

# State of Maryland Board of Revenue Estimates

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March 11, 2003

Honorable Robert L. Ehrlich, Jr.  
Governor, State of Maryland  
State House  
Annapolis, MD 21401

Dear Governor Ehrlich:

In accordance with our 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 recent performance and economic developments. Based on this review, the Board submits to you revised estimates of total general fund revenue of \$9.367 billion for fiscal year 2003, and \$9.900 billion for fiscal year 2004. This represents a downward revision of \$106.1 million for fiscal year 2003 and \$111.9 million for fiscal year 2004, for a combined downward revision of \$218.0 million. General fund revenues are estimated to decline by 1.4% in fiscal year 2003, and to increase by 5.7% in fiscal year 2004.

In general, the macroeconomic outlook is marginally weaker since our last report. There has been some good news—Maryland employment growth has been slightly positive for the past two months, and fourth quarter gross domestic product grew more strongly than first reports had indicated. Alternatively, the most recent national economic data do not bode well. Over 300,000 jobs were lost nationwide in February, far exceeding most analysts' expectations. Several one-time factors are involved, including the mobilization of many reservists, but these do not explain the depth of the drop. Perhaps not coincidentally, consumer confidence plunged the same month to the lowest level in over nine years. Oil prices rose dramatically in January, leading other energy prices. Some analysts believe the war premium is approaching one-third or more of the price of oil, and further sharp increases are possible. Based on changes in the national outlook, we are reducing our forecast of Maryland wage and salary growth from 4.2% to 3.6% in 2003, and from 5.9% to 5.5% in 2004.

The fiscal year 2003 individual income tax estimate has been reduced from \$4.807 billion to \$4.731 billion, a reduction of \$76.2 million. Fiscal year 2004 revenues are estimated at \$5.003 billion rather than \$5.082 billion, a \$78.7 million reduction. Income tax withholding has underperformed expectations since November, as the labor market has been essentially stagnant during that period. Withholding for February will be weaker than had been expected, as many businesses were closed, or might as well have been, for several days over a holiday weekend. Although estimated income tax payments are no longer declining at double-digit rates, fourth quarter estimated payments were still

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down 8.2%, slightly weaker than expected. This factor, and the first pieces of data from the income tax filing season lead us to believe final payments will be weaker and refunds will be higher than we had previously expected.

The sales tax estimate has been reduced by \$20.8 million to \$2.709 billion for fiscal year 2003, while the fiscal year 2004 estimate has been reduced by \$24.0 million to \$2.827 billion. These new estimates call for growth of 2.5% in 2003 and 4.3% in 2004. Sales taxes from consumers have been reduced to reflect the weak consumer confidence. Our forecast for utility-related sales taxes are unchanged; performance has been as expected since December and, if anything, could be boosted by the cold. Sales taxes from both capital goods and construction have not met expectations in the three months since December, and have been reduced accordingly. In addition, housing starts in fiscal year 2004 now look less robust, resulting in an additional reduction to the construction sales taxes. Construction activities and consumer spending were affected by the cold and snow this winter. All told, the severe winter weather, not forecast by us in December, is expected to result in the loss of about \$9 million of sales tax revenues.

Death taxes have continued to underperform. The collateral inheritance tax has declined by 6.0% year-to-date, while the full-year estimate called for a 3.3% increase. Similarly, the estate tax is down 39.7%, but it was only expected to decline by 28.4% for the full year. Clearly, the fall in the equity market has had a much larger impact on estate values than previously anticipated. It is also possible that the increase in the federal unified credit for the estate tax has exempted more estates than previously estimated. Although one large estate could conceivably make up the difference, large estates have been few and far between this year. The inheritance and estate taxes have therefore been revised downward by \$12.6 million for fiscal year 2003 and by \$13.0 million for fiscal year 2004.

Interest earnings totaled only \$19.1 million through February. The State's investments are timed to mature at certain points throughout the year when large expenditures are required. The timing and relative size of the investments' maturing through the end of the fiscal year are roughly similar to the past several years. Given that the State's balances and interest rates are very low, general fund interest earnings have been reduced by \$7.0 million in both fiscal years 2003 and 2004.

Insurance premium taxes are the one bright spot in the revenue forecast, although the overall impact on the State, businesses and residents is most likely not positive. Premiums have increased dramatically recently as a result of higher insurance payouts due to natural and manmade disasters, lower portfolio values as a result of the ongoing market decline, and 40-year low interest rates. As insurance companies have increased premiums, the 2% premium tax results in increased revenues for the State. Based on historical collection patterns and year-to-date performance, the premium tax revenue has been increased by \$10.5 million in fiscal year 2003, and by \$10.8 million in fiscal year 2004.

The performance of corporate income taxes also is deserving of note. While gross receipts are slightly behind expectations, refunds are well below the expected level. Final payments for tax year 2002 are yet to come (for calendar year taxpayers), as well as two estimated payments (for most taxpayers); those payments could reflect amounts that had been expected to be paid out in refunds. Due to the disconnect between Maryland corporate income tax performance and corporate profits nationwide, we believe it is prudent not to adjust general fund corporate income taxes upwards at this time.

We must stress that the economy is on very uncertain footing at the present time. In December we noted:

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.

Based on the most recent economic data, it may no longer be true that the former is more likely than the latter. The longer the situation in the Middle East remains unresolved, the greater the chance that both business and consumer confidence will not rebound soon. Although we continue to believe that consistent economic growth will resume at some point in the second half of this year, real downside risks remain. The period until growth resumes will likely be more volatile than previously expected.

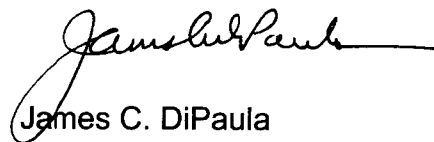
Sincerely,



William Donald Schaefer



Nancy K. Kopp



James C. DiPaula

**Maryland General Fund Revenues**  
Fiscal Years 2002 - 2004

\$ Thousands	FY 2003					FY 2004			
	FY 2002 Actual	December Estimate <sup>1</sup>	March Estimate	Difference	Growth	December Estimate <sup>1</sup>	March Estimate	Difference	Growth
<b>INCOME TAXES:</b>									
Personal	4,771,649	4,807,169	4,730,989	(76,180)	-0.9%	5,081,669	5,003,015	(78,654)	5.7%
Corporation	273,235	323,262	323,262	0	18.3%	330,051	330,051	0	2.1%
Total	5,044,884	5,130,431	5,054,251	(76,180)	0.2%	5,411,720	5,333,066	(78,654)	5.5%
<b>SALES AND USE TAXES</b>	2,642,477	2,730,274	2,709,464	(20,810)	2.5%	2,850,795	2,826,774	(24,021)	4.3%
<b>STATE LOTTERY</b>	414,063	431,991	431,991	0	4.3%	448,385	448,385	0	3.8%
<b>FRANCHISES, EXCISES, LICENSES, FEES:</b>									
Business Franchise Taxes	145,180	154,843	154,843	0	6.7%	158,017	158,017	0	2.0%
Tax on Insurance Companies	193,718	209,544	220,046	10,502	13.6%	215,818	226,647	10,829	3.0%
Death Taxes	184,725	146,581	133,937	(12,644)	-27.5%	149,925	136,884	(13,041)	2.2%
Property Transfer Tax	--	47,269	47,269	0	--	47,269	47,269	0	--
Tobacco Tax	209,887	211,778	211,778	0	0.9%	275,566	275,566	0	30.1%
Alcoholic Beverages Excise Tax	25,747	26,172	26,172	0	1.7%	26,598	26,598	0	1.6%
Motor Vehicle Fuel Tax	12,266	12,349	12,349	0	0.7%	12,608	12,608	0	2.1%
District Courts	72,592	71,168	71,168	0	-2.0%	70,456	70,456	0	-1.0%
Clerks of the Court	42,634	48,888	48,888	0	14.7%	45,845	45,845	0	-6.2%
Hospital Patient Recoveries	97,788	61,393	61,393	0	-37.2%	73,927	73,927	0	20.4%
Interest on Investments	71,510	42,877	35,877	(7,000)	-49.8%	45,076	38,076	(7,000)	6.1%
Miscellaneous	198,598	198,730	198,730	0	0.1%	211,306	211,306	0	6.3%
Total Franchises, Excises, Licenses, Fees	1,254,644	1,231,592	1,222,450	(9,142)	-2.6%	1,332,411	1,323,199	(9,212)	8.2%
<b>TOTAL CURRENT REVENUES</b>	9,356,068	9,524,288	9,418,156	(106,132)	0.7%	10,043,311	9,931,424	(111,887)	5.4%
Transfers	119,465	--	--	--	--	--	--	--	--
Tax Amnesty	28,509	--	--	--	--	--	--	--	--
Heritage Structure Rehabilitation Credit <sup>2</sup>	--	(51,600)	(51,600)	0	--	(31,700)	(31,700)	0	--
<b>GRAND TOTAL</b>	9,504,042	9,472,688	9,366,556	(106,132)	-1.4%	10,011,611	9,899,724	(111,887)	5.7%

<sup>1</sup> Does not include technical adjustments and other revenues assumed in the budget.

<sup>2</sup> Not separately stated for fiscal year 2002