

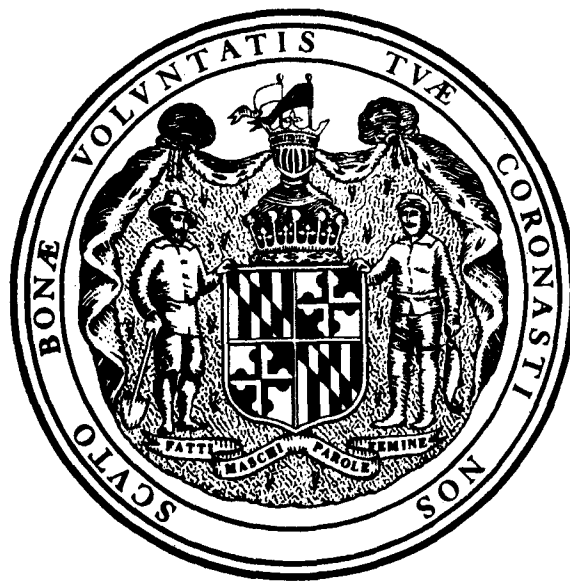
**REPORT OF THE MARYLAND
BOARD OF REVENUE ESTIMATES
ON
ESTIMATED MARYLAND REVENUES**

FISCAL YEARS ENDING

JUNE 30, 1980

AND

JUNE 30, 1981



SUBMITTED TO
GOVERNOR HARRY R. HUGHES
MARCH 10, 1980

March 10, 1980

Honorable Harry Hughes,
Governor of Maryland
State House
Annapolis, Maryland 21401

Dear Governor Hughes:

In accordance with our official policy of keeping you fully advised of important developments affecting revenue prospects, the Board of Revenue Estimates has prepared and herewith submits to you revised estimates of General Fund revenues for the Fiscal Years ending June 30, 1980 of \$2,584,429,000 and June 30, 1981 of \$2,683,583,000, based upon existing State laws and the current economic outlook. These revisions are \$75,000,000 and \$13,000,000, respectively, greater than the estimates provided on December 10, 1979 for these two years. These revisions are set forth, together with their basic data, in the accompanying review and update to our December 10, 1979 Report.

It should be stressed that these revisions do not include the projected impact of legislation currently pending before the U.S. Congress and the 1980 Maryland General Assembly which would, if enacted, affect State revenues. The full effects of such enactments, to the extent known, will be reflected in the 1981 FISCAL DIGEST, which will be published in June 1980.

Pending outcome of the May referendum to permit a D.C. lottery, the Board urges caution in new spending and tax relief programs. We also recommend that a plan be developed to begin a phased implementation of certain recommendations made by the State's independent auditors to conform Maryland's revenue recognition practices to Generally Accepted Accounting Principles.

The Board will continue its study of revenue data and will continue to keep you fully advised in coming months of any further important developments affecting revenue prospects.

Respectfully yours,

Thomas W. Schmidt

William S. James

Louis L. Goldstein, Chairman

Robert D. Rader, Executive Secretary

RDR/cah
Enclosures

ESTIMATED MARYLAND STATE REVENUES
FOR THE FISCAL YEARS 1980 AND 1981:
REVIEW AND UPDATE

The Board of Revenue Estimates has completed its first review and update of Maryland's General Fund revenue prospects for Fiscal Years 1980 and 1981.

Certain revisions have been made to the revenue estimates prepared and submitted by the Board on December 10, 1979, prior to submission of the 1981 State Budget. These revisions are based upon the existing revenue structure as set forth in Maryland statutes and on study by the Board of available information on present economic conditions and trends as they may affect revenue collections.

These revisions do not include the projected impact of proposed legislation currently pending before the U.S. Congress and the Maryland General Assembly which would, if enacted, affect State revenues.

These revisions are based upon analyses of current trends in revenue collections and the latest projections of future national and state economic conditions, as analyzed by the Bureau of Revenue Estimates. For this purpose, economic statistics and related data published by Federal and State government and econometric forecasts prepared by leading business and private organizations have been analyzed for their effect upon Maryland's present and future revenue prospects.

The Board wishes to call attention to a possible factor which could have adverse fiscal effects upon Maryland. Financial difficulties in the District of Columbia could cause that government to implement a lottery. An advisory referendum on pari-mutuel gambling, jai alai and a legal lottery will go before Washington voters on May 6. If a D.C. lottery were approved and subsequently implemented, Maryland's net annual lottery revenues could be reduced by \$30 million or more. It is too soon to predict with any degree of accuracy (a) whether the referendum will be successful and (b) if successful, the speed with which a lottery can be implemented. Therefore, the Board urges extreme caution in State financial policies for Fiscal Year 1981 and thereafter.

The Board recommends that the Comptroller and the Secretary of Budget and Fiscal Planning develop a plan to begin a phased conversion toward the Individual Income Tax revenue recognition policies recently recommended by the State's independent auditors. This conversion is necessary to conform State financial practices to Generally Accepted Accounting Principles ("GAAP"). A discussion of the issues involved in this conversion is included in Appendix B.

In addition, there are a number of difficult economic factors to measure at the present time in developing the revised estimates.

U.S. Economic Prospects

The U.S. economy finished Calendar Year 1979 with an unexpected growth spurt. Real Gross National Product increased by 2.3 percent during 1979.4. At the same time, inflation has accelerated throughout late 1979 and early 1980. If unchecked, this acceleration of prices increases the likelihood that, when a recession does occur, it will be more severe than originally forecast.

As summarized in Appendix A, a number of the major economic forecasters continue to look for a moderate to mild recession during the first half of 1980, with inflation continuing at a high rate. Some elements that may improve economic prospects are posed by the projected national defense buildup in response to continued troubles in Iran and Afghanistan as well as prospects for a tax cut during 1980.

State Economic and Revenue Outlook

Maryland's economy has continued to grow through Calendar Year 1979. Personal income during 1979.3 was 10.4 percent greater than during 1978.3. Preliminary data indicate that employment during 1979.4 averaged 41,000 more than during 1978.4, a growth rate of 2.1 percent. Real Gross State Product grew slowly throughout the year.

Inflation, measured by a composite of the Baltimore and Washington consumer price indices, increased by 11.4 percent during 1979. It is to be expected that inflation will continue at a high rate during 1980.

Maryland's General Fund revenue estimates are currently being revised upwards by \$75 million in Fiscal Year 1980. Due to the prospects for a national recession within the next six months and the developments which could result in competition from a D.C. lottery described above, the Board is conservatively revising Fiscal Year 1981 General Fund revenues upward by \$13 million. Further revisions may be made at the upcoming December meeting of the Board, based upon the economic and revenue outlook at that time.

The table below and the accompanying narrative outline the basis for these revised revenue estimates.

Individual Income Tax. Individual Income Tax receipts are currently exceeding estimates due principally to the unexpectedly high rate of inflation and the continued delay of the recession. These factors have had a positive impact on Maryland personal income. According, the Board is increasing its estimate of the General Fund portion of Individual Income Tax receipts by 3.8 percent, from \$1,063,577,000 to \$1,103,577,000 for Fiscal Year 1980.

The Board is raising the estimated General Fund portion of Individual Income Tax receipts during Fiscal Year 1981 from \$1,201,186,000 to \$1,209,186,000.

Receipts from the local "piggyback" tax are expected to exceed current estimates by \$19.5 million in Fiscal Year 1980 and by \$4.0 million in Fiscal Year 1981.

MARYLAND GENERAL FUND REVENUE ESTIMATES
FISCAL YEARS 1980 AND 1981

	FISCAL YEAR 1980			FISCAL YEAR 1981		
	Present Estimate (12/10/79)	Revision (3/10/80)	Difference	Present Estimate (12/10/79)	Revision (3/10/80)	Difference
----- (\$ THOUSANDS) -----						
INCOME TAXES:						
Individual	1,063,577	1,103,577	40,000	1,201,186	1,209,186	8,000
Corporation	120,036	120,036	-	123,127	123,127	-
Total	<u>1,183,613</u>	<u>1,223,613</u>	<u>40,000</u>	<u>1,324,313</u>	<u>1,332,313</u>	<u>8,000</u>
RETAIL SALES AND USE TAXES	<u>706,887</u>	<u>716,887</u>	<u>10,000</u>	<u>760,000</u>	<u>760,000</u>	<u>-</u>
FRANCHISES, EXCISES, LICENSES, FEES:						
Business Franchise Taxes	76,149	76,149	-	78,361	78,361	-
State Tobacco Tax	36,950	36,950	-	36,950	36,950	-
Tax on Insurance Companies	57,952	57,952	-	63,685	63,685	-
Alcoholic Beverage Excises	19,000	19,000	-	19,325	19,325	-
Death Taxes	20,600	20,600	-	21,000	21,000	-
Motor Vehicle Titling Tax	27,200	27,200	-	30,000	30,000	-
Tax on Horse Racing	11,832	11,832	-	11,880	11,880	-
Hospital Patient Recoveries	19,140	19,140	-	19,450	19,450	-
Interest on Investments	50,000	65,000	15,000	25,000	30,000	5,000
District Courts	24,735	24,735	-	25,500	25,500	-
Miscellaneous	44,031	44,031	-	45,906	45,906	-
Total	<u>387,589</u>	<u>402,589</u>	<u>15,000</u>	<u>377,057</u>	<u>382,057</u>	<u>5,000</u>
STATE LOTTERY RECEIPTS	<u>149,609</u>	<u>159,609</u>	<u>10,000</u>	<u>155,610</u>	<u>155,610</u>	<u>-</u>
FEDERAL TITLE XIX RECOVERIES	<u>37,199</u>	<u>37,199</u>	<u>-</u>	<u>42,566</u>	<u>42,566</u>	<u>-</u>
FEDERAL REVENUE SHARING	<u>44,532</u>	<u>44,532</u>	<u>-</u>	<u>11,037</u>	<u>11,037</u>	<u>-</u>
GRAND TOTAL	<u><u>2,509,429</u></u>	<u><u>2,584,429</u></u>	<u><u>75,000</u></u>	<u><u>2,670,583</u></u>	<u><u>2,683,583</u></u>	<u><u>13,000</u></u>

Retail Sales and Use Tax. Sales Tax collections are currently exceeding estimates due principally to favorable retail sales activity during 1979.4 and a relatively mild winter. Consequently, Retail Sales and Use Tax collections are expected to reach \$716,887,000 during Fiscal Year 1980, up 1.4 percent from the Board's December estimate of \$706,887,000.

Interest on Investments. Due to the current high level of interest rates and more funds available for investment, the interest earned by the State on its invested monies has increased dramatically. At the present time, the Board expects such Interest on General Fund Investments to reach \$65 million in Fiscal Year 1980.

According to most economic and financial analysts, interest rates are expected to peak and recede in the future. Consequently, as State spending programs begin to reduce the amount of State funds available for investment, interest income will decline. The Board currently projects General Fund investment earnings to therefore decline to \$30 million in Fiscal Year 1981.

State Lottery Receipts. The General Fund portion of State Lottery Receipts are currently exceeding estimates due to continued expansion in ticket sales and other factors. It is to be expected that this expansion will continue throughout Fiscal Year 1980. Therefore, the Board is increasing its estimate of Fiscal Year 1980 net Lottery revenues from \$149,609,000 to \$159,609,000.

Due to the uncertainty arising from the D.C. gambling referendum in May, the Board is maintaining its present estimate for Fiscal Year 1981. Any upward or downward revisions warranted by the outcome of this referendum will be made in December.

APPENDIX A

1980 ECONOMIC PROSPECTS

1. Chase Econometric Macro Interim Report of January 22, 1980

By all measures, the U.S. economy held up considerably better in the second half of 1979 than we anticipated. Real GNP grew at about a 2.2% annual rate instead of the significant decline that we forecast. Consumer spending was the key to this growth, with households trying to hold off on making the cuts in living standards by reducing their savings and adding to consumer debt in the face of declining real personal income.

We expect real income per household will continue to fall, but with no further off-setting decline in the savings rate. Thus, we expect that the recession will finally intensify, with real output declining in each of 1980.1, 1980.2 and 1980.3. Real GNP will decline by 1.2% for the year as a whole, with a very modest recovery of 2.2% growth to follow in 1981. Inflation will subside somewhat later this year, but will still increase by about 10% between 1979.4 and 1980.4. Corporate profits will decline by 10.9% during 1980, but will grow by 11.7% during 1981. Unemployment will increase to nearly 8% of the labor force by year end. Short-term interest rates will probably decline through most of the year, falling about 5 percentage points below peak rates by year end.

2. Wharton Quarterly Model Forecast - January 28, 1980

During 1979 some sectors of the economy were very strong while others were very weak. We expect this mixed performance to continue into 1980 with some of the sectors which grew rapidly in 1979 slowing or declining and some of the weaker sectors becoming stronger.

A recession is forecast for the first two quarters of 1980, with real GNP declining by 1.0% between 1979.4 and 1980.2. The recovery which begins in 1980.3 will be weak, with real GNP increasing by only 1.3% between 1980.2 and 1980.4. Inflation is expected to decline slowly in 1980, with the Consumer Price Index expected to increase by 12.0%. The unemployment rate is expected to rise continuously throughout the year, reaching a level of 7.5% during 1980.4. Short-term interest rates are expected to gradually decline from the peaks reached in 1979.4.

3. Manufacturers Hanover Trust "Business Report" - First Quarter 1980

There are three main reasons why the economy failed to drop as much as expected in 1979. First is the advance warning given by economists that 1979 would be a bad year. As a result, businessmen kept control over inventories, receivables and other aspects of business activity that cause problems when economic activity declines. Consequently, inventories remained lean in most lines of business during 1979.

A second reason for the strength of the economy during 1979 was consumer spending. Rather than slowing their spending as inflation worsened and real disposable income dropped, most consumers sped up their spending, either by dipping into savings or borrowing.

The third reason is that in most industries, the U.S. is exporting more than it imports. This has added to the strength created by consumer spending and has helped keep the economy out of recession.

The high level of consumer debt and low rate of personal savings, coupled with declining real disposable income, should cause a decline in consumer spending which in turn should lead to a recession during 1980.1 and 1980.2. Real GNP is expected to fall by 1.1% between 1979.4 and 1980.2 before recovering, and is expected to show zero growth for the year as a whole. Inflation is expected to decline slowly in 1980, with the Consumer Price Index expected to increase by 11.3%. The unemployment rate is expected to rise continuously throughout the year, reaching a level of 7.1% in 1980.4.

4. National City Bank of Minneapolis - January 21, 1980

As we assess the present situation, unexpected strength in consumer spending postponed the recession in 1979 and rising defense spending will soften it in 1980. Real GNP is expected to decline by 1.2% during 1980. Inflation, measured by the Consumer Price Index, is expected to increase by 9% during the year.

5. The Wall Street Journal - February 15, 1980

The Business Council expects a mild recession this year, followed by a sluggish recovery and only a modest improvement in the inflation rate. Its January survey of business economists suggests that real GNP will decline 1% in 1980 and then climb 2.7% in 1981. Inflation will reach 11.2% this year, slowing to 8.5% to 9% in 1981.

In comparison with a similar survey taken in December, the economists surveyed forecast that the recession would be delayed further into 1980 and that the downturn will be milder than that forecast in December.

In his 1981 budget, President Carter forecast that real GNP will decline 0.6% this year and then rise 1.7% in 1981. Unemployment will rise to 7.5% of the labor force by December 1980 before dropping to 7.3% by the end of 1981. Inflation should average 11.8% in 1980 and drop to 9.2% in 1981.

APPENDIX B

DISCUSSION OF PROPOSED CHANGES IN ACCOUNTING POLICY

Individual Income Taxes are collected and administered on a calendar, or tax year basis, while the State's accounts are kept on a July 1 - June 30 fiscal year basis. Under the State's current modified accrual basis of accounting, each calendar year's receipts flow into two consecutive fiscal years: the first six months' employer withholding (including June withholding actually received by the State in July) and estimated payments are collected during the first fiscal year; and the second six months' employer withholding and estimated payments, as well as final payments with returns are collected during the second fiscal year. The second fiscal year also excludes refunds for the entire calendar year.

While this modified accrual basis is an appropriate fiscal practice, it is not in conformance with Generally Accepted Accounting Principles ("GAAP"). Under GAAP, revenues must be accounted for on either a pure cash or a full accrual basis. Converting to a pure cash basis would have entailed the deferral of June 1979 employer withholdings from Fiscal Year 1979 to Fiscal Year 1980. In addition, a provision for refunds would have to be established, which would further reduce revenues.

Converting to a full accrual basis, as recommended by the State's outside auditors, entails prorating each calendar or tax year's net receipts by allocating 50% to each of the fiscal years spanned by that calendar year. Since the total net receipts for any current calendar year will not be known at June 30 of that year, an estimate must be made based upon collection experience as of that date. Fifty percent of this estimate is allocated to the current fiscal year. Any excess or shortfall in revenues will be added to or subtracted from the revenues allocated to the next fiscal year. Prior year receipts representing delinquencies, audit adjustments and late filings are recognized on a cash basis in the year collected. Deductions are made for local "piggyback" revenues, the Fair Campaign Finance Fund and the old City, County, Town tax.

The following table demonstrates the differences that would have occurred in Fiscal Years 1979 and 1980 in State and local revenues resulting from this proposed change.

Tax Year	\$ MILLIONS				
	Net Collections	Modified Accrual		Full Accrual (GAAP)	
		1979	1980	1979	1980
Prior	-	12.9	20.5	12.9	20.5
1978	1,381.0	662.1	-	689.8	-
1979	1,523.7	797.8	725.9	750.0	773.7
1980	1,706.4	-	874.8	-	853.2
Total		1,472.8	1,621.2	1,452.7	1,647.4
Local Tax		467.3	517.7	464.6	546.9
General Fund		1,005.5	1,103.5	988.1	1,100.5

Full conversion to GAAP would entail a cost of \$74 million during Fiscal Year 1980. Of this amount, approximately \$40 million would be needed to fully and adequately fund the local income tax reserve accounts. Another \$28 million would be needed to offset the deferral of State revenues into future fiscal years, while another \$6 million would be required to be paid to local governments as unallocated withholding from the 1976 tax year, as mandated by the 1979 General Assembly.

APPENDIX C
 ANALYSIS OF GENERAL FUND SURPLUS
 FISCAL YEAR 1980
 \$ Thousands

ACTUAL SURPLUS AT JUNE 30, 1979	\$318,997
Reserved to Fund Fiscal Year 1980 Budget (Per Fiscal Digest)	(229,324)
UNAPPROPRIATED SURPLUS AT JUNE 30, 1979	\$ 89,673
Revision in Estimates (12/10/79)	139,759
ESTIMATED SURPLUS AT JUNE 30, 1980 AS PROJECTED BY BOARD OF REVENUE ESTIMATES (12/10/79)	\$229,432
Deficiency Appropriations per Original Budget	(33,869)
ESTIMATED SURPLUS AT JUNE 30, 1980 PER ORIGINAL BUDGET	\$195,563
Deficiency Appropriations Per Supplemental Budget	(5,070)
Revision in 1980 Estimates Reversions per Supplemental Budget	5,000
Revision in Revenue Estimates (3/10/80)	75,000
ESTIMATED SURPLUS AT JUNE 30, 1980	\$270,493
Reserved to Fund Fiscal Year 1981 Budget per Original Budget	(195,381)
Revision in Revenue Estimates (3/10/80)	13,000
Executive Proposals	
Federal Revenue Sharing	\$34,700
15% Standard Deduction	(4,800)
Revenues to Transportation Trust Fund	(89,100)
Supplemental Budget	(29,242)
Estimated Legislative Budget Reductions	2,000
Peabody Grant	7,500
ESTIMATED UNAPPROPRIATED SURPLUS AT JUNE 30, 1981	<u>\$ 9,170</u>

Note: The above figures do not incorporate pending legislative budget cuts, or the fiscal impact of any subsequent supplemental budgets submitted by the Governor.