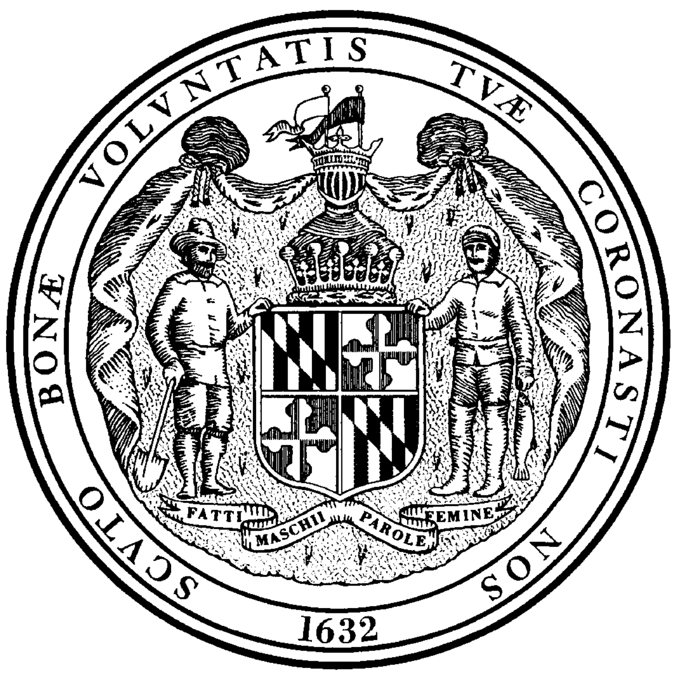
SPENDING AFFORDABILITY COMMITTEE

Report of the 2001 Interim



ANNAPOLIS, MARYLAND
DECEMBER 2001

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MARYLAND GENERAL ASSEMBLY
SPENDING AFFORDABILITY COMMITTEE

December 19, 2001

The Honorable Parris N. Glendening
Governor, State of Maryland
State House
Annapolis, Maryland 21401

Dear Governor Glendening:

We are pleased to submit the fiscal policy recommendations of the Spending Affordability Committee made during the 2001 interim. These recommendations were adopted by the committee at its meeting on December 18, 2001. The committee reviewed data concerning the economic condition of the State, revenue and expenditure trends during the past several years, personnel data, the current status of the State Reserve Fund, the Transportation Trust Fund, and the results of the Capital Debt Affordability Committee report.

Recommendations were made concerning the fiscal 2003 spending limit, future budget sustainability, Temporary Assistance to Needy Families, general and reserve fund balances, capital debt, transportation debt, and State positions.

The Spending Affordability Committee has completed its assigned tasks. As required by law, the recommendations of the committee have been submitted to the Governor and the Legislative Policy Committee.

We are most appreciative of the time and effort expended by each member of the committee. A special note of thanks and appreciation is extended to the members of the Citizens Advisory Committee for their valuable assistance and input.

Sincerely,

Senator Barbara A. Hoffman
Presiding Chairman

Delegate Nancy K. Kopp
House Chairman

MARYLAND GENERAL ASSEMBLY
SPENDING AFFORDABILITY COMMITTEE

December 19, 2001

The Honorable Thomas V. Mike Miller, Jr., Co-Chairman
The Honorable Casper R. Taylor, Jr., Co-Chairman
Members of the Legislative Policy Committee

Ladies and Gentlemen:

We are pleased to submit the fiscal policy recommendations of the Spending Affordability Committee made during the 2001 interim. These recommendations were adopted by the committee at its meeting on December 18, 2001. The committee reviewed data concerning the economic condition of the State, revenue and expenditure trends during the past several years, personnel data, the current status of the State Reserve Fund, the Transportation Trust Fund, and the results of the Capital Debt Affordability Committee report.

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Sincerely,

Barbara A. Hoffman
Senator Barbara A. Hoffman
Presiding Chairman

Nancy K. Kopp
Delegate Nancy K. Kopp
House Chairman

Spending Affordability Committee

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Delegate Nancy K. Kopp, House Chairman

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Leo E. Green
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George R. Houston, Jr., President, Mount St. Mary's College
John C. Miller, P.A., Director, Maryland Farms Bureau
Edward A. Mohler, President, Maryland State and D.C. AFL-CIO

Staff

Lori J. O'Brien
David C. Romans

Contents

2001 Spending Affordability Committee Report and Recommendations to the Governor and the Legislative Policy Committee

The Spending Affordability Committee was created in 1982 (Chapter 585, Acts of 1982). The committee is composed of 18 legislative members including the presiding officers, the majority and minority leaders, the chairmen of the fiscal committees (or their designees), and other members appointed by the presiding officers. The committee is assisted by a four-member citizen advisory committee.

The committee's primary responsibility is to recommend to the Governor and the General Assembly a level of spending for the State operating budget that is reflective of the current and prospective condition of the State's economy. Consideration is given to constraining disproportionate growth in State-funded expenditures in any fiscal year which might necessitate or "build in" unsupportable levels of spending in future years. Thus, especially during periods of strong economic growth, the committee has attempted to exert a "smoothing effect" on spending.

The committee's prior recommendations and legislative action on the operating budget are set forth in the following table:

$ in Millions

	Committee Recommendation		Legislative Action	
Session Year	**Growth Rate**	**Amount**	**Growth Rate**	**Amount**
1982	10.18%	$431.9	9.62%	$412.8
1983	9.00%	428.0	5.70%	269.8
1984	6.15%	326.7	8.38%	402.0
1985	8.00%	407.2	7.93%	404.6
1986	7.70%	421.5	7.31%	402.2
1987	7.28%	430.2	7.27%	429.9
1988	8.58%	557.5	8.54%	552.9
1989	8.79%	618.9	8.78%	618.2
1990	9.00%	691.6	8.98%	689.7
1991	5.14%	421.8	5.00%	410.0
1992	No recommendation		10.00%	823.3
1993	2.50%	216.7	2.48%	215.0
1994	5.00%	443.2	5.00%	443.2
1995	4.50%	420.1	4.50%	420.0
1996	4.25%	415.0	3.82%	372.8
1997	4.15%	419.6	4.00%	404.6
1998	4.90%	514.9	4.82%	506.6
1999	5.90%	648.8	5.82%	640.6
2000*	6.90%	803.0	6.87%	800.0
2001	6.95%	885.3	6.94%	884.6

*2000 legislative action does not reflect $266 million of Cigarette Restitution Fund (CRF) appropriations. CRF dollars were excluded from the calculation during the 2000 session because they had not previously been available to the State. The 2000 growth rate including CRF dollars was 9.16%.

The committee notes that operating spending in relation to the State's economy, as measured by the personal income statistic, is lower now than when the spending affordability process began. As illustrated in the chart on the next page, throughout much of the 1980s, the ratio remained relatively stable. During the 1990 and 1991 sessions the combination of increased spending demands and economic slowdown caused the spending ratio to increase. Following the recession, however, operating spending in relation to personal income fell acutely. With the onset of a recession in 2001, spending in relation to personal income will again rise but will remain below the high of 7.6% reached during the last recession.

To constrain spending growth in light of the weakening economy and ensure that current spending levels are sustainable in the long term, the committee recommends adjustments to the methodology for calculating the spending affordability limit and the use of a second affordability test. The details of these proposals are provided below.

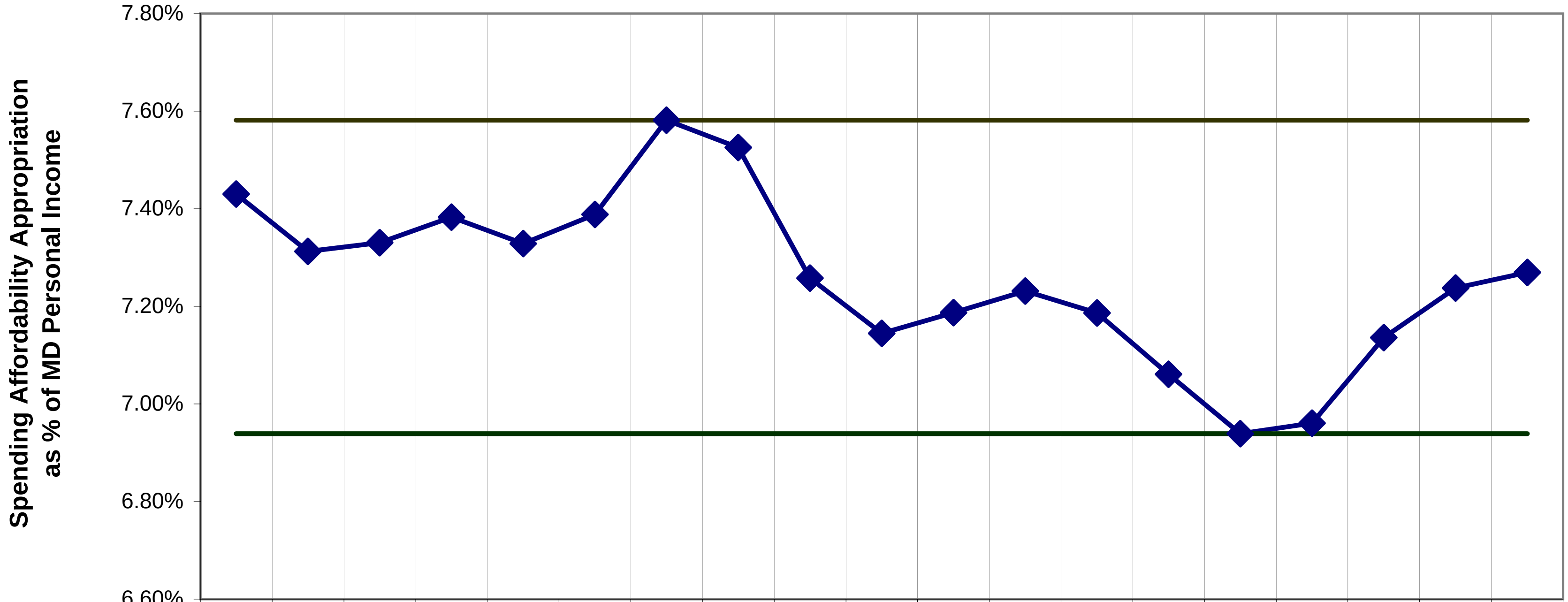
The committee's statutory responsibility is to consider spending growth in relation to growth anticipated in the State's economy. In its review of the State's economy, the committee considered both income and wealth factors in developing a broad understanding of Maryland's economic position. In determining the spending limit, the committee has considered economic performance, revenue estimates, and budget requirements.

Economy

After three years of very strong growth (1997-1999), the U.S. economy slowed significantly beginning in the second half of 2000. U.S. real (inflation-adjusted) gross domestic product grew 4.1% for all of 2000 but by the end of the year the economy was growing at a rate of less than 2%. The economy weakened further during the first half of 2001. In the second quarter, U.S. real gross domestic product grew at a 0.3% pace. The consensus among economists early in 2001 was that the U.S. economy would just miss slipping into a recession and growth would start to pick up in the second half of 2001. The terrorists attacks of September 11 changed that assessment. The attacks pushed the fragile U.S. economy into a recession. Real gross domestic product fell at a 1.1% pace in the third quarter.

The consensus economic forecasts predict the recession will be relatively short and mild. Economists expect the economy to begin to recover by the second quarter of 2002 with growth accelerating significantly in the second half of 2002. There are basically three factors driving the expectation for a short, mild recession. First, interest rates have fallen as the Federal Reserve Board has cut the federal funds rate 11 times in 2001. Second, energy prices, which soared late last year and early this year, have fallen considerably. Third, Congress is working on a stimulus package of $75 to $100

Ongoing Spending in Relation to Personal Income
Under Spending Affordability Concept



	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
SA as % of PI	7.43%	7.31%	7.33%	7.38%	7.33%	7.39%	7.58%	7.53%	7.26%	7.14%	7.19%	7.23%	7.19%	7.06%	6.94%	6.96%	7.14%	7.24%	7.27%
19-year low	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%	6.94%
19-year high	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%	7.58%

Calendar/Session Year

Please note: The 2001 and 2002 data reflect the revised methodology; data from the earlier years reflect the older methodolgy.

billion, a mix of tax cuts and additional spending. This would be in addition to a $55 billion package that was passed shortly after September 11.

Revenues

After exceeding estimates by $148.9 million in fiscal 2001, general fund tax revenues are expected to decline in fiscal 2002. A modest rate of growth is forecast for fiscal 2003. The Board of Revenue Estimates (BRE) expects revenues for fiscal 2002 to be $276.3 million *less* than the estimates upon which the current budget is based. This downward revision is largely driven by the weakening economic outlook and poor revenue performance during the first five months of fiscal 2002. Three of the main revenue sources are particularly affected: the estimate for personal income tax was lowered by $114.4 million, sales tax by $128.0 million, and corporate income tax by $96.1 million. With this downward revision, fiscal 2002 ongoing general fund revenue is expected to drop by $169.9 million, or -1.7% compared to fiscal 2001. The continued phase-in of the State's personal income tax reduction and the redirection of certain revenues from the general fund to the Transportation Trust Fund to support the transit initiative account for almost $80 million of the decline in revenue. This decrease will be mitigated by a transfer of $119.5 million from the local income tax reserve account into general fund revenues.

Projected growth in ongoing general fund revenue for fiscal 2003 ($154.8 million or 1.6%) reflects the rate of projected growth in the national economy, the ongoing phase-in of the State's personal income tax reduction, diversion of revenues to the Transportation Trust Fund, changes in federal tax law, and a decline in hospital patient recoveries.

Budget Requirements

The committee is projecting a $268.6 million deficiency need for fiscal 2002 due to a number of shortfalls in Medicaid and mental health, homeland security expenditures, increased costs in foster care, and unaddressed needs in public safety and other agencies. A transfer of $30 million in general funds to the revenue stabilization fund as a fiscal 2002 deficiency (Chapter 275, Acts of 2001) takes the State to the total projected fiscal 2002 deficit. At the same time, the fiscal 2003 budget forecast reflects the cost of legislatively mandated spending for education and other critical areas and executive multi-year commitments. The forecast assumes a smaller than usual investment in the State workforce because almost all State agency personnel are eligible for merit-based increases, but none will receive a general salary increase. Health insurance costs spurred by sharply rising prescription and health insurance costs are projected to increase 14% in fiscal 2003.

In fiscal 2003, without a decrease in expenditures or the addition of new revenue, operating expenditures could exceed revenues by $1.3 billion ($1.1 billion ongoing). By fiscal 2004, that disparity could be $1.6 billion ($1.3 billion ongoing). Factors contributing to the projected deficit include the residual effects of the fiscal 2002 and 2003 revenue shortfalls, the continuing effects of the final year of the phased-in income tax reduction, the use of general funds to maintain funding for programs previously funded with cigarette restitution and federal Temporary Assistance for Needy Families (TANF) funds, growth in Medicaid costs, and the impact of ongoing costs of 2001 session legislation.

New Methodology

The committee recommends changes to the methodology used for calculation of the spending affordability limit. Among them are the inclusion of ongoing or multi-year general fund PAYGO in the spending limit, inclusion of general fund PAYGO additions to the State capital improvement plan in the spending limit, and the "true-up" of base costs for transportation and higher education.

The committee also recommends new exclusions for fiscal 2002 homeland defense costs, payment of fiscal 2001 Medicaid and mental health bills, and business-like enterprise activities at Baltimore Washington International Airport, the Port Administration, and the State Lottery Agency. As a group, these changes bring more of the State's spending within the SAC limit, reduce restrictions on revenue generating entities, and encourage accuracy rather than subterfuge in the budget process. The committee believes these actions will make the spending limit more effective in constraining the growth of State spending.

The three primary refinements to the spending affordability calculation methodology include:

A. Ongoing General Fund PAYGO

The committee recommends the inclusion of ongoing or multi-year general fund PAYGO commitments within the spending limit. These commitments put continuing demands on current resources and should compete equally with other public programs for resources within the limit. General funds for revolving loan accounts and capital programs involving multi-year funding streams would be captured within the limit by this change.

B. New Additions to General Fund PAYGO in the *Capital Improvement Program* (CIP)

Include within the limit any general fund PAYGO appropriations that represent additions to the State CIP submitted after the beginning of session. This will provide an incentive to use future "excess" funds in ways which accelerate the capital program or reduce the need for borrowing for projects within the plan. This will also require that supplemental budgets which distribute capital funds outside the capital plan do so within the overall spending limit.

C. True-up Base Costs for Transportation and Higher Education Funds

Through the years these costs have become understated as both the executive and legislative branches have made tentative reductions based on sometimes erroneous estimates. The error is then corrected through budget amendment after session. Consequently, the budget that is submitted and approved does not represent an accurate estimate of the real cost of services. **The committee suggests that the base for calculating the limit be adjusted upward to recognize this circumstance. It also strongly admonishes both the Governor and the legislature against understating budget requirements in the future. In the legislative context, this would mean that reductions to special funds should not as a rule authorize the amounts to be subsequently restored by budget amendment.**

D. New Exclusions

Any recommendation made by the committee will continue to take into consideration reasonable exclusions from the spending affordability limit. New exclusions recommended by the committee provide for a balance between the fiscal and programmatic needs of the State, and include:

- ***Homeland Defense:*** Circumstances have compelled the State to address a new and unplanned for threat. **The committee recommends that fiscal 2002 costs ($25 million is the deficiency estimate) be excluded from the limit.** To the extent these costs will be ongoing, however, it also believes that fiscal 2003 needs should be counted within the limit.

- ***2001 Roll Forwards:*** Mental hygiene will be rolling costs forward from fiscal 2001. **To provide an incentive to identify and resolve those costs, the committee recommends that they be excluded from the limit.**

- ***Enterprise Activities:*** For a number of years the Maryland Department of Transportation has argued that its business-like enterprise activities at the port and airport should be excluded from the appropriation limit. **The committee concurs and recommends that those costs be excluded, up to the revenues**

generated by the activity. The same rationale as that used for the port and the airport can be logically applied to the State Lottery Agency. **The committee recommends that costs for Lottery be excluded, up to the revenue generated by the agency.**

- **Medicaid Deficiency:** A Medicaid deficit of $173 million is forecast for fiscal 2002. **To ensure proper funding for the program, the committee recommends excluding the entire Medicaid deficiency.** The exclusion shall only apply to the extent that the budget provides adequate funding for fiscal 2003 and fully funds the fiscal 2002 deficit.

Recommendations

In light of the considerations discussed above, the committee proposes the following recommendations for the 2002 session:

1. Operating Budget

A. Spending Limit

Appropriations subject to the spending affordability limit shall be 3.95% over appropriations approved at the 2001 session, subject to the revised methodology described in this document. This limit would provide for a $543.1 million increase in appropriations at the 2002 session, resulting in expenditures of $14,293.2 million available to spending affordability. This limit is based on personal income growth in Maryland forecasted to be 3.6% for calendar 2002 and 5.0% for calendar 2003. Given the extreme uncertainty in the outlook, the committee believes it prudent to choose a mid-range limit.

This practical consideration is derived from the relative scarcity of general fund revenues in the near term. The BRE estimates that general fund revenues for fiscal 2003 will total $9.8 billion. By contrast, general fund baseline operations, excluding ongoing capital and reserve fund transfers, could cost about $10.9 billion. Budget deficiencies are expected to add $268.6 million to 2002 session costs.

B. Fiscal 2003 Budget and Future Sustainability

Based on estimates provided to the committee, supporting the baseline budget will require at least $1 billion in general funds over current revenues. This can come from reserves, fund balances created through additional reductions made by the Governor to the current budget, statutory transfers of special fund balances to the general fund, or by adjustments to current tax laws.

In recent years, the committee has recommended that the budget be balanced in the "business sense," that is, that revenues be sufficient to sustain estimated ongoing costs. These recommendations have been substantially complied with when the budget is enacted. However, because ongoing costs were under-estimated in the current budget and current revenues were over-estimated, maintaining this balance in the current year will be exceedingly difficult.

To the extent the gap is closed with general fund reductions or increases to general fund revenues, budget sustainability is improved. To the extent it is simply filled with one-time reductions or cash, it is not. ***The committee recommends that future sustainability be a primary consideration in the development of the fiscal 2003 general fund budget and that the imbalance between revenues and expenditures be erased as soon as practicable.***

C. Temporary Assistance for Needy Families

Maryland receives $229.1 million annually through the federal TANF block grant. Funding in fiscal 2003 is uncertain as Congressional reauthorization is scheduled for calendar 2002. In fiscal 2001 and 2002, excess TANF dollars available from prior years were funding ongoing State programs, but the surplus will be completely exhausted by fiscal 2003. Financing options for future years include the use of monies set aside for this purpose in the Dedicated Purpose Fund, reducing transfers of TANF dollars to the Child Care Block Grant, or substituting general funds for federal funds in programs currently funded with TANF. **The committee recommends that the budget committees closely monitor the use of TANF funds in the 2003 budget.**

2. Revenue Stabilization and General Fund Balances

In addition to its recommendation for a general fund increase, the committee recommends the prudent use of the Revenue Stabilization Fund ("Rainy Day Fund") to address general fund needs. At the end of fiscal 2002, the committee expects the Rainy Day Fund to hold about $566 million, $82 million in excess of the 5% of general fund revenues established as its target balance. Fund balances and reserves are a conspicuous feature of State finance and are relied upon by bond rating agencies and others as one measure of fiscal health. **Accordingly, the committee recommends that the State retain a combined balance equivalent to 5% of general fund revenues in the Rainy Day Fund and general fund at the end of the budget period.**

3. Capital Budget

A. General Obligation Debt

The committee notes the recommendation of the Capital Debt Affordability Committee that $520 million in general obligation bonds may be authorized at the 2002 session but finds that an upward revision to the limit is appropriate.

Even under conservative economic assumptions, $1.2 billion in debt capacity exists, in addition to the $520 million level recommended by the Debt Affordability Committee. Some portion of this additional capacity could be used to re-finance projects previously authorized as general fund PAYGO. It could also be helpful in relieving some portion of the roughly $1 billion in future capital commitments that the 2001 capital plan supported with general funds.

Accordingly, the committee recommends increasing by up to $200 million the limit proposed by the Capital Debt Affordability Committee for the 2002 session. The use of this additional bond capacity shall be limited to previously authorized PAYGO projects. This would leave $1.0 billion in capacity in the event of an extraordinary circumstance, while giving the Governor and the legislature considerable flexibility to restructure the capital financing in the context of the total budget needs of the State.

B. PAYGO in the Capital Plan

In order to ensure that State funds will not be over committed in future years, general fund PAYGO out-year funding in the **CIP should be limited to only those uses for which tax exempt debt cannot be used (e.g., economic development, housing, environment).** This entails revision to the development of the CIP.

C. Academic Revenue Debt

The committee concurs in the recommendation of the Capital Debt Affordability Committee that $40 million in new academic revenue bonds may be authorized at the 2002 session.

D. Operating Maintenance Exclusion

The committee notes that there is a backlog of identified operating maintenance projects at State facilities that totals over $53 million. A backlog also exists for higher education projects. These problems, if left uncorrected, will continue to deteriorate and will eventually qualify for capital funding as major repair projects. It is more cost effective to make immediate repairs. **In an effort to reduce this backlog, the committee continues to support the exclusion from the spending affordability**

calculation of up to $40 million for operating maintenance projects funded through the Department of General Services' operating maintenance program and higher education institutions. Projects qualifying for this exclusion should not be large construction or basic ongoing maintenance projects.

E. Transportation Debt

The draft Consolidated Transportation Program anticipates the issuance of new debt through fiscal 2007 resulting in a 85% increase in outstanding debt over fiscal 2001 levels. The committee is concerned that this increase in debt would exhaust the Transportation Trust Fund's debt capacity thereby making it more difficult to maintain the capital program if Trust Fund revenue growth slows.

Based on current revenue forecasts and the proposed increase in debt, the State transportation capital program (including State and federal funds) will average $1.37 billion each year through fiscal 2007. To the extent transportation revenues exceed those projected by MDOT, those additional funds should be used to reduce the amount of bonds sold.

4. State Positions

Given current financial conditions, the prudent allocation of personnel resources is critical. The committee recognizes the necessity of the hiring freeze on non-essential personnel instituted by the Governor for the duration of fiscal 2002 and all of fiscal 2003 as a way to constrain State spending. **The budget committees are urged to examine whether some of the positions held vacant under the hiring freeze or other positions could be permanently abolished without seriously harming the operations of State government**. In that personnel costs comprise approximately a quarter of the State operating budget, any effort to permanently reduce personnel spending will help resolve the structural budget gap.

To further constrain the growth in State spending, the committee recommends that the creation of new positions during the 2002 session be limited to:

- **critical public safety and homeland security needs;**
- **facilities scheduled to open in fiscal 2003; and**
- **addressing workload increases in higher education and essential services at 24-hour facilities.**

Part 1

Economic Outlook

What We Know: U.S. Economy

- Growth in the U.S. economy has slowed significantly over the past year.

% change*	CY 2000 Actual	CY 2001 Y-T-D	2001 Notes:
Real GDP	4.1%	-1.1%	*3rd Qtr. annual rate*
Employment	2.2%	0.5%	*January – November*
Personal Income	7.0%	5.3%	*January – October*
CPI	3.4%	3.1%	*January – October*
Consumer Confidence	-9.3%	-36.1%	*Nov. '01 vs Dec. '00*
S&P 500 Index	-9.3%	-11.4%	*since Jan. (12/11 close)*
30-Yr Mortgage Rate	8.1%	7.0%	*average Jan.-Nov.*
** except mortgage rate*			

What We Know: Maryland Economy

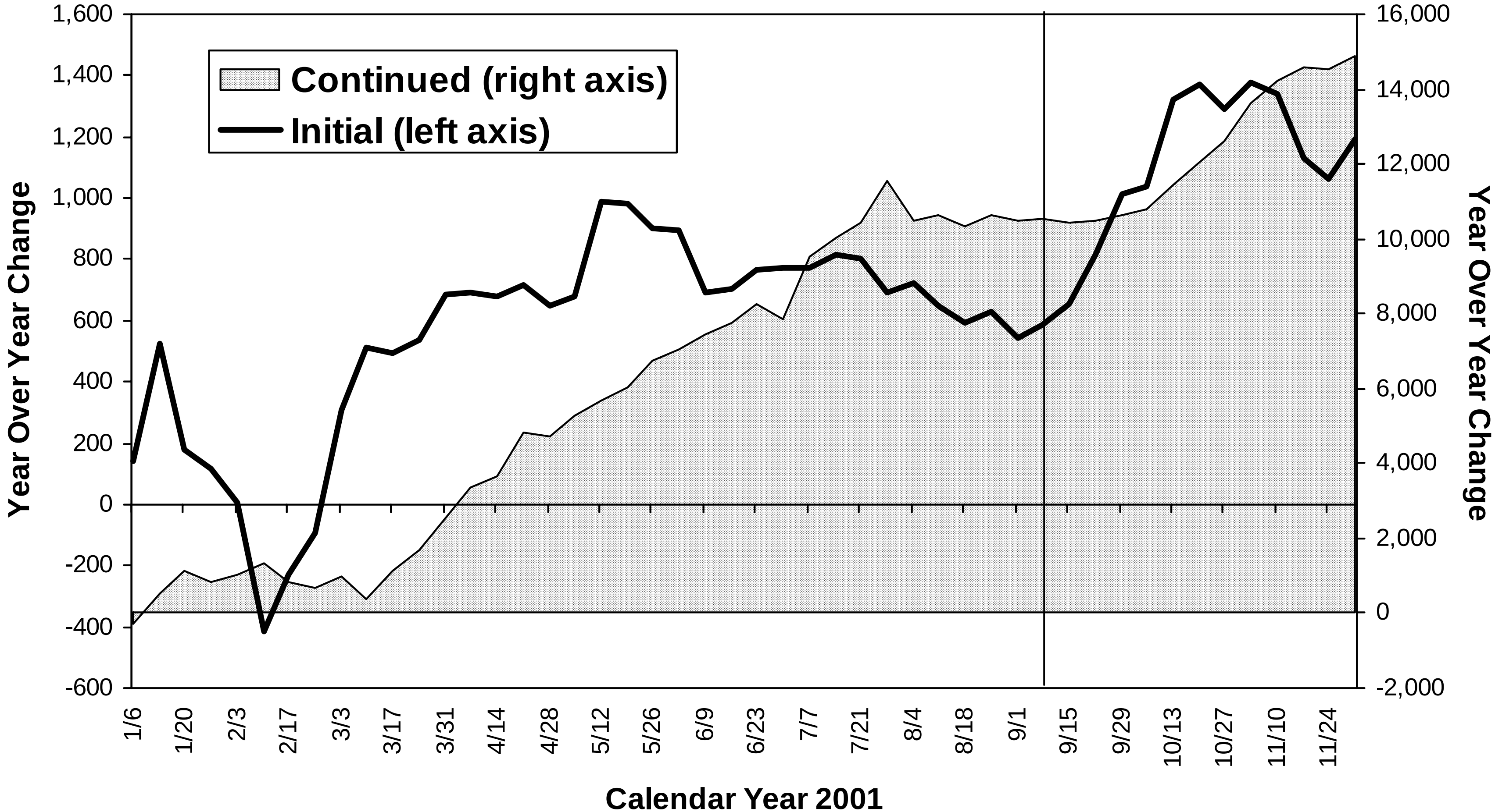
- Maryland's economy is mixed with employment growth slowing but personal income growth accelerating during the first half of the year.

Year over year % change	**CY 2000 Actual**	**CY 2001 Y-T-D**	**2001 Notes:**
Employment	2.7%	1.1%	*January – October*
Personal Income	6.8%	7.2%	*January – June*
Wage & Salary Income	7.8%	8.6%	*January – June*
Vehicle Sales	3.6%	2.5%	*January – October*
Existing Home Sales	2.0%	12.3%	*January – October*
Sales Tax*	8.5%	2.5%	*January - October*

** Gross receipts (excludes tax amnesty payments); CY 2001 adjusted for tax-free week.*

Weekly Unemployment Insurance Claims*

Four-Week Moving Average



* *Claims filed against the Maryland fund.*

Forecast: Maryland Economy

- For Maryland, the Board of Revenue Estimates is forecasting significantly slower growth especially in 2002.

Year over Year Percent Change

CY		***BRE - December 2000*** Employment	Personal Income	***BRE - December 2001*** Employment	Personal Income
2001Q1	A			2.3%	7.5%
2001Q2	A			1.0%	6.8%
2001Q3	A*			0.9%	5.4%
2001Q4	E			0.0%	4.5%
2002Q1	E			-0.3%	3.9%
2002Q2	E			-0.2%	3.3%
2002Q3	E			0.0%	3.4%
2002Q4	E			0.6%	3.9%
2001	E	1.6%	6.3%	1.0%	6.1%
2002	E	1.9%	6.2%	0.0%	3.6%
2003	E	1.9%	5.6%	1.4%	5.0%
2004	E	1.8%	5.1%	1.9%	5.7%

** Employment for the 3rd quarter of 2001 is the actual, personal income is an estimate.*

Part 2

General Fund Revenues

General Fund Revenues: Fiscal 2001

($ in Millions)

Source	Actual FY 2000	Fiscal Year 2001 Estimated*	Actual	Difference	% Change FY00-01
Personal Income Tax	$4,746.3	$5,066.0	$5,133.7	$67.7	8.2%
Sales and Use Tax	2,478.5	2,647.7	2,626.8	-20.9	6.0%
State Lottery	367.8	383.4	385.0	1.6	4.7%
Corporate Income Tax (1)	319.5	349.0	374.4	25.4	17.2%
Business Franchise Taxes (1)	178.7	169.7	167.4	-2.3	-6.3%
Insurance Premiums Tax	172.5	177.2	190.4	13.2	10.4%
Estate & Inheritance Taxes	157.0	142.4	168.8	26.4	7.5%
Tobacco Tax	210.0	195.0	205.6	10.7	-2.1%
Alcohol Beverages Tax	24.4	24.7	24.5	-0.2	0.5%
Motor Vehicle Fuel Tax	11.3	11.3	12.0	0.7	6.3%
District Courts	70.3	72.2	69.6	-2.5	-1.1%
Clerks of the Court	37.7	39.5	39.5	0.1	4.8%
Hospital Patient Recoveries	102.1	76.2	66.2	-10.0	-35.1%
Interest on Investments	128.4	123.7	140.6	16.9	9.5%
Miscellaneous	215.6	175.7	197.8	22.1	-8.2%
Total	**$9,220.1**	**$9,653.5**	**$9,802.4**	**$148.9**	**6.3%**

** From the report of the Board of Revenue Estimates, December 2000. The fiscal 2002 budget increased the Board's estimate of hospital patient recoveries by $5.1 million which is reflected here. Also, the fiscal 2002 budget included a reversion of $100,000 that is reflected here in miscellaneous revenues.*

1. FY 2000 reflects a half-year impact, and FY 2001 reflects a full-year impact of the tax changes associated with utility restructuring.

General Fund Revenues: Fiscal 2002

($ in Millions)

	Fiscal Year Through November			
Source	**FY 2001**	**FY 2002 ***	**$ Diff.**	**% Diff.**
Personal Income Tax	$1,450.9	$1,402.3	-$48.6	-3.3%
Sales and Use Tax (1)	864.0	866.2	2.2	0.3%
State Lottery	147.8	156.2	8.4	5.7%
Corporate Income Tax	67.9	33.6	-34.3	-50.5%
Business Franchise Taxes	43.5	37.5	-6.0	-13.9%
Insurance Premiums Tax	47.7	47.9	0.2	0.4%
Estate & Inheritance Taxes	69.2	85.2	15.9	23.0%
Tobacco Tax	72.8	69.8	-3.0	-4.1%
Alcohol Beverages Tax	8.4	8.9	0.5	5.5%
Motor Vehicle Fuel Tax	3.1	3.2	0.1	2.5%
District Courts	28.7	29.9	1.2	4.1%
Clerks of the Court	14.6	15.4	0.8	5.3%
Hospital Patient Recoveries (2)	4.1	7.7	3.6	87.5%
Interest on Investments	37.0	30.7	-6.2	-16.9%
Miscellaneous	34.9	37.1	2.2	6.4%
Total	**$2,894.6**	**$2,831.4**	**-$63.2**	**-2.2%**

* FY 2002 does not include tax amnesty payments.

1. FY 2002 reflects the impact of the tax-free week in August.
2. Does not include Medicaid recoveries and disproportionate share payments.

General Fund Revenue Projections
($ in Millions)

Source	Actual FY 2001	Fiscal Year 2002 May*	Fiscal Year 2002 Dec-01	$ Diff.	% Change FY01-02	Estimate FY 2003	% Change FY02-03
Personal Income Tax (1)	$5,133.7	$5,227.9	$5,113.5	-$114.4	-0.4%	$5,197.9	1.7%
Sales and Use Tax (2)	2,626.8	2,763.6	2,635.5	-128.0	0.3%	2,731.4	3.6%
State Lottery	385.0	396.4	396.7	0.3	3.0%	403.3	1.7%
Corporate Income Tax	374.4	341.3	245.2	-96.1	-34.5%	302.4	23.3%
Business Franchise Taxes	167.4	171.8	157.4	-14.4	-6.0%	168.6	7.1%
Insurance Premiums Tax	190.4	182.0	192.7	10.6	1.2%	197.1	2.3%
Estate & Inheritance Taxes (1)	168.8	133.2	171.6	38.4	1.7%	139.2	-18.9%
Tobacco Tax	205.6	187.8	203.6	15.9	-1.0%	199.9	-1.9%
Alcohol Beverages Tax	24.5	25.0	25.1	0.1	2.4%	25.0	-0.4%
Motor Vehicle Fuel Tax	12.0	11.7	12.0	0.3	0.0%	12.1	0.8%
District Courts	69.6	73.9	70.8	-3.1	1.7%	72.1	1.7%
Clerks of the Court	39.5	39.0	40.2	1.2	1.7%	38.6	-3.9%
Hospital Patient Recoveries (3)	66.2	76.4	87.7	11.3	32.4%	63.9	-27.1%
Interest on Investments	140.6	82.5	72.6	-9.9	-48.3%	70.3	-3.3%
Miscellaneous (4)	197.8	166.4	179.3	12.9	-9.3%	165.6	-7.6%
Tax Amnesty	0.0	30.0	28.5	-1.5	n.a.	0.0	n.a.
Subtotal	**$9,802.4**	**$9,908.9**	**$9,632.5**	**-$276.3**	**-1.7%**	**$9,787.3**	**1.6%**
Transfer (5)	0.0	0.0	119.5	119.5	n.a.	0.0	n.a.
Grand Total	**$9,802.4**	**$9,908.9**	**$9,752.0**	**-$156.8**	**-0.5%**	**$9,787.3**	**0.4%**

* Board of Revenue Estimates, March 2001 with adjustments for the legislative actions of the 2001 session.

1. FY 2003 reflects the impact of the federal Economic Growth and Tax Relief Reconciliation Act of 2001.
2. FY 2002 reflects a partial impact, and FY 2003 reflects the full impact of transferring 100% of the sales tax on rental vehicles to the Transportation Trust Fund (HB 309, 2001 session).
3. FY 2001-03 reflect new federal caps on disproportionate share payments that limit the amount that can be recovered for state hospitals.
4. FY 2002 reflects the transfer of $6 million of uninsured motorist penalty fees to the Transportation Trust Fund (TTF). FY 2003 reflects the transfer of all of those fees, $9 of the $14 in security interest filing fees and special license plate fees to the TTF (HB 309, 2001 session).
5. FY 2002 includes a one-time accounting adjustment due to overfunding of the local reserve account.

Impact of Tax Law Changes

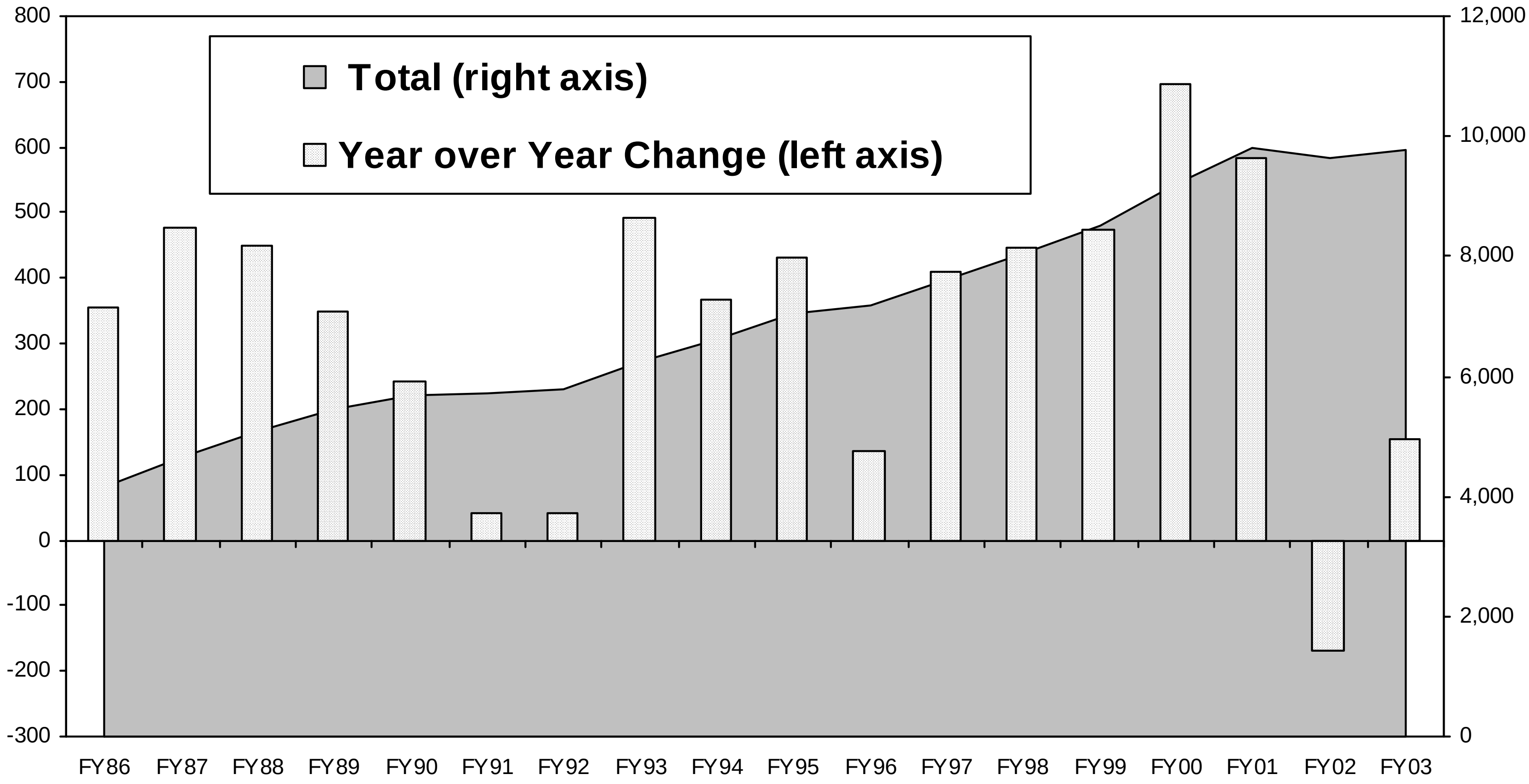
($ in Millions)

	FY 2001	FY 2002	FY 2003
Before Tax Impacts	**$9,802.4**	**$9,712.3**	**$10,015.7**
$ change over the prior year		-90.1	303.4
% change over the prior year		-0.9%	3.1%
Federal Changes			
-- income tax			-30.0
-- estate tax			-26.0
State Changes			
Income Tax			
-- income tax cut		-56.6	-118.8
-- refundable EITC		-4.3	-7.5
-- other		-0.4	-0.6
Transit Initiative			
-- sales tax on rental vehicles		-12.4	-26.0
-- uninsured motorist and other fees		-6.0	-19.4
Net General Fund Revenues*	**$9,802.4**	**$9,632.5**	**$9,787.3**
$ change over the prior year		-169.9	154.8
% change over the prior year		-1.7%	1.6%

** FY 2002 excludes transfers.*

General Fund Revenues*: Fiscal 1986-2003

($ in Millions)



** Excludes transfers (FY 1990-1997, 2002) and the Medicaid provider tax (FY 1991-1993). FY 2002 and 2003 are estimates from the Board of Revenue Estimates (December 2001).*

Part 3

General Fund Budget

Potential Fiscal 2002 General Fund Deficiencies

($ in Millions)

Program	**Dollars**
Medicaid	$173.1
Homeland Security	25.0
Mental Health	10.5
Foster Care (Placement Costs Rise and Federal Fund Attainment Falls Short)	9.3
Public Safety (Medical Care, Health Insurance, Data Center, etc.)	8.8
Public Defender (Salaries and Information Technology)	3.5
Labor, Licensing, and Regulations Operations	2.6
Child Welfare Computer System (Development Costs)	2.1
Other	3.7
Subtotal	**238.6**
Rainy Day Fund (Required under Tax Amnesty Legislation)	30.0
Total	**$268.6**

Medicaid Deficit

- Fiscal 2002 budget proposed by executive was developed using three spurious assumptions:
  - Caseload drop from more than 440,000 in January 2001 to 428,000 in fiscal 2002.
  - No increase in managed care rates for calendar 2002.
  - Overly optimistic medical inflation of 3%.

- Fiscal picture has worsened since end of session producing $173 million deficit.

• Fiscal 2001 deficit	$40 million
• Enrollment grows to 466,508 -- current enrollment is 457,000	$42 million
• Nursing home rates rise 13%	$33 million
• Managed care rates for calendar 2002	$16 million
• Medical Inflation/Utilization	$27 million
• MD Pharmacy Assistance -- enrollment grows by 10,000	$15 million

- Continuing Fiscal Pressures
  - Managed Care Organizations are dissatisfied with calendar 2002 rates.
  - Sluggish economy could result in a surge in enrollment. Enrollment grew 10% during first year of recession in early 1990s. A 10% increase in fiscal 2002 or 2003 would cost the State anywhere from $60 to $75 million in general funds.
  - Physician rates: Medicaid rates are about one-third of Medicare rates. Raising Medicaid rates to Medicare level would cost State about $200 million in general funds.
  - State could address some of the deficit through cost containment actions.

Mental Hygiene Administration Deficit

Summary of Budget Woes

($ in Millions)

Item	
Fiscal 1998-2000 deficit	$34.3
Tax Amnesty/Dedicated Purpose Fund	(28.5)
Remaining fiscal 1998-2000 deficit	5.8
Fiscal 2001 deficit	9.3
Total deficit rolled into fiscal 2002	15.1
Unfunded fiscal 2002 increase in psychiatric hospital rates	3.5
Fiscal 2002 funds earmarked for deficit reduction	(8.1)
Projected Fiscal 2002 deficit	**$10.5**

- During the 2001 legislative session, the General Assembly attempted to address deficit accumulated over multiple years by:
  - authorizing transfer of $28.5 million from Dedicated Purpose Fund for deficit reduction; and
  - restricting $8.1 million of fiscal 2002 funding for deficit reduction.
- Despite efforts to eradicate the deficit, a $7 million deficit from prior years remains.
- Unfunded $3.5 million increase in rates for private free-standing psychiatric hospitals accounts for the remainder of the fiscal 2002 deficit.
- Total deficit may exceed $10.5 million if fiscal 2002 cost containment actions implemented by the Mental Hygiene Administration are ineffective.

Fiscal 2003 Baseline Budget Forecast Assumptions

Baseline Budget Concepts

- Current laws, policies, and practices are continued.
- Inflationary increases are recognized.
- Large one-time purchases and non-recurring PAYGO expenditures are removed.
- Anticipated deficiencies are identified.
- Federal mandates and multi-year commitments are observed.
- Legislation adopted in the prior session is funded.
- Non-discretionary changes in workload are recognized.
- Full year costs of programs started during the previous year are included.
- Amendments in the current year affecting ongoing expenditures are recognized.
- Positions and operating expenses associated with new facilities are recognized.
- Employee turnover is adjusted to reflect recent experience.

Caseload Assumptions

	FY 2001	FY 2002	FY 2003	Percent Change FY02 - 03
Pupil Enrollment *	797,230	803,185	808,063	0.6%
Medicaid	443,186	466,508	486,569	4.3%
Children's Health	86,004	108,700	114,870	5.7%
Temporary Cash Asst.	75,710	73,484	72,090	-1.9%
Foster Care/Adoption	14,450	14,743	15,021	1.9%

* Data for 2001, 2002, and 2003 reflect 9/99, 9/00, and 9/01 (est.) enrollments respectively.

Fiscal 2003 Baseline Budget Forecast Assumptions (Cont.)

Inflation Assumptions

- Employee Health Insurance (14%)
- Medical Contracts and Supplies (5%)
- Prescription Drugs for State Facilities (14%)
- Human Service Providers (2%)
- Postage (3%)

Employee Compensation

- Fully fund phased-in fiscal 2002 general salary increase.
- Merit increases of 2% and 4% based on salary plan. Pay for performance program is fully funded.
- No general salary increase for fiscal 2003.
- Retirement rates rise to reflect contribution rate recommended by actuary.

Other Assumptions

- General Funds will support some education programs previously funded with Cigarette Restitution Funds (CRF) to allow for scheduled expansion of CRF-supported health programs.

- Maryland's share of federal Temporary Assistance to Needy Families (TANF) funding will remain $229.1 after Congressional re-authorization. TANF surplus will be completely exhausted in fiscal 2002. No utilization of the $89.6 million set aside in the Dedicated Purpose Fund for Family Investment Program expenses is assumed.

- Executive cost containment actions save $127 million in fiscal 2002 and $78 million in fiscal 2003. Hiring freeze ($41 million), 1.5% operating reduction ($21 million), and cancelling PAYGO projects ($65 million) produce fiscal 2002 savings. Hiring freeze ($57 million) and 1.5% reduction ($21 million) continue in fiscal 2003.

State Expenditures -- Building the Baseline
($ in Millions)

Fiscal 2003 Baseline Increase Over Projected Fiscal 2002 Spending		$283.4
Estimated Fiscal 2002 Deficiencies		268.6
Total Baseline Increase in State Expenditures		552.0
Ongoing Requirements/Entitlements		**536.7**
Medical Assistance -- Inflation, MCO rates, enrollment, unpaid fiscal 2001 bills	268.8	
Education and Libraries Formulas	147.9	
Disparity Grant	24.9	
Foster Care -- cost per case and lower federal fund attainment	21.2	
Community Colleges -- Cade formula	22.1	
Other (Health, non-public placements, community colleges, homeowner's tax credit, etc.)	14.4	
Higher Education (BCCC, St. Mary's, Sellinger, Scholarships)	14.0	
Temporary Cash Assistance caseload exceeds fiscal 2002 budget	13.7	
Debt Service	9.7	
Legislation/Commitments		**241.3**
Higher Education -- Continuing phase-in of MHEC guidelines for USM and MSU	96.1	
Appropriation to Dedicated Purpose Fund -- required as part of Tax Amnesty legislation	30.0	
Developmental Disabilities -- Phase-in of waiting list initiative	16.7	
Raise rates for providers serving developmentally disabled -- Chapter 722, Acts of 2001	16.2	
Medicaid Nursing Home Staffing -- Chapter 212, Acts of 2000	10.0	
Higher Education -- Funding to comply with Office of Civil Rights agreement	9.5	
Mental Health -- Annualization of initiatives	6.1	
Comply with Health Insurance Portability and Accountability Act of 1996 (HIPAA)	5.7	
Funding of circuit court law clerks -- Chapter 677, Acts of 2001	5.4	
Annualize Costs of Chapters 134 and 135, Acts of 2001, Senior Prescription Drug Relief Act	5.3	
Substance Abuse Treatment Outcomes Partnership (STOP) -- Chapter 675, Acts of 2000	4.0	
Other legislation and commitments smaller than $4 million each	36.3	
State Agency Costs		**267.3**
Increments, annualize fiscal 2002 COLA, health insurance (13.9%)	103.0	
Fund shifts from Cigarette Restitution Fund and other sources to General Fund	32.2	
Homeland defense/security	30.0	
Retirement rates increase	13.1	
Reduce turnover expectancy at the Department of Juvenile Justice to 3.5%	14.5	
Mental Hygiene -- Inflation and utilization	14.1	
Fully fund pay for performance bonuses and annual salary review adjustments	13.2	
Corrections -- Population growth, utilities, medical contract, IT, and 160 new positions	12.5	
Public Defender -- Workload and information technology costs	9.6	
Community Providers -- Increase to keep pace with annualization of State employee COLA	7.8	
Other	17.3	
Remove One-Time Expenses		**(542.0)**
PAYGO Capital	(511.0)	
Various Operating (information technology and other)	(31.0)	
State Reserve Fund		**-0.3**
Impact of Cost Containment Actions Taken by Governor Diminished in Fiscal 2003		**$49.0**

State Expenditures -- General Funds
($ in Millions)

Category	Work. Appr. FY 2001	Leg. Appr. FY 2002	Baseline FY 2003	$ Diff. 02 to 03	% Diff. 02 to 03
Debt Service	$204.5	$204.0	$213.7	$9.7	4.8%
Aid to Local Governments					
General Government	175.5	202.8	227.4	24.6	12.1%
Community Colleges	163.6	178.5	205.7	27.2	15.2%
Education & Libraries	2,719.8	2,857.9	3,034.8	176.9	6.2%
Health	52.2	56.9	62.1	5.2	9.1%
	3,111.1	3,296.2	3,530.0	233.9	7.1%
Entitlements					
Foster Care Payments	119.6	129.3	150.5	21.2	16.4%
Assistance Payments	65.3	62.7	76.4	13.7	21.9%
Medical Assistance	1,320.1	1,407.1	1,691.2	284.1	20.2%
Property Tax Credits	53.5	52.6	55.2	2.7	5.0%
	1,558.4	1,651.7	1,973.3	321.6	19.5%
State Agencies					
Health	1,006.2	1,106.6	1,200.9	94.3	8.5%
Human Resources	285.2	297.7	321.3	23.6	7.9%
Systems Reform Initiative	46.9	43.1	44.9	1.8	4.2%
Juvenile Justice	143.8	163.4	179.1	15.7	9.6%
Public Safety & Police	863.4	918.1	990.0	71.9	7.8%
State Colleges & Universities	886.5	974.5	1,078.3	103.8	10.7%
Other Education	248.6	277.5	308.6	31.2	11.2%
Agric./Natl Res./Environ.	125.5	151.5	153.6	2.1	1.4%
Other Executive Agencies	540.0	565.3	643.6	78.3	13.9%
Judicial & Legislative	281.4	317.7	334.5	16.8	5.3%
	4,427.5	4,815.3	5,254.9	439.5	8.5%
Anticipated Deficiencies	0.0	238.6	0.0	(238.6)	-100.0%
Workers' Compensation Charges	0.0	0.0	11.6	11.6	n.a.
Subtotal	**$9,301.5**	**$10,205.8**	**$10,983.5**	**$777.7**	**7.6%**
Capital	645.3	688.9	177.8	(511.1)	-74.2%
Transfers	2.0	2.0	0.0	(2.0)	-100.0%
Subtotal	**$9,948.8**	**$10,896.6**	**$11,161.3**	**$264.7**	**2.4%**
Reserve Fund	311.0	186.4	156.0	(30.3)	-16.3%
Appropriations	**$10,259.7**	**$11,083.0**	**$11,317.3**	**$234.3**	**2.1%**
Executive Cost Containment Actions	0.0	(127.0)	(78.0)	49.0	-38.6%
Reversions	(29.4)	(25.0)	(25.0)	0.0	0.0%
Grand Total	**$10,230.3**	**$10,931.0**	**$11,214.3**	**$283.3**	**2.6%**

Note: FY 2002 Reserve Fund appropriation includes $30 million deficiency appropriation.

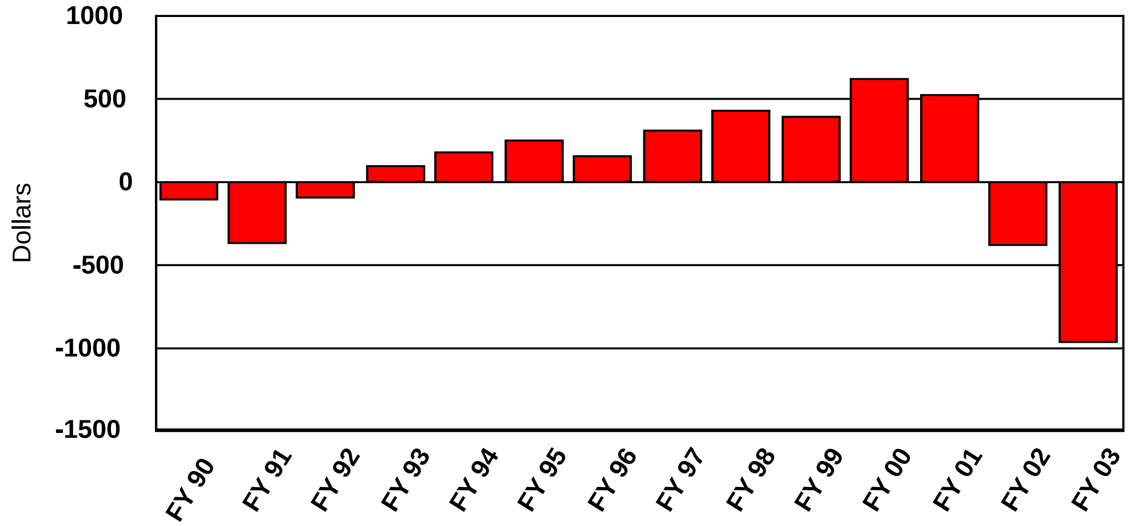
General Fund PAYGO Capital
Legislative Appropriation vs. Baseline

($ in Millions)

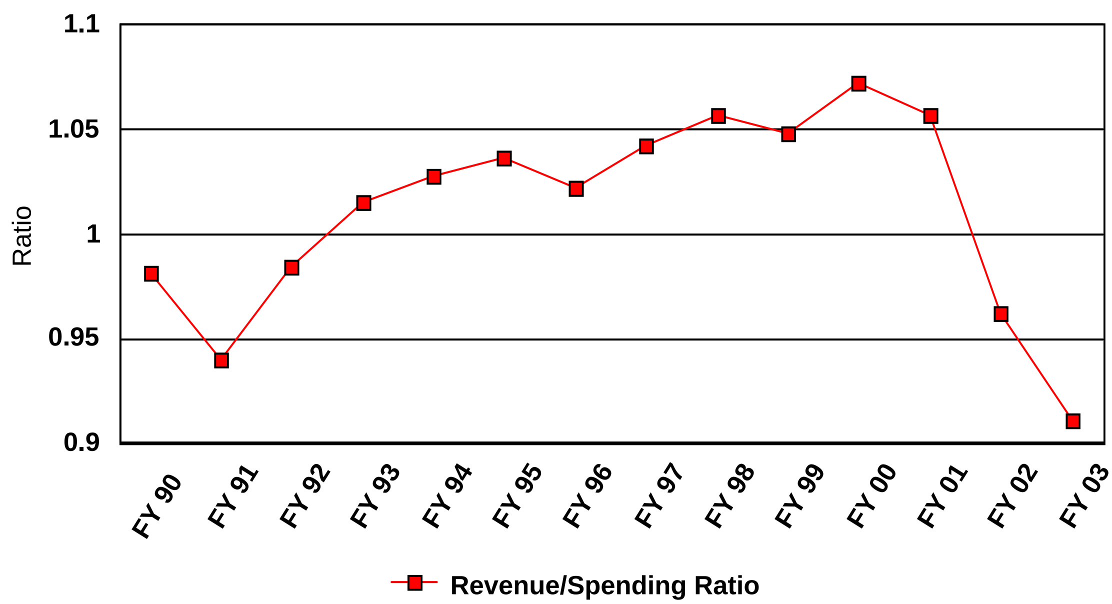
	FY 2002 Leg. Approp.	FY 2003 Baseline	Change
State Facilities	$21.5	$5.0	($16.5)
Health/Social	1.6	1.6	0.0
Environment	41.2	16.0	(25.2)
Public Safety	2.6	0.0	(2.6)
School Construction	133.7	0.0	(133.7)
Higher Education	274.8	7.7	(267.2)
Housing/Community Development	36.1	35.0	(1.1)
Economic Development	52.1	34.6	(17.5)
Local Projects	80.3	8.0	(72.3)
Transportation	45.0	70.0	25.0
Total	**$688.9**	**$177.8**	**($511.1)**

Ongoing Revenues No Longer Exceed Operating Expenses

($ in Millions)



Ongoing Revenue Per Dollar of Operating Spending



Part 4

General and Reserve Fund Forecast

There Are Two Main Points to This Presentation

- For fiscal 2002 and 2003, forecasted general fund revenues are insufficient to cover the costs of current services and capital commitments.
- General fund and reserve fund balances, and announced cost containments will not balance the budget.

Doing the Math

($ in Millions)

Fiscal 2002/2003 Combined		
DLS Estimate General Fund Revenues	$20,330	
DLS Estimate General Fund Expenditures	22,199	
Revenue/Expenditure Imbalance		($1,869)
Cost Containment (10/17)	205	
Transfer of Local Income Tax Revenue	120	
DLS Estimate GF and Rainy Day Fund Balances	729	
		1,054
Unresolved Imbalance		($816)

No % Solution
Budget Summary: FY 2001-03
Entire Rainy Day Fund Utilized
($ in Millions)

	Actual FY 2001	FY 2002	FY 2003
Funds Available			
Beginning Fund Balances	$1,518.1	$1,426.7	$454.3
Interest on Reserve Fund Balances & Transfers from Dedicated Purpose Fund	101.4	34.8	5.8
Estimated General Fund Revenues	9,802.4	9,632.5	9,787.3
Transfer from Local Income Tax Reserve Account	0.0	119.5	0.0
	$11,422.0	$11,213.5	$10,247.4
Appropriations and Deficiencies			
Operating Budget/Current Services Estimate/Deficiencies[1]	$9,350.0	$10,197.4	$10,963.5
Capital Plan	645.3	688.9	177.8
Potential Executive Branch Cost Savings	0.0	-127.0	-78.0
	$9,995.3	$10,759.2	$11,063.3
Balance Remaining	$1,426.7	$454.3	-$815.8

[1] Less appropriations to the Reserve Fund from the General Fund of $235.0 million in fiscal 2001, $171.8 million in fiscal 2002, and $151.0 million in fiscal 2003.

General Fund Projections
Assuming 5% Solution
($ in Millions)

	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	Annual Growth Rate FY02-FY03	Avg. Annual Growth Rate FY03-FY07
Revenues								
Individual Income	$5,113	$5,198	$5,460	$5,787	$6,166	$6,549	1.7%	4.7%
Sales and Use	2,636	2,731	2,891	3,056	3,235	3,390	3.6%	4.4%
Lottery	397	403	411	418	426	438	1.7%	1.7%
Other	1,487	1,455	1,554	1,504	1,502	1,538	-2.2%	1.1%
Subtotal	**$9,633**	**$9,787**	**$10,316**	**$10,764**	**$11,329**	**$11,914**	**1.6%**	**4.0%**
Adjustments:								
Balance	$538	$0	$0	$0	$0	$0		
Transfer - Reserve Fund	612	165	0	2	2	0		
Transfer - Local Reserve Account	120	0	0	0	0	0		
	$10,903	**$9,952**	**$10,316**	**$10,767**	**$11,332**	**$11,914**	**-8.7%**	**3.7%**
Expenditures								
Debt Service	$204	$214	$234	$255	$271	$285	4.8%	5.9%
Local Aid	3,296	3,530	3,726	3,912	4,072	4,233	7.1%	3.7%
Entitlements (includes deficiencies)	1,834	1,973	2,131	2,279	2,439	2,614	7.6%	5.8%
State Operations (includes deficiencies)	4,745	5,188	5,505	5,763	5,979	6,190	9.3%	3.6%
Reversions	-25	-25	-25	-25	-25	-25	0.0%	0.0%
Subtotal	**$10,054**	**$10,881**	**$11,571**	**$12,183**	**$12,737**	**$13,297**	**8.2%**	**4.1%**
Capital	$689	$178	$336	$449	$198	$148	-74.2%	-3.6%
Transfers	2	0	0	0	0	0	n.a.	n.a.
Reserve Fund	186	156	0	0	0	0	-16.3%	-100.0%
Total Expenditures	**$10,931**	**$11,215**	**$11,907**	**$12,632**	**$12,934**	**$13,445**	**2.6%**	**3.7%**
Surplus (Shortfall)	-$28	-$1,263	-$1,591	-$1,866	-$1,602	-$1,531		
Annual Change		-1,234	-329	-274	263	72		
Revenue Stabilization Fund								
Ending Balance	$483	$496	$523	$549	$575	$604		
As a Percent of Revenues	5.0%	5.1%	5.1%	5.1%	5.1%	5.1%		
Ratio of Operating Revenues to Expenditures	0.96	0.90	0.89	0.88	0.89	0.90		

General Fund PAYGO Capital
Out Year Funding Plan
($ in Millions)

	Baseline FY 2003	FY 2004	FY 2005	FY 2006	Total
State Facilities	$5.0	$13.0	$68.4	$8.0	$94.4
Health/Social	1.6	1.6	38.9	1.6	43.7
Environment	16.0	59.9	44.1	49.3	169.2
Public Safety	0.0	0.0	0.0	0.0	0.0
School Construction	0.0	0.2	22.0	25.2	47.4
Higher Education	7.7	79.0	46.3	18.5	151.4
Housing/Community Development	35.0	42.9	47.2	39.0	164.1
Economic Development	34.6	47.7	34.2	33.0	149.5
Local Projects	8.0	21.5	23.0	13.0	65.5
Transportation	70.0	70.0	125.0	10.0	275.0
Total	**$177.8**	**$335.7**	**$449.1**	**$197.5**	**$1,160.2**

Source:
Fiscal 2003 -- Department of Legislative Services, Office of Policy Analysis
Fiscal 2004-2006 -- Fiscal 2002 *Capital Improvement Program*

Part 5

Cigarette Restitution Fund

Cigarette Restitution Fund – Legal Fees

- A hearing before the Board of Contract Appeals is scheduled for May 6, 2002.

- A hearing before the national tobacco arbitration panel was completed on July 27, 2001. The panel will determine whether the State has standing to file for compensation of legal fees; and if so, what level of compensation for legal fees is due from the tobacco companies.

- By the end of fiscal 2002, approximately $120 to $125 million will be in the escrow account. The amount will vary based upon consumption, investment earnings, and non-participating manufacturers' adjustment.

- Fiscal 2003 payments, after legal fee escrow, are estimated to be $127.1 million.

- At the end of fiscal 2002, it is estimated that there will be a $11.5 million fund balance in the Cigarette Restitution Fund.

Cigarette Restitution Fund
Fiscal 2003 Baseline Estimates
($ in Millions)

	FY 02 Legislative Appropriation	Contingent Funds	FY 02 Working Appropriation	FY 03 Baseline Appropriation
Beginning Fund Balance	$10.0		$10.0	$11.5
Settlement Payments	165.7		165.7	167.4
Less 25% in Escrow	(41.4)		(41.4)	(41.8)
Total Available Revenue	**134.3**		**134.3**	**137.1**
Health				
Tobacco	$30.7	($10.7)	$20.0	$30.7
Cancer	43.0	(8.0)	35.0	43.0
Substance Abuse	18.5		18.5	18.5
MD Health Care Foundation	1.5	(0.5)	1.0	1.5
Subtotal	**$93.7**	**($19.2)**	**$74.5**	**$93.7**
Education (K-12)				
Baltimore City Partnership	$3.2		$3.2	$0.0
Academic Intervention	19.5		19.5	0.0
Aid to Nonpublic Schools*	8.0		8.0	5.0
Judy Hoyer Centers	4.0		4.0	4.0
School Wiring	3.6	(3.6)	0.0	5.9
Teacher Mentoring	2.5		2.5	2.5
Teacher Certification	2.0		2.0	1.5
Technology Academy	1.7		1.7	1.7
Readiness and Accreditation	3.0		3.0	0.0
Subtotal	**$47.5**	**($3.6)**	**$43.9**	**$20.6**
Higher Education				
MAITI Technology	$3.7	($3.7)	$0.0	$3.7
Access/Success	1.0		1.0	1.0
Digital Library	0.5	(0.5)	0.0	0.0
Subtotal	**$5.2**	**($4.2)**	**$1.0**	**$4.7**
Crop Conversion	**$6.3**		$6.3	$6.3
Attorney General	**$0.1**		$0.1	$0.0
Total Expenses	**$152.8**	**($27.0)**	**$125.8**	**$125.3**
Surplus/Deficit	($18.5)		$8.5	$11.8
Anticipated Reversions*			$3.0	
Ending Fund Balance	**($18.5)**		**$11.5**	**$11.8**

* Anticipated reversions are based on $3 million in aid to nonpublic schools which may not be spent in fiscal 2002 and must revert to the CRF.

Part 6

Local Government Assistance

State Aid to Local Governments

- In fiscal 2003, State aid to local governments is projected to increase by 4.9%, or $191.3 million.

- Direct aid will increase by 4.0%, or $142.4 million.

- For comparison purposes, direct aid increased by almost 8.0% in both fiscal 2001 and fiscal 2002.

- Retirement payments on behalf of local governments will increase by $48.8 million, or 14.0% in fiscal 2003. This increase reflects a higher contribution rate for fiscal 2003 and increased salary levels.

- This is the first time since fiscal 1997 that retirement expenditures have increased. Due to high investment returns, State retirement payments and the retirement contribution rate have been decreasing. Between fiscal 1997 and 2002, retirement payments decreased by $129.8 million, or 27.1%.

Summary of State Aid

General and Special Funds -- $ in Millions

Fiscal Year	Direct State Aid	Payments on Behalf	Total State Aid	Percent Change
1993	$2,012.3	$387.4	$2,399.7	9.5%
1994	2,085.3	383.8	2,469.1	2.9%
1995	2,217.0	423.1	2,640.1	6.9%
1996	2,327.3	455.6	2,782.9	5.4%
1997	2,441.4	479.7	2,921.2	5.0%
1998	2,659.6	474.8	3,134.5	7.3%
1999	2,910.2	442.5	3,352.7	7.0%
2000	3,029.7	420.5	3,450.3	2.9%
2001	3,269.0	390.3	3,659.3	6.1%
2002	3,525.4	349.9	3,875.3	5.9%
2003	3,667.8	398.7	4,066.6	4.9%

Increase in State Aid to Local Governments

- Funding for public schools accounts for most of the increase in State aid (72%). Public schools are projected to receive an additional $91.7 million in direct aid in fiscal 2003 and an additional $46 million in teachers' retirement payments.

- The largest increases occur in five programs – basic current expense aid, compensatory aid, student transportation, teacher quality, and class size reduction.

- Aid to local community colleges is projected to increase by $27.2 million in fiscal 2003. This includes a 15% increase in the formula program, which reflects spending increases at four-year institutions of higher education. Retirement payments on behalf of community colleges will increase by $2 million.

- State aid to general governments will increase by $18.6 million in fiscal 2003. The disparity grant program will increase by $25 million, or 28%. This is due to slow growth in income tax revenues in less affluent counties. Police aid is projected to increase by $1.8 million, or 2.9%.

($ in Millions)	Fiscal 2002	Fiscal 2003	Difference	Percent Change
Public Schools	$2,892.7	$3,030.5	$137.8	4.8
General Government	702.3	721.0	18.6	2.6
Community Colleges	178.5	205.7	27.2	15.3
Local Health	56.9	62.1	5.2	9.1
Libraries	44.8	47.3	2.5	5.5
Total	**$3,875.3**	**$4,066.6**	**$191.3**	**4.9**

- Highway user revenue is projected to decrease by $4.1 million and Program Open Space funding is projected to decrease by $2.9 million.

- Local health departments will receive an additional $5.2 million and local libraries will receive an additional $2.5 million, which reflects enhancements to both the formula aid and funding for the State library network. Retirement payments on behalf of library boards will increase by $0.7 million.

Part 7

Capital Outlook

Capital Outlook

Debt Affordability

- **Affordability Criteria**
  - State tax supported debt outstanding should not exceed 3.2% of Maryland personal income.
  - Debt service on State tax supported debt should not exceed 8% of revenues.
- **Capital Debt Affordability Committee Recommendations**
  - New authorizations of general obligation debt should be limited to $520 million during the 2002 session.
  - Academic debt authorizations should be limited to $40 million.
- **Affordability Outlook**
  - Debt ratios are generally higher than was projected last year but considerable capacity still remains within the debt criteria limits.

	Debt Outstanding As % of Personal Income		Debt Service As % of Revenues	
Fiscal Year	**2000 Projection**	**2001 Projection**	**2000 Projection**	**2001 Projection**
2002	2.53%	2.53%	5.99%	5.91%
2003	2.50%	2.56%	6.03%	6.13%
2004	2.49%	2.50%	5.94%	6.06%
2005	2.46%	2.42%	6.08%	6.17%
2006	N/A	2.39%	N/A	5.94%

Source: Department of Legislative Services

- Even using the Department of Legislative Services' pessimistic forecast of personal income and revenues, there exists nearly $1.2 billion of capacity to issue debt in fiscal 2003 without exceeding the affordability criteria. The following table shows the affordability ratios that would result from authorizing and immediately issuing $1.2 billion of general obligation debt in addition to authorizing the $520 million recommended by the

Capital Outlook (continued)

Capital Debt Affordability Committee for fiscal 2003. It would cost approximately $1.84 billion over 15 years to repay this $1.2 billion.

Fiscal Year	Debt Outstanding as % of Personal Income	Debt Service as % of Revenues
2003	3.20	6.38
2004	3.09	6.67
2005	2.99	6.75
2006	2.91	6.98
2007	2.85	6.72

- **Fund Balances Grab Bag**

($ in Millions)

Fund Source (as of 10/1/2001)	**Available Balance**
Program Open Space -- State Program	$44.6
Program Open Space -- Local Program	82.9
Waterway Improvement	1.8
Housing Fund Balances	37.0
Economic Development Fund Balances	120.5
PAYGO -- Embargoed Projects	130.5
PAYGO -- Fiscal 2001 and 2002 projects with no expenditures	233.1
PAYGO -- Unencumbered balance of fiscal 2001 and 2002 projects for which expenditures have been made	372.6

Findings and Recommendations

- The $520 million general obligation bond authorization recommended by the Capital Debt Affordability Committee for fiscal 2003 results in debt ratios well within the affordability criteria limits. There is considerable capacity available to meet additional demands.
- Limit general fund PAYGO in the out-years of the *Capital Improvement Program* to only those uses for which tax exempt debt cannot be used (e.g., economic development, housing, environment). Legislation would be required.

Part 8

Transportation Trust Fund

Transportation Trust Fund Closes Fiscal 2001 Stronger Than Projected
($ in Millions)

Fund Balance	**Projected**	**Actual**	**Variance**
Starting Fund Balance	$198	$198	$0
Ending Fund Balance	108	128	20
Change in Fund Balance	**($90)**	**($70)**	**$20**
Gross Receipts/Adjustments			
Gross Revenues			
Motor Fuel Taxes	$653	$687	$34
Titling Taxes	622	613	(9)
Corporate Income Taxes	110	118	8
Other Taxes and Fees	307	314	7
Operating Revenues and Misc. Revenues	317	364	47
Subtotal	**2,009**	**2,096**	**87**
Other Receipts/Adjustments			
MdTA Transfers	(20)	(20)	0
GF Transfers	50	35	(15)
Subtotal	**30**	**15**	**(15)**
Total Gross Receipts/Adjustments	**$2,039**	**$2,111**	**$72**
Gross Expenditures and Deductions			
MDOT Expenditures			
Operating Expenditures and Debt Service	$1,040	$1,059	$19
Capital Expenditures	617	639	22
Subtotal	**1,657**	**1,697**	**40**
Local Grants and Deductions			
Local Highway User Revenue Grants	422	435	13
Deductions	49	50	1
Subtotal	**473**	**485**	**14**
Total Gross Expenditures and Deductions	**$2,130**	**$2,182**	**$54**

Note: Numbers may not sum to total due to rounding.

Source: Maryland Department of Transportation

- Special fund balance closes at $128 million, which is $20 million greater than projected and $28 million greater than the $100 million target fund balance.

- Gross revenues were $87 million greater than projected, allowing the department to cancel bond sales which resulted in $648 million in debt outstanding, the lowest level since fiscal 1990.

- Capital expenditures totaled $1.2 billion (including federal funds), a 30% increase over fiscal 2000.

Transportation Trust Fund Outlook Better Than General Fund Outlook

($ in Millions)

	Actual FY 2001	Estimate FY 2002	Estimate FY 2003	Estimate FY 2004	Estimate FY 2005	Estimate FY 2006	Estimate FY 2007	Total FY 2002-07
Starting Fund Balance	$198	$128	$100	$100	$100	$100	$100	$128
Closing Fund Balance	128	100	100	100	100	100	100	100
Net Revenues								
Taxes and Fees	1,248	1,258	1,314	1,371	1,410	1,449	1,486	8,288
Operating/Misc.	393	362	385	376	381	388	399	2,291
GF Transfers for Capital Program	35	60	70	70	125	10	0	335
MdTA Transfer for BWI/Transit	(20)	22	43	43	43	43	43	237
Net Revenues Subtotal	1,657	1,702	1,812	1,860	1,958	1,889	1,928	11,151
Bonds	0	235	340	175	120	135	125	1,130
Total Revenues	1,657	1,937	2,152	2,035	2,079	2,025	2,053	12,281
Debt								
Debt Coverage Ratio -- Net Revenues	4.9	3.7	3.4	3.3	3.2	3.7	4.0	
Debt Outstanding	648	799	1,034	1,118	1,122	1,165	1,198	
Local Highway User Grants	435	418	424	443	456	468	480	2,690
Expenditures								
Debt Service	110	119	140	155	172	150	133	869
Operating	979	1,053	1,115	1,158	1,207	1,253	1,298	7,084
Subtotal	1,089	1,172	1,255	1,313	1,379	1,403	1,431	7,953
Capital Summary								
State Capital in draft CTP	636	794	896	719	620	515	480	4,024
Federal Capital	572	776	863	852	732	530	453	4,206
Subtotal Capital	1,208	1,570	1,759	1,571	1,352	1,045	933	8,230
Additional Capital Program	0	0	0	1	79	110	142	332
Total Special Fund Expenditures	$1,725	$1,966	$2,152	$2,035	$2,079	$2,028	$2,053	$12,309

- Forecast assumes a mild recession in fiscal 2002, followed by steady growth.
- Reduced debt allows MDOT to issue $575 million in bonds to continue growing the program through the economic downturn.
- Forecast supports $332 million in capital projects in addition to the projects programmed in the 2002 draft CTP.

Funds Transferred to the Transportation Trust Fund to Support New Initiatives

($ in Millions)

Funding by Program	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	Total
Transit Initiative	$10.0	$35.6	$90.1	$90.7	$91.2	$91.8	$92.3	$501.7
Capital Program -- Woodrow Wilson Bridge Replacement and Addison Road Metrorail Extension	50.0	45.0	70.0	70.0	125.0	10.0	0.0	370.0
Total by Program	**$60.0**	**$80.6**	**$160.1**	**$160.7**	**$216.2**	**$101.8**	**$92.3**	**$871.7**
Funding by Source								
General Fund Appropriations -- Wilson Bridge and Addison Road Metrorail	$50.0	$45.0	$70.0	$70.0	$125.0	$10.0	$0.0	$370.0
General Fund Revenue -- Transit Initiative (Chapter 568, Acts of 2001)	0.0	17.9	41.4	43.8	44.2	44.7	45.0	237.0
Subtotal General Funds	**50.0**	**62.9**	**111.4**	**113.8**	**169.2**	**54.7**	**45.0**	**607.0**
Maryland Transportation Authority Funds	10.0	12.1	43.0	43.0	43.0	43.0	43.0	237.1
Uninsured Motorist Penalties -- Maryland Automobile Insurance Fund	0.0	3.6	3.7	3.9	4.0	4.1	4.3	23.6
Uninsured Motorist Penalties -- Vehicle Theft Prevention Fund	0.0	2.0	2.0	0.0	0.0	0.0	0.0	4.0
Subtotal Other Revenues	**10.0**	**17.7**	**48.7**	**46.9**	**47.0**	**47.1**	**47.3**	**264.7**
Total by Source	**$60.0**	**$80.6**	**$160.1**	**$160.7**	**$216.2**	**$101.8**	**$92.3**	**$871.7**

Note: Numbers may not sum to total due to rounding.

Source: Maryland Department of Transportation, November 2001

- Through fiscal 2007, the Transportation Trust Fund (TTF) is projected to receive $871 million in additional funds to support the transit initiative and the capital program.
- The largest donor to the TTF is the general fund, which provides $607 million through fiscal 2007.
- These revenues support continued growth in transportation funding through the economic downturn.

Part 9

Higher Education Funding

Higher Education Fund Balances

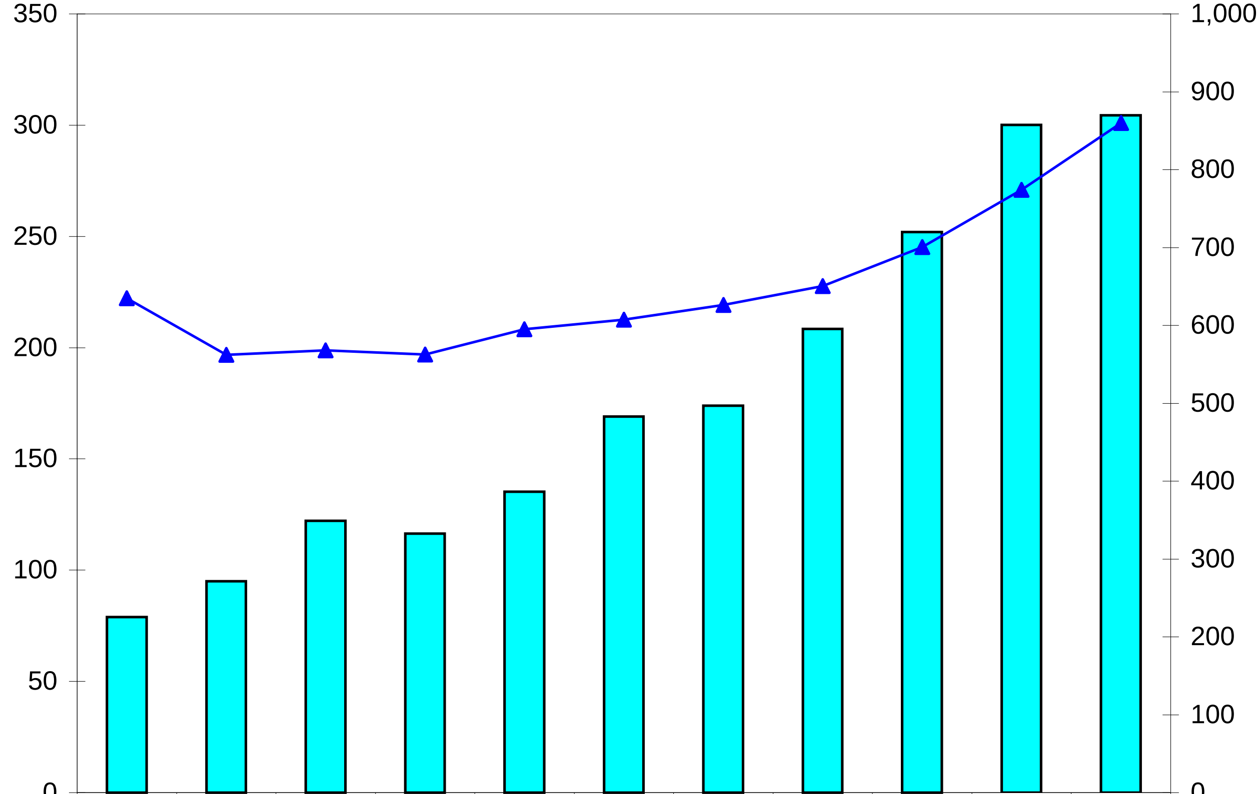
- As of June 30, 2001, institutions of higher education had combined fund balances of $304.5 million.
- According to the University System of Maryland and Morgan State University, only $74 million of the combined fund balances is related to state-supported activities. St. Mary's College of Maryland does not distinguish between state-supported and non-state-supported activities when accounting for its fund balance.
- Approximately 67% of the combined fund balances are attributed to the University of Maryland, College Park; University of Maryland, Baltimore; and Morgan State University.

Fiscal 2001 Appropriated v. Actual Revenues and Expenditures
($ in Millions)

Fund Balance (CUF)		Legislative Appropriation	Actual	Variance
	Starting Fund Balance	$228.0	$293.9	$65.8
	Ending Fund Balance	232.1	304.5	72.4
	Change in Fund Balance	**$4.0**	**$10.6**	**$6.6**
Revenues				
	Current Unrestricted Revenue			
	Tuition and Fees	$605.9	$638.0	$32.1
	State Appropriations	859.7	860.1	0.4
	Federal Grants and Contracts	58.8	69.4	10.6
	Private Gifts, Grants, and Contracts	7.7	14.5	6.8
	State and Local Grants and Contracts	11.4	12.3	0.9
	Sales and Services of Educational Activities	109.3	105.6	(3.8)
	Sales and Services of Auxiliary Enterprises	331.8	349.2	17.4
	Other Sources	38.8	47.4	8.6
	Transfer (to)/from fund balance	(4.0)	(10.6)	(6.6)
	Total Unrestricted Revenue:	**$2,019.4**	**$2,086.0**	**$66.5**
	Current Restricted Revenue			
	Federal Grants and Contracts	$365.9	$347.7	($18.2)
	Private Gifts, Grants, and Contracts	84.1	101.2	17.0
	State and Local Grants and Contracts	100.4	124.1	23.7
	Sales and Services of Educational Activities	30.1	32.1	2.0
	Endowment Income	2.2	2.9	0.6
	Other Sources	1.6	0.1	(1.4)
	Total Restricted Revenue	**$584.2**	**$608.0**	$23.8
Total Revenues		**$2,603.7**	**$2,694.0**	**$90.3**
Expenditures				
	Salaries, Wages, and Fringe Benefits	$1,528.8	$1,568.1	$39.3
	Technical and Special Fees	88.1	97.4	9.3
	Operating Expenses	986.7	1,028.4	41.7
Total Expenditures		**$2,603.7**	**$2,694.0**	**$90.3**

Sources: The Legislative Appropriation is from the FY 2001 budget books, except for State Appropriations (General Fund) and Operating Expenses, which are adjusted for supplemental appropriations and legislative reductions.
Actual figures come from FY 2003 USM, Morgan State, and St. Mary's College budget requests.

Higher Education Unrestricted Fund Balances, Fiscal 1991 through 2001
($ in Millions)



	FY 1991	FY 1992	FY 1993	FY 1994	FY 1995	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
USM, MSU, SMC Fund Balances	79	95	122	116	135	169	174	208	252	300	304
Higher Education State Appropriations	635	562	568	563	595	607	626	650	700	774	860

Sources: Governor's Budget Books, university budget requests, USM Office, St. Mary's College, Morgan State University

Part 10

State Employment

Regular and Contractual Full-time Equivalent Employees
1997 and 2002

Agency	1997 Actual Total	1997 Percent Contractual	2002 Actual Total	2002 Percent Contractual	Change in Total	Percent Change in Total	Change in Percent Contractual
Legislative	673.0	0.0%	729.0	0.0%	56.0	8.3%	-
Judiciary & Legal	4,083.4	10.7%	4,866.1	9.8%	782.7	19.2%	(0.9)
Executive & Administrative Control	1,517.8	14.1%	1,740.2	7.7%	222.4	14.6%	(6.4)
Financial & Revenue Administration	2,128.6	2.6%	2,201.7	1.5%	73.1	3.4%	(1.0)
Budget & Management	404.3	8.6%	540.3	5.6%	136.0	33.6%	(3.0)
Retirement	163.4	5.8%	228.5	15.3%	65.1	39.8%	9.6
General Services	647.0	7.6%	757.0	4.2%	110.0	17.0%	(3.3)
Transportation	9,268.8	3.1%	9,718.9	1.7%	450.1	4.9%	(1.4)
Natural Resources	1,908.3	26.7%	2,052.8	20.5%	144.4	7.6%	(6.2)
Agriculture	459.7	10.5%	519.1	7.5%	59.5	12.9%	(3.0)
Health & Mental Hygiene	8,764.7	4.4%	9,070.5	5.7%	305.8	3.5%	1.3
Human Resources	8,339.2	16.8%	8,451.3	2.1%	112.0	1.3%	(14.6)
Labor, Licensing, & Regulation	1,789.0	14.4%	1,800.7	5.3%	11.8	0.7%	(9.2)
Public Safety & Correctional Services	10,533.3	2.3%	12,164.8	4.1%	1,631.5	15.5%	1.8
Higher Education	23,263.8	22.9%	26,719.6	22.1%	3,455.8	14.9%	(0.8)
Other Education	1,968.3	6.2%	2,174.7	10.4%	206.5	10.5%	4.2
Housing & Community Development	450.6	15.6%	526.7	14.8%	76.1	16.9%	(0.8)
Business & Economic Development	321.0	24.6%	368.3	12.3%	47.3	14.7%	(12.3)
Environment	977.1	10.9%	1,073.3	3.7%	96.2	9.8%	(7.3)
Juvenile Justice	1,419.9	26.9%	2,258.0	6.0%	838.1	59.0%	(20.9)
Police & Fire Marshal	2,486.9	0.3%	2,622.4	1.3%	135.4	5.4%	1.0
Total	**81,568.1**	**12.3%**	**90,583.6**	**10.1%**	**9,015.4**	**11.1%**	**(2.2)**

Top Five Agencies in Terms of Growth					Change in Total	Percent Change in Total	% of Total Change
Higher Education	23,263.8	22.9%	26,719.6	22.1%	3,455.8	14.9%	38.3%
Public Safety & Correctional Services	10,533.3	2.3%	12,164.8	4.1%	1,631.5	15.5%	18.1%
Juvenile Justice	1,419.9	26.9%	2,258.0	6.0%	838.1	59.0%	9.3%
Judiciary & Legal	4,083.4	10.7%	4,866.1	9.8%	782.7	19.2%	8.7%
Transportation	9,268.8	3.1%	9,718.9	1.7%	450.1	4.9%	5.0%
Other State Employment	32,998.9	10.1%	34,856.3	5.6%	1,857.3	5.6%	20.6%
Total	**81,568.1**	**12.3%**	**90,583.6**	**10.1%**	**9,015.4**	**11.1%**	**100.0%**

Part 11

Spending Affordability Concept

Staff Concepts for Revising Spending Affordability Accounting

- Alter capital exclusion, provide incentives to:
  - reduce debt;
  - accelerate planned projects; and
  - restrain multi-year commitments of State funds.
- Declare a SAC Amnesty for Higher Education and Transportation Accounts:
  - Budget actions based on faulty assumptions over the years have led to understatement of base funding requirements in certain special fund agencies.
- Alter treatment of "enterprise" activities:
  - Exclude airport, port, and lottery to the extent of their revenues.
  - Discussions with higher education institutions indicate preference for status quo.
- Special focus on general fund for 2002 session:
  - Ratio of current revenues to operating expenses
  - Use of fund balances

State Spending Under the Spending Affordability Concept In Relation to Maryland Personal Income ($ in Millions)

Session/CY	Approp. Under SA	Percent Change	Personal Income	Percent Change
1984	5,090		68,506	
1985	5,474	7.53%	74,853	9.26%
1986	5,909	7.96%	80,612	7.69%
1987	6,477	9.60%	87,731	8.83%
1988	7,041	8.71%	96,072	9.51%
1989	7,684	9.13%	104,005	8.26%
1990	8,374	8.98%	110,450	6.20%
1991	8,614	2.87%	114,466	3.64%
1992	8,667	0.61%	119,419	4.33%
1993	8,865	2.29%	124,076	3.90%
1994	9,332	5.27%	129,849	4.65%
1995	9,771	4.70%	135,116	4.06%
1996	10,119	3.56%	140,809	4.21%
1997	10,509	3.85%	148,827	5.69%
1998	10,998	4.65%	158,491	6.49%
1999	11,638	5.83%	167,195	5.49%
2000	12,738	9.45%	178,506	6.77%
2001	13,623	6.94%	188,132	5.39%
2001*	13,750	n/a	188,132	5.39%
2002	14,293	3.95%	194,717	3.50%

* This is the 2001 session SAC appropriation utilizing the new method for calculating a SAC limit.