State of Maryland
# Board of Revenue Estimates
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March 6, 2008

Honorable Martin O'Malley
Governor, State of Maryland
State House
Annapolis, MD 21401

Dear Governor O'Malley:

In accordance with our continuing policy of keeping you fully advised of developments concerning Maryland's revenue prospects, the Board of Revenue Estimates has reviewed the current estimates of general fund revenue in light of the most recent economic data and developments and recent revenue collections. Based on our review, the Board submits to you revised current law general fund estimates of $13.558 billion for fiscal year 2008 and $14.485 billion for fiscal year 2009. This represents a decline in fiscal year 2008 of $74.7 million and a decline in fiscal year 2009 of $258.2 million, for a combined reduction of $332.9 million. In our judgment, the risks remain on the downside.

The national economy has slowed faster than expected at the time of our December forecast. At that time, consensus opinion was that the United States would skirt a recession. Now, with real GDP growth slowing to 0.6% in the fourth quarter of 2007 and 17,000 jobs lost in January, many respected economists believe we are in the midst of a recession, though likely a shallow and short one. As you are aware, trouble in the housing market has spread to credit markets, and both consumer and business confidence have suffered.

To date, the State's economy has continued to expand, though very sluggishly. Current employment statistics show that the number of jobs in the State increased 1.2% in calendar year 2007, although we expect that the coming annual benchmarking will result in official growth of under 1.0%. Maryland's economic performance over the forecast period, however, now appears likely to be weaker than previously thought, in line with changes to the national economic forecast. Rather than slowing slightly over half a percentage point in 2008, growth in both total personal income and wage and salary income is expected to decelerate by about one full percentage point before picking up in 2009, though also at a rate lower than previously expected.

Our analysis of collections through February shows that, while the general fund as a whole stands only slightly below expectations, several revenue sources show troubling developments. The individual income tax and the sales tax, the two largest revenue sources and among the most sensitive to economic conditions, are being written down, as

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is the forecast for the State's interest income. On the other hand, the estate tax is exceeding expectations by a substantial enough amount that an upward revision is required.

There is one encouraging sign for the individual income tax (and for the broader economy)—withholding has grown 6.6% through February, and is running ahead of expectations (based on the December forecast). Growth can slow considerably and the current forecast still be met; given current risks, however, and that we do in fact expect a further slowdown over the course of this calendar year, we deem it prudent not to increase the forecast for withholding. But the lower than expected growth in fourth quarter estimated income tax payments and concern for the income tax filing season have led us to bring down the general fund individual income tax forecast by $48.7 million in fiscal year 2008. In fiscal year 2009, withholding is now expected to slow more than previously forecast, and the weak economy in 2008 will result in slower growth in nonwithheld income tax as well. Growth of just 4.2% is now forecast, bringing revenues to a level $153.4 million below the December forecast.

The sales tax has already shown the effects of the deteriorating economy in a rather dramatic fashion. Baseline general fund receipts have declined each of the last two months, by 5.5% and 1.8%. Consumer sales tax collections, roughly two-thirds of the total, have grown only 1.1% through February, and declined 6.6% and 3.5% the last two months. The only other time since at least fiscal year 1982 that consumer sales tax revenues declined two consecutive months was in 1991, during a recession much deeper in Maryland than is currently expected. Despite the stronger fundamental economic performance in the present period than in 1991, high energy prices, the negative wealth effect as a result of falling housing prices and expectations of the slowdown to come have resulted in revenue performance at historically weak levels. Growth is expected to slow even further, to about 0.5%, for the rest of the fiscal year, resulting in scant baseline growth of just 0.9% for the consumer piece of the sales tax. All other major components remain on course with the December forecast for fiscal year 2008 (although revenues from construction are expected to decline 3.7%).

The deeper economic slowdown now forecast results in a sizable writedown to fiscal year 2009 sales tax revenues. Consumer-related revenues, previously forecast to rise 5.0%, are now expected to grow only 4.4%. Revenues derived from construction activity are now forecast to fall 2.4% rather than rise 2.7%, as the housing market is expected to take longer to recover than previously thought. Baseline net collections are forecast to increase 3.2%, more than a percentage point slower than the previous forecast.

These reductions will be partially mitigated by the federal economic stimulus legislation. Roughly $2.4 billion will come to Maryland in the form of tax rebates, an amount equivalent to about 1.8% of Maryland wage and salary income. Assuming one-third of this amount is spent on taxable goods, sales tax revenues will increase by $48 million. The Internal Revenue Service will begin mailing these checks in May; the timing of this impact is difficult to determine, but we assume one-third of this spending will occur in fiscal year 2008, with the remainder in fiscal year 2009. This additional spending will result in $16.0 million of general fund sales tax revenue in fiscal year 2008 and $29.9 million in fiscal year 2009. The net reduction to general fund sales tax receipts, accounting for all of the above, is $43.5 million this year and $76.9 million next year.

Estate tax revenues are well ahead of expectations at this point of the year. As a result, we are adjusting the forecast up by $17.5 million. Due to the one-time nature of revenue from this tax, however, we are leaving the fiscal year 2009 estimate unchanged. Interest income will be reduced due to the quicker than expected rate reductions, as well as the reduced revenues the State will receive. Fiscal year 2008 interest is expected to be roughly at the December forecast level, since the revenue writedown is not large for fiscal year 2008 and the maturities of the State's investments are longer than has been the case in the past. In 2009, though, with the lower rates, revenues, and balances, we now project $97.1 million of interest, $27.9 million lower than previously.

General fund revenue growth of 4.8% is now projected for fiscal year 2008, rather than the 5.3% forecast in December. For fiscal year 2009, general fund growth of 6.8% is expected, instead of December's 8.1% forecast. These figures include all of the effects of legislation enacted during the 2007 Special Session of the General Assembly.

We will keep you informed of any major developments.

Sincerely,

Peter Franchot

Peter Franchot

Nancy K. Kopp

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**Maryland General Fund Revenues**
**Fiscal Years 2007 - 2009**
$ in thousands

| | FY 2007 Actual | FY 2008 December Estimate | FY 2008 March Estimate | FY 2008 Difference | FY 2008 % Growth | FY 2009 December Estimate | FY 2009 March Estimate | FY 2009 Difference | FY 2009 % Growth |
|---|---|---|---|---|---|---|---|---|---|
| INCOME TAXES | | | | | | | | | |
| Individual | 6,679,168 | 7,035,060 | 6,986,396 | (48,664) | 4.6% | 7,431,594 | 7,278,183 | (153,411) | 4.2% |
| Corporations* | 589,782 | 558,769 | 558,769 | - | -5.3% | 672,973 | 672,973 | - | 20.4% |
| Total | 7,268,950 | 7,593,829 | 7,545,165 | (48,664) | 3.8% | 8,104,567 | 7,951,156 | (153,411) | 5.4% |
| SALES AND USE TAXES | 3,420,149 | 3,735,208 | 3,691,717 | (43,491) | 7.9% | 4,260,155 | 4,183,249 | (76,906) | 13.3% |
| STATE LOTTERY RECEIPTS | 473,119 | 497,111 | 497,111 | - | 5.1% | 507,269 | 507,269 | - | 2.0% |
| OTHER REVENUES | | | | | | | | | |
| Business Franchise Taxes | 206,568 | 209,077 | 209,077 | - | 1.2% | 206,485 | 206,485 | - | -1.2% |
| Tax on Insurance Companies | 283,342 | 289,647 | 289,647 | - | 2.2% | 295,799 | 295,799 | - | 2.1% |
| Death Taxes | 224,341 | 202,987 | 220,487 | 17,500 | -1.7% | 213,029 | 213,029 | - | -3.4% |
| Tobacco Tax | 278,189 | 393,262 | 393,262 | - | 41.4% | 450,980 | 450,980 | - | 14.7% |
| Alcoholic Beverages Excises | 28,682 | 29,553 | 29,553 | - | 3.0% | 30,290 | 30,290 | - | 2.5% |
| Motor Vehicle Fuel Tax | 13,197 | 13,350 | 13,350 | - | 1.2% | - | - | - | -100.0% |
| District Courts | 97,026 | 99,036 | 99,036 | - | 2.1% | 101,096 | 101,096 | - | 2.1% |
| Clerks of Court | 52,316 | 46,896 | 46,896 | - | -10.4% | 46,349 | 46,349 | - | -1.2% |
| Hospital Patient Recoveries | 84,945 | 86,090 | 86,090 | - | 1.3% | 86,278 | 86,278 | - | 0.2% |
| Interest on Investments | 178,903 | 122,585 | 122,585 | - | -31.5% | 125,000 | 97,100 | (27,900) | -20.8% |
| Miscellaneous | 330,499 | 313,812 | 313,812 | - | -5.0% | 315,843 | 315,843 | - | 0.6% |
| Total | 1,778,009 | 1,806,295 | 1,823,795 | 17,500 | 2.6% | 1,871,149 | 1,843,249 | (27,900) | 1.1% |
| TOTAL CURRENT REVENUES | 12,940,228 | 13,632,443 | 13,557,788 | (74,655) | 4.8% | 14,743,140 | 14,484,923 | (258,217) | 6.8% |
| Extraordinary Revenues | | - | - | - | N/A | - | - | - | N/A |
| GRAND TOTAL | 12,940,228 | 13,632,443 | 13,557,788 | (74,655) | 4.8% | 14,743,140 | 14,484,923 | (258,217) | 6.8% |