



Analysis of state policy choices with particular attention to their impacts on low- and moderate-income Marylanders

**Special Report: Special Session
on Budget and Taxes – Wrap Up**
By Neil Bergsman, Director

Maryland's Unfinished Fiscal Symphony

Maryland Policy Reports

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Summary

Maryland's legislators worked into the early morning hours on Monday, November 19 to complete their work on a package of revenues and budget provisions for the upcoming year. The result is an "unfinished symphony" with some sweet passages for low and moderate income Marylanders, but with also some discordant notes. The composers – including Governor O'Malley, the members of the legislature, and the state's voters – will need to complete the final movement over the next year.

- Revenue increases: \$1.36 billion in fiscal 2009.
- Spending reductions: \$550 million.
 - About 1/3 of reductions are to public school aid formulas,
 - 1/3 from state employee health account surpluses, other local aid, and position reductions, and
 - 1/3 to be identified by Governor in January.
- Taxes increased – sales, vehicle titling, corporation income, tobacco.
- Income tax more progressive.
- Sales tax expanded to computer services.
- Expands Medicaid health coverage.
- Establishes new funds for environmental programs and higher education.
- Referendum on slot machines.
 - Voters to decide November 2008.
 - About 1/2 of proceeds dedicated to education for "Thornton" aid increases, public school construction, and higher education facility construction.
 - Revenue would begin in fiscal 2010, and reach \$422 million in 2012.

Background

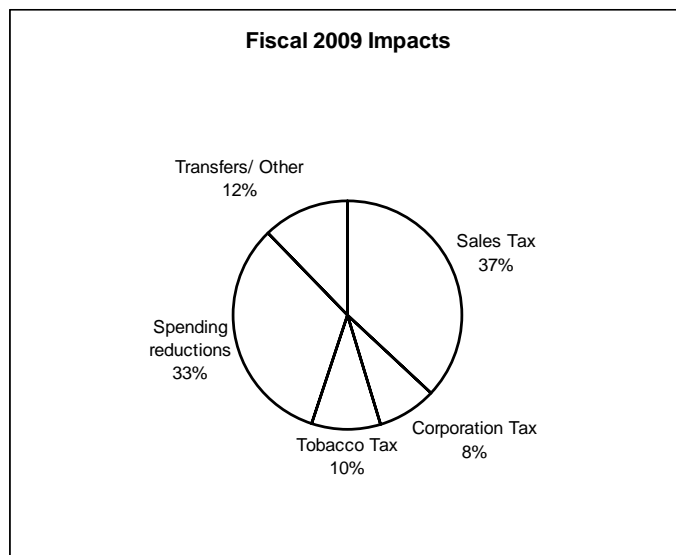
As the legislature completed its work last April, the state budget was balanced through June 30, 2008. But the balance relied on the use of surplus funds. The state continued to spend more in each year than it took in: a “structural deficit.” Governor O’Malley implemented about \$200 million in budget reductions in July to provide a “down-payment” on the structural deficit.

In the fall, he developed a multi-faceted fiscal plan affecting most major sources of state revenue, as well as slowing the planned growth of public school aid. After a round of meetings with legislative leaders and publicity events around the state, the Governor called a special session to consider the proposals, which began on October 29.

Overview

The projected budget gap for fiscal year 2009 (July 2008 through June 2009) was \$1.7 billion, according to the Department of Legislative Services. The total package includes provisions which increase and decrease revenues, increase and decrease expenditures, and re-allocate revenues among different funds – some of them newly established.

With some liberty for interpretation and simplification, the final package addresses the structural deficit with these pieces.



SOURCE: Department of Legislative Services

The largest slices in this pie, sales tax increases and spending reductions, are measures which tend to hurt low-income and disadvantaged populations. However, two features counteract this harm, at least to some extent. First, a third of the sales tax increase comes from an expansion of the tax to computer services. Second, although not a large net change, the program substantially re-engineers the personal income tax to improve its progressivity.

- Spending Reductions \$550 million

The package slows the growth in public school aid under the “Thornton” initiative. Specifically, it freezes the per-pupil “foundation” amounts used to calculate the state’s main education formula for two years. It provides a system of “supplemental” grants to ensure that each school system receives at least a 1% increase. The reductions in education aid for fiscal 2009 (from the amounts under the old formulas) total \$152 million. The largest estimated losses are \$29 million for Prince George’s County and \$22 million for Baltimore County. After the two-year freeze, the increases in the formula foundation will be limited to 5% or one of two measures of inflation, whichever is lower.

The package either requires or suggests other reductions in spending, for example:

- \$77 million from surplus employee health insurance funds to reduce the amount the state will need to pay for employee health insurance in fiscal 2009.
- \$31 million from grants to 11 counties related to electric de-regulation, and its impact on local property taxes. Counties are permitted to alter their property tax provisions to make up this revenue.
- \$21 million to be transferred from Program open Space funding, to state park and forest operations.
- \$10 million from the elimination of 500 vacant state positions.

The remainder of the \$550 million--\$213 million--must be identified by the Governor when he presents his detailed budget proposal in January.

- Taxes increased

The sales tax increases from 5% to 6% in January, 2008. In July, 2008 the 6% sales tax rate will apply to computer services.

- Income tax more progressive

Several changes improve the income tax's progressivity. The existing tax rate is essentially flat at 4.75% for all income above \$3,000. The legislative package increases the tax for high-income earners, with new marginal rates for tax year 2008. For single filers, the rates are 5% for income from \$150,000 to \$300,000; 5.25% from \$300,000 to \$500,000; and 5.5% for income over \$500,000. For joint returns and heads of households, the rates are 5% for \$200,000 to \$350,000; 5.25% for \$350,000 to \$500,000; and 5.5% for income over \$500,000.

Low-income earners benefit from an increased personal exemption (to \$3,200 from \$2,400) and an expanded Earned Income Tax Credit.

The corporation income tax rate increases from

7% to 8.25%. In addition, the legislature closed the long-standing loophole allowing corporations to avoid real estate transfer and recordation taxes. The legislature did not enact "combined reporting" for corporation income taxes proposed by the Governor.

New and expanded programs

The legislature passed an expansion in state Medicaid coverage, intended to insure 100,000 Marylanders. It established a new Chesapeake Bay 2010 Trust Fund to provide \$50 million per year for bay clean-up efforts. A higher education fund was also created.

Slot machines

The package calls the voters to decide whether to authorize slot machines at five locations in a referendum in November 2008. The locations would be in Baltimore City, Allegany, Anne Arundel, Cecil and Wicomico counties.

The proceeds would be split 33% to the operators, 7% for racing purses and horse breeder incentives, 5.5% to local governments, 2.5% for the first 8 years to a racetrack renewal fund, 2% for administrative cost, 1.5% for small, minority and women-owned businesses and the remainder to an Education Trust Fund.

The fund could be used to fund the increases in the "Thornton" school aid program, public school construction, and higher education construction. The revenue would begin flowing in fiscal 2010, and would reach an estimated \$422 million for the state in fiscal 2012.

How will the symphony end?

The package enacted by the legislature is an unfinished symphony. The composers have yet to write the final movement. The cuts still necessary in the fiscal 2009 budget could be very damaging to programs serving Maryland's most vulnerable citizens.

The voters will need to determine whether to approve the referendum on slot machines. If they do not, the state hits another financial crisis in fiscal 2010. Very significant new taxes or cutbacks would then be needed again to fund the state's public education and health care commitments.

There are already some discordant passages in the movements that we are hearing now. The income tax changes are not as progressive as those proposed initially by the Governor. Most services, the largest and fastest-growing share of the economy, remain untaxed. Since higher income consumers spend relatively more on services, expanding the tax base to more services would help reduce the sales tax's overall regressive nature. Multi-state corporations retain their ability to shelter profits from Maryland's tax. The corporation tax rate increase will not affect the 50% of big corporations which pay no tax each year. Many of the new revenues are restricted for specific purposes, such as transportation, environmental programs and higher education. While these are all worthy public purposes, these restrictions reduce the funds available for other programs, and particularly those that support disadvantaged children and families.

We will provide more detailed accounts of the effect of the special session actions in December's "Report" and other upcoming publications.

SOURCES:

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About the Maryland Budget & Tax Policy Institute

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