The Maryland Budget: A State of Crisis

by Tori Gorman

The Maryland Public Policy Institute

ABOUT THE AUTHOR

Tori Gorman is a public policy analyst and former economist for the Maryland General Assembly. In addition to her work at the state level, Ms. Gorman advised members of the U.S. Congress as a budget analyst for the U.S. House of Representatives Committee on the Budget. She holds both a bachelor's degree and master's degree in Economics from the University of California-Santa Cruz.

The Maryland Budget:
A State of Crisis

by Tori Gorman

Published by
The Maryland Public Policy Institute
P.O. Box 195
Germantown, Maryland 20875-0195
(240) 686-3510
www.mdpolicy.org

Like many states, Maryland is grappling with sizeable budget deficits that are forcing state lawmakers to make tough decisions. After a year in which General Fund revenues fell, Gov. Robert L. Ehrlich inherits an ominous legacy from his predecessor—a $550 million shortfall in the current fiscal year and a $1.2 billion deficit for fiscal year (FY) 2004. In addition, the new governor will have to decide whether to honor popular but pricey spending commitments made as Parris Glendening left the State House—including a $100 million raise for state employees and Glendening's Smart Growth initiative.

Maryland is not alone in its budget morass. According to a recent survey by the National Governors Association (NGA), nearly every state is experiencing a fiscal crisis. The NGA reports that in FY 2002, 37 states cut more than $12.6 billion from their budgets, the highest number of states and largest amount cut (in dollar terms) in any given year. [1]

Theories abound as to the root cause of Maryland's budget woes. Some analysts point to the softening economy and the "aftershocks" of the September 11th tragedy. Others blame the federal and state tax cuts promulgated in the late 1990s when coffers seemingly overflowed with surplus revenues. Significant spending increases, especially during Gov. Glendening's second term, also have been singled out for criticism.

Although the numbers are daunting, on a percentage basis Maryland's budget deficits are only slightly larger than those experienced during the last budget crisis in 1991-1992. Unfortunately, the solutions available to close the gap between revenues and program needs are much more limited this time around. Regardless, any fiscally responsible solution to Maryland's budget problems will require permanent, structural changes that bring spending in line with revenues. Lawmakers must be wary of papering over short-term deficits with gimmicks at the expense of long-term financial health.

DEFICIT STRUCTURE

The Constitution of Maryland requires that the state operating budget be balanced; total estimated revenues must equal or exceed total appropriations. The primary source of revenue for the operating budget is the General Fund. As described in Table 1, the deficits that lawmakers must address this fiscal year and next occur on the General Fund side of the budget.

1. *The Fiscal Survey of the States*, National Governors Association, November 2002.

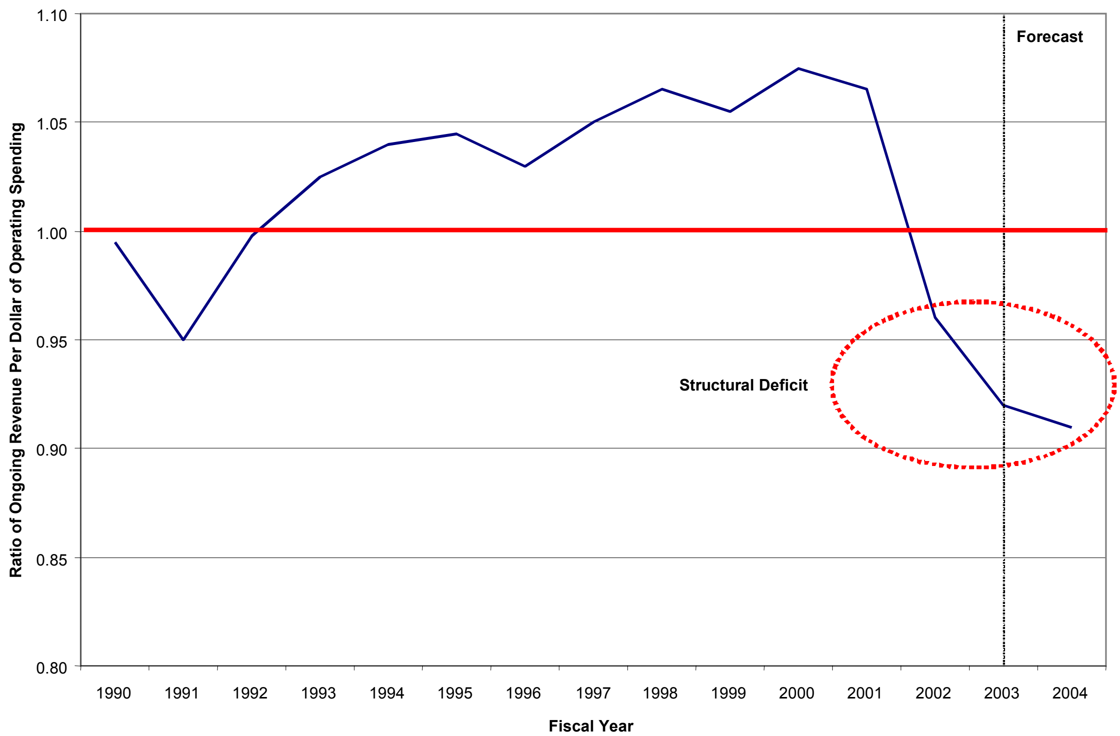
Table 1. Maryland General Fund: Recent History and Outlook
($ in Millions)

	Actual FY 2002	Forecast FY 2003	Forecast FY 2004
Funds Available			
Current Revenues	$9,504	$9,473	$10,012
Beginning Fund Balance	538	309	0
Transfers to General Fund	814	334	0
Subtotal Funds Available	10,857	10,116	10,012
Appropriations			
Operating Costs	10,004	10,434	11,149
Capital	366	50	47
Appropriations to Reserve Fund	177	181	0
Subtotal Spending	10,548	10,665	11,196
Surplus (Deficit)	**$309**	**($549)**	**($1,184)**

Source: Department of Legislative Services for the Spending Affordability Committee, November 2002, updated to reflect most recent revenue projections released by the Board of Revenue Estimates in December 2002. Totals may not add because of rounding.

Maryland's operating budget deficit is structural in nature. Specifically, ongoing operating revenue is no longer sufficient to meet ongoing spending obligations. (See Figure 1.) Phrased differently, the budget suffers from a persistent, systemic imbalance. The deficit *is not* the result of a single exogenous shock that can be papered over with one-time only revenue plugs. Structural reform is necessary to bring spending in line with revenues. Moreover, as shown in Table 2, the Department of Legislative Services (DLS) predicts that the structural deficit extends beyond the budget window that will be addressed in the 2003 legislative session.

Figure 1. Ongoing Revenue Per Dollar of Operating Spending



Source: Maryland Department of Legislative Services, Office of Policy Analysis

Table 2. Structural Deficits Are Expected to Extend Beyond Fiscal Year 2004
($ in Millions)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Revenues	$9,473	$10,012	$10,457	$11,009	$11,508
Expenditures	10,665	11,196	12,095	12,882	13,729
Surplus (Deficit)	**($590)**	**($1,184)**	**($1,638)**	**($1,873)**	**($2,221)**
Annual Chg.		*($594)*	*($454)*	*($235)*	*($348)*

Source: Department of Legislative Services for the Spending Affordability Committee, November 2002 updated to reflect most recent revenue projections released by the Board of Revenue Estimates in December 2002. Totals may not add because of rounding.

General Obligation Debt. In addition to the operating deficit, DLS estimates that in fiscal years 2004 through 2008, the average annual growth rate in General Obligation (GO) debt service will outpace the estimated growth rate in revenues needed to support it. GO debt service primarily is paid for through property taxes and general revenues. Between FY 2004 and FY 2008, Maryland property tax revenues are expected to rise an average of three percent per year, including increases in assessments.[2] General Fund revenues are expected to rise an average of 5.2 percent per year.

2. Debt Affordability Briefing before the Spending Affordability Committee, Department of Legislative Services, November 19, 2002.

Debt service on GO bonds, however, is expected to rise at an average of 6 percent, outpacing its two primary revenue sources. Those projections are shown in Table 3.

Table 3. GO Debt Service Outpaces Growth in Supporting Revenues

Average Annual Growth Rates Fiscal Years 2004-2008	
Total General Obligation Debt	6.0%
General Fund Revenues	5.2%
Property Tax Revenues	3.0%

Source: Maryland Department of Legislative Services for the 2002 Spending Affordability Committee, November 2002

If the property tax rate remains constant, over time more general funds will be required to meet increasing debt service requirements. That will require a diversion of funds from other purposes and possibly exacerbate the state's operating budget deficit.

A UNIQUE CONFLUENCE OF EVENTS

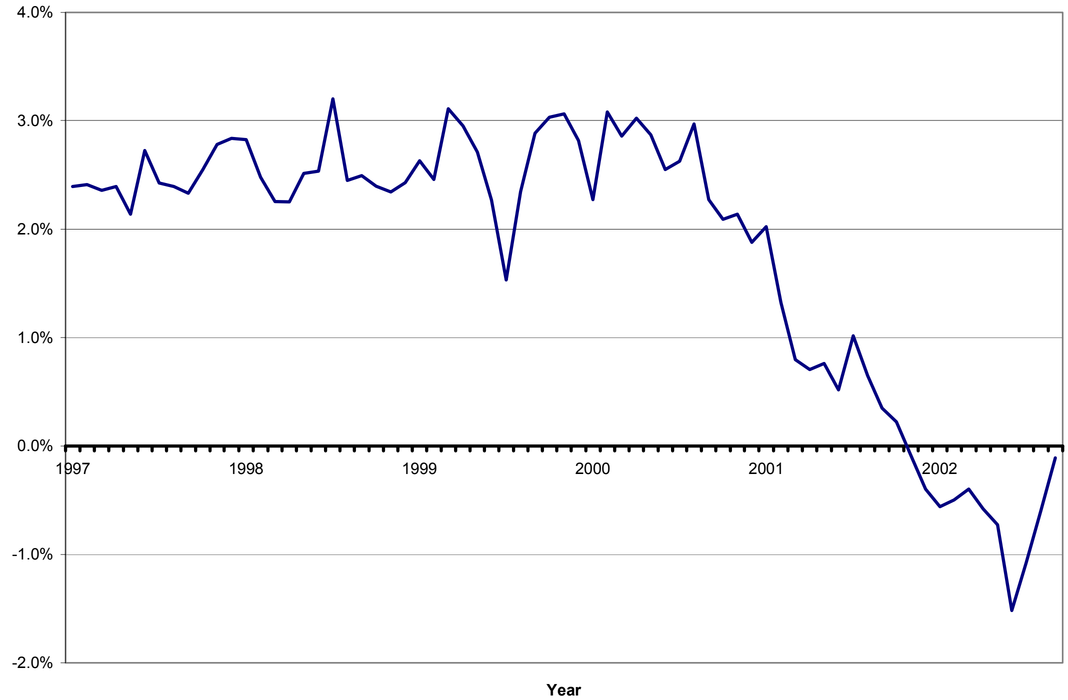
State lawmakers face a daunting task. Not only must they address a sizeable current year shortfall, but they must contend with a structural deficit in the outyears that could threaten the state's financial health. How did that happen? Evidence shows that Maryland's fiscal crisis results from the unique confluence of three events: lackluster economic growth, significant increases in state spending, and a sizeable cut in the state personal income tax. Experienced independently, the state budget may have been able to absorb each impact—some with minor adjustments—but the combined effect of all three factors has undermined state finances.

Lackluster Economic Growth. During the 1990s, stock options and mutual funds helped extend stock ownership to the working class. The bull market of the 1990s created a wealth effect that stimulated a nationwide consumer-driven spending spree lasting into the new millennium. In Maryland, job and income growth followed similarly. According to the Maryland Bureau of Revenue Estimates, "The [market] bubble supercharged revenue growth during the late 1990s," and revenues gained an average of 8.1 percent per year, even after the effects of the state personal income tax cut.[3] Strong economic growth gave way to an economic slowdown however, and in March 2001 the United States entered a short-lived recession.

Maryland's economy was unable to escape the effects of the national recession, although the impact was somewhat mitigated by the state's large population of federal workers (which represents a stable employment base) and Maryland's minimal exposure to the manufacturing-led recession. According to the Bureau of Labor Statistics, state employment growth slowed in the last quarter of 2001 and the number of working Marylanders actually fell in 2002. (See Figure 2.) Although the national economy has begun to create jobs, there is no clear sign that the downward trend in Maryland employment has reversed itself. Employment continued to decline in October 2002 (the most recent data available), albeit only by 0.1 percent.

3. *Report of the Maryland Board of Revenue Estimates on Estimated Maryland Revenues, Fiscal Years Ending June 30, 2003 and June 30, 2004*, Bureau of Revenue Estimates, December 2002, p. 26.

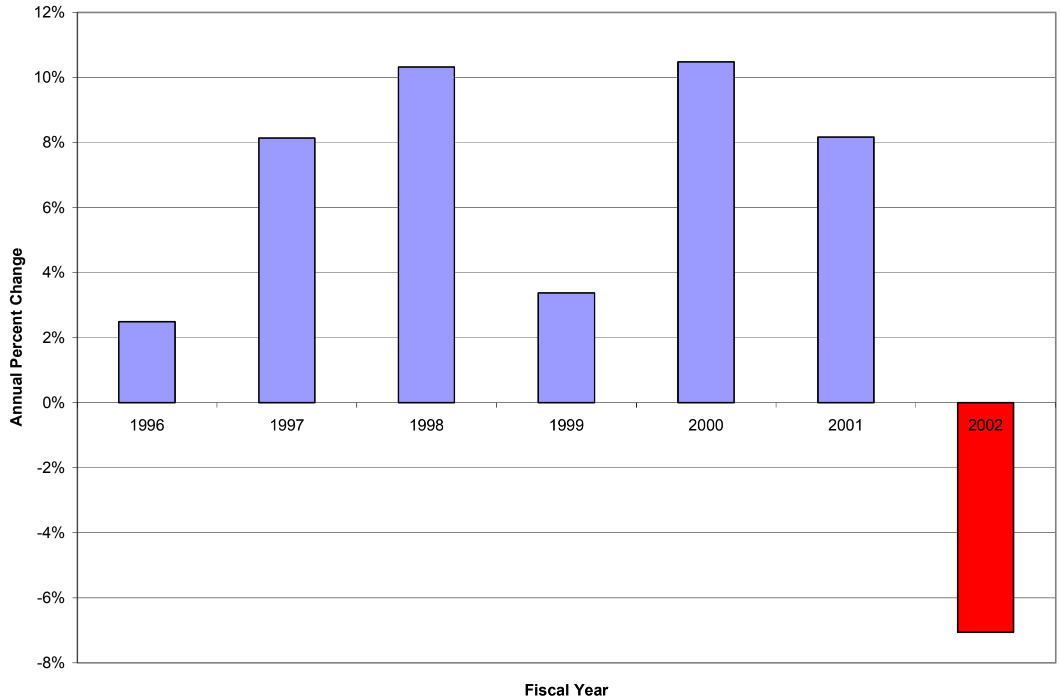
Figure 2. Growth in Maryland Total Non-Farm Employment
Percent Change, Year over Year



Source: Bureau of Labor Statistics

The impact of the regional recession on revenues was narrowly focused. Nearly all of the recession and the slumping stock market was manifest in falling personal income tax revenues, specifically a rapid decline in capital gains taxes. Because of the proliferation of stock ownership, taxes on capital gains had become an important component of personal income tax revenues. When the stock market entered the current protracted bear market, Maryland personal income tax collections fell, as shown in Figure 3.

Figure 3. General Fund Personal Income Tax Collections
Annual Percent Change



Source: Maryland Bureau of Revenue Estimates

The importance of capital gains taxes to Maryland state revenue collections was never more evident than in FY 2002. That year—a year in which corporate accounting scandals hammered the capital markets—personal income tax revenues from withholding (typically wage and salary income) actually grew 3 percent, but estimated and final payments (conduits through which capital gains and losses are reported) fell 18 percent and refunds increased 18 percent.[4]

For FY 2003, the Board of Revenues Estimates (BRE) has again revised downward its estimate of general fund revenues, this time by $293 million. Of this, $265 million, or 91 percent, was attributable to a write-down in personal income tax revenues.

While the current budget shortfall can be attributed in part to lackluster economic growth and a concomitant slowdown in personal income tax receipts, the structural deficit that exists beyond the 2003 window is not adequately explained by those factors. Although income tax collections are expected to be flat in FY 2003, the BRE expects personal income tax receipts to grow at an annual average of 5.7 percent between 2003 and 2007. Total General Fund revenues are expected to grow an average of five percent per year. Since General Fund revenues are expected to grow moderately in the future, other factors must contribute to outyear deficits.

Spending. Like many other states, Maryland took advantage of significant budget surpluses in the late 1990s and enacted significant ongoing spending increases for high-priority projects and

4. Maryland Office of the Comptroller, Bureau of Revenue Estimates.

programs such as medical assistance, primary and secondary education, capital improvements, and higher education. In addition, the state workforce has grown appreciably and with it, the cost of providing fringe benefits like medical, prescription and dental coverage. Overall, general fund spending across all categories increased $3.1 billion, or 43 percent, between FY 1996 and FY 2002.

In Maryland, the degree to which General Fund spending growth has outpaced revenue growth has been remarkable. The average annual growth rate in General Fund spending between FY 1996 and FY 2002 was 6.1 percent, whereas revenue growth averaged 4.7 percent per year over the same time period. In a state where the Executive branch wields tremendous budget power, during Gov. Glendening's eight years in office lawmakers adopted five budgets that incorporated general fund spending increases in excess of revenue growth—three during his last term in office—making the current budget deficits almost inevitable.

Table 4 illustrates the composition of general fund spending in Maryland today and how it has changed since Gov. Glendening submitted his first full-year budget (for FY 1996).

Table 4. Analysis of General Fund Spending FY 1996-2002
($ in Millions)

Category	FY 1996 Actual	Percent of Total	FY 2002 Working Appr.	Percent of Total	FY96-02 Percent Change	FY96-02 $ Change
Education / Libraries	$2,123.7	28.7%	$2,847.3	27.0%	34.1%	$723.6
Medical Assistance	1,041.8	14.1	1,547.0	14.7	48.5	505.2
Health	749.0	10.1	1,090.0	10.3	45.5	341.0
Public Safety / Police	634.4	8.6	920.8	8.7	45.1	286.4
Higher Education	623.8	8.4	961.3	9.1	54.1	337.4
Other Executive Agencies	366.0	5.0	553.2	5.3	51.1	187.2
Capital	97.2	1.3	366.4	3.5	277.1	269.2
Human Resources	220.4	3.0	289.4	2.7	31.4	69.1
Judicial / Legislative	201.2	2.7	316.5	3.0	57.3	115.3
Other Education	155.2	2.1	275.5	2.6	77.6	120.4
Debt Service	149.2	2.0	204.0	1.9	36.7	54.7
General Government	111.5	1.5	200.9	1.9	80.2	89.4
Community Colleges	118.8	1.6	178.5	1.7	50.2	59.7
Juvenile Justice	106.2	1.4	162.2	1.5	52.7	56.0
Foster Care Payments	90.6	1.2	137.8	1.3	52.2	47.2
Reserve Fund	250.0	3.4	176.8	1.7	-29.3	(73.2)
Ag. / Nat. Res. / Env.	88.3	1.2	147.3	1.4	66.8	59.0
Assistance Payments	137.1	1.9	55.5	0.5	-59.6	(81.6)
Property Tax Credits	56.0	0.8	55.7	0.5	-0.6	(0.3)
Health	38.5	0.5	56.9	0.5	47.9	18.4
Systems Reform Initiative	28.5	0.4	43.1	0.4	51.2	14.6
Total	**$7,387.4**	**100.0%**	**$1,0536.0**	**100.0%**	**42.6%**	**$3,148.5**

Source: Department of Legislative Services, December 2002

Some observations:

- The composition of spending has not changed much with the exception of spending on capital projects which has more than tripled (from $97 million or 1.3 percent of general fund spending in FY 1996 to $366 million or 3.5 percent of general fund spending in FY 2002).

- Between FY 1996 and FY 2002, the categories that received the greatest spending increases on an absolute basis (in dollar terms) were:
  - Primary and Secondary Education / Libraries ($724 million)
  - Medical Assistance ($505 million)
  - Health ($341 million)
  - Higher Education ($337 million)
  - Public Safety / Police ($286 million)

- Between FY 1996 and FY 2002, the categories that received the greatest spending increases on a percentage basis were:
  - Capital (277 percent)
  - General Government (80 percent)
  - Other Education (78 percent)
  - Agriculture / Natural Resources / Environment (67 percent)
  - Judicial / Legislative (57 percent)

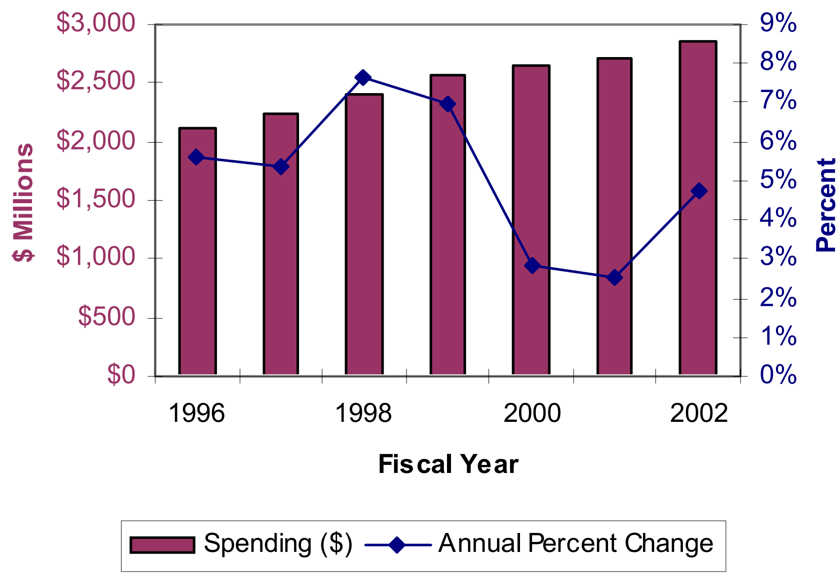
- The categories of spending that received the largest increases on a percentage basis, combined, compose less than 13 percent of overall General Fund spending.

The following section provides a brief summary of key spending patterns that led to the budget deficits the state is facing today—deficits that Maryland will continue to face in the future if structural changes are not adopted.

Schools and Libraries. General Fund spending on education is the largest category of spending, comprising 27 percent of the operating budget in FY 2002. Between FY 1996 and FY 2002, general fund spending on education and libraries increased $724 million, or 34 percent, as shown in Figure 4. Enrollment growth, new funding formulas for school and libraries, spending increases on teachers (salary increases, recruiting and retention bonuses, quality incentives) and efforts to reduce class size drove growth. In addition, during the 2002 session, lawmakers adopted new funding recommendations by the Commission on Education Finance, Equity and Excellence that will increase state aid for education by an additional $3.4 billion over the next 5 years.[5]

5. *Ibid*, p. L-11.

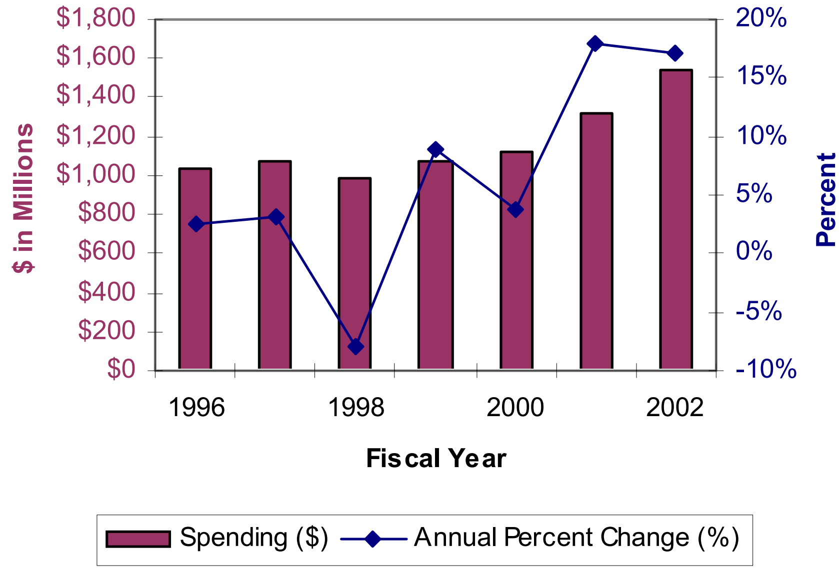
Figure 4. General Fund Spending on Education / Libraries
FY 1996-FY 2002



Source: Maryland Department of Legislative Services, Office of Policy Analysis

Medical Assistance. General Fund spending on medical assistance payments is the second largest category of general fund spending, comprising nearly 15 percent of the operating budget in FY 2002. Spending in this area grew $505 million, or 49 percent, between FY 1996 and FY 2002, as shown in Figure 5. That growth was largely the result of growth in entitlements—specifically, Medicaid enrollment growth, the adoption and expansion of the Maryland Children's Health Program, higher nursing home reimbursement rates, and general medical cost inflation.

Figure 5. General Fund Spending on Medical Assistance
FY 1996-FY 2002



Source: Maryland Department of Legislative Services, Office of Policy Analysis

During the 1997 session, Maryland established "HealthChoice" under a Medicaid waiver from the federal government. HealthChoice uses managed care organizations (HMOs) to deliver healthcare services to low-income individuals. Enrollment growth has been substantial, rising from 300,000 in FY 1998 to 435,000 today, a 45 percent increase.[6]

In 1998, Gov. Glendening created the Maryland Children's Health Program (MCHP) which extended comprehensive medical coverage to children up to age 19 with family incomes up to 200 percent of the federal poverty level (FPL). Since that time, the state has enacted several program expansions and more than 100,000 children have been enrolled.

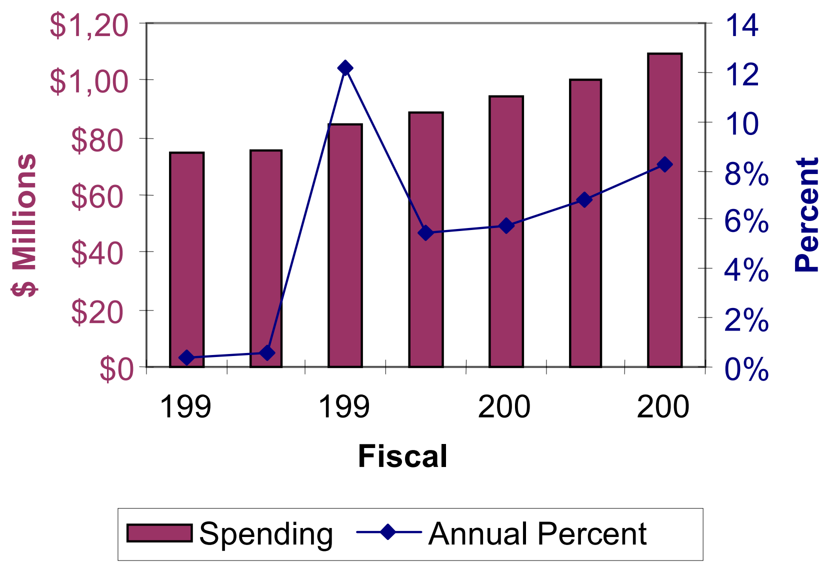
In 2000, the state increased funding for the Medicaid nursing home reimbursement formula by adding $10 million in both FY 2002 and FY 2003 and added another $10.1 million to expand community-based services.

Health. This category refers to all state health spending outside of medical assistance payments such as Medicaid and the Maryland Children's Health Program as well as local health aid to counties and municipalities. The "Health" category encompasses the remainder of the budget for the Department of Health and Mental Hygiene such as the Mental Health Administration, the Alcohol and Drug Abuse Administration, and Developmental Disabilities Administration. It is the third largest category of General Fund spending. Between FY 1996 and FY 2002, spending in this area increased $341 million, or nearly 46 percent, as shown in Figure 6.

---

6. *Major Issues Review, 1999–2002*, Maryland Department of Legislative Services, July 2002, p. J-1.

Figure 6. General Fund Spending on Health
FY 1996-FY 2002



Source: Department of Legislative Services, Office of Policy Analysis

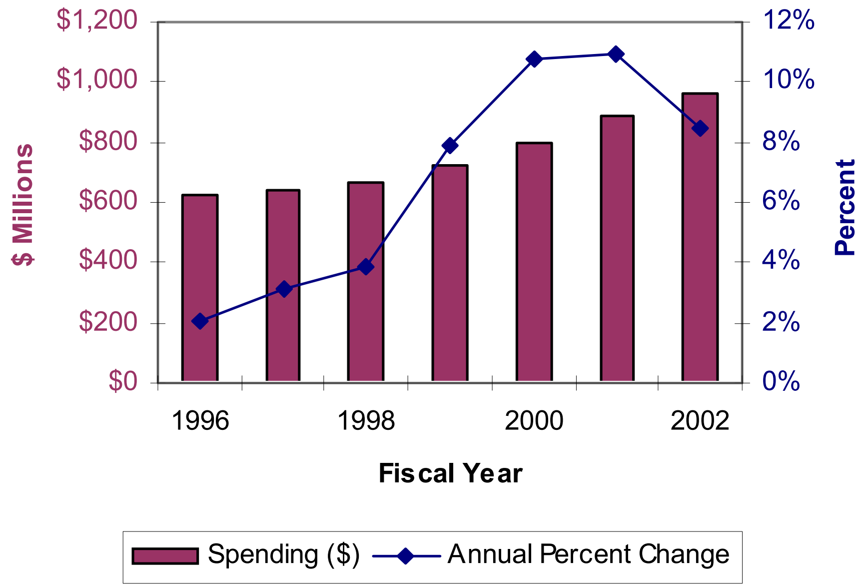
The 2001 General Assembly session marked a new emphasis on the funding deficiencies in Maryland's fee-for-service mental health system. Between FY 2000 and FY 2002, funding for community services increased $35.7 million, or 9.7 percent. The state invested similarly at its state-run facilities where spending increased $15 million, or 6.6 percent, over the same period. State budget analysts warn, however, that program support still is not adequate to meet the demand for community services and increased funding for mental health services will be necessary, potentially exacerbating future year General Fund budget deficits.

The budget for the Alcohol and Drug Abuse Administration (ADAA) will nearly double between FY 2000 and the end of FY 2003, largely as a result of dedicated cigarette restitution funds that helped the state boost treatment capacity. Overall, the budget for the ADAA increased $45.5 million between FY 2000 and FY 2002, a 61 percent increase.

Two major initiatives have significantly increased the budget for the Developmental Disability Administration (DDA) the last four years. First, in FY 1999, the DDA implemented its Waiting List Initiative designed to reduce the waiting time for constituent community services. State budget analysts estimate that the program provided services to an additional 6,000 clients at a five-year cost of $481 million. Second, in 2001 lawmakers acted to eliminate the wage disparity between employees in state residential centers and direct-support workers employed by community providers. As a result of those initiatives, the budget for the DDA increased $66.9 million, or 16.4 percent, between FY 2000 and FY 2002.

Higher Education. Between FY 1999 and FY 2002, General Fund support for higher education increased $212 million, or 28 percent, as shown in Figure 7. Growth was spurred in part by funding guidelines established by the Maryland Higher Education Commission, which suggested that financial support for state institutions be based on "peer institutions" with similar characteristics. With the exception of St. Mary's College of Maryland, all universities and other segments of higher education received double-digit increases in funding in FY 2000 and FY 2001.

Figure 7. General Fund Spending on Higher Education
FY 1996-FY 2002

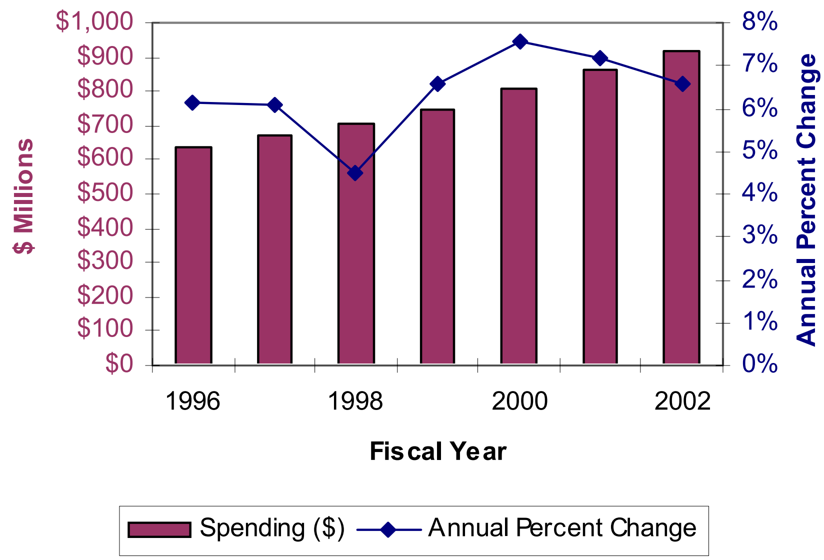


Source: Maryland Department of Legislative Services, Office of Policy Analysis

Public Safety / Police. General fund spending on public safety and police is the fourth largest component of the operating budget, comprising 8.7 percent of the spending in FY 2002. Spending in this area increased $286 million, or 45 percent, between FY 1996 and FY 2002, as shown in Figure 8. During that time, the state added new public safety and administrative personnel and enhanced the retirement benefits for current retirees and active duty members.[7] Retirement benefit changes included a reduction in the retirement age, enhancement of the formula used to calculate initial retirement benefits, increased retirement fund contributions by employees, and lump-sum payments to existing retirees.

7. For additional information on the number of FTEs added, see Table 5 below.

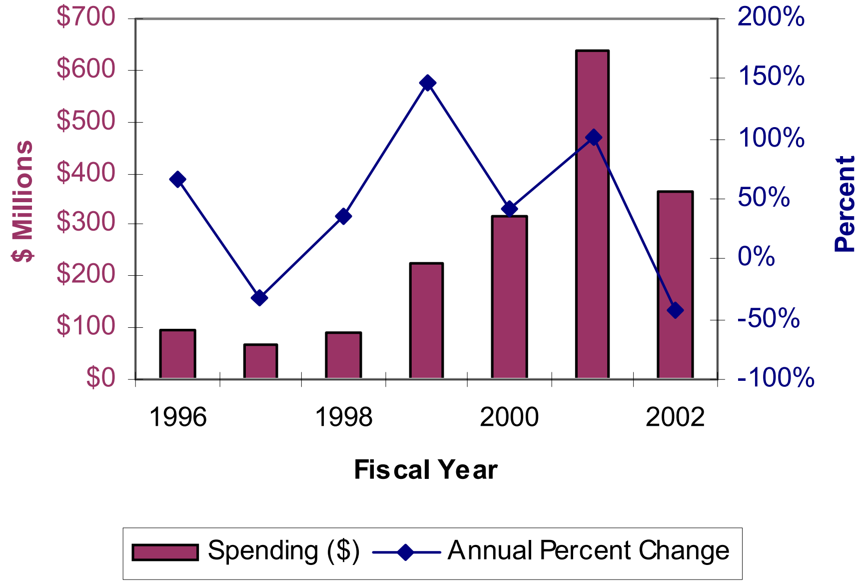
Figure 8. General Fund Spending on Public Safety / Police
FY 1996-FY 2002



Source: Department of Legislative Services, Office of Policy Analysis

Capital. As shown in Figure 9, General Fund spending on capital projects increased $269 million between FY 1996 and FY 2002, nearly 277 percent. Clearly this category was a beneficiary of the large revenue surpluses that Maryland experienced in the late 1990s. Surplus general funds in FY 2001-2002 were primarily directed to capital projects for public school construction, new facilities at state colleges and universities, and local projects. As noted by the Department of Legislative Services in a briefing before the Spending Affordability Committee, the use of large amounts of General Fund revenues for higher education capital projects in the 1990s was a new phenomenon.

Figure 9. General Fund Spending on Capital Projects



Source: Maryland Department of Legislative Services, Office of Policy Analysis

The economy slowed following the 2001 session, however, forcing lawmakers to rescind many capital projects slated for FY 2003 and refinance them with public debt. During the 2002 session, the General Assembly withdrew $457 million of General Fund-backed debt to help balance the budget.

State Workforce. The number of regular, non-contractual state employees has grown 12.3 percent since FY 1998, even with the recent round of eliminations. At its highest in FY 2002, the state authorized over 82,000 full-time equivalent (FTE) positions. Current employment stands at nearly 81,000 FTEs.[8] In addition to the increased salary costs of a growing workforce, health, prescription, and dental insurance premiums are expected to increase a total of 14 percent in FY 2004, adding further expense to the state wage bill.

The largest growth in FTEs in absolute terms has been in higher education—over 2,700 new FTEs have been added since FY 1998. (See Table 5.) On a percentage basis, the largest increase has been in the juvenile justice system; investigative reports in 1999 revealed problems within the juvenile justice system necessitating reforms.

8. Department of Legislative Services Briefing for the Spending Affordability Committee, November 19, 2002. Of these, approximately 58,700 FTEs are supported by the General Fund.

Table 5. Regular State Workforce Over Last Five Years
Units: Full Time Equivalent Positions (FTEs)

Agency / Service Area	Regular FY 1998 Actual	Regular FY 2003 Working	New FTEs Added	Percent Change 1998-2003
Higher Education	18,613.9	21,399.5	2,785.6	15.0%
Human Resources	6,381.8	7,733.1	1,351.3	21.2%
Public Safety and Correctional	10,507.7	11,562.5	1,054.8	10.0%
Juvenile Justice	1,075.0	1,996.2	921.2	85.7%
Judiciary and Legal	3,724.3	4,584.7	860.3	23.1%
Subtotal	**40,302.7**	**47,276.0**	**6,973.2**	**17.3%**
Executive & Administrative Control	1,315.9	1,603.7	287.8	21.9%
Transportation	9,070.5	9,318.5	248.0	2.7%
Natural Resources	1,362.5	1,577.2	214.7	15.8%
General Services	598.0	802.5	204.5	34.2%
Other Education	1,840.4	2,018.6	178.2	9.7%
Budget & Management	390.5	531.3	140.8	36.1%
Environment	899.4	1,032.0	132.6	14.7%
Police & Fire Marshal	2,478.5	2,574.5	96.0	3.9%
Labor, Licensing & Regulation	1,534.0	1,617.0	83.1	5.4%
Business & Economic Development	236.0	319.0	83.0	35.2%
Legislative	652.0	730.0	78.0	12.0%
Agriculture	407.4	460.0	52.7	12.9%
Housing & Community Development	380.5	424.0	43.5	11.4%
Retirement	154.5	184.5	30.0	19.4%
Financial & Revenue Administration	2,078.2	2,102.2	24.0	1.2%
Health & Mental Hygiene	8,229.3	8,206.9	(22.4)	(0.3%)
Total	**71,930.2**	**80,777.9**	**8847.7**	**12.3%**
Summary:				
Non Higher Education	53,316.3	59,378.4	6,062.1	11.4%
Higher Education	18,613.9	21,399.5	2,785.6	15.0%

Source: Maryland Department of Legislative Services, Office of Policy Analysis

The state has enacted a hiring freeze, but of the nearly 58,700 FTEs supported by the General Fund, over half (52 percent) are exempt from the freeze because of their critical nature (e.g., public safety officials, judges, public defenders, etc.).

Federal Tax Cuts. Federal and state governments reacted to the surpluses of the late 1990s with tax cuts. The federal tax cuts promulgated by President Bush in 2001, however, had little to no effect on Maryland revenues and thus have no bearing on the state's current fiscal crisis.

The rate cuts on the federal personal income tax actually enhanced Maryland revenue collections. The tax cut was retroactive and the Bush administration ordered the Treasury to immediately remit refund checks to all qualified taxpayers. The Maryland Office of the Comptroller was able to garnish the refund checks of state residents who carried overdue tax liabilities owed to the State. Thus, the Bush tax cut actually enhanced compliance at the state level and provided the state with a one-time revenue bump.

Other elements of the Bush tax cut would have had a significant impact on Maryland tax collections but the state enacted changes to preserve its revenue base. For example, Maryland de-coupled from the federal estate tax cut and other business-related tax cuts. State tax liabilities no longer will be based on federal adjusted gross income, but rather Maryland adjusted gross income.

Some of the federal tax changes will have an impact on Maryland revenue, such as the deduction for higher education expenses and the expansion of the Earned Income Tax Credit, but the impact of those changes is small and will be felt in the future.[9]

State Tax Cuts. In 1997, Maryland adopted a 10 percent personal income tax rate cut phased in over five years. The cost was significant. Budget analysts estimated the cost of the tax cut at $1.4 billion over 5 years, or $550 million per year when fully implemented.

Critics blame the state tax cut for the current fiscal imbalance, especially the General Assembly's desire to implement the final phase of the tax cut in the midst of increasing budget deficits. This argument has merit. Although politically unpopular, delaying the implementation of the final phase of the tax cut would have reduced the budget deficit by $100 million in FY 2003 alone. In isolation, the state could have weathered the budget impact of the tax cut. But the combined effect of the tax cut, the weakened regional economy, and the significant spending increases promulgated in fiscal years 2000-2002 was more than state finances could tolerate.

Given the current status of the Maryland economy, however, rescinding the tax cut could potentially have a negative effect. Higher taxes would reduce household disposable income and could possibly cause consumer spending to fall and further weaken the local economy.

Moreover, proponents of rescinding the tax cut ignore the fact that without it, the budget surpluses probably would have been spent in other ways. If the tax cut had instead been spent on ongoing programs that grow faster than state taxable income, Maryland's structural deficit would be even larger today. So while the final phase of the tax cut did exacerbate the current deficit, without the tax cut overall, it is possible the state fiscal crisis would be much worse.

PAINFUL SOLUTIONS, BUT KEY OPPORTUNITIES

The failure of lawmakers to respond to the changing economic climate has created a structural deficit: Ongoing revenues are no longer sufficient to keep pace with spending needs. For that reason, one-time revenue "plugs" will be unable to erase future deficits. Instead, lawmakers will have to address the multi-year shortfalls with fundamental reforms. As the Commission on Maryland's Fiscal Structure has concluded, only tough choices remain; many of the "painless" solutions that helped Maryland through the 1991-1992 budget crises are no longer available.[10] According to the

9. "Impact of the Economic Growth and Tax Relief Reconciliation Act of 2001 on Maryland Revenues," Maryland Bureau of Revenue Estimates (undated).
10. During the 1990-91 budget crisis, the state rescinded several revenue sharing programs with the localities, promulgated a significant tobacco tax increase, and established a system of biennial license fees, the latter of which provided a one-time revenue bump.

commission, current solutions include politically unpopular items such as program reductions, one-time fund transfers, salary reductions for state employees, and tax and fee increases.[11]

Despite the dismal fiscal climate facing the new governor, there is some good news. First, the decline of the stock market and the demise of stock options as a compensation tool should reduce the importance of capital gains in Maryland's personal income tax revenues. That reduces variability and unpredictability in the state's largest source of revenue, thereby improving the accuracy of the revenue forecasts.

Second, the latest revision of revenue estimates for the current and upcoming fiscal years left the overall deficits relatively unchanged. That may be the first empirical evidence that the regional economy has bottomed and that a recovery may be on the horizon.

11. "Budget and Revenue Options," Presentation to the Commission on Maryland's Fiscal Structure by the Department of Legislative Services, November 14, 2002.

Bibliography

1. *2002 Spending Affordability Committee Report and Recommendations to the Governor and the Legislative Policy Committee*, Staff of the Maryland Spending Affordability Committee, November 2002.

2. *Budget and Revenue Options*, Presentation to the Commission on Maryland's Fiscal Structure, Maryland Department of Legislative Services, November 14, 2002.

3. *The Fiscal Survey of the States*, National Governors Association, November 2002.

4. *Impact of the Economic Growth and Tax Relief Reconciliation Act of 2001 on Maryland Revenues*, Bureau of Revenue Estimates, Maryland Office of the Comptroller.

5. *Major Issues Review 1999-2002*, Maryland Department of Legislative Services, July 2002.

6. *Report of the Maryland Board of Revenue Estimates on Estimated Maryland Revenues, Fiscal Years Ending June 30, 2003 and June 30, 2004*, Maryland Board of Revenue Estimates, December 2002.

7. *Spending Affordability Briefing*, Maryland Department of Legislative Services, November 12, 2002

8. *Spending Affordability Briefing*, Maryland Department of Legislative Services, November 19, 2002

Founded in 2001, The Maryland Public Policy Institute is a nonpartisan public policy research and education organization that focuses on state policy issues. Our goal is to provide accurate and timely research analysis of Maryland policy issues and market these findings to key primary audiences.

The mission of The Maryland Public Policy Institute is to formulate and promote public policies at all levels of government based on principles of free enterprise, limited government, and civil society. The Institute is a member of the State Policy Network.

In order to maintain objectivity and independence, the Institute accepts no government funding and does not perform contract research.

The Maryland Public Policy Institute is recognized as a 501 (C) (3) research and education organization under the Internal Revenue Code.

The Maryland Public Policy Institute | P.O. Box 195 | Germantown, Maryland 20875-0195
www.mdpolicy.org | (240) 686-3510