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THE WEEKLY WHIP

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This edition of the Weekly Whip is designed to help you answer questions about the structural deficit. The answers are neither short nor pithy – because the issue is complex. But we hope this document provides a comprehensive and user-friendly guide to the structural deficit.

Q: What is a structural deficit?

A: A structural deficit occurs when ongoing spending exceeds actual income. This occurs in one of two situations: (1) when the cost of maintaining programs grows faster than the State's income over a long period of time, or (2) when policy makers decide to reduce revenue or increase spending without making necessary adjustments to the other side of the ledger. Economic cycles have a direct impact on a structural deficit. For instance, the real estate boom increased State revenue, which temporarily closed the gap between spending and income and helped balance the budget in FY 2005 and 2006.

Q: I thought we ended the 2006 session with a $1 billion surplus. Where did the deficit come from?

A: Maryland's structural deficit has been 10 years in the making. A $600 million income tax cut in 1997, combined with $1.5 billion in increased education spending with the Thornton law left Maryland facing a $1.2 billion structural deficit as early as 2002. During the first years of Governor Ehrlich's term, the deficit was masked with tuition hikes, fee increases, spending cuts and raids on the Transportation Trust Fund and Program Open Space. In the final year of the term, the real estate boom caused an unexpected surge in State revenue, which created a one-time cash surplus. While this helped the State get through another fiscal year, nothing was done to address the ongoing gap between projected revenue and spending. In the 2006 *90 Day Report*, analysts noted: "The fiscal 2007 budget is balanced on a cash basis… However, a structural imbalance between ongoing revenues and spending persists and is projected to exceed the billion dollar level in the out-year forecast."

Q: What role did the legislature play in balancing the budget during the previous administration?

A: The legislature played a critical role in reducing spending during the previous administration, and in checking unrestrained spending growth in the final year of the term. The legislature cut over $1 billion from the State budget over four years and eliminated over 3,000 positions from the State workforce. In the final year of the term, over the objections of House Republicans, the legislature raised the minimum account balance of the Rainy Day Fund from 5% to 7.5%, increasing the State's cash balance by over $300 million in FY2007.

Q: How does the O'Malley administration's budget stack up against the previous administration?

A: Governor O'Malley's FY08 budget grew modestly compared to recent budgets. As introduced, it increased spending 2.5% over FY07, and had a lower growth rate than 9 of the last 10 budgets. The budget grew at a rate *below* the spending affordability limit set by the General Assembly. In addition to being fiscally realistic, the Governor funded Program Open Space and the Transportation Trust Fund, ensuring the money in these funds will be used for their intended purposes.

Q: When I talk to people, they want to know why we can't trim State spending to solve this problem. Why can't we?

A: The legislature has taken the lead in cutting State spending. The legislature cut over $1 billion from the State budget during the previous administration and eliminated over 3,000 positions from the State workforce. During the 2007 session, the legislature cut more than $225 million from the Governor's budget proposal and eliminated over 140 State jobs. After the 2007 session, the Governor and the Board of Public Works cut an additional $280 million from the State budget.

Q: I think those cuts are a good start, but aren't there more cuts to be made?

A: Yes. The Appropriations and Ways & Means Committees were briefed this summer on options for balancing the budget without revenue enhancements. The so-called "Doomsday Budget" included 70 potential cuts which would reduce the budget by $1.45 billion. The list included some common sense solutions to promote efficiency, such as re-bidding contracts and reducing administrative costs. Other recommendations were more onerous, and likely to jeopardize core services. Among other cuts, the list included cutting $184 million in retiree health benefits, cutting $44 million to the State Aid for Police Protection program, and eliminating the Aging Schools Program. Although the legislature must be mindful of reductions to core services, further cuts to the State budget will be a part of a comprehensive revenue solution.

Q: When I'm in Annapolis, I hear a lot of talk about the services government provides. When I'm at home in my district, I hear a lot of talk about wasteful spending. How does the State spend its money?

A: Education and Medicaid account for half of the general fund budget. The State's $14.6 billion general fund is divided between public education (35%), State agencies (33%), Medicaid (15%), higher education (8%), and other programs (9%). Of the money invested in State agencies, 32% goes to public safety, corrections and the judiciary, 29% goes to mental hygiene, developmental disabilities, and other health-related programs, and 12% goes to juvenile and social services.

Q: What role do spending formulas and mandates play in driving State spending?

A: Mandates play a major role in driving State spending. Altogether, funds with a mandated amount or purpose represent 79% of the State-sourced portion of the budget. Of the State's non-mandated spending, 67% is spent on higher education, public safety, and health programs in the FY08 budget. Over 90% of mandated spending in the general fund goes directly to local government or individual programs.

Q: How does Maryland's spending compare with other States?

A: Maryland spends less on its government programs than most states in the nation. According to the U.S. Census Bureau, Maryland ranks dead last in State spending as a percentage of State income, and 31st in State spending on a per capita basis. Maryland spends $6,810 per capita, $531 below the national average. Of our neighboring states, Delaware (6th), New Jersey (10th), and Pennsylvania (17th) all spend more on a per capita basis.

Q: What are the primary sources of Maryland's tax revenue?

A: Nearly 80% of the State's general fund revenue comes from the personal income tax (52%) and the sales tax (27%). Other major sources of revenue include business taxes (8%) and lottery revenue (4%).

Q: How does Maryland's tax burden compare with surrounding states?

A: Maryland's tax revenue is competitive with – and in many cases lower than – surrounding states. Adjusted for state income, Maryland's property tax revenue is 45th in the nation, property tax is 41st, and corporate income tax is 28th.

Q: There's a lot of talk about increasing the sales tax and expanding the base. How does Maryland's sales tax compare with surrounding states?

A: Maryland's sales tax is 5 cents – lower than New Jersey (7 cents), Pennsylvania (6 cents), West Virginia (6 cents) and the District of Columbia (5.5 cents), and several states allow local jurisdictions to levy a sales tax. Maryland's sales tax base is much narrower than surrounding states. There are a total of 168 services on which states could assess services. Of those 168, Maryland only taxes 39. Delaware taxes 143, West Virginia taxes 110, the District of Columbia taxes 70, and New Jersey taxes 55. Virginia only taxes 18 – but Virginia also taxes food.