New Mexico VOICES for Children

Taking a closer look at tax and budget policies affecting New Mexico's quality of life

New Mexico Fiscal Policy Project

New Mexico's Revenue Crisis

State Revenues and the Economy: FY 2008 to FY 2013

Executive Summary

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The consensus revenue forecast presented earlier this month shows New Mexico in the grip of a crisis. New Mexico's general fund revenues have fallen below the level they were in fiscal year 2008 (FY08), and this trend is expected to continue through FY11. Revenues will finally top FY08 levels in FY12. The revenue level of FY08 will not be sufficient to maintain the current level of services, such as health care, public safety, and K-12 educational programs. In fact, the gap between baseline growth – the amount needed to cover increases in inflation and population – and actual growth will be 10 percent of revenues. This is a significant shortfall.

The shortfall is due to a number of factors. The revenue estimates used by the Legislature to craft the general fund budget for this fiscal year (FY09) were produced in December 2007. Since then, the price of oil has soared – and revenue estimates were raised to accommodate them. The future looked so promising that a special legislative session was held in August 2008 to spend the anticipated revenue surplus. But the oil and natural gas fueled surplus promptly evaporated in late summer.

Before oil prices dropped, the housing bubble began to deflate, the stock market plummeted, and the nation slumped into a recession. The national economic turmoil, along with moderating inflation and a slowing state economy, will continue to affect the state's revenue picture. In addition, the phase-in the of state income tax cuts of 2003 was complete in 2008. This has led to a loss of $400 million annually. Unlike the similarly structured federal income tax cuts also enacted in 2003, the state cuts are not scheduled to sunset.

Economic Indicators

The behavior of state revenues depends on both national and state economic performance as measured by several key economic indicators. The state fiscal agencies' testimony on revenues always includes growth rate projections of the US gross domestic product (GDP), CPI inflation, and the federal funds rate, which is a key monetary policy tool used by the Federal Reserve for influencing interest rates.

The key New Mexico indicators are job growth, personal income growth, and private wage and salary growth. All of these indicators will perform worse than was expected in December 2007.

Revenue Sources

General fund revenues can be divided into four broad categories for ease of analysis: sales taxes, income taxes, oil and gas receipts, and investment income. There are also some smaller revenue sources, such as license fees and revenue sharing from tribal casi-

nos. Each of the revenue categories is influenced by national and state economic developments in specific ways, so the share of each category can fluctuate. By far the most volatile of the revenue components are oil and gas revenue shares. And during the past year, they have been more volatile than usual, as the price of oil topped $100 a barrel before plummeting back down to half that. Oil and natural gas production is also declining in New Mexico as supplies are depleted, although this is a fairly predictable process.

Conclusion

In summary, New Mexico general fund revenues will drop from FY08 to FY09 and be insufficient to meet baseline growth from FY09 through FY12. The onset of a national recession, moderating inflation (especially for gasoline), lower oil and natural gas prices, and a slowing state economy will continue to affect the state's revenue picture.

Policy Recommendations

Revenue shortfalls of this magnitude are generally dealt with one of three ways: inefficiencies in government agencies are eliminated while hiring is frozen, services are cut or taxes are raised. While cutting waste in government programs is an attractive solution, it will not yield nearly enough in the way of savings to bridge such a deficit.

When raising new sources of revenue, policymakers should take into consideration New Mexico's regressive tax system and make it more progressive with whatever tax reforms are proposed. Legislators should also revisit whether, in approving some of the tax cuts of the last six years, they may have overreached. Some of those tax cuts could be rolled back, at least temporarily.

We could also safely tap into the state's operating reserve. The so-called rainy day fund is currently 10 percent of the state's general fund budget, which is double what it's been in the past. The state could draw it down to 5 percent without any undue risk.

New Mexico should focus its own economic recovery efforts at creating good jobs, strengthening consumer protections, extending unemployment insurance (UI) benefits, expanding work supports such as childcare assistance and health care, increasing Food Stamp utilization, and increasing the Low Income Home Energy Assistance Program (LIHEAP).

This means, among other things, fully funding Medicaid, where every dollar invested is matched by another $2.90 in federal dollars, and fully funding other essential services like education and public safety.

Consumer protection means enacting strong lending regulations for mortgages, payday and car title lenders, rent-to-own practices and refund anticipation loans (RALs) to prevent the kind of predatory practices that contributed to this economic meltdown.

While investing in infrastructure projects does provide economic stimulus, it primarily helps male workers. Medicaid, on the other hand, creates jobs in the private health care industry, which employs a more diverse workforce. We should also continue to invest in adult basic education and worker training programs, with a special emphasis on incumbent worker training.

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