



Report of the
Maryland Board of Revenue Estimates
on

**ESTIMATED
MARYLAND
REVENUES**

FISCAL YEARS ENDING JUNE 30, 2003 AND JUNE 30, 2004

Submitted to
Governor Parris N. Glendening
December 16, 2002



State of Maryland
Board of Revenue Estimates

Louis L. Goldstein Treasury Building, P. O. Box 466
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Director, Bureau of
Revenue Estimates

December 16, 2002

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, 2003 and June 30, 2004, 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

Nancy K. Kopp

T. Eloise Foster

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Executive Summary

Unsurprisingly, Maryland's economy was unable to escape the effects of the national recession that began in the first quarter of 2001. By the third quarter of that year, signs of the slowing economy appeared in Maryland. Employment growth slowed towards the end of 2001, and actually declined throughout most of 2002. While the recession came late to Maryland, the State appears to have escaped the worst; employment will only decline by 0.6%, compared to 0.8% nationally. The unemployment nationwide rose a full percentage point in 2002, to 5.8%, while Maryland's only rose four-tenths of one percent to 4.5%. The trough in national employment growth occurred in the first half of 2002; Maryland's came in the third quarter, but recovery is on the way.

Although both the national and State economies are climbing back towards solid economic growth, it has not been a steady climb. A number of factors, including a recalcitrant stock market throughout the year and the continuing uncertainty of war with Iraq have worked to undermine business confidence, without which robust growth will not occur. What expansion has existed in the economy is due to the insatiable appetite of consumers for spending. The desire to spend must be coupled with a continued ability to spend while businesses regain confidence, or the economy may lapse back into recession. While that does not appear the likely path, many economists believe the odds of a double-dip recession are an uncomfortable one in three.

As Maryland's economy recovers its footing through the end of fiscal year 2003, revenue growth will recover as well. Ongoing general fund revenues declined by 4.6% in fiscal year 2002, due primarily to the approximately 50% decline in realized capital gains in tax year 2001--indeed, the personal income tax dropped 7.1% last year. Though capital gains will drop again in tax year 2002, the base is half as small, so the deleterious impact on the income tax will not be as large. The final step of the five-year phased-in income tax reduction will affect revenue growth in fiscal year 2003, however, along with the slowed economy. Income tax revenue growth will be a meager 0.75%--certainly not strong, but better than a 7% decline.

Sales tax growth will be slow but steady, increasing by 3.0% in 2003. Consumers, responsible for over two-thirds of the sales tax, will increase spending on taxable goods by 3.3%. Revenue from construction, utilities and capital goods spending will barely grow, however. The situation will reverse in 2004, as business investment recovers; two of these three categories will grow faster than the consumer segment, resulting in relatively strong 4.4% growth.

The lottery has performed exceedingly well, driven by Keno and instant ticket sales. Changes to the Big Game, re-christened Mega Millions, create the potential for enormous jackpots and correspondingly high levels of sales and revenues. A new international lotto-type game, scheduled to roll out in 2004, will help keep interest in the lottery high. Insurance premium taxes have benefitted from the market decline, as insurers have to recoup their market losses as well as their underwriting losses and have therefore raised premiums. On the other

hand, the market collapse has dramatically reduced death taxes, which are based on the value of estates and inheritances.

Alcoholic beverage excise taxes have been growing of late, and are expected to grow again in both fiscal years 2003 and 2004. Tobacco taxes will continue their downward trend, although general fund revenues will receive a boost in 2004 when the one-time \$80.5 million special fund distribution ends. Interest income will decline by 40% in fiscal year 2003, due to dramatically reduced State balances compounded by record-low interest rates.

Fiscal year 2003 will see a 0.3% decline in net general fund revenues, although ongoing general fund revenues will increase by 1.2%, to \$9,472.7 million. As the economy recovers, and the uncertainties of war have presumably been resolved, general fund revenue growth will reach 5.7%, climbing above 2001 levels to \$10,011.6 million.



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The U.S. Economy

The United States economy has recovered from the 2001 recession in fits and starts. While the National Bureau of Economic Research has yet to date the end of the recession which began in March of 2001, many economists believe it ended sometime in the first quarter of 2002. Between the first quarter of 2001 and the last, roughly coinciding with the recession, real gross domestic product grew at an annual rate of 0.3%, and in fact that was the rate of growth of the economy for the full year. GDP growth, of course, is not the determinant of a recession, but most other measures demonstrate the slackening of the economy in 2001 and the lack of a strong rebound this year. On balance, the economy looks set to tread water through the first half of 2003 before resuming steady though unremarkable growth. Obviously, a number of factors may preclude solid growth during this period, and the risks of a double-dip recession are uncomfortably large.



The Current Situation

Consumers almost single-handedly supported the economy in 2001. Real GDP grew at an anemic 0.3%; had the economy been composed solely of consumers, growth would have been 1.7%. The government sector contributed 0.65 percentage points of growth, while trade sapped 0.2 percentage points and the sharp decline in private investment deducted a whopping 1.9 percentage points of growth. The decline in investment was not the only place the private sector was cutting back. Employment grew by only 0.2%, the slowest rate in ten years; the lackluster growth of available jobs caused the labor force to grow by only 0.7%, also the slowest rate of growth in ten years. The number of unemployed grew by nearly 20%, sending the unemployment rate from 4.0% to 4.8%.

While the economy was in recession long before September 11 2001, the terrorist attacks exacerbated the effects of the economic slowdown. Estimates by Economy.com, a nationally recognized economic consultant, are that the attacks shaved over \$63 billion from real GDP, resulted in 520,000 lost jobs, and drove the unemployment rate from 4.3% to 4.8%.

The 2001 recession was extraordinarily mild by any measure, even more so when considering the fact that the economy was coming out of the longest period of growth in American history and had to absorb the impact of the burst dot-com bubble, the precipitous market plunge, and the impact of September 11. Similarly, the economy has generally performed better than expected thus far in 2002. Through the first three quarters, real GDP has increased by an annual rate of 3.1%, supported by consumption and government expenditures. Investment has grown strongly, but this is due solely to the fact that inventories were drawn down throughout 2001, and that drawdown has now ended. Nonresidential investment has declined 2.6% through the first three quarters.

While growth resumed more quickly and more strongly than had been expected at this time last year, recent data bring the vitality of the recovery into question. It was clear earlier

that much of the GDP growth was not lasting—additions to inventory provided half of net growth in the first quarter and were equivalent to all of net growth in the second. As the change in inventories was nearly flat in the third quarter, so was investment's contribution to GDP growth. Government consumption and investment represented about 20% of net GDP growth in the first quarter, slowing to just over 10% in the third quarter as State and local budgets became increasingly tight. Only the consumer has remained consistent over this period, providing almost half of the economy's growth in the first quarter, and over 90% of net growth in the second and third (of the second quarter net growth of 1.3%, 1.2 percentage points were from consumption, 1.3 percentage points were from additions to inventory, and -1.4 percentage points were from net exports). Underlying strength in consumption, however, is difficult to determine given the reinstatement of zero percent financing for automobiles; but the strength exists.

The power of the purse over the past few quarters stems from the same source that has sustained it over the past few years—debt. Record low mortgage rates have caused a refinancing boom. The Mortgage Bankers' Association's index of refinancing activity reached an all-time high the week of October 4, 2002, exceeding by almost 30% the previous peak reached in the two months after September 11 2001, and exceeding by more than 75% the prior all-time high, reached almost exactly four years ago during the Asian financial crisis. If consumers follow past trends, recently released home equity will result in \$70 billion or more of spending, over one percent of annual spending.

Much of this spending will be on vehicles. Through September, light vehicle sales were on a 16.8 million annual pace, nearly the level of 1999 sales, which were a record high (exceeded, of course, by nearly 500,000 units and 250,000 units in 2000 and 2001). Zero percent financing obviously spurred sales both this year and last, and may represent a future drag on consumer spending. The fact that zero percent financing was generally eliminated over the summer but reintroduced on many more models for longer terms than was available last fall is an indication that the automobile manufacturers are struggling to maintain volume, and perhaps borrowing from the future to a large degree (sales could slump dramatically if deflation takes hold). Nonetheless, these incentives have provided a boost in the current year.

The stock market plunge that has perhaps—perhaps—only now bottomed out has taken a tremendous toll on consumer confidence, and there is evidence that the negative wealth effect has had an impact on spending. Luckily for the economy, growth in real estate values has offset much of the \$7 trillion or so of wealth lost in the stock markets, so the impact on spending is not as much as would have otherwise been the case. Barring a strong recovery over the last quarter of the year, equity markets will have turned in their worst three-year performance since the 1930s.



The Outlook

The health of the economy depends primarily on the willingness and ability of consumers to maintain spending in the face of uncertainty over war. If consumers can maintain

their pace for several quarters, business investment should recover and relatively respectable and stable growth should be assured. If, on the other hand, consumers falter, businesses would have no need nor desire to invest. This situation would lead to an economy one side or the other of flat for some period of time.

Several factors support the continued ability of consumers to spend. While the mortgage refinancing boom has freed up a great deal of homeowner's equity, more could be done. Homeowners who have not refinanced in the past fifteen months or in late 1998 and early 1999 could well find it profitable to do so now, as rates are currently around record lows, well below 7%. Given recent large increases in home prices, homeowners may desire to refinance even if they don't save much on their monthly payments, in order to unlock some of the newfound equity. Mortgage rates do not appear likely to rise significantly over the next twelve months. The increases in home values will help to support spending even if homeowners don't refinance, as they will help to maintain consumer confidence damaged by the market fall and the uncertain employment situation.

Low interest rates will support consumer spending in other ways. As mentioned above, many automobile manufacturers are currently offering zero percent financing on current year models, some for up to 60 months or more. Additionally, many credit cards are offering zero percent interest on purchases through the end of 2003 and beyond. Again, these incentives to spend will represent an acceleration of future purchases for many consumers, although it is certainly true that lower interest costs would allow consumers to purchase more today than would otherwise be possible.

Further reasons for consumers to be able to continue spending is that incomes will continue to increase. While perhaps not achieving the lofty heights claimed by proponents of the New Economy, productivity has in fact grown strongly throughout the latter half of the 1990s and into the new decade, interrupted only briefly by the recession. While much of the productivity gains will accrue to profits, particularly since business' pricing power has generally been weak for several years, productivity increases cannot help but to increase income.

On the other hand, consumer confidence has fallen to ten-year lows after five consecutive months of decline. Disturbingly, the future expectations component of the Conference Board's measure fell more severely in October than the present situation component. The extent to which the recent decline is caused by war jitters will become clear in time.

In addition to declining consumer confidence, consumer debt levels are a concern. While there are some reasons to think that consumers can take on more debt, as described above, consumer debt levels as a percentage of income are at 30-year highs, by a wide margin. The previous peak was in 1986, at around 17%. In 1996, the ratio peaked at just under 18% before a slight decline, then rose again from 1999 through the present to almost 19%. In addition, this ratio did not fall during the 2001 recession, as it has in all other recessions in the past 30 years. While this growth in debt ratios may not be a problem in light of record low interest rates, any increase in rates could cause noticeable consumer retrenchment.

If consumers show staying power until businesses are confident enough to invest, the economy will avoid a double-dip recession. If consumers waver, however, business investment

will likely not pick up. A downward cycle of consumer confidence, reductions in spending, and reductions in employment could take hold. At present, it appears that the former is more likely than the latter.

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

	1998	1999	2000	2001	2002	2003	2004
Real Gross Domestic Product (\$ in billions)	8,508.9 4.3%	8,858.9 4.1%	9,191.4 3.8%	9,214.6 0.3%	9,438.9 2.4%	9,676.4 2.5%	10,017.1 3.5%
Federal Funds Rate (%)	5.35	4.97	6.24	3.89	1.69	1.86	4.64
10-Year Treasury Bond Yield (%)	5.26	5.64	6.03	5.02	4.61	4.61	5.49
Consumer Price Index (% change from prior year)	1.5%	2.2%	3.4%	2.8%	1.6%	1.9%	2.1%
Housing Starts (thousands of units)	1,621.0 9.9%	1,647.2 1.6%	1,573.5 -4.5%	1,602.7 1.9%	1,687.5 5.3%	1,590.0 -5.8%	1.5 -99.9%
Light Vehicle Sales (thousands of units)	15,417.0 2.3%	16,776.3 8.8%	17,243.0 2.8%	17,021.0 -1.3%	16,503.2 -3.0%	16,175.0 -2.0%	16,250.0 0.5%
Corporate Profits after Tax (\$ in billions)	482.3 -13.1%	514.3 6.6%	522.9 1.7%	470.9 -10.0%	447.5 -5.0%	485.5 8.5%	546.8 12.6%
Total Non-Agricultural Employment (thousands)	125,851.5 2.6%	128,904.0 2.4%	131,718.8 2.2%	131,924.7 0.2%	130,808.5 -0.8%	131,707.7 0.7%	134,390.8 2.0%
Unemployment Rate (%)	4.5	4.2	4.0	4.8	5.8	6.2	5.7
Total Personal Income (\$ in billions)	7,426.0 7.0%	7,786.5 4.9%	8,406.6 8.0%	8,685.4 3.3%	8,939.5 2.9%	9,235.9 3.3%	9,673.6 4.7%

Sources: Economy.com, December 2002
Bureau of Revenue Estimates, December 2002



The Maryland Economy

Maryland's economy has experienced difficulties over the past year, as has the national economy. Equivalent to roughly 1.9% of the United States' economy, Maryland's economy cannot remain apart from the conditions affecting the national economy for a sustained period of time. While the State's economy has slowed, however, it continues to outperform the national economy in many respects. And although by many measures Maryland's economy remains in recession as of this writing, the long-term prospects for the State continue to be, on balance, positive.

The United States' economy fell into recession in March 2001. The recession didn't reach Maryland, however, until the end of the third quarter of 2001. Several factors allowed the State to escape the nationwide slowdown as long as it did. The recession predominantly affected the manufacturing industry, but manufacturing plays only half as important a role in Maryland as it does nationally. Even if Maryland manufacturers were suffering to the same extent as their U.S. counterparts, the impact on Maryland's economy would have been much smaller. In addition, government plays a much larger role in Maryland than it does nationwide. With the federal government enjoying its first period of surplus in many years (now gone) and State and local revenues inflated by cresting capital gains, the government sector of the economy remained strong throughout 2001. Finally, with the highest median household income in the country, Maryland consumers were likely less concerned with their near-term economic prospects, and therefore less likely to restrain spending. These three factors kept the State's economy growing as the national economy contracted.

National employment growth slowed throughout 2001, was nearly flat through the summer, and actually began to decline in September. As 2001 came to a close, the inevitable occurred and the national recession reached Maryland. Employment growth slowed every month through the autumn, and declined for the first time on a year-over-year basis in December 2001. Employment growth in the nation was 0.2% in 2001, compared to 0.8% for Maryland. Since March of 2002, the national picture has improved nearly every month, with the rate of decline slowing. Maryland's decline, on the other hand, accelerated through the end of the summer and may have just now turned the corner—or maybe not. The good news for Maryland, though, is that national employment declined at 1% annual rates or more from December 2001 through July 2002. Maryland employment has only declined at that rate for two months, one of which may partially be a result of a statistical blip.

Even if Maryland's economy has not yet turned the corner, there is still reason to believe that the downturn will not be as severe in the State as it has been nationwide. Moreover, assessments of last year that the recession is likely to affect Maryland much less severely than that of the early 1990s appear to be holding true. Positive signs for the State include the fact that three-quarters of Maryland businesses expect revenue increases in the coming year, a larger number than have at any time since before the second quarter of 2001. In addition, almost half of Maryland firms expect to add jobs in the coming year. One continuing piece of good news/bad news is that over half of Maryland businesses report difficulties in recruiting

labor, especially for the trades and unskilled labor. If firms are having difficulty hiring, the recession cannot be cutting too deeply.

Indeed, Maryland employment will decline by 0.6% for all of 2002, with national employment falling off by 0.8%. Maryland is expected to rebound more strongly in 2003, with growth of 1.0% compared to a national forecast of 0.7%. Growth in the State will be led by some of the largest sectors—services, construction and government. Laggards will include transportation, communications and public utilities (TCPU) and retail trade, which may not resume growth until 2004.



Manufacturing

Unsurprisingly, manufacturing has not fared well over the past year. Some Maryland manufacturers have struggled, cutting back on operations or expansion plans. General Motors' Allison Transmission plant in White Marsh was to double in size to 800 workers, which would have partially offset the expected loss of 1,500 jobs from the Chevrolet Astro plant at Broening Highway, but those expansion plans were postponed in June. Shortly after, a silver lining appeared when GM announced that they would give the Broening Highway plant a reprieve until 2005. Without an unexpected rise in demand for these older model vans or a major overhaul of the 67-year-old plant, which GM has consistently ruled out, the plant is unlikely to remain open much beyond that time. In late October GM announced that the winter holiday plant closing at the Broening Highway plant would be three weeks longer than other GM plants due to a drop in demand.

Black and Decker has cut 100 jobs at its Towson headquarters, and by December 2003, another 1,300 jobs will be eliminated as the company closes its Easton factory. Production of the DeWalt power tools made there will shift primarily to Mexico. Northrop Grumman has cut 150 jobs in the State while consolidating about 450 from other locations, including Carroll and Prince George's counties, to Anne Arundel County since July. Bethlehem Steel has been hampered by bankruptcy, ineffective import duties and large pension liabilities. On October 10, MeadWestvaco Corp. announced it would lay off 150 of its employees in Luke. The layoffs will come as the company permanently shuts down eight machines that cut rolls of paper into sheets and consolidates that operation at one of its plants in Ohio. This will reduce the number of workers at the Luke plant by just over 10%. MeadWestvaco will continue to manufacture coated paper at the Luke plant.

While these old-line companies have struggled, high-tech manufacturing firms have had an even worse time of late. The massive overinvestment in telecommunications equipment in the waning period of the dot-com boom have caused fiber-optics manufacturer Ciena to implement four rounds of layoffs over the past year, cutting employment by almost 2,000 including 450 workers laid off in September, while Columbia-based Corvis, which laid off nearly 30% of its workforce a year ago, has outsourced most of its Columbia manufacturing to Canada. Fiber-optics testing equipment manufacturer Acterna laid off 1,300 employees over three rounds in the past seven months. Egide USA, which manufacturers packaging materials

for electronic devices, will cut nearly half of its 133 employees in Dorchester County in December. Depressed conditions in this segment of the industry look to continue through 2004.

High-tech troubles are not confined to the telecommunications sector; some biotechnology manufacturers have suffered as well. Celera Genomics in Rockville reduced its workforce by over 130 positions, while Guilford Pharmaceuticals has laid off 70 employees. Guilford was counting on Food and Drug Administration approval of Gliadel for treating brain cancer. When the FDA rejected Gliadel, the company lost an estimated \$8 million in potential 2002 sales, resulting in the layoffs and a cutback in products in development. Similarly, Novavax pulled a drug from the FDA approval process. The company had counted on sales for the drug of several million dollars in 2002; as a result of the withdrawal, 15 of 75 employees were fired, and Novavax now has just enough cash to last through mid-2003.

The State's manufacturing sector is not in unmitigated decline. A number of firms have started or expanded operations in the State. Strescon Industries, a maker of precast concrete based in Towson, is building a manufacturing plant in the Edgewood enterprise zone that will result in 100 jobs. Hydro Aluminum North America is consolidating some of its U.S. operations in Linthicum, doubling its workforce in the State to about 80. And Collins & Aikman, a manufacturer of instrument panels, automotive floor and acoustic systems and other car parts, is expanding its Havre de Grace plant. Its workforce will increase from 200 to 300 jobs over the next year and a half.

And some biotechnology firms are faring well. Baltimore-based FASgen will be adding fifteen employees over the next year as it moves toward production of its cancer, obesity and tuberculosis treatments. Avalon Pharmaceuticals, developing genetic-based drugs to fight cancer, will relocate its headquarters in the first quarter of 2003 to a new laboratory/office facility in Germantown. The new facility will allow for planned expansion of its 56-strong workforce.

The biotechnology industry in Maryland is extraordinarily well positioned due to the presence of the National Institutes of Health, Johns Hopkins and the University of Maryland. A recent report shows that 41 biotech companies were founded by former NIH employees, 30 were founded by individuals with degrees or employment ties to Johns Hopkins, and 23 were founded by individuals with similar relationships with the University of Maryland. Indeed, a recent Ernst & Young study shows that Maryland and Northern Virginia have surpassed San Diego and now have the third-largest concentration of biotech companies, second only to New England and the San Francisco area. Though many biotechnology companies will no doubt fail over the coming year, as occurs in all new industries, the long-term future is bright.

Despite the good environment some manufacturers have found in Maryland, the difficulties of both old and new manufacturers will result in a job decline of 3.2% in 2002 followed by growth of 1% in 2003 and 2004.



Construction

The construction sector, which had grown faster than any other Maryland sector save services from 1998 through 2001, will decline more rapidly than all but one sector in 2002. While growth had been boosted by record low mortgage rates and a variety of public and private projects through 2001, the bursting of the dot-com bubble and the recession have caused vacancy rates to rise and, therefore, construction activity to slow. Indeed, in the first half of 2002, construction of new office space in and around Baltimore dropped by two-thirds, and the construction sector statewide shed nearly 900 jobs. The still-booming housing market has not been enough to offset the slowdown in commercial construction; as a result, the industry will decline by 3.0% in 2002.

Office vacancy rates rose across the State in the first half of 2002, and look to continue increasing through the end of the year. In part, this is due to several large deliveries of space, including the 1.3 million square foot Montgomery Park Business Center. This development will house the State Lottery and Department of Environment, along with a 500-employee call center for NCO Group, Inc., a debt collection company. But it is only 25% pre-leased, so its arrival will drive up vacancy rates. Partly because of the redevelopment of that building, construction of office space in Baltimore dropped by two-thirds in the first half of 2002, one of the ten largest declines nationwide.

The Annapolis market saw a dramatic increase in vacant office space, to over 16% at mid-year, but demand from defense contractors and others will drive it below 10% by the end of the year. The one area in the State that has seen falling vacancy rates is the area around BWI airport—a fall of 4.3 percentage points over the first half of the year to 14.6%. Demand by the defense industry and others should maintain a downward trend for vacancy rates in the area.

Similarly, industrial vacancy rates have been rising in most regions of the State. Speculative building has slowed, as businesses are increasingly desirous of build-to-suit. This has become a concern for biotechnology companies, which require expensive laboratory facilities. While many companies have outgrown their space at incubators, there is little space on the market since developers are concerned about the viability of the industry. Recently, a local development group has begun planning a facility of up to 45,000 square feet in Baltimore, which could be ready for occupancy in a year or two. Short of projects of this type, large amounts of space suitable for the industry will not be available for up to ten years, when planned bioscience parks at Johns Hopkins and the University of Maryland are completed.

As the economy recovers, however, and vacancy rates begin to decline again, demand for new office and industrial space will grow. Defense contractors and related firms will start the turnaround, which will be supported by continued State government projects. Should the National Harbor project in Prince George's County get off the ground, it would provide a substantial boost for construction—it would be the largest private project ever undertaken in Maryland.

A recent study by the Department of Business and Economic Development showed that Maryland lost 877 jobs in the construction sector between December 2001 and May 2002. The only region that gained jobs was Southern Maryland, likely due to the expanding federal presence at the Patuxent River Naval Air Station. The study indicates that construction will pick up in the second half of the year, with up to 250 jobs being added to the rolls. Although the housing market is expected to slow, partly as a result of an ever-shrinking amount of land available for development, the fact that vacancy rates will level off and perhaps decline and continued though weakening support from the public sector will result in growth of 2.0% in the construction sector in 2003 and 1.7% in 2004.



Transportation, Communication, and Public Utilities

One of the hardest hit industries in Maryland in 2002 has been the TCPU sector. The September 11 atrocities and the general economic conditions have resulted in perhaps lasting structural changes to the passenger air travel market, especially to business travel. As a result, USAirways and Midway Airlines have declared bankruptcy; United Airlines may soon follow, and American Airlines has cut 7,000 employees nationwide and dropped several routes. These airlines have reduced service at Baltimore-Washington International Airport, but others, notably Southwest and American Airlines, have filled the gap.

The presence of low-fare, thus-far profitable Southwest at BWI will continue to provide support for the growth of the airport, particularly as other airlines falter and restructure their routes and services. The airline has added a transcontinental flight from BWI, and recently announced ten more new flights daily, including a second transcontinental route. The airline will be claiming at least 26 of the 31 new gates under construction, allowing it to increase from the current 138 daily flights to almost 250 flights. Southwest has increased staffing at the airport by about 20% over the past year. Aer Lingus service will return March 28, 2003, with flights to Shannon five times a week. Delta, AirTran Airways and Skyway Airlines have all added flights over the past few months. Though suffering through the downturn affecting the entire transportation industry, BWI is particularly well-situated in relative terms and perhaps in absolute terms.

While BWI has performed beyond expectations with regard to passenger traffic, concerns have recently arisen over its cargo business. Complaints center around what is perceived as slow progress on the expansion of cargo facilities, particularly a \$3 million access road between the midfield cargo complex and a nearby terminal, along with cold storage facilities. As with passenger traffic, BWI is in competition with Dulles for cargo traffic. Last year, Dulles handled almost 730 million pounds of freight and mail, almost 50% more than BWI's just under 500 million pounds. In addition to these troubles, parts of the airport's expansion have been put on hold due to the State's budget problems. Generally, though, the expansion proceeds—a 3,000 space parking garage has opened, with another 3,000 spaces to be open shortly.

Like the airport, the Port of Baltimore has had dramatic successes over the past year but is also facing potential problems. On the upside, the roll-on/roll-off business continues to expand, with Honda, Ford, Hyundai, Porsche and Case New Holland inking new deals this year which will bring about 215,000 cars, SUVs and tractors through the port, creating about 400 jobs. This follows last year's substantial agreements—a 20-year contract with Wallenius Wilhelmsen Lines (roll-on/roll-off) and a 10-year agreement with Mediterranean Shipping Company (container) which created over 1,000 jobs and will support business at the port for years. The port is now the largest exporter of vehicles on the East Coast. On a smaller scale, other recent successes include the doubling of a molasses storage facility to 20 million gallons, adding several jobs; the \$20 million renovation of the Masonville automobile facility and the \$14 million renovation of the forest products warehouses at Dundalk; and the securing of \$3.6 million of federal funds to improve cargo screening capabilities.

Also like the airport, the ports have recently been criticized for being slow to take advantage of new opportunities (some attribute that perceived sluggishness to being a part of State government, rather than being operated as an Authority). This inability to act was most apparent when a parcel of land at Port Covington was sold for development as a Wal-Mart and Sam's Club—the land was next to Interstate 95 and has deep water channels. The port could not act quickly enough to raise funds, as it has to go through State budget or bond sale processes. Complicating matters, the Port Administration was subject to the State's hiring freeze and other cost containment measures—measures which are likely to recur over the coming eighteen months.

In addition to difficulties in raising funds for expansion, the port faces several other challenges over the coming years. Land around the port is becoming scarce; several existing customers including Wallenius would like to expand, and the port would like to bring in new business. Other developers, however, also find waterfront land near Interstate 95 desirable. A recent study indicated that there are 3,000 acres of land around the port that could be redeveloped for port or other use, so this issue could be resolved for the medium-term if the port gets increased flexibility. The Port Administration did acquire some additional land when the City abandoned some unused streets and transferred the land to the Port.

Access to the port, both by land and sea, may become an issue. While the harbor has a 50-foot deep channel in the harbor, the Chesapeake & Delaware Canal is only 35 feet deep. A plan to dredge the canal to 40 feet was suspended last year. Furthermore, the port may run out of dredging capacity in the next decade or so. As for rail in and around the port, Baltimore has been described as “the biggest choke point on the entire East coast.” An *Interstate 95 and Mid-Atlantic Rail Operations Study* has proposed almost \$1.8 billion of rail improvements for the Baltimore region to build and improve tunnels, connect some tracks, provide more double-track capacity between Baltimore and Washington, and to build new track. Given that almost one-third of cargo moving through the port is transported by rail, any improvements would benefit the port. Funding, however, will not be immediately forthcoming.

Telecommunications companies continue to be battered by a wide range of regulatory changes and falling prices. Long distance carriers such as AT&T, MCI and Sprint face increased competition as the four remaining Baby Bells, such as Verizon, increasingly win permission to offer long distance in their local service areas. Verizon has asked the Public Service Commission to allow it to offer long-distance service, but the PSC has not yet ruled in

the case. Meanwhile, the job base in the state is shrinking, with over 800 employees laid off over the past year—the vast majority of whom were laid off by WorldCom, 100 in Frederick and the remainder in Hunt Valley. Given the overcapacity problems in the industry, it seems likely that many of these individuals would have been laid off even without the scandals at WorldCom. Maryland had its own telecommunications accounting scandal when Network Technologies Group of Fells Point shut down abruptly in July, laying off all 125 employees.

All but one of the six largest cable television providers nationwide have faced severe financial difficulties, and several have admitted to accounting irregularities. Given recent restructuring and scandals in the cable TV industry, there has been little progress made in expanding cable telephony to compete with local phone companies. Lanham-based StarPower, a money-losing joint partnership of RCN and Pepco offering bundled telephone, cable TV and high-speed internet access, has been slow to expand in the last year after deciding not to offer service in Prince George's County.

The different strategies pursued by electric companies in Maryland are now beginning to show results, and they are not all good. Although all the regulated distribution companies are stable, the Maryland-headquartered utility holding companies, which opted to delve into energy trading and merchant energy businesses, are on the ropes, while out-of-state holding companies that focused on their core distribution functions are thriving.

Allegheny Energy, Inc., parent company of Allegheny Power, entered technical default on loans of approximately \$250 million after Moody's Investors Service downgraded its debt to junk status. Other ratings agencies quickly followed suit. Although mechanically the decline of Allegheny follows the Enron model, there have been no allegations of criminal or unethical conduct at Allegheny that could lead to the total collapse of the company. Allegheny is scrambling to line up additional credit and trying to get permission from the federal authorities to mortgage some of its assets to stabilize the company's finances. Allegheny also said it would cut operating expenses by \$45 million, and lay off 10% of its workforce.

Constellation Energy Group also struggled after an abortive effort late last year to spin off its BGE subsidiary. Constellation announced it would lay off about 900 workers and close its BGE Home appliance stores. An oversupply of electric power has caused Constellation to halt construction on several power plants, all outside the Mid-Atlantic region. After refocusing on its core utility business, however, Constellation managed to make a profit, although the company twice reduced its earnings projections for the year.

In contrast to the difficulties experienced by the Maryland holding companies, Pepco Holdings, Inc. (parent of Potomac Electric Power Company and Conectiv) and WGL Holdings, Inc. (parent of Washington Gas Light Company) are doing well. The Pepco-Conectiv merger, which created the largest electric distribution utility in the Mid-Atlantic region, was approved by all the federal and state agencies and closed on August 1. By abandoning the volatile electric supply market, staying out of energy trading and concentrating on its distribution services, Pepco has avoided the downturn experienced by Allegheny and Constellation.

Washington Gas Light purchased an insurance policy in 2000 to protect the company's profits in the event a warm winter suppressed natural gas sales. In October that policy paid out \$14.8 million, or \$6.3 more than the two years of premium payments the company made. The

outlook for the 2002-03 winter are for colder temperatures and higher gas prices. Faced with mounting losses from its energy-trading business, Williams Companies, Inc. managed to raise some much-needed capital by selling the Cove Point liquified natural gas terminal in Calvert County to Dominion Resources. Williams purchased Cove Point in 2000 for \$150 million and sold it to Dominion 27 months later for \$217 million. As Cove Point's capacity is fully subscribed, Dominion plans to maintain Williams' schedule to reopen Cove Point in early 2003 and increase storage capacity by 50% in 2004.

TCPU employment reached its zenith in 2001 at 117,800 jobs. The continuing fallout from deregulation of the electric industry, the travails of the airlines and the expected dismal performance of telecommunications companies for the foreseeable future will result in job declines of 3.2% in 2002. Modest growth will resume in 2003, primarily on the strength of BWI.



Retail and Wholesale Trade

As the third largest employment sector in the State behind services and government, the retail sector is very important to the Maryland economy. The immediate outlook for the retail sector in Maryland is stagnation, due primarily to the fact that consumer spending will slow as the refinancing boom levels off and debt burdens continue to increase. Retailers are expecting a slow holiday season at the end of 2002, a time when some stores rack up 25% or more of their annual sales.

Two major retailers succumbed to the Wal-Mart marketing and logistics juggernaut: K-Mart and Ames. Since January K-Mart has operated under Chapter 11 bankruptcy, closing 283 of its stores, including those in Aberdeen, Columbia, Forestville, Laurel, La Vale, Randallstown, and Waldorf. Ames shuttered all its retail operations in August, including twenty stores in Maryland, from Frostburg to Lexington Park to North East, eliminating 577 full-time and 678 part-time jobs. Ames was the third large retailer to go out of business in the last few years, following Montgomery Ward and Caldor.

Several big-name retailers are expanding their presence in the State, however. Construction started in January on the first phase of Ikea's new 1.7 million square foot U.S. distribution center in Perryville, Cecil County. When construction is finished in 2004 or 2005, it will employ 300 people. In February the company opened a 40,000 square foot customer care center in White Marsh, and the company is building its second Maryland store near College Park. That 340,000 square foot store is expected to employ 450 people when it opens. Apple Computer opened its first retail outlet in the State in Towson, employing over 20 people, and Barnes & Noble has filled the location of one of the defunct Bibelot bookstores in Owings Mills. Limited Brands is opening two women's health and beauty stores in Maryland to test the new upscale concept, and china-maker Lenox is expanding its Williamsport warehouse, creating an additional 70 jobs.

One of the most compelling retail success stories nationwide is Hampstead-based menswear retailer Jos. A. Bank Clothiers, which has seen rising sales, a 224 percent increase

in second quarter profits, and a stunning 220 percent increase in its stock price over the past year. The company will have opened 46 new stores in 2001 and 2002, and plans to add about 350 more over the next five years, at which point it will be operating about 500 outlets. In 2003, the company will also begin selling its clothes on the internet through Amazon.com. As it began and is based in Maryland, much of that expansion will be elsewhere. Nonetheless, Jos. A. Bank's success will be a boon to the State's economy.

Maryland continues to grow as a regional distribution center for the mid-Atlantic. Pier 1 Imports, an Ikea competitor, is increasing its warehouse space in Aberdeen by about 50% to over one million square feet and adding about 50 employees. Charming Shoppes, Inc. has purchased a distribution center in White Marsh and is expected to employ 150 people soon and another 130 within three years. Charming Shoppes operates several retail chains, the largest among them are Lane Bryant and Fashion Bug. Maryland also managed to retain Giant Food's fresh food distribution center which will move from a 45-year old facility in Landover to a new facility in Jessup, Howard County.

Prince George's County has been working hard to get retailers to enter or expand in the county. Before Bowie Town Center is completely built out, ground was broken on Boulevard at the Capital Centre in Landover. The retail development at the site of the arena that once housed the Washington Capitals and the Washington Bullets is expected to include 400,000 square feet of retail space and provide 750 jobs. At least some of the new center should be open by fall 2003. A mile away, the 110-acre former Landover Mall site is slated to become a mixed-use development property by its owner, Lerner Enterprises, including office, medical and retail space.

Maryland's retail sector is more at risk than that in many states due to a possible sharp decline in home values, which could cause consumers to cut back on spending. Both the Baltimore and Washington D.C. housing markets have been identified as highly overpriced. While that does not necessarily indicate a bubble exists, the presence of one is a possibility. After a decline of 0.8% in 2002, employment in the retail and wholesale sector is expected to remain stagnant in 2003, before accelerating to 0.9% growth in 2004 as consumers resume their spending.



Finance, Insurance and Real Estate

The finance, insurance and real estate sector has suffered with the economy as a whole, and has also been directly affected by both the plummeting stock market and the ongoing threat of terrorism, among other ills. Investment firms have struggled nationwide as the bear market has persisted for over 30 months. Partly in response, T. Rowe Price has been broadening its services as its profits have flattened. The firm is the steward of the State's \$529 college savings plan, has added a new class of shares for some variable annuities and funds targeted for 401(k)s to find new distribution channels, and created new funds aimed at those saving for retirement.

Others in the State's financial services firms are restructuring their services as well. Mercantile Bankshares has cut its personal wealth management unit by 30 positions, over 10% of the workforce, and has joined Wells Fargo in a joint mortgage and other consumer lending ventures, allowing it to eliminate another 20 or so jobs. The bank, along with Columbia Bancorp and Annapolis Bancorp, has been identified as one of the ten banks most at risk nationwide of having profits hurt by further interest rate cuts. Meanwhile, Maryland employment at the former Alex. Brown has been cut by about one-third to just over 1,000 over the past few years. Most of the lost jobs have been shifted by new parent, Deutsche Bank, to New York, leaving behind many low-paying processing positions, although 230 of those jobs were cut in June when Deutsche Bank closed its operations center in Timonium.

The currency trading scandal at Allfirst Financial led to its sale to M&T Bank of Buffalo. Allfirst employs 5,600 in the mid-Atlantic region, about half of them in Maryland. Since M&T's only Maryland presence is limited to Western Maryland, most Allfirst branch jobs would appear to be safe. M&T has, however, indicated plans to reduce Allfirst expenses by 17% primarily by cutting corporate overhead and combining back office operations, which may put Baltimore headquarters jobs at risk. Indeed, the company offered early retirement in August in hopes of eliminating 300 positions. Beginning in 2003, retirement health care benefits will be cut in half, and the company will not offer pension benefits to new employees (though it will contribute to 401(k) plans). Also potentially at risk are the 46 people who work for Ark Funds, Allfirst's \$6.7 million mutual fund line.

Allfirst, Mercantile and Deutsche Bank aren't the only banks in the State looking to cut costs. The Bank of America has laid off about 60 people from its Baltimore City offices, following another dozen positions eliminated in January. On the other hand, Morgan Stanley is opening a processing center in Baltimore as part of a decentralization plan following September 11, creating 150 jobs in Fells Point.

The insurance sector is currently in a state of suspended animation, as the outcome of the pending sale of CareFirst Blue Cross/Blue Shield to WellPoint Health Networks is not at all certain. Included in the proposed deal was a provision that would place WellPoint's southeast regional headquarters in Owings Mills, where CareFirst is currently headquartered. A competing proposal for CareFirst by Trigon Health Care, which some reports have indicated was a better overall package for the State, would eliminate the Owings Mills headquarters and presumably many jobs. In either case, job cuts seem probable. The merger is currently under review by the Maryland Insurance Administration, will likely face review by the General Assembly, and in any case will certainly be restructured by the two companies before it is finalized.

All insurers are currently facing the difficulties caused by the declining equity markets. The impact of the bear market on variable annuities has caused customers to move to other, less profitable products. At the same time, investment income for insurers has turned, in many cases, into investment losses, compounded by large underwriting losses in 2001. Some of these losses relate to medical malpractice cases. Princeton Insurance Company, one of the largest malpractice and workers' compensation insurers in the State, is considering pulling out of the market, as it has recently pulled out of the medical malpractice market in Pennsylvania. St. Paul Cos., with 800 employees in Maryland, has stopped issuing malpractice insurance

nationwide. Only 14 insurers were offering health insurance to Maryland small businesses, fewer than half of the 37 companies offering such coverage in 1995.

The news has not been all bad for insurers in the State; Allstate Insurance expanded its presence in the State by consolidating regional offices, which will retain 470 jobs and create up to 160 more. Sierra Military Health Services, based in Baltimore, renewed a \$1 billion managed care contract with the Department of Defense, keeping about 500 jobs downtown. Dependent upon a successful bid on a new Defense contract next year, Sierra could expand dramatically—up to 1,500 additional jobs.

Despite the difficulties in this sector, average salaries for professionals in the finance industry rose by 7% in 2002. Employment in this sector, however, will decline by 0.7% in 2002. As the economy and markets recover, this sector is expected to grow modestly in 2003 and to grow at a 1.5% rate in 2004.



Services

The service sector is the largest in the State, and through the late 1990s was by far the largest engine of employment growth. The national recession brought booming growth to an end as a result of its impact on the business services sector, the largest component. Employment in business services declined by 4.6% in 2001, and the loss will increase to 6.7% in 2002. All other components, health services, education services, and professional services, have grown throughout the recession and will continue to do so, but the sharp decline in business services in 2002 will result in no growth for the year for Maryland's service sector.

Nationwide, one of the most prominent stories from the service sector was the demise of Arthur Andersen as a result of its discredited accounting for Enron. Locally, Andersen lost a number of prominent business clients in the first half of the year, including Jos. A. Bank Clothiers, Host Marriott, F&M Bancorp, and Digex. Ultimately, Ernst & Young absorbed Andersen's accounting operations in Baltimore, along with many of Andersen's clients, becoming the largest accounting practice in Baltimore. About half of Andersen's 200 Baltimore employees, however, did not make the transition.

The State had been a regional hotbed of internet services, but the dot-com crash has calmed the excitement. Digex, which provides e-commerce hosting services, laid off 86 people in July after removing its CEO, and a further 200 positions in August, most from its Beltsville headquarters. USinternetworking, an applications service provider which emerged from bankruptcy protection in May, is looking to sell 20,000 square feet of its Annapolis office space. USi will have reduced its Annapolis space by 35% over the past year. A recent \$80 million investment by Bain Capital Partners and merger with North Carolina-based Interpath will keep the company afloat with its 520 employees, although a recently announced shareholder lawsuit may prove to be an obstacle to profitability.

Rockville-based Manugistics, the software developer, cut more than 140 jobs in the second quarter despite acquiring the operator of a website for bidding on transportation contracts. The company will likely cut up to 160 more positions by the end of the year. On the other hand, 4GL School Solutions, an offshoot of 4GL Software Solutions, won contracts this year with the Oklahoma City and Milwaukee school districts to track special education students. The company has 150 employees, more than doubling in the past year, and has reaped over \$11 million worth of contracts from December to April alone. The company anticipates doubling employment again over the coming year.

Other more mundane service companies have been expanding in the region. U.S. Lawns, a national landscaping and maintenance chain focusing on homeowners' associations, apartments and other business properties, is looking to place up to seven franchises in the Baltimore area. A Baltimore nonprofit that employs disabled workers won a federal contract for custodial services at the five-building Fallon Federal Complex, will employ about 30 individuals.

Business services employment actually declined by 9.1% from July of 2001 to July of 2002. The turnaround may have begun, as temporary help and placement services indicate growing demand. This will help growth in this category directly, and also bodes well for the near-term future of the economy as a whole.

Professional services look poised to bounce back strongly. A number of firms are opening or expanding their presence in the State. O'Neal Incorporated, an architecture, engineering and construction management firm focusing on pharmaceutical businesses, is doubling its office space and increasing employment from 13 to 20. Vanderweil Engineers of Boston is opening a Baltimore office, initially with two partners and support staff, with the potential to grow to up to 30 positions over the next three years. The firm has worked with the Peabody Institute, the Maryland State Police Crime Laboratory, Fort Detrick and the Institute for Genomic Research. They will be joined in opening a Baltimore office by Hill International, a construction consulting firm, which will start business with a handful of employees. These firms see opportunity in a market that has caused the Baltimore headquarters of RTKL Associates, an international architecture, planning and engineering firm, to lay off 15 of its employees in the region--despite securing a \$1.6 million contract to help rebuild the Pentagon.

Other service companies are experiencing increased business from the newfound focus on defense. Bethesda-based Counter Technology (aviation security), Baltimore-based Argus Security and General Alarm (video surveillance), and Silver Spring's Global Investigative Services (personnel investigation) and Network Engineering & Resources Development Specialists (computer network security) all expect substantial increases in demand—up to 25 percent or more. The influx of federal funds and substantial private sector demand will keep companies of this sort growing for the foreseeable future.

After two nearly flat years in 1999 and 2000, health services grew by a strong 2.5% in recessionary 2001. As six of the State's twenty-five largest employers are in the health services industry, the performance of this sector directly affects the health of the State economy. The State is host to three of the top medical research centers worldwide—the National Institutes of Health, Johns Hopkins and the University of Maryland. As biological and radiological terrorist threats have become a focus over the past year, these institutions stand to gain research funds and employment in the near future. Gains to the sector due to the unstable

international situation have already occurred—Columbia-based Meridian, a provider of cardiac testing and drug delivery devices, has sold \$7.8 million of homeland security products to the United States military in the last year, almost eight times more than its combined 2000 and 2001 sales. General Physics Corporation, headquartered in Elkridge, has secured a contract with Tennessee to assess the readiness of 160 hospitals in the State for a bioterrorism attack. Johns Hopkins Medicine created an Office of Critical Event Preparedness and Response, which will assist all Johns Hopkins institutions in preparing bioterrorism plans. The office will cost \$2.8 million to sustain; Johns Hopkins Hospital plans to spend another \$7 million on bioterrorism preparedness.

In an effort to stem the tide of red ink, two Baltimore hospitals have teamed up with federally funded community health centers to take over their primary care facilities (the centers can recoup more funds from the federal government than can the hospitals). This move will reduce the roughly \$2 million annual losses of both Sinai Hospital and Mercy Medical Center. At least three other hospitals are considering similar moves. But the largest problem facing hospitals, as well as other health care providers, is the ongoing nursing shortage—an estimated 15% of nursing jobs in the State are unfilled. To address this problem, the Institute for Johns Hopkins Nursing has enhanced its program to provide increased educational and career opportunities for nurses. Coppin State and other colleges around the State, including community colleges, are expanding programs to help fill the void.

Led by growth in health services and helped by the resumption of growth in business services, the service sector looks to expand by 1.8% in 2003, followed by 3.0% growth in 2004, when this sector will reclaim its recent role as best performing in the State's economy.



Government

Employment in the public sector remains a bulwark of the State's economy. Public employment is now 18.2% of all employment in the State, the second largest sector of the economy after services. The proportion of Maryland jobs in the public sector remains higher than the national average of 15.8%. Total growth in government employment is expected to be 1.0% for 2002, with federal, state and local government employment all contributing to the increase. In fact, the government sector may be the only sector that actually expands during 2002. The outlook is not quite so bright, however, as growth will slow in 2003 and 2004 as a result of the State's fiscal problems.

Local government employment will continue to grow. 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 required. Direct intergovernmental transfers from the State to local governments amounts to over \$3.5 billion annually, but local governments may feel pressure on their budgets as State tax revenues slow and the possibility of reduced transfers from the State increases. Increases in property tax revenues from higher property values will offset other losses, but not at a rate sufficient to avoid slowing employment growth.

Likewise, State employment has continued to grow, but growth will slow in the coming years. The fiscal year 2003 budget authorized 903 additional State positions, bringing the total to 82,951. The position increases are primarily in the judiciary where the State assumed responsibility for law clerks and standing masters in the circuit courts. There were also substantial increases in higher education and transportation. These three areas comprise 70% of the increase in authorized positions. In September the Governor announced a "hard" hiring freeze, though with exceptions. It is currently expected that State employment will increase only very slightly in 2003 and 2004, though the situation is very fluid.

Federal spending and civilian employment are expected to grow by just under 2.5% annually in the near future. As commonly predicted last year, attempts to balance the federal budget have essentially been abandoned as spending has increased for security, military operations, and economic stimulus programs. Furthermore, the Republicans promised to make the tax cuts enacted in 2001 permanent when they gain control of Congress, although 107th Congress has all but adjourned without doing so. This will likely be on the agenda for the 108th Congress that begins in January 2003. While this lack of fiscal control is damaging to the federal coffers, assuming the benefits of the tax cuts and spending continue to fall disproportionately in the national capital area, it is good for Maryland's economy and State budget. Recent continuing resolutions have held federal expenditures at last year's levels; the recent elections may preclude a lengthy budget standoff in the upcoming lame duck session, which most likely will ensure strong gains in federal employment for the State.

The response to September 11 will, in addition to making the nation more secure, also provide direct benefits to Maryland's economy. By all accounts except the official ones, the National Security Agency is Maryland's largest employer. No doubt, if numbers were public, the NSA would be seen to have pulled further ahead. Federal defense spending will provide a large boost to the economy over the coming years. Total procurement spending will increase by 9.5% in federal fiscal year 2003. Research, development, testing and engineering expenditures will increase by 9.3%, and personnel costs will increase by 11.2%. Maryland ranks seventh in the nation in defense procurement spending as a percentage of gross domestic product, and is eighth in military payrolls. In overall military spending, Maryland ranks sixth. These factors will provide large direct and indirect benefits to Maryland businesses and consumers alike.

Government employment is expected to remain essentially flat in 2003 and 2004, with slow growth in federal and local employment offsetting declining to flat state government employment.



Agriculture

Uncooperative weather and the tobacco buyout program will make 2002 one of the worst years in the last decade for Maryland crops. Soybean production is expected to be 47.2% below the 2001 harvest, and corn will be down 40.5%. The barley yield will be up to near the record, but the number of acres planted was the lowest since 1938, leaving overall

production down 7.9%. Tobacco yields are also expected to be good by historical standards, but overall production down 27.0% as the tobacco buyout program has dramatically reduced the number of acres in production. Tobacco production is now 2.4 million pounds, about 20% of its 1994 level, and only 5.1% of the record high level of 46 million pounds in 1946. 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.

After falling steeply in 2000, broiler chicken sales, measured in dollar terms, grew rapidly to \$553 million in 2001. Broilers account for 35% of Maryland's agricultural cash receipts. Cash receipts from cattle, milk, and hogs also increased by 6.4% between 2000 and 2001.

The contribution of the Chesapeake Bay to the dinner tables of Americans continues to decline as drought, pollution, over-harvesting, and disease all contribute to lower the volume of food taken from the Bay. All commercial landings were down 54.0% by weight and 52.3% by value. The 2002 oyster harvest was the lowest since 1993-94 as record droughts and record disease levels battered the oyster population. The new Chesapeake Bay agreement seeks to increase the oyster population ten-fold by 2010. If successful, commercial harvests may rise, but no increase is expected in the immediate future. Rockfish landings were down 42% in 2002, the third year of significant declines. Commercial catches of other fin fish was down by 46%.

After several consecutive years of employment growth exceeding 2.5%, the recession resulted in growth in the State of only 0.8% in 2001. As the recession's full impact reaches Maryland in 2002, employment will actually decline by 0.6%. Led by construction, services, and federal and local governments, growth will resume in 2003 at a 1.0% annual rate. As the national economy experiences a full year of growth in 2004, with businesses investing again and as consumers' concerns about the economy and their jobs recede, employment growth in the State will spring up to 1.6%.

Table 2
Forecast of the Maryland Economy

	1998	1999	2000	2001	2002	2003	2004
Total Non-Farm Employment (000)	2,325.3 2.5%	2,386.2 2.6%	2,448.9 2.6%	2,469.6 0.8%	2,453.7 -0.6%	2,477.0 1.0%	2,515.8 1.6%
Total Personal Income (\$ Millions)	158,502 6.5%	167,246 5.5%	180,353 7.8%	189,142 4.9%	196,814 4.1%	205,499 4.4%	216,353 5.3%
Wages and Salaries	81,618 7.1%	87,121 6.7%	93,904 7.8%	98,791 5.2%	102,595 3.9%	106,811 4.1%	113,139 5.9%
Proprietors' Income	8,479 4.2%	9,621 13.5%	10,206 6.1%	10,611 4.0%	10,944 3.1%	11,682 6.7%	13,021 11.5%
Dividends, Interest and Rent	30,994 9.0%	31,390 1.3%	34,167 8.8%	34,931 2.2%	35,474 1.6%	36,032 1.6%	37,120 3.0%
Transfer Payments	16,248 2.0%	16,926 4.2%	17,740 4.8%	19,257 8.5%	21,099 9.6%	22,466 6.5%	22,800 1.5%
Capital Gains	7,817 16.5%	9,313 19.1%	11,294 21.3%	5,647 -50.0%	4,518 -20.0%	4,066 -10.0%	4,473 10.0%
Unemployment Rate (%)	4.5	3.5	3.9	4.1	4.5	4.4	4.0
Housing Starts (units)	32,912 20.1%	30,779 -6.5%	30,510 -0.9%	30,659 0.5%	31,735 3.5%	32,052 1.0%	32,440 1.2%

Bureau of Revenue Estimates, December 2002



General Fund Revenues

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

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

Table 3 shows detail on general fund and selected special fund revenue sources for fiscal years 2002 through 2004. 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 2002 - 2004

\$ Thousands	GENERAL FUND			SPECIAL FUND			TOTAL		
	Fiscal Year	Fiscal Year	Fiscal Year	Fiscal Year	Fiscal Year	Fiscal Year	Fiscal Year	Fiscal Year	Fiscal Year
	2002 Actual	2003 Revised Estimate	2004 Estimate	2002 Actual	2003 Revised Estimate	2004 Estimate	2002 Actual	2003 Revised Estimate	2004 Estimate
INCOME TAXES									
Personal	4,771,649	4,807,169	5,081,669				4,771,649	4,807,169	5,081,669
Corporation	273,235	323,262	330,051	85,468	107,754	110,017	358,703	431,016	440,068
Total	5,044,884	5,130,431	5,411,720	85,468	107,754	110,017	5,130,352	5,238,185	5,521,737
SALES AND USE TAXES	2,642,477	2,730,274	2,850,795	35,447	22,932	23,728	2,677,924	2,753,206	2,874,523
STATE LOTTERY RECEIPTS	414,063	431,991	448,385	78,789	73,933	75,501	492,852	505,924	523,886
TRANSPORTATION REVENUES									
Motor Vehicle Fuel Tax	12,266	12,349	12,608	691,268	699,251	713,992	703,534	711,600	726,600
Motor Vehicle Licenses, Fees				372,996	379,013	383,823	372,996	379,013	383,823
Motor Vehicle Titling Tax				650,210	653,000	674,000	650,210	653,000	674,000
Maryland Transit Fees				96,632	100,658	102,105	96,632	100,658	102,105
Maryland Port Fees				77,067	83,147	83,062	77,067	83,147	83,062
Maryland Aviation Fees				123,790	116,414	131,697	123,790	116,414	131,697
Total	12,266	12,349	12,608	2,011,963	2,031,483	2,088,679	2,024,229	2,043,832	2,101,287
PROPERTY TAXES, FRANCHISES, ETC.									
State Real and Personal Property Tax				170,009	282,504	301,070	170,009	282,504	301,070
Property Transfer Tax	--	47,269	47,269	122,414	68,265	68,939	122,414	115,534	116,208
Business Franchises and Filing Fees	145,180	154,843	158,017				145,180	154,843	158,017
State Tobacco Tax	209,887	211,778	275,566	--	80,524	--	209,887	292,302	275,566
Tax on Insurance Companies	193,718	209,544	215,818				193,718	209,544	215,818
Alcoholic Beverages Excises	25,747	26,172	26,598				25,747	26,172	26,598
Death Taxes	184,725	146,581	149,925				184,725	146,581	149,925
Clerks of the Court	42,634	48,888	45,845				42,634	48,888	45,845
District Courts	72,592	71,168	70,456				72,592	71,168	70,456
Hospital Patient Recoveries	97,788	61,393	73,927				97,788	61,393	73,927
Interest on Investments	71,510	42,877	45,076						
Miscellaneous Fees, Other Receipts	198,598	198,730	211,306						
Total	1,242,378	1,219,243	1,319,803						
Total Current Revenues	9,356,068	9,524,288	10,043,311						
Transfers	119,465	--	--						
Tax Amnesty	28,509	--	--						
Heritage Structure Rehabilitation Credit ¹	--	(51,600)	(31,700)	--	(2,000)	(1,200)			
GRAND TOTAL	9,504,042	9,472,688	10,011,611						

Notes: Includes all general fund revenues, all Transportation revenues and selected special fund taxes.

In conjunction with Appendix B of the Fiscal Year 2004 Budget Book, this table will comprise the official estimate of total state revenues.

¹ Not separately stated for fiscal year 2002; see Appendix A.

Table 4
Maryland General Fund Revenues
 Fiscal Years 2000 - 2004

\$ Thousands	FY 2003						
	FY 2000 Actual	FY 2001 Actual	FY 2002 Actual	Official Estimate	Revised Estimate	Difference	2004 Estimate
INCOME TAXES:							
Personal	4,746,341	5,133,726	4,771,649	5,071,993	4,807,169	(264,824)	5,081,669
Corporation	319,454	374,397	273,235	302,271	323,262	20,991	330,051
Total	5,065,795	5,508,123	5,044,884	5,374,264	5,130,431	(243,833)	5,411,720
SALES AND USE TAXES	2,478,539	2,626,775	2,642,477	2,767,476	2,730,274	(37,202)	2,850,795
STATE LOTTERY	367,763	385,045	414,063	430,029	431,991	1,962	448,385
FRANCHISES, EXCISES, LICENSES, FEES:							
Business Franchise Taxes	178,688	169,008	145,180	168,609	154,843	(13,766)	158,017
Tax on Insurance Companies	172,491	190,397	193,718	196,772	209,544	12,772	215,818
Insurance Licenses and Fees	--	--	--	--	--	--	--
Death Taxes	157,039	168,803	184,725	159,828	146,581	(13,247)	149,925
Property Transfer Tax	--	--	--	47,269	47,269	0	47,269
Tobacco Tax	210,012	205,636	209,887	212,949	211,778	(1,171)	275,566
Alcoholic Beverages Excise Tax	24,399	24,522	25,747	24,997	26,172	1,175	26,598
Motor Vehicle Fuel Tax	11,275	11,984	12,266	12,076	12,349	273	12,608
District Courts	70,349	69,606	72,592	72,058	71,168	(890)	70,456
Clerks of the Court	37,713	39,534	42,634	38,619	48,888	10,269	45,845
Hospital Patient Recoveries	102,113	66,221	97,788	63,886	61,393	(2,493)	73,927
Interest on Investments	128,391	140,588	71,510	70,259	42,877	(27,382)	45,076
Miscellaneous	215,552	196,191	198,598	177,817	198,730	20,913	211,306
Total	1,308,022	1,282,490	1,254,644	1,245,139	1,231,592	(13,547)	1,332,411
Total Current Revenues	9,220,119	9,802,433	9,356,068	9,816,908	9,524,288	(292,620)	10,043,311
GAAP Transfer	--	--	119,465	--	--	--	--
Tax Amnesty	--	--	28,509	--	--	--	--
Heritage Structure Rehabilitation Credit ¹	--	--	--	--	(51,600)	(51,600)	(31,700)
GRAND TOTAL	9,220,119	9,802,433	9,504,042	9,816,908	9,472,688	(344,220)	10,011,611

¹ Not separately stated for fiscal year 2002; see Appendix A.



Individual Income Tax

Due to a weak economy and plummeting capital gains, general fund individual income tax revenues declined by 7.1% in fiscal year 2002. Baseline revenue growth, excluding the impact of the continued income tax reduction began in tax year 1998 and other tax changes, would have been -4.8%. The toll of the recession and the capital gains decline had been expected; growth of -0.4% for fiscal year 2002 was forecast. The recession, however, dragged on longer than expected—in Maryland if not nationwide—and the capital gains slump was significantly larger than had been expected. Growth will resume in fiscal year 2003, if for no other reason than that capital gains will now be so small as a percentage of taxable income that they will have a negligible impact on revenues even if they decline substantially again.

Income tax growth over the past few years has been dramatically affected by the stock market bubble of the late 1990s and the resultant growth in realized capital gains. From 1990 to 2000, realized gains grew at an average annual rate of 18.5%, greatly exceeding the long-term average growth rate of about 11%. After the collapse of the bubble in 2000, and the spike in realizations that the collapse occasioned, gains declined by an estimated 50% in 2001. This drop brought the average annual growth rate from 1990 to 9.6%, below the long-term average. More importantly, it eliminated over \$5 billion of potentially taxable income.

With the stock market down substantially on the year—the S&P 500 is down about 20% and the NASDAQ is down about 30%—capital gains are virtually certain to decline again in tax year 2002 (although there is not a direct relationship between the markets and realized capital gains). Unless the market picks up substantially over the next two weeks, 2002 will mark the third consecutive year of decline; the performance of stocks over that period will be of historic proportions, worse even than the bear market of 1929 to 1932. Most market observers expect some period of stagnation before sustainable growth resumes. After a decline of 20% in 2002 and a further 10% decline in 2003, realized gains are expected to resume growth in the range of the long-term average, estimated at 10%.

The bubble supercharged revenue growth during the late 1990s, which averaged 8.1% even after the impact of the tax cut. The revenue decline in fiscal year 2002 was largely attributable to the drop in capital gains realizations; now that the excesses of the late 1990s have been wrung out of the system, income tax revenue growth will more closely match the growth in personal income over the coming years. One risk to the income tax forecast is the extent to which taxpayers will be able to carry forward 2001 losses (and perhaps 2002 as well), against both future year capital gains and up to \$3,000 of other income. If there is a sizable pool of such losses, revenue growth will be restrained for at least one year.

Maryland employment is expected to decline by about 0.7% in 2002, bottoming out in the third quarter. Despite the decline in employment, personal income will grow by 4.1%, and wages and salaries by 3.8%—Marylanders who kept their jobs experienced reasonable income growth over the course of the year, given the recession. While employment growth will rebound in 2003 to 1.0%, personal income growth will not bounce back as strongly as businesses try to

improve profitability. Nonetheless, income tax withholding will rebound from 3.4% growth in fiscal year 2002 to 4.3% in 2003, and, as the State economy fully recovers from the recession, a more normal 5.7% growth in 2004 (average growth in withholding since 1990, including the early 1990s recession, is 6.0%).

Estimated income tax payments are forecast to drop by 5.8% in fiscal year 2003, following a 13.7% decline in fiscal year 2002. These payments are, to a large degree, the mechanism through which income taxes on capital gains are paid. As the market bubble developed and capital gains grew at rates twice or more the long-term average, estimated payments increased in importance. In fiscal year 1995, these payments were 13.0% of net income tax collections. By fiscal year 2001, estimated payments totaled 15.4% of net collections, the highest level on record. The declines in 2002 and 2003 will bring estimated payments back to 12.9% of net collections, slightly below the 20-year average of 13.6%. As taxpayers bring their estimated payments in line with current-year liability, these payments will begin to grow again in fiscal year 2004, at 1.7%.

The decline of capital gains and the demise of stock options has caused all non-withholding (estimated payments, final payments and refunds) income tax payments to become much less important to overall collections. Between 1980 and 1997, withholding accounted for 92.9% of net collections. As capital gains and stock options grew in the late 1990s (tax is not withheld from some types of options), withholding's share of net collections fell to a low of 86.4% in fiscal year 2001. The estimated 50% decline in capital gains brought withholding back to 93.6% of collections in fiscal year 2002; that share is expected to rise slightly in fiscal year 2003.

There have been significant changes to the income tax over the past five years, most importantly the phased-in five-year income tax reduction, which is fully effective beginning in fiscal year 2003. Other major State changes include the refundable earned income credit and the heritage structure rehabilitation tax credit (see Appendix A). Many federal income tax changes have an impact on State revenues, although the General Assembly took action in 2002 to reduce the impact of some of those federal changes. Baseline growth for the income tax is forecast at 1.9% in fiscal year 2003, following the 4.8% drop in 2002. In fiscal year 2004, when capital gains will no longer be a drag and strong personal income growth resumes, baseline growth of 5.3% is estimated. Actual general fund revenues will grow by 0.75% in 2003 to \$4,807.2 million, and by 5.7% in 2004 to \$5,081.7 million.

Table 5
Individual Income Tax Revenues
 Fiscal Years 2001 - 2004
 (\$ in thousands)

	<u>2001 Actual¹</u>	<u>2002 Actual^{1,2}</u>	<u>2003 Revised Estimate</u>	<u>2004 Estimate</u>
Gross Receipts (State & Local)				
Withholding	7,370,100	7,617,716	7,945,107	8,395,533
Estimated Payments	1,315,923	1,135,737	1,070,091	1,088,335
Payments with Final Returns	1,008,522	794,297	727,996	714,875
Fiduciary	87,538	73,148	66,664	66,399
<hr/>				
Total Gross Receipts	9,782,083	9,620,898	9,809,858	10,265,142
Refunds	(1,251,391)	(1,485,281)	(1,522,278)	(1,539,771)
<hr/>				
Baseline Net Receipts	8,530,692	8,135,617	8,287,580	8,725,371
Loss from Federal Changes ³	(15,990)	(12,590)	(33,090)	(36,190)
<hr/>				
Net Receipts, State & Local	8,514,702	8,123,027	8,254,490	8,689,181
Local Reserve Account	(3,036,627)	(2,902,770)	(2,957,477)	(3,113,706)
Income Tax Check-offs	(1,088)	(1,244)	(1,000)	(1,000)
<hr/>				
Net Receipts	5,476,987	5,219,014	5,296,013	5,574,475
State Tax Cut/Other Changes ⁴	(343,261)	(447,365)	(488,844)	(492,806)
<hr/>				
Net General Fund	5,133,726	4,771,649	4,807,169	5,081,669

¹ For FY 2001 and FY 2002, the income tax components in the absence of the tax cut have been estimated and the estimated tax cut deducted to arrive at actual general fund revenues.

² Excludes \$26,678,789 from the 2001 tax amnesty.

³ Does not include induced capital gains receipts, which are included in gross receipts.

⁴ Includes the refundable earned income credit and heritage structure rehabilitation tax credit, among others.



Corporate Income Tax

Corporate income tax revenues were hit from both ends in fiscal year 2002. The recession hit corporate profits hard, with declines in every quarter from the third quarter of 2000 to the second quarter of 2002. As a result, gross receipts fell from a record high \$611.0 million in 2001 to \$506.4 million, a drop of 17%. At the same time, refunds increased from an already-record high \$118.4 million in 2001 by 22% to \$144.9 million. The result was a decline in net collections of 27%, from \$492.6 million to \$361.6 million.

As the economy recovers and, with it, corporate profits, gross collection are expected to improve. Through the year, corporations make estimated income tax payments. These payments are generally based on current earnings, but with an eye towards total tax liability at the end of the year. The forecast calls for growth in gross collections of 18%, to \$594.2 million. At the same time, refunds, which are affected by misestimating year-end liability when calculating estimated payments and also by net operating losses (which can be carried back to prior tax years or forward to future tax years), are expected to grow beyond fiscal year 2002's record level to \$163.2 million.

Corporate income taxes are very volatile in the best of times; the recession, changes to State and federal tax law and the deregulation of the electric generation industry make this revenue source even more volatile. Although the forecast calls for growth of 18% in gross receipts and 20% in net receipts when profits have yet to start growing again, net receipts through the first four months of the fiscal year have grown by 75.5%; excluding extraordinary payments, the growth is still a startling 34%. For the rest of fiscal year 2003, net receipts will have to grow by 10% to meet the estimate. The improving economy in fiscal year 2004 will result in growth of 2% in net receipts.

Table 6
Corporate Income Tax Revenues
 Fiscal Years 2001 - 2004
 (\$ in thousands)

	<u>2001 Actual</u>	<u>2002 Actual¹</u>	<u>2003 Revised Estimate</u>	<u>2004 Estimate</u>
Gross Receipts	611,000	502,605	594,188	600,186
Refunds	(118,403)	(144,854)	(163,172)	(160,118)
<hr/>				
Net Receipts	492,597	357,751	431,016	440,068
Transportation Trust Fund ²	(52,778)	(38,342)	(107,754)	(110,017)
Department of Transportation	(65,423)	(46,174)	-	-
<hr/>				
Net to General Fund	374,396	273,235	323,262	330,051

¹ Excludes \$3,807,565 from the 2001 tax amnesty.

² The distribution to the Transportation Trust Fund was simplified by the 2002 General Assembly.



Sales and Use Taxes

Sales and use taxes comprise over 25% of general fund revenue. Over two-thirds of sales taxes result from sales of consumer goods; growth of the sales tax is therefore closely tied to consumer spending. The remainder is paid by businesses, particularly utility and construction-related businesses. Sales and use taxes are divided into six major categories—consumer, construction, capital goods, utilities, assessment collections and refunds.

Sales tax revenues in fiscal year 2002 were affected by general economic conditions, by the September 11 terrorist atrocities, and by several one-time legislative changes. Following three years of growth at 6% or more, fueled to a large degree by the market bubble but also by substantial gains in personal income, general fund sales tax growth slumped to a meager 0.9% as the recession reached Maryland in fiscal year 2002. The consumer and construction sectors maintained growth, as consumers have continued to spend throughout the slowdown and low interest rates have kept housing starts high. The capital goods and utility categories both declined rather precipitously, the only declines in these categories since the early 1990s. Both revenue sources suffered from the drop-off in business investment, which in itself precipitated the recession.

In fiscal year 2003, the consumer segment is expected to accelerate modestly, from 3.0% growth to 3.3% growth, as the economy recovers. Although growth in the first quarter of the fiscal year was relatively strong (4.5% after legislative changes), it was in comparison to a particularly weak period last year, including the month of September. In some respects, notably the short holiday shopping season, ever-increasing Internet commerce, and most importantly the uncertainty of potential war, the remainder of the year is likely to suffer in comparison to last year. Nonetheless, taxes collected through consumer expenditures will increase by 3.3% to \$1,874 million in fiscal year 2003, and by a further 4.0% to \$1,948.5 billion in fiscal year 2004 as employment and income growth, and therefore consumer confidence, achieve levels reflective of a healthy economy.

Sales tax revenues arising from construction activity grew by 4.5% in fiscal year 2002, but growth is expected to be nearly flat in 2003. While housing starts are still increasing, most other aspects of the construction industry are likely to have a difficult time during the fiscal year. Vacancy rates have nearly doubled in large parts of the State, dramatically slowing the construction of office and industrial space. Though public construction projects planned and funded in the late 1990s will continue, additional projects are likely to be relatively scarce due to the State's fiscal problems. And while new houses continue to go up, growth in homeowners' expenditures on renovating their current abodes will remain at a relatively low level.

These factors will result in 0.4% growth in fiscal year 2003, to \$391.3 million, and as the economy recovers (and, more directly, as increasing demand for office space by defense-related companies in the BWI Airport and Annapolis areas brings about a resumption of new

construction), growth in these revenues will improve to 4.3% in fiscal year 2004, to \$408.2 million.

Sales taxes from utilities declined by 6.2% in fiscal year 2002. This decline results directly from plummeting levels of business investment, though in the case of utilities some of the decline is also a result of general business activity slowing during the recession, resulting in slower growth in energy consumption. As the economy recovers, sales taxes from industrial and commercial energy consumption will rebound from a 6.8% decline in fiscal year 2002, growing at roughly 3% over the forecast period.

The 6.2% decline in utility sales taxes would have been worse if not for the continuing double-digit increase in cellular telephone usage (which is taxable), and the expansion of wireless infrastructure. The heady years leading to the turn of the century, when growth in communications-related sales taxes averaged over 20% for nine years, will not be repeated. That growth resulted from what has been termed one of the most egregious misallocations of capital in the modern economy—the massive over-investment in fiber optic cable, switches and related equipment. The rapidly expanding cellular communications market will provide whatever growth exists in the communications subcategory until that excess capacity is absorbed. Growth in this subcategory is estimated at 2.4% in fiscal year 2003 and 0.6% in 2004. Altogether, the utilities category will grow at a modest 2.5% in fiscal year 2003, slowing to 1.6% growth in the next fiscal year, for revenue of \$226.0 million and \$229.6 million, respectively.

Nonresidential investment has declined every quarter since the fourth quarter of 2000, resulting in a record 9.9% decline of sales tax revenue from sales of capital goods in fiscal year 2002. The decline has slowed every quarter in 2002, however, and was nearly flat in the third. This trend reflects the fact that depreciation has taken its toll, and even if businesses are not investing for expansion or increased productivity, and will not be any time soon, they must replace equipment that is wearing out. Coupled with the fact that much of the computer hardware put in place leading up to Y2K is approaching obsolescence, and so spending on hardware is set to increase over the next year, revenues from this category are forecast to increase, but not until fiscal year 2004. Fiscal year 2003 will see a slight decline to \$252.9 million, before increasing by 10.3%, as businesses catch up from the nearly three-year period of slow investment, to \$279.1 million.

Sales tax assessments totaled \$21.2 million in fiscal year 2002, rather higher than in recent years due to the 2001 tax amnesty. Assessments will fall back to an estimated \$19.8 million in fiscal year 2003, though there is a risk that with the State's worsening fiscal condition and the ongoing hiring freeze, the number of audits may fall. Refunds are expected to remain constant in fiscal year 2003, at \$21.7 million, before increasing to \$22.7 million in 2004. Beginning January 1, 2002, all sales tax collected from short-term vehicle rentals was distributed to the Transportation Trust Fund (TTF), an increase from the 45% distribution previously received. Due to the State's budget problems, the old 45% distribution was resumed effective July 1, 2003. Thus, the distribution of sales tax revenues to the TTF will decline from \$35.4 million in fiscal year 2002 to an estimated \$22.9 million in 2003, then resuming normal growth to \$23.7 million in 2004.

After adjustments for legislative changes, assessments, refunds and the TTF distribution, general fund sales and use tax receipts are expected to increase by 3.0% in fiscal year 2003 to \$2,730.3 million, and by 4.4% in fiscal year 2004 to \$2,850.8 million, as shown in Table 7.

Table 7
Sales and Use Tax Revenues
 Fiscal Years 2001 - 2004
 (\$ in thousands)

	<u>2001 Actual</u>	<u>2002 Actual¹</u>	<u>2003 Revised Estimate</u>	<u>2004 Estimate</u>
Consumer	1,760,865	1,813,665	1,874,037	1,948,500
Construction	372,904	389,689	391,327	408,206
Capital Goods	282,805	254,680	252,950	279,130
Utilities	234,984	220,455	226,013	229,593
<hr/>				
Net Collections	2,651,558	2,678,489	2,744,327	2,865,429
Assessments ²	17,500	21,184	30,559	31,731
Refunds	(22,960)	(21,748)	(21,680)	(22,637)
Transportation Trust Fund	(19,324)	(35,447)	(22,932)	(23,728)
<hr/>				
Total General Fund	2,626,774	2,642,477	2,730,274	2,850,795

¹ Excludes \$8,866,768 from the 2001 tax amnesty.

² Includes approximately \$11 million in fiscal years 2003 and 2004 for the reduction in the vendor discount.



Lottery

Lottery sales grew by a strong 7.9% in fiscal year 2002, the fifth consecutive year of growth after a dip in sales in 1997. Revenues increased even faster, at 8.6%, due largely to lower than expected payouts for some games. As those growth rates imply, the State's take from each dollar of sales increased slightly, from 33.6¢ to 33.9¢. Sales are expected to remain robust, particularly for a mature lottery, growing at 5.2% in fiscal year 2003 and 4.4% in 2004.

Pick 3 sales increased by 0.5% in 2002, the first growth since 1996. Pick 4 sales did even better, increasing by 1.4%, though this is well below average growth over the past few years. Large deviations from statistically expected payouts in these games has resulted in revenue growth that diverges from sales growth. In 2002, Pick 3 revenues declined by 6.6%, while Pick 4 revenues increased by nearly 11%. Sales of these two games are expected to remain relatively stagnant, but the lower than expected payout for Pick 3, which has caused year to date revenue growth of 18%, will result in estimated revenue growth of 4.3% in 2003. Conversely, the return to usual payouts from the very low level for Pick 4 in 2002 will result in a decline in revenue of 12.4% in 2003.

Instant ticket sales have grown at a double-digit pace for the last four years. This trend is expected to continue, though just barely, in fiscal year 2003. Continued innovation in the game mix has driven this growth, which will moderate to 7.5% in 2004. Sales of instant tickets will surpass Pick 3 in 2003, making it the second-largest game (behind Keno), but the much higher prize payout for instant games will keep it in fourth place in terms of revenue generation.

Keno sales grew by 11.4% in fiscal year 2002, boosted to a degree by promotions, more terminals, and, towards the end of the year, draws every four minutes instead of every five minutes. There are approximately 1,800 Keno outlets presently; another 100 may be in place by the end of the fiscal year. Keno became the best-selling lottery game in 2001; by 2004 it will be close to overtaking Pick 3 as the revenue leader, with both games taking in about \$124 million.

Cash-in-Hand was discontinued early in fiscal year 2003; sales had declined every year since it was introduced. The game was replaced with Bonus Match 5, returning after a five-year hiatus. The forecast assumes sales of these two games in fiscal year 2003 will equal Cash-in-Hand sales in 2002, but early indications for Bonus Match 5 are promising. Lotto continued its long-term decline in 2002, down 27.4%. This slide is not expected to end, so the game may—at least in its present form.

The Big Game is now the new and improved Mega Millions. Since the start of 2003, New York, Ohio and Washington State have joined the consortium. The minimum jackpot has been raised from \$5 million to \$10 million, and the odds of winning the jackpot have been increased, which should result in a quicker escalation of the jackpot to much higher levels than previously. These changes have enhanced the attractiveness of the game; sales are up nearly 28% through the first five months of fiscal year 2003 without a large jackpot. Growth of 15% for

the full fiscal year is expected before leveling off in 2004, although very large jackpots will dramatically affect growth.

Legislation adopted by the 2002 General Assembly authorized the Lottery Agency to take part in an international lottery game. The international consortium is headquartered in Australia, and includes a number of Western European and Asian countries as well as a number of other states. The lotto-type game is scheduled to begin January 1, 2004, with tickets priced at \$2. The game is expected to generate large jackpots, and is expected to have several innovative features. While the structure of the game and starting date are not quite finalized, implementation is near enough that \$5 million of revenue has been included in the fiscal year 2004 revenue estimate.

After deductions for the Lottery's operating budget and the Stadium Authority distribution, \$21,949,000 in fiscal year 2003 and an expected \$22.0 million in 2004, general fund revenues will total \$432.0 million in 2003, a 4.7% increase, and \$448.4 million in 2004.

Table 8
Lottery Sales and Revenues by Game
 Fiscal Years 2001 - 2004
 (\$ in millions)

	Sales				Revenues ¹			
	<u>2001 Actual</u>	<u>2002 Actual</u>	<u>Estimated 2003</u>	<u>Estimated 2004</u>	<u>2001 Actual</u>	<u>2002 Actual</u>	<u>Estimated 2003</u>	<u>Estimated 2004</u>
Pick 3	305.4	306.9	305.4	302.3	128.5	119.7	125.2	124.3
Pick 4	198.6	201.4	203.4	206.5	84.9	93.8	82.4	83.6
Lotto	51.9	37.7	33.0	28.8	20.4	14.5	12.8	11.2
Cash-in-Hand	22.2	18.2	3.7	0.0	3.0	6.5	1.3	0.0
Instant	264.1	299.2	329.1	353.8	58.9	69.9	75.1	78.7
Keno	319.5	355.7	386.0	416.8	92.9	103.4	114.2	123.7
Match 5	0.0	8.3	22.7	26.5	0.0	2.4	6.4	7.5
International	0.0	0.0	0.0	12.3	0.0	0.0	0.0	5.0
Mega Millions	47.6	77.9	89.6	98.6	19.7	31.8	36.5	36.5
Let It Ride	1.4	1.3	0.0	0.0	(1.3)	0.5	0.0	0.0
Total	1,210.6	1,306.6	1,372.9	1,436.6	407.0	442.5	453.9	470.5
			Less Stadium Authority Revenue		(22.0)	(26.2)	(21.9)	(22.0)
			Transfer to Horse Racing		-	(2.2)	-	-
			General Fund Revenue		385.0	414.1	432.0	448.4

¹Special fund revenues (the Lottery Agency's operating expenses) of \$47.6 million in 2001 and \$50.3 million in 2002 are not included in revenues; these revenues, generally proportional to sales by game, are expected to be \$52.0 million in 2003 and \$53.5 million in 2004. Figures may not sum to totals due to rounding.



Business Franchise Taxes

Elimination of the Financial Institutions Franchise Tax continues to sap the growth of this revenue source. Taxpayers who formerly paid the franchise tax continue to file amended returns, requiring the State Department of Assessments and Taxation to issue refunds that are not offset by current revenues. This will continue for the next few years, although the dollar amount of the refunds will steadily decline. Concurrent with the repeal of the franchise tax was the elimination of the tax on deposits of savings and loan institutions. Fiscal year 2001 was the last year these taxes were collected.

Public Service Company Franchise Tax

All the data shown in Table 9 are for years following deregulation of the telecommunications, gas and electric utilities. In addition, full use of the Maryland Mined Coal credit means that the trends are no longer distorted by the credit. As part of energy deregulation, the gross receipts tax was split into two separately calculated components, one a flat rate on the number of units (kilowatts for electricity, therms for gas), and the other a percentage of the revenue collected. As a result, revenues vary with both the amount of energy delivered and the retail price. Although these revenue sources tend to be fairly stable, a booming economy, extreme weather, and higher energy prices all tend to increase revenues while recession, mild weather, and lower energy prices all tend to decrease revenues.

The telecommunications portion of the franchise tax is more volatile. Prices for long distance service in particular have been stagnant or falling, although a higher calling volume and recent price increases have helped prop up this revenue source. Verizon Maryland, Inc. has asked the Public Service Commission for approval to begin selling long distance telephone service in Maryland. If granted, this additional competition could further depress long distance revenues in the short term. Also, for the first time Verizon has seen a decrease in the number of wire lines operating in Maryland. This is due in large part to increased use of wireless phones and a decline in the number of homes and businesses that use second lines for dial-up computer connections as broadband technologies (i.e., cable, DSL, fixed wireless, satellite, and wireless) penetrate the State. Growth of the public service company franchise tax is expected to be less than 0.5% in fiscal year 2003, with a growth rate three times higher in fiscal year 2004 as the economy improves.

Filing Fees

Without a significant change in statute or the economy, filing fees remain fairly stable, with slight growth over time. The recession of 2001-2002 resulted in reduced revenues in fiscal year 2002. With the anticipated recovery beginning in 2003, revenues should begin to rise again, by about 6% in fiscal year 2003. Revenues will level off in 2004, growing by 1%.

Table 9
Business Franchise Tax Revenues
 Fiscal Years 2001 - 2004
 (\$ in thousands)

	<u>2001 Actual</u>	<u>2002 Actual</u>	<u>2003 Revised Estimate</u>	<u>2004 Estimate</u>
Public Service Company Franchise Tax	144,047	140,895	141,578	143,702
Financial Institution Franchise Tax	8,768	(9,658)	(1,485)	(585)
Tax on Deposits of Savings and Loans	1,591	13	0	0
Filing Fees	14,602	13,930	14,750	14,900
Total	169,008	145,180	154,843	158,017



Insurance Premium Tax

The insurance premium tax is levied at the rate of 2% of the premiums collected by insurance companies. Insurance premiums are somewhat cyclical as the industry tends to be more competitive in prosperous years, raising premiums in years following major losses. While insurance prices were generally low prior to September 11, 2001, premiums have tended to increase since that date as a result not only of the catastrophic underwriting losses suffered, but also because of losses on their investment portfolios over the past two years.

Federal legislation passed in November that will partially indemnify insurance companies with big losses due to future terrorist attacks may help moderate increases in premiums for property and casualty insurance. Nonetheless, growth of 8.2% in fiscal year 2003 is expected; growth will slow to 3.0% in fiscal year 2004 as insurance rates begin to return to equilibrium.

Table 10
Insurance Premium Tax Revenues
Fiscal Years 2001 - 2004
(\$ in thousands)

	<u>2001 Actual</u>	<u>2002 Actual</u>	2003 Revised <u>Estimate</u>	2004 <u>Estimate</u>
Premium Tax	190,397	193,718	209,544	215,818



Death Taxes

Death taxes are difficult to predict with any accuracy as they depend entirely upon the number and value of estates settled during the fiscal year. A few large estates radically affect the totals. This has happened several times in the past few years. Twenty-two large estates (estates with over \$500,000 of tax liability) have been settled in fiscal year 2003 through the end of November, paying \$26.5 million in tax. That is a 10% increase in the number of large estates, but a 39% decrease in tax from the same period last year. As is shown in the table below, revenue attainment as of November 30 has no relationship to year-end revenues.

Prior to 2002, Maryland's tax was directly tied to the federal credit for State estate taxes. Federal law phases out this federal credit by calendar year 2005, but Maryland, like many states, has decoupled its tax from the federal credit.

Federal law also increases the size of estates exempt from federal estate taxes, which will flow through to the Maryland estate tax. Prior to the law changes, estates under \$700,000 in 2002 and 2003 were exempt from the tax, increasing to \$850,000 in 2004. The recent change exempts estates under \$1 million from the tax in 2002 and 2003, rising to \$1.5 million in 2004 and 2005. Due to the administrative complexities of decoupling from that change, Maryland estate tax revenues will be reduced by roughly 2% in fiscal year 2003 and by roughly 8% in fiscal year 2004.

The direct inheritance tax was eliminated for persons who die after June 30, 2000, and siblings were reclassified as direct heirs. Revenues shown in Table 11 for direct inheritance tax reflect payments made by estates where the decedent died before July 1, 2000; marginal amounts of revenue will trickle in for a number of years. The 20.6% decline in total death tax revenue in fiscal year 2003 is partially attributable to the increased federal exemption, but is mostly a function of the bursting of the market bubble, which dramatically reduced the size of many large portfolios and, therefore, estates. Revenue growth in fiscal year 2004 is expected to be 2.3%.

Large Estate Tax Payments

Fiscal Year	As of December 1			Full Year	
	#	\$Million	% of Yr	#	\$Million
1999	7	8.9	32.9%	23	26.9
2000	13	31.6	74.7%	21	42.3
2001	14	22.2	39.8%	26	55.7
2002	20	43.3	57.2%	42	75.6

Table 11
Death Tax Revenues
 Fiscal Years 2001 - 2004
 (\$ in thousands)

	<u>2001 Actual</u>	<u>2002 Actual</u>	<u>2003 Revised Estimate</u>	<u>2004 Estimate</u>
Collateral Inheritance Tax	48,316	47,797	49,281	50,390
Direct Inheritance Tax	17,122	2,786	1,200	300
Estate Tax	103,365	134,142	96,100	99,235
<hr/>				
Total	168,803	184,725	146,581	149,925



Alcohol and Tobacco Excise Taxes

Effective June 1, 2002, the excise tax on cigarettes increased by 34¢ to \$1 per pack of 20 cigarettes. This increase accounts for the slight increase in fiscal 2002 (the higher rate was in effect for one month of the fiscal year) and about \$81.2 million in fiscal year 2003. Cigarettes on which the 66¢ tax had been paid but which were in retail inventory as of June 1 were subject to the incremental tax—the floor tax. Although starting from a higher base in 2003, cigarette tax revenue is expected to continue to decline annually as the number of smokers declines.

In fiscal year 2003, \$80.5 million of cigarette tax revenue is dedicated to a special fund to offset the cost of the programs established in the Bridge to Excellence in Public Schools Act (Chapter 288, Acts of 2002). This is a one-year diversion, and beginning in fiscal 2004 the full amount of the tobacco tax will again accrue to the general fund.

Tax rates on beer, wine and alcohol have not changed, but consumption continues to rise, a relatively recent trend after nearly two decades of decline. Increases in consumption have led to revenues outpacing forecasts, near 5% in fiscal 2002. As recent rates of increase outstrip growth in both population and income, it is expected that growth in these sources will be closer to historical averages in the forecast years. For fiscal years 2003 and 2004, the increase is expected to slow to about 1.5% each year.

Table 12
Excise Tax Revenues
 Fiscal Years 2001 - 2004
 (\$ in thousands)

	<u>2001 Actual</u>	<u>2002 Actual</u>	<u>2003 Revised Estimate</u>	<u>2004 Estimate</u>
Cigarette Tax	199,839	203,730	275,067	269,566
Floor Tax on Inventories	-	-	11,235	-
Other Tobacco Products Tax	5,797	6,158	6,000	6,000
Total Tobacco Taxes	205,636	209,887	292,302	275,566
General Fund	205,636	209,887	211,778	275,566
Special Fund	0	0	80,524	0
Distilled Spirits Tax	11,435	12,250	12,482	12,716
Wine Tax	3,946	4,197	4,302	4,408
Beer Tax	9,140	9,300	9,388	9,474
Total Alcoholic Beverages Tax	24,521	25,747	26,172	26,598



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 upon projections of use and reimbursement rates. Medicaid recoveries are expected to be lower in fiscal 2003 as use and reimbursement rates decline. In fiscal 2002, the Department of Health and Mental Hygiene hired a contractor to evaluate past financial transactions between the State and the federal government. This increased recoveries by just over \$14 million in fiscal 2002. As this review is completed, this extra revenue will disappear. The fiscal 2002 disproportionate share includes a federal payment of about \$10 million that was expected in fiscal 2001.

A recent federal administrative determination has reduced Medicaid recoveries for treatment of certain individuals by about \$2 million annually. The State is challenging this decision, which may result in a turnaround. On the other hand, the federal government may decide to recoup the affected expenditures from the past several years, which could result in a one-time revenue loss of about \$7 million.

Table 13
Hospital Patient Recoveries
 Fiscal Years 2001 - 2004
 (\$ in thousands)

	<u>2001 Actual</u>	<u>2002 Actual</u>	<u>2003 Revised Estimate</u>	<u>2004 Estimate</u>
Medicaid	48,009	53,142	41,156	39,530
Medicare	2,045	16,792	2,614	2,689
Insurance and Sponsors	7,704	7,850	7,385	7,453
	<hr/>	<hr/>	<hr/>	<hr/>
	57,758	77,784	51,155	49,672
Disproportionate Share	8,463	20,004	10,238	24,255
	<hr/>	<hr/>	<hr/>	<hr/>
Total	66,221	97,788	61,393	73,927



Court Revenues

Revenues from the clerks of the circuit courts include recordation tax commissions, recording fees, and other miscellaneous fees that are largely related to the strength of the housing market. Although mortgage rates are at their lowest levels in many years, the majority of transactions have been refinances, which are exempt from recordation and transfer taxes. The revenue increase does, however, reflect the strength of the housing market in fiscal year 2003.

Revenues from the District Court of Maryland are primarily from traffic fines and court 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.

Excluding a bump up in fiscal year 2003 from real estate transactions in the clerks' offices, revenues from these sources in the aggregate are expected to remain relatively stable, growing by only 0.9% between 2002 and 2004.

Table 14
General Fund Court Revenues
Fiscal Years 2001 - 2004
(\$ in thousands)

	<u>2001 Actual</u>	<u>2002 Actual</u>	2003 Revised <u>Estimate</u>	2004 <u>Estimate</u>
Clerks of the Court	39,534	42,634	48,888	45,845
District Court	69,606	72,592	71,168	70,456



Interest Earnings

Interest earnings are dependent on two factors: the principal balance and the interest rate. In fiscal year 2002, a significant drop in interest rates cut interest income by nearly 50%. Interest rates are now lower than in 2002, and not expected to increase significantly in the forecast period. In addition, the State continues to spend more money than it collects, lowering the balances on which it earns interest. As a result, there will be further significant reductions in interest earnings, with a 40% drop in fiscal year 2003. Interest earnings will improve 5% in fiscal year 2004, as balances level out when the State brings its finances under control.

Table 15
Total Interest Earnings
Fiscal Years 2001 - 2004
(\$ in thousands)

	<u>2001 Actual</u>	<u>2002 Actual</u>	<u>2003 Revised Estimate</u>	<u>2004 Estimate</u>
General Fund Interest	140,588	71,510	42,877	45,076



Miscellaneous Revenues

Miscellaneous revenues are expected to be basically flat between fiscal year 2002 and fiscal 2003, although there are significant changes within the total. Approximately \$30 million in general fund revenues from the Public Service Commission and the Workers' Compensation Commission are diverted to special funds beginning in fiscal year 2003. That revenue loss is offset by increases in unclaimed property and uninsured motorist penalty fees.

In fiscal year 2003, the collections for unclaimed property were accelerated by one year, adding approximately \$25 million to general fund revenue. In addition, there has been an extraordinary collection of \$5.5 million in 2003. In fiscal year 2004, the collections will be accelerated another year, again resulting in a \$25 million increase. In fiscal year 2005, this revenue source is expected to drop back down to normal levels, around \$30 million per year.

In fiscal year 2002, the Motor Vehicle Administration began aggressive enforcement of the requirement that drivers have liability insurance and collection of penalty payments. The result has been a significant increase in the penalty fees paid. In fiscal 2002, \$9.6 million of this increase was diverted to the mass transit initiative before that flow was restored to the general fund. The MVA anticipates it will be able to maintain this higher level of collections through fiscal 2004, but will have a drop in fiscal 2005.

Every year about \$13 million is paid by local governments to the State for reimbursement of costs of collecting the personal income tax. This is currently a general fund revenue, but will become a special fund in fiscal year 2004. Offsetting this loss will be an additional \$25 million in general fund revenue that currently flows to a special fund. The \$25 million is reimbursement from local education authorities for retirement contributions paid by the State on behalf of school employees whose costs are paid for with federal funds.

Fluctuation in revenue from the Department of Labor, Licensing and Regulation is primarily due to biennial registration for many professional and occupational licenses. Excess fees of office is the net of the commission retained by the registers of wills for collecting inheritance taxes less the money they spend to operate their offices. Decreases in this amount are due to the reduction in size of taxable estates and the increasing size of the registers' budgets. Most other miscellaneous revenues reflect a variety of small fees and commissions collected by non-revenue collecting State agencies.

Table 16
Miscellaneous Revenues
 Fiscal Years 2001 - 2004
 (\$ in thousands)

	2001 <u>Actual</u>	2002 <u>Actual</u>	2003 Revised <u>Estimate</u>	2004 <u>Estimate</u>
Recording, Organization & Capitalization Fees	3,760	3,890	3,810	3,810
Transportation - Filing Fees & License Tags	8,982	9,835	9,870	10,155
PSC Filing Fees	11,762	12,587	*	*
Excess Fees of Office	14,600	8,454	7,650	7,416
Legislature	414	375	225	225
Workers' Compensation	20,291	18,985	*	*
Public Defender	1,652	1,214	1,500	1,500
Attorney General	21,396	20,291	18,200	17,500
Executive & Administrative Control	5,483	6,259	4,360	4,629
Financial & Revenue Administration	6,602	7,868	7,925	8,084
Budget & Fiscal Administration	1,738	1,181	1,222	1,323
General Services	63	192	63	63
Natural Resources	1,173	1,251	582	582
Agriculture	286	309	287	291
Health & Mental Hygiene	5,089	8,620	8,808	8,923
Human Resources	3,410	3,181	2,898	2,898
Labor, Licensing & Regulation	11,480	17,395	13,042	17,823
Public Safety & MD State Police	10,835	10,544	10,270	10,219
Public Education	2,047	2,957	2,004	26,871
Housing and Community Development	1,386	631	655	680
Environment	402	429	538	260
Juvenile Justice	438	439	248	225
Unclaimed Property	36,965	31,374	62,188	58,001
Alcoholic Beverage Licenses	584	622	600	600
Local Income Tax Reimbursement	12,700	12,879	12,887	*
Uninsured Motorist Penalty Fees	12,861	14,420	23,887	24,215
Miscellaneous Revenues and Transfers	(208)	2,416	5,012	5,012
Total	196,191	198,598	198,730	211,305

* General fund revenue source moved to a special fund account.



Transportation Revenues

After robust 6.1% growth in fiscal 2002, titling tax revenue is expected to grow at a much more modest 0.4% in fiscal 2003. The strong growth in fiscal 2002 was due to aggressive marketing by automakers, including 0% financing. Although the 0% continued into fiscal 2003, its effect on consumers has waned, as the market demand for automobiles was sated. Revenue is expected to pick up again, near 3.2% in fiscal 2004.

As predicted last year, growth in motor vehicle fuel tax will be essentially flat: 1.1% growth in fiscal 2003 and 2.4% in fiscal 2004. As the tax is a fixed amount per gallon of fuel, this slow growth is the result of lower consumption stemming from both the economic doldrums and reduced demand due to higher prices.

The funding that was earmarked to mass transit programs by the 2001 General Assembly was redirected back to the general fund by the 2002 General Assembly in an effort to bring the budget back into balance. As a result, no diversions to the mass transit initiative are shown on Table 17.

Money received for some fees and permits has increased as the Motor Vehicle Administration has raised some fees.

Most motor vehicle user revenues are paid into the Motor Vehicle User account of the Transportation Trust Fund to fund transportation construction and maintenance.

Table 17
Maryland Motor Vehicle User Revenues
 Fiscal Years 2001 - 2004
 (\$ in thousands)

	<u>2001 Actual</u>	<u>2002 Actual</u>	<u>2003 Revised Estimate</u>	<u>2004 Estimate</u>
Motor Vehicle Administration				
Registrations	183,108	185,048	191,600	193,900
Licenses	13,535	21,960	27,400	28,100
Med-Evac Surcharge	37,212	48,699	49,183	49,478
Miscellaneous Motor Vehicle Fees	71,802	88,417	81,600	82,500
Vehicle Emission Inspection Fees	4,110	4,758	4,400	4,400
Security Interest Filing Fees				
Special Funds	3,346	3,539	3,540	3,630
General Funds	5,018	5,309	5,310	5,445
General Funds - Baltimore City	2,788	2,950	2,950	3,025
Hauling Fees	7,374	7,784	7,600	7,600
Learners & New Drivers' Licenses	8,897	11,141	12,000	12,500
Special License Tags				
Special Funds	380	380	380	380
General Funds	1,153	1,576	1,610	1,685
DOT	742	405	410	415
Chesapeake Bay Tags - MDOT	389	865	900	920
Titling Tax	612,779	650,210	653,000	674,000
Sales Tax on Rental Vehicles				
MDOT-Rental Vehicles	19,324	35,222	22,675	23,475
MVA - Clean Fuel Vehicle Credit	0	225	225	225
	<u>971,957</u>	<u>1,068,488</u>	<u>1,064,783</u>	<u>1,091,678</u>
Motor Vehicle Fuel Tax	672,495	688,611	696,600	711,300
Road Tax	14,403	14,814	15,000	15,300
Decals	76	109	0	0
	<u>686,974</u>	<u>703,534</u>	<u>711,600</u>	<u>726,600</u>
Total	<u><u>1,658,931</u></u>	<u><u>1,772,022</u></u>	<u><u>1,776,383</u></u>	<u><u>1,818,278</u></u>



Five Year Forecast

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

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

The reduction to the State's income tax will no longer restrain growth, but even if capital gains return to double-digit growth, it will be several years before they are large enough to have a significant impact on revenues. Over the long term, income taxes are likely to grow at about the growth rate of personal income. Sales taxes generally grow at about that rate, but with the increasing move towards services and with Internet commerce encroaching upon the tax base, sales taxes may grow at rates slightly below personal income growth. Thus, about three quarters of general fund revenue will be growing no faster than personal income growth.

The lottery will continue to grow. Although the double-digit growth of Keno and instant ticket games will end, some of that slack may be made up by Mega Millions and the new international game. Death taxes are likely to remain at relatively low levels, due to federal law changes and dramatically lower investment portfolios.

Table 18

Long Term Economic Forecast
Primary Indicators

CALENDAR YEAR	2000	2001	2002	2003	2004	2005	2006
U.S. GDP (Billion \$96 chained)	9,191.4	9,214.6	9,438.9	9,676.4	10,017.1	10,327.6	10,690.9
% change	3.8%	0.3%	2.4%	2.5%	3.5%	3.1%	3.5%
U.S. Total Non-Farm Employment (Millions)	131.7	131.9	130.8	131.7	134.4	136.9	138.8
% change	2.2%	0.2%	-0.8%	0.7%	2.0%	1.8%	1.4%
U.S. Personal Income (Billion \$)	8,406.6	8,685.4	8,939.5	9,235.9	9,673.6	10,172.8	10,681.2
% change	8.0%	3.3%	2.9%	3.3%	4.7%	5.2%	5.0%
CPI - % Change	3.36%	2.83%	1.56%	1.92%	2.14%	2.48%	2.45%
U.S. 10-Year Treasury Bond Yield (%)	6.03%	5.02%	4.61%	4.61%	5.49%	5.82%	5.86%
MD Total Non-Farm Employment (Millions)	2,448.9	2,469.6	2,455.8	2,479.2	2,519.1	2,567.1	2,606.6
% change	2.6%	0.8%	-0.6%	1.0%	1.6%	1.9%	1.5%
MD Total Personal Income (Million \$)	180,353	189,142	196,814	205,499	216,353	227,733	239,041
% change	7.8%	4.9%	4.1%	4.4%	5.3%	5.3%	5.0%

Table 19
Maryland General Fund Revenues
 Fiscal Years 2002-2007
 (\$ in thousands)

	2002 Actual	2003 Estimate	2004 Estimate	2005 Estimate	2006 Estimate	2007 Estimate
Income Taxes						
Individual	4,771,649	4,807,169	5,081,669	5,394,285	5,695,726	5,999,089
Corporation	273,235	323,262	330,051	339,953	350,151	360,656
TOTAL	5,044,884	5,130,431	5,411,720	5,734,238	6,045,877	6,359,744
Sales and Use Taxes	2,642,477	2,730,274	2,850,795	2,999,376	3,150,430	3,297,710
State Lottery	414,063	431,991	448,385	457,353	466,500	475,830
Franchise, Excise, License, Fee	1,183,134	1,188,715	1,287,335	1,254,164	1,281,444	1,292,324
Interest on Investments	71,510	42,877	45,076	54,091	56,868	59,637
TOTAL CURRENT REVENUES	9,356,068	9,524,288	10,043,311	10,499,222	11,001,119	11,485,245
Transfers	119,465	-	-	-	-	-
Tax Amnesty	28,509	-	-	-	-	-
Heritage Structure Rehabilitation Credit		(51,600)	(31,700)	(42,300)	8,300	22,400
GRAND TOTAL	9,504,042	9,472,688	10,011,611	10,456,922	11,009,419	11,507,645

Heritage Structure Rehabilitation Tax Credit

The heritage structure rehabilitation tax credit can be claimed against the personal and corporate income taxes and the insurance premium tax. Because the taxpayer claiming the credit can decide against which tax to apply the credit, the revenue loss cannot be estimated by tax type. Further complicating the analysis is the structure of pass-through entities that are often involved in these projects. The credit for one project could be divided among several taxpayers and claimed against more than one tax type and in more than one fiscal year. Several changes in the program over its lifetime have also affected how and when the credits are claimed, and how much of the credit is claimed. If the credit is claimed against the corporate income tax, part of the revenue loss accrues to the Transportation Trust Fund.

The Maryland Historical Trust is responsible for tracking and approving these projects. Based on MHT reports, projects earning \$98.2 million in credits should be completed in calendar year 2002. The credit for these projects will be claimed in fiscal years 2003 and 2004. In 2003, the MHT expects another \$18.8 million in credit to be earned based on current applications, which would be claimed in fiscal years 2004 and 2005. It is assumed that new projects will be added to the pipeline, for credits totaling about \$30 million in calendar 2003 and \$50 million in 2004, when the credit is scheduled to expire. After adjusting for higher than anticipated project costs, late project completions and differing tax payment schedules, total credits of \$79.6 million are expected to be claimed in fiscal year 2003 and \$58.9 million in 2004.

In all tables in this report, fiscal year 2002 revenue figures are net of the credit because the distribution of the credit between the corporate income tax and personal income tax cannot be determined until tax year 2002 returns are processed and analyzed (approximately \$10 million of credit was claimed against the insurance premium tax). As a result, the baseline for fiscal years 2003 and 2004 includes about \$26 million of credits, the estimate of the total amount claimed against all taxes in 2002. The line item shown in Table 3 and Table 4 as the Heritage Preservation Tax Credit is the additional amount expected to be claimed in each year above the 2002 baseline amount. The line item is further adjusted in Table 4 to account for some portion of the credit claimed against the corporate income tax, 25% of which will be deducted from the Transportation Trust Fund (assumed to be 15% of the total credit in each year).