
Budget and Revenue Options

Presentation to the Commission on Maryland's Fiscal Structure

**Department of Legislative Services
Office of Policy Analysis
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Commission on Maryland's Fiscal Structure

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Chairman

November 15, 2002

Members of the Commission on Maryland's Fiscal Structure
Citizens of Maryland

As we all now understand, Maryland has entered a period of significant fiscal stress. This document was prepared at my request by the non-partisan staff of the Department of Legislative Services, Office of Policy Analysis. It provides a variety of staff concepts for reducing spending and increasing revenues to address the current fiscal problem. Its purpose is to serve as a stepping off point for public discussion of the most appropriate solutions to the current problem and, if nothing else, illustrates the difficult decisions that lie ahead for the Governor and the General Assembly. Be assured, however, that this report is no more than a starting point, and that the staff concepts reported do not reflect my position or the position of any of the commission members.

Sincerely,

Fred W. Puddester

**Potential Items for Balancing
the Fiscal 2003 General Fund Budget
(\$ in Millions)**

	<u>FY 2003</u>
Aid to Local Governments	
Unallocated reduction to local aid (administered through the local income tax)	\$90
Aid Subtotal	\$90
State Employees/Government	
No one-time bonus	\$24
1% reduction in employee salaries	15
Reduce grants	15
Increase prescription co-pays	5
Employees/Government Subtotal	\$59
Fund Transfers/Shifts	
Transfer FY 2002 and 2003 overattainment of and unencumbered transfer tax revenues	\$60
Transfer from the State's reserves for State employees workers compensation administered by the Injured Workers Insurance Fund (IWIF)	50
Highway user revenues over-estimate	10
Joseph Fund balance	8
Transfers Subtotal	\$128
Capital	
Recoup PAYGO capital	\$50
Capital Subtotal	\$50
Revenues	
Eliminate graduated withholding	\$45
Revenues Subtotal	\$45
Total Actions	\$372

**Potential Items for Balancing
the Fiscal 2004 General Fund Budget
(\$ in Millions)**

	<u>FY 2004</u>
Debt Service on State Bonds	
Reduce General Fund support for debt service	\$70.0
Debt Service Subtotal	\$70.0
Aid to Local Governments	
Unallocated reduction to local aid (administered through the local income tax)	\$100.0
Accelerate termination of funding for Teachers Salary Challenge (current law phases out all funding by FY 2006)	36.0
Eliminate or phase-out utility property tax grants	30.0
Freeze State payments for teachers retirement at FY 2003 level (local governments would be responsible for additional costs)	29.0
Freeze General Fund State aid for counties, community colleges, and health departments	12.0
1% reduction in General Fund State aid for counties, community colleges, and health departments	4.7
Aid Subtotal	\$211.7
Health/Entitlements	
Eliminate fee-for-service coverage of Medicaid ineligible mentally ill and fund a safety net system through grants to providers	\$20.0
Delay second year of developmental disabilities wage initiative	16.0
Develop a preferred drug list for Medicaid prescription drugs, require prior authorization for drugs which are not on the list, and seek supplemental rebates from manufacturers seeking to add their companies to the drug list	8.0
Reduce Medicaid managed care payments and delay a portion of the calendar 2003 increase until calendar 2004	6.0
Freeze temporary cash assistance rates at November 2002 levels	3.5
Entitlement Subtotal	\$53.5
State Employees	
No employee increments and no pay-for-performance bonuses	\$37.0
Abolish 1,000 positions	30.0
1% reduction in employee salaries	30.0
No deferred compensation match (was reduced from \$600 to \$500 in FY 2003)	13.2

Raise employee share of health insurance costs by five percent (e.g. from 15% to 20% for HMOs),effective January 2004 8.0

Eliminate out-of-state travel 2.3

Employees Subtotal \$120.5

State Agencies/Colleges and Universities

Level fund State colleges and universities \$38.0

Executive department reduction/consolidation - merge DBED and DHCD, merge DNR and MDA, merge Military and State Police, reduce funding for MDP and MHEC, and abolish OCYF and LMBs 35.0

Defer funding to reduce the State's unfunded liability for workers' compensation charges 20.0

Defer information technology projects 20.0

Liquidate the Maryland Housing Fund 20.0

Provide HOPE scholarships only for teaching candidates 7.0

Defer additional HOPE Scholarships 4.8

Defer Private Donation Incentive Program payments another year 4.7

No increase in substance abuse treatment (STOP) grants to counties 4.0

Use collective bargaining process to attempt to preserve service levels and quality through revision of work processes and staffing patterns in ways which improve productivity -- if the process is not effective in cooperatively resolving workforce issues, consider its repeal

Agency Subtotal \$153.5

Fund Transfers/Shifts

Fund Program Open Space and related programs with bonds -- shift remaining transfer tax revenues to GF \$47.0

Transfer from the State's reserves for State employees workers compensation administered by the Injured Workers Insurance Fund (IWIF) 20.0

Fund entire State Police Aviation Division and Maryland Emergency Management Agency through the Maryland Emergency Medical System Operations Fund (would eventually require a vehicle registration fee increase) 9.0

Transfers Subtotal \$76.0

Capital

No PAYGO capital (use taxable bonds if necessary) \$47.0

Capital Subtotal \$47.0

Total Actions \$732.2

**Potential Revenue Items for
Balancing the Fiscal 2004 Budget
(\$ in Millions)**

	<u>Annual Amount</u>
Personal Income Tax -- Rate	
Increase the top income tax rate to 6% for incomes over \$100,000, \$150,000 for joint returns	\$200.0
Rate Subtotal	\$200.0
Personal Income Tax -- Repeal Current Deductions	
Home mortgage interest deduction	\$355.0
Charitable contributions deduction	135.0
Real property tax deduction	105.0
Social Security benefits subtraction	70.0
Pension income subtraction	55.0
Deductions Subtotal	\$720.0
Corporate Income Tax*	
Provide for combined reporting and address other issues related to multi-state corporations	\$100.0
Increase the corporate income tax rate to 8%	57.0
Corporate Subtotal	\$157.0
Sales Tax -- General	
Increase sales tax rate to 6%	\$520.0
Eliminate sales tax vendor discount	22.0
Advance sales tax due date by one day	0.3
General Sales Subtotal	\$542.3
Sales Tax -- Taxation of Services	
Business services	\$600-\$700
Information services	325-385
Professional services	200-260
Transportation services	200-250
Financial services	150-230
Personal services	75-115
Repair services	50-80
Services Subtotal	\$1,600-\$2,020

Sales Tax -- Repeal Current Exemptions

Food for off-premises consumption (1% = \$56 million)	\$280.0
Residential sales of energy	145.0
Property used in manufacturing	115.0
Medical/health supplies	70.0
Sales to charitable, educational, or religious organizations	70.0
Sales for agricultural purposes	55.0
Exemptions Subtotal	\$735.0

Property/Transfer Taxes

Increase State property tax rate from 8.4 cents to approximately 14.4 cents to cover debt service	\$200.0
Enact controlling interests legislation for recordation and transfer taxes (House Bill 557 of 2002)	10.0 **
Property Tax Subtotal	\$210.0

Transportation Taxes -- Revenues

Increase the motor fuel tax by seven cents	140.0 ***
Increase the titling tax from 5% to 6%	99.0
Eliminate titling tax vendor discount	4.0
Use tire fee to support general environmental programs	2.0
Eliminate motor fuel tax vendor discount	1.4
Revenues Subtotal	\$246.4

Transportation Taxes -- Fund Transfers from the TTF

Credit corporate income tax revenues to the GF	\$95.0
Credit remaining sales tax revenues on vehicle rental revenues to the GF	20.0
Transfers Subtotal	\$115.0

Tobacco Tax

Increase the tobacco tax by 25 cents per pack	\$51.0
Eliminate tobacco tax wholesaler discount	2.0
Tobacco Subtotal	\$53.0

Health Taxes

Expand the insurance premium tax to HMOs (Senate Bill 10 of 2002)	\$40.0
Nursing home provider tax	33.0
Health Subtotal	\$73.0

Alcoholic Beverage Taxes

Double the alcoholic beverage tax rates	\$25.0
Alcoholic Beverage Subtotal	\$25.0

Tax Credits

Eliminate the Heritage Structure Rehabilitation Credit	\$50.0
Freeze the refundable earned income tax credit (EITC) at 16%	16.0 ****
Eliminate the Maryland-Mined Coal Credit	12.0
Credits Subtotal	\$78.0

Tax Administration

Accelerate collection of withholding taxes	\$14.0
Expand license clearance to DLLR, DNR, DHMH, MDE, and MVA	10.0
Require clearance before clerks issue business and other licenses	10.0
Streamline bank attachment process	10.0
Give Comptroller the authority to challenge transfer pricing for related corporations	10.0
Require withholding on out-of-state contractors	5.0
Allow Comptroller to limit withholding exemptions of tax delinquents to actual shown on prior year's return	5.0
Permit direct salary attachment for taxes other than income taxes	5.0
Lower the \$20,000 threshold for electronic funds transfer payments	2.0
Add 1% to the current minimum interest rate of 13%	2.0
Miscellaneous compliance activities for the Comptroller	2.0
Require withholding at racetracks	0.4
Administration Subtotal	\$75.4

Total Actions **\$4,830-\$5,250**

* 24% of the revenues would go to the TTF.

** \$32 million annually to local governments.

*** Assumes local distributions under the current formula and does not include increased bonding authority.

**** \$8 million reduction for fiscal 2004.

Video Lottery Terminals -- Considerations

- Number and location of video lottery sites
- Number of machines per location
- Average daily play per machine
- Prize payout to winners
- Ownership and administration of the machines
- Where the net proceeds go
- Impact on other gaming activities

Video Lottery Terminals -- Revenues

- It is estimated that up to \$800 million in annual revenues could be generated, after prize payouts and before any revenue distributions.
- This estimate assumes that four locations in the State would each have 2,500 video lottery terminals, with approximately 90% of gross proceeds paid out in prizes and an average daily revenue of \$217 per machine. It also assumes a 10% reduction in State lottery revenues.

Securitization of Tobacco Settlement

- To securitize means to issue bonds backed by the tobacco settlement payments
- Several states created special entities to securitize a portion of their future payments in exchange for an up-front lump sum payment. The proceeds have been used:
 - to fund special endowments;
 - to fund one-time expenditures; and
 - as a temporary supplemental funding source for ongoing operating expenses.

Issues Surrounding Securitization

- Higher Costs
 - Issuance costs and interest rates higher than GO
- Uncertain Revenue Stream
 - Payments fluctuate and may be insufficient for debt service
- View of Rating Agencies
 - Debt not counted but considered an indicator of financial management
- Determining a Minimum Rate of Return
 - Weighing future payments against current needs
- Use of Proceeds
 - Short-term fixes or long-term benefits

Scenario Review

Securitize 25% of Settlement Proceeds

	<u>Total Cash Flow</u>
No Securitization	\$3,824.1 million
Estimated Payments 2002 – 2023	
Securitization Proposal	
Net Proceeds from sale	\$ 355.3 million
Payments 2002 - 2023 (excludes debt service)	\$3,190.6 million
Total amount available	\$3,545.8 million
Payments foregone 2002 - 2023	\$ 633.5 million

How much the State realizes from a sale of bonds is subject to various estimates:

- 93 cents on the dollar (total available divided by no securitization)
- 56 cents on the dollar (proceeds divided by foregone payments)

Comparison of Debt Vehicles

Yields A Net Proceed of \$355 Million

	Tobacco Settlement Bonds	General Obligation Bonds
<u>Issuance Components</u>	<u>(\$ Millions)</u>	<u>(\$ Millions)</u>
Par Amount	\$ 423.8	\$ 355.2
Discount	(10.1)	*
Debt Service Reserve Fund	(41.2)	n/a
Capitalized Interest	(12.2)	n/a
Issuance Expenses	(5.0)	(.2)
Total Issuance Costs	\$ (68.5)	\$ (.2)
<u>Repayment Components</u>		
Interest Rate	6.7%	4.0%
Last Expected Payment	14 years	15 years
Average Annual Payment	\$ 45.3	\$ 32.7
Total Repayment Costs	\$702.1	\$490.9
Interest	\$278.3	\$135.7
Principal	\$423.8	\$355.2

* The State has received \$46.9 million in premiums from the last two bond sales.

Move Toward Real Results Based Management

- Develop legislative/executive consensus on
 - Missions of state agencies and programs
 - Measures of efficiency, quality, outcomes
- Develop performance goals for agencies and programs
- Develop a culture where performance matters
 - Devote necessary resources to collecting, analyzing and reporting data
 - Make managers accountable for results
 - Provide incentives for success
- Use performance information in decisions to
 - Expand, reduce, or eliminate programs
 - Revise or restructure agencies or programs
- Requires
 - Legislative participation and a statutory basis
 - Ongoing, hands-on Executive oversight of operations

Budget Process Improvements

- Convene an executive/legislative commission to study modernization of process
- Questions could include:
 - Should the Governor be expressly required to keep the budget in balance during budget implementation?
 - Should the legislature's power to mandate future appropriations be limited?
 - Should limits be put on the Governor's authority to introduce Supplemental Budgets?
 - Should the Governor's authority to initiate spending be shared with the legislature?