

## Revenues in New Mexico: The Five Year Path to a Revenue Squeeze

This paper will trace the trajectory of New Mexico general fund revenue growth during the Richardson administration. Revenue growth sets the constraint within which the state's budget must operate. In New Mexico, the state's general fund pays for public and higher education, Medicaid and other health care, and prisons and public safety. The state's recurring revenues grew from \$3.891 billion in FY 2003 to \$5.836 billion in FY 2008, a growth of nearly 50%. After FY 2003, revenues kept pace with the state's overall economic growth: revenues

were 8.65% of state personal income in FY 2003, then rose to 9.5% for the next two years. After a final jump to 9.8% in FY 2006, the revenue share of the state's economy subsided to 9.6% in FY 2007 and 9.3% in FY 2008. Oil and gas revenues came to represent a larger share of the state's economy during the FY 2003 – FY 2006 period because of high and rising oil and natural gas prices. Oil and natural gas prices tended to stabilize after FY 2007. This stabilization of oil and natural gas prices has a lot to do with the flattening trend for New Mexico general fund revenues.

**Revenue Share of New Mexico Economy**

	<b>Revenues (General Fund)</b>	<b>Personal Income</b>	<b>Share</b>
<b>FY 2003</b>	\$3,891.10	\$45,665.00	8.65%
<b>FY 2004</b>	\$4,283.00	\$48,649.00	9.48%
<b>FY 2005</b>	\$4,906.30	\$52,361.00	9.49%
<b>FY 2006</b>	\$5,594.00	\$55,860.00	9.84%
<b>FY 2007</b>	\$5,661.20	\$59,220.00	9.56%
<b>FY 2008</b>	\$5,836.00	\$62,709.00	9.31%

*Note - Numbers in millions*

Source: Calculated by NM Voices for Children from "General Fund Consensus Revenue Estimates" December 11, 2006 and US Bureau of Economic Analysis data

It is important to note that much of New Mexico's recent revenue growth was driven by revenue sources related to high oil and natural gas prices, and that these taxes are largely exported to the rest of the United States. Even though the ratio of revenues to the state's economy rose, the burden on the typical New Mexico taxpayer did not. The price of New Mexico oil was \$44 in FY 2005, rising to \$59 in FY 2006 and \$61 in FY 2007 and FY 2008. Natural gas was \$5.80 per thousand cubic feet in FY 2005, rising to \$7.46 in FY 2006 but dropping to \$6.20 in FY 2007 and rising only slightly to \$6.30 in FY 2008.

**New Mexico Economic Indicators**

	<b>Non-Farm Employment Growth</b>	<b>Personal Income Growth</b>	<b>Wage &amp; Salary Growth</b>	<b>Private Wage &amp; Salary Growth</b>
<b>FY 2005</b>	2.10%	8.80%	5.80%	6.40%
<b>FY 2006</b>	2.60%	6.00%	7.00%	8.50%
<b>FY 2007</b>	2.80%	7.10%	6.40%	7.00%
<b>FY 2008</b>	2.40%	5.90%	6.00%	6.50%

Source: Calculated by NM Voices for Children from "General Fund Consensus Revenue Estimates" December 11,2006

The pattern of growth of the state's overall economy plays an important role in the state's revenue collections. The next table shows that most general economic indicators are expected to show that their strongest growth was in FY 2006 or FY 2007. After that, growth tapers off. This is the case with employment growth, personal income, and wage and salary growth. This is one of the main factors in the gradual slowdown of general fund revenues this year and next.

This paper will focus on recurring revenues: revenues that can be expected to continue under current law. Nonrecurring revenues are far less important to the picture, and are the result of one-time events. The earlier years of the Richardson administration saw spectacular revenue growth in New Mexico: recurring revenues were up 10.1% in FY 2004 over the previous fiscal year, but rose to a peak of 14.6% in FY 2005 and 14.1% in FY 2006. The impetus behind this rapid growth was mainly high oil and natural gas prices: the oil and natural gas school tax, New Mexico's main severance tax, rose by nearly 30% for three years in a row. Also, about half of the substantial growth in corporate income tax revenues was also due to high oil and natural gas prices, according to testimony on the revenue estimates presented in December 2006 by the Cabinet secretaries of Taxation & Revenue and Finance & Administration.

Growth in revenues was affected by two major changes to the revenue structure that took place in the New Mexico Legislature in the 2003 and 2004 regular sessions. These changes were 1.) a major reduction in the top marginal rate for the personal income tax coupled with a large reduction in the income tax rate on capital gains; and 2.) the removal of the gross receipts tax for food consumed at home. These changes affected receipts from the personal income tax and gross receipts tax, which are the stable and broad-based revenue sources in the New Mexico tax structure.

**Sales Taxes**

After growing by 5.5% in FY 2005, gross receipts tax revenue shot up to 12% in FY 2006. Gross receipts revenue growth was 8.1% in FY 2007 and 6.3% in FY 2008, as the effects of the food tax exemption were felt. The gross receipts tax is paired with the compensating tax (a tax on bringing taxable goods and services into New Mexico from other states) in a category called general sales taxes. General sales taxes grew by 5% in FY 2004 and were estimated to grow by 6.3% in FY 2008. Between those years, general sales taxes had grown by as much as 12% in FY 2006. The pattern for general sales tax receipts showed a rapid acceleration up to FY 2006, and then a gradual slowdown to a more typical growth rate.

Selective sales tax growth showed a somewhat different pattern, growing from \$284 million in FY 2004 to \$411 million in FY 2008. The most rapid increase was a 25 % increase in FY 2004, with more gradual increases through FY 2008. The cause of the growth in FY 2004 was an increase in the insurance premium tax..

**Income Taxes**

The personal income tax is a significant source of revenue in New Mexico. This revenue source has seen significant change in recent years, as the top marginal rate has been reduced from 8.3% to 4.9%. FY 2008 is the last year of the phased-in cuts to

**General Sales Taxes FY 2003 - FY 2008**

	Gross Receipts		Compensating		General Sales Taxes	
	Total	Growth Rate	Total	Growth Rate	Total	Growth Rate
FY 2003	\$1,336.50		\$38.40		\$1,374.90	
FY 2004	\$1,409.60	5.50%	\$33.70	-12.20%	\$1,443.30	5.00%
FY 2005	\$1,512.50	7.30%	\$44.10	30.90%	\$1,556.60	17.90%
FY 2006	\$1,693.10	11.90%	\$51.80	17.55%	\$1,744.90	12.10%
FY 2007	\$1,830.00	8.10%	\$60.00	15.80%	\$1,890.00	8.30%
FY 2008	\$1,945.30	6.30%	\$63.10	5.20%	\$2,008.40	6.30%

Source: Calculated by NM Voices for Children from "General Fund Consensus Revenue Estimates" December 11, 2006

the top marginal rate. The rate cuts, coupled with a reduction in tax on capital gains, will result in a \$400 million loss in revenues in FY 2008 compared to the original rate structure. Personal income tax receipts increased from \$923 million in FY 2003 to \$1,181 million in FY 2008. The corporate income tax is coupled with the personal income tax in the income tax category, but in many ways the corporate tax behaves quite differently. Receipts from the corporate income tax have quadrupled from FY 2003 to FY 2008, growing from \$102 million in FY 2003 to \$400 million in FY 2007 and FY 2008.

The corporate income tax is heavily affected by oil and natural gas prices. State government economists estimate that about half of total receipts from the corporate income tax come from the oil and natural gas industry. High oil and natural gas prices have played a large role in the remarkable quadrupling of revenues from the corporate income tax. The final tax considered in the income tax category is the estate tax. The revenue from the estate tax was cut to zero between FY 2003 and FY 2006 by a combination of federal and state actions. The federal government ended the state's estate tax

credit, thereby reducing state revenue from this tax to zero. The state could have decoupled from the federal estate tax, but failed to do so, at a cost of about \$20 million annually.

Income tax revenues rose from \$1,040 million in FY 2003 to \$1,481 million in FY 2008. About three-quarters of the revenue decline from the rate cuts to the personal income tax in the 2003 legislative session have been offset by the effect of high oil and natural gas prices on the corporate income tax. The failure of New Mexico to decouple from the federal estate tax changes is simply a \$20 million windfall for high income taxpayers. The revenue shift from the personal income tax to the corporate income tax within the income tax category is a shift from a broad-based tax that grows with the economy (the personal income tax) to a narrowly based tax that is subject to erratic movements (the corporate income tax). Receipts from the corporate income tax grow only slightly in FY 2007, and are forecast to stop growing in FY 2008. The relationship between the corporate income tax and such measures of state economic activity as personal income or gross state product are quite indirect.

**Total Income Taxes FY 2003 - FY 2008**

	Personal Income Tax		Corporate Income Tax		Total Income Taxes	
	Total	Growth Rate	Total	Growth Rate	Total	Growth Rate
FY 2003	923.1		101.7		\$1,040.20	
FY 2004	1,007.20	9.10%	138.2	35.90%	\$1,153.10	10.90%
FY 2005	1,086.00	7.80%	242.5	75.50%	\$1,333.40	15.60%
FY 2006	1,126.60	3.70%	381.6	57.40%	\$1,512.30	13.40%
FY 2007	1,138.00	1.00%	400	4.80%	\$1,538.00	1.70%
FY 2008	1,181.00	3.80%	400	0.00%	\$1,581.00	2.80%

Note : Total includes Estate Tax for FY 2003-FY 2005

Source: Calculated by NM Voices for Children from "General Fund Consensus Revenue Estimates"  
December 11,2006

**Severance Taxes**

There are four taxes that, taken together, are called severance taxes in the state revenue estimates. These taxes nearly double in the five-year period, growing from \$268 million in FY 2003 to \$484 million in FY 2008. Since oil production in New Mexico is slowly declining and natural gas production has flattened, the increase in oil and natural gas severance taxes is driven by prices, not

additional production. These are the oil and gas school tax, the natural gas processor's tax, the oil conservation tax, and the natural resources excise tax. Natural resources excise tax revenues, although fairly small, have almost doubled over the five-year period, from \$5 million in FY 2003 to \$10 million in FY 2008. The natural resources tax increase reflects the recovery of copper mining, which is

**Total Severance Taxes FY 2003 - FY 2008**

	Oil & Gas School Tax		Oil Conservation Tax		Nat. Gas Processors		Total	
	Total	Growth Rate	Total	Growth Rate	Total	Growth Rate	Total	Growth Rate
FY 2003	\$229.60		\$11.90		\$21.10		\$268.40	
FY 2004	\$296.70	29.40%	\$13.60	-5.20%	\$13.50	-36.00%	\$329.60	22.80%
FY 2005	\$380.90	28.20%	\$17.80	18.20%	\$21.70	60.70%	\$427.00	29.60%
FY 2006	\$491.60	29.10%	\$23.00	36.90%	\$27.90	28.60%	\$551.40	29.10%
FY 2007	\$415.30	-15.50%	\$21.00	19.10%	\$31.30	32.30%	\$483.80	12.30%
FY 2008	\$413.30	-0.50%	\$21.90	4.70%	\$33.00	10.60%	\$477.30	1.30%

Note - Total includes resource excise tax  
Note - Numbers in millions

Source: Calculated by NM Voices for Children from "General Fund Consensus Revenue Estimates"  
December 11,2006

located in Grant County in southeastern New Mexico. Severance tax revenues are known to be quite volatile, and increasing reliance on these revenues also ratchets up the level of risk in the state revenue stream. Severance tax revenues actually peaked at \$551 million in FY 2006, and are expected to be \$477 million in FY 2008.

#### **Interest on State Permanent Funds**

The state of New Mexico derives a significant portion of its general fund revenues from interest payment on three state permanent funds. Interest on state funds has risen from \$479 million in FY 2003 to \$646 million in FY 2008. The increase in the body of the permanent funds is due to oil and natural gas revenues, so these revenue sources are the indirect result of oil and natural gas extraction. The current receipts from the funds are related to the level of interest rates, since the funds are invested by the state. Revenues from interest earnings are expected to increase minimally between FY 2007 and FY 2008, from \$643 million to \$646

million. The pattern seen with several other general fund revenue sources also holds in this case, with revenue increases peaking in FY 2006, and falling off slightly in FY 2007 and FY 2008.

#### **Other Revenue Sources**

Tribal casinos, a relatively small source of state revenues, paid roughly \$34 million to the state in FY 2003, rising to an expected \$54 million in FY 2008. License fees were also projected to be about \$50 million in FY 2008.

Revenues from oil and natural gas will be about \$1.23 billion in FY 2008, or about one-fifth of total general fund revenues of \$5.8 billion in FY 2008. Revenues from oil and natural gas were roughly \$552 million in FY 2003 or about one-eighth of total general revenues of about \$4 billion. The structure of the state general fund revenue has tilted toward revenues from oil and natural gas over the past five years, and this has increased the level of risk to the stability of general fund revenues.

#### **Total Tax Revenues FY 2003- FY 2008**

	<b>Sales Taxes</b>		<b>Income Tax</b>		<b>Severance Taxes</b>		<b>Total</b>	
	<b>Total</b>	<b>Growth Rate</b>	<b>Total</b>	<b>Growth Rate</b>	<b>Total</b>	<b>Growth Rate</b>	<b>Total</b>	<b>Growth Rate</b>
<b>FY 2003</b>	\$1,374.90		\$1,040.20		\$268.40		\$3,890.40	
<b>FY 2004</b>	\$1,443.30	5.00%	\$1,153.10	10.90%	\$329.60	22.80%	\$4,283.00	10.10%
<b>FY 2005</b>	\$1,556.60	17.90%	\$1,333.40	15.60%	\$427.00	29.60%	\$4,906.30	14.60%
<b>FY 2006</b>	\$1,744.90	12.10%	\$1,512.30	13.40%	\$551.40	29.10%	\$5,594.00	14.00%
<b>FY 2007</b>	\$1,890.00	8.30%	\$1,538.00	1.70%	\$483.80	12.30%	\$5,661.20	1.20%
<b>FY 2008</b>	\$2,008.40	6.30%	\$1,581.00	2.80%	\$477.30	1.30%	\$5,836.00	3.10%

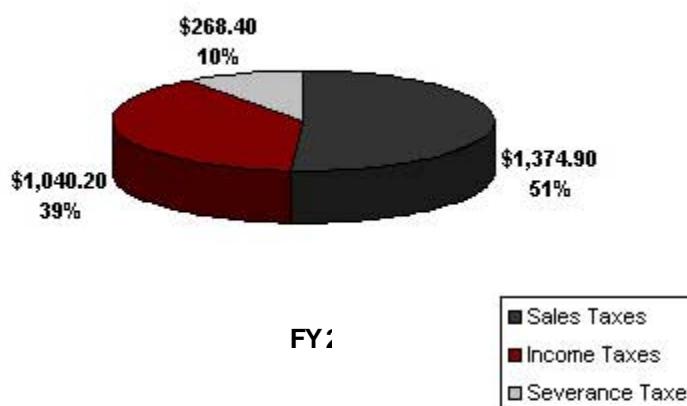
Note - Total includes all other revenue sources  
Note - Numbers in millions

Source: Calculated by NM Voices for Children from "General Fund Consensus Revenue Estimates"  
December 11,2006

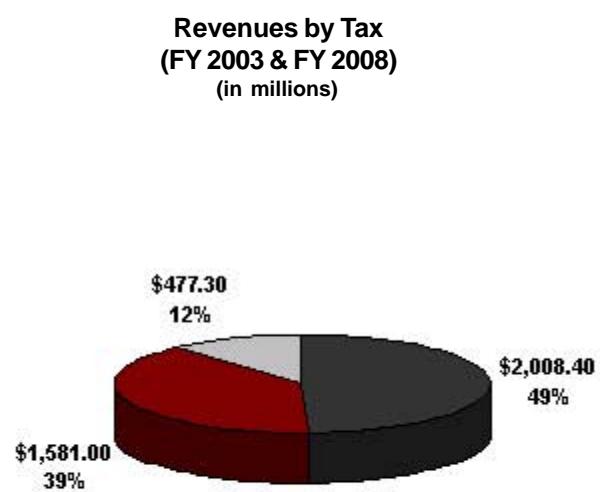
## **Summary**

Growth in state general fund revenues was very healthy in the FY 2003 to FY 2006 period: growth was 10% in FY 2004, 14.6% in FY 2005 and 14% in FY 2006. However, growth subsided to 1.2% in FY 2007 and is expected to be near 3% in FY 2008. Operating reserves were used by the Legislature to maintain a healthy level of growth, and revenue will be available from this source to a lesser extent in FY 2008. The December 2006 revenue estimates forecast growth in recurring revenues to be near 3% from FY 2008 and in the next three years. That would represent an increase in state general fund revenues of about \$180 million

per year for the next three or four years, a very modest increase that will leave the state scrambling to maintain current services with expenses rising due to price increases and population growth. New Mexico's population is expected to grow by about 1.1% annually and the rate of inflation should be about 3%. Growth in revenues of at least 4% will be required in order to maintain state support of education and health care at current levels. If current revenue projections are accurate, tax growth will be barely sufficient to maintain current service levels, and increases will be out of the question.



Source: Calculated by N.  
from "General Fund  
Estimates" December 11



This report, as well as other reports by the New Mexico Fiscal Policy Project, is available online at [www.nmfiscalpolicyproject.org](http://www.nmfiscalpolicyproject.org). The New Mexico Fiscal Policy Project is a program of New Mexico Voices for Children - [www.nmvoices.org](http://www.nmvoices.org).