



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

SPECIAL REPORT

Maryland Budget Update

On August 26, Governor Martin O'Malley and Maryland's Board of Public Works approved \$454 million in additional budget cuts for the current year.

Special Report
August 27, 2009

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Combined with cuts approved in July, the current budget has now been reduced by \$736 million since its enactment. Details are available on [Governor O'Malley's Web site](#).

The cuts include \$211 million in cuts to local aid (most of it from transportation programs), \$75 million from state employee furloughs of 5 to 10 days, and various rate reductions and program closures and curtailments.

The cuts abolish 364 state positions, 202 of them filled. The health and public safety departments lose the largest number of positions.

\$454 Million in More Cuts

Three-fourths of Maryland's state general fund revenue comes from income tax and sales tax. These sources are very sensitive to economic conditions, so the prolonged national recession has caused a series of revenue shortfalls over the past two years. The 2009 revenue shortfall creates two problems for fiscal year 2010, which began on July 1.

First of all, the budget plan was counting on that \$437 million balance carrying forward to help fund fiscal year 2010 spending. Since the approved budget plan would have spent all but \$90 million of this balance by June 30, 2010, there's a shortfall right there.

Second, forecasters believe that the weak revenue performance will continue into fiscal year 2010. Budget managers working for the Governor and the legislature are guessing that the fiscal year 2010 estimates might drop another \$400 million. In that case, there will be a combined shortfall of about \$750 million to be solved before June 30.

First-round cuts

The Governor and the Board of Public Works had made a first dent in the fiscal year 2010 problem with \$281 million in cuts and transfers approved on July 22. The Maryland Budget & Tax Policy Institute issued a full report on those actions available at <http://www.marylandpolicy.org/documents/bpwjulyspecial.pdf>.

The July cuts approved by the Board include over 140 separate actions in 40 state agencies. The cuts included 53.5 state employee positions, 39 of them filled and 18.5 vacant. Health and higher education are the hardest-hit areas. The complete list is available on [the Governor's web site](#).

Fiscal Year 2010 general funds \$millions

	Original	Adjusted	
Beginning	437	37	\$400 m shortfall in FY '09
Revenues	12,997	12,597	\$400 m shortfall
Transfers In	449	753	Transfers in BPW plan (both rounds)
Expenditures	13,797	13,369	BPW cuts (both rounds)
Ending	86	18	

Second-Round Cuts

This round of cuts includes 190 separate actions. The ten largest are these:

Agency	Item	General Fund Amount
Local	"Highway User" Transportation aid to counties and municipalities	\$159.5 million
Statewide	Employee furloughs	67.4 million
Local	Police aid	20.6 million
Local	Health aid	20.1 million
University of Md.	Fund balance transfer	20.0 million
University of Md.	Operating expenses	16.1 million
Health & Mental Hygiene	Community provider rate reductions	12.7 million
Local	Community college aid	10.5 million
Health & Mental Hygiene	Medicaid funds left over from 2009	8.7 million
Health & Mental Hygiene	Cancer research grants	7.5 million

These top ten cuts constitute about $\frac{3}{4}$ of the reductions in this round of cuts.

Summarizing All the Cuts

The Maryland Budget and Tax Policy Institute has combined the August 26 and July 22 rounds of reductions, and analyzed the totals. The great bulk of reductions overall come from the Department of Health and Mental Hygiene, local government aid cuts, statewide budget actions (mostly the employee furloughs), and the University System of Maryland.

General Funds \$millions			
Agency	July 22 Round	August 26 Round	Total
DHMH	145.1	73.3	218.4
Local		210.7	210.7
Furloughs & other statewide actions	29.1	75.8	104.9
University System of Md.	37.7	36.0	73.7
Others	69.5	58.3	127.9
Total	281.5	454.2	735.7

The Maryland Budget and Tax Policy Institute has also tabulated the reductions according to the type of action being taken to reduce the budget.

General Funds \$millions			
Type of Cut	July 22 Round	August 26 Round	Total
Local Aid		210.7	210.7
"Fund Swap"	93.6	10.8	104.5
Fund Transfers	43.5	37.3	80.8
Program or service reductions	42.1	50.0	92.1
Employee Compensation	1.7	68.1	69.8
Operating cost reductions	28.8	10.7	39.5
Provider rate reductions	25.3	21.8	47.1
Other	25.7	4.7	30.4
Funds no longer needed	6.7	15.8	22.5
Grant reductions	8.2	9.2	17.4
Positions eliminated (not otherwise classified)	5.9	6.6	12.6
Employee Health Insurance Savings		8.4	8.4
Total	281.5	454.2	735.7

Local Aid - Although public school aid – which comprises over 80% of all state payments to local governments, was spared, state aid for local transportation was reduced by 90% for most jurisdictions. Health and police aid were cut by 35%, and community college funding by 5%.

Fund Swaps - \$105 million in reductions involve using an alternative fund source to replace general funds - \$11 million in the August 26 round of cuts. The largest examples in this round are \$5 million in Hospital Uncompensated Care recoveries substituting for Medicaid, \$1 million in special funds to be used for a data system for tax administration, and \$1 million in federal funds replacing state funds for environmental programs.

Transfers - \$81 million in transfers from dedicated fund balances to the general fund. The largest is a \$40 million transfer from the University System of Maryland: \$20 million in each round. Another \$6 million will be transferred to the general fund from the Chesapeake Bay 2010 Fund established in 2007.

Programs - \$81 million in cuts directly affect service programs.

- The University System of Maryland will make a total of \$33 million in cut-backs.
- The Health Department will reduce cancer research funding by \$7.5 million.
- The Health Department will also be closing the Upper Shore Community Mental Health Center and closing units at three other facilities.
- The Division of Corrections will reduce recreation activities for inmates.

Some programs will be eliminated entirely, such as the Tolbert Scholarship program which provided financial assistance to over 500 students at private career schools.

Employee Compensation – The proposed employee furloughs of 3 to 10 days are estimated to save \$67 million in general funds.

Operations - \$39 million is from reductions in routine operating costs. Examples include holding vacant positions open or deferring purchases of supplies or equipment.

Rate Cuts - \$47 million will be cut from rates paid to health care providers. In this round, this includes \$12.6 million for community services providers in mental health, developmental disabilities and substance abuse treatment. These reductions cause concern, because if rates fall too low, they can drive providers out of business or cause them to stop accepting Medicaid patients and state agency referrals.

Reduced Need – The Governor explains \$22 million on the basis of reduced need for the item. This includes \$8.7 million in Medicaid funds carried over from fiscal year 2009.

Grants – Grant programs will be cut by \$17 million. The largest reductions are \$6.7 million from non-public colleges and universities and \$1 million from local management boards that coordinate services for children. Grants for Nano-biotechnology and for Entrepreneurial Opportunities provided by the Department of Business and Economic Development are being eliminated.

Positions - \$5.9 million of savings is tied to abolished employee positions.

Employee Health Insurance – The Governor proposes to save \$8.4 million in the employee health program through initiatives like rewarding the use of generic prescriptions and improved reviews of healthcare utilization.

Position Cuts

The August cuts eliminate 363.5 state positions, 202 of them currently filled. The bulk of the positions are taken from the Health, Public Safety and transportation departments.

Health and Mental Hygiene	175.0
Public Safety	88.0
Transportation	66.5
Natural Resources	14.0
Agriculture	7.0
Public Defender	4.0
Treasurer	2.0
State Dep't of Education	2.0
State Police	2.0
Labor, Licensing & Regulation	1.0
Governor's Office	1.0
Planning	1.0

Fiscal Year 2011 Budget

Even while trimming the current budget, state agencies are at work on the upcoming budget, which must be delivered to the legislature in January. A rough estimate by the Maryland Budget & Tax Policy Institute puts the fiscal year 2011 shortfall at \$1.7 billion, or 11%. This gap would be even larger except for \$850 million from the final year of federal stimulus funding.

Some of the reductions approved by the Board of Public Works can be extended into fiscal year 2011 to help balance this shortfall. Most, however, are temporary measures which cannot necessarily continue into another year.

The amounts of local transportation, health, community college and police aid are specified in law. The Governor will have to restore the full amounts in the 2011 budget. Fund swaps and transfers cannot always be continued, because the special fund balances become depleted or the funds are required for their original purposes.

Furloughs are intended as a temporary measure. When the furlough program ends, the employees expect to receive their full salaries.

These categories make up 64% of the 736 million in reductions in the July 22 and August 26 rounds. This leaves only 36% - \$270 million – that might be extended into 2011. And some of these are also temporary when you examine them. For example, the Natural Resources Police will put off replacing cars and boats that are reaching the ends of their useful lives. They can put these replacements off for a year, but not forever. The Department of Information Technology is saving over \$1 million from computer system projects that are moving more slowly than planned. Next year, presumably, these projects will be under way and will need their money.

To balance the 2011 budget, the state will need to identify further measures totaling well over \$1 billion.

A Balanced Approach to Balancing the Budget

As the recession continues to shrink revenues and grow residents' need for state services, states are adopting a balanced approach to their budgets that includes revenue increases as well as spending cuts. Since January 1, 30 states have raised taxes and another seven states are considering doing so, according to analysts at the Center on Budget and Policy Priorities.

Like Maryland, the great majority of states have cut services to families and individuals, including services that benefit vulnerable families. But these cuts have not been sufficient to solve state budget shortfalls. These shortfalls are too large for a cuts-only strategy - especially when the needs for healthcare and safety-net services are growing.

By July 1, the start of the fiscal year in all but four states, most states will have employed a combination of budget solutions that also involves drawing down reserve funds, maximizing the use of federal dollars, and raising taxes. A number of prominent economists have pointed out that budget cuts are more harmful to state economies during a recession than properly structured tax increases, so it is good policy to use tax increases to fill a substantial portion of deficits that exceed the amount that can be closed with reserves or federal funds.

Historically, raising taxes in a recession is a common response by states. During the recession of the early 1990s, 44 states raised taxes by a significant margin (at least 1 percent). In the recession of 2001, 30 states did so. These actions increased annual revenue collections by tens of billions of dollars.

Tax increases are a better option than deep spending cuts — better both for families already suffering due to the recession and better for Maryland's economy. Moreover, as the economists Joseph Stiglitz and Peter Orszag (among others) have noted, tax increases take less money out of the economy than spending cuts do.

Maryland has a number of revenue options it can consider: extending the temporary surtax on income over \$1 million, raising the gas tax for the first time since 1992, raising taxes on alcoholic beverages for the first time since 1972, and preventing multi-state corporations from using accounting gimmicks to avoid corporate taxes are all reasonable options.

In the longer term, Maryland should modernize its sales tax should to cover a broad range of consumer services. Limiting sales tax to the goods restricts the revenue base to a narrow and shrinking slice of the economy. It also makes lower-income families pay a larger share of the sales tax, because they tend to purchase more goods and fewer services as a percentage of their total income.

As the Governor considers the fiscal year 2011 budget, he should put reasonable revenue options back on the table.

Next Steps

Late August –	Comptroller reports on fiscal year 2009 close-out
September –	Most agencies submit their fiscal year 2011 budget requests to the Department of Budget and Management. These requests are not publicly available.
Mid-September –	Board of Revenue Estimates issues preliminary revenue estimates for 2011 and revised estimates for 2010.
December –	Board of Revenue Estimates issues official revenue estimates. Legislative Spending Affordability Committee makes recommendation for state spending growth. Governor makes final budget decisions.
January 20, 2010 –	Governor submits proposed fiscal year 2011 budget to legislature.

Sources

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About the Maryland Budget & Tax Policy Institute

The Maryland Budget and Tax Policy Institute is a nonpartisan research organization that provides timely, accurate and accessible analysis of state budget and tax issues. In addition to general budget and tax research and analysis, the Institute examines issues affecting low-income Marylanders and other vulnerable populations and the important community programs that serve them. For additional information, to be added to our e-mail list, or to make a tax-deductible contribution, please visit our website at www.marylandpolicy.org.

The Maryland Budget and Tax Policy Institute gratefully acknowledges the Ford Foundation, which provides financial support for the Institute under its State Fiscal Analysis Initiative. Additional general support for the Maryland Budget and Tax Policy Institute is provided by the Moriah Fund, the Aaron Straus and Lillie Straus Foundation, the Eugene and Agnes E. Meyer Foundation, the Fund for Change, the Open Society Institute-Baltimore, and generous individual donors.

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