General Fund Revenue Update and Outlook for 2010 Legislative Session

Presentation to the New Mexico Tax Research Institute
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N.M. Legislative Finance Committee
Economic Outlook

• U.S. GDP shrank 2.3% in FY09 and minimal growth is expected in FY10; 2.4% growth expected in FY11

• CPI only 0.9% growth in FY10, 1.5% expected in FY11

• NM employment down 3.5% in FY10, up 1.6% in FY11

• NM wages & salaries down 3.1% in FY10, up 3.8% in FY11

• Oil Price:    $70.00 FY10,    $75.00 FY11

• Gas price:    $4.30 FY10,    $5.40 FY11
• **Taxable gross receipts were down by 14% in the first quarter of FY10**
• **All business sectors are affected, Construction is down over 20%**
New Mexico Oil and Gas Prices

Forecast

Natural Gas - left axis
Oil - right axis
December 2009 Consensus General Fund Revenue Outlook
(million dollars)

<table>
<thead>
<tr>
<th></th>
<th>FY09</th>
<th>FY10</th>
<th>FY11</th>
<th>FY12</th>
<th>FY13</th>
<th>FY14</th>
</tr>
</thead>
<tbody>
<tr>
<td>February 2009 Revenue Estimates</td>
<td>5,727.0</td>
<td>5,485.1</td>
<td>5,756.1</td>
<td>5,992.3</td>
<td>6,180.6</td>
<td>6,397.0</td>
</tr>
<tr>
<td>August 2009 Revisions</td>
<td>(309.1)</td>
<td>(433.1)</td>
<td>(358.3)</td>
<td>(331.5)</td>
<td>(352.7)</td>
<td>(409.4)</td>
</tr>
<tr>
<td>October/December 2009 Revisions</td>
<td>(98.3)</td>
<td>(228.8)</td>
<td>(276.9)</td>
<td>(234.9)</td>
<td>(209.8)</td>
<td>(179.0)</td>
</tr>
<tr>
<td>Total Recurring Revenue</td>
<td>5,319.6</td>
<td>4,823.3</td>
<td>5,120.8</td>
<td>5,425.8</td>
<td>5,618.1</td>
<td>5,808.5</td>
</tr>
<tr>
<td>Annual percent change</td>
<td>-11.6%</td>
<td>-9.3%</td>
<td>6.2%</td>
<td>6.0%</td>
<td>3.5%</td>
<td>3.4%</td>
</tr>
</tbody>
</table>

- December forecast reduced FY10 by $10 million, FY11 by $53 million

- Cumulative FY08 - FY10 decrease now 20%, $1.2 billion in annual revenue

- 6% growth forecast in FY11, but FY08 level not reached until FY15
- Long-term growth rate through FY10 = 5.1%, personal income growth = 5.7%.
- Revenue growth decelerated since 2003, from 6.1% to 3.4% annual average.
Risks to the Forecast

• Economic recovery still poses significant risk:
  – Positives:
    • Job losses have slowed dramatically;
    • Productivity growth is improving corporate bottom line and limiting inflation
  – Negatives:
    • Federal deficits are unsustainable
    • Stimulus effects are in question
    • New home construction still very weak
    • House prices still falling
Risks (continued)

• Gas price risk significant for FY11
  – Dramatic productivity improvement implies downward pressure on prices
  – Could also imply downward pressure on NM production if shale development reduces demand for NM gas
- 6-month FY09 error = $407 million
- 18-month FY10 error = $660 million
- Errors are “additive”, a combined shortfall of almost $1.1 billion or 20% of FY10 appropriations
• Revenue growth from FY03 to FY11 = 31% (3.4%/year)
• Expenditure growth FY03-FY10 including temporary funds = 47% (5.7%/yr)
• FY10 gap = $910 million
• FY11 “New Money” = -$133 million
• Need to replace up to $300 million in federal money
Public School Support

• Public K-12 accounts for 45% of general fund budget.

• Since FY02, formula funding has increased approximately $728 million -- 43% -- although workload was flat.

• $210 million in federal stabilization funds were used in FY10; Only $23.9 million remains for FY11.

• Funding formula revisions in this session unlikely.

• Formula changes could improve efficiency: e.g. Changing eligibility requirements for school and district size adjustment
**Higher Education**

- 16% of General Fund appropriations.

- NM among top states in funding per capita, but performance outcomes are behind national averages, and are particularly low for minority students.

- Funding formula is input (enrollment) driven; no emphasis on outcomes.

- General Fund incremental cost of formula workload very high in FY11 --- $21 million, but base budget cuts also needed due to state’s fiscal situation.

- Overall tuition levels are among the lowest in the nation --- some room for tuition increases, but need to hold student financial aid flat.

- Need to focus on productivity savings and reduced funding for special projects.

- Need to find other savings such as taxpayer funding of tuition waivers for out-of-state students.

- ARRA stimulus funding helping to offset state funding reductions.
Medicaid

- 11.4% of general fund budget in FY10, up from 9.7% in FY03.

- Medical inflation, enrollment growth, provider rate increases, and new programs (e.g., SCI) have driven costs up. More than 500,000 New Mexicans get healthcare coverage through Medicaid and SCI.

- Federal stimulus raised matching rates by more than 10% for NM, now at 80.49%. Enhanced rates end on December 31, 2010 – creating a significant general fund need for FY11.

- Possible savings: slow enrollment, change eligibility, administrative savings, cut provider rates, reduce or eliminate benefits. Long term: redesign the program.

- Federal healthcare reform may have significant budget impacts – e.g., new enrollment mandates in 2013 or requirements to maintain enrollment and eligibility.
**Employee Pay and Benefits**

- NM public employee pay has grown relatively rapidly in the last 6 years
  - Ratio of NM state employee salaries to peer group average rose from 93% to 103%
  - Teacher pay now ranks 38th
- Benefits generous and underfunded
  - Vested state employees retire at 25 years with no minimum age
  - 3 percent cost-of-living adjustment
- Retirement fund condition’s weak and unsound
  - Retiree health contributions are about $200 million below normal cost
  - Unfunded liability for education retirement at $4.5 billion
  - PERA UAAL doubled in a year
- Investment performance is sub-par
Revenue Changes Since 2003

Cumulative Annual Impacts of Significant General Fund Tax Measures: 2003 to 2009 Legislative Sessions

<table>
<thead>
<tr>
<th></th>
<th>FY 2011 ($ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue increasing provisions</td>
<td>$340</td>
</tr>
<tr>
<td>Revenue decreasing provisions</td>
<td>-$939</td>
</tr>
<tr>
<td>Net impacts</td>
<td>-$600</td>
</tr>
</tbody>
</table>

- 2003 PIT cuts - $400 million per year
- Food GRT deduction - $228 million
- Medical deductions/credits - $100 million+
- Film production credits - $70 million
- Low-income tax credits/exemptions - $70 million
**Tax Policy Principles & Revenue Raising**

- NM is about average in tax burden on businesses, slightly above average in burden on households: Thus any significant tax increase is likely to push the NM burden above average
  - Other states are also looking at tax increases

- Although somewhat regressive, NM’s system is relatively fair in the distribution of tax burdens between high-income and low income households (DC Government survey)

- Raising income tax on high-income households improves vertical equity but narrows the base and may impair economic growth: 9% of taxpayers pay 60% of income taxes

- Federal tax deduction reduces net impacts on households that itemize (30% of all taxpayers but 80% of taxpayers over $100,000)
Tax Policy Principles (cont.)

• Corporate income tax issues:
  – Highly concentrated tax: 250 taxpayers pay 90%
  – NM’s tax rate one of highest in region
  – Combined reporting revenue yield is highly uncertain

• Excise tax issues:
  – Most NM rates are high compared with neighboring states—exception is Motor Vehicle Excise tax
  – Revenue yield from cigarette tax is sharply limited due to tribal exemption

• Gross receipts tax issues:
  – Retail sales are now only 25% of the tax base; business-to-business transactions more than 1/3; 70% of household purchases are exempt or deductible
  – Incidence may be regressive but evidence is lacking
### General Fund Revenue Impacts of Various Revenue Raising Options

(Dollar amounts in millions)

#### Income tax options:

<table>
<thead>
<tr>
<th>Description</th>
<th>Effect. Date</th>
<th>FY10</th>
<th>FY11</th>
<th>FY12</th>
</tr>
</thead>
<tbody>
<tr>
<td>1% income tax increase on current top bracket (married $24,000/single $16,000)</td>
<td>Tyba 1/1/2010</td>
<td>25.5</td>
<td>170.0</td>
<td>179.4</td>
</tr>
<tr>
<td>1% income tax increase over $100,000 (single), $150,000 (married)</td>
<td>Tyba 1/1/2010</td>
<td>5.0</td>
<td>56.1</td>
<td>59.4</td>
</tr>
<tr>
<td>Addback income tax deduction for state &amp; local taxes</td>
<td>Tyba 1/1/2010</td>
<td>-</td>
<td>40.0</td>
<td>42.0</td>
</tr>
<tr>
<td>Reduce deduction for capital gains from 50% to 25%</td>
<td>Tyba 1/1/2010</td>
<td>-</td>
<td>20.0</td>
<td></td>
</tr>
</tbody>
</table>

#### Corporate income tax options:

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<tr>
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<tr>
<td>Require combined reporting for corporate income tax</td>
<td>Tyba 1/1/2011</td>
<td>-</td>
<td>12.0</td>
<td>30.0</td>
</tr>
<tr>
<td>Increase corporate franchise tax from $50 to $250 per year</td>
<td>Tyba 1/1/2010</td>
<td>-</td>
<td>7.5</td>
<td>7.5</td>
</tr>
</tbody>
</table>

#### Gross receipts tax options:

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<tr>
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<th>FY12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repeal GRT deduction for food</td>
<td>7/1/2010</td>
<td>-</td>
<td>228.0</td>
<td>238.9</td>
</tr>
<tr>
<td>Repeal GRT food deduction and reinstate 0.5% GRT credit in muni areas</td>
<td>7/1/2010</td>
<td>-</td>
<td>48.0</td>
<td>48.0</td>
</tr>
<tr>
<td>Repeal GRT deduction for medical services</td>
<td>7/1/2010</td>
<td>-</td>
<td>65.0</td>
<td>69.9</td>
</tr>
<tr>
<td>Apply compensating tax to in-state sales currently exempt from all tax</td>
<td>7/1/2010</td>
<td>-</td>
<td>13.2</td>
<td>13.8</td>
</tr>
<tr>
<td>Increase statewide GRT rate by 0.25%</td>
<td>7/1/2010</td>
<td>-</td>
<td>126.0</td>
<td>132.0</td>
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</tbody>
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#### Excise tax options:

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<thead>
<tr>
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<th>FY11</th>
<th>FY12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase motor vehicle excise tax by 1.0%</td>
<td>4/1/2010</td>
<td>7.7</td>
<td>34.3</td>
<td>37.7</td>
</tr>
<tr>
<td>Increase O&amp;G Emergency School Tax on oil by 1%</td>
<td>4/1/2010</td>
<td>10.1</td>
<td>40.4</td>
<td>41.8</td>
</tr>
<tr>
<td>Increase O&amp;G Emergency School Tax on gas by 1%</td>
<td>4/1/2010</td>
<td>10.8</td>
<td>52.8</td>
<td>53.8</td>
</tr>
<tr>
<td>Increase liquor excise tax by 5 cents per drink</td>
<td>4/1/2010</td>
<td>10.0</td>
<td>40.0</td>
<td>40.7</td>
</tr>
<tr>
<td>Increase insurance premiums tax on health insurance by 1%</td>
<td>1/1/2011</td>
<td>-</td>
<td>22.0</td>
<td>47.0</td>
</tr>
<tr>
<td>Increase cigarette tax by $1 per pack from $0.91 to $1.91 per pack</td>
<td>4/1/2010</td>
<td>7.5</td>
<td>30.0</td>
<td>30.0</td>
</tr>
<tr>
<td>Increase cigarette tax by $1 with no exemption for tribal sellers for increase</td>
<td>4/1/2010</td>
<td>24.8</td>
<td>99.0</td>
<td>99.0</td>
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<tr>
<td>Increase tobacco products tax from 25% to 40%</td>
<td>4/1/2010</td>
<td>0.8</td>
<td>3.0</td>
<td>3.0</td>
</tr>
</tbody>
</table>

#### Options to reduce tax expenditures:

<table>
<thead>
<tr>
<th>Description</th>
<th>Effect. Date</th>
<th>FY10</th>
<th>FY11</th>
<th>FY12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repeal angel investor tax credit</td>
<td>Tyba 1/1/2010</td>
<td>-</td>
<td>0.8</td>
<td>0.8</td>
</tr>
<tr>
<td>Reduce film production credit rate from 25% to 15% of expenditures</td>
<td>Tyba 1/1/2010</td>
<td>6.5</td>
<td>26.0</td>
<td>28.6</td>
</tr>
<tr>
<td>Reduce rate of high wage jobs tax credit from 10% to 7% of wages</td>
<td>7/1/2010</td>
<td>-</td>
<td>5.0</td>
<td>5.5</td>
</tr>
<tr>
<td>Reduce rate of technology jobs tax credit from 8% to 6% of expenditures</td>
<td>7/1/2010</td>
<td>-</td>
<td>1.5</td>
<td>1.7</td>
</tr>
<tr>
<td>Reduce rate of investment credit from 5% to 4% of expenditures</td>
<td>7/1/2010</td>
<td>-</td>
<td>1.6</td>
<td>1.8</td>
</tr>
<tr>
<td>Reduce renewable energy production credit by 20%</td>
<td>Tyba 1/1/2010</td>
<td>-</td>
<td>1.0</td>
<td>1.1</td>
</tr>
<tr>
<td>Freeze hospital GRT credit at FY10 level</td>
<td>7/1/2010</td>
<td>-</td>
<td>4.0</td>
<td>8.0</td>
</tr>
<tr>
<td>Reduce rate of credit for NMMIP assessments by 20%</td>
<td>7/1/2010</td>
<td>-</td>
<td>10.0</td>
<td>14.0</td>
</tr>
<tr>
<td>Eliminate GRT back to school tax holiday</td>
<td>7/1/2010</td>
<td>-</td>
<td>2.7</td>
<td>2.7</td>
</tr>
<tr>
<td>Reduce lab small business partnership credit by 50%</td>
<td>7/1/2010</td>
<td>-</td>
<td>2.0</td>
<td>2.1</td>
</tr>
</tbody>
</table>

"Tyba" = Tax years beginning on or after.
• Unexpected revenue decreases have dropped reserves despite solvency measures and federal stimulus spending.

• FY10 reserves of less than 1% are inadequate in any economy, more so in highly uncertain times.

• Voiding capital projects required to boost reserves.
Capital Outlay

- Net senior STB capacity is estimated at $30.8 million in FY10.

- Supplemental STB capacity is estimated at $156.1 million in FY10.

- General obligation bonding capacity is estimated at $175.3 million in FY10.

Source: LFC