
Maryland's Fiscal Structure and the Deficit Within

**Presentation to the
Senate Budget and Taxation Committee
House Committee on Appropriations
House Committee on Ways and Means**

**Department of Legislative Services
Office of Policy Analysis
Annapolis, Maryland**

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What We Have Been Asked to Do

- Discuss the structure of State finances with special focus on the long-term condition of the general fund
- Examine the effect of funding mandates and entitlements on the structure of the budget
- Describe a set of actions that could restore structural balance to the general fund without new revenues
- This document addresses the first topic

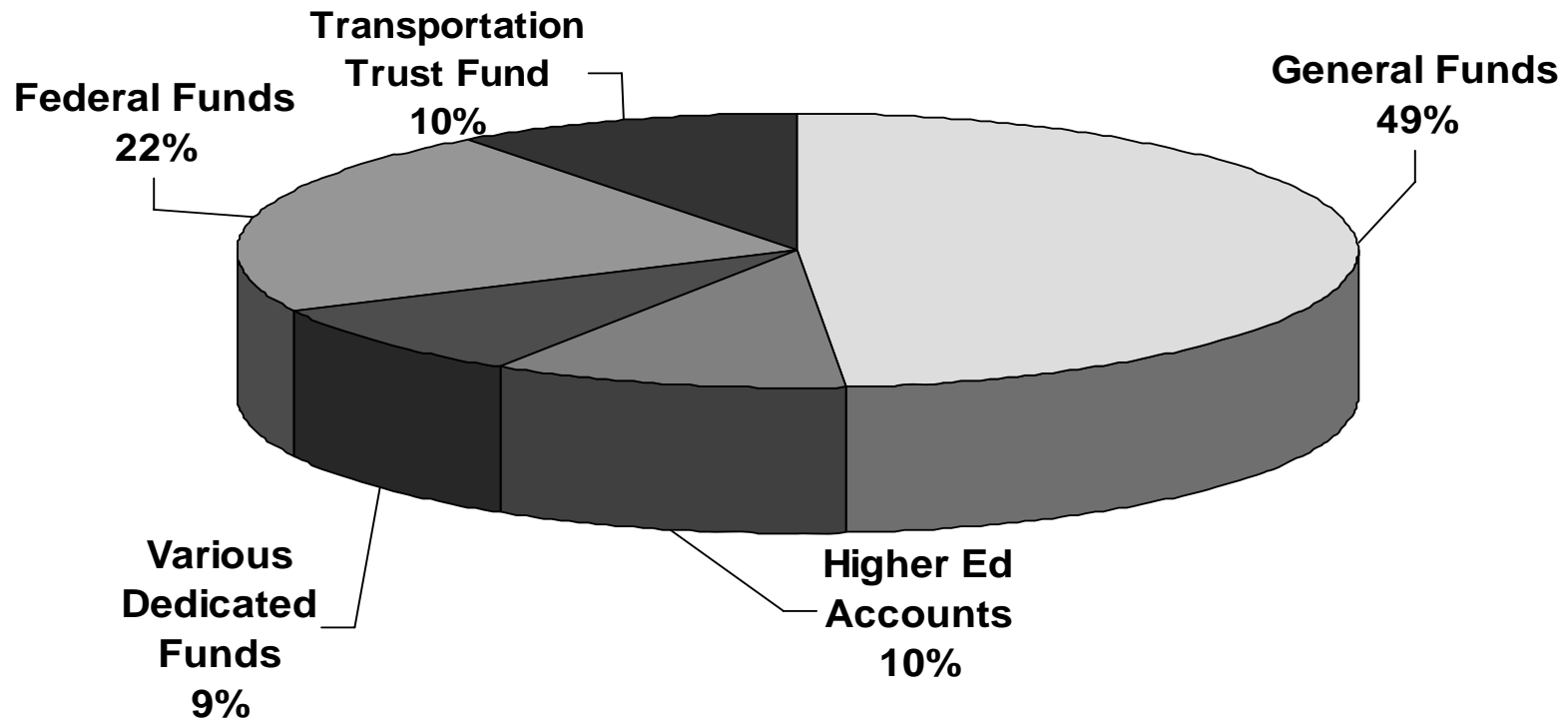
Maryland State Budget

Sources of Revenue

- General Funds – Primarily revenues from broad-based taxes not dedicated to a specific purpose
- Dedicated Funds – Other State revenues, primarily from taxes and fees, dedicated to specific purposes; higher education (mainly tuition) and transportation revenues account for over two-thirds of these funds
- Federal Funds – Revenues from the federal government for specific purposes

Maryland State Budget by Fund Account

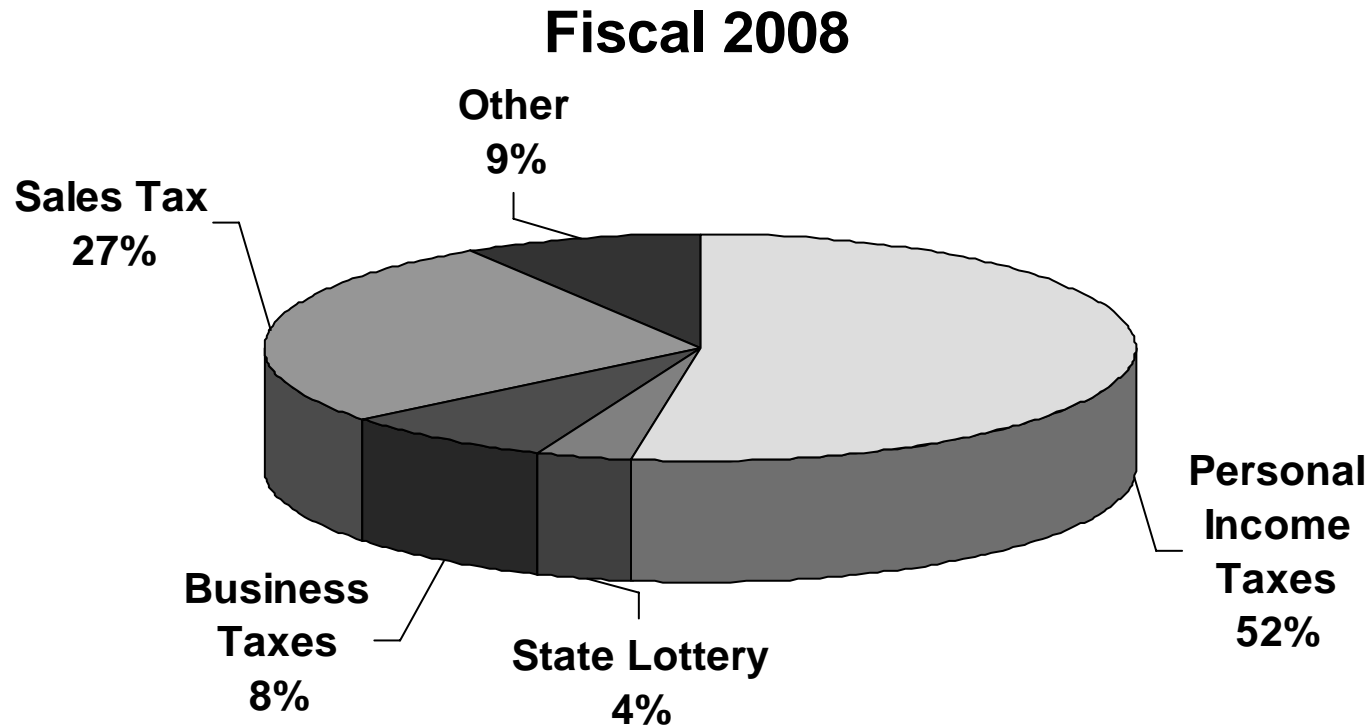
Fiscal 2008



Total Budget \$30.0 Billion

General Fund Revenues

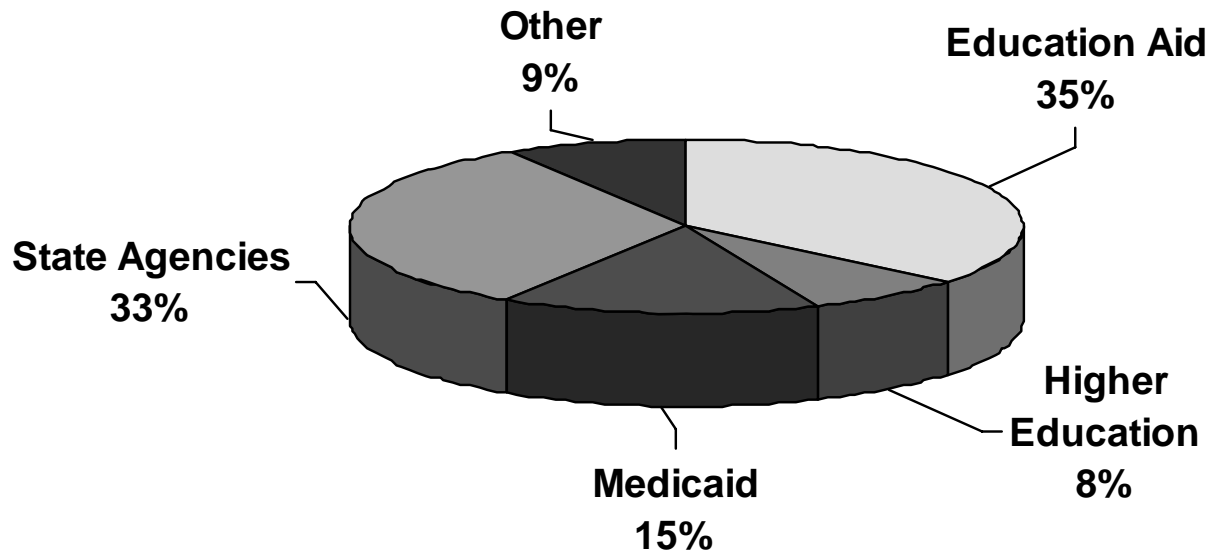
About 80% from Sales and Income Taxes



Total Revenue – \$13.4 Billion

Education Aid and Medicaid Account for Half of the General Fund Budget

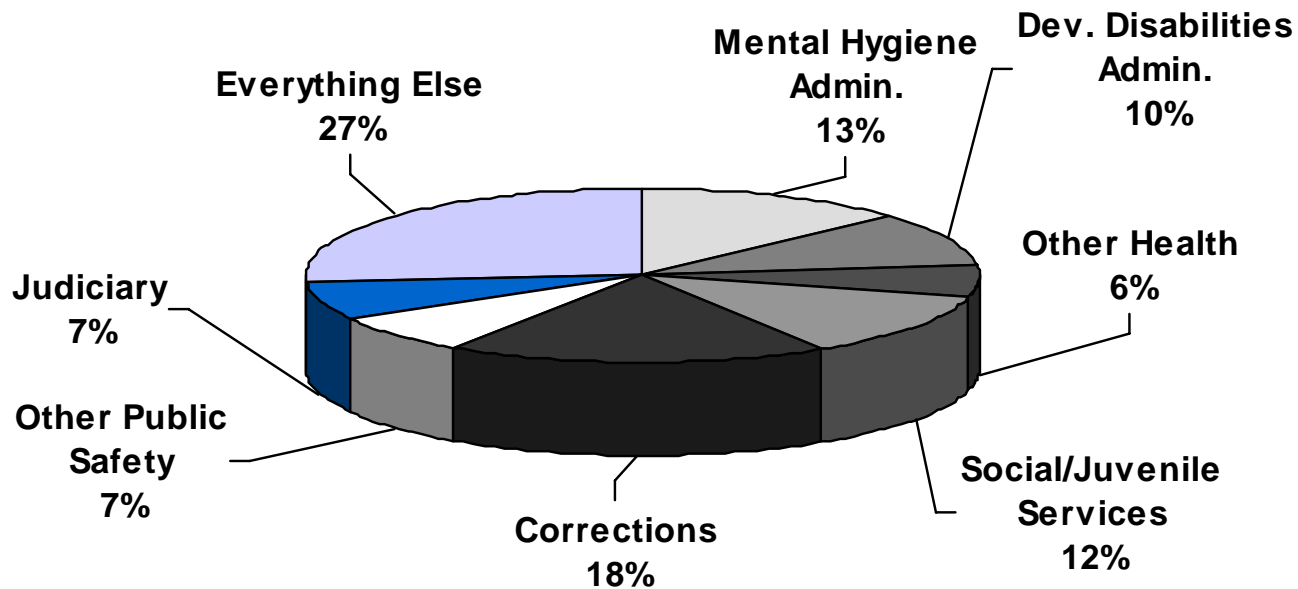
Fiscal 2008



Total General Fund Budget – \$14.6 Billion

Health and Public Safety Account for Over Half of State Agency Spending

Fiscal 2008



Total Agency Spending – \$4.7 Billion

How Maryland Compares

Maryland State and Local Spending Comparison to Selected States

	<u>Spending Per Capita</u>	<u>Spending Per Capita Rank</u>	<u>Spending % of Income Rank</u>	<u>Per Capita Income Rank</u>
Maryland	\$6,810	31	51	5
Delaware	\$8,480	6	17	12
Virginia	\$6,442	37	48	9
Pennsylvania	\$7,369	17	30	19
New Jersey	\$7,968	10	46	3
Connecticut	\$7,730	14	50	2
Massachusetts	\$8,379	7	39	4
North Carolina	\$6,575	34	28	35
National Average	\$7,341			

Source: *State and Local Government Finances, U.S. Census Bureau (June 2007)*

How Maryland Compares Selected Indicators

- Medicaid Eligibility
 - Children/Pregnant Women – ranks 2nd (2006)
 - Working Parents – ranks 42nd (2006)
- Medicaid Physician Rates – ranks 16th (2003)
- Cash Assistance Benefits – ranks 18th (2003)
- Primary/Secondary Education
 - Revenues Per Student – ranks 15th (fiscal 2005)
 - Average Teachers' Salaries – ranks 12th (fiscal 2005)
- State/Local Government Employment Per 10,000 Population – ranks 40th (2006)

What Is a “Structural Deficit”?

- Golden Rule of Budgets
 - Revenue collected in a fiscal year should cover ongoing expenditures
- Structural Deficit
 - Chronic failure to observe the Golden Rule

What Causes a Structural Deficit?

- Trend deficit
 - Over the long term, the cost of maintaining current services grows faster than ongoing revenues
- Policy deficit
 - Decisions to significantly reduce revenues or increase spending without offsetting adjustments to the other side of the budget
- Economic cycle may exaggerate or mitigate

This Decade the Structural Deficit First Appears in Fiscal 2002

- Fiscal 2002 revenues actually decline compared to fiscal 2001
- Bridge to Excellence Act (Thornton) enacted in 2002 requires significant increases in State education aid through fiscal 2008
- The structural problem widens with a second year of declining revenues in fiscal 2003
- In December 2002, structural deficit of over \$1 billion forecasted for fiscal 2004, growing to over \$2 billion by fiscal 2008

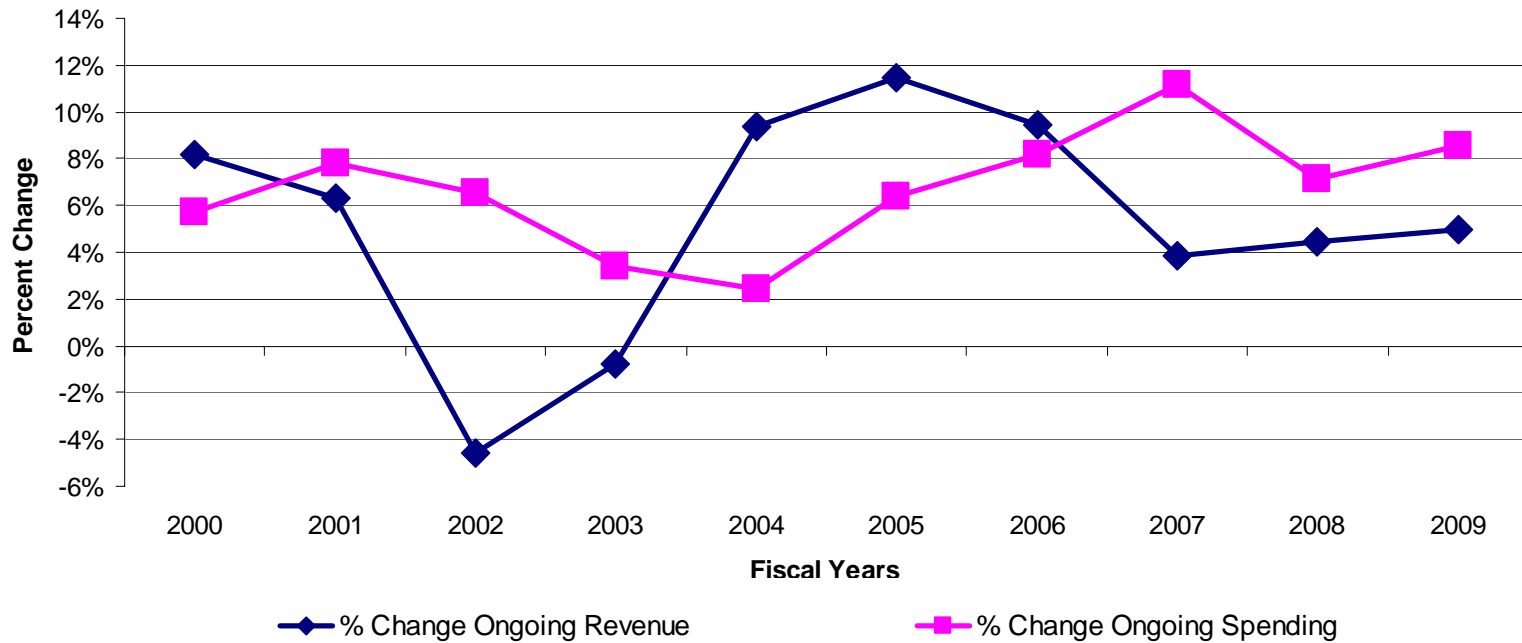
By Fiscal 2005 the Forecasted Structural Deficit Has Temporarily Become a Surplus

- Forecasted structural gap of almost \$1.5 billion for fiscal 2005 becomes an actual \$200 million surplus of ongoing revenues versus ongoing spending
- This \$1.7 billion change in the State's fiscal condition resulted from the following:
 - Tax and Fee Increases/Tax Compliance – \$450 million
 - Spending Reductions from Baseline Forecast – \$600 million
 - Revenues Exceeding December 2002 Forecast – \$640 million
- These actions and one-time fund transfers to balance the fiscal 2004 and 2005 budgets result in large cash balances through fiscal 2007

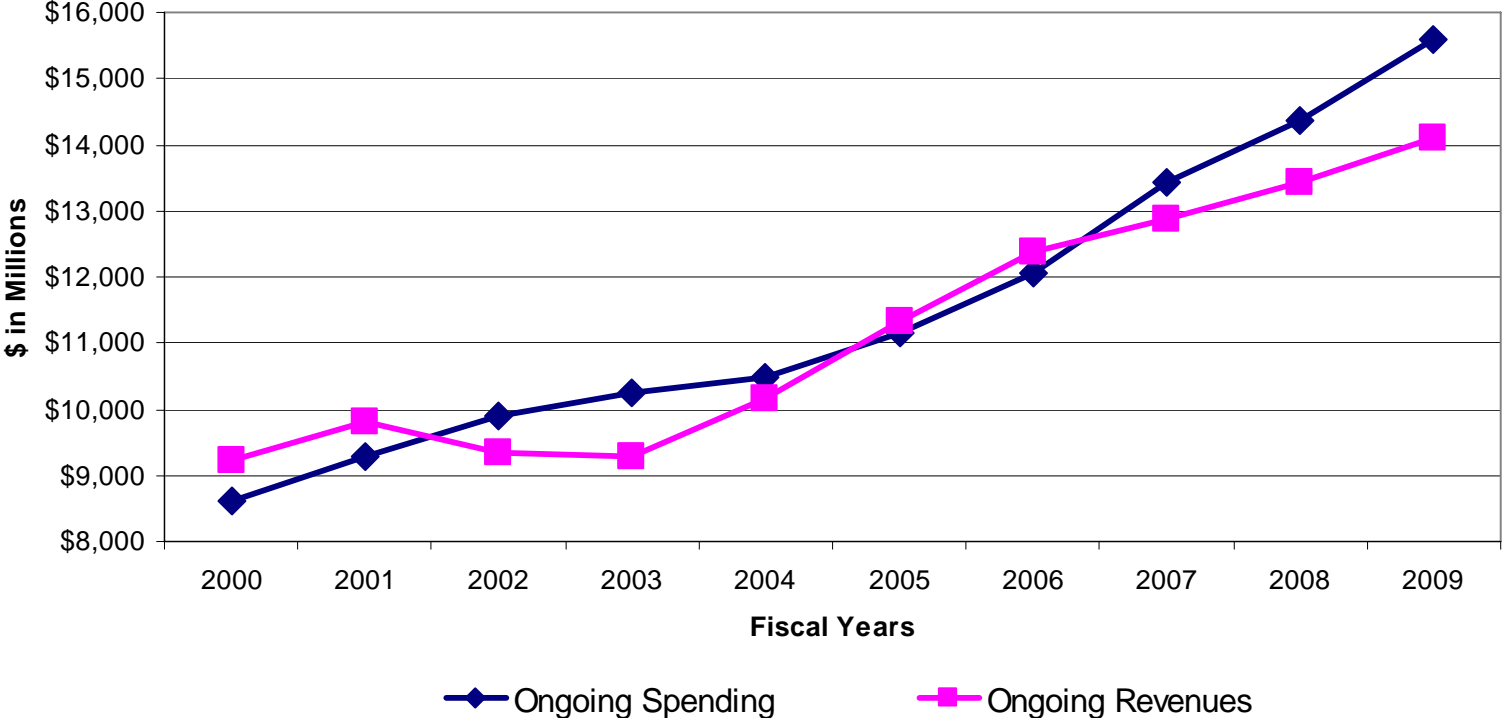
The Structural Deficit Is Back! (It Never Really Left)

- Revenues, which exceeded 9% annual growth for three years, are forecasted to grow 4% in fiscal 2007 and 2008
- Ongoing spending, driven primarily by the last two years of the Bridge to Excellence legislation, grows 11% in fiscal 2007 and 7% in fiscal 2008
- The structural gap between ongoing revenues and ongoing spending in fiscal 2007 is estimated to be over \$500 million, growing to around \$1.5 billion in fiscal 2009 before leveling off

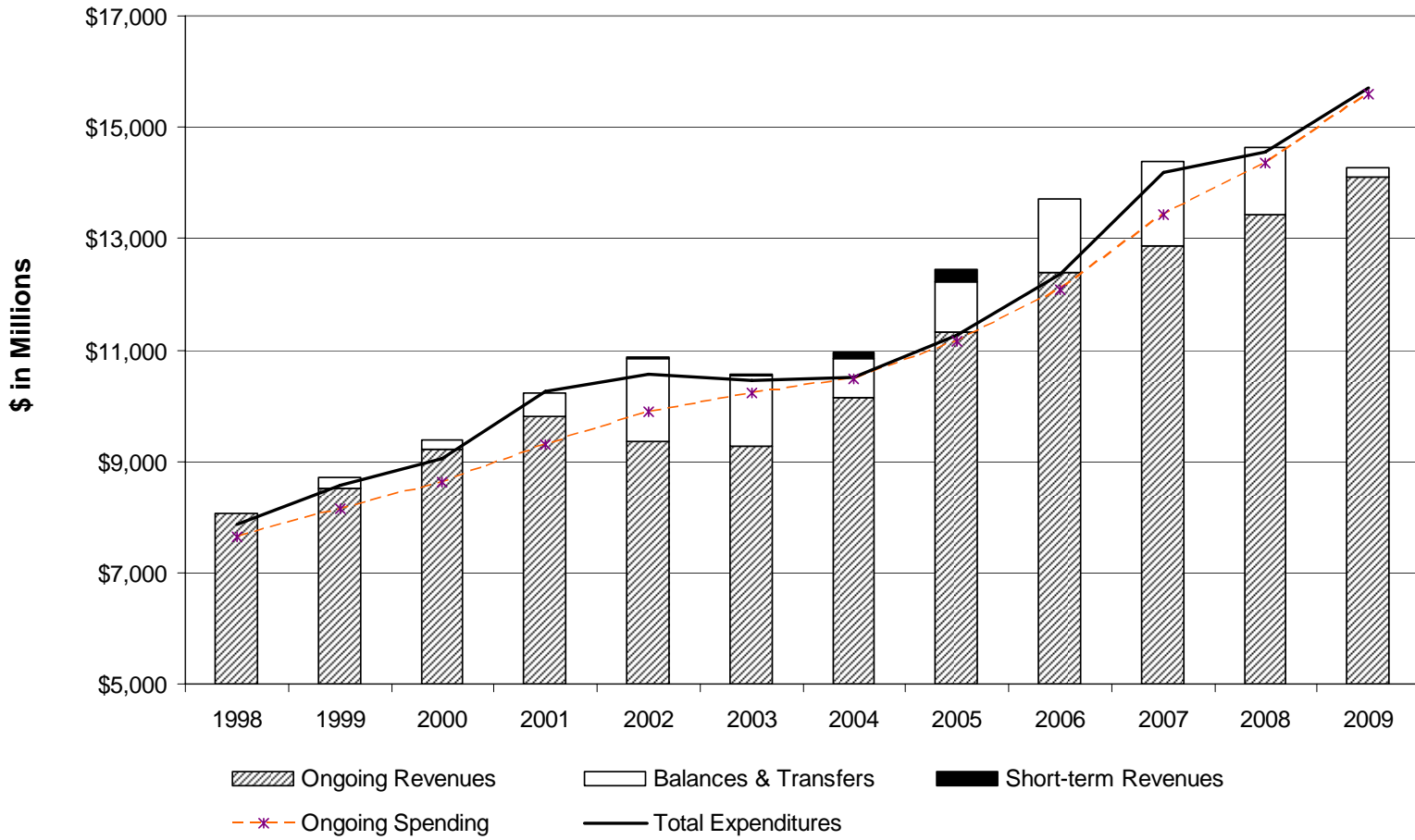
Welcome to the State Budget Roller Coaster



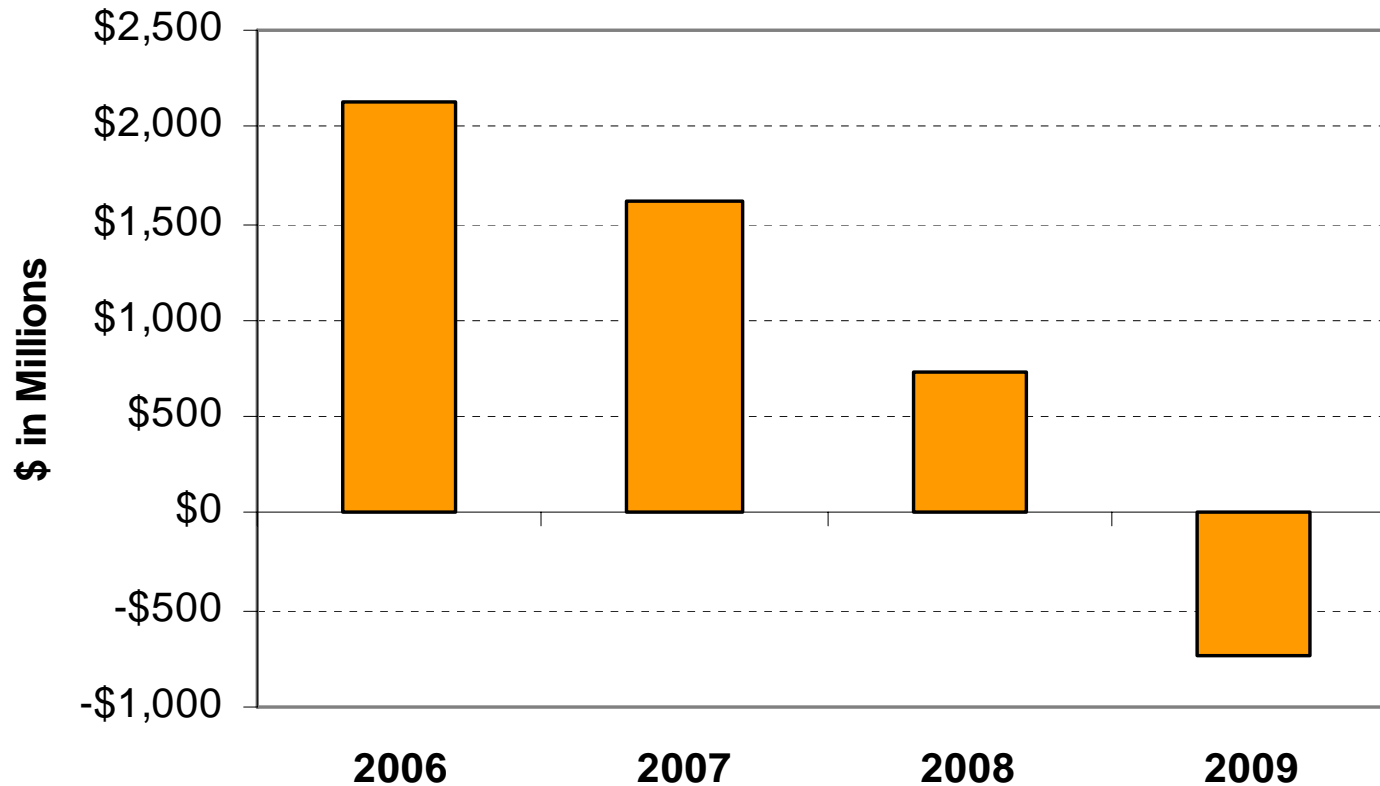
Roller Coaster Results



Paying for the Ride



Cash Balances Fall and Estimated Deficit Swamps Rainy Day Fund in 2009



Is the Deficit Real or Just a Forecast?

It is Both

- **Real**

- Fiscal 2007 is almost complete, and revenues are generally tracking estimates – gap between ongoing revenues and ongoing expenditures is over \$500 million
- Fiscal 2008 budget is enacted, and there is little indication that the revenue estimate is overly conservative – structural gap is almost \$1 billion

- **Forecast**

- Revenue estimate is for growth of about 5% which is consistent with long-term trends
- Fiscal 2009 spending forecast is current services estimate plus several currently unfunded commitments

Revenues Tracking Estimate Growth Is Modest

Maryland General Fund Revenues (\$ in Millions)

<u>Source</u>	July - May				<u>Full-year Estimated Growth Rates</u>
	<u>FY 2006</u>	<u>FY 2007</u>	<u>\$ Difference</u>	<u>% Difference</u>	
Personal Income Tax	\$5,366.0	\$5,714.7	\$348.7	6.5%	6.3%
Sales and Use Tax	2,748.2	2,797.6	49.4	1.8%	3.0%
Lottery	438.8	429.2	-9.6	-2.2%	-0.6%
Corporate Income Tax	499.1	474.1	-25.0	-5.0%	-8.0%
Business Franchise Tax	149.0	154.3	5.3	3.5%	-1.1%
Insurance Premiums Tax	213.9	220.8	6.9	3.2%	4.1%
Estate and Inheritance Taxes	203.0	204.0	1.0	0.5%	-0.8%
Excise Taxes ⁽¹⁾	270.3	269.7	-0.6	-0.2%	1.7%
Court Revenue	139.1	145.2	6.1	4.4%	-0.3%
Interest	123.1	130.0	6.9	5.6%	6.3%
Other ⁽²⁾	204.0	227.9	23.9	11.7%	4.5%
Total	\$10,354.5	\$10,767.5	\$413.0	4.0%	3.9%
DE holding company	20.4	0.0	-20.4	-100.0%	-100.0%
Grand Total	\$10,374.9	\$10,767.5	\$392.6	3.8%	3.7%

⁽¹⁾ Tobacco, alcohol beverages, and motor fuel taxes. Motor fuel tax revenue through April.

⁽²⁾ Includes miscellaneous revenues and hospital patient recoveries.

Looking Ahead at Revenues

	<u>Fiscal 2007</u>	<u>Fiscal 2008</u>	<u>Fiscal 2009</u>	<u>\$ Change</u>	<u>% Change</u>
Revenues					
Individual Income	\$6,594	\$7,041	\$7,486	\$445	6.3%
Sales and Use	3,457	3,623	3,789	166	4.6%
Lottery	477	499	520	20	4.1%
Other	2,321	2,264	2,305	41	1.8%
Administration Adjustments	15	3	3	0	-6.2%
Legislation – 2007 Session	0	7	5	-2	-23.4%
Subtotal	\$12,865	\$13,438	\$14,108	\$671	5.0%
Balances/Transfers					
Balance – General Fund	\$1,362	\$195	\$67	-\$128	
Rainy Day Fund Transfer	0	978	64	-914	
Other Transfers	160	17	24	6	
Total Revenues	\$14,387	\$14,628	\$14,263	-\$365	-2.5%

Looking Ahead at Spending

	<u>Fiscal 2007</u>	<u>Fiscal 2008</u>	<u>Fiscal 2009</u>	<u>\$ Change</u>	<u>% Change</u>
Expenditures					
Debt Service	\$0	\$29	\$57	\$28	94.5%
Local Aid – Education\Libraries	4,535	5,227	5,537	311	5.9%
Local Aid – Other	501	554	588	34	6.1%
Entitlements	2,543	2,612	2,832	219	8.4%
State Operations/Reversions	5,656	5,834	6,283	449	7.7%
Multi-year Commitments	183	115	253	138	120.0%
Capital	136	27	56	29	107.2%
Legislation – 2007 Session	0	-1	50	51	
Subtotal	\$13,554	\$14,397	\$15,655	\$1,259	8.7%
Reserve Fund Appropriation	638	163	50	-113	-69.3%
Total Expenditures	\$14,192	\$14,559	\$15,705	\$1,146	7.9%

Expenditure Forecast Appears High but Underlying Growth More Modest

- Expenditures forecast to grow almost 9% in fiscal 2009 (\$1.3 billion) but reflect new commitments, legislation, and one-time fiscal 2008 savings
 - Higher OPEB Commitment \$100 million
 - Begin Funding GCEI \$40 million
 - New 2007 Session Legislation \$50 million
 - No One-time Health Insurance Savings \$128 million
 - Fiscal 2008 Reductions Not Ongoing \$110 million
- Total** **\$428 million**
- Accounting for these changes, underlying budget growth about 5.7%

GCEI: Geographic Cost of Education Index
OPEB: Other Postemployment Benefit