2024 Spending Affordability Committee Report and Recommendations to the Governor and the Legislative Policy Committee

The Spending Affordability Committee (SAC) was created in 1982 (Chapter 585). The committee is composed of equal numbers of senators and delegates and includes the Presiding Officers, the majority and minority leaders, the chairs of the fiscal committees (or their designees), and other members appointed by the Presiding Officers. A citizen advisory committee assists the committee.

The committee's primary responsibility is to recommend to the Governor and the General Assembly a level of spending for the State operating budget that is reflective of the current and prospective condition of the State's economy. Historically, this has been in the form of a recommended growth limit. More recently, however, the structural budget gap has been the focus of the committee's recommendations. The full list of the committee's prior recommendations and legislative action on the operating budget are reflected in the table in **Appendix 1**. Since the committee's inception over 40 years ago, its recommendations have been adhered to by the legislature in all but 1 year.

The committee's statutory responsibility is to consider spending in relation to the State's economy. In determining its recommendations, the committee has considered economic performance, revenue estimates, and current and future budget requirements.

Economy

After a deep but relatively brief recession resulting from the COVID-19 pandemic, the U.S. economy has recovered and experienced sustained growth in the last two years with inflation-adjusted gross domestic product increasing 2.9% in calendar 2023 and 2.9% in the first three quarters of 2024. The average annual growth rate in the five years prior to the pandemic (2014 to 2019) was 2.6%. Nationally, employment exceeded the prepandemic level in June 2022, and the economy added 6.9 million jobs between June 2022 and November 2024, a 4.6% increase.

In Maryland, the impact of the recession was similar to the country as a whole. Maryland's inflation-adjusted gross state product fell 8.9% between the fourth quarter of calendar 2019 and the second quarter of calendar 2020. Maryland exceeded the prepandemic peak in the fourth quarter of 2021, just three quarters after the United States achieved that milestone. The labor market, however, has been a different story. Although the U.S. economy attained the prepandemic level of jobs by summer 2022, Maryland has yet to achieve that goal as of fall 2024.

Employment growth for calendar 2024 has been very weak according to the monthly data from the Current Establishment Survey (CES), up just 0.3% through October with private-sector jobs falling 0.1%. However, data from the Quarterly Census of Employment and Wages (QCEW), available through June, shows much stronger growth of 2.0% for total employment and 1.8% for the private sector. By contrast, the CES data through June shows Maryland employment up just

0.1% and the private sector down 0.5%. The QCEW data is more consistent with data on wage growth, which was up 6.6% in calendar 2024 through June.

In September, the Board of Revenue Estimates (BRE) issued a revised economic forecast for Maryland, its first since March 2024. BRE estimated that employment growth of 1.2% in calendar 2023 will slow to 0.4% in calendar 2024 and 2025. Employment growth slows to just 0.1% in calendar 2026 and 2027 due to low population growth and an aging workforce. Wage growth slows to just under 4.0% per year, consistent with the prepandemic trend. In December 2024, BRE revised upward their estimate of personal income growth in calendar 2024 due to revisions and new data for the second quarter. The economic forecast beyond 2024 was little changed in December.

Revenues

Fiscal 2024 general fund revenues exceeded the estimate by $217.2 million, or 0.9%. General fund revenues totaled $24.9 billion in fiscal 2024, an increase of 5.0% over fiscal 2023, reflecting a one-time transfer in 2023 of $800 million to the Blueprint for Maryland's Future Fund. In fiscal 2024, ongoing revenues grew 1.0% over fiscal 2023.

Among the major revenue sources, the personal income tax was below the estimate by $79.7 million, or -0.6%. The sales tax was just slightly below the estimate ($13.1 million, or -0.2%), and the corporate income tax exceeded the estimate by $130.5 million (7.4%). The State lottery was over the estimate in fiscal 2024 by $5.6 million (0.9%). Among other sources, there was substantial overattainment for the tax on insurance premiums, interest on investments, and miscellaneous revenues, but estate/inheritance tax and tobacco and alcohol tax revenues were below expectations. Combined, the other revenue sources were over the estimate in fiscal 2024 by $173.8 million (7.0%).

In September 2024, BRE increased its estimate for fiscal 2025 general fund revenues by $88.4 million, or 0.4%. Total general fund revenues were projected to increase by 0.8% in fiscal 2025, reflecting a one-time transfer in fiscal 2024 of $150 million from the Local Income Tax Reserve Account to the General Fund. Ongoing revenues were forecasted to grow 1.4% in fiscal 2025 and 2.1% in fiscal 2026.

In December, BRE increased the estimate for fiscal 2025 general fund revenues by $194.5 million, or 0.8%. Most of the revision was due to an increase in the personal income tax estimate of $160.9 million (1.1%). The corporate income tax and sales tax were also revised up, but there was a substantial downward revision to the estimate for tobacco tax revenues. Fiscal 2025 revenues are projected to increase 1.6% in total and by 2.2% for ongoing revenues.

Despite the upward revision to the personal income tax in fiscal 2025, BRE chose not to change the estimate in fiscal 2026. This was due to uncertainty regarding the federal budget, tax, and economic policies of the incoming presidential administration. Of particular concern would be major reductions to federal spending and the federal workforce, which could have a significant negative impact on the Maryland economy. Therefore, BRE thought it prudent to leave the personal income tax estimate unchanged in fiscal 2026. As a result, total general fund revenues in fiscal 2026 were revised up by just $67.8 million (0.3%).

Budget Requirements

Taking into consideration the revenue projections by BRE in December 2024, the committee projects a cash shortfall of $396 million at the close of fiscal 2025. The cash shortfall represents a change in circumstance from the $1.0 billion balance at the close of fiscal 2024. The shortfall results from substantial anticipated general fund deficiency appropriations totaling $1.42 billion, which include $372 million related to prior year expenses with Medicaid bills from prior years representing the largest item. The remaining $1.05 billion in anticipated general fund deficiencies relates to projected shortfalls in fiscal 2025. The largest projected deficiency is to pay provider reimbursements in the Developmental Disabilities Administration ($350 million), which were understated due to erroneous budget assumptions. Additional anticipated deficiency appropriations exceeding $100 million support:

- Medicaid and Medicaid-eligible behavioral health provider reimbursements ($301 million) driven by higher than anticipated enrollment, utilization, and acuity;

- child care scholarships ($155 million) due to the continuing impacts of statutory and departmental policy changes that altered eligibility and reimbursement rates; and

- inmate medical contracts ($107 million), as the final contract amounts were not known at the time of the budget development.

The baseline estimate for fiscal 2026 projects general fund spending will increase by $1.24 billion compared to the fiscal 2025 legislative appropriation after adjusting for anticipated deficiencies. The fiscal 2026 general fund ending balance is projected to be a shortfall of $2.95 billion, after accounting for a transfer of $70.2 million from the Revenue Stabilization Account (Rainy Day Fund) representing the amount over 10% of general fund revenue. The significant general fund spending increase reflects $507 million of increased spending related to entitlements, driven primarily by Medicaid and Medicaid-eligible behavioral health provider reimbursements ($455 million). In addition, the baseline anticipates $469 million in appropriations to the Reserve Fund, including $419.5 million for the required appropriation to the Rainy Day Fund and $50 million of required appropriations for the retirement system and other postemployment benefits. Spending on local aid increases by $221.5 million, driven primarily by retirement costs.

State agency costs are projected to increase by $612 million. The largest increase in State agency spending supports an increase in compensation costs ($172 million) and certain other fringe benefits including pension and health insurance costs ($110 million). Compensation changes include the anticipation of a 2% cost-of-living adjustment for State employees, step increases, and the annualization of certain fiscal 2025 increments. Additional significant increases include Major Information Technology Development projects ($155 million) and the child care scholarship program ($103 million). These increases are partially offset by a decrease of $150 million related to one-time operating support for the Washington Metropolitan Area Transit Authority.

The committee budget forecast assumes that the State will close fiscal 2026 with a balance of $2.5 billion in the Rainy Day Fund, which represents 10.0% of general fund revenues.

As previously noted, current baseline projections estimate the General Fund to have a cash shortfall of $396 million at the close of fiscal 2025 and $2.95 billion at the close of fiscal 2026. The structural shortfall in fiscal 2026 is projected to be $2.47 billion. As shown in **Exhibit 1**, which provides the cash and structural balance projections for the General Fund through fiscal 2030, the cash outlook worsens over time with a cash shortfall of $6.28 billion in fiscal 2030. The structural shortfall increases to $2.88 billion in fiscal 2027 before increasing substantially in the out-years, reaching $4.83 billion in fiscal 2028, $5.36 billion in fiscal 2029, and $6.06 billion in fiscal 2030. Both the cash and structural shortfalls increase beginning in fiscal 2028, due to the need for general funds to support costs related to the Blueprint for Maryland's Future. The general fund need for these costs increases from $185 million in fiscal 2027 to $2.1 billion in fiscal 2028, increasing further to $3.4 billion in fiscal 2030.

Exhibit 1

General Fund Budget Outlook

Fiscal 2025-2030 Est.

($ in Millions)

	Working Appropriation 2025	Est. 2026	Est. 2027	Est. 2028	Est. 2029	Est. 2030
Cash	-$396	-$2,950	-$3,100	-$5,045	-$5,575	-$6,276
Structural Balance	-1,071	-2,474	-2,882	-4,827	-5,357	-6,058

Note: Estimates assume a Rainy Day Fund balance of 10% of general fund revenues.

Recommendations

In light of the considerations discussed earlier, the committee proposes the following recommendations for the 2025 session:

1. Operating Budget Spending Limit and Sustainability

A structural deficit of $2.5 billion is forecast for fiscal 2026 and is projected to increase to $6.0 billion by fiscal 2030. Cash shortfalls are expected to grow from $3.0 billion in fiscal 2026 to $6.3 billion by fiscal 2030. Maryland's budget challenges are exacerbated by uncertainty about the policy changes President-elect Trump and the new Congress may implement. The State's current revenue and spending forecasts do not assume any positive or negative impact on the Maryland economy or the availability of federal funds from changes in federal policy.

While the State has significant cash reserves and can take one-time actions to reduce the projected fiscal 2026 cash deficit, these one-time actions alone will not resolve the projected shortfall. Aligning long-term revenues and spending will require limiting spending and increasing revenue. These actions must be accompanied by strategies to stimulate growth in Maryland's private-sector workforce and productivity, which have experienced sluggish growth since 2017.

In recognition of this outlook, the committee recommends that the fiscal 2026 budget, as introduced and enacted:

- **erase the projected $2.5 billion gap between ongoing general fund revenues and ongoing spending in fiscal 2026; and**

- **improve the outlook for fiscal 2028 so that ongoing revenues will support at least 94% of projected ongoing spending. Achieving this goal may require adjusting spending growth associated with mandates, entitlements, and other long-term commitments to better align with available revenues.**

2. Fund Balances

After assuming the transfer of funds in excess of 10% of general fund revenues from the Rainy Day Fund, it is anticipated that there will be cash shortfalls of $299 million and $2.7 billion at the close of fiscal 2025 and 2026, respectively. Reducing the Rainy Day Fund balance below 10% would assist the State in resolving the deficits in the short term but is insufficient to fully resolve the fiscal 2026 deficit. In light of current economic uncertainties, it is prudent to retain a healthy fund balance so that funds remain available in the event of a recession or federal actions that harm the Maryland economy. **Before considering drawing on the Rainy Day Fund, opportunities should be explored to (1) better align ongoing spending with ongoing revenues and (2) achieve one-time budgetary savings. The committee recommends:**

- **maintaining a Rainy Day Fund balance of <u>at least</u> 7.5% of general fund revenues to ensure resources are available to mitigate the impact of an economic downturn and/or federal actions that harm the Maryland economy; and**

- **a minimum ending balance of at least $100 million in the General Fund for fiscal 2026.**

3. Capital Budget

A. General Obligation Debt

In its 2024 report, the Capital Debt Affordability Committee (CDAC) recommended keeping annual general obligation (GO) bond authorizations at $1.75 billion in fiscal 2026 and through the five-year planning period, which is consistent with the amount planned by CDAC last year and with the amount programmed in the 2024 *Capital Improvement Program* (CIP). However, in its 2023 recommendations, SAC recommended the annual level of authorizations be increased by 2% annually as a hedge against inflation. If the 2% annual growth policy were adopted, the fiscal 2026 authorization level would be $1.785 billion, which is $35 million higher than the amount recommended by CDAC. Over the five-year planning period from fiscal 2026 through 2030, the 2023 SAC recommended authorizations would total $530 million greater than the CDAC recommendation.

The committee recommends the authorization of $1.750 billion in new GO bonds for the 2025 session. For planning purposes, the level of authorizations should remain at the CDAC-recommended level of $1.750 billion from fiscal 2027 through 2030.

The committee is concerned that potential reductions in the federal workforce and other actions by the President-elect may lead to a significant revenue write-down in March. If the Board of Revenue Estimates writes revenues for fiscal 2025 and 2026 down by a cumulative amount of at least $400 million, the General Assembly is authorized to increase the GO bond authorization for the 2025 session to as much as $2.000 billion. Any authorization above $1.750 billion may only be used to replace general fund pay-as-you-go appropriations from prior years and thereby provide one-time cash resources to help offset the shortfall caused by the revenue write-down. Both a $1.750 billion and $2.000 billion limit keep the State well within the CDAC debt affordability criteria, which limit debt service to 8% of State revenues and debt outstanding to 4% of State personal income.

The committee also recommends that the capital plan continue to make strategic capital and operating investments in facility renewal for State facilities managed by the Department of General Services and higher education facilities to reduce the backlog of projects and improve the condition of State facilities.

B. Higher Education Debt

The University System of Maryland (USM) intends to issue up to $30 million in academic debt for fiscal 2026, which is the same amount authorized in fiscal 2025 and is consistent with the amount programmed in the 2024 CIP for fiscal 2026. This level of issuance will result in a debt service ratio within the 4.5% of current unrestricted funds and mandatory transfers criterion recommended by the system's financial advisers.

The committee concurs with the recommendation of CDAC that $30 million in new academic revenue bonds may be authorized in the 2025 session for USM. USM should consider focusing the additional revenues to address facility maintenance needs.

4. State Employment

Personnel costs comprise approximately 18% of the State's operating budget. The committee anticipates a net increase of 468 positions in the fiscal 2026 budget compared to the fiscal 2025 legislative appropriation. This is comprised of 208 positions added in higher education, 243 new positions in the Executive Branch, and 17 new positions in the Judiciary. The resulting authorized number of State employees would be 86,047 in fiscal 2026.

The Executive Branch currently has a vacancy rate of 10.4% with 5,347 Executive Branch vacancies in October 2024, excluding higher education. While the number of vacant positions is still relatively high, there are approximately 2,300 more filled positions than there were at this time last year.

The committee recommends that that State fill existing positions within the limitations of the State's fiscal condition, prioritizing its most critical vacancies such as those that provide health, public safety, and other essential services. New activities requiring additional personnel, including the operation of new facilities and the implementation of new programs and agencies, should be prioritized in the same manner.

5. Transportation

The target closing balance for the Transportation Trust Fund (TTF) is intended to ensure that the Maryland Department of Transportation (MDOT) has sufficient working cash to administer its operating and capital programs. System preservation spending is necessary to maintain or bring capital assets into a State of Good Repair (SOGR), which is where assets are performing as designed, and the chance of breakdowns is small. MDOT's most recent calculation of the SOGR funding needs and the amount of programmed and projected funding identified a 10-year gap of $11.2 billion. **The committee recommends:**

- **a fiscal 2026 target closing balance of at least $400 million for the TTF; and**

- **fiscal 2026 spending on system preservation of at least $1.14 billion, which is the average annual amount spent over the previous 10 years.**

Appendix 1
Prior Recommendations and Legislative Action on the Operating Budget
($ in Millions)

	Committee Recommendation		Legislative Action	
Session Year	**Growth Rate**	**Amount**	**Growth**	**Amount**
1983	9.00%	$428.0	5.70	$269.8
1984	6.15%	326.7	8.38	402.0
1985	8.00%	407.2	7.93	404.6
1986	7.70%	421.5	7.31	402.2
1987	7.28%	430.2	7.27	429.9
1988	8.58%	557.5	8.54	552.9
1989	8.79%	618.9	8.78	618.2
1990	9.00%	691.6	8.98	689.7
1991	5.14%	421.8	5.00	410.0
1992	No recommendation		10.0	823.3
1993	2.50%	216.7	2.48	215.0
1994	5.00%	443.2	5.00	443.2
1995	4.50%	420.1	4.50	420.0
1996	4.25%	415.0	3.82	372.8
1997	4.15%	419.6	4.00	404.6
1998	4.90%	514.9	4.82	506.6
1999	5.90%	648.8	5.82	640.6
2000[1]	6.90%	803.0	6.87	800.0
2001[2]	6.95%	885.3	6.94	884.6
2002	3.95%	543.2	3.40	468.1
2003	2.50%	358.2	0.94	134.1
2004	4.37%	635.2	4.33	629.0
2005[3]	6.70%	1,037.1	6.69	1,036.3
2006[3]	9.60%	1,604.7	9.57	1,599.0
2007	7.90%	1,450.0	7.51	1,378.4
2008	4.27%	848.7	4.16	826.8
2009[4]	0.70%	145.7	0.19	39.2
2010[4]	0.00%	0.0	-	-626.9
2011	Reduce fiscal 2012 structural deficit by 33⅓%		36.90%/46.00%[5]	
2012	Reduce fiscal 2013 structural deficit by 50.0%		50.60%	
2013	Reduce fiscal 2014 structural deficit by $200.0 million			-211.2
2014	4.00%	937.8	2.76	646.4
	Reduce fiscal 2015 structural deficit by $125.0 million			-126.1

	Committee Recommendation		Legislative Action	
Session Year	**Growth Rate**	**Amount**	**Growth**	**Amount**
2015	Reduce fiscal 2016 structural deficit by 50.0%		68.27%	
2016	4.85%	1,184.2	4.55	1,111.2
2017	Reduce fiscal 2018 structural deficit by at least 50.0%		90.19%	
2018	Eliminate 100% of the fiscal 2019 structural deficit		100%	
2019	3.75%	1,019.0	3.31	900.7
	Maintain structural balance in fiscal 2020			76.0[6]
2020	Maintain structural balance in fiscal 2021			160.2
2021	Limit fiscal 2022 structural deficit to $700 million or less			63.0
2022	Maintain structural balance in fiscal 2023			276.0
2023	Structural surplus of $100 million in fiscal 2024			146.0
2024	Limit fiscal 2025 structural deficit to $508 million or less			483.1

[1]2000 legislative action does not reflect $266 million of Cigarette Restitution Fund (CRF) appropriations. CRF dollars were excluded because it had not previously been available to the State. The 2000 growth rate, including CRF dollars, was 9.16%.
[2]Methodology revised effective with the 2001 session.
[3]The committee initially approved a limit of 5.70% for 2005 and 8.90% for 2006.
[4]Legislative action calculation includes federal funds under the American Recovery and Reinvestment Act of 2009 used in lieu of ongoing general fund spending.
[5]Spending reduction/total reduction.
[6]Amount reflects difference between the estimated structural deficit of $64 million in the Governor's allowance and the structural surplus of $12 million in the legislative appropriation.