2001 Actual	2002 Estimate	2003 Estimate	2004 Estimate	2005 Estimate	2006 Estimate
INCOME TAXES:						
Individual	5,133,726	5,113,497	5,197,893	5,459,853	5,786,625	6,166,074
Corporation	374,397	245,212	302,370	376,214	359,888	363,265
Total	5,508,123	5,358,709	5,500,263	5,836,067	6,146,513	6,529,339
SALES AND USE TAXES	2,626,774	2,635,530	2,731,403	2,890,656	3,055,685	3,235,469
STATE LOTTERY	385,045	396,745	403,345	410,954	418,352	425,882
FRANCHISE, EXCISE, LICENSE, FEE	1,141,903	1,140,456	1,082,071	1,097,847	1,063,714	1,058,691
INTEREST ON INVESTMENTS	140,588	72,623	70,259	80,000	80,000	80,000
TOTAL CURRENT REVENUES	9,802,434	9,604,063	9,787,341	10,315,524	10,764,264	11,329,381
TRANSFERS	-	119,500	-	-	-	-
TAX AMNESTY	-	28,453	-	-	-	-
GRAND TOTAL	9,802,434	9,752,017	9,787,341	10,315,524	10,764,264	11,329,381

## **Maryland Tax Amnesty**

Legislation enacted in 2001 provided for an amnesty period from September 1, 2001 through October 31, 2001 for penalties attributable to the nonpayment, nonreporting or underreporting of income taxes, withholding taxes, sales and use taxes, or admissions and amusement taxes. The legislation provided that the appropriate distributions would be made to local governments (from the individual income tax and the admissions and amusement tax) and the Transportation Trust Fund (from the corporate income tax).

After those distributions, the first \$2 million was made available for the Comptroller's use in administering the amnesty and for providing increased enforcement after the amnesty period. The next \$30 million was to be distributed to the general fund. A further \$18 million of anticipated revenue was directed to education and volunteer fire companies. All revenue over that amount was to be placed in a Maryland Tax Amnesty Reserve Fund for future use as directed by the General Assembly.

As shown in the following table, the tax amnesty resulted in \$28.5 million for the general fund, \$8 million for local governments, and nearly \$1 million for the Department of Transportation. As the \$30 million general fund allocation was not reached, the other distributions were not made.



## **IMPACT OF THE ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001 ON MARYLAND REVENUES**

On June 7, 2001, President Bush signed into law the Economic Growth and Tax Relief Reconciliation Act of 2001 (the Act). The largest impact on federal income tax revenues is through a reduction of federal income tax rates, which do not directly affect Maryland revenues. There are a variety of changes which will directly affect Maryland revenues, however, notably including the repeal of the federal estate tax and accompanying credit for state death taxes, as well as various changes to federal income tax treatment of pension contributions, education tax benefits, and others. The Comptroller issued a report on August 6, 2001 detailing these changes and their impact on Maryland revenues. This report is available from the Comptroller's Office, and is also available from the Comptroller's website at [www.marylandtaxes.com](http://www.marylandtaxes.com).

As a result of the changes in federal tax law, State revenues had been expected to increase by \$3.4 million in fiscal year 2002, but will decline by an estimated \$50.9 million in fiscal year 2003. The revenue losses will increase to \$72.3 million in 2004 and \$101.6 million in 2005, with the majority of the revenue losses in those years resulting from the impact on Maryland's estate tax. The entire Act sunsets on December 31, 2010, and some major provisions sunset well before then. The estimated revenue losses for years leading up to the sunset are therefore very uncertain, as Congress is likely to take action either to repeal some provisions which phase in over this period, or to make these changes permanent.

Since the time these estimates were made, the economic outlook has changed considerably. Thus, the estimated impact on Maryland revenues will likely not be quite as large as previously expected. The official estimates contained in this report take this factor into account.