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

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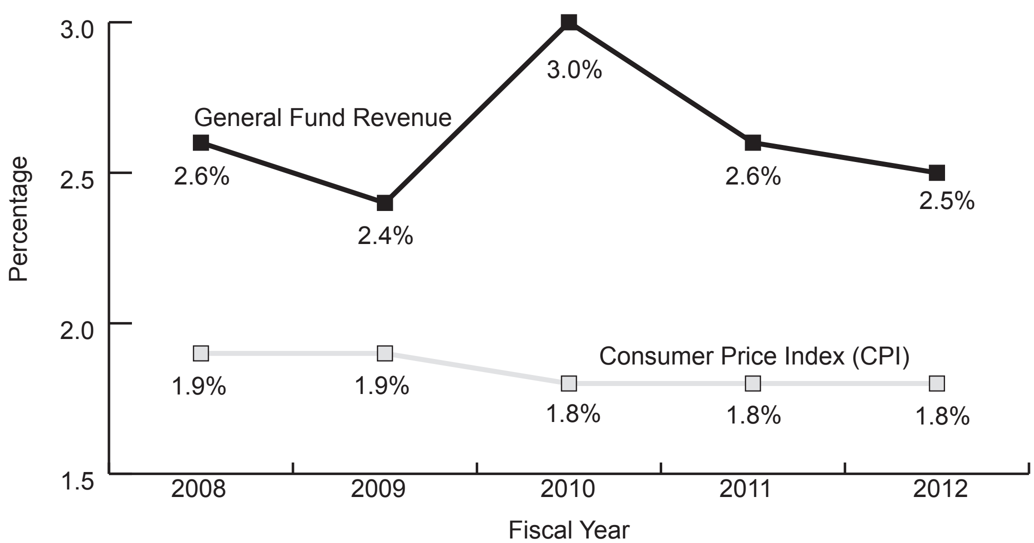
New Mexico's Revenue Forecast: The Coming Drought

New Mexico's general fund pays for education, health care and public safety services for the people of New Mexico. The general fund must grow every year to keep up with inflation and population growth or services must be cut. The Legislative Finance Committee's 2008 Post Session Review estimated that a baseline budget – one that provides a 'bare bones' level of services – will need to grow by about 3.4 percent per year. Unfortunately, that same Post Session Review expects that revenue growth will not be enough to meet baseline levels starting in fiscal year 2010.

Background

Every year, the state has to create an operating budget before the revenue for that year has been collected. In order to create the budget, then, a forecast of future revenues must be made. In New Mexico, forecasts of general fund revenue growth are prepared by a team of economists from the legislative and executive branches of government: Legislative Finance Committee (LFC), the Department of Finance and Administration, and the Taxation and Revenue Department. The estimates are a consensus of the revenue expectations of these

Graph I
Expected Growth Rates of General Fund Revenues and the CPI



Source: New Mexico Legislative Finance Committee's 2008 Post Session Review, March 2008 three organizations. Revenue estimates are presented prior to each legislative session, updated during the session, and then published after the session in the LFC's Post Session Review. The LFC's 2008 Post Session Review was published in March 2008.

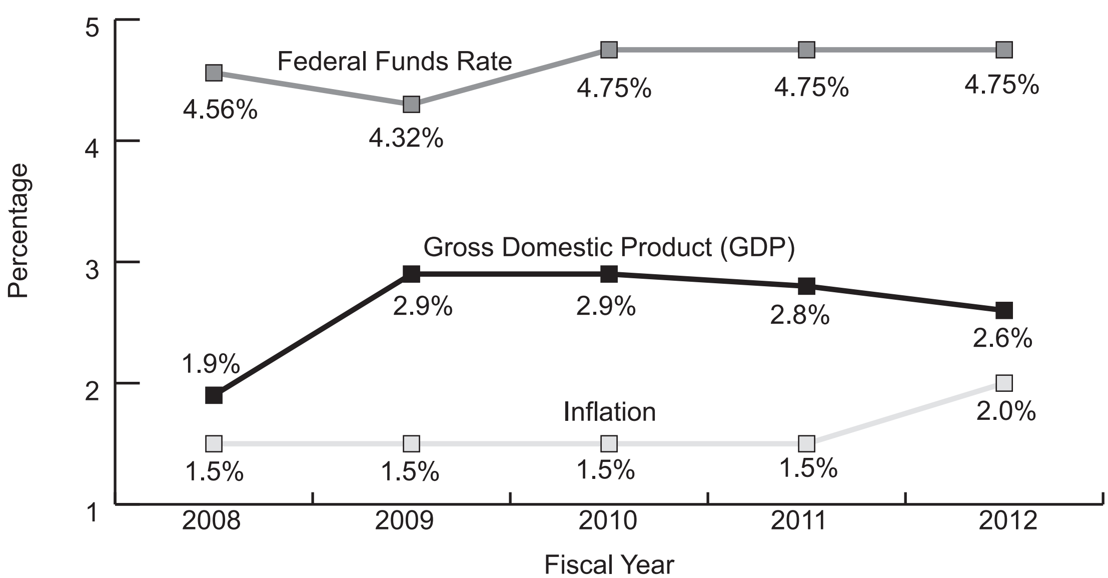
General fund revenues for FY07 were $5.745 billion. This represented an increase of 3.1 percent over FY06. As Graph I shows, growth in revenues will be slightly higher than growth in inflation as measured by the Consumer Price Index (CPI). However, New Mexico's revenue growth will be insufficient to support the 3.4 percent baseline expenditure growth required to maintain current services starting in FY10.

Economic Indicators

The behavior of general fund revenues depends on economic performance as measured by several key national and state economic indicators. The 2008 Post Session Review also projects the growth rates of the U.S. gross domestic product (GDP), inflation and the federal funds rate. The federal funds rate, the monetary policy tool used by the Federal Reserve for influencing interest rates, was at 5.25 percent in FY07. As Graph II indicates, the GDP is expected to grow, inflation will remain relatively steady and stay below 2 percent, and the federal funds rate is expected to fall.

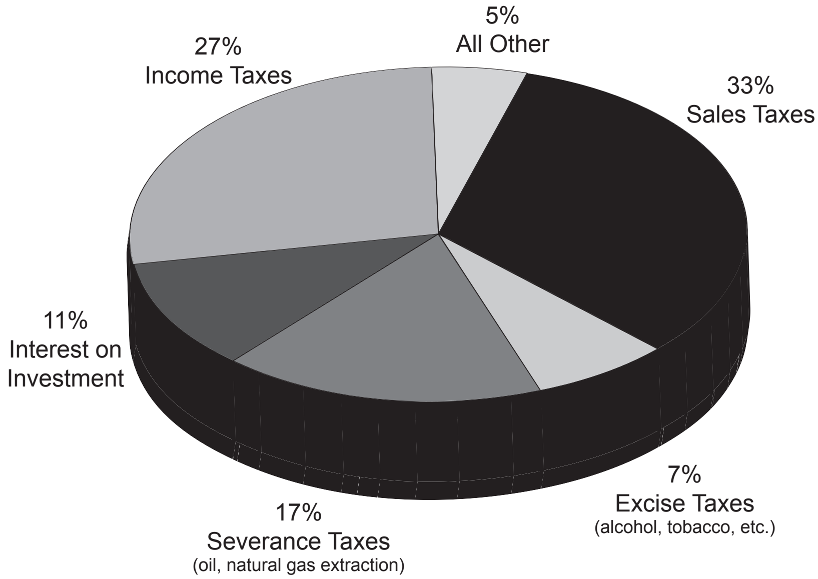
Revenue estimators also use economic indicators that are specific to New Mexico in building their projections. The main New Mexico indicators are job growth, personal income growth (which includes dividends and interest, etc.), and private wage and salary growth. Revenue estimators expect New Mexico job growth to be on a gradual downward trajectory from fairly strong growth of 2.7 percent in FY07 to more typical growth of 1.5 percent in FY12. Personal income growth, too, is expected to fall from 7.6 percent in FY07 to 4.9 percent in FY12. Private wage and salary growth, though, is expected to topple from growth of 11.9 percent in FY07 to 3.9 percent in 2012. The behavior of these economic indicators sets the parameters for the growth of general fund revenues.

Graph II
Expected Growth Rates of the GDP, Inflation and Federal Funds Rate



Source: New Mexico Legislative Finance Committee's 2008 Post Session Review, March 2008

Graph III
New Mexico's General Fund Revenue Sources for FY09
(by percentage)



Source: Legislative Finance Committee, 2008 Post-Session Review

General Fund Revenues

General fund revenues can be broken down into four broad categories for ease of analysis: sales taxes, income taxes, oil and gas receipts, and investment revenues.

There are also some smaller revenue sources, such as license fees and revenue sharing from tribal casinos. Each of the broad categories of revenues is influenced by national and state economic developments in specific ways.

Revenue estimators see sales tax receipts as influenced largely by growth in jobs, wages and salaries. All of these indicators are expected to gradually slow between FY07 and FY12. Sales taxes are made up of general taxes (largely gross receipts taxes on the sale of most goods and services) and selective (or excise) sales taxes (which include taxes on tobacco and alcohol). Growth in revenues from general sales taxes is expected to slow from 8.7 percent in FY07 to 3.3 percent in FY09 and remain near 3 percent through FY12. Selective sales taxes are more volatile and are expected to show no growth in FY07 and a 5 percent drop in FY08 before moving to more stable growth in the 3 to 4 percent range through FY12. General sales taxes are expected to be $1.974 billion in FY08, while selective sales taxes were $407.8 million.

Income taxes, which include personal and corporate income taxes, behave differently because they are driven by different economic factors. Personal income taxes are driven by state personal income growth, which is expected to decline from 7.6 percent in FY07 to 4.9 percent in FY12. Personal income tax revenues are also affected by policy changes such as the cuts enacted in 2003. Personal income tax revenues were growing at 3.5 percent in FY07, then slid to 0.6 percent in FY08. They are expected to grow by about 3 percent in most years out to FY12, except for growth of 6 percent in 2010. Personal income taxes are expected to be $1.147 billion in FY08.

The corporate income tax is a tax on corporate profits, which can vary widely. Corporate income tax revenues grew by 22 percent in FY07 on the strength of high oil and gas company profits, but are expected to fall by 4.5 percent in FY08. Although corporate income tax revenues will grow by 2.3 percent in FY09, there will be little or no growth in this revenue source in the fiscal years out to FY12. As much as 60 percent of corporate income tax revenues have come from oil and gas companies in recent years, according to the Taxation and Revenue Department. Corporate income tax receipts were expected to be $440 million in FY08.

Taxes on oil and gas and other minerals are extremely variable because they depend on production rates and global prices. Taxes on the production of oil and gas account for about one sixth of state general fund revenues. Oil prices were expected to rise from $60 per barrel in FY07 to $75 per barrel in FY 2012, and natural gas prices were expected to fall very slightly, from $6.54 per thousand cubic feet in FY07 to $6.35 in FY 2012. Clearly, recent developments, such as oil prices surpassing $100 per barrel, have made these forecasts unrealistic. Oil and natural gas production are also declining in New Mexico, falling from 57.8 million barrels in FY07 to 53.9 million barrels in FY12. Natural gas sales are expected to fall from 1,493 billion cubic feet in FY07 to 1,349 in FY12. These forecasts are realistic, as oil and natural gas production continually fall. Given this scenario of prices and production, mineral production taxes fall in most years of the forecast period, from a drop of 7.6 percent in FY07 to a drop of 3.6 percent in FY12. By 2012, the share of mineral production taxes in total general revenue will fall to about 15 percent.

The final category of general fund revenues is investment income, which is received from interest on the state's investments. Interest income is strongly influenced by the national economy. U.S. interest rates are strongly influenced by policies set by the Federal Reserve. Monetary policy, as measured by the federal funds rate, is expected to be loose in FY08 and FY09, before tightening again in FY10. This means lower interest rates, while a tightening involves higher interest rates. Higher interest rates mean increased revenues on state investments, while lower interest rates reduce investment revenues. Revenues from state investments are expected to be $646.8 million in FY08.

Summary

New Mexico general fund revenues will grow at a modest rate from FY07 to FY12 but will not be enough to meet baseline growth starting in FY10. All major revenue sources except taxes on oil production are expected to slow. The LFC anticipates a general fund deficit of $8 million in FY10, $63 million in FY11 and $122 million in FY 12. This means that new spending priorities that have come before the Legislature — such as the school funding formula and several transportation and health care programs — will not be funded unless significant cuts are made in current programs or new sources of revenue are found.

Solutions

- Mandating that multi-state corporations pay their fair share of corporate income tax through combined reporting would bring in $80 million annually, and it would make our New Mexico businesses more competitive.
- Requiring those who itemize on their personal income tax forms to add back to their state tax form the deduction on their federal form of state and local taxes would bring in $60 million annually. Nearly every other state already has this requirement.
- Reinstating the GRT on soda would bring in millions of dollars and help the state offset the high medical cost of obesity and diabetes.
- Reforming the statue regarding Tax Increment Development Districts would stem the loss of billions of dollars that is likely to be diverted to developers. (The state will have lost $1.1 billion on just two TIDDs if the SunCal bonds are authorized. Several more TIDD requests will be filed in the coming months.)