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

ORIGINAL DATE 02/06/09
SPONSOR Taylor **LAST UPDATED** **HJR** 9

SHORT TITLE Limit State Expenditure Increases, CA **SB**

ANALYST Hoffmann

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY09	**FY10**		
	See Narrative	Recurring	General Fund Severance Tax Permanent Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

SUMMARY

Synopsis of Bill

House Joint Resolution 9 proposes a constitutional amendment that would limit the legislature's ability to increase state expenditures, imposes additional limits on expenditures if the state's revenues decrease by more than five percent from the prior year's revenues, and transfers any excess general fund balances (as calculated by a formula) to the Severance Tax Permanent Fund.

The bill also specifies a requirement for an operating reserve of no less than ten percent of the expenditure limit, and an extraordinary operating reserve of four percent in addition to the operating reserve. The operating reserve could be appropriated "pursuant to standards established in law for expenditure in economic emergencies…" The extraordinary reserve could only be appropriated 1) if current fiscal year revenues fall below the prior fiscal year revenues as determined by the consensus revenue estimating group (composed of the economists from the legislative and executive branches), and 2) the legislature has voted by a two-thirds majority to appropriate money from the extraordinary reserve for use.

If this constitutional amendment were to pass, the Legislature would have annual limits to general fund appropriations. Beginning in fiscal year 2012, the annual limit would be equal to (the previous year's appropriation) plus (the previous year's appropriation times the percent of population growth for the most recent calendar year for which the data are available) plus (the previous year's appropriation times three and six-tenths percent).

The bill also provides that beginning at the end of fiscal year 2012, 100 percent of the unexpended or unencumbered balance in the general fund in excess of the expenditure limit will be deposited in the Severance Tax Permanent Fund (STPF).

The proposed amendment would be put to a vote of the citizens at the next general or special election, if prior to the next general election.

FISCAL IMPLICATIONS

No immediate fiscal impact is associated with this resolution. In the case that it passes, is put to a vote and approved, the fiscal implications could be large in years where revenues grow faster than three and six-tenths percent estimate of inflation plus the percentage increase in population.

SIGNIFICANT ISSUES

The Department of Finance and Administration and the Legislative Finance Committee provided the following notes.

The spending limit proposed by this bill ensures that spending will actually grow at a rate slower than inflation plus population. This is because revenue growth is not smooth from year to year. In some years revenues grow faster than the proposed rate and other years by less. Thus, in years when revenues grow more slowly, spending would naturally be constrained to a rate less than inflation plus population growth. In Colorado, which at one time implemented this type of limit (the Taxpayer Bill of Rights or TABOR amendment), years of declining revenues forced budget reductions, which could not be made up when revenues started to grow again.

Situations like the one above caused the Colorado legislature to reexamine this restriction, and a referendum to the voters reversed the constitutional restriction. Some advocates of spending limits have suggested an alternative that would cap state spending to a percentage of state income. This would allow state spending to grow at the rate of income growth and also allow for the variability in the growth of the state's economy and revenues. So, while budgets would still have to be reduced in years of declining revenues, these reductions could be made up in years when the economy and revenues recovered.

Public finance theory suggests no consensus as to the "correct" rate of spending growth. Spending restrictions such as the one proposed here would require spending to grow by a rate lower than that for the state's economy. The alternative discussed above would have state spending and the economy (as measured by income growth) grow at the same rate. Letting spending increase at a rate faster than economic growth is another alternative.

New Mexico's revenue structure used to be thought to be modestly elastic. That is, revenues grew a little faster than income. In large part this was due to the personal income tax, which typically—prior to the income tax cuts--grew by about 1.4 percent for each 1 percent growth in personal income. Once income tax cuts are fully implemented, the personal income tax will be considerably less elastic and is likely to grow at a rate only slightly faster than personal income growth. Elastic revenue growth from the personal income tax revenues has typically been at least partially offset by other slowly growing revenues. For example, gross receipts taxes grow at about 85 to 90 percent of the rate of income growth, e.g. income growth of 5 percent might imply gross receipts revenue growth of 4.5 percent. Selective sales taxes as a group grow relatively slowly as do most other revenues. The wild card is energy related revenues, which display no discernible pattern. Recent revenue growth for the state has been linked to energy related revenues, but these are expected to continue to decline in future years.

OTHER SUBSTANTIVE ISSUES

Colorado's Taxpayer Bill of Rights (TABOR) amendment was similar to the measures found in HJR 9, except that it limited revenue collections to the previous year's population growth rate and inflation instead of expenditures. TABOR also required that revenues in excess of this limit be refunded to taxpayers. As a result of TABOR, Colorado's fiscal crisis was among the worst in the nation. In FY 2002, facing a $933 million budget shortfall, TABOR forced the refund of $927 million in excess FY 2001 revenues to the taxpayers.

Unlike some states, Colorado's budget crisis forced painful budget cuts, including terminating Medicaid services for legal immigrants and pregnant women. An expenditure limit of this type could have devastating effects on the state budget if New Mexico experiences another sharp revenue decline in the future. If revenues decline sharply, necessitating a year-over-year expenditure decrease, the state would begin economic recovery from a permanently reduced expenditure base. This risk is high considering the volatility of New Mexico's oil and natural gas revenues. In Colorado, in an effort to protect the revenue base in FY 2002, the legislature raided $487 million from various trust funds and transferred them to the General Fund as revenue. In New Mexico, the expenditure limit could create an incentive to spend the maximum each fiscal year to protect the expenditure base.

The mechanism transferring funds to the Severance Tax Permanent Fund contained in the expenditure limit would eliminate New Mexico's ability to build and maintain prudent general fund reserve balances in years of high revenue growth. Lower reserves would exacerbate the problem of permanently reducing the expenditure base in years when expenditure cuts are necessary.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The Legislature will continue to establish appropriation levels in accordance with annual revenues.

CH/mt