

January 23, 2011



Maryland Budget & Tax Policy Institute

Instant Analysis of the Proposed Budget

On January 18, 2012, Maryland Governor Martin O'Malley proposed a budget for the state for fiscal year 2013. Fiscal 2013 begins July 1, 2012 and ends June 30, 2013.

Budget Dimensions

- Total funds: \$35.9 billion percent
 - Increase of \$1.1 billion 2.9percent
 - Increase of \$0.7 billion (2.0percent) if you exclude payments to state reserve fund
- General funds: \$15.3 billion
 - Increase of \$0.3 billion (1.9percent)
 - General fund expenditures decline in 2013 if payments to the state reserve fund (the "Rainy Day Fund") are excluded
- Positions: 79,244 permanent, 9,390 contractual
 - Increase of 123 permanent and 211 contractual employees
 - Most of the new permanent positions relate to security improvements at Clifton Perkins Hospital
 - The budget adds most of the new contractual positions in the state court system and Department of Public Safety

Three largest sources of revenue:

- | | |
|--------------------------|---------------|
| 1. Federal funds | \$9.3 billion |
| 2. Individual income tax | \$7.6 billion |
| 3. Sales tax | \$4.2 billion |

Three largest agencies (total funds):

1. Department of Health and Mental Hygiene \$10.1 billion

Includes \$7.3 billion in Medical Assistance (Maryland's Medicaid program for low-income families, children, and elderly and disabled residents), funded jointly with state and federal funds.

2. Department of Education \$7.2 billion

Includes \$6.9 billion in funding for local public schools.

3. University System of Maryland \$4.7 billion

\$1 billion represents state support. The remainder is funded from tuition and fees, research grants and contracts, and other revenues generated by the colleges and universities.

Three largest increases:

1. State Reserve Fund +\$325 million

This increase reflects the legal requirement to deposit most of the fiscal year 2011 surplus into the "Rainy Day Fund." The payment into the fund is mostly offset by a transfer of \$315 million out of the fund in fiscal 2013 to help balance the budget. The Rainy Day Fund will end fiscal 2013 with a balance of \$721 million, approximately 5 percent of state general fund revenues. This is the minimum target amount set in statute for the Rainy Day Fund.

2. Department of Health and Mental Hygiene +\$285 million

\$222 million of this increase relates to Medical Assistance. Other significant increases appear in services for individuals with developmental disabilities and AIDS drug rebate funding.

3. Department of the Environment +\$207 million

The increase reflects water quality projects funded from the Chesapeake Bay Restoration Fund (funded by the "Flush Tax") and other dedicated revenues.

Three Largest Decreases:

1. Department of Human Resources - \$146 million

The reductions reflect anticipated caseload declines and cuts in federal funds for assistance payments and foster care. The state must be prepared to restore funding in the event that the number of eligible recipients does not decline as much as projected.

2. Department of Housing and Community Development - \$54 million

The reduction is mostly from the loss of federal emergency homeowners' loan program funds from the budget.

3. Military Department - \$10 million

The reduction relates to a decrease in projected federal funding for National Guard facility maintenance and improvement projects.

How is the budget balanced?

The Governor faced a \$1 billion projected revenue shortfall in preparing the budget for fiscal 2013. The Governor's proposal uses a combination of cuts, revenues and transfers to resolve the shortfall. In doing so, he significantly reduces the projected shortfall in future years. However, the proposed reductions raise some serious concerns.

Cuts:

- Teacher pension shifts \$239 million

The largest single cut involves transferring \$239 million of the cost of teachers' retirement contributions to local governments. This additional local expense would be offset in fiscal 2013 by increases in local income tax revenues and an increase in the "disparity grant" for jurisdictions with low average incomes.

Local government budgets are themselves under extreme pressure at this time. Although state revenues are showing signs of a modest recovery, local revenues are now at their lowest point since 2007. They are low because property tax – the main source of local government revenues – takes longer to react to economic changes than do income and sales taxes – the state's main revenue sources. Education advocates are understandably concerned that the shift in funding responsibility for teacher retirement will ultimately result in less funding for public schools. If so, school systems serving lower-income communities could lose their hard-fought gains in student achievement from the last decade.

- Medical assistance \$211 million

The governor's budget claims savings of \$211 million in the Medicaid program. \$102 million will come from cutting or limiting rates for various healthcare providers: hospitals, outpatient clinics, and others. Another \$63 million is projected to come from realizing additional federal recoveries, improving management practices, and detecting more fraud and abuse. \$36 million will be cut by limiting inpatient

services for “medically needy” recipients – those whose medical expenses make them eligible for Medicaid. \$10 million is to be cut from Medicaid-funded mental health costs.

Reductions to services for mental health patients and medically needy recipients can result in those individuals losing needed treatments. Reductions in provider rates will gradually mean a loss of access to care, as more and more doctors, clinics, and other providers find they cannot afford to serve Medicaid patients.

- Local aid \$21 million

State assistance for local police, health departments, and community colleges are all held at the same level as the current fiscal year – cutting out annual increases prescribed by current law. Enabling legislation would amend the law to allow this maneuver.

Revenues

- Income Tax \$182 million

The Governor’s proposal raises income tax revenue by reducing the value of exemptions and deductions for the highest income tax filers. The changes would affect single filers making over \$100,000 and joint filers making over \$150,000. This is a fair and reasonable reform that cuts back on tax breaks for the taxpayers who need them the least.

- Sales Tax \$21 million

The Governor proposes to require some online sellers to collect sales tax from Maryland purchasers. The Internet retailing industry is no longer in its infancy and has no need for special treatment. In fact, companies that sell from both physical stores in Maryland and online—from small local businesses to national chains—already collect Maryland sales tax on internet purchases. This places these Maryland employers at a disadvantage. To fully remedy this outmoded and unfair situation Congress needs to take action. However, there are steps the state can take to require some online sellers to collect Maryland tax. This will help to level the playing field for Maryland employers and provide revenue needed to forestall damaging cuts.

- Tobacco tax \$19 million

The tax on cigars, smokeless tobacco, and pipe tobacco will be adjusted to match the tax on cigarettes. The tax on these products has not been increased since 1999, when the cigarette tax was 1/3 of its current level. Some tobacco companies have exploited this gap by marketing cigar and other non-cigarette tobacco products that appeal to young people.

- Other revenue provisions \$31 million

Among other proposals: eliminating tax exemptions for gold and silver coins and bars, coal mining, and telecommunications, and deferring a planned increase in lottery agent commissions.

Transfers

The budget is supported by \$431 million in transfers from special funds to the general fund.

- Rainy Day Fund \$315 million

This transfer retains approximately 5percent of general fund revenues in the Rainy Day Fund.

- Capital Programs \$99 million

State real estate transfer tax revenues are normally dedicated to the purchase of open space, recreational, and agricultural property. During the economic downturn, the state has diverted this funding to the general fund to offset revenue shortfalls, and used bond proceeds to fund the land preservation programs. The Governor proposes to continue this practice in fiscal 2013. The five-year capital plan envisions restoring the transfer tax funds to land preservation in fiscal years 2014 and 2015.

- Others \$17 million

The Governor proposes to transfer from reserve funds for biotechnology and sustainable community tax credit programs, and special funds for correctional enterprises, spinal cord research, various professional boards, nonprofit development and others.

Use of fund balance

The proposed budget draws down the state's general fund balance by \$122 million (from \$285 million at the start of the year to \$164 at the end). The fund transfers and the use of general fund balance total \$553 million in temporary measures. This amount will effectively produce the remaining structural imbalance that Maryland will need to address in future years.

Next steps

Budget Process

- The state constitution requires a balanced budget.
 - The Governor has-as required-presented a balanced budget to the legislature and the legislature must now work to enact a balanced budget.
- Maryland is the only state where the legislature, in most cases, cannot add to the budget proposed by the Governor.
 - The legislature may reduce the amounts proposed by the Governor, and may restrict the use of funds.
- The House of Delegates and Senate take turns each year in initiating action on the budget bill.
 - This year, it is the Senate's turn to take action first.
- The budget is referred to the Senate Budget and Taxation Committee and the House Committee on Appropriations.

- Over the course of the session, the committees will hold hearings on each agency's proposed budget. The budget committees divide into a number of subcommittees for this purpose.
- The Governor may propose any number of "supplemental" budgets after introducing the initial budget and before the legislature takes final action.
 - The balanced budget requirement also applies to proposed supplemental budgets.
- The budget bill becomes law upon passage by both houses of the legislature. It does not require the Governor's signature.
 - There is no veto power or item veto of the budget bill.
- If the budget is not passed by the 90th day of the session (April 9 this year), the Governor proclaims an "extended session" and no other business may be conducted except to complete action on the budget.
- The capital budget (bond authorizations) is a completely different process from the operating budget.
 - The legislature has much more flexibility with the capital budget.

Related legislation

- The Governor must propose separate legislation to raise revenues, transfer funds from special accounts, and alter funding formulas to realize his balanced budget plan. These bills will go through the regular legislative process.
- Traditionally, many of the legal provisions needed to balance the budget are packaged into a single bill called the "Budget Reconciliation and Financing Act," or "BRFA."
- The BRFA and any other budget enabling legislation will be assigned to committees and receive hearings. The legislature is likely to amend the bills and they will eventually face votes in the Senate and House of Delegates.
- In order for the legislature to enact a balanced budget, legislative committees will coordinate their decisions on this legislation with their budget decisions.

In early February, the Maryland Budget and Tax Policy Institute will publish the "Regular Person's Guide to the Governor's Fiscal Year 2013 Budget." This report will provide more detailed information on the overall budget and the budgets for the 8 largest state agencies.

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.

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