Almost a century ago, Maryland voters approved a new State budget system whose principal aim was to avoid deficits. Yet, over the course of the last 30 years, Maryland has lurched from one budget deficit to the next. And now, despite the approval of slots by Maryland voters on November 4, 2008, the Department of Legislative Services estimates that the structural deficit will continue until FY 2014 (the last year for which estimates are made). In that year, ongoing expenses are expected to exceed ongoing revenues by almost $1 billion.¹

In the face of these projected budget deficits far into the future, the State needs long term solutions rather than those responsive only to the economic crisis du jour. ² The current state of Maryland’s fiscal affairs, like those of a

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¹ Department of Legislative Services, Spending Affordability Briefing, p.32 (October 14, 2008).
² In 2002, the General Assembly established a Commission on Maryland’s Fiscal Structure that was to make recommendations for change to the Maryland budget process. The Commission held eight public hearings in 2002 and issued an interim report on December 15, 2002. The interim report provided a list of short term remedies for Maryland’s budget problem but noted that “we still have much work to do in examining the longer term changes necessary to make
The reforms recommended in this study, like those envisioned in 1916, are principally directed to assuring that State expenditures do not exceed State revenues and to providing Maryland’s elected officials and its citizens, with greater access, in a timely fashion, to fiscal information. Adoption of the recommended changes will more closely align State expenditures with State revenues and will raise the awareness of the costs of new programs and the limited resources that are available, without massive tax hikes or gambling revenues, to pay for such programs.

I. The Maryland Budget System

Prior to 1918, state appropriations were contained in multiple bills that often passed during the fading hours of the legislative session. In his December 1914 annual report to the Governor, Comptroller Harrington described the process as follows: “Our appropriation bills and omnibus bills are generally passed about the last days of the session, when the Finance Committees are overburdened with work, and they have not sufficient time properly to estimate the total amount of the appropriations, for I do not believe that the Legislature, with their eyes fully opened to the subject, would deliberately make appropriations for the two fiscal years intervening from the meeting of one Legislature to another so largely in excess of the revenues of the State applicable to the payment of such appropriations.”

In 1915, this approach to State budgeting resulted in a deficit of more than $1 million, when total State expenditures were $11 million.

The need to reform the State’s budget process became a central issue in the 1915 gubernatorial election. Each party’s platform pledged a new budget system.

The Democratic party platform created a commission, headed by Dr. Frank J. Goodnow, the President of Johns Hopkins University, to recommend the details of a new budget system. In January 1916, the Commission presented its report to Governor Harrington.

Improvements to and remove inefficiencies from our budget…” Transmittal letter for the interim report. After the interim report was delivered, there were no further Commission meetings and no final report addressing the longer term budget changes.

5 Comptroller Harrington was the Democratic nominee and won the election in November 1915.
7 Other members of the Commission were Joseph D. Baker, B. Howell Griswold, Jr., Philip Laird, William Maloy, F. Neal Parke, and James Albert Pearce. Richard E. Israel, History of the Adoption of the Maryland Executive Budget System, p.43 (2004).
The Goodnow plan required the Governor to provide to the legislature a comprehensive plan of estimated revenues and expenditures. The Commission rejected the idea that the Board of Public Works should have responsibility for the budget because it “would have the disadvantage of dissipating personal responsibility for financial propositions and would also run the risk of not securing party responsibility.”

The Commission also recommended limiting legislative power “to make it impossible for the Legislature so to change the plans proposed by the Governor as to produce a deficit...” Under the Commission’s plan, the legislature would have the power to increase appropriations for itself and the Judiciary but it could only reduce or eliminate the rest of the appropriations proposed by the Governor. This restriction would prevent the General Assembly from redirecting to other purposes the amounts of any reductions it makes to the appropriations proposed by the Governor.

Nevertheless, the Commission believed that the General Assembly should have the power to “make provisions for any purpose not included in the Governor’s plan on the condition that it provide also for the revenue which the accomplishment of its purpose necessitates.” The General Assembly could pass a supplementary appropriation bill authorizing new or additional spending. But – and this is key – it must identify a new revenue source to pay for the proposed spending. It could not rely on funds that the Governor did not allocate in the budget and that remained as surplus for succeeding years or on the reductions it made to the Governor's budget.

These supplementary appropriation bills could only be enacted after the budget submitted by the Governor was enacted. These bills also require the Governor's approval. In contrast, the budget bill becomes law immediately upon adoption by the General Assembly.

The Commission’s plan was designed to avoid deficits. It presumed that the budget submitted by the Governor would be balanced and would remain balanced when the legislature adopted it. The Commission plan, however, did not specifically require a balanced budget.

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8 The Board of Public Works is comprised of the Governor, the Treasurer and the Comptroller. The Governor and the Comptroller are elected by the voters. The Treasurer is elected by the General Assembly.
11 Appropriations for the legislature and the Judiciary account for less than 2% of the FY 2009 budget of $31.4 billion.
13 Since the Governor sets the maximum amount of appropriations, other than those for the General Assembly and the Judiciary, there was no reason to provide veto power over the budget.
In November 1916, the Goodnow Commission’s proposed budget system was submitted to and approved by the voters as a Constitutional amendment. The first budget under the new system was approved during the 1918 legislative session. Although altered in some respects, the Maryland budget system in effect in 2008 is substantially the same as that approved in 1916.

In 1948, the State budget became an annual budget, instead of a biennial budget. This change coincided with the advent of annual legislative sessions.

In 1951, the Commission on Administrative Organization of the State (also known as the Sobeloff Commission) recommended that the State abandon the line item budget and replace it with a program budget. The Commission believed that the line item budget focused too much on items to be purchased (personal services, equipment, etc.) and not enough on the services to be provided. A shift to a program budget would provide legislators with a better understanding of the “kind and quality of performance for which funds were asked.”

Based on the Sobeloff Commission recommendation, a constitutional amendment changing the Maryland budget to a program budget was submitted and approved by the voters in 1952.

In 1974, the implicit requirement for a balanced budget became explicit. In that year, voters approved a constitutional amendment providing that “The Budget and the Budget Bill as submitted by the Governor to the General Assembly shall have a figure for the total of all proposed appropriations and a figure for the total of all estimated revenues available to pay the appropriations, and the figure for total proposed appropriations shall not exceed the figure for total estimated revenues. Neither the Governor in submitting an amendment or supplement to the Budget Bill nor the General Assembly in amending the Budget Bill shall thereby cause the figure for total proposed appropriations to exceed the figure for total estimated revenues, including any revisions, and in the Budget Bill as enacted the figure for total estimated revenues always shall be equal to or exceed the figure for total appropriations.”

In 1978, voters approved another constitutional amendment, this one requiring the Governor to include funding for programs at a level set by law. These laws create what are referred to as “mandatory appropriations” because the Governor must include the specified appropriation in the budget submitted to the voters.

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14 Maryland Constitution, Article III, §52. The Commission’s recommendation that a three-fifths vote of each House of the General Assembly be required to approve supplementary appropriation bills was deleted from the amendment when it was submitted to the voters.
16 Report of the Commission on Administrative Organization of the State, p.16 (October 29, 1951).
17 Report of the Commission on Administrative Organization of the State, p.18 (October 29, 1951).
18 Maryland Constitution, Article III, §52(5a).
General Assembly. To be considered a mandatory appropriation, the law providing for the appropriation must include either a specific dollar amount or an objective statutory formula from which an amount can be calculated.

The Governor retains the right to veto the mandatory appropriation bills as they are submitted for approval. If the bill becomes law, the funding level is the minimum that the Governor (and all future Governors) must include in budgets to be submitted after the bill becomes law. The constitutional amendment authorizing mandatory appropriations effectively granted the General Assembly the power to appropriate without the necessity of identifying a revenue source.

During the last 30 years, the General Assembly has frequently considered constitutional amendments that would provide it with the power to increase appropriations without the necessity of identifying a revenue source. Under these proposed amendments, the General Assembly would be authorized to use the reductions it makes to the Governor’s budget to increase appropriations. None of these proposals have received sufficient votes to be submitted to the voters for approval.19

During the November 2007 special session, the General Assembly directed the Spending Affordability Committee and the Department of Budget and Management to review the Maryland budget process.20 On November 18, 2008, the Department of Legislative Services provided to the Spending Affordability Committee a report titled Maryland’s Budget Process and Structure.

The report does not provide recommendations for improvements that would address the structural deficit. Instead, the report focuses on enhancing the General Assembly’s power over the Maryland’s budget. The report’s sole recommendation is “to permit the legislature greater authority to reallocate funds while reducing authority to mandate future funding.”21

II. Maryland’s Structural Budget Deficits

Comptroller Harrington in his last annual report as Comptroller, just before he became Governor, heralded the reforms that were to be recommended by the Goodnow Commission. He wrote that they would “mark a new era in our financial affairs.”22 Despite the significant and positive reforms to the State’s budget system that were adopted in 1916, recent history suggests that

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19 Proposed amendments were considered in 1976 (SB 3; HB 1902); 1977 (SB 924; HB 184; HB 1654); 1978 (SB 1046; HB 485; HB 1474; HB 1475; HB 1614); 1979 (SB 727; HB 1415); 1980 (SB 474; HB 1703); 1982 (HB 103; HB 1495); 1983 (HB 408); 1989 (SB 324); 1994 (SB 395); 2001 (SB 245; HB 1024); 2002 (SB 476); 2004 (HB 1247; SB 370).
20 Chapter 2, §14, Laws of Maryland, 2007 Special Session.
21 Department of Legislative Services, Maryland’s Budget Structure and Process, p.15 (November 18, 2008)
Comptroller (soon to be Governor) Harrington may have been too optimistic in assessing the promise of the Goodnow Commission reforms.

During the last ten years, the State has experienced an almost uninterrupted series of structural budget deficits in which the State’s ongoing spending commitments exceed its ongoing revenues.

Despite recent proclamations that Maryland has conquered its structural budget deficit, that deficit is projected to continue until FY 2014, the last year for which projections have been made. This optimistic projection includes significant revenues from 15,000 slot machines which were approved by Maryland voters on November 4, 2008. And it does not account for the cost of new programs that have already been promised or that will be enacted during the five years included in the forecast.

To provide the context for understanding the need for budgetary reforms recommended in this study, consider the following summary of the state’s recent fiscal history and current budget projections. In December 2006, the state’s Spending Affordability Committee, comprised exclusively of legislators who are advised by a citizen’s advisory committee, forecast structural imbalances of $1.5 billion for FY 2009 through 2012. This forecast remained unchanged after the 2007 legislative session and the enactment of the FY 2008 budget.

The FY 2008 budget depleted most reserves and state revenues were unlikely to increase by $1.5 billion based on then current law. Consequently, future balanced budgets would require reductions in spending of $1.5 billion. To avoid reductions of this magnitude, Governor O’Malley called the General Assembly into Special Session in October 2007.

The Governor’s plan, most of which was adopted by the General Assembly, increased the personal income tax, the sales tax, the corporate tax, the tobacco tax and the vehicle excise tax. Governor O’Malley also proposed significant new revenues from the legalization of slot machines. The only program curtailment proposed by the Governor was a slower rate of growth in the funding for K-12 education and the repeal of the utility property tax grant to certain Maryland counties.

At the same time that significant tax increases were proposed to meet existing obligations, the Governor proposed additional spending to expand Medicaid eligibility, to provide a State subsidy for small businesses to offer health care to their employees and to increase funding for higher education. The

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23Department of Legislative Services, Spending Affordability Briefing, (October 14, 2008).
25The FY 2008 budget was balanced through the transfer of almost $1 billion of reserves from the State’s Rainy Day Fund and $100 million from the Dedicated Purpose Account and a cash surplus from FY 2007 of $284 million. FY 2009 Fiscal Digest, p. A-1. The transfers to balance the FY 2008 budget essentially depleted the Rainy Day Fund balance to the statutory minimum of 5% of general fund revenues. 2007 Spending Affordability Report , p.77
General Assembly adopted most of the Governor’s proposals, which entailed estimated total increases in State tax revenues of more than $1.5 billion, slot machine revenues of an additional $600 million and additional State spending of more than $500 million.\(^{26}\)

As a result of the increase in the sales tax from 5% to 6% on January 1, 2008 approved during the 2007 Special Session, the State received approximately $350 million in revenue not originally anticipated in FY 2008. Even with this new revenue, the Spending Affordability Committee projected that the structural deficit in FY 2008 would be $674 million.\(^{27}\) Similarly, despite the significant tax increases during the Special Session, the Committee’s December 2007 report projected that the structural deficit would continue until FY 2012, at which time the budget would be just within structural balance due to the first receipts from slots.

In April 2008, just after the 2008 Session of the General Assembly and after the enactment of more than $1.5 billion in tax increases in November 2007, the Department of Legislative Services (“DLS”) projected that the structural deficit would continue until FY 2013.\(^{28}\) The Department warned that: “While an upturn in projected economic activity will serve to mitigate these projected shortfalls, both the Administration and the legislature will need to consider some magnitude of spending reductions, revenue enhancements or use of reserves in order to resolve the projected gap between revenues and spending.”\(^{29}\)

On July 10, 2008, the DLS warned that State revenues were falling short of the estimates used for the FY 2009 budget that began only ten days earlier. The DLS estimated that general fund revenues could fall short of estimates by $200 million.\(^{30}\) Neither the April or July 2008 analysis includes the cost of new programs adopted during the 2008 session or commitments made by the Governor that have yet to be incorporated in legislation or the budget, such as the Maryland Bio 2020 initiative that promises $1.1 billion in State funds for biotechnology companies over the next ten years or the plan for statewide communications interoperability with an unknown but likely significant cost or the State’s commitment to provide $75 million over 5 years beginning in FY 2011 to Prince George’s Hospital.\(^{31}\)

In its October 14, 2008 briefing to the Spending Affordability Committee, the DLS projected that, even with the revenue from slot machines, the structural

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\(^{26}\) The Constitutional Amendment authorizing slot machines was approved by Maryland voters on November 4, 2008.

\(^{27}\) 2007 Spending Affordability Report, p.38.

\(^{28}\) Department of Legislative Services, 90 Day Report, p. A-18 (2008). This projection does not take into account additional spending commitments as a result of legislation passed during the 2008 session.

\(^{29}\) Department of Legislative Services, 90 Day Report, p. A-17 (2008).


The deficit will continue until FY 2014. The anticipated cumulative structural deficit over the next 5 years is $5.6 billion.

In light of these projected deficits, it is apparent that the Goodnow Commission’s plan to avoid budget deficits is no longer adequate to protect the State in the 21st century. One of the reasons is that the Goodnow Commission focused solely on the consideration and enactment of the budget.

The Commission did not address the enactment of general legislation that adds hundreds of millions of dollars in annual State spending without any revenue source. The 1978 constitutional amendment that provided for mandatory appropriations only exacerbated the problem of enacting programs with significant implementation costs and no funding source. Finally, instead of avoiding budget deficits and controlling the growth in the State budget, the spending affordability process adopted by the General Assembly in 1982 has done the opposite.

III. Legislation Imposes Costs Without Identifying the Means of Payment

The members of the Goodnow Commission could not have anticipated the explosion in the volume and cost of enacted legislation that would jeopardize Maryland’s fiscal health. Some of the increased cost is attributable to an increase in the number of legislators and some is attributable to an increase in the frequency and length of legislative sessions. Much of the increased cost is, however, attributable to the failure of governors and legislators to match their proposals with revenues to pay for them.

When the Goodnow Commission was making its 1916 recommendations for a new budget system, the Maryland General Assembly was comprised of 95 Delegates and 26 Senators. In 2008, the General Assembly is comprised of 141 Delegates and 47 Senators, an increase of 50%.

Until 1947, the Maryland General Assembly met in biennial sessions. The advent of annual legislative sessions coincided with a change to Maryland’s budget system from a biennial budget to an annual budget.

In 1947, the General Assembly began to meet annually for 90 days in odd numbered years and 30 days in even numbered years. The 90 day sessions dealt with all State matters, including the State budget. The 30 day sessions were limited to consideration of budget and fiscal matters and legislation that had statewide application. Since 1971, the General Assembly has been meeting in annual 90 day sessions.

\[32\text{ FY 2014 is the last year of the Department’s estimates. Department of Legislative Services, Spending Affordability Briefing, October 14, 2008.}\]
In 1914, 864 laws were enacted in the biennial session. This included many appropriation bills as well as myriad local laws. Now, each year the General Assembly enacts more than 600 laws, most of which expand or create programs. Each of these bills has a cost associated with its implementation - some have multimillion dollar costs. Yet, virtually none of these bills include a funding source to pay for the costs of implementation.

Under the Maryland Constitution, only laws that authorize immediate spending require a funding source. The effect of adopting 600 laws each and every year without identifying a means of paying for those laws easily outpaces annual growth in State revenues.

The current legislative process is based on an unrealistic assumption that inflationary increases in State revenues will pay for new programs. The State’s perpetual structural deficit flatly contradicts this assumption.

In most years, the spending required by legislation signed by the Governor has a significant full implementation cost. For example, during the 2002 and 2006 legislative sessions, the General Assembly adopted and the Governor approved legislation having a full implementation net annual general fund cost of $731 million and $372 million, respectively. In just these two years, the General Assembly adopted legislation that required more than $1 billion of new annual State spending but it did not identify revenue sources or spending reductions to pay for the new spending. Normal growth in state revenue cannot match this level of increased State spending.

Two noteworthy examples of the significant budgetary impact from legislation are the revised education funding formula enacted in 2002 (often referred to as Thornton funding) and the enhanced pension benefit for teachers and State employees adopted in 2006. Each of these very expensive programs was adopted in an election year.

Upon full implementation in FY 2008, the education funding bill was estimated to cost an additional $1.3 billion annually. The enhanced defined benefit pension benefit that provided a retroactive increase in pension benefits increased State pension contributions by $120 million annually. Neither of these bills identified a funding source.

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33 In 1914, all local legislation was enacted by the General Assembly. In 1915, the Maryland Constitution was amended to authorize home rule that allowed the counties to adopt their own laws. In 1947, Montgomery County became the first county to avail itself of home rule. Baltimore City’s charter dates to 1797 but it was first authorized to amend its own charter with the 1915 constitutional amendment that authorized home rule. Thurgood Marshall Law Library Guide to Legal Research, p. 9-2 -5 (2008-2009). In 2008, eight jurisdictions retain a County Commissioner form of government under which the Commissioners have more limited power to enact local legislation. http://www.msa.md.gov/msa/mdmanual/01glance/html/govern.html

34 Department of Legislative Services, 90 Day Report, p. L-7 (2002).

The education funding bill was adopted at the same session in which $154 million of new revenues and a transfer of $249 million from the Rainy Day Fund were required to balance the State’s FY 2003 budget. The pension enhancement was adopted when the Spending Affordability Committee estimated that the State’s ongoing expenses for the year in which it would be effective (FY 2008) would exceed ongoing revenues by $655 million, not including the costs of any new legislation.36

The Governor through use of the veto power can limit some of the spending commitments. To make a substantial reduction, however, would require vetoes of most bills, an unlikely solution from a political perspective.

The Goodnow Commission had the right idea – requiring a revenue source for new expenditures. Its mistake was in applying the requirement too narrowly.

If elected officials continue to make promises without a plan for paying for those promises, Maryland will never escape the structural deficits in which ongoing spending commitments exceed ongoing revenues. Requiring a revenue source for each new State commitment, whether a new program or an enhancement of existing programs, is the only way to avoid future deficits.

IV. Mandated Appropriations Exacerbate the Spending Problem

Prior to the enactment of the new budget system in 1916, the General Assembly would adopt what were known as “continuing appropriations.” Once enacted, these laws provided for appropriations that were required to be funded each year without any further legislative action.

In his December 1914 annual report, Comptroller Harrington, noting that some of the continuing appropriation bills had been adopted more than a century before, urged the repeal of these continuing appropriations bills and the prohibition of any future such bills. Instead, he endorsed the kind of comprehensive system ultimately recommended by the Goodnow Commission and adopted by Maryland voters in 1916. In this way, “the General Assembly having before it the revenue of the State could always keep its appropriations within those limitations.”37

The Goodnow Commission did not include in its proposed constitutional amendment any specific provision to deal with continuing appropriations. Instead, the Commission recommended that the General Assembly could by legislation (rather than constitutional amendment) repeal these continuing appropriations.38

The General Assembly, in fact, did repeal continuing appropriations in 1916. It also rejected the inclusion of a provision in the 1916 constitutional amendment that provided for the new budget system that would require the Governor to include appropriations as provided by law.  

Under the budget system approved in 1916, the Governor has significant discretion in allocating funding to State programs. Until 1978, this discretion applied to all appropriations other than debt service, education funding that is determined by statutory formulae, the salaries of State officers and funding for the judicial and legislative branches of government. In the 1978 session, the General Assembly approved a constitutional amendment for submission to the voters that limited the Governor’s discretion. 

The constitutional amendment, approved by the voters in November 1978, provided the General Assembly with authority that was almost identical to that of continuing appropriations that in 1916 were viewed as significant contributors to State deficits. The 1978 amendment requires the Governor to include in the budget the amount of funding specified by the General Assembly. To be considered a “mandated appropriation” under the amendment, the amount of the appropriation must either be specified as a sum certain or must be calculable by reference to a formula contained in the legislation specifying the funding. 

Mandated appropriation laws do not require a revenue source. This omission violated one of the guiding principles of the budget system adopted in 1916 – matching expenditures with revenues. The 1978 constitutional amendment essentially allowed the General Assembly to appropriate funds without bearing the burden of finding a revenue source to pay for the appropriation. 

When the Governor submits the State budget, the mandated appropriations must be included regardless of the State’s fiscal condition or competing State priorities. The General Assembly, as part of its power to reduce appropriations, may reduce mandated appropriations during its consideration of the budget. Legislative reduction of these mandated appropriations has occurred only when a budget crisis is in full bloom. 

The absence of a requirement that a funding source accompany a mandated appropriation has resulted in significant growth of these appropriations and a consequent burden on the State budget. In fiscal year 2008, programs with mandates in excess of $100 million per year accounted for

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41 The General Assembly may not reduce mandated appropriations for K-12 education (including retirement for teachers) or library aid. To reduce a mandated appropriation for one of these purposes, the General Assembly must enact separate legislation changing the funding formula.
$9.8 billion of general funds, 67% of total general funds. Many of these programs have automatic escalators that increase the mandate without regard to the growth in State revenues, the State’s fiscal situation or competing State priorities.

To restore fiscal discipline, these mandated appropriation laws should be required to identify a revenue source that will support the appropriation and that will grow as the mandated appropriation grows. In addition, just as the General Assembly repealed continuing appropriations when the Goodnow budget system was adopted, existing mandated appropriations should also be repealed to allow for a better allocation of State resources to current State priorities.

V. The Spending Affordability Process is Broken

The Spending Affordability Committee considers loads of economic data. It produces an annual report of more than 50 pages. And the end result is a lengthy string of deficits, whether structural or cyclical. How does this happen if the State’s budgets have been “affordable” for the last quarter century?

The spending affordability process is broken and should be abandoned. Instead of ensuring fiscal responsibility, it facilitates fiscal irresponsibility.

1. Background

On June 6, 1978, California voters approved Proposition 13, an amendment to the State’s constitution that imposed a cap on property taxes and required a two-thirds majority for all subsequent tax increases of any kind. Proposition 13 had consequences far beyond the California borders.

In Maryland, the Washington Post reported that Acting Governor Blair Lee III announced a hiring freeze just two days later in reaction to “California’s resounding vote.” The gubernatorial campaign was underway and Gov. Lee was a Democratic candidate for the office.

Spending limits became a campaign issue in the 1978 election when Republican candidate Louise Gore proposed a constitutional amendment that would limit increases in the Maryland budget. Ms. Gore’s proposal was to limit spending to the yearly percentage increase in total personal income. Gov. Lee’s proposal was to limit increases in the State budget to 7% of total personal income.

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42 Department of Legislative Services, Mandated Appropriations in the State Budget (June 27, 2007).
43 California State Constitution, Article 13 A.
Neither Ms. Gore nor Gov. Lee became the nominees of their respective parties.

After Harry Hughes won the 1978 election, the issue of spending limits did not advance during the 1979 legislative session. During the 1980 session, a constitutional amendment that would have limited budget growth to the growth in personal income was defeated but only as a result of aggressive opposition by Governor Hughes.46

On January 12, 1981, at the outset of the 1981 legislative session, the Legislative Policy Committee, comprised of the legislative leadership, created the Spending Affordability Committee (“SAC” or “Committee”) to recommend annual spending ceilings.47 This move assured the defeat in the 1981 legislative session of another constitutional amendment limiting State spending.

The SAC provided its first report to the 1982 General Assembly. The SAC was codified into law in 1982, an election year and a year in which legislative districts were redrawn after the 1980 census.

2. The Spending Affordability Process

The SAC is comprised of the Senate President, the House Speaker, the chairpersons of the budget committees, the majority and minority leadership of each House and other members who may be appointed by the Senate President and the House Speaker. The Committee is advised by a citizens advisory committee appointed by the President and the Speaker.

By law, the intent of the spending affordability process is “to limit the growth of State spending to a level that does not exceed the rate of growth of the State’s economy.”48 Each year after several briefings from the Department of Legislative Services that describe both economic trends and government spending needs, the SAC makes a recommendation to the Governor and the General Assembly as to an “affordable” rate of growth in the State budget.

The recommendation is generally provided in December so that the Governor is aware of the limitation before submitting the State budget to the General Assembly in January. There is little, if any, public discussion or debate about the proposed spending limit or how it is calculated.

47Spending Affordability Committee Recommendations to the 1982 General Assembly, p.1.
48State Government Article, § 2-1002.
The spending limits set by the SAC are voluntary. Neither the Governor when drafting the budget nor the General Assembly when considering the budget is required to limit growth in the budget to the spending affordability recommendation.

The General Assembly historically has reduced the enacted budget so that it does not exceed the spending limit. Governors, however, have often exceeded the limit.

Sometimes, the Spending Affordability Committee adopts a recommended spending level only to revise it upward after the Governor submits the State budget. When the Committee has done so, there generally has been little or no public notice of the meeting at which the upward revision will be approved and little or no public discussion as to why an increase is proposed or warranted.

An increase in the spending limit reduces the amount of spending that the General Assembly must cut from the Governor’s budget in order to ensure compliance with the recommended spending level. As a result, the legislature can avoid difficult decisions to reduce programs to the original “affordable” level.

In every year since FY 1984, the Committee has deemed an increase in spending to be affordable. Increases ranged from a low of .94% in FY 2004 to a high of 10% in FY 1993. Since FY 1984 spending affordability recommendations have allowed cumulative growth in the State budget of almost $15 billion.

### 3. The Spending Affordability Methodology

At its inception, the spending affordability process applied to all operating funds, excluding only federal funds. Over the years, the Committee excluded certain funds from the process, some on a one-time basis and others on a permanent basis.

For example, for FY 2003, the Committee excluded a Medicaid deficit of $173 million from the calculation of the spending limit. In the same report, the Committee also permanently excluded costs, up to revenues generated by the activity, of the port, airport and the State Lottery. Appropriations for unfunded liabilities, such as pension contributions for teachers and State employees and

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49 The General Assembly has only once since adoption of the spending affordability process approved a budget that exceeded the spending limit. That was in 1984 when the recommended limit was 6.15% and the approved budget increased by 8.38%.

50 The SAC increased the limits for the budgets considered in the 2005 session from 5.7% to 6.7% and in the 2006 session from 8.9% to 9.6%. For the budget considered during the 1992 session, the SAC did not make a recommendation. 2007 Spending Affordability Committee Report, p.2.

51 The Spending Affordability Committee made no recommendation for FY 1993 but the approved budget reflected growth of 10%.

health benefits for State retirees are also excluded in determining the rate of
growth of the State budget.\textsuperscript{53}

In the early years of the process, the Committee included a description of
how spending affordability was determined and which appropriations were
subject to the limit. The reports for recent years do not contain similar
descriptions.

The report for FY 2009 states merely that the “appropriations subject to
the spending affordability limit shall be limited to growth no greater than 4.27%
over those approved at the 2007 Session.” Neither legislators nor citizens have
any way of knowing which appropriations are subject to or excluded from
spending affordability without combing through all prior reports.

The concept of “spending affordability” suggests a mathematical process
that would yield an objective spending limit. Yet, no statutory or regulatory
formula exists to determine what is affordable other than the statutory reference
to growth in the State economy. Nor has the Committee adopted a consistent
approach to measuring affordability.

The SAC has instead resorted to various methods that have resulted in an
unbroken string of recommendations for increasing State expenditures
regardless of the fiscal circumstances of the State. In the absence of any formula,
the method changes each year, in an ad hoc fashion, to validate the desired
amount of increased spending.

In the early years, the Committee used a percentage of estimated growth in
personal income in the budget year. But the percentage of personal income
growth used to calculate the “affordable” rate of growth varied from 60\% for FY
1992 to 120\% for FY 1986 as did the rate of budget growth from 5.1\% for FY 1992
to 10.18\% for FY 1983 (the first year for which a recommendation was made).

In FY 1989, the increase in State spending was 8.58\% based on the three
year average growth in personal income. In more recent years, the spending limit
was unrelated to any specific measure. Rather, it was an estimate of general
growth in the economy.

While a review of economic growth is useful in assessing the accuracy of
estimates in revenue growth, growth in either personal income or the State
economy is not identical to the growth in general fund revenues. As a result, the
spending affordability limit often exceeded estimated increases in State general
fund revenues, allowing spending to grow faster than general fund revenues.

For example, the aggregate spending limit established by the SAC for FY
2008 was 7.9\%. The actual increase in general fund appropriations after

\textsuperscript{53} 2005 Spending Affordability Report, p. 11.
legislative action on the budget was 8.13%. Both the SAC and the Board of Revenue Estimates estimated that general fund revenues for FY 2008 would increase by 4.5%. Thus, under spending affordability, expenditures were permitted to grow at almost double the rate of estimated revenues.

At the time the FY 2008 spending limit was adopted, ongoing spending was projected to exceed ongoing revenues by $1.3 billion. With spending already vastly exceeding estimated revenues and with general fund revenues estimated to increase by only 4.5%, it is difficult to understand how an 8.13% increase in general fund spending could be deemed “affordable.”

The 2006 and 2007 spending affordability recommendations abandoned any pretense that the spending limit was related to economic conditions or to any objective criteria. In its 2006 report, the SAC recommended a 7.9% increase in state spending and concluded “[T]he spending limit for the 2007 session will allow the State to complete the phase-in of the Bridge to Excellence in Public Schools Act and meet the current service needs of the remaining programs.”

The 2007 report for FY 2009 recommended a 4.27% increase in State spending. The recommendation was supported by this statement: “[T]he spending limit reflects the actions taken during the 2007 special session to increase revenues, slow the rate of budget growth and undertake key new initiatives.” In other words, the spending limit was calculated merely to assure that new programs could be funded. And, as with the 2006 report, no mention of what economic factors led to the conclusion that a 7.9% increase was “affordable.” In fact, the 2007 report recognized that State revenues and the State’s economy would be slowing and still recommended an increase.

As part of its analysis, the SAC does review estimated State revenues. But its recommendations have no necessary connection to growth in those revenues.

Even in years when the State’s revenues were insufficient to pay current expenses, the SAC recommended an increase in the size of the budget. In its 1990 report for FY 1992, the SAC was concerned about the structural deficit. It noted that “revenues are running about a year behind costs. Moreover, out year estimates hold little prospect for improvement. Actions must be taken to bring expenditures and revenues in line.” Incredibly, after this discussion, the Spending Affordability Committee nevertheless recommended a spending increase of 5.1%.

\(^{54}\)The 8.13% growth does not include $82 million in the State Employee’s Health Insurance Fund that was used to support the State’s share of premiums for retirees and employees. Department of Legislative Services, 90 Day Report, p. A-10. (2007).

\(^{55}\)The Board of Revenue Estimates is comprised of the Comptroller, the Treasurer and the Secretary of Budget and Management. The Board provides the revenue estimates that are used by the Governor to prepare the State budget.

\(^{56}\)1990 Spending Affordability Report, p. 2.
In each of the past 10 years, fund transfers (primarily from the Rainy Day Fund) and revenue increases were required to balance the “affordable” State budget. In some of those years, during the budget year, additional transfers and spending reductions were required to balance the budget when actual revenues were less than estimated revenues.

In FY 2002, spending affordability allowed general fund expenditures to grow by $547 million. Estimated general fund revenues were insufficient to match this growth and a transfer of $533 million from the Rainy Day Fund was necessary to balance the general fund budget as it was enacted by the General Assembly. During the fiscal year, additional transfers of $281 million were made from other funds and expenditure reductions of $288 million were made as actual revenues were less than estimated.

If FY 2002 general fund spending had been limited by spending affordability to the estimated general fund revenues, the Rainy Day Fund transfer would have been available to meet the deficiencies that arose as a result of actual revenues that were less than estimated. Moreover, if spending had not been permitted to grow by 6.94% under spending affordability, the budgetary problems experienced in FY 2003 would have been somewhat less severe.

Another problematic aspect of spending affordability is that the spending limit is an aggregate limit on general and some special funds. This combination prevents legislators or citizens from comparing estimated State general fund revenues to “affordable” general fund appropriations. If such a comparison could be made, the imbalance between revenues and expenditures would be clear.

The spending affordability process is vague and malleable and, thus, easily manipulated. The General Assembly reduces special fund appropriations but authorizes an increase in the appropriation (and thus spending) during the fiscal year through the use of budget amendments. The General Assembly also reduces general funds and authorizes the use of special funds in lieu of the general funds through budget amendments.

The amounts authorized to be appropriated by budget amendment are not included in calculating how much the budget grows for purposes of the spending affordability limit. Thus, these maneuvers have the effect of reducing the amount of appropriations for purposes of meeting the spending affordability limit but allowing actual spending to grow more than the limit.

In addition to the Committee’s recommendations regarding an annual spending limit, the law provides that spending is to be controlled through “the budgetary process as well as through legislative oversight and program review.” The law further requires “careful scrutiny of new programs or expansion of

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57 State Government Article, §2-1002(b)(1).
existing programs” and program evaluation “to eliminate those no longer required and to avoid overlap and duplication of services and activities.”58

These aspects of spending affordability have largely been ignored by the General Assembly. In 1952, the State budget became a program budget rather than a line item budget to afford legislators the opportunity to more closely scrutinize the effectiveness of programs. More than fifty years later, legislative review of appropriations is still focused on what will be purchased rather than what services will be delivered with the funds provided.

4. "Spending Affordability" Contributes to the Structural Deficit

The reports of the Spending Affordability Committee are eerily reminiscent of the credit crisis that currently threatens the U.S. economy. All of the warning signs regarding the precarious condition of the State’s fiscal affairs have been clearly evident. In fact, most were discussed at length in the SAC reports over the last ten years. And still, the SAC recommended spending more money each year.

Rather than avoiding deficits or limiting State spending, the spending affordability process has contributed to the creation and perpetuation of deficits. By providing a false sense of fiscal restraint, the spending affordability process facilitates continued budget growth even when structural deficits appear as far into the future as estimates are made.

Describing increased spending as “affordable” when the State has insufficient revenues to pay current expenses allows State officials to pretend that they are being responsible. And it encourages citizens to demand ever increasing services from the State.

In sum, the spending affordability process is a byzantine process that has failed miserably in controlling state spending and in avoiding deficits. There is a simpler and more transparent mechanism – matching spending to revenues. This approach is also what has been explicitly required by Article III, sec. 52 (5a) of the Maryland Constitution since 1974.

Abandoning the spending affordability process in favor of matching state expenditures and state revenues would free Maryland from a pattern of spending beyond its means. It would also save countless hours and would be transparent to all. The General Assembly could then focus on the more difficult portion of the spending affordability charge: To eliminate inefficiencies in governmental activities and to evaluate programs in order to eliminate those no longer required.

58 State Government Article, §2-1002(b)(3).
It is time that the State return to an elementary budgetary principle – spending no more than estimated revenues in any year.

VI. Recommendations

Maryland state fiscal affairs are far worse in 2008 than in 1916 when the current budget system was adopted. Now, as then, drastic action is required to address the State’s seemingly endless structural deficit. It is apparent that the $2 billion in new taxes and slot machine revenue will not resolve the problem.

How can Maryland break the cycle of structural deficits that have plagued it since the beginning of the 21st Century? A moratorium on the adoption of new or enhanced programs would stop the cycle. Despite the common sense appeal of such a moratorium, the political process and human nature makes this a somewhat unlikely solution. The best alternative solutions are reforms that will limit State spending to estimated State revenues and will enhance accountability and transparency in the legislative and budgetary processes.

1. The spending affordability process should be abandoned and State spending should be limited to estimated revenues.

For 26 years, Maryland has relied on the spending affordability process to control growth in its budget. Instead of avoiding deficits and constraining growth, it has encouraged legislators and citizens to believe that the State’s resources were sufficient to provide for an unending series of new and enhanced programs.

By excluding significant appropriations from the spending affordability calculation, by frequently changing the method for determining a limit and by recommending increases in spending when state resources are already insufficient to meet existing State commitments, the State budget is allowed to grow far more than is truly “affordable.” The fact that structural deficits have become a permanent problem for the State reflects how broken the process is.

While there are a number of improvements that could be made to the spending affordability process, these improvements will not address the underlying problem with spending affordability. The spending affordability process fosters a false sense of fiscal responsibility that prevents elected officials and citizens from a clear understanding of how imbalanced spending and revenues have become, even after substantial increases in taxes and fees and significant expansions of State sponsored gambling. Continued use of the spending affordability process assures a permanent and growing structural deficit.

59 In FY 2005 and FY 2006, there was a structural surplus. 2006 Spending Affordability Report, p.37.
60 Some of these improvements were recommended in the July 30, 2008 preliminary version of this study.
Limiting state expenditures to estimated state revenues offers a better measure of affordability than the convoluted process used for the last 26 years. Moreover, it is the standard established in the Maryland Constitution.

In 1974, Maryland voters approved a constitutional amendment that provides: “The Budget and the Budget Bill as submitted by the Governor to the General Assembly shall have a figure for the total of all proposed appropriations and a figure for the total of all estimated revenues available to pay the appropriations, and the figure for total proposed appropriations shall not exceed the figure for total estimated revenues. Neither the Governor in submitting an amendment or supplement to the Budget Bill nor the General Assembly in amending the Budget Bill shall thereby cause the figure for total proposed appropriations to exceed the figure for total estimated revenues, including any revisions, and in the Budget Bill as enacted the figure for total estimated revenues always shall be equal to or exceed the figure for total appropriations.”61

Since the adoption of this constitutional provision, proposed appropriations have often exceeded “total estimated revenues.” Fund transfers and prior year surpluses have routinely supplemented estimated revenues to balance the State budget.62

Reliance on fund transfers to balance the budget allows spending to grow much faster than revenues. When the funds are depleted as they were after enactment of the FY 2008 budget, the overspending cannot be supported without significant new revenues.

Compliance with the constitutional provision that restricts total appropriations to total estimated revenues would have a salutary effect on the structural deficit. And not only would compliance represent sound fiscal policy, it would show respect for the rule of law.

2. Each proposed law should identify the source of funds to support the spending required by it.

To assure that the State does not commit more funds to programs than it expects to receive, each bill should be required to identify how the new spending required under the bill will be funded.63 The funds could be a new source of

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61Maryland Constitution, Article III, §52 (5a).
62While some may argue that fund transfers constitute revenues, the budget bill and many other budget related documents distinguish between revenues and fund transfers.
63The requirement to identify the means to pay for proposed legislation can be imposed by regular statute or by an amendment to the Maryland Constitution. Imposing the requirement by constitutional amendment has the appeal of making it more difficult to change the requirement. The Goodnow Commission, for example, recommended a constitutional amendment to implement the new budget system on the belief that “A mere statutory provision... cannot, in our
revenue or specifically identified savings from reducing or eliminating specifically identified programs. Such a requirement would also alert legislators and Governors to the fiscal consequences of whatever new programs they propose and would educate the public that new or expanded programs are not free.

A cumulative listing of the proposed sources of revenue or spending reductions should be combined with the cumulative listing of costs of each bill (recommended below). This would foster a better understanding of choices that must be made with limited resources or the new burdens to be imposed upon the State’s residents by reason of new revenue sources.

To the extent that the Governor’s proposals are not reflected in legislation, the Governor too should be required to identify how new programs or enhancements will be funded. Press releases announcing each new program or program enhancement should identify the source of the funding as announcements are made.

3. All mandated appropriations (other than education funding) should be repealed and no additional mandated appropriations should be adopted.

Mandated appropriation bills set a specific level of funding for specific programs. This provides a preferred status for those appropriations and eliminates ongoing scrutiny of whether the appropriations continue to be warranted. This preferred status also hampers an analysis of the relative priority of the protected programs.

Just as continuing appropriations contributed to deficits in the early 20th century, mandated appropriations have contributed to the current structural deficit and should be repealed. To the extent mandated appropriations are deemed necessary, they should be accompanied by revenues that grow with the mandates.

4. Fiscal estimates for each proposed law should be available to the public at least two days before the first hearing on the legislation.

While much of the attention in resolving budget deficits is focused on the budget process, as noted above, the cumulative impact of general legislation enacted each year has a significant impact on the State’s financial condition. Lack of attention to the cumulative costs fosters the chronic fiscal distress that the State has experienced and expects to continue experiencing over the coming years.

judgment, produce the reform in State finance which is demanded by the people and voiced in the Democratic platform.” The Goodnow Report, Maryland Senate Journal, p. 130 (January 28, 1916).
The General Assembly currently receives a fiscal note for each proposed law. Fiscal notes, prepared by the Department of Legislative Services, provide an estimate of the costs to the State for a five year period of the new spending required and any new revenues that will be generated. Too often, the fiscal note is not available until the day of the hearing and sometimes not until after the hearing. When the fiscal estimates are not available until the date of the bill hearing, legislators and citizens do not have the tools to make appropriate inquiries about cost estimates.

Fiscal notes can be very useful tools in educating the public and legislators about the costs of new programs, a critical step to averting structural deficits. In order to maximize the usefulness of fiscal notes, they should be issued at least two days in advance of the hearing to allow both citizens and legislators the opportunity to review and question the costs.

Fiscal notes sometimes assert that the costs of implementation are minimal and can be absorbed within existing resources. While this might be true if only one or two bills were enacted each year, the aggregate costs of 600 separate pieces of legislation each year belie a conclusion that no added revenues sources will be necessary to implement legislation.

Fiscal notes should specify the new spending that will be required no matter how minor they seem. Understanding all of the potential costs for all proposed legislation is critical to avoiding structural deficits.

5. During the legislative session, the Department of Legislative Services should maintain on its website a cumulative list that reflects the estimated full implementation costs of each proposed law.

After the Governor has finished signing bills, the Department of Legislative Services prepares a report that estimates the cumulative impact of adopted legislation on the State’s financial condition. This report is very useful because it indicates how much additional revenue will be necessary to fund the new spending required under all of the bills that have been adopted. Unfortunately, the information comes after the legislative process is over and, thus, does not have a meaningful impact on decisions concerning enactment.

Looking at each individual fiscal note does not provide the same view as looking at the cumulative costs of all proposed legislation. Maintaining such a cumulative list during the session would provide both legislators and citizens with information about the costs to State taxpayers of implementation of all of the proposals under consideration. Such a list would provide a sobering picture of the costs of expanding and enacting new programs.

The Governor too should notify the public about the amount of spending required as a result of the new bills that are to be signed. When the Governor’s Office announces what bills the Governor will sign, the announcement should
include an estimate, based on the fiscal notes, of the cumulative spending required by the legislation to be signed. The estimate should include a cumulative total for each bill signing event. This would enhance public awareness of the costs to the taxpayers of the legislation adopted each year by their elected officials.

6. **Upward adjustments in revenue by the Board of Revenue Estimates in March should not be used to fund additional appropriations.**

   The Board of Revenue Estimates issues its report on estimated revenues in December of each year and reviews the recommendation in March. Frequently, the revenue estimates are increased based on trends from December through February. Governors often use these additional revenues to provide for spending not included in the budget submitted in January.

   In the early years of the Spending Affordability process, the Committee recommended that: “Additional appropriations should not be added to the operating budget as a result of increased revenues, if any, from the March report of the Board of Revenue Estimates. If the March estimates project increased revenues, the additional amounts shall be transferred to the Loan Fund to be used in lieu of previously authorized bonds or transferred to the pension funds to reduce future State contributions.”

   Returning to this practice would be a small step in averting structural deficits.

7. **Budget Conference Committee meetings should be held in a public place and with adequate public notice.**

   After the budget is passed by each House of the legislature, a Conference Committee consisting of representatives from each House is appointed to resolve the differences between the Senate and House action on the budget. The decisions made by the Conference Committee are in effect the final decisions on the State’s $31 billion budget because changes almost never occur on the floor of either House during final consideration of the budget and the Governor has no veto authority over the budget bill once it is enacted.

   The meetings of the Conference Committee are held in a room on the second floor of the legislative services building. The meetings are often held with only a few hours notice to legislators and to the Governor’s representatives. The meetings are not reflected in the legislative schedule and are not announced to the public, although a few members of the press may be in attendance.

   The public should be able to witness these discussions on the final decisions on spending their money. In order to ensure more accountability, the Conference Committee meetings should be held in a public place with adequate public notice. Additionally, the Conference Committee should be restricted from

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64 Spending Affordability Committee Report to the 1982 General Assembly, p. 1.
considering any proposals that had not previously been discussed at public hearings.

8. **All reports that are submitted by State agencies to the General Assembly should be available in a timely manner on the General Assembly’s web site.**

Many statutes require regular reports from State agencies to the General Assembly. In addition, each year the budget bill imposes reporting requirements on many State agencies. These reports would be useful to Maryland citizens in assessing programs and the delivery of services by state agencies. Yet, most of these reports are largely unavailable to the public because the public does not know they exist. In fact, no cumulative list of all the reports required to be submitted by State agencies is available to the public.

Since taxpayer funds are used to produce these reports, taxpayers are entitled to know the reports exist and to obtain copies. In light of significant technological advances, there should be no barrier to publication of all of the reports on the Internet.

The availability of these reports to the general public would be a significant step toward assuring transparency in government spending and would enhance accountability of governmental agencies and elected officials.

9. **Each State Task Force should be required to identify the source of funding for each recommendation.**

Each year, the General Assembly by law and the Governor by Executive Order create many new Task Forces and Commissions. These groups examine a specific issue and make recommendations. The narrow focus of each of these Task Forces and Commissions often results in recommendations that have significant costs, particularly because the members are focused on addressing the specific issue rather than the costs of any proposed solution and how those costs will be funded. The recommendations often result in great expectations among the prospective beneficiaries that cannot be fulfilled without substantial reductions in existing programs or without substantial new revenue.

As with each proposed new law, Task Forces and Commissions should be required to estimate the costs for each recommendation and to specify how the additional spending would be funded. This would assure that both public officials and the public understand how each new recommendation would impact the State’s financial condition as well as existing programs.

VI. **Conclusion**

Aligning state expenditures with current State revenues and raising the awareness of elected officials and taxpayers concerning the cumulative costs of new programs and new laws is fundamental to preventing structural budget
deficits. Adoption of the foregoing recommendations to reform the state’s budget process would instill greater fiscal discipline in the budget process. In turn, such discipline will restore the state’s fiscal health so that Maryland’s taxpayers will not be called upon to produce ever greater amounts of revenue to fill the state’s coffers.