# F I S C A L   I M P A C T   R E P O R T

**ORIGINAL DATE** 1/29/19
**SPONSOR** Thomson **LAST UPDATED** ______ **HB** 132

**SHORT TITLE** Remove Tobacco Fund As Reserve Fund **SB** ______

**ANALYST** Clark

## GENERAL FUND RESERVES (dollars in thousands)

| Estimated Reserve Impact | | | | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| **FY19** | **FY20** | **FY21** | **FY22** | **FY23** | | |
| NFI | ($216,600.0) to ($344,200.0) | Indeterminate but Significant Negative Impact | | | Recurring, but not Cumulative Impact | General Fund Reserve Balances (*Not Revenue*) |

Parenthesis ( ) indicate revenue decreases

Relates to the General Appropriation Act

**SOURCES OF INFORMATION**
LFC Files

Responses Received From
New Mexico Attorney General (NMAG)
Taxation and Revenue Department (TRD)
State Investment Council (SIC)
Human Services Department (HSD)
Department of Health (DOH)

**SUMMARY**

Synopsis of Bill

House Bill 132 amends Section 6-4-9 NMSA1978 to remove the tobacco settlement permanent fund (TSPF) as a reserve fund of the state's general fund. It removes the Legislature's ability to authorize a transfer in the annual General Appropriation Act from this fund to the general fund in an amount necessary to meet general fund appropriations if general fund balances are insufficient to meet the level of appropriations authorized for a fiscal year.

The bill also performs minor language clean-up.

The effective date of this bill is July 1, 2019.

## FISCAL IMPLICATIONS

The State Investment Council (SIC) reports that short term, removing the TSPF as a reserve of the state has the potential to negatively impact the state's bond rating, though this is less likely to be considered – if at all - by bond rating agencies should those funds be replaced in the general fund reserve account.

However, LFC staff note the LFC budget recommendation and accompanying financial summary show an estimated $344.2 million in the TSPF by the end of FY20, representing 4.9 percent of recurring appropriations. If this bill is enacted, in order to achieve the LFC reserve target of 20 percent, general fund appropriations would need to be reduced by $280.5 million.

The executive budget recommendation and accompanying financial summary show an estimated $216.6 million in the TSPF by the end of FY20 (lower due to transfers to the fund in the LFC recommendation), representing 3 percent of recurring appropriations. If this bill is enacted, in order to achieve the executive reserve target of 25 percent, general fund appropriations would need to be reduced by $214.4 million.

The impact to the general fund reserves would be recurring; as long as this change were in effect, the balances would not include any money in the TSPF. However, the impact would not be cumulative – if the Legislature reduced appropriations or otherwise replaced general fund revenues to offset this impact, the Legislature would not need to continue making such offsets in future fiscal years.

## SIGNIFICANT ISSUES

The New Mexico Attorney General (NMAG) provided the following background related to this fund.

> In the wake of the landmark 1998 Master Settlement Agreement between most of the states (including New Mexico) and the largest cigarette manufacturers, the Legislature enacted Section 6-4-9 NMSA 1978, which created the tobacco settlement permanent fund, into which would be placed "money distributed to the state pursuant to the master settlement agreement." Under Section 6-4-9, the tobacco settlement permanent fund is considered a reserve fund of the state, and therefore the money maintained therein may be transferred to the general fund "in the event that general fund balances … will not meet the level of appropriations authorized from the general fund for a fiscal year."

Pursuant to the current provision in statute, the Legislature "swept" the tobacco settlement permanent fund in 2016 as part of a significant effort to maintain fiscal solvency in the face of a severe decline in revenues.

NMAG reports there are no significant issues with the historical uses of this fund or the proposed changes to statute. The Legislature has the "exclusive power of deciding how, when, and for what purpose the public funds [of the state] shall be applied in carrying on the government." *State ex rel. Schwartz v. Johnson*, 1995-NSMC-080, ¶ 14, 120 N.M. 820. The Master Settlement Agreement makes no provision for how signatory states may, or must, spend the tobacco settlement payments that the cigarette industry must pay to the states in perpetuity. (*See, e.g.*, *United States General Accounting Office, Tobacco Settlement: States' Use of Master Settlement*

*Agreement Payments* (June 2001 report) at page 3: "The MSA imposes no requirements on how states spend their MSA payments; states are free to use the funds for any purpose.").

SIC notes that while changing the statute under which the TSPF is governed would help protect the 'permanent' status of the TSPF, it would still not be a constitutionally-protected fund like the land grant (LGPF), severance tax (STPF), and water trust permanent funds. The TSPF is not attached to any section of the state constitution, and therefore, this legislation could be revised at a future date without approval of the electorate. Changes to the LGPF, STPF, and water trust permanent fund require constitutional change. The TSPF was not created through constitutional construct and could therefore be changed back to 'reserve fund' status through future legislation.

The Department of Health (DOH) provided the following analysis.

> As tobacco use rates decrease in New Mexico, MSA payments and tobacco tax revenues could decrease. The Tobacco Industry has also been aggressive in litigating with states receiving MSA payments, including New Mexico, to lower and/or eliminate payments to those states. If such became the case, income from the investment of the Tobacco Settlement Permanent Fund could become the only source of perpetual MSA funding available to the programs that rely on these revenues. At the Department of Health, this includes the Tobacco Use, Prevention and Cessation Program, the Breast and Cervical Cancer Program, the Hepatitis and Harm Reduction Programs, and the Diabetes Prevention and Control Program.
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> Sustained funding of tobacco control programs is important for reducing the burden of tobacco use in New Mexico. It is important to note that other states that have implemented comprehensive tobacco prevention and cessation programs have achieved significant reductions in tobacco use among both adults and youth; however, many state tobacco control programs, even the model ones, have recently experienced drastic reductions in funding. Cuts to program funding are taking their toll – reductions in youth smoking have stalled, and sales of tobacco to youth and youth susceptibility to smoking are on the rise. Even more alarming is how quickly progress can be slowed or reversed. Examples of states that have been impacted by these funding decisions include: California, Minnesota, Massachusetts, Florida, Indiana, Washington, and Ohio.
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> http://www.tobaccofreekids.org/research/factsheets/pdf/0270.pdf

**PERFORMANCE IMPLICATIONS**

SIC reported the following performance analysis.

> The TSPF is currently invested by SIC with the potential need for liquidity in mind, due to the TSPF's "reserve fund" status. As such, the TSPF, while still prudently invested, does not participate in long-horizon private market assets which are often higher-returning and less-liquid than stocks and bonds in the publicly-traded markets. The result on a multi-year basis is the TSPF has more volatility, a higher risk profile and less diversification than the LGPF. While the TSPF will outperform more balanced funds like the LGPF during years of high public market equity returns, there is a high probability they will underperform during average or down market years and over a full market cycle.

## OTHER SUBSTANTIVE ISSUES

SIC provided the following additional information.

> Originally established in statute in 1999, the TSPF was originally conceived as a future endowment for the state, where of the (on average) ~$40 million in annual tobacco settlement payments to the state, half would be spent, and half saved to the permanent fund. Once the permanent fund reached a size large enough to both be self-sustaining and produce annual distributions to meet the state's needs, it would begin distributing 4.7% of its five-year average value to the general fund, as does the STPF. At the time (1999), it was estimated that this would occur in approximately 2017, and that by 2025, assuming normal inflows annually, the fund would grow to $1.9 billion with distributions of $74 million per year by approximately 2025.
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> State fiscal needs however, have largely led to the vast majority of dollars intended to flow into the fund to be "swept" legislatively, and more recently, for the corpus to be called down and used as part of the state reserve funds. The chart below captures this on an annual basis, but through FY18, can be summarized as follows:
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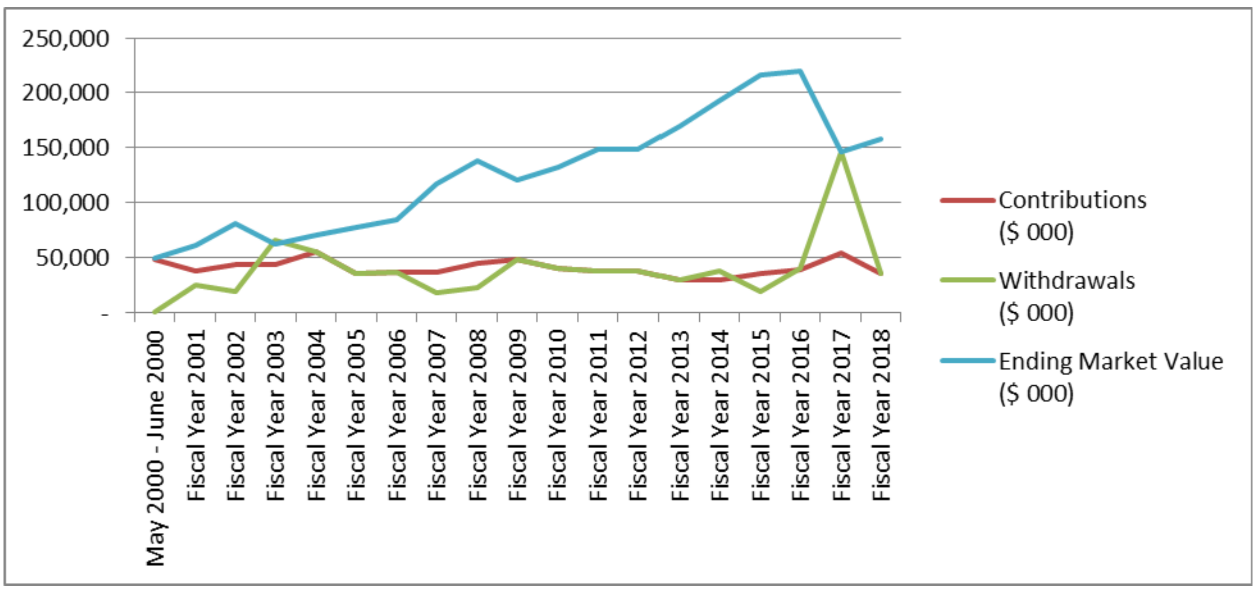
> - Cash into fund, since inception: $769.1 million
> - Cash withdrawn, since inception: $748.5 million (97%)
> - Current value as of 12/31/18: $149.8 million

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| **Does the bill meet the Legislative Finance Committee tax policy principles?**<br>1. **Adequacy**: Revenue should be adequate to fund needed government services.<br>2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.<br>3. **Equity**: Different taxpayers should be treated fairly.<br>4. **Simplicity**: Collection should be simple and easily understood.<br>5. **Accountability**: Preferences should be easy to monitor and evaluate |

JC/al