



State of Maryland Board of Revenue Estimates

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September 9, 2008

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

Dear Governor O'Malley:

At the beginning of a new budget cycle, the Board of Revenue Estimates is reporting to you revised general fund revenue estimates for fiscal year 2009 and the first official estimates for fiscal year 2010. We have reviewed the current estimate for fiscal year 2009 in light of the most recent economic data and developments, as well as revenue collections for fiscal year 2008. Based on our analysis, the Board submits to you a revised estimate of general fund revenues for fiscal year 2009 of \$14.089 billion (a reduction of \$431.9 million from the official estimate), and an estimate of \$14.702 billion for fiscal year 2010. Writedowns to the sales tax and individual income tax are primarily responsible for these changes. In our judgment, downside risks predominate and will continue to do so until the national economy resumes sustained growth.

The nation's economy has struggled for several quarters. While real gross domestic product (GDP) grew at a reasonable 3.3% rate in the second quarter of this year—mostly as a result of exports—the economy shed about 218,000 jobs, on top of the 113,300 lost in the first quarter. Most recent economic releases have disappointed; if they have met expectations, the bar was set very low. Home prices continue to fall (though at a slower pace of late), foreclosures continue to increase, real consumer expenditures are down, and initial claims for unemployment are up.

As a result, successive forecasts have grown weaker and weaker. The Philadelphia Federal Reserve Bank's *Survey of Professional Forecasters* has shown slower expected growth for six consecutive quarters. In the first quarter, the report called for real GDP growth of 2.8% in 2009; the third quarter release showed forecast growth was cut by nearly half, to 1.5%. Tight credit, a faltering global economy, and continuing troubles in the housing market are expected to keep the national economy idling if not declining through mid- to late 2009.

Maryland's economy has slowed along with the national economy, although by most measures it does continue to grow. Official figures from the Bureau of Labor Statistics show employment in Maryland has grown at or over one percent every month this year except for January, and personal income statistics from the Bureau of Economic Analysis indicate that wage and salary income grew at 4.4% in the first quarter. There is

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reason to believe, however, that both of these figures are overstated. Among the factors leading to this conclusion is individual income tax withholding (perhaps one of the most timely economic indicators), which has grown only at 2.1% for calendar year 2008.

As with the national economy, signs of weakness are widespread, and there are few positive indicators. Sales of existing homes have declined for 34 consecutive months, prices have dropped 12 months straight, and inventories are at a record high. Business bankruptcies have doubled over the last year, and personal bankruptcies have increased by 36%. Employment of Maryland manufactures is declining at an accelerating rate, the finance sector has lost jobs since late 2006 (though it appears the bottom may have passed), and the construction industry is also in decline. What little good news exists is that two of Maryland's largest and highest-paying industries, professional and business services and education and health services, are performing relatively well, and government employment continues to grow.

Given the struggling national economy, weakness in many Maryland industries, housing market conditions and low consumer confidence, the economy is expected to remain very sluggish through the middle of next year. As economic growth resumes nationally, Maryland's housing market reaches equilibrium, and consumers are less uncertain about the course of the economy, relatively healthy economic growth should resume in 2010.

Maryland Economic Forecast

	2008	2009	2010
Employment	0.6%	0.3%	1.2%
Personal Income	4.4%	3.4%	4.9%
Wage & Salary Income	3.8%	3.3%	4.5%

The drawn-out slowdown has a substantial impact on our expectations for the individual income tax and the sales tax. Individual income tax receipts are expected to increase 5.3% in fiscal year 2009 to \$7.310 billion, a writedown of \$135.0 million. Growth of 5.3% in 2010, to \$7.698 billion, is forecast. Adjusted for tax changes enacted over the last year, baseline general fund growth of only 3.8% is forecast for 2009, followed by 4.8% growth in 2010. Collections will be boosted in fiscal year 2009 by the new brackets enacted during the 2007 Special Session and the 2008 regular session, although the effect of those brackets is mitigated by the increased personal exemptions and refundable earned income credit. Income tax withholding, adjusted for these changes, is expected to decelerate a full percentage point in fiscal year 2009 to 3.8%, before accelerating only modestly to 4.1% in 2010. Estimated payments are forecast to grow in low single digits with the slow economy and very low growth in capital gains.

The weaknesses in Maryland's economy appear likely to have the greatest impact on sales tax collections. General fund sales tax collections are forecast to grow 3.1% in fiscal year 2009 to \$3.787 billion, a reduction in the forecast of \$265.3 million. In fiscal year 2010, growth of 3.8% to \$3.933 billion is expected. Baseline receipts are expected to drop 1.8% in 2009, but will increase by 4.8% in 2010. The recent increase from 5% to

6%, along with changes to the distribution of sales tax revenues, adds almost five percentage points of growth to general fund receipts for fiscal year 2009.

Record high prices for gasoline and surging food prices have resulted in a redirection of consumer spending from taxable goods to these necessities, while plummeting housing starts will continue to put pressure on collections from both construction activities and large consumer purchases such as appliances and furniture. Adjusted for the rate increase from 5% to 6% effective January 3, 2008, receipts from consumer purchases are expected to be flat in fiscal year 2009 before increasing at a 4.7% rate in 2010, while construction-related revenues are forecast to drop by double-digits in 2009 but will rebound in 2010, growing at 8.1%.

General fund lottery revenues are expected to decline 0.4% to \$495.2 million in fiscal year 2009, a reduction in the estimate of \$16.1 million. Because of abnormally low prize payouts, revenues exceeded the forecast in fiscal year 2008 even though sales were \$35.4 short of the forecast. A lower sales forecast for Pick 3, Pick 4 and Keno/Racetrax and a return to normal prize payouts are responsible for the reduced forecast. Modest sales growth is expected for fiscal year 2010, resulting in a 2.5% increase in general fund revenues. Tobacco tax revenues are expected to grow 15.1% in fiscal year 2009 to \$433.0 million, although that figure is \$18.0 million below the prior forecast. The \$1.00 per pack increase in the cigarette tax effective January 1, 2008, resulted in a greater decline in sales than had been expected, which has been accounted for in the revised estimates. In fiscal year 2010, after the distortions caused by the rate increase have passed, revenues are expected to resume their long-term trend decline.

Changes to the estimates for other revenue sources result primarily from fiscal year 2008 results. General fund revenue growth of 4.0% is now forecast for fiscal year 2009, and general fund revenues are expected to increase 4.3% in fiscal year 2010. We will keep you apprised of any major developments.

Sincerely,



Peter Franchot



Nancy K. Kopp



T. Eloise Foster

**Maryland General Fund Revenues
Fiscal Years 2008 - 2010**

	FY 2008 Actual	FY 2009				FY 2010	
		Current Estimate	September Estimate	Difference	% Growth	September Estimate	% Growth
INCOME TAXES							
Individual	6,940,134,008	7,444,873,141	7,309,840,000	(135,033,141)	5.3%	7,697,728,000	5.3%
Corporations	551,672,600	672,704,811	672,704,811	-	21.9%	746,526,000	11.0%
Total	7,491,806,608	8,117,577,952	7,982,544,811	(135,033,141)	6.6%	8,444,254,000	5.8%
SALES AND USE TAXES	3,675,263,017	4,052,629,995	3,787,370,000	(265,259,995)	3.1%	3,932,843,000	3.8%
STATE LOTTERY RECEIPTS	497,111,000	511,269,000	495,201,000	(16,068,000)	-0.4%	507,778,000	2.5%
OTHER REVENUES							
Business Franchise Taxes	207,967,736	206,845,000	200,885,000	(5,960,000)	-3.4%	209,381,000	4.2%
Tax on Insurance Companies	301,830,605	295,799,000	309,377,000	13,578,000	2.5%	317,111,000	2.5%
Death Taxes	243,541,022	213,029,000	210,445,000	(2,584,000)	-13.6%	214,077,000	1.7%
Tobacco Tax	376,112,273	450,980,000	433,004,000	(17,976,000)	15.1%	427,851,000	-1.2%
Alcoholic Beverages Excises	28,966,186	30,290,000	28,688,000	(1,602,000)	-1.0%	29,255,000	2.0%
Motor Vehicle Fuel Tax	13,199,104	6,500,000	6,500,000	-	-50.8%	-	-100.0%
District Courts	91,307,305	101,096,000	93,511,000	(7,585,000)	2.4%	95,773,000	2.4%
Clerks of Court	42,559,225	46,832,750	40,816,000	(6,016,750)	-4.1%	40,396,000	-1.0%
Hospital Patient Recoveries	86,555,827	75,313,257	75,313,257	-	-13.0%	62,000,000	-17.7%
Interest on Investments	166,517,552	97,100,000	122,000,000	24,900,000	-26.7%	115,000,000	-5.7%
Miscellaneous	322,901,060	315,762,069	303,515,000	(12,247,069)	-6.0%	306,022,000	0.8%
Total	1,881,457,895	1,839,547,076	1,824,054,257	(15,492,819)	-3.1%	1,816,866,000	-0.4%
TOTAL CURRENT REVENUES	13,545,638,520	14,521,024,023	14,089,170,068	(431,853,955)	4.0%	14,701,741,000	4.3%