COMPTROLLER *of* MARYLAND

Serving the People

Peter Franchot
Comptroller

Sandra L. Zinck, CPA
Director
General Accounting Division

August 28, 2019

The Honorable Peter Franchot
Comptroller of Maryland
Comptroller's Office
80 Calvert Street
Annapolis, Maryland 21404

Dear Comptroller Franchot:

Enclosed you will find the statement of General Fund Balance for the year ended June 30, 2019. In addition, you will find a schedule of General Fund revenues and an analysis of the variances between the 2019 estimated and actual revenues prepared by the Bureau of Revenue Estimates.

The State closed the fiscal year ended June 30, 2019 with a fund balance of \$974.2 million in the General Fund. Of this amount \$622.8 million was assigned by the 2019 General Assembly for fiscal year 2020 operations leaving an unassigned fund balance of \$351.4 million.

Please advise me if you have any questions or would like additional information.

Sincerely,

Sandra L. Zinck
Director

SZ:ma

Enclosure

cc: The Honorable David Brinkley
The Honorable Nancy Kopp
Ms. Victoria Gruber
Mr. Len Foxwell
Ms. Sharonne Bonardi
Mr. Andrew Schaufele

General Fund Balance
June 30, 2019

General Fund Balance, June 30, 2018		$	589,590,296
Add:			
2019 Estimated Revenues (Board of Revenue Estimates March 2019)			17,931,825,375
Adjustments to Revenues (See detail)			50,580,297
Reimbursement from reserve for Tax Credits			23,291,975
Deduct:			
2019 General Fund Appropriations			
Appropriated by 2018 General Assembly	$ 17,908,914,162		
Deficiency appropriations	52,079,072		
Legislative reductions (see detail)	(48,894,918)		
Estimated agency reversions	(35,000,000)		
Net appropriations			(17,877,098,316)
Estimated 2019 General Fund Balance			718,189,627
Add:			
Excess of Actual Revenues over estimates	216,633,130		
Excess of Actual Transfers over (under) estimates	(4,654,015)		
			211,979,115
Add:			
Excess of Actual Reversions over estimates			44,019,838
Total General Fund Balance			974,188,580
Deduct:			
General Fund Balance Reserved for 2020 Operations	718,234,627		
Minus 2020 Estimated Surplus	(95,485,196)		
			622,749,431
2019 Unassigned General Fund Balance		$	351,439,149

EXHIBIT A
GENERAL FUND BUDGET SUMMARY
Detail – Fiscal Year 2019

Adjustments to Revenues – Other	
Medicaid Settlement	$49,758,147
State Police Closeout Audit Credit	820,750
Chapter 141 of 2019 – MDTA Facilities – Video Tolls	1,400
Total	$50,580,297

Legislative Reductions	
MDH – Medicaid Provider Reimbursements	$(25,000,000)
State Reserve Fund – Economic Development Opportunities Account	(10,000,000)
DPSCS – Correctional Officer Salary Savings	(7,500,000)
MDH – Developmental Disabilities Administration	(3,894,918)
MSDE – Teacher Induction, Retention, and Advancement Pilot	(2,000,000)
DJS – Residential Per Diems	(500,000)
Total	$(48,894,918)

STATE OF MARYLAND
State Reserve Fund
June 30, 2019
(In Dollars)

	Revenue Stabilization Account (Rainy Day) A0101 (fund 0201)		Dedicated Purpose Account A0201 (fund 0202)		Economic Development Opportunity (Sunny Day) A0301 (fund 0203)		Catastrophic Event Account A0401 (fund 0204)		Total
Beginning Balance - July 1, 2018	$ 856,842,154.82		$ 500.00		$ 21,733,614.35		$ 4,985,629.28		$ 883,561,898.45
Investment Earnings	16,307,132.75								16,307,132.75
Replenishment	-				5,000,000.00				5,000,000.00
Distributions/Transfers	3,345,241.00	(a)	-	(b)	(15,000,000.00)	('c)	(2,441,707.85)	(d)	(14,096,466.85)
Ending Balance - June 30, 2019	$ 876,494,528.57		$ 500.00		$ 11,733,614.35		$ 2,543,921.43		$ 890,772,564.35

Source: DAFRG110 & DAFRG400.

(a) JBY01GAD 002	3,345,241.00	Transfer from General Fund per DBM Memo dated 02/07/2019.
(b) JB519Y01	6,000,000.00	General Fund transfer to fund 0002
(b) JTK00004	(6,000,000.00)	To DNR per BA 004-19.
('c) JBY01GAD 004	5,000,000.00	Transfer from General Fund per DBM Memo dated 02/07/2019.
('c) JTT00Y01	10,000,000.00	Transfer from General Fund per DBM Memo dated 07/10/2019.
(d) JT072718	45,954.41	From DHCD
(d) JTS00Y01	(2,500,000.00)	To DHCD Per BA 002-19.
(d) JT101818	4,166.65	From DHCD
(d) JT012319	8,171.09	From DHCD
Fund 0204 transfers	**(2,441,707.85)**	

COMPTROLLER of MARYLAND
Serving the People

Peter Franchot
Comptroller

Andrew Schaufele
Director
Bureau of Revenue Estimates

August 28, 2019

To: Honorable Peter Franchot
Honorable Nancy K. Kopp
Secretary David R. Brinkley

From: Andrew Schaufele
Director, Bureau of Revenue Estimates

Subject: Fiscal Year 2019 Revenues

General Fund (GF) revenues in Fiscal Year (FY) 2019 totaled $18.199 billion, an increase of 4.8% over FY 2018, and 1.2%, or $216.6 million, above the estimate. Excluding irregular distributions and transfers, revenues increased 6.3% from FY 2018.

Key Variances
($ in Millions)

Item	Dollar Variance	$ Variance Rank	Percent Variance	% Variance Rank
Total General Fund	216.6	NA	1.2%	NA
Personal Income Tax	207.7	1	2.4%	8
Insurance Premium Tax	75.1	2	7.8%	4
Sales Tax	-51.0	3	-1.0%	12

- Personal Income Tax
  - Increased Personal Income Tax (PIT) revenue resulting from the federal Tax Cuts and Jobs Act (TCJA) has been generally in line with our expectations.
  - Large capital gains realizations likely caused much of the over-attainment in the PIT
  - Income tax withholding growth was weaker than expected, reflecting lower than expected wage growth
- Corporate Income Tax (CIT) revenue exceeded the estimate by 7.8%. It is likely that either our estimated impact of the TCJA was too low or that corporations shifted sizable amounts of income into tax year 2018.

- Sales and Use Tax
    - Sales and Use Tax (SUT) growth was generally weak, at 3.6%
        - Revenue buoyed by revenue from remote sellers, without this revenue growth would have been just 1.9%
    - Demographic trends suggest this weakness will continue
    - Consumers' continued shift away from tangible goods consumption towards services and digital goods is evident in the shrinking tax base

Outlook

Growth in revenue at the levels we have just experienced is not expected to continue for two main reasons. First, much of the growth in FY 2019 is of a one-time nature, driven by tax planning incentives created by the TCJA as well as the systematic changes to the federal income tax that resulted in higher State tax bills for many Marylanders. Second, our forecast calls for underlying economic growth to slow. Economic growth has recently been buoyed by significant fiscal stimulus, the effect of which appear to be diminishing. Furthermore, the imposition of trade barriers is restraining aggregate demand. Concerning to Maryland in particular is the recent reduction in federal government jobs – our highest paying industry.

At 121 months through July, this expansion is already the longest in recorded US history. And while expansions do not die of old age, certain indicators suggest the probability of a recession in the near term is elevated. In the US, the unemployment rate has typically not stayed stable and low for long. A look at the history in the graph on the next page shows that once the rate stops falling, a recession is typically not far away. Over this time period, a recession has occurred around seven months after unemployment rate reached its minimum level for the expansion, though the minimum is only identifiable in retrospect. In this context the current expansion may be the longest because it took so long to return to full employment.

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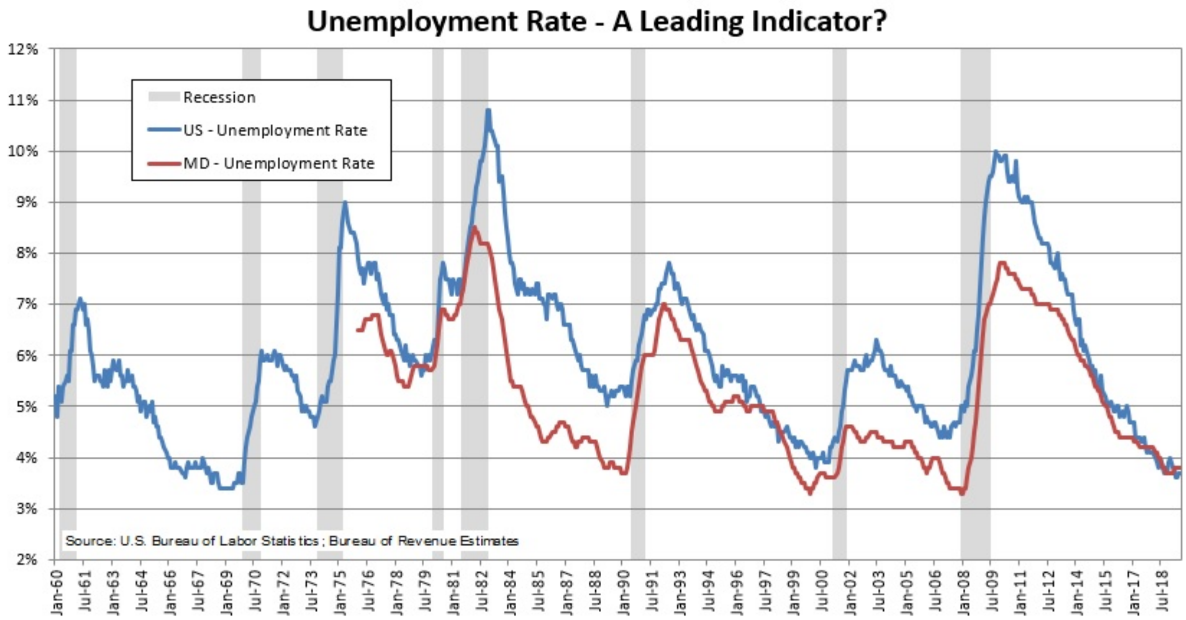

Another possible indicator is the yield curve (chart on next page), which charts interest rates from short to long term. It is typical in our history for the yield curve to be positively sloped – for short run rates to be lower than long run rates. Recently the curve has "inverted", meaning short rates exceeded long rates, as displayed below by the interest rate spread on 3-month to 10-year bonds. Leaving aside the most recent inversion, an inversion of these rates has happened 9 times since 1960, with a recession following 8. Since 1960, there has not been a recession without a prior inversion in the US. On average, and ignoring the false alarm in the 1960s, a recession has begun about 11 months after the bond spread has gone negative.

Looking at rich countries other than the US, the yield curve is not a reliable a predictor of recessions, but remains a predictor of *slowing* growth. And slowdowns often turn into recessions. These leading indicators are simple correlations; a low unemployment rate or inverted yield curve does not *cause* a recession. But given their track record in the US, while nothing is inevitable, it would be prudent to plan for a slowdown at best and a recession at worst.

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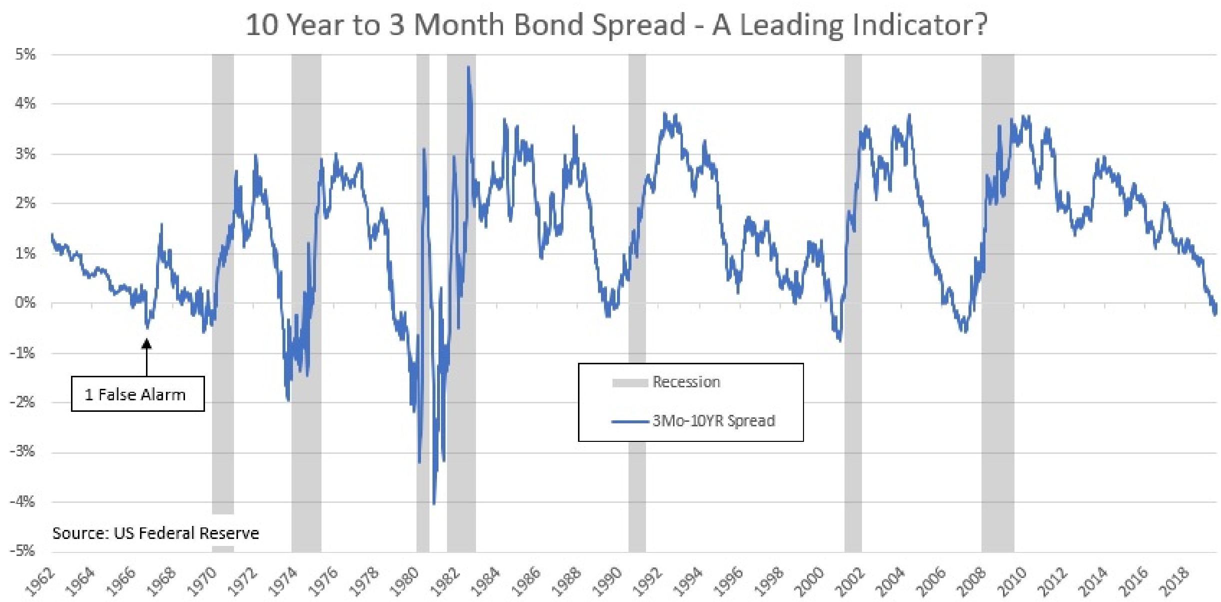

Personal Income Tax

$10.272 billion was collected through the PIT in FY 2019, 2.1% higher than the most recent estimate. This corresponds to 8.0% growth from the prior fiscal year. This unusually high rate of growth was driven by higher final payments and lower refunds.

The TCJA increased the federal standard deduction, which resulted in more taxpayers taking the standard deduction rather than itemizing deductions (see chart on next page). State law requires that if a taxpayer takes the federal standard deduction they must also take the State's standard deduction. On average, taxpayers who itemize at the State level pay a lesser share of their income in PIT than those who take the standard deduction. As a result, the average taxpayer who switched from itemized deductions to the standard deduction paid more in state PIT. In prior years about half of Maryland taxpayers took itemized deductions, in TY 2018 only a quarter did.

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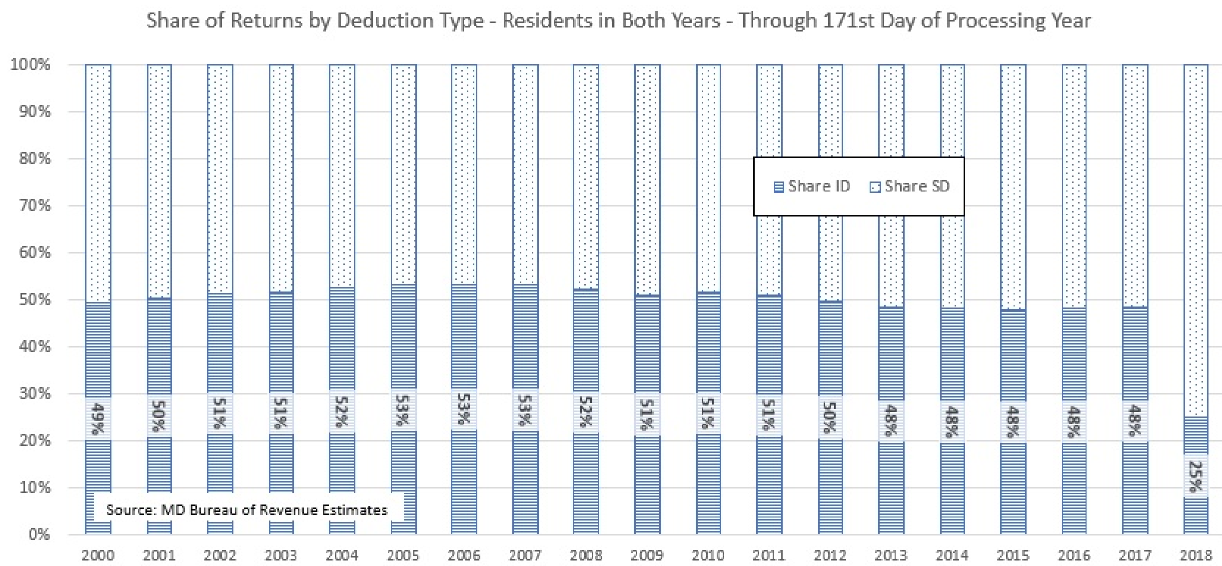
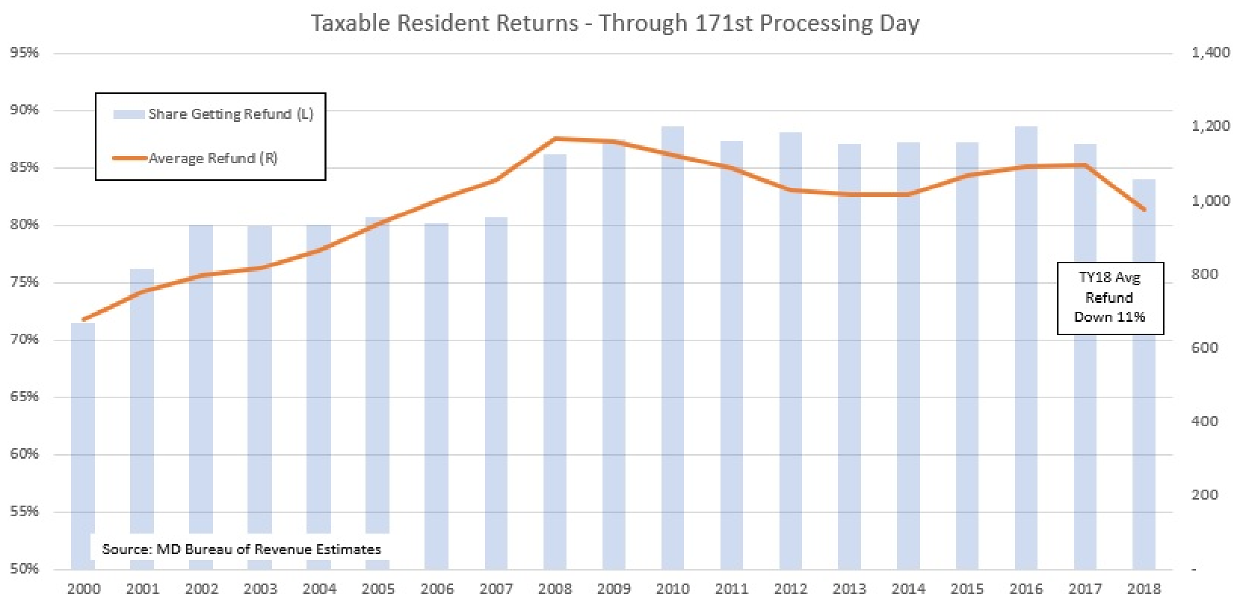


Generally, switching to the standard deduction meant lower refunds or sometimes a final payment for those taxpayers.



The increase in taking the standard deduction is likely to be ongoing. However, the timing of revenue collections, and their realization through final payments / refunds is likely to adjust to the new reality. For example, taxpayers may become more aware that the tax minimizing deduction option at the federal level depends not just on the impact on their federal liability, but on their overall State and federal liability. Additionally, taxpayers who typically receive a refund but ended up owing a final payment this year, or who came close to owing, may adjust their withholding to avoid that outcome. In such a case revenue would come in earlier in the year through withholding. These behavioral changes will be difficult to accurately predict.

All in all, the Bureau's estimate of the revenue impact of the TCJA in the 60 Day Report has held up well. But the exact timing of revenue realizations has been complex. In addition to the above factors, the TCJA created an incentive for individuals to pull expenses forward, thus reducing a greater federal tax liability under the pre-TCJA law, and push income outward, to be taxed at a lower rate. Wealthier taxpayers generally have a greater ability to adjust the timing of expense and income realizations. This has temporarily increased the volatility of tax collections for a given amount of underlying income growth.

The TCJA explains much of the significant growth in PIT revenue but, as it was expected, does not explain the over-attainment. The size of the over-attainment suggests that it is driven by non-wage income gains, particularly capital gains. We do not yet have data on capital gains for TY 2018. But we do know how much overall taxable income was up, and withholding data offers a good proxy for wage income growth. As a result, we estimate that capital gains were up 25 to 45% in TY 2018. This range means capital gains are approaching levels last achieved in 2007. That comparison alone should drive home the point that this rate of growth is not sustainable.

Income tax withholding growth finished close to, but under, the estimate. Employment growth in TY 2018, of 0.8% was in line with expectations. The under-attainment was therefore driven by lower than expected wage growth. Both wage and employment growth has occurred more so at the bottom of the wage distribution. Put another way, the job mix of our labor market is shifting, with lower wage industries accounting for more of total employment. The industries with fastest job growth pay an average wage below that of the statewide average. That such industries are growing is not bad news in and of itself, rather the problem is that employment growth in highest wage industries shrank in TY 2018 (see chart on next page).

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Employment Growth & Wages -- State of Maryland

Growth Factor Rank	Industry	(a) 2018Q4 YTD Employment Growth	(b) 2018Q4 YTD Share of Total	= (a) * (b) Growth Factor	2018Q4 YTD Average	Average Wage Rank
	Total	0.9%	100.0%	0.9%	61,175	
1	Education & Health Services	2.1%	16.6%	0.347%	54,296	9
2	Professional & Business Services	2.0%	16.9%	0.340%	79,487	4
3	Manufacturing	2.7%	4.1%	0.110%	78,926	5
4	Local Government	0.9%	9.1%	0.085%	57,516	8
5	State Government	2.0%	3.7%	0.074%	58,304	7
6	Leisure & Hospitality Services	0.6%	10.5%	0.065%	24,036	13
7	Construction	0.6%	6.1%	0.039%	65,892	6
8	Other Services	0.3%	3.4%	0.011%	43,236	11
9	Trade, Transportation, & Utilities	0.1%	17.3%	0.010%	46,653	10
10	Natural Resources & Mining	0.2%	0.2%	0.001%	43,101	12
11	Information	-3.6%	1.4%	-0.049%	92,839	3
12	Federal Government	-1.2%	5.4%	-0.064%	105,797	1
13	Financial Activities	-1.4%	5.2%	-0.074%	94,207	2

Sources: U.S. Bureau of Labor Statistics, M.D. Department of Labor, Licensing, and Regulation, Bureau of Revenue Estimates
Note 1: Average Wage is Annualized

The information sector likely shrank due to Discovery moving its headquarters out of Maryland. The government sector shrank due to cuts to direct federal employment. Year over year growth in federal employment has been negative in both Maryland and Washington, D.C., where many Marylanders work, for well over a year (see chart on next page). On the plus side, the Professional and Business Services industry, our 4th highest wage industry, grew the 2nd fastest. This industry includes many of our federal contractors, whose employment is growing and thus offsetting some of the decrease in direct federal employment. As a result of the changing job mix, we now experience lower aggregate wage growth, and therefore withholding collections, per job created.

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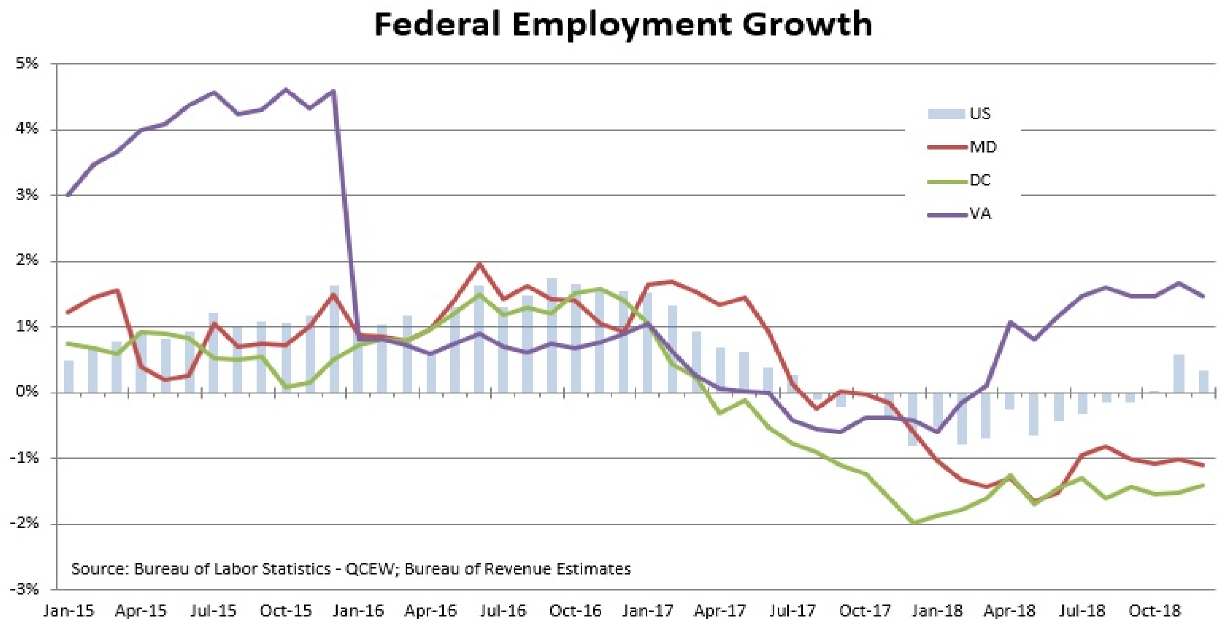

Further restraining wage growth is the age demographic transition in the United States as laid out in the Bureau's 2017 report. Data suggests that more of the baby-boomer generation have been retiring over the last several years. This coincides with better home prices and a high valuation for the stock market. Experience and seniority tends to be rewarded with higher wages. Replacing those workers with less experienced workers results in a "churn," where even with employment unchanged aggregate wages may decline because the average wage of workers has fallen.

Corporate Income Tax

$1.033 billion in GF revenue was collected through the CIT in FY 2019, 7.8% higher than the estimate. This corresponds to 25.9% growth from FY 2018. We attribute the over-attainment to factors relating to the TCJA. The same income shifting incentives exist for corporations as do for individuals, and corporations are generally able to shift the realization of costs and revenues to a greater extent than individuals. Furthermore, at the time of the 60 Day Report, and resulting adjustments to our CIT forecasts, there was, and still is, considerable uncertainty surrounding definitions and regulations concerning the treatment of certain income by the IRS.

Clearly, while we expected significant growth in the CIT, it may be the case that our estimate of the TCJA's impact on the CIT was conservative. However, we have much less data and information on which to base such estimates than for the PIT. Because of income shifting incentives, much of the elevated rate of growth will be one-time in nature. Put another way, at this time, we do not expect the full amount of FY 2019's over-attainment to be ongoing.

Sales and Use Tax

$4.812 billion was collected by the SUT in FY 2019, 1.0% below the estimate. This corresponds to just 3.6% growth from FY 2018. It is important to note that following the Supreme Court's decision in *South Dakota v Wayfair, Inc* and the Comptroller's subsequent promulgation of emergency regulations, the State began collecting sales tax from remote sellers who hadn't met the prior definition of having economic nexus with the State in FY 2019. This boosted SUT growth compared to FY 2018, which remote sellers were not taxable. Revenue from these remote sellers was $80.0 million in FY 2019, modestly above our initial estimate of $69.0 million. Without this additional revenue, year over year SUT growth would have been just 1.9%

Slowing wage growth also contributes to subdued consumption growth, particularly since consumption typically increases less than income in response to a wage increase. As mentioned above, Maryland's three highest wage industries contracted in TY 2018, which serves to subdue consumption growth as well as income tax withholding. Age demographic trends also contribute to slow growth of the SUT. Past middle age, average income, and therefore consumption, declines, and consumers tend to shift away from spending on taxable goods towards tax exempt services, especially out-of-pocket health care costs.

Federal policies also have a significant impact on State SUT collections. In early 2018, following the passage of the TCJA, the IRS adjusted federal withholding tables with the result of reducing federal income tax withholding. This gave consumers marginally more money per paycheck, which appears to have boosted spending on taxable goods at the time. The flip-side of this action was that taxpayers would get lower refunds than would have otherwise been the case. Tellingly, SUT revenue growth weakened around tax season towards the end of FY 2019. While these actions made no difference in the amount taxpayers would ultimately owe on net, they changed the timing of consumption and therefore tax collections across fiscal years.

Lastly, the structure of the SUT – namely that it is a tax on consumption of tangible goods and a few select services – is increasingly out of step with consumption patterns. Household consumption spending is shifting away from goods towards services, the vast majority of which are not taxable. Furthermore, consumers continue to transition to digital goods, which are not tangible and therefore not taxable, implying that the base for traditional goods continues to contract as well. This means the SUT tax base is becoming a smaller share of consumption spending. As a result, we collect less SUT per dollar of consumption than in the past. The shrinking tax base increases the volatility of SUT revenue to the business cycle. In times of economic stress, consumers are better able to delay or forego consuming goods than services. The impact of these structural problems will only continue to increase with time.

Actual and Estimated General Fund Revenue
Fiscal Year 2019

	Fiscal Year 2019				Fiscal Year 2018		
			Difference from Estimate			Growth FY 18 - FY 19	
	Actual	Estimated [1]	$	%	Actual	$	%
INCOME TAXES							
Individual	10,272,351,915	10,064,623,201	207,728,714	2.1%	9,507,776,217	764,575,698	8.0%
Corporation	1,033,109,278	958,047,962	75,061,317	7.8%	820,401,157	212,708,121	25.9%
Total	11,305,461,193	11,022,671,163	282,790,031	2.6%	10,328,177,374	977,283,819	9.5%
SALES AND USE TAXES	4,812,089,855	4,863,055,776	(50,965,921)	-1.0%	4,645,755,937	166,333,919	3.6%
STATE LOTTERY RECEIPTS	552,375,064	544,454,488	7,920,576	1.5%	534,598,098	17,776,967	3.3%
OTHER REVENUES							
Business Franchise Taxes	245,064,807	242,553,299	2,511,508	1.0%	245,945,748	(880,941)	-0.4%
Tax on Insurance Companies	335,168,061	377,456,295	(42,288,234)	-11.2%	386,427,178	(51,259,117)	-13.3%
Estate and Inheritance Taxes	180,439,693	177,371,918	3,067,775	1.7%	214,383,030	(33,943,337)	-15.8%
Tobacco Tax	356,696,875	372,350,354	(15,653,478)	-4.2%	372,735,070	(16,038,195)	-4.3%
Alcoholic Beverages Excises	32,534,251	32,432,219	102,032	0.3%	32,031,841	502,410	1.6%
District Courts	59,858,584	58,671,409	1,187,175	2.0%	62,990,048	(3,131,463)	-5.0%
Clerks of Court	30,204,423	31,860,829	(1,656,406)	-5.2%	31,764,976	(1,560,554)	-4.9%
Hospital Patient Recoveries	64,296,997	56,171,150	8,125,847	14.5%	69,802,699	(5,505,702)	-7.9%
Interest on Investments	50,239,933	45,000,000	5,239,933	11.6%	32,001,272	18,238,661	57.0%
Miscellaneous	374,609,065	358,356,773	16,252,292	4.5%	354,513,396	20,095,669	5.7%
Total	1,729,112,689	1,752,224,245	(23,111,556)	-1.3%	1,802,595,258	(73,482,569)	-4.1%
TOTAL CURRENT REVENUES	18,399,038,802	18,182,405,672	216,633,130	1.2%	17,311,126,667	1,087,912,135	6.3%
Extraordinary Revenues [2]	0	0	-	#N/A	15,336,944	(15,336,944)	-100.0%
Transfer Tax Revenues [3]	0	0	-	#N/A	46,028,000	(46,028,000)	-100.0%
Excellence in Education Fund [4]	(200,000,000)	(200,000,000)	-	0.0%	-	(200,000,000)	#N/A
GRAND TOTAL	18,199,038,802	17,982,405,672	216,633,130	1.2%	17,372,491,611	826,547,191	4.8%

[1] The 2019 Legislative Session resulted in an additional $50.580 million in estimated revenues beyond the March 2019 official estimate; this table has been adjusted accordingly

[2] The 2017 BRFA diverted VLT revenue dedicated to the SMWOB Account to the General Fund for FY 2018. In FY 2019 and 2020, that money will be distributed to the Education Trust Fund

[3] The Tax Property Article §13-209 has been been altered across several legislative sessions so as to provide various distributions to the general fund

[4] The 2018 BRFA diverted $200M from individual income tax revenues to the Commission on Innovation and Excellence in Education Fund

Bureau of Revenue Estimates, August 28, 2019