



Report of the
Maryland Board of Revenue Estimates
on

**ESTIMATED
MARYLAND
REVENUES**

FISCAL YEARS ENDING JUNE 30, 2012 AND JUNE 30, 2013

Submitted to
Martin O'Malley
Governor

December 9, 2011



State of Maryland

Board of Revenue Estimates

Louis L. Goldstein Treasury Building, P.O. Box 466
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Nancy K. Kopp
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T. Eloise Foster
Secretary, Department of
Budget and Management

Executive Secretary:
David F. Roose
Director, Bureau of
Revenue Estimates

December 9, 2011

Honorable Martin O'Malley
Governor of Maryland
State House
Annapolis, Maryland 21401

Dear Governor O'Malley:

In compliance with Section 6-106(b) of the State Finance and Procurement Article of the Annotated Code of Maryland, the Board of Revenue Estimates has prepared and herewith submits to you new estimates of State revenues for the fiscal years ended June 30, 2012 and June 30, 2013, based upon current laws and administrative practices. As in the past, the estimates represent the collective efforts of each of the Board members and their staffs.

The Board will continue its study of economic and revenue trends and will report to you any significant changes that may affect Maryland's revenues.

Respectfully yours,

A handwritten signature in black ink that reads "Peter Franchot". The signature is written in a cursive style with a long, sweeping tail that extends to the right.

Peter Franchot, Chairman

A handwritten signature in black ink that reads "Nancy K. Kopp". The signature is written in a cursive style with a large, prominent "N" and "K".

Nancy K. Kopp

A handwritten signature in black ink that reads "T. Eloise Foster". The signature is written in a cursive style with a large, prominent "T" and "F".

T. Eloise Foster

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Executive Summary

While the United States' economy has expanded through 2011, the recovery from the Great Recession has been by most measures the most sluggish expansion in at least the past six decades. Gross domestic product, employment, personal income, and many other economic yardsticks took longer to reach their pre-recession levels or remain further below their pre-recession levels at this point of the economic cycle in recent recessions. The recovery has survived one crisis after another; while it is expected to continue, the risk of another recession remains possible.

Employment has grown relatively steadily—the number of jobs has increased fourteen straight months. But it has grown relatively slowly—just enough to keep pace with population growth. Employment growth has been and will continue to be hampered by low business and consumer confidence. Confidence, in turn, has been shaken by concerns that policymakers in Washington appear unable to come to agreement on how to address the federal budget deficit, and more recently, that policymakers in Europe seem unable to conclusively deal with their ongoing financial crisis. A recession in Europe would endanger the recovery, while a collapse of the Euro would make a U.S. recession difficult to avoid.

While Maryland's economy is stronger than most states, with relatively low unemployment and high income rates, Maryland is clearly affected by global and national financial events. Maryland's economy is affected by events in Europe, but events in Washington will certainly have a much more direct impact. The federal government has generally been a positive influence on the State's economy for almost two decades, including during the most recent recession. But the cushioning effect of the federal government may not last much longer. The Base Realignment and Closure process, which brought over 21,000 jobs to the State, is now essentially complete.

The failure of the Congressional Joint Select Committee on Deficit Reduction to agree on \$1.5 trillion in budgetary savings over ten years will result, under present law, in automatic spending cuts of \$1.2 trillion. As federal spending in Maryland is the equivalent of nearly one-third of the State's economy and Maryland has a significant share of federal jobs, the federal government may swing from a source of growth to a drag on growth if Congress allows the automatic reductions to stand. Debate has already begun about paring back the cuts. Nonetheless, to be prudent the Board has, to the extent possible, attempted to quantify these potential cuts and incorporate the impact into the revenue estimates.

The effect of federal cutbacks will show up not just in federal employment, but may also appear in the professional and business services, education and health services, and most other major sectors of the State's economy. Since Maryland's federal presence is diversified and largely focused on health care, the sciences, and intelligence—highly paid jobs in sectors of increasing importance to the nation—it is possible that despite the State's significant share of federal employment, the impact may not be as large as first feared. In any case, the direct

effect of these reductions (as presently structured) will not be felt until fiscal year 2014 at the earliest.

Employment growth of roughly 1% is expected over the next three years, below the rate typically experienced in Maryland at this point of the economic cycle. Wage income is forecast to grow at roughly 3.5% annually through 2014. As is the case with the U.S. economy, the economic recovery in Maryland is expected to continue.

General fund revenues are forecast to grow 3.8% in fiscal year 2012, slowing to 2.6% growth in 2013. The individual income tax, which increased 7.5% in fiscal year 2011, will slow slightly to 6.9% growth. Income tax withholding will remain relatively steady at 3.7%, and estimated payments are expected to grow at about the same rate. Net income tax receipts are projected to grow 4.8% in fiscal year 2012, slowing to 4.4% in fiscal year 2013. The difference in growth of net receipts and general fund revenues results from a change in the allocation to the local income tax reserve account. Distributions of local income tax revenue to the counties and municipalities are unaffected by this change.

Corporate income tax receipts are expected to decline in fiscal year 2012, with a slight decline in net receipts and a slight increase in refunds expected. Relatively modest growth in net receipts is forecast for fiscal year 2013 as corporate profits are expected to increase by mid-single digits, but a change in the distribution of revenues will boost general fund revenue growth by approximately 18 percentage points to over 26%. Sales tax revenues are projected to grow 8.8% in fiscal year 2012, although the growth is fundamentally a result of the new 9% sales tax on alcoholic beverages, which is expected to generate \$70.5 million, and the repeal of the distribution of 5.3% of sales tax revenues to the Transportation Trust Fund. Baseline growth is expected to be 1.3% in fiscal year 2012 and 1.6% in 2013.

These revised estimates, totaling \$14.055 billion in fiscal year 2012 and \$14.423 billion in fiscal year 2013, are \$49.9 million lower and \$71.2 million lower, respectively, than the previous official forecast. Adjusted for law changes, baseline growth is estimated at 3.7% and 3.3%.

The Board of Revenue Estimates has assumed in its forecast that current law with respect to federal taxes and federal budgeting will continue (see Potential Federal Changes, below). The two percentage point reduction in the payroll tax is set to expire at the end of this year; if Congress does agree on an extension by the end of the year, growth in total personal income will increase by roughly one percentage point in 2012. Several major provisions of the Internal Revenue Code are scheduled to sunset at the end of 2012, including rate reductions for all income brackets, preferential tax rates for capital gains and dividends, and the enhanced \$1,000 per child tax credit. If Congress does agree to extend some or all of these, disposable personal income in 2013 will be higher than currently expected. These changes will largely affect the sales tax, although there will be some direct effect on the individual income tax as well.



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The U.S. Economy

The most recent economic data for the United States continue to indicate a very slow economic recovery. The threat of a double-dip recession has waxed and waned; while another recession is not the likely outcome, the risk is uncomfortably large. Policy decisions, both in the U.S. and abroad, may be the decisive factor in determining whether the U.S. economy expands or contracts over the near future. To avoid recession, U.S. policymakers must restore economic confidence and agree upon a strategy that sets the federal budget on a sustainable path without stifling economic growth. Even if policymakers are able to achieve this goal, the Eurozone financial crisis may plunge Europe into a deep recession, which would then likely tip the scales and lead to another recession at home.

In the third quarter of 2011, real gross domestic product (GDP) grew 2.5%, accelerating from 1.3% growth in the second quarter and 0.4% growth in the first. The third quarter growth slightly understates current economic activity as sales outpaced production. Inventory decreases, which account for the higher sales, will result in higher GDP growth in the future as companies restock inventories. Manufacturing has been especially important in the third quarter, accounting for nearly half of the increase in output. Further strengthening in manufacturing is expected; the earthquake in Japan slowed the production of vehicles in the U.S. as supply chains tightened. As Japanese suppliers have recovered, production in the U.S. will resume at normal levels.

The unemployment rate fell to 8.6% in November, the lowest level since March 2009. Although employment increased by 120,000 jobs, the drop in the unemployment rate was largely due to discouraged workers leaving the work force, which is not necessarily a positive development—in fact, over the past year, the number of Americans not in the labor force is growing faster than the net number of jobs created. Employment growth in October was led by the private sector, which added 140,000 jobs while the public sector lost 20,000. Private sector corporate balance sheets continue to be positive. As a result, investments in fixed capital, business equipment and software by these businesses have increased in the third quarter. This increase, however, may also be due to the 100% expensing incentive in 2011, and may slow in future years.

Consumer confidence has been more affected by U.S. political developments than usual for an off-cycle year. Following the recent U.S. Debt Ceiling Crisis, consumer confidence plummeted to its lowest level since the deepest parts of the Great Recession. Concurrently, stock prices fell by over 20% and the growth rate for per capita disposable income slowed by nearly a percentage point. Personal consumption expenditures accelerated to over 5% growth, however, posting the best performance since before the recession. This increase in consumer spending in the third quarter was financed by a decline in the savings rate which, at 3.5%, is as low as it has been since prior to the recession. Increased spending financed by lower savings is most likely not an effective driver for sustained economic growth.

Food and oil price increases led an increase in the Consumer Price Index (CPI) of 3.2% this year. Pressures on both are expected to moderate, lowering inflationary pressures. A strengthening dollar arising from continued fears over Eurozone instability would also put downward pressure on inflation. These factors could be offset, however, by a sustained reduction in the unemployment rate or a new round of quantitative easing from the Federal Reserve. Housing prices have not recovered to pre-recessionary values. Arguably, housing prices have yet to hit bottom, and may have been supported by low interest rates and a variety of federal programs. A new round of quantitative easing would most likely be partially aimed at buying up mortgage-backed securities, preventing a further reduction in housing prices. Pent-up demand from young adults who are currently living with family or others may ultimately lead to a spike in housing demand and housing prices, or help to bring declining prices to an end, but this outcome will only occur with relatively strong, sustained job creation.

Political uncertainty in the U.S. and abroad has made the modest recovery very fragile. The federal budget deficit ended at \$1.3 trillion (8.7% of GDP) in fiscal year 2011. The magnitude of the debt, coupled with Congress' inability to successfully negotiate a plan to lower this debt, led the Standard & Poor's rating agency to downgrade the U.S. credit rating for the first time. Despite this downgrade, the U.S. credit rating remained at its AAA rating with other rating agencies, and long-term treasury yield rates fell following the news. With the failure of the Congressional Joint Select Committee on Deficit Reduction to adopt deficit-reducing proposals, automatic budget cuts loom that may be a drag on the struggling economic recovery. Further complicating matters, the two percentage point reduction in the payroll tax is scheduled to expire at the end of this year, and many of the tax reductions enacted in 2001 and 2003 will expire at the end of 2012 unless Congress can agree on which to extend, if any, and how to address any impact on the deficit that results.

Much like the U.S., many countries in the Eurozone have reached a point where lowering sovereign debt while not stifling economic growth is at the center of political debate. Greece, Ireland, and Portugal have already required bailouts, and Italy, whose sovereign debt is the third largest in the world behind the U.S. and Japan, may be close behind with their 10-year yields having increased to nearly 7%—it is widely believed that interest payments become overwhelming after 6%. To aid in the Eurozone crisis, the U.S. Federal Reserve and many other central banks around the world have made domestic currencies available to foreign banks in order to boost liquidity. Should the European economy falter, or worse yet, should several countries exit the Euro, America's hundreds of billions of dollars of exports and investments and trillions of dollars of financial interrelationships will be at risk. The collapse of the Euro would make a U.S. recession nearly unavoidable.

While the risks to the U.S. economy are extremely high at this point, the recovery is expected to struggle forward. Real gross domestic product is forecast to grow less than 2.0% through 2012, inching towards 3.5% growth in 2014. The unemployment rate is expected to ease its way down to 8.0% over the next three years, at which point employment will almost reach the peak achieved in early 2008.

Table 1
Forecast of the U.S. Economy
Primary Indicators

CALENDAR YEAR	2007	2008	2009	2010	2011	2012	2013
Real Gross Domestic Product (\$ billions)	13,206	13,162	12,703	13,088	13,316	13,556	13,887
	1.9%	-0.3%	-3.5%	3.0%	1.7%	1.8%	2.4%
Federal Funds Rate (%)	5.0%	1.9%	0.2%	0.2%	0.1%	0.1%	0.1%
10-Year Treasury Bond Yield (%)	4.6%	3.7%	3.3%	3.2%	2.8%	2.3%	2.8%
Consumer Price Index (% Δ from prior year)	2.9%	3.8%	-0.3%	1.6%	3.1%	1.5%	1.7%
Housing Starts (thousands of units)	1,342	900	554	585	600	675	960
	-25.9%	-32.9%	-38.4%	5.6%	2.5%	12.6%	42.2%
Light Vehicle Sales (thousands of units)	16,089	13,195	10,402	11,555	12,706	13,323	14,734
	-2.5%	-18.0%	-21.2%	11.1%	10.0%	4.9%	10.6%
Corporate Profits Before Tax (\$ billions)	1,511	1,248	1,362	1,800	1,959	1,971	2,004
	-6.1%	-17.4%	9.1%	32.2%	8.8%	0.6%	1.6%
Total Non-Agricultural Employment (thousands)	137,587	136,778	130,789	129,822	131,128	132,630	134,775
	1.1%	-0.6%	-4.4%	-0.7%	1.0%	1.1%	1.6%
Unemployment Rate (%)	4.6%	5.8%	9.3%	9.6%	9.0%	9.0%	8.8%
Total Personal Income (\$ billions)	11,912	12,460	11,930	12,374	12,962	13,395	13,899
	5.7%	4.6%	-4.3%	3.7%	4.8%	3.3%	3.8%

Source: Board of Revenue Estimates and Global Insight (December 2011 Forecast)



The Maryland Economy

Maryland's recovery from the Great Recession has been feeble to this point, almost two and a half years after the trough. Employment growth has been tepid, still declining at times, while growth in wage income has accelerated but at historically low rates. Contributing to the recovery, the Base Realignment and Closure (BRAC) process concluded in September, resulting in the addition of many above average wage jobs. Conversely, the prospect of cutbacks in federal spending, a moribund housing market, and global economic uncertainties give little reason to expect a surge in economic activity any time in the near future. Looking forward, economic growth is expected to continue at a subdued rate, particularly for this point in the economic cycle. The recovery will remain delicate and susceptible to shocks.

Historically, Maryland economic activity has mirrored that of the nation as a whole except during periods of recession. At those times Maryland's core strengths, particularly its highly educated workforce and proximity to the federal government, have served to mitigate downturns. The Great Recession was no different, with economic output deteriorating more slowly and shallowly in Maryland than nationwide. During and immediately after that period, from 2008 to 2010, Maryland federal government employment and wages grew 10.0% and 16.8%, respectively. At the same time, national federal government employment increased 7.9% and wages increased 12.6%.

The more robust nature of federal employment in Maryland can be seen in the contrast between the average federal salary in Maryland as compared to the nation—\$88,915 compared to \$69,198. Further contrast can be drawn by the composition of that employment—the second quarter of 2010 saw a ramp up in federal employment for the decennial census. That work was temporary; recent data show that the wind down of that employment has affected the nation to a much greater extent than Maryland, indicating that Maryland's federal job growth during that period was of a more permanent nature.

Certainly, the BRAC process has had a substantial positive impact on Maryland's economy. As part of BRAC, the commands of the Army Team C4ISR, Defense Information Systems Agency, Defense Media Activity, Army Research, Development, and Engineering, and Walter Reed hospital have been moved to Maryland. The Regional Economic Studies Institute estimates that 45,232 jobs with an average wage of \$70,388 would be created in or moved to Maryland as part of the process--of that, more than 15,000 would be direct, more than 22,000 would be indirect, and more than 7,000 would be induced. The job transfers were completed in September of this year, and many of the indirect jobs are also in place. A substantial amount of economic upside remains--a portion of the positions may be tele-working at this time and will likely either move to Maryland at a later date or be filled with Maryland residents as employees turn over. Also, separately but related, the U.S. Cyber Command, established in May 2010 and activated in October 2010, is expected to add 1,000 jobs annually for the next several years.

Maryland is witnessing its first growth in total non-farm employment in three years. Total employment (Total NF) began to contract in 2008 before doing so at a rapid pace in 2009 with the recession fully underway. The contraction eased in 2010 and we are just now seeing the first signs of growth, 0.2% year to date. The big picture shows that Maryland lost 4.3% of its jobs from peak employment in the first quarter of 2008 to the trough in the first quarter of 2010, a net loss of more

than 123,000 jobs. Since then, the net number of jobs in the State has increased by close to 36,000.

The education and health services (E&H) industry served to buffer the State from further net job losses, providing growth throughout the recession. In Maryland, those jobs are concentrated on the health side and have an average wage of \$49,346, slightly below the statewide average of \$57,412. Unfortunately, growth in this sector has slowed of late, with an increase of under 1.0% through the first ten months of this year. No other non-federal sector has benefited from BRAC more than the professional and business services (P&B) segment; growing 1.9% year to date with an average wage of \$72,449 after suffering steep losses in the recession. The retail segment was the hardest hit of the five largest industries, losing 9.6% of its jobs from peak to trough, almost 29,000 jobs. Since then only 5,000 of those jobs have been recovered at an average wage of \$29,795. The contraction in local government (Loc Gov) has lagged the recession, with losses beginning in 2010 and continuing into this year as local governments wrestle with declining revenues and structural changes to their fiscal relationship with the State. The leisure and hospitality (L&H) industry continues to suffer, losing jobs in each of the last three years; to date 4.4% of the industry's jobs have been lost at an average salary of just over \$23,000.

Through October, only three of the State's major industries are performing worse this year than last year—the aforementioned education and health services industry, state and local government employment, and federal government employment. All other sectors have experienced acceleration in employment this year, although several of those, such as construction and manufacturing, are still declining.

While the federal government has provided substantial support for Maryland's economy in the past and present, that support seems very likely to ebb. Because the Congressional Joint Select Committee on Deficit Reduction was unable to come to an agreement on \$1.5 trillion in budgetary savings over a ten year period, automatic spending cuts of \$1.2 trillion are now required. While this requirement may last only until the cuts are imminent—federal fiscal year 2013, starting October 1, 2012—it does seem likely that a new era in federal spending is afoot, with substantial reductions in the growth of federal spending, although probably not outright reductions.

The federal government spent \$96.3 billion in federal fiscal year 2010, the equivalent of nearly one-third of Maryland's gross domestic product. Almost 5.6% of Maryland jobs are federal, compared to a national average of 2.2%, and many more are supported directly or indirectly by the federal presence. Having the federal government swing from a source of growth to a drag will be a difficult headwind for the rest of the State's economy to overcome.

Maryland housing prices continued to fall even as volume increased in 2010. The number of unit sales totaled almost 51,000, a 4.3% increase over the previous year. The 4.2% drop in the median price marks the fourth consecutive year of decline. The price declines have continued this year; every month through October shows a drop from year-ago levels, although the declines have generally been moderating. The median price in October was 9.6% below that of October 2010. It was, however, 28% below that of October 2006. Inventory levels increased marginally in 2010, averaging close to 44,000 but well below the 2008 peak, and are down 16.1% year to date.

Working through the inventory of unsold homes will prove the critical component to a housing market recovery, though many barriers remain including looming foreclosures and the shadow inventory, both of which will hold prices down for some time. Foreclosures are expected to remain at elevated levels for the next several years, possibly longer, while the shadow inventory—homes held off the market despite a desire to sell—continues to grow. The ongoing travails of the housing market could, at any time, sap consumer confidence and put a dent in

spending, in addition to the ongoing negative effect on construction employment and retail sales (that often accompany home sales, whether existing homes or not).

Should the European financial crisis deepen substantially, there could be direct effects on Maryland aside from the broader implications of a sharp European recession. Almost one-fifth of Maryland exports are to the Euro Zone, with another 8% or so to the rest of Europe. Nationally, exports to Europe are only 22% of total exports, indicating that, all else equal, Maryland manufacturers are more at risk from a European downturn. As manufacturing is only about half the proportion of Maryland's economy as it is of the nation's, though, the overall impact on the State's economy would not be as large. Obviously, activity at the Port of Baltimore would suffer in such an event. The Port directly employs about 16,500 individuals, with over three-quarters of a billion dollars of wages and salaries. The broader economic impact of the Port has been measured at over one percent of the State's gross domestic product; a substantial reduction in traffic through the Port would create that much more of an impediment to growth for the State's economy.

Maryland's economy is growing, but at a very slow rate. Employment growth of roughly 1% is forecast for the next several years, with wage growth of approximately 3.5% annually. Tremendous uncertainties abound, particularly with regard to potential federal budget cutbacks. The reductions do seem likely in some form or another over the next several years; despite the uncertainties, this forecast accounts for a loss of nearly 5,000 jobs in 2013, 12,000 in 2014, and 12,700 in 2015—roughly half of a percentage point of the State's employment in the latter years. Ultimately, the impact on the State could be lighter, or it could be much worse.

Table 2
Forecast of the Maryland Economy

CALENDAR YEAR	2007	2008	2009	2010	2011	2012	2013
Total Non-Agricultural Employment (thousands)	2,608.5	2,600.0	2,522.8	2,512.7	2,541.5	2,563.4	2,586.6
	0.7%	-0.3%	-3.0%	-0.4%	1.1%	0.9%	0.9%
Existing Median Home Price	390,347	352,964	336,248	326,877	309,644	297,207	315,436
	1.8%	-9.6%	-4.7%	-2.8%	-5.3%	-4.0%	6.1%
Existing Single Family Home Sales	87,800	63,400	71,900	73,700	79,403	81,312	88,168
	-23.1%	-27.8%	13.4%	2.5%	7.7%	2.4%	8.4%
Total Private Housing Starts	18,322	12,837	10,040	12,001	11,065	12,472	15,245
	-20.2%	-29.9%	-21.8%	19.5%	-7.8%	12.7%	22.2%
Total Personal Income (\$ millions)	264,798	277,731	273,193	283,920	299,228	307,908	318,744
	4.9%	4.9%	-1.6%	3.9%	5.4%	2.9%	3.5%
Wages and Salaries	134,715	137,774	136,722	139,850	146,031	151,047	156,199
	4.9%	2.3%	-0.8%	2.3%	4.4%	3.4%	3.4%
Dividends, Interest and Rent	46,995	51,776	44,620	46,374	49,470	51,395	52,541
	8.7%	10.2%	-13.8%	3.9%	6.7%	3.9%	2.2%
Capital Gains (\$ millions)	15,614	5,806	3,729	5,593	6,432	6,947	7,502
	20.4%	-62.8%	-35.8%	50.0%	15.0%	8.0%	8.0%
Unemployment Rate (%)	3.6%	4.5%	7.1%	7.5%	7.1%	7.0%	6.5%

Source: Board of Revenue Estimates and Global Insight (December 2011 Forecast)



Potential Federal Changes

As of the publication of this report, several policy issues are under debate in Washington that may have substantial effects on the national economy, Maryland's economy, and Maryland revenues. The policy outcomes are uncertain at this time; of necessity, the economic forecasts of consultants to the Board of Revenue Estimates and the Board's economic and revenue forecasts make assumptions about how these debates will play out. Obviously, the resolution of each of these issues may result in a larger or smaller impact on the State's economy and revenues than currently forecast. These issues will be monitored and evaluated over the coming year, and the Board will adjust its forecast appropriately.

Sequestration

The Budget Control Act of 2011 enacted in August brought a conclusion to the United States debt ceiling crisis. Included were measures that would cut the budget deficit by an estimated \$2.1 trillion over ten years. Mechanisms within this legislation to reduce the deficit include caps on discretionary appropriations, estimated to reduce spending by \$0.9 trillion (including debt-service costs), as well as the creation of the Congressional Joint Select Committee on Deficit Reduction (the "super committee"), which was to draft a proposal by late November to reduce the budget deficit by an additional \$1.2 trillion.

The super committee's failure to adopt a proposal by the deadline, however, triggered automatic across-the-board spending cuts of \$1.2 trillion that will begin on January 1, 2013. These automatic cuts are evenly split between defense and non-defense spending, including lower caps on certain discretionary budget programs, mandatory cancellation of certain budgetary resources, and savings from debt-service costs. The Congressional Budget Office (CBO) estimates that the total savings from these automatic mechanisms will reach \$1.1 trillion by 2021, with 71% of the savings resulting from discretionary spending cap reductions, 13% resulting from cuts in mandatory spending, and 16% resulting from debt-service cost savings. The Budget Control Act exempts many programs from spending cuts, including certain entitlement programs such as Social Security and Medicaid.

As Maryland receives large amounts of direct and indirect revenues from government spending—federal spending in the State is the equivalent of one-third of the State's economy—the Budget Control Act will decrease Maryland's revenues beginning in fiscal year 2014. Congress may act to alter these required reductions, although President Obama has stated he would veto such a move. The Board's economic forecast explicitly accounts for the sequestration measures, though the actual allocation of cuts remains uncertain. Based on actual federal spending in 2010 in Maryland and across the nation, these cuts could reduce Maryland's wage and salary base by \$2.5 billion, and employment by over 12,600, amounts that have been factored into the economic forecast. The actual impact, however, could vary significantly, depending upon how the reductions are structured.

Payroll Tax Reduction

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 was signed into law on December 17, 2010. This law included a reduction of the Social Security

tax rate from 6.2% to 4.2% for calendar year 2011. The payroll tax relief, set to expire at the end of the year, affected 159 million workers nationwide. The Department of the Treasury estimated that it increased the income of the typical working family by \$1,000, totaling \$109 billion in tax relief. In Maryland, it is estimated that this tax cut affected 3.2 million people and raised after-tax income of these individuals by \$2.6 billion. Congress is currently discussing extending the payroll tax cut through 2012. President Obama has proposed expanding this payroll tax reduction by 1.1 percentage points, which would lead to a tax cut of about \$1,550 for the typical working family, providing \$179 billion in tax relief. In Maryland, such a reduction would increase after-tax income by \$4.3 billion. As a payroll tax cut provides a greater percentage benefit to lower-income workers, the Treasury Department's analysis states that middle and low income class families are the most likely to spend this additional after tax income instead of saving it, which will lead to greater short term economic growth and job creation than would be the case if higher income families received the greatest proportion of benefits. Some economists estimate that letting the tax cut expire would reduce economic growth by as much as 0.5%.

The President's proposal is financed by a 3.25% income tax surcharge on individuals with taxable income over \$1 million. The Senate Republican plan would maintain the current two percentage point payroll tax reduction and pay for it with a three-year freeze on federal salaries and the reduction the federal work force by 10% through attrition. Additionally, the Republican plan would lower entitlement benefits for wealthy Americans, requiring Americans earning \$750,000 or more a year to pay higher Medicare premiums, and preventing millionaires from receiving food stamps or unemployment benefits. If either of the payroll tax plans were to pass, Maryland would realize an additional \$39.0 million in sales and use tax collections in fiscal years 2012 and 2013. While the President's plan would provide a larger reduction, the additional sales and use tax benefit from the larger cut would be offset by effect of the surcharge on millionaires on disposable income.

Expiration of Income Tax Reductions

A group of tax reform measures passed in 2001 and 2003, commonly referred to as the Bush tax cuts, substantially reduced the federal income tax burden on most taxpayers. These amendments to the tax code were originally enacted through the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), and were accelerated and modified by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) as a means to encourage economic activity. Most provisions were set to sunset at the end of 2010, however the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the Bush tax cuts through 2012. Extended provisions originally introduced in EGTRRA include the phase-out of itemized deduction limitations and the repeal of the personal exemption phase-out for higher income individuals, and a new 10% income tax bracket. Provisions that were extended from JGTRRA include lowered dividend income and capital gains tax rates and reduced rates for the marginal income tax brackets.

These tax cuts have put several billion dollars in the hands in Marylanders annually over the last several years. If that money is instead redirected to Washington in the form of higher federal income taxes, the sales and use tax would be directly affected through a reduction in Maryland disposable income. The one tax cut that flows through to Maryland's income tax is the limitation on itemized deductions; reinstating that limitation would generate between \$70 and \$80 million annually in State income tax revenues. While Congress has a year to determine which, if any, of these tax cuts will be extended beyond 2012, this forecast assumes that the marginal rate reductions will sunset, resulting in a sales and use tax loss of close to \$40 million annually, beginning with \$20 million in the last half of fiscal year 2013. However, for fiscal year 2014 and beyond, that loss would be more than offset by an additional \$75 million in income tax revenues from the sunset of the limitation on itemized deductions.



General Fund Revenues

In preparing these estimates, all of the State's revenue collecting agencies were consulted. In addition, the Board of Revenue Estimates continued to rely on the Revenue Monitoring Committee, comprised of key State staff with revenue estimating knowledge or collection responsibility. The committee compared and considered alternative economic forecasts from national economic consulting firms Moody's Analytics and Global Insight, and local economists at Sage Policy Group.

Table 3 shows detail on general funds and selected special fund revenue sources for fiscal years 2011 through 2013. Table 4 provides additional detail on general fund revenues. The following sections of this report provide more information on each of the State's general fund revenue sources.

Table 3
Selected Revenues
 Fiscal Years 2011 - 2013

	GENERAL FUND			SPECIAL FUND			TOTAL		
	Fiscal Year 2011 Actual	Fiscal Year 2012 Revised Estimate	Fiscal Year 2013 Estimate	Fiscal Year 2011 Actual	Fiscal Year 2012 Revised Estimate	Fiscal Year 2013 Estimate	Fiscal Year 2011 Actual	Fiscal Year 2012 Revised Estimate	Fiscal Year 2013 Estimate
\$ Thousands									
INCOME TAXES									
Individual	6,643,429	7,099,212	7,412,049				6,643,429	7,099,212	7,412,049
Corporations	571,301	559,035	706,702	204,544	200,152	115,626	775,845	759,187	822,328
Total	7,214,730	7,658,247	8,118,751	204,544	200,152	115,626	7,419,274	7,858,399	8,234,377
SALES AND USE TAXES	3,656,043	3,979,527	4,043,889	240,656	40,238	47,545	3,896,699	4,019,765	4,091,434
STATE LOTTERY RECEIPTS	499,394	502,693	507,464	73,221	73,784	72,939	572,615	576,477	580,403
TRANSPORTATION REVENUES									
Motor Vehicle Fuel Tax	5,000	5,000	5,000	752,318	744,200	752,600	757,318	749,200	757,600
Highway User Revenue	377,055	190,895					377,055	190,895	0
Motor Vehicle Licenses, Fees				641,106	694,895	715,481	641,106	694,895	715,481
Motor Vehicle Titling Tax				594,938	635,000	711,000	594,938	635,000	711,000
Maryland Transit Fees				133,494	141,323	153,620	133,494	141,323	153,620
Maryland Port Fees				49,156	48,513	41,020	49,156	48,513	41,020
Maryland Aviation Fees				207,897	201,237	207,262	207,897	201,237	207,262
Total	382,055	195,895	5,000	2,378,909	2,465,168	2,580,983	2,760,964	2,661,063	2,585,983
OTHER REVENUES									
State Real and Personal Property Tax				798,290	752,631	725,724	798,290	752,631	725,724
Property Transfer Tax				118,523	118,523	131,287	118,523	118,523	131,287
Business Franchises and Filing Fees	210,171	209,191	208,932				210,171	209,191	208,932
State Tobacco Tax	407,570	407,545	406,932				407,570	407,545	406,932
Tax on Insurance Companies	285,942	298,901	308,109				285,942	298,901	308,109
Alcoholic Beverages Excises	30,435	30,533	31,089				30,435	30,533	31,089
Estate & Inheritance Taxes	216,044	200,379	219,352				216,044	200,379	219,352
Clerks of the Court	29,263	33,516	34,339				29,263	33,516	34,339
District Courts	86,867	80,783	80,783				86,867	80,783	80,783
Hospital Patient Recoveries	74,233	67,985	67,985				74,233	67,985	67,985
Interest on Investments	58,381	30,000	35,000						
Miscellaneous Fees, Other Receipts	386,234	359,988	355,415						
Total	1,785,141	1,718,821	1,747,936						
Total Current Revenues	13,537,364	14,055,183	14,423,040						
Extraordinary Revenues									--- See Notes ---
GRAND TOTAL	13,537,364	14,055,183	14,423,040						--- See Notes ---

Notes: Includes all general fund revenues, all Transportation revenues and selected special fund taxes. In conjunction with Appendix B of the Fiscal Year 2013 Budget Book, this table will comprise the official estimate of total state revenues.

Table 4
Maryland General Fund Revenues
 Fiscal Years 2011 - 2013

\$ Thousands	FY 2012					FY 2013			
	FY 2011 Actual	September Estimate	December Estimate	Difference	Growth	September Estimate	December Estimate	Difference	Growth
INCOME TAXES:									
Individual	6,643,429	7,010,773	7,099,212	88,439	6.9%	7,321,800	7,412,049	90,249	4.4%
Corporation	571,301	588,652	559,035	(29,617)	-2.1%	739,258	706,702	(32,556)	26.4%
Total	7,214,730	7,599,425	7,658,247	58,822	6.1%	8,061,058	8,118,751	57,693	6.0%
SALES AND USE TAXES	3,656,043	4,062,020	3,979,527	(82,493)	8.8%	4,177,665	4,043,889	(133,776)	1.6%
STATE LOTTERY	499,394	511,651	502,693	(8,958)	0.7%	506,378	507,464	1,086	0.9%
OTHER REVENUES									
Business Franchise Taxes	210,171	209,191	209,191	0	-0.5%	208,932	208,932	0	-0.1%
Tax on Insurance Companies	285,942	298,901	298,901	0	4.5%	308,109	308,109	0	3.1%
Estate and Inheritance Taxes	216,044	214,037	200,379	(13,658)	-7.3%	205,336	219,352	14,016	9.5%
Tobacco Tax	407,570	407,545	407,545	0	0.0%	406,932	406,932	0	-0.2%
Alcoholic Beverages Excise Tax	30,435	30,533	30,533	0	0.3%	31,089	31,089	0	1.8%
Motor Vehicle Fuel Tax	5,000	5,000	5,000	0	0.0%	5,000	5,000	0	0.0%
Highway User Revenue	377,055	190,895	190,895	0	-49.4%	0	0	0	-100.0%
District Courts	86,867	80,783	80,783	0	-7.0%	80,783	80,783	0	0.0%
Clerks of the Court	29,263	33,516	33,516	0	14.5%	34,339	34,339	0	2.5%
Hospital Patient Recoveries	74,233	67,985	67,985	0	-8.4%	67,985	67,985	0	0.0%
Interest on Investments	58,381	30,000	30,000	0	-48.6%	35,000	35,000	0	16.7%
Miscellaneous	386,234	363,573	359,988	(3,585)	-6.8%	365,648	355,415	(10,233)	-1.3%
Total	2,167,196	1,931,959	1,914,716	(17,243)	-11.7%	1,749,153	1,752,936	3,783	-8.4%
Total Current Revenues	13,537,364	14,105,055	14,055,183	(49,872)	3.8%	14,494,254	14,423,040	(71,214)	2.6%
Extraordinary Revenues		0	0	0	0.0%	0	0	0	0.0%
GRAND TOTAL	13,537,364	14,105,055	14,055,183	(49,872)	3.8%	14,494,254	14,423,040	(71,214)	2.6%



Individual Income Tax

General fund individual income tax revenue rebounded from two years of decline to grow 7.5% in fiscal year 2011. Despite this unexpectedly strong growth, income tax revenues remain almost \$300 million below fiscal year 2008 levels. With Maryland employment growing again during the fiscal year—up only 0.3% after two consecutive years of 2.0% declines—income tax withholding increased 4.3%. Estimated income tax payments showed steady improvement throughout the fiscal year, declining 8.3% in September, for third quarter payments for calendar year 2010, but increasing 13.6% in June for second quarter payments for calendar year 2011. For the full fiscal year, estimated payments increased 7.3%. Growth in estimated payments was boosted by capital gains, which are estimated to have increased 50% in tax year 2010, and by taxable nonwage income, which increased by 5.5% after falling 12.2% in 2009. These income sources also spurred final payments to growth of over 20% and a 6.3% decline in refunds. The decline in refunds was, by far, the largest on record, and only the second (refunds declined 0.2% in fiscal year 1989). These results indicate that taxpayers took advantage of safe harbor requirements for estimated payments; the relatively sharp rebound in income in 2010 was not fully reflected in estimated payments throughout the year, which then led to the surprisingly strong growth in final payments and the unusual decline in refunds.

Income tax withholding is expected to grow steadily, 3.7% in fiscal year 2012 and 4.0% in fiscal year 2013, in line with the slow but stable economic growth expected. Reasonably strong growth in estimated payments in tax year 2011 will subside in the first half of fiscal year 2012 as income growth relative to the prior year is expected to slow and safe harbor requirements reset to tax year 2011 liability. In addition, the 6.25% income tax bracket for taxable income over \$1 million expired at the end of tax year 2010, resulting in lower estimated payments for the last half of fiscal year 2011 than otherwise would have been the case. Accordingly, estimated payments are forecast to increase only 3.8% in fiscal year 2012, improving slightly to 5.0% growth in 2013. Final payments are expected to increase almost 15% in fiscal year 2012, supported in part by an additional \$32.0 million from the recently-enacted requirement that tax clearances be obtained before a driver's license or motor vehicle registration can be renewed. While that amount is expected to continue in fiscal year 2013, growth in final payments is forecast to slow to 6.8%. Net receipts are expected to grow relatively modestly, at 5.1% in fiscal year 2012 and 4.4% in 2013.

While net receipts are expected to grow commensurately with the economy, general fund revenues are forecast to increase 7.2% in fiscal year 2012 as a result of adjustments to the distributions to the local income tax reserve fund. After returns filed under the automatic filing extension in October 2011 were processed and tax year 2010 was complete, State revenues were a noticeably greater share of income tax revenues than was the case in 2009. Accordingly, a smaller percentage of collections can be directed to the local income tax reserve account from this point forward. But the strong growth expected for income tax revenues is not reflective of the underlying economic activity.

Table 5
Individual Income Tax Revenues
 Fiscal Years 2010-2013
 (\$ in thousands)

	<u>2010 Actual</u>	<u>2011 Actual</u>	<u>2012 Revised Estimate</u>	<u>2013 Estimate</u>
Gross Receipts (State & Local)				
Withholding	10,273,070	10,713,144	11,104,690	11,550,781
Estimated Payments	1,329,324	1,811,514	1,479,703	1,553,073
Payments with Final Returns	1,021,465	816,089	1,380,787	1,475,222
Fiduciary	44,021	68,944	67,835	74,586
<hr/>				
Gross Receipts	12,667,880	13,409,691	14,033,015	14,653,662
Refunds	(2,689,866)	(2,520,357)	(2,590,175)	(2,709,095)
<hr/>				
Net Receipts (State & Local)	9,978,014	10,889,334	11,442,840	11,944,567
Local Reserve Account	(3,776,596)	(4,244,246)	(4,341,628)	(4,530,518)
Income Tax Check-offs	(1,615)	(1,659)	(2,000)	(2,000)
Amnesty	(21,560)	0	0	0
<hr/> <hr/>				
Net General Fund	6,178,243	6,643,429	7,099,212	7,412,049

Figures may not sum to totals due to rounding.



Corporate Income Tax

General fund corporate income tax revenues declined 17.1% to \$571.3 million in fiscal year 2011. That decline is a result, however, of several truly extraordinary payments in fiscal year 2010. Accounting for these payments, net receipts would have increased slightly. Gross receipts, adjusted for those payments, fell 2.9%. Despite the 15.1% growth in corporate profits nationally over the course of the fiscal year, estimated payments increased only 3.6%. Final payments, largely reflecting prior year activity, possibly adjusted for net operating loss carryforwards, declined almost 15% for the year. Corporate income tax refunds fell almost 17% for the year.

Growth in corporate profits has decelerated from record growth rates over the past several quarters, but growth remains near double-digits. National measures of corporate profits are generally not correlated with corporate income tax receipts in Maryland. This is partly due to timing issues related to the corporate income tax, including net operating losses and normal tax administration issues, and partly due to differences between national income accounting and tax accounting. The degree to which this difference arises from differences between Maryland's corporate income tax base and corporations nationwide is unknown. Corporate profits are expected to grow relatively modestly over the course of fiscal years 2012 and 2013, perhaps accelerating in 2014 and 2015 with the national economy.

Through November, gross receipts have declined 3.4%, with estimated payments falling marginally and final payments down 8.7%. Refunds surged in the month of November to near-record levels. Analysis of nearly a dozen very large refunds reveals no commonality with respect to industry, tax year, or cause. Refunds have increased 7.8% for the year, while the official forecast called for a 13.1% decline. As a specific cause for the increase in refunds has not been identified, it is presumably a result of broad-based factors, and the higher than previously expected levels of refunds are expected to continue. For fiscal year 2012, gross receipts are forecast to decline slightly, while refunds are now expected to increase 5.6% for the year. Net receipts before distributions and general fund revenues are both expected to decline slightly.

In fiscal year 2013, gross receipts and refunds are both projected to increase by mid-single digits, resulting in 8.3% growth in net receipts before distributions. A statutory reduction in the distribution to the Gasoline and Motor Vehicle Revenue Account of the Transportation Trust Fund will redirect an estimated \$101.2 million to the general fund, boosting general fund revenue growth to 26.4%.

Table 6
Corporate Income Tax Revenues
 Fiscal Years 2010-2013
 (\$ in thousands)

	<u>2010 Actual</u>	<u>2011 Actual</u>	<u>2012 Revised Estimate</u>	<u>2013 Estimate</u>
Gross Receipts	1,149,953	991,077	986,436	1,056,473
Refunds	(258,561)	(215,232)	(227,249)	(234,146)
<hr/>				
Net Receipts	891,392	775,845	759,187	822,327
Transportation Trust Fund	(155,254)	(157,993)	(154,601)	(66,286)
Higher Education Investment Fund	(45,744)	(46,551)	(45,551)	(49,340)
Amnesty	(1,083)	0	0	0
<hr/> <hr/>				
Net General Fund	689,311	571,301	559,035	706,702

Figures may not sum to totals due to rounding.



Sales and Use Taxes

Sales and use tax revenues provide the second largest source of general fund revenue. In fiscal year 2011, general fund receipts increased 3.8% after declining 2.7% for fiscal year 2010. Gross receipts are expected to increase 3.1% to \$4.0 billion in fiscal year 2012 and then 1.8% to \$4.1 billion for fiscal year 2013; although, after incorporating legislative changes, general fund revenues are expected to increase 8.8% and 1.6% in fiscal years 2012 and 2013 respectively. Growth in 2012 is a result of the redirection of 5.3% of revenues from the Transportation Trust Fund to the general fund, a distribution that was put in place during the 2007 Special Session and an increase in the sales tax rate applicable to sales of alcohol to 9%, which is expected to generate \$70.5 million in fiscal year 2012 and \$71.6 million in fiscal year 2013.

Weak baseline growth of only 1.4% is expected for fiscal year 2012, with only a slight acceleration in fiscal year 2013 to 1.8%. The expiration of the payroll tax cut at the end of this year and several substantial federal income tax provisions at the end of 2012 will reduce the disposable income of almost all Marylanders, constraining growth during what was already expected to be a very weak period for the sales tax. Additionally, expected cutbacks in federal spending will place downwards pressure on the income of many Marylanders and eliminate many jobs. All four of the major sales tax components, however, are expected to grow in fiscal year 2013 for the first time since fiscal year 2006.

The consumer segment of sales tax revenues is the largest, accounting for approximately two-thirds of sales tax collections. Fiscal year 2011 saw strong growth of 4.2% after declining 0.3% in fiscal year 2010. Adjusted for the 2008 rate increase, however, baseline collections remained below fiscal year 2007 levels, indicating that spending had not yet rebounded to pre-recession levels. Lingering unemployment, higher food and gas prices, and falling home values, among other factors, have and will continue to take their toll on consumer spending. Year to date receipts are up 5.7% through November, though after adjusting for the increased tax rate for alcohol sales, the underlying rate of growth is only 3.0%. Fiscal year 2012 gross receipts are expected to slow to 4.6%, 2.0% adjusted for the alcohol rate, as disposable income is affected by the expiration of the payroll tax cut and household balance sheets continue to decline. For fiscal year 2013, gross receipts are expected to grow 1.6% as the overall economic conditions for consumers remains weak and the federal income tax cuts that have facilitated spending expire.

The second-largest component of the sales tax, and the most volatile, is the construction component. Construction-related remittances had surged throughout much of the past decade shadowing the housing boom. Falling home prices, mortgage refinancing, and reduced sales volume have led to a reduction in home improvement spending and new home construction. Baseline construction collections grew 4.7% in fiscal year 2011 after falling 7.7% in fiscal year 2010; year to date collections are up 2.4%. With sales volume expected to increase through the last half of the year, 2012 construction receipts are forecast to grow 3.0% in fiscal year 2012 and at roughly the same rate in fiscal year 2013. Stronger growth is expected in the out years, though baseline collections are not expected to reach fiscal year 2007 levels until fiscal year 2015.

Revenue from the utility sector—from the sale of electricity and natural gas to commercial and industrial customers, purchases of equipment by electric, gas and telephone companies, and cellular phone service—declined 8.6% and 0.8% in fiscal years 2010 and 2011 respectively. The decline in fiscal year 2010 was the first since fiscal year 2002 when deregulation of the power industry took place. As a result of the recession and slow recovery, many businesses have

reduced activity or are searching for savings, including reducing their consumption of energy. Additionally, personal consumption expenditures for telecommunications services fell on a nationwide basis in fiscal year 2010. Year to date, the power segment is down 5.7%, likely the result of reduced commercial and industrial consumption of electricity, while the communications segment is down 6.7% year to date as investment in business communications equipment has fallen. Taken in the aggregate, collections are expected to remain depressed for the current fiscal year, falling 4.1%, before accelerating to modest 1.4% in fiscal year 2012.

Growth in remittances from sales of capital goods—generally durable goods purchased and used by business—grew 4.4% in fiscal year 2011 after falling 5.5% in fiscal year 2010. Year to date receipts have remained relatively flat as businesses seem to be either foregoing or delaying capital investments. Collections are expected to be flat in fiscal year 2012 and grow 2.0% in fiscal year 2013 as companies resume investment in durable goods and computers.

Table 7
Sales and Use Tax Revenues
 Fiscal Years 2010-2013
 (\$ in thousands)

	<u>2010 Actual</u>	<u>2011 Actual</u>	<u>2012 Revised Estimate</u>	<u>2013 Estimate</u>
Consumer	2,607,910	2,717,578	2,843,100	2,889,246
Construction	471,667	494,103	506,468	520,953
Capital Goods	295,832	308,871	308,679	314,738
Utilities	381,302	378,252	362,600	367,739
<hr/>				
Gross Collections	3,756,711	3,898,804	4,020,847	4,092,676
Assessments	14,302	12,228	12,534	12,847
Refunds	(17,026)	(14,333)	(13,616)	(14,088)
Transportation Trust Fund	(218,791)	(227,981)	(24,933)	(25,930)
Other ¹	(6,235)	(12,675)	(15,305)	(21,615)
Amnesty	(6,187)	0	0	0
<hr/>				
Total General Fund	3,522,774	3,656,043	3,979,527	4,043,889

Figures may not sum to totals due to rounding.



Lottery

General Fund Lottery collections increased 1.7% to \$499.4 million for fiscal year 2011, with sales increasing by 0.5%. Powerball sales almost doubled relative to fiscal year 2010, only because the game was introduced in February 2010. Mega Millions sales decreased by 21.2% as the introduction of Powerball, an almost identical game, cannibalized sales. Instant sales increased by 0.5%, though an increased payout level resulted in a decline of revenues from instant tickets. Pick 4 sales continued to grow, and Racetrax sales increased a substantial 15.9%.

Fiscal year 2012 sales are expected to rise 0.8% to \$1.729 billion, generating \$522.7 million in revenues. Sales growth of 0.5% is projected for fiscal year 2013 despite the projected opening of the Arundel Mills casino, which will likely compete for the same pool of discretionary funds as non-jackpot games. Net revenues are expected to increase to \$526.7 million.

Pick 3 is expected to continue a trend of declining sales and finish 2012 down 2.4%, but favorable payouts from the State's perspective will result in an increase in revenues of 1.0%. Pick 4 sales have been strong this year; revenues are expected to increase 4.1% on a 4.4% increase in sales. Down 3.4% year to date, instant ticket sales are expected to continue to decline—sales fell in both fiscal years 2009 and 2010 before posting a marginal increase for fiscal year 2011. While some of the decline can be attributed to poor economic conditions, instant ticket sales do seem to have plateaued after a new inventory system boosted sales in fiscal year 2008. A turn to higher-priced tickets with larger payouts has also affected revenues adversely. Keno and Racetrax in the aggregate are expected to realize 4.8% sales growth in fiscal year 2012, but high payouts for Keno this year will restrain revenue growth.

MultiMatch has seen impressive growth year to date and is expected to continue that growth; revenues are expected to increase 5.1% in fiscal year 2012 and 1.6% in fiscal year 2013. Year to date, Match 5 has paid out at a rate very favorable to the State, driving strong revenue growth in fiscal year 2012. The MegaMillions and Powerball games sales are expected to fall 2.2% for fiscal year 2012 despite year to date growth of 8.6%. The first five months of fiscal year 2011 were very weak in terms of jackpots, with the average jackpots of both games well below historic averages; fiscal year to date 2012 revenues are only 0.2% greater than over the same time period in fiscal year 2010 when there was only one game. For the remainder of fiscal year 2012, the games will be comparing to a period of very high jackpots last year, resulting in expectations of a sales decline.

Table 8
Lottery Sales and Revenues by Game
 Fiscal Years 2010-2013
 (\$ in millions)

	Sales				Revenues			
	2010 <u>Actual</u>	2011 <u>Actual</u>	2012 Revised <u>Estimate</u>	2013 <u>Estimate</u>	2010 <u>Actual</u>	2011 <u>Actual</u>	2012 Revised <u>Estimate</u>	2013 <u>Estimate</u>
Pick 3	266.9	260.8	254.6	247.0	109.5	106.1	107.1	101.6
Pick 4	246.7	254.6	265.9	272.4	92.0	104.8	109.1	114.7
Multimatch	35.2	27.9	29.1	29.7	12.6	10.1	10.6	10.8
Instant	490.9	493.5	481.2	471.6	89.7	87.3	84.9	82.2
Keno/Racetrax	492.0	496.7	520.5	531.1	134.1	136.6	137.0	142.1
Bonus Match 5	20.8	21.4	21.9	22.4	7.8	7.4	7.8	7.5
Mega Millions/Powerball	154.1	159.3	155.8	163.1	64.9	67.1	66.2	67.9
Total	1,706.6	1,714.4	1,729.0	1,737.3	510.6	519.4	522.7	526.8
Less Stadium Authority Revenue					<u>(19.6)</u>	<u>(20.0)</u>	<u>(20.0)</u>	<u>(19.3)</u>
General Fund Revenue					491.0	499.4	502.7	507.5

Figures may not sum to totals due to rounding.



Business Franchise Taxes

The public service company tax, or business franchise tax, is levied on electric and gas utilities and telephone companies. Natural gas is taxed at 0.402 cents per therm and electricity at 0.062 cents per kilowatt hour. In addition, there is a 2.0% tax on the cost of distribution. The tax on telephone service is also 2.0%. Filing fees, collected from corporate and non-corporate entities, are also counted as business franchise taxes and include the annual \$300 fee required by most entities doing business in the State.

Gas and electric receipts increased by 13.1% to \$94.4 million in fiscal year 2011, while receipts from telecommunications declined 8.1% to \$37.4 million. Telephone company receipts have steadily declined the past several years as consumers and businesses have abandoned land lines in favor of cellular phones. Maryland mined coal credits taken against the franchise tax remained flat with \$4.5 million taken in both fiscal year 2010 and fiscal year 2011. Currently, the Maryland mined coal credit is set to increase to \$6 million for tax year 2013.

Receipts from the telephone service sector are expected to continue trending downwards, declining 8.6% in fiscal years 2012 and 2013. Gas and electric receipts are expected to moderate in fiscal year 2012, as fiscal year 2011 receipts were extraordinary and consumption growth is expected to dissipate, returning to trend in fiscal year 2013. The minimal increase from gas and electric gross receipts tax is not expected to outweigh the strong decline in receipts from telephone companies; therefore total gross receipts taxes are expected to fall 2.2% in fiscal year 2012 and another 1.7% in fiscal year 2013. Filing fees are expected to increase in both years, although not at a rate sufficient to offset the franchise tax losses. In the aggregate, general fund business franchise taxes are expected to decrease 0.5% to \$209.2 million in fiscal year 2012 and 0.1% to \$208.9 million in fiscal year 2013.

Table 9
Business Franchise Tax Revenues
 Fiscal Years 2010-2013
 (\$ in thousands)

	2010 <u>Actual</u>	2011 <u>Actual</u>	2012 Revised <u>Estimate</u>	2013 <u>Estimate</u>
Public Service Company Franchise Tax	124,081	131,551	128,705	126,536
Filing Fees	78,371	78,620	80,486	82,395
Total	202,452	210,171	209,191	208,931



Insurance Premium Tax

Insurance premiums are taxed at a rate of 2.0%. Collections increased 3.2% in fiscal year 2011, seemingly rebounding after increasing less than 1% in fiscal year 2010 and after declining 8.8% in fiscal year 2009 which marked the first year of negative collection growth since 2000. Across the different spectrums, insurance premiums are closely tied to automobile purchases, home ownership, home prices, and employment. However, volume and value reductions are not the sole culprit in the diminution of collections; increased competition has led to a reduction in premium prices. That being said, the industry as a whole often raises premiums to offset financial losses or to account for actuarial increases in the amount of outstanding risk. Premium tax revenues are expected to increase 4.5% to \$298.9 million in fiscal year 2012 and increase 3.1% in fiscal year 2013.

For the long-term forecast, it is estimated that premium tax revenues will receive an additional boost from federal health care reform as many individuals become incentivized to purchase health insurance. Our estimate of this new activity is sourced from the final report of the Health Care Reform Coordinating Council which estimates that premium taxes will increase \$28.0 million in fiscal year 2014 and more than \$65 million annually thereafter.

Table 10
Insurance Premium Tax Revenues
 Fiscal Years 2010-2013
 (\$ in thousands)

	<u>2010 Actual</u>	<u>2010 Actual</u>	<u>2012 Revised Estimate</u>	<u>2013 Estimate</u>
Premium Tax	277,007	285,942	298,901	308,109



Estate and Inheritance Taxes

Estate and inheritance tax revenues are inherently volatile. Together, they are the second most volatile revenue source behind the corporate income tax. By definition, they are determined by the number and wealth of decedents each year. In recent years, unusually high volatility in the value of stocks, real estate, and other assets have caused dramatic year-over-year changes in the tens of millions of dollars. State and federal law changes can also play a role in the volatility, although Maryland's estate tax is decoupled from most of the recent changes in the federal estate tax.

After declining for the past three years following an all-time high in fiscal year 2008, estate tax revenue grew 27% in fiscal year 2011. While the number of large estates—those making payments over \$1 million dollars—remained relatively flat, increasing from twenty-two estates to twenty-three, the number of estates making payments between \$500,000 to \$1 million grew significantly, from fifteen to twenty-six. The tax paid increased significantly as a result, almost doubling from \$9.6 million in fiscal year 2010 to \$20.0 million in fiscal year 2011. Over half of total estate tax collections came from large estates (payments over \$500,000) in fiscal year 2011.

Through the first five months of fiscal year 2012, twelve estates made payments over \$1 million with an average value of over \$1.8 million dollars. For the same period in fiscal year 2011 there were only 9 such estates, but the average value was over \$3 million. Payments between \$500,000 and \$1 million are up 69% in dollars, with the number of such estates increasing from eleven to nineteen. While the strong growth from estates between \$500,000 to \$1 million is encouraging, wealth has continued to be shaky while the economy regains its footing. As a result, it is estimated that estate tax revenues will decrease 6.6% for fiscal year 2012.

Inheritance tax revenue is now essentially from the collateral inheritance tax, a 10.0% tax applied to bequests to anyone aside from lineal relatives and siblings of the decedent. As with the estate tax, inheritance tax revenues have fluctuated over the years; with record growth bringing collections to the second-highest level on record. Year to date revenues are down 5.9%. As the economy still works to stabilize itself, inheritance tax revenues are expected to decrease 9.3% in fiscal year 2012 with modest growth of 2.5% in fiscal year 2013. Although the direct inheritance tax was repealed in 2000, residual receipts are still collected. Direct inheritance tax receipts are expected to total \$170,000 and \$150,000 in 2012 and 2013, respectively.

Table 11
Estate and Inheritance Tax Revenues
 Fiscal Years 2010-2013
 (\$ in thousands)

	<u>2010 Actual</u>	<u>2011 Actual</u>	<u>2012 Revised Estimate</u>	<u>2013 Estimate</u>
Collateral Inheritance Tax	47,310	55,540	50,385	51,644
Direct Inheritance Tax	197	158	175	150
Estate Tax	125,967	160,346	149,819	167,558
Total	173,473	216,044	200,379	219,352

Figures may not sum to totals due to rounding.



Alcohol and Tobacco Excise Taxes

Tobacco tax collections, comprised of separate taxes on cigarettes and other tobacco products, grew slightly in fiscal year 2011, experiencing growth of 0.4%. Cigarette stamps sales declined marginally for the second fiscal year in a row, falling 0.03% and 0.02% in fiscal years 2010 and 2011 respectively. Year to date, stamp sales remain 0.2% off from last year while the forecast calls for a 0.1% decline in fiscal year 2012. While the rate of decline in cigarette stamp sales has recently moderated, the expectation that consumption is declining remains and stamp sales are expected to decline 0.4% in fiscal year 2013. Unlike cigarette collections, tax collections on other tobacco products have trended upwards in each year since the tax's inception, growing at an average annual rate of 7.3% over the past five years. In contrast to historical norms, year to date collections of other tobacco products are down 1.5%, prompting a fiscal year 2012 forecast of -0.8%. Consumption of other tobacco products is expected to return to trend, growing in fiscal year 2013. As a result, overall tobacco collections are forecasted to remain relatively flat in fiscal year 2012, before experiencing a decrease of 0.2% in fiscal year 2013.

Alcohol excise tax revenues grew 1.9% to \$30.4 million in fiscal year 2011. Collections from spirits and wines increased 2.8% and 3.5%, respectively. Conversely, revenues from purchases of beer fell 0.6% in fiscal year 2011, possibly due to increased prices. The combined alcoholic beverage revenue is forecasted to grow 0.3% to \$30.5 million in fiscal year 2012, as revenues divert from trend, the result of the increase in the alcoholic beverage sales tax rate from 6% to 9% that was effective at the beginning of fiscal year 2012. An increase in the price of a product (in this case the sales tax on a product) will lead to reduced consumption, and although consumption of alcohol is considered relatively inelastic, decreased consumption is none the less the result. Revenues are expected to return to trend in fiscal year 2013, growing 1.8%.

Table 12
Excise Tax Revenues
 Fiscal Years 2010-2013
 (\$ in thousands)

	<u>2010 Actual</u>	<u>2011 Actual</u>	<u>2012 Revised Estimate</u>	<u>2013 Estimate</u>
Cigarette Tax	394,147	395,203	395,279	392,702
Other Tobacco Products Tax	11,769	12,367	12,266	14,230
Total Tobacco Taxes	405,915	407,570	407,545	406,932
Distilled Spirits Tax	15,153	15,575	15,657	16,072
Wine Tax	5,600	5,795	5,920	6,131
Beer Tax	9,121	9,065	8,956	8,886
Total Alcoholic Beverages Tax	29,874	30,435	30,533	31,089

Figures may not sum to totals due to rounding.



Hospital Patient Recoveries

Hospital patient recoveries are revenues received for services provided in State hospitals paid by the patients, their sponsors or insurance, and by the federal Medicaid and Medicare programs. Medicaid and insurance reimbursements primarily relate to patients in psychiatric hospitals. In fiscal year 2011 the Brandenburg Center closed, resulting in a loss of revenues of approximately \$3 million. Currently, no hospitals are expected to be closed during fiscal years 2012 and 2013.

Total revenues grew 2.1% from \$72.7 million in fiscal year 2010 to \$74.2 million in fiscal year 2011. Recoveries in fiscal year 2011 were supported by the American Recovery and Reinvestment Act, though the enhanced funding attributable to ARRA ended June 30, 2011. Total fiscal year 2012 revenues are expected to decrease by 8.4% to \$68 million, mainly the result of decreased Medicaid reimbursements. For the long-term forecast, it is estimated that federal health care reform will have an adverse effect on hospital patient recoveries as many individuals become incentivized to purchase health insurance, therefore reducing disproportionate share payments. Our estimate of this new activity is sourced from the final report of the Health Care Reform Coordinating Council which estimates that the disproportionate share will decrease by \$9.0 million in fiscal year 2015, growing marginally thereafter.

Table 13
Hospital Patient Recoveries
 Fiscal Years 2010-2013
 (\$ in thousands)

	2010 <u>Actual</u>	2011 <u>Actual</u>	2012 Revised <u>Estimate</u>	2013 <u>Estimate</u>
Medicaid	33,959	35,640	27,624	27,624
Medicare	6,956	7,241	7,414	7,414
Insurance and Sponsors	5,017	6,048	6,553	6,553
	45,932	48,929	41,591	41,591
Disproportionate Share	26,758	25,305	26,394	26,394
Total	72,690	74,234	67,985	67,985

Figures may not sum to totals due to rounding.



Court Revenues

Revenues from the District Court of Maryland result from court fees and traffic fines, which vary with enforcement activities, weather, the rate of contested citations, and the fees and fines actually imposed. While the long-term trend is positive, revenues have fallen each year since fiscal year 2008, when they declined by 5.9%. Revenues declined by 2.1% in fiscal year 2009, 2.3% in fiscal year 2010, and 0.5% in fiscal year 2011. Currently, year to date performance is nearly flat, up just 0.3%; however, revenues are expected to drop by 7.0% for fiscal year 2012, largely the result of an accounting change that serves to record certain money in the clerks of court that had previously been reported within the District Court. That money is not paid into the general fund until the end of the year, and is therefore not effecting the year to date numbers; baseline growth is expected to be down 1.5% for fiscal year 2012 and flat for fiscal year 2013.

General fund revenue from the clerks of the circuit courts are derived largely from recordation-related activity, although about \$8.5 million is received annually from a variety of court fees. Clerks revenue has fallen in each of the preceding five fiscal years as the State's housing market has struggled. Between calendar years 2004 and 2006, an average of over 93,000 homes were sold annually with a median price that rose to over \$300,000. In each of the following four years, sales volume has remained at nearly half of the 2005 peak. While sales increased by 29% on a year over year basis in fiscal year 2010, that pace of sales was boosted by the federal income credit for homebuyers. In fiscal year 2011, with the credit having expired, home purchases declined by nearly 10% from fiscal year 2010 totals. Fiscal year to date unit sales are up 7.6% over last year, though the median price is down 8.2%. Clerk revenues are expected to increase 14.5% in fiscal year 2012, largely the result of the aforementioned accounting adjustment, and 2.5% in fiscal year 2013.

Table 14
General Fund Court Revenues
 Fiscal Years 2010-2013
 (\$ in thousands)

	2010 <u>Actual</u>	2011 <u>Actual</u>	2012 Revised <u>Estimate</u>	2013 <u>Estimate</u>
District Courts	87,331	86,867	80,783	80,783
Clerks of the Court	35,484	29,263	33,516	34,339



Interest Earnings

General Fund interest earnings increased significantly in fiscal year 2011 to \$58.4 million—16.2% growth over fiscal year 2010. Fiscal year 2011 was the second year in a row that interest from various special funds had been credited to the general fund. The increase in revenues can largely be attributed to stronger revenue growth throughout the year. The fiscal year 2010 and 2011 transfers had been temporary transfers, though the statute was changed in the 2011 session of the General Assembly to make such transfers permanent.

Despite a downgrade from Standard and Poor's, the yields on United States Treasury debt remain low. In fact the downgrade drove yields down, signaling that United States debt remains a relatively low risk investment. The current forecast for three-month Treasury bill rates calls for a decrease to 0.020% in fiscal year 2012 before a modest increase to 0.035% in fiscal year 2013. Lower rates, in combination with smaller balances, lead to expected interest earnings of \$30.0 million in fiscal year 2012 and \$35.0 million in fiscal year 2013.

Table 15
Interest Earnings
Fiscal Years 2010-2013
(\$ in thousands)

	<u>2010 Actual</u>	<u>2011 Actual</u>	<u>2012 Revised Estimate</u>	<u>2013 Estimate</u>
Interest Earnings	50,223	58,381	30,000	35,000



Miscellaneous Revenues

The general fund receives a substantial amount of revenues each year from a number of fees and other non-tax revenue sources. Excluding the addition of the Federal Retiree Drug Subsidy and the Tobacco Conversion Program Bond Repayment, miscellaneous revenues grew 4.8%. As in past years, the majority of this revenue is from Unclaimed Property and Uninsured Motorist Penalty Fees. While revenues from Uninsured Motorist Penalty Fees decreased by 4%, this was offset by a 15% increase in Unclaimed Property.

Revenues from the State Admissions and Amusement Tax increased 5.4% in fiscal year 2011, after growing 55% in fiscal year 2010. This growth was largely based on legislative changes made during the 2008 session. Fiscal year 2012 is expect to grow 25%, due to a legislative change in the distribution.

In total, the general fund is expected to receive \$200.0 million in miscellaneous revenues in fiscal year 2012, a decrease of 5.0% over 2011, and increase a marginal \$300,000—or 0.2%—in fiscal year 2013 to \$200.3 million.

Table 16
Miscellaneous Revenues
 Fiscal Years 2010-2013
 (\$ in thousands)

	2010 <u>Actual</u>	2011 <u>Actual</u>	2012 <u>Revised Estimate</u>	2013 <u>Estimate</u>
Recording, Organization & Capitalization Fees	10,304	11,068	11,097	11,330
Excess Fees of Office	2,878	4,997	2,262	2,235
Unclaimed Property	64,259	73,810	75,000	75,000
Local Income Tax Reimbursement	12,613	13,407	14,319	13,524
Uninsured Motorist Penalty Fees	61,261	59,019	57,249	55,531
State Admissions & Amusement Tax	12,599	13,277	16,600	13,300
Federal Retiree Drug Subsidy	0	32,228	17,644	23,578
Tobacco Conversion Program Bond Repayment	0	1,845	3,323	3,323
Miscellaneous Revenues and Transfers	5,515	1,953	2,500	2,500
Total	169,430	211,604	199,993	200,321

Figures may not sum to totals due to rounding.



Miscellaneous Agency Revenues

Agency general fund revenue is comprised of revenue received by those agencies whose primary purpose is not revenue collection, but whose ancillary collections are directed to the general fund. Sixty-two percent of miscellaneous agency revenues come from three agencies: the Attorney General's Office, the Department of Health and Mental Hygiene, and Public Education. Revenues from the Attorney General are comprised of stockbroker registration fees, investment advisor fees and large settlements, the latter of which can be quite volatile. Revenues from the Department of Health and Mental Hygiene come from a variety of sources including certified copies, hospital license fees, narcotic fees and laboratory tests. Public Education revenues are largely reimbursements from the counties for education-related expenses.

Revenue from Public Education increased 41% in 2011 due to an extraordinary transfer of funds amounting to \$12 million. Excluding this one time transfer, total miscellaneous agency revenues decreased 2.3% for fiscal year 2011 and will decrease 1.6% in fiscal year 2012.

Table 17
Miscellaneous Agency Revenues
 Fiscal Years 2010 - 2013
 (\$ in thousands)

	2010 <u>Actual</u>	2011 <u>Actual</u>	2012 <u>Revised Estimate</u>	2013 <u>Estimate</u>
PSC Fines, Citations and Filing Fees	233	335	219	219
Legislature	178	87	60	51
Workers' Compensation	55	58	55	55
Public Defender	1,765	1,734	1,708	1,759
Attorney General	26,627	30,372	26,817	27,738
Executive & Administrative Control	7,335	8,129	8,683	6,689
Financial & Revenue Administration	13,443	14,751	15,032	14,517
Budget & Fiscal Administration	1,008	2,764	825	810
General Services	88	96	75	75
Natural Resources	186	197	190	190
Agriculture	192	555	182	164
Health & Mental Hygiene	39,875	28,163	32,009	32,081
Human Resources	1,321	15	4,265	1,613
Labor, Licensing & Regulation	11,863	11,001	11,981	9,961
Public Safety & MD State Police	16,366	13,203	14,788	16,794
Public Education	42,024	59,144	40,187	39,409
Housing and Community Development	955	965	1,000	1,000
Business & Economic Development	904	964	112	35
Environment	577	830	705	813
Juvenile Services	390	95	0	0
Alcoholic Beverage Licenses	1,114	1,172	1,100	1,120
Total	166,499	174,630	159,995	155,094

Figures may not sum to totals due to rounding.



Transportation Revenues

Table 18
Maryland Motor Vehicle User Revenues
 Fiscal Years 2010-2013
 (\$ in thousands)

	<u>2010</u> <u>Actual</u>	<u>2011</u> <u>Actual</u>	<u>2012</u> <u>Revised</u> <u>Estimate</u>	<u>2013</u> <u>Estimate</u>
Department of Transportation				
Registrations	350,120	360,514	364,100	371,200
Licenses	39,322	37,176	34,900	36,900
Med-Evac Surcharge	50,898	50,885	51,391	52,393
Trauma Physician Services Surcharge	11,564	11,585	11,700	11,928
Miscellaneous Motor Vehicle Fees	124,994	125,924	174,115	180,869
Vehicle Emission Inspection Fees	9,541	31,984	32,489	34,791
Security Interest Filing Fees				
Special Funds	8,040	9,251	9,700	10,600
Hauling Fees	8,990	10,200	10,500	10,700
Special License Tags				
Special Funds	3,383	3,587	6,000	6,100
Titling Tax	543,411	594,938	635,000	711,000
Sales Tax on-Rental Vehicles	22,366	24,362	24,933	25,930
Special Distribution from Sales Tax	195,976	203,656	0	0
	<u>1,368,605</u>	<u>1,464,062</u>	<u>1,354,828</u>	<u>1,452,411</u>
Motor Vehicle Fuel Tax				
	712,620	746,817	736,000	744,300
Road Tax	8,573	5,320	8,200	8,300
Decals	118	181	0	0
	<u>721,311</u>	<u>752,318</u>	<u>744,200</u>	<u>752,600</u>
Total	2,089,916	2,216,380	2,099,028	2,205,011

Figures may not sum to totals due to rounding.



Five Year Forecast

These estimates are based on a trend scenario for the U.S. and Maryland economies. A trend scenario does not attempt to forecast cyclical economic patterns beyond the current period, but projects the average growth that the economy is likely to register based on the fundamental factors affecting the economy.

Structural changes in the long-term outlook include an increase in individual income tax revenues beginning in fiscal year 2014 as a result of the scheduled reinstatement of the limitation on itemized deductions for high-income taxpayers, which will flow through to the Maryland income tax. Also in fiscal year 2014, growth in lottery revenues will be constrained by the increasing presence of video lottery terminals. In fiscal year 2017, a change in the distribution of corporate income tax revenues will redirect some revenue from the Transportation Trust Fund to the general fund.

Table 19
Long Term Economic Forecast
Primary Indicators

CALENDAR YEAR	2009	2010	2011	2012	2013	2014	2015
U.S. GDP (\$ billion, chained)	12,703	13,088	13,316	13,556	13,887	14,377	14,851
	-3.5%	3.0%	1.7%	1.8%	2.4%	3.5%	3.3%
U.S. Total Non-Farm Employment (thousands)	130,789	129,822	131,128	132,630	134,775	137,423	140,194
	-4.4%	-0.7%	1.0%	1.1%	1.6%	2.0%	2.0%
U.S. Personal Income (\$ billion)	11,930	12,374	12,962	13,395	13,899	14,621	15,400
	-4.3%	3.7%	4.8%	3.3%	3.8%	5.2%	5.3%
Consumer Price Index - % Change	-0.3%	1.6%	3.1%	1.5%	1.7%	2.1%	2.2%
U.S. 10-Year Treasury Bond Yield	3.3%	3.2%	2.8%	2.3%	2.8%	3.6%	4.6%
MD Total Non-Farm Employment (thousands)	2,523	2,513	2,542	2,563	2,587	2,625	2,673
	-3.0%	-0.4%	1.1%	0.9%	0.9%	1.5%	1.8%
MD total Personal Income (\$ million)	273,193	283,920	299,228	307,908	318,744	333,162	350,732
	-1.6%	3.9%	5.4%	2.9%	3.5%	4.5%	5.3%

Source: Global Insight and Board of Revenue Estimates (December 2011 Forecast)

Table 20
Maryland General Fund Revenues
 Fiscal Years 2011-2017
 (\$ in thousands)

	2011 Actual	2012 Estimate	2013 Estimate	2014 Estimate	2015 Estimate	2016 Estimate	2017 Estimate
Income Taxes							
Individual	6,643,429	7,099,212	7,412,049	7,787,553	8,180,818	8,630,763	9,105,455
Corporation	571,301	559,035	706,702	684,399	739,835	770,169	817,209
TOTAL	7,214,730	7,658,247	8,118,751	8,471,952	8,920,653	9,400,932	9,922,664
Sales and Use Taxes	3,656,043	3,979,527	4,043,889	4,180,239	4,376,264	4,555,597	4,783,377
State Lottery	499,394	502,693	507,464	510,360	523,119	536,197	549,602
Franchise, Excise, License, Fee	2,167,196	1,914,716	1,752,936	1,815,271	1,908,494	1,957,748	1,991,666
TOTAL CURRENT REVENUES	13,537,364	14,055,183	14,423,040	14,977,822	15,728,530	16,450,473	17,247,309

Figures may not sum to totals due to rounding.
 Totals do not include extraordinary revenues.

