6

The Fiscal Structure of New Mexico

Legislative Finance Committee[1]

INTRODUCTION AND OVERVIEW

This chapter on New Mexico's fiscal structure attempts to provide a comprehensive overview of the state's fiscal structure and pertinent issues and policies. It reviews recent revenue and expenditures data in a comparative framework. Throughout the chapter references are made to provisions of the state constitution that govern public finances. These represent key underpinnings necessary to understanding fundamental issues including the requirement for a balanced budget and limitations on debt.

The chapter begins with a review of state and local governments' general revenues and direct expenditures. These are compared with data for the rest of the country. The overview is followed by sections on the state's tax and revenue structure, major state government funds, state budget process including an increasingly important focus on government performance, state government recurring spending, state capital spending and debt policies, and local government finance.

New Mexico state and local governments' finances for fiscal year 2002 (July 1, 2001 to June 30, 2002) are summarized in **exhibit 6.1**[2]. As reported by the United States Bureau of Census, New Mexico state and local governments collected nearly $11 billion in general revenues. The state collected more than three quarters of this revenue, with the remainder collected by cities, counties, and school districts. This is significantly higher than the average 45 percent state share for all other states. Of the $11 billion of general revenue in New Mexico, the federal government contributed $3.1 billion or 28 percent. This is up from about 18 percent in FY 1989. The decade prior to 1989 witnessed a large decline in federal revenue funding—from 27 percent to 18 percent—because of the end of the federal revenue sharing program. Subsequent growth largely reflects rapid growth in the Medicaid program, where roughly three quarters of the program's costs are absorbed by the federal government.

Taxes levied by state and local governments, which include property, income, and sales (gross receipts) taxes account for 45 percent of the total revenue.[2] Charges and miscellaneous revenues account for 26 percent of general revenue and include tuition charges, hospital fees, and significant interest income from the state's two permanent funds.

While the state collects more than three-fourths of own source revenue in New Mexico, the state-local expenditure division is more even, with the state accounting for 56 percent of total expenditures. This difference is possible because there are significant transfers from the state to local governments on both the expenditure and revenue sides. For example, nearly half the state's General Fund revenues are transferred to local school districts in support of public education, while about one-fourth of the state gross receipts tax (often called the "sales" tax) is transferred to municipalities in New Mexico as a revenue distribution for general budget support.

Total public spending for all levels of education in FY 2002 was $4.2 billion, 36.5 percent of total New Mexico state and local general expenditures. Sixty percent of education expenditures go for elementary and secondary education; higher education spending accounts for most of the remainder. The second largest spending category is public welfare, with 18.2 percent of the total, up from about 8.6 percent in FY 1989. The significant increase in the share of spending represented by this category is largely due to the high, sustained growth in the Medicaid program. Transportation spending accounted for 10.7 percent of total spending. These expenditure rankings are similar to those of other states, although New Mexico tends to spend a higher proportion on education than the average state.

EXHIBIT 6.1

New Mexico State and Local Government's General Revenues and Direct Expenditures, FY 2002 (in millions of dollars)

	State	*Local*	*Combined*
GENERAL REVENUES			
Intergovernmental			
Federal	$2,759.6	$364.0	$3,123.5
Taxes			
Property	52.8	703.2	756.0
Sales & Gross Receipts	1,822.9	496.6	2,319.5
Income	1,107.2	0.0	1,107.2
Other Taxes	645.2	49.8	695.0
Charges & Misc.	1,995.4	871.2	2,866.5
TOTAL REVENUES	$8,383.0	$2,484.7	$10,867.7
GENERAL EXPENDITURES			
Education			
Public	0.0	2,506.8	2,506.8
Higher	1,260.6	201.2	1,461.8
Other	207.0	0.0	207.0
Libraries	2.4	32.5	34.8
Public Welfare	2,028.3	48.5	2,076.8
Health & Hospitals	739.1	89.9	829.1
Other Social Services	57.2	0.0	57.2
Highways	924.7	218.7	1,143.4
Other Transportation	2.7	76.2	78.9
Police Protection	88.8	320.9	409.7
Fire Protection	0.0	146.3	146.3
Correction	241.5	130.0	371.4
Protective Insp. & Reg.	59.5	3.5	63.0
Natural Resources	138.2	69.3	207.5
Parks & Recreation	48.9	156.2	205.1
Sewerage	11.4	108.0	119.4
Other Envir. & Housing	14.2	182.5	196.8
Government Administration	349.1	276.9	625.9
Interest on General Debt	192.2	185.7	377.8
Other General Expenditure	79.5	237.8	317.2
TOTAL EXPENDITURES	$6.445.2	$4,990.9	$11,436.0

Source: U.S. Department of Commerce, Bureau of the Census, *Government Finances: 2001–02*.

THE TAX STRUCTURE

Eighty-five percent of total state and local taxes collected in FY 2002 can be attributed to three revenue sources: Sales and gross receipts taxes (48 percent), income taxes (22 percent), and property taxes (11 percent). Most states depend on these same revenue sources, but there are significant differences among states as to their relative importance in producing revenues. Such differences may be attributed to the various states' economic circumstances, politics and historical tax structure. Also, unlike all but a few states, New Mexico also collects a significant share of revenues from taxes and rents and royalties on mineral production. **Exhibits 6.2 and 6.3** compare New Mexico's tax structure with the averages for all other states.

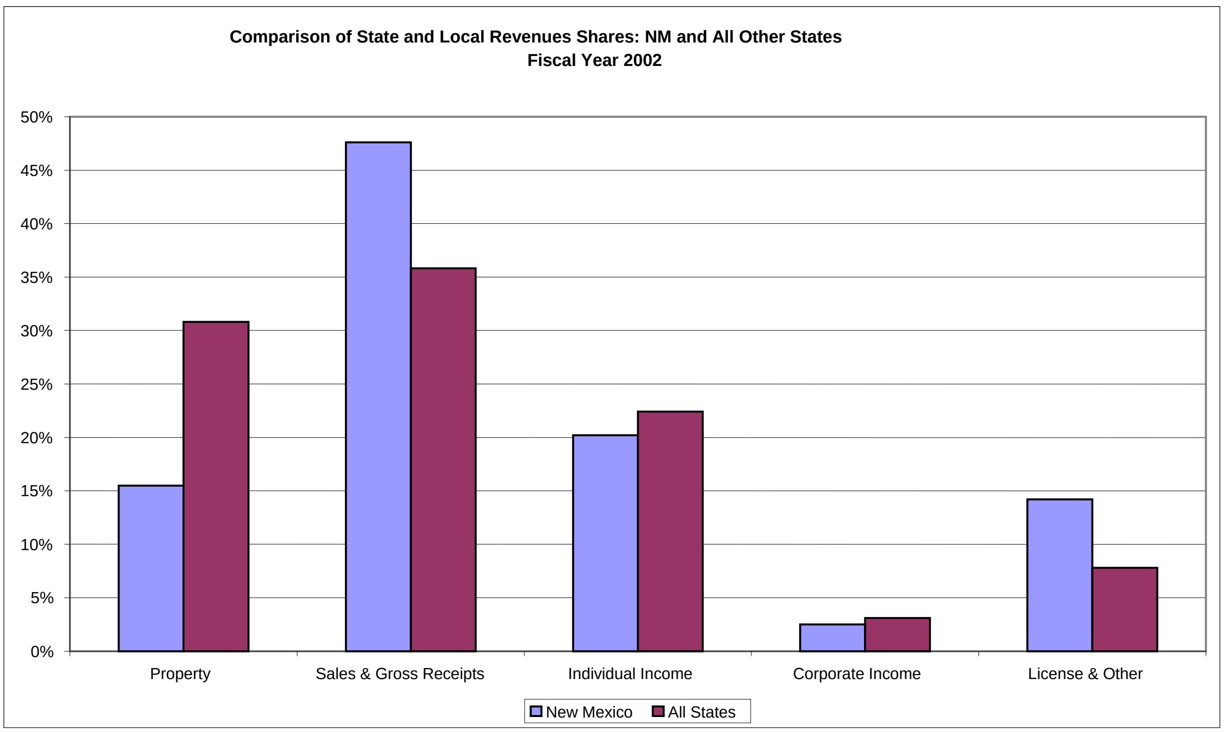
EXHIBIT 6.2

Comparison of State and Local General Tax Revenues
All States and New Mexico, FY 2002
(in millions of dollars)

	State	Local	Combined	Percent of Total
ALL STATES				
Property	$ 9,702	$269,419	$279,122	30.8
Sales & Gross Receipts	262,361	61,679	324,040	35.8
Individual Income	185,697	17,162	202,858	22.4
Corporate Income	25,123	3,029	28,152	3.1
License & Other	52,358	18,441	70,799	7.8
TOTAL	$535,241	$369,730	$904,971	100.0
Per Capita Tax			$3,143 (not $ millions)	
Percent of personal income			10.4 percent	
NEW MEXICO				
Property	$ 53	$ 703	$ 756	15.5
Sales & Gross Receipts	1,823	497	2,320	47.6
Individual Income	983	0	983	20.2
Corporate Income	124	0	124	2.5
License & Other	645	50	695	14.2
TOTAL	$3,628	$1,250	$4,878	100.0
Per Capita Tax			$2,634 (not $ millions)	
Percent of personal income			11.1 percent	

Source: U.S. Department of Commerce, Bureau of the Census, *Government Finances: 2001–02*.

EXHIBIT 6.3



In FY 2002 New Mexico governments raised slightly less than half (47.6 percent) of its tax revenues from general sales (gross receipts) and selective excise taxes (such as those on cigarettes, gasoline, and alcohol). Compared to most other states, New Mexico relies more heavily on sales taxes, ranking eighth highest in the country for the percent of revenues generated by general sales taxes. Other rankings underline the importance of sales taxes in New Mexico. State and local sales taxes accounted for 6.4 percent of personal income in the state in FY 2000, third highest in the country. These taxes amounted to $1,338 per person, ranking the state 7th in that category.

Although sales taxes continue to be a key part of the tax structure, the state is somewhat less dependent on this revenue source than in the past. In 1989, sales taxes accounted for 52 percent of own source revenue. A significant characteristic of the New Mexico gross receipts tax is the comprehensiveness of its base. New Mexico is one of only a few states that tax services as well as goods. This broader tax base allows a larger tax yield for a given gross receipts tax rate. Taxing services also may tend to make this tax less regressive than many states' sales tax systems, since upper-income families spend relatively more on services. Furthermore, because services are a growing sector of the general economy, the New Mexico gross receipts tax is relatively elastic compared to many states' sales tax systems. New Mexico gross receipts tax revenues grow at a rate nearly proportional to overall state economic growth. Finally, gross receipts tax receipts tend to be less sensitive to the business cycle than a tax on goods alone would be.

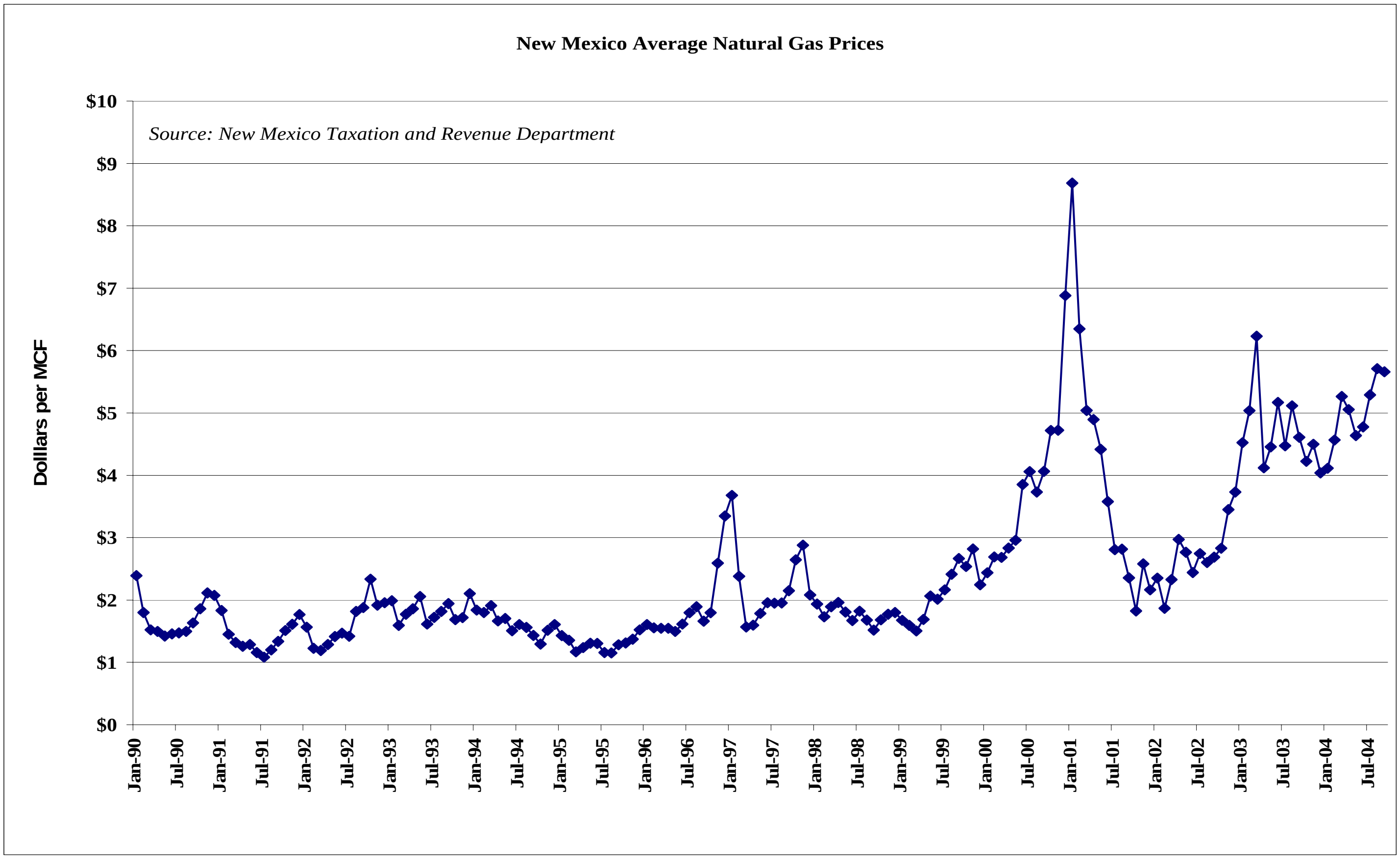
One reason why the New Mexico gross receipts share of revenues has decreased in recent years is that the state has begun to allow more exemptions from the tax, narrowing the base. Prescription drugs were exempted in 1990s, and legislation passed in 2004 exempted food and some medical services from the tax. Prior to these exemptions, New Mexico was one of just a handful of states with a sales tax on these goods and services. Equity concerns regarding the taxation of necessities like food and medicines were offset, at least partially, by a low-income tax rebate program. The elimination of the gross receipts tax on food was accompanied by an increase in the overall gross receipts tax rate to make up foregone revenue. A remaining, unresolved gross receipts tax policy issue is the taxation of business services. Taxing inputs results in a pyramiding effect that can put some businesses at a disadvantage with competitors from other states where such inputs are not taxed. While this issue is of keen interest to the business community and political leaders, an immediate fix may prove difficult because the revenue loss implied would be large.

In FY 2002, use of the property tax accounted for only 15.5 percent of total taxes in New Mexico, about half the 30.8 percent share in the average state. New Mexico ranks forty-ninth among the states in the share of revenues from property taxes. In 1981, after the so-called "Big Mac" tax cut, the property tax in New Mexico largely became a local government revenue source, funding both general operations and capital outlay. This low utilization of the property tax is mainly due to a constitutional provision (Article 7, Section 2) that limits the property tax for operational purposes to 20 mills (one mill equals one one-thousandth of a dollar of assessed property value). The 20 mills are divided between counties (11.85), municipalities (7.65) and school districts (0.50). The constitutional provision was passed during the 1930s, at the same time the gross receipts tax was enacted. The New Mexico Supreme Court has ruled that assessed value should be uniform throughout the state, at one-third of market value. Thus the 20 mills represent 2 percent of one-third of market value, resulting in an effective tax rate of two-thirds of 1 percent. Also, many local governments do not impose the maximum rate.

The personal income tax has also grown rapidly throughout the past two decades as a source of revenue in New Mexico. In FY 2002 this tax represented 20.2 percent of total New Mexico taxes, up from 14.7 percent in FY 1989 and just 5.0 percent in FY 1978. However, New Mexico still relies less on the personal income tax than most other states (see exhibit 6.2). As of FY 2002, New Mexico ranked thirty-fifth among the states in the percentage revenues from state personal-income taxes. Other comparative information showed that in FY 2000, individual income taxes per capita were $484, for a rank of 37th among all states. The tax accounted for 2.3 percent of personal income, putting the state in the 35th highest position. While state income tax revenues measured as a share of total revenues and per-capita and per-share of personal income rankings indicate that the state's income tax policies are competitive, some business and political leaders contended that the state's top marginal rate placed the state at a competitive disadvantage in the battle for economic development. As of 2003, the state's top personal income tax rate was 8.1 percent, the 8th highest top rate in the country. In response to these concerns and the urging of the governor, the legislature passed legislation significantly reducing income tax rates over a five-year period in 2003. The phased-in rate reductions gradually reduce the top marginal tax rate from 8.1 percent in Fiscal Year 2003 to 4.9 percent in Fiscal Year 2008. Once the rate reductions are fully implemented, the state's ranking can be expected to drop below the median top rate for all states, which stood at 6 percent in 2003. Historically, New Mexico's personal income tax has been very progressive and responsive to increases in income, growing faster than personal income. The newly enacted tax rate reductions will make the tax both less progressive and less elastic. Never the less, the income tax can be expected to continue grow at a little faster rate than personal income.

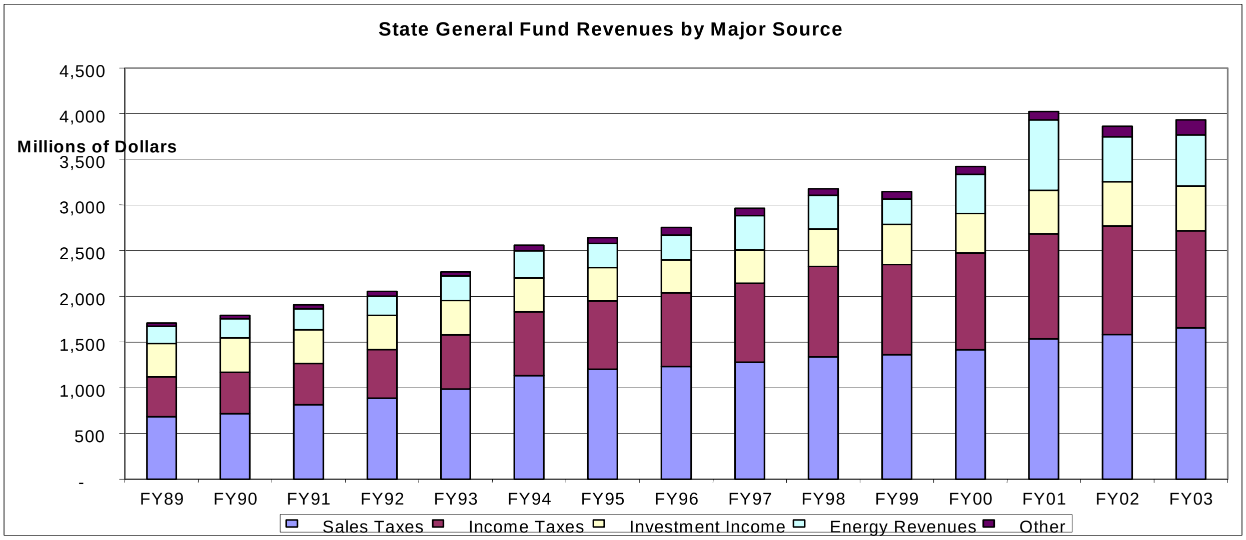
Another major revenue source for the state is taxes and rents and royalties on natural resources, primarily crude oil, natural gas and coal. These revenues constitute a significant share of state General Fund revenues, and are a major source for the state's capital investment program. Energy related revenues constitute a challenge for state fiscal policy because they are volatile and difficult to forecast. The base for these revenues is the value of production less deductions for royalties and transportation costs. Sharp swings in prices affect values and thus revenues. The graph of natural gas prices shown in **exhibit 6.4** illustrates historical volatility.

EXHIBIT 6.4



In FY 1982 energy related revenues brought $993 million to New Mexico, by 1990 these had declined to $424 million. In recent years, energy prices have increased sharply, leading to large revenue increases in some years. In FY 2004 revenues to state and local governments totaled $1,286 million. The varying shares of state general fund revenues from these revenues again illustrate their volatile nature. In FY 1999 energy related revenues distributed to the general fund totaled $280 million or 8.8 percent of total revenues. Two years later, these revenues contributed $769 million to the General Fund, or 19.1 percent total revenue. **Exhibit 6.5 and 6.6** summarize the State's general fund revenue sources.

EXHIBIT 6.5



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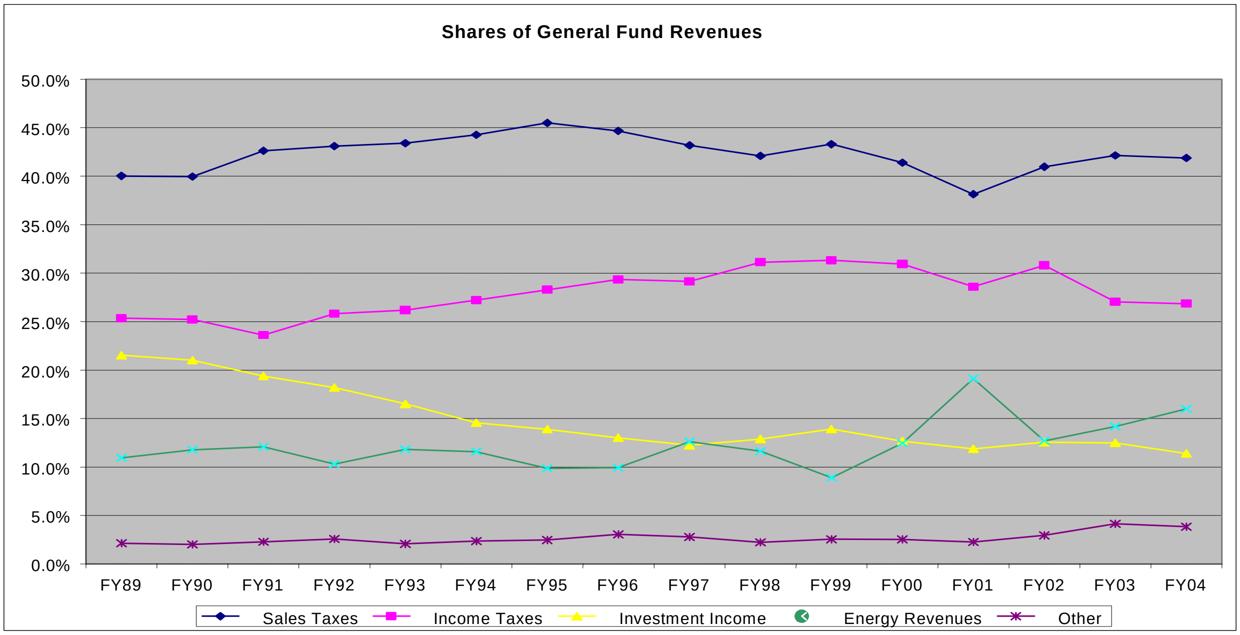


FUND STRUCTURE OF STATE GOVERNMENT

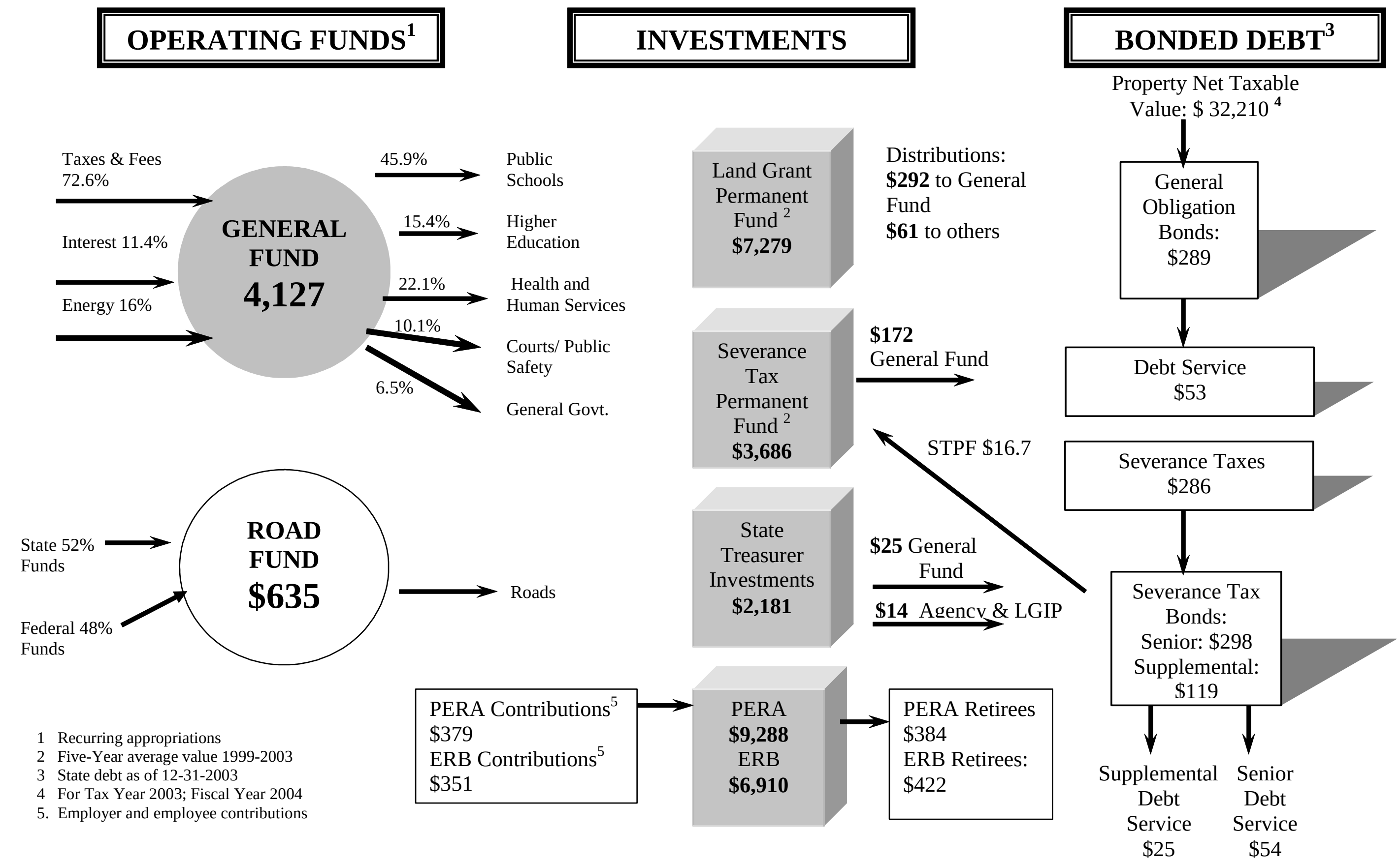
Article IV, Section 30 of the New Mexico Constitution provides that "money shall be paid out of the treasury only upon appropriations made by the legislature." Appropriations are made and accounted by fund. There are approximately one thousand funds in the state treasury, many authorized by state statute, others established by the Department of Finance and Administration.

Exhibit 6.7 presents the most important state funds.

EXHIBIT 6.7

OVERVIEW OF NEW MEXICO FINANCES: FY 04

(Millions of dollars)



The General Fund is the state's principal operating fund. It receives most state tax revenue, investment income from the two permanent and shared federal mineral royalties and provides funding for most state agencies and universities and public schools. For FY 2004 General Fund appropriations for recurring operations were $4.127 billion. The second biggest operating fund is the Road Fund with FY 2004 appropriations of $635 million which receives gasoline and diesel taxes, weight distance taxes and vehicle registration fees. Road fund revenues are dedicated to maintenance and construction of roads. Other state funds accounted for approximately $1.5 billion of FY 2004 appropriations for such purposes as game protection, risk management, boards and commissions, and water resources management. In addition in FY 2004, the state received approximately $4 billion of Federal funds for operations.

Pursuant to the Ferguson Act enacted by Congress in 1898 and the State Constitution of 1912, federal land was conveyed to the state of New Mexico to benefit twenty public institutions (see Article XIV, Sections 1 and 2). A significant share of the state's oil and gas resources occur on these state lands and royalties from production are deposited in the Land Grant Permanent Fund. As shown in exhibit 6.7 average assets of the Land Grant Permanent Fund have grown to more than $7 billion. Eighty-three percent of the Land Grant Permanent Fund investment income benefits public schools by a distribution to the General Fund, $292 million in FY 2004. (An important 1996 constitutional amendment eased restrictions on investment in stocks and modernized the distribution method for beneficiaries.)

Article VIII, Section 10 of the Constitution, adopted in 1976, provides for some severance taxes, again mostly on oil and gas production. These revenues are dedicated to pay debt service on severance tax bonds, with revenue in excess of that needed to pay debt service transferred to the Severance Tax Permanent Fund (STPF). The State Investment Council invests STPF funds, with a share of the fund (4.7 percent of the average five-year value) transferred to the general fund. Severance Tax Permanent Fund average balances reached $3.6 billion, generating $172 million in revenue for the General Fund in FY 2004.

Other major state investment funds include the Public Employees and Educational Retirement Funds with FY 2004 assets of approximately $16 billion and State Treasurer's investments of approximately $2 billion.

Finally, Exhibit 6.7 portrays the state's two major capital outlay/bonding programs. Article IX, Section 8 of the New Mexico Constitution authorizes issuance of General Obligation (GO) bonds backed by property taxes up to 1 percent of the state's net assessed valuation (at one-third of market value.) On December 31, 2003, $288.5 million GO Bonds were outstanding. Also, severance taxes discussed above are deposited in the Severance Tax Bonding Fund for debt service on Severance Tax Bonds; $416 million were outstanding on December 31, 2003. Over the last decade legislation gradually expanded the use of severance tax revenue for debt service from 50 percent of total severance tax revenue to 95 percent. Surplus severance tax revenues not needed for debt payments are transferred to the Severance Tax Permanent Fund.

THE NEW MEXICO APPROPRIATION PROCESS AND ACCOUNTABILITY IN GOVERNMENT ACT

In New Mexico, the appropriation process officially begins in mid-June when the Department of Finance and Administration, State Budget Division is statutorily required to send each state agency budget request instructions. As part of their request, agencies are required to provide information such as revenue or anticipated revenue and expenditures or anticipated expenditures from all sources for the fiscal year completed, the current fiscal year and for the succeeding fiscal year. Agencies are statutorily required to submit this information and other information such as an organizational chart, strategic plan and information technology plan no later than September 1 to both Department of Finance and Administration and Legislative Finance Committee.

The Legislative Finance Committee is an interim committee of the legislature charged with examining the laws governing the finances and operations of departments, agencies and institutions of New Mexico and with reviewing the policies, costs and effect of laws on the functioning of governmental units.

New Mexico is fairly unique in that both the governor and a legislative agency, the Legislative Finance Committee, propose a comprehensive state budget to the full legislature. The primary motivation behind the dual executive and legislative recommendations is to help ensure a system of checks and balances and to incorporate the different perspectives of the two branches into the budget process.

During the months of September through December both State Budget Division and Legislative Finance Committee staffs analyze agency budget requests and hold meetings and hearings to pursue issues pertinent to the requests. Also during this time, economists from the Legislative

Finance Committee, Department of Finance and Administration, the Taxation and Revenue Department, and the Department of Transportation develop a consensus General Fund revenue estimate. Like most states, New Mexico must balance its budget each year without incurring a deficit (see Article IX, Section 7 of New Mexico Constitution). Both the governor and members of the Legislative Finance Committee face a difficult task of balancing agency requests with available revenues. In order to deal with the fact that both revenues and spending for entitlement programs are estimated, the state maintains an account for reserves that can be tapped in the event of a revenue shortfall. The reserve target traditionally has been 5 percent. However, in years where the revenue estimate seems particularly prone to risk, reserve balance targets have been increased to as high as 9 percent.

State law requires the governor to prepare a budget and submit it to the Legislative Finance Committee and each member of the legislature no later than January 5 in even-numbered years and no later than January 10 in odd-numbered years. The Legislative Finance Committee finalizes its budget recommendations in December and prepares a full report of its findings to the full legislature on the first day of the legislative session in January.

On the first day of the legislative session which begins on the third Tuesday in January and lasts 60 days in odd numbered years and 30 days in even numbered years, the executive Budget in Brief and the Legislative Finance Committee Budget Recommendations are released to legislators, agencies, press and the general public. Simultaneously the General Appropriation Act also known as the “state budget” is introduced in the House of Representatives. Typically, the introduced version of the General Appropriation Act represents the governor’s budget recommendations in summary by agency.

Close to the start of the legislative session, Legislative Finance Committee and State Budget Division prepare difference sheets – reports by agency and program that shows the major differences in revenues, expenditures and total budget between the executive and Legislative Finance Committee recommendations. The House Appropriations and Finance Committee holds budget hearings for each agency during which executive and Legislative Finance Committee staff present the difference sheet report to the committee. The committee will either adopt the executive recommendation, the Legislative Finance Committee recommendation, parts of both recommendations, or its own recommendation. Once House Appropriations and Finance Committee complete its work, the product becomes the House Appropriations and Finance Committee substitute version of the budget and is voted on by the members. The bill then moves to the House floor for third reading and final passage and the bill is debated. Typical floor action is to amend or to pass the bill on to the Senate with no changes.

Once the General Appropriation Act is passed by the House, the Senate begins deliberations. The Senate Finance Committee conducts its own hearings and analysis. Typically over several days, Senators propose amendments to the General Appropriation Act. Amendments are reviewed and considered by the Senate Finance Committee and are either adopted, modified then adopted or not. The amendments are compiled and a committee report is prepared and voted on by Senate Finance Committee which then becomes the Senate Finance Committee version of the General Appropriation Act. The amended General Appropriation Act then moves to the Senate floor for third reading and final passage where the bill is debated. Typical floor action is to further amend or to pass the bill to the House of Representative for concurrence. If the House fails to concur, they will ask the Senate to recede from its amendments. If the Senate refuses to recede, a conference committee consisting of three members from each house is appointed to reconcile and negotiate the differences.

The Conference Committee meets privately to negotiate the differences. A Conference Committee report is prepared and adopted by both houses. The bill is enrolled and engrossed and delivered to the Governor for signature.

The governor may sign the General Appropriation Act, veto or partially veto the bill. The time the governor has is dependent on when it reaches his desk. If the legislature is still in session and the General Appropriation Act is delivered, he has three days to sign or veto the bill. If it is not signed, the bill automatically becomes law. If however, the General Appropriation Act reaches the governor with less than three days remaining in the legislative session, the governor has twenty days to sign or veto the bill. If the governor vetoes a bill while the legislature is still in session, it can be overridden with a two-thirds majority vote in both the House and Senate. Following a veto of the General Appropriations Act in 2002, in unprecedented action, the legislature convened itself and overrode a governor's budget veto for the first time in state history.

It should be noted that not all appropriations are made through a single bill. Article IV, Section 16 of the New Mexico Constitution limits the appropriations in the General Appropriation Act to those expenses "required under existing law." For example, various one-time capital outlay projects or tax bills that might generate additional revenue will not be included in the General Appropriation Act.

Following passage of the General Appropriation Act, agencies are required to submit their plan (or operating budget) on how they will spend funds appropriated on or before May 1 to State Budget Division. The Legislative Finance Committee also receives a copy of the agency operating budget.

Accountability in Government Act. With the state's adoption of the Accountability in Government Act in 1999, New Mexico began in earnest to focus its attention on results. The primary feature of the Accountability in Government Act is the implementation of performance-based budgeting. Performance-based budgeting requires that agencies identify programs and performance measures and submit performance-based budget requests with targeted levels of performance. Select performance measures and corresponding targets are included in the General Appropriation Act immediately following program appropriations. The result has been that a few agencies have been able to improve the link from their budget to performance. For example, Children, Youth and Families Department used data to show the benefits of the department's efforts on rehabilitation as opposed to incarceration. Higher education institutions used “gap analysis,” the difference between their current performance and comparative group performance, to develop action plans to address improvements and to develop realistic performance targets.

Recent efforts have sought to focus on key measures for large agencies, improve the quality of measures and implement quarterly reporting. In the near future, agency quarterly performance reports will be available to all stakeholders on state web sites.

STATE GOVERNMENT EXPENDITURES

The dominant object of state government spending for operations in New Mexico is education. **Exhibit 6.8 and 6.9** shows General Fund recurring appropriation trends over past several years. Public schools and higher education recurring appropriations represent 61 percent of the total in FY 2005. The next largest component of General Fund recurring expenditures is health and welfare, with the Medicaid program driving spending growth. The public safety budget is about 6.5 percent of the state’s recurring budget. Combined, the legislative, judicial, general government, commerce and industry, agriculture and energy categories represent only about 10 percent of the state’s budget.

EXHIBIT 6.8

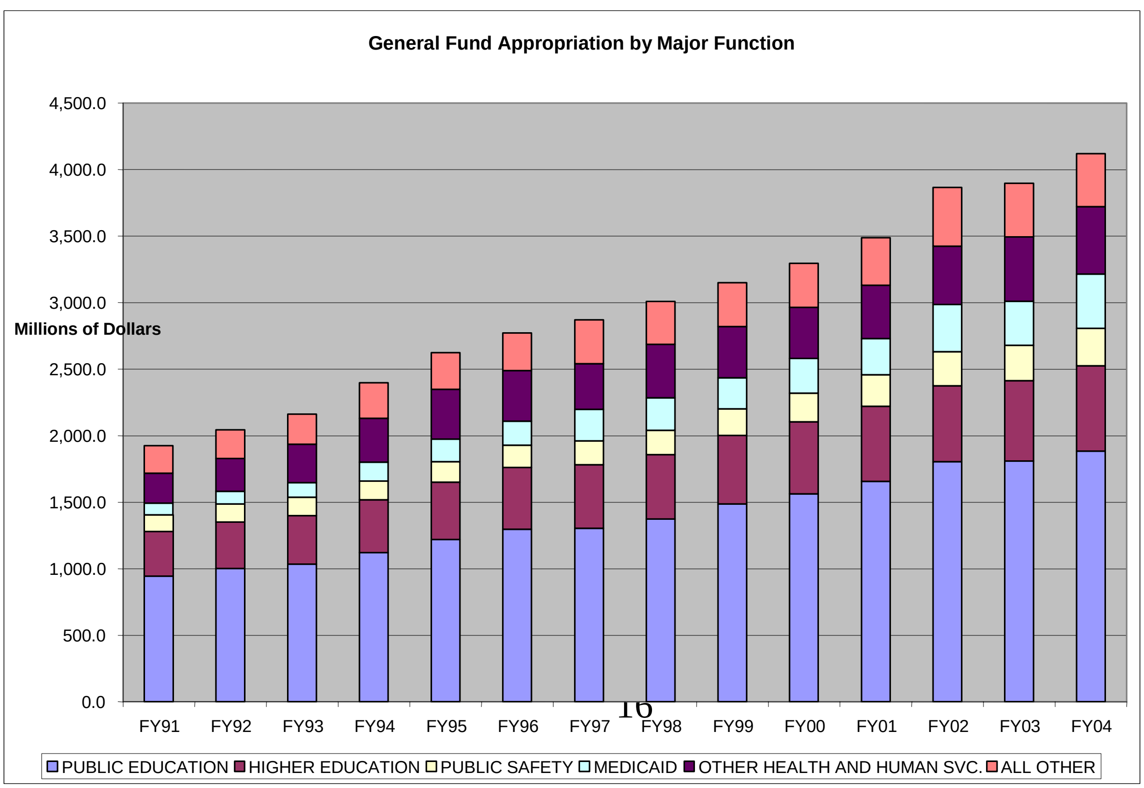
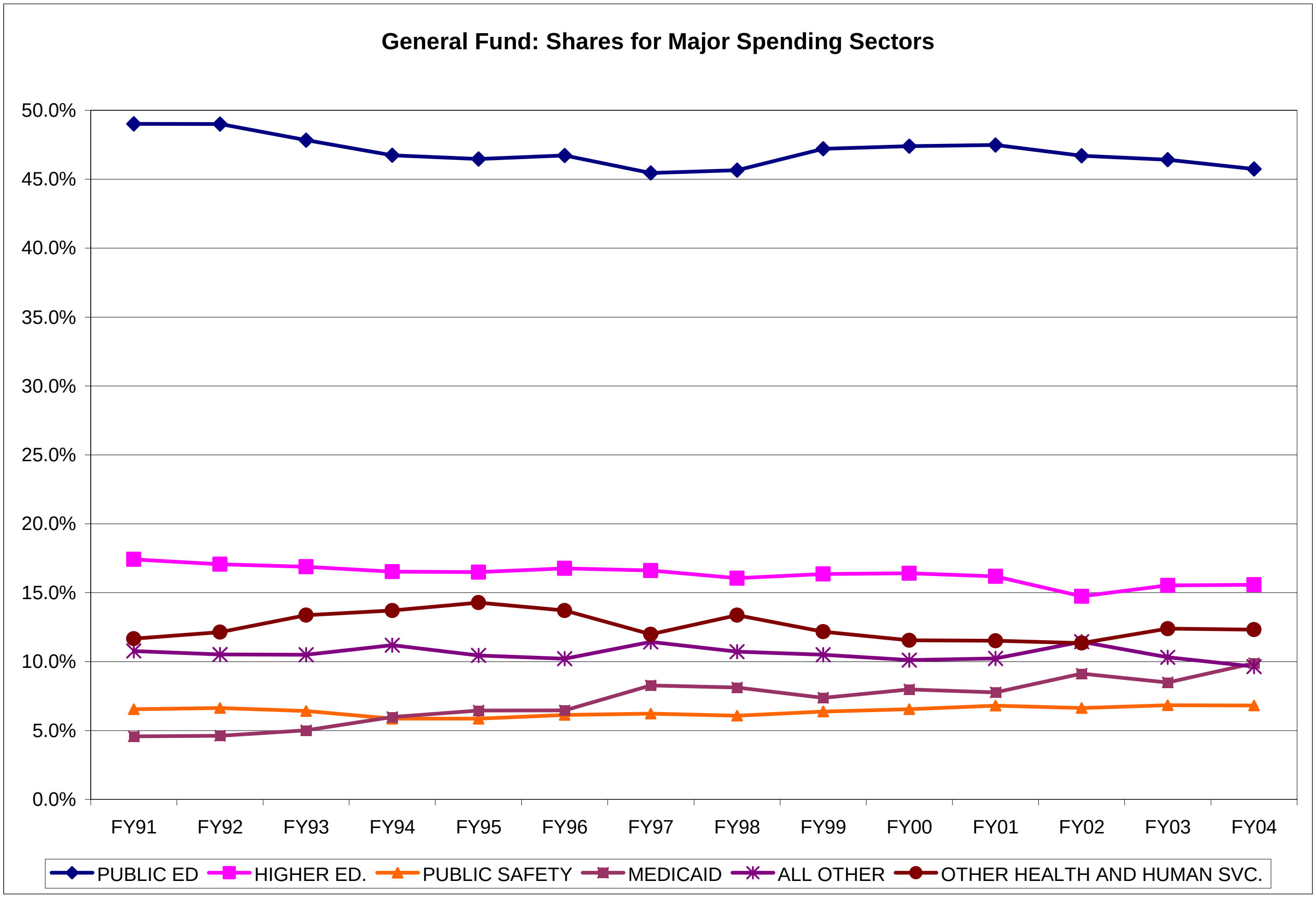


EXHIBIT 6.9



Public Schools. There are eighty-nine school districts in New Mexico, ranging in size from Mosquero, with an average daily membership (ADM) of less than 50 to Albuquerque, with an ADM of 6,875 in New Mexico. Statewide public school enrollment in the 2003-2004 school year was 314,926.

The state provides nearly all funding for school operations, with funding levels determined by the public school funding formula as specified in state statute. The present state education distribution formula for public schools was enacted in 1974, with several significant modifications made since that time. The state's public school funding formula emphasizes a policy that all students are entitled to an "equal educational opportunity". The formula focuses on funding enrollment plus fixed costs. This approach is commonly referred to as the "cost of opening the doors". Approximately 90 percent of school districts' operational revenue is derived from the state equalization guarantee (SEG) appropriation; New Mexico typically ranks among the lowest in the nation for its percentage of school funds from local sources. A school districts' SEG is the amount of money the state guarantees each public school district to provide equal access to programs and services appropriate to their educational needs regardless of geographic location or local economic conditions. School districts have the discretion to spend their formula dollars according to local priorities. However, they must comply with statutory requirements and relevant directives from the Public Education Department. In the calculation of State Equalization Guarantee, the state takes credit for 75 percent of property tax revenues, federal forest reserve revenues and certain operational federal impact aid fund revenues received by the school district.

The formula begins with a basic unit of education equal to 1.0. However, due to adjustments made over the years, all but one student category has a different weighting factor. For instance, pupils in kindergarten have a factor of 1.44, and grades 7 through 12 are given a weight of 1.25, respectively implying costs of education equal to 44 and 25 percent higher than for a basic unit. Additional weights are added for special education classes, bilingual education, fine arts education, at-risk students and special factors for school and district size and rural isolation. Finally additional weight is given to both the experience and formal education of the faculty. The weighted ADMs of various schools in a district are then added together, to obtain a total for the school district. Currently the formula results in an average of about 1.9 units per member.

Each year, the state legislature sets a dollar value per weighted ADM, and depending on available General Fund revenues and other budget priorities, appropriates funding for public school support. The Secretary of the Public Education Department sets the unit value based on appropriations and estimated program units. A final unit value is determined in January each year based on program units reported by school districts.

As shown in **exhibit 6.8**, state spending on public schools rose from just over $800 million to under $2 billion from FY 1989 to FY 2005. Maintaining the share of General Fund spending for public schools at 50 percent has been a point of the fiscal policy debate of the state. In recent years, although public schools have received significant, real (inflation adjusted) funding increases, the share has drifted down to about 45 percent.

A 2003 amendment to Article 12, Section 7 increased distributions from the land grant permanent fund to designated beneficiaries, with public schools receiving 83% of the increased distributions. The annual distribution increased from 4.7 percent to 5 percent of the five-year average of year-end market values of the fund. For FY 2005 through FY 2012, an additional distribution of eight-tenths of one percent (a total of 5.8 percent) and from FY 2013 through FY 2016, the additional distribution reduces to five-tenths (a total of 5.5 percent). After FY 2017, the distribution remains at 5 percent. This provided an additional distribution to public schools of $67 million in FY 2005.

The major emphasis of the incremental funding and school reform is an initiative to improve teacher quality with implementation of a three-tiered licensure program, a progressive career system for teachers and school administrators in which teachers are required to demonstrate increased competencies and undertake increased duties as they progress through three licensure levels. In the first phase, all teachers were provided with a minimum salary of $30 thousand. In the next phase, qualifying teachers reach the level 2 and 3 levels with associated salaries of $35 thousand. Latest analysis indicates the three-tiered licensure ladder could cost over $100 million when fully implemented with additional costs for retirement contributions.

Also, in part due to the federal No Child Left Behind (NCLB) Act of 2001, there has been increased focus on student progress and on successful schools. For FY 2005, the Public Education Department released the final assessments of public schools under the federal NCLB Act and the New Mexico School Reform Act. For the 2003-04 school year, 521 schools made adequate yearly progress, while 244 did not. Particularly worrisome, only 45 percent of the state’s high schools made adequate yearly progress.

Higher Education. Public, post-secondary education in New Mexico consists of three research universities, three comprehensive universities, nine branch community colleges and eight independent community colleges. There are also three public special schools. Total Fall 2002 enrollment was 113,650 students, of which 55 percent attended community colleges and 45 percent attended universities. Of full-time students, approximately 56 percent were at universities. Of total degrees awarded in 2001-2002 academic year, just under 64 percent of associate's degrees were awarded to women, while nearly 60 percent of bachelor's and graduate degrees were awarded to women.

Like most states, higher education has become the swing factor in balancing the budget; however, New Mexico spending on higher education has remained strong compared to national trends. As shown in **exhibit 6.8**, over the last fifteen years, state General Fund recurring spending for higher education has increased from the high $200 million to the high $600 million level. Over the same time period, the share of General Fund recurring expenditures on higher education has drifted slightly downward from about 17 percent to about 15 percent. The state typically ranks in the top nationally for state and local spending for higher education on a per capita basis as well as on a percentage of general spending basis.

In contrast to public schools, the funding formula for higher education is not contained in statute. Rather, various state statutes direct the Commission on Higher Education to develop a funding formula and provide general guidance on the state's priorities. In 2002, a blue ribbon task force modified the state's higher education funding formula by developing a simple "base-plus-incentive" funding model to determine an institution's base expenditure level. The model begins with the current appropriation, recognizes increases or decreases in workload driven by enrollment changes and the mix of courses offered. Formula-generated transfers, such as building renewal and replacement, equipment renewal and replacement and three percent scholarships, are added, then revenue credits, such as land and permanent fund, mill levy, and tuition revenue credit, are subtracted. The formula adjusts for compensation increases and recognizes changes in fixed costs such as utilities, library acquisitions, health insurance and risk management premiums. This model is similar to the public school funding formula that is based on the basic costs to “open the doors.” The model is largely input driven, although the task force recommended five incentive funds to address other components of institutional missions. One of these funds, the Performance Fund, is intended to offer performance awards to institutions based on achieving targeted outcomes.

Health and Welfare. As shown in **exhibit 6.8**, health and human services programs have grown significantly in the last fifteen years. Within the health and welfare category, the Medicaid program represents a significant driver of General Fund spending growth.

As is the case in many other states, eligibility demands and changes in federal Medicaid policy put strong pressures on state spending. Total General Fund recurring spending for health and welfare has risen from over $200 million to about $1 billion over the last fifteen years. This component of the state budget has mushroomed from about 15 percent of recurring spending to about 23 percent.

The Medicaid program has shown dramatic growth in recent years as reflected in Figure 6.8; on a total expenditure basis, the size of the program has increased by $1.2 billion in six years, from $1.5 billion in FY 2001 to $2.7 billion in FY 2006. Principal drivers of the cost of Medicaid are large increases in medical costs, increased utilization of services, prescription drugs, new technologies, and growing enrollments, particularly in the state’s implementation of home-based personal care services. Further, changes in the share of cost borne by the federal government (the federal medical assistance percentage rate) tend to create a degree of uncertainty in state funding requirements for the program from year to year.

Within the other health and human services category, an important program is the Temporary Assistance for Needy Families (TANF) program, which replaced the federal Aid to Families with Dependent Children program with the enactment of welfare reform. The new program is financed largely with a federal block grant. However, states must demonstrate that they have maintained state funding at a level at least equal to that prior to welfare reform. This so-called maintenance of effort is presently about $32 million for New Mexico. Other programs in this category include services to the developmentally disabled, behavioral health services, juvenile justice, child care, foster care and adoption responsibilities.

Public Safety. The public safety component of General Fund appropriations mostly goes to the Department of Corrections and the Department of Public Safety. The Corrections budget is driven by inmate population growth which had surged due to annual increases above 5 percent. More recently, inmate population growth has slowed, due to alternative sentencing considerations.

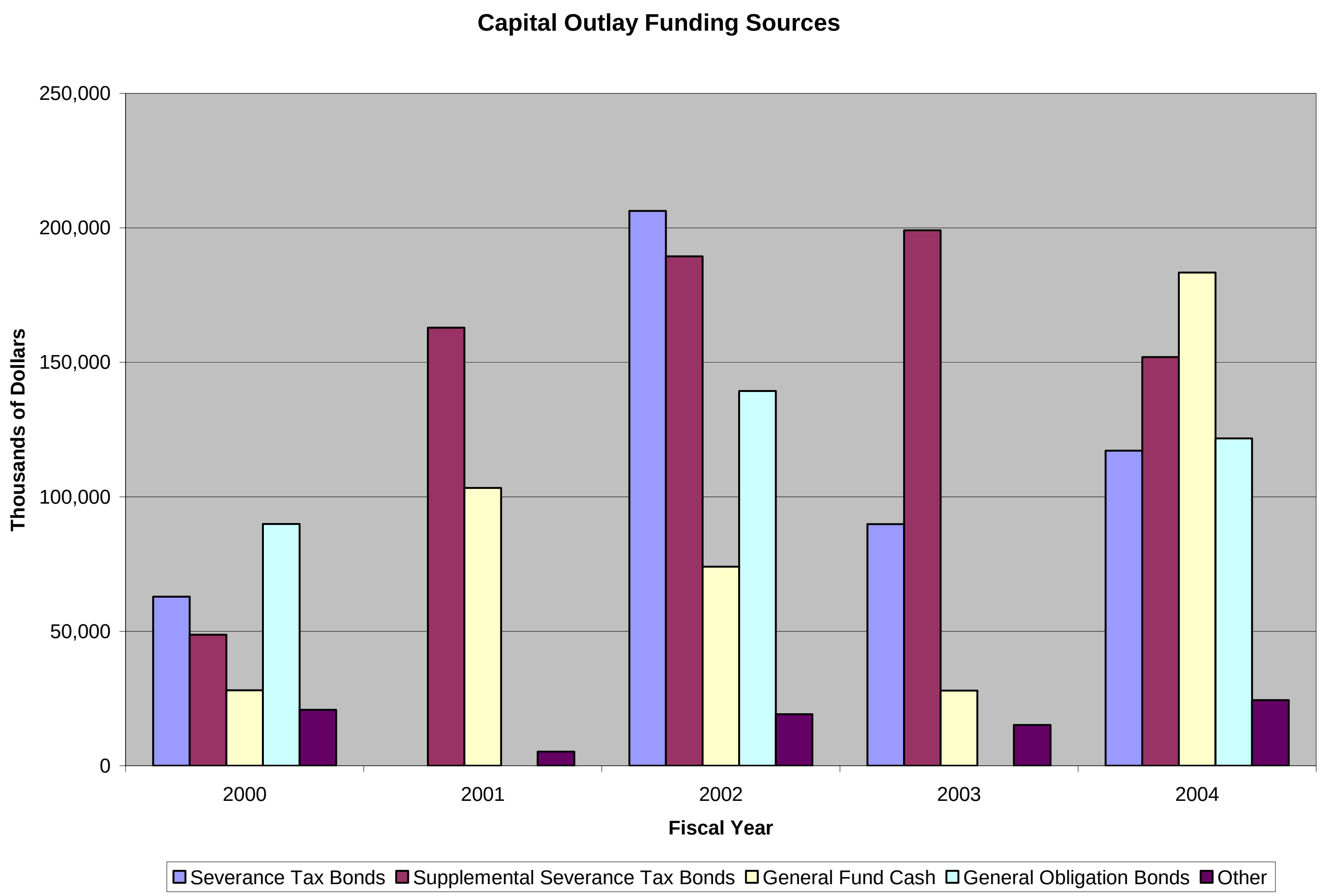
Other. Nominal appropriations to other categories of General Fund recurring spending have increased over time, these components have remained relatively stable as a percentage share of total recurring spending. In effect, the other components of state government spending are quite small in relation to the total operating budget. Efforts to constrain spending within these components result in only marginal savings.

CAPITAL OUTLAY AND DEBT

Funding sources. Exhibit 6.10 shows capital outlay appropriations and funding sources for the last five-years. Funding ranged from $250 million to $628 million. The principal sources of funding are severance tax bonds, general obligation bonds and General Fund cash. Severance tax bonds are revenue bonds, where revenue from taxes on the value of natural resource extraction, primarily oil and gas, is dedicated to repay bonds. General obligation bonds are backed by the full-faith and credit of the state and paid for by a statewide property tax levy. Total general obligation debt may not exceed one percent of the assessed value of property in the state (assessed value equals one-third of market value). Projects financed by General obligation bonds must be approved by the voters. The General Fund and other state funds also are used to pay for capital projects on a cash basis. Revenue from these sources, however, can be uneven. Roads and other transportation projects are financed from the transportation projects and revenue enhancement fund.

In addition to annual appropriations, a continuing appropriation of supplemental severance tax bonds is authorized for public school construction. This program was initiated in the late 1990s due to equity concerns raised in litigation by predominantly Native American school districts. FY 2004 supplemental severance tax bonds were $152 million, and 2004 awards to districts were $85 million.

EXHIBIT 6.10

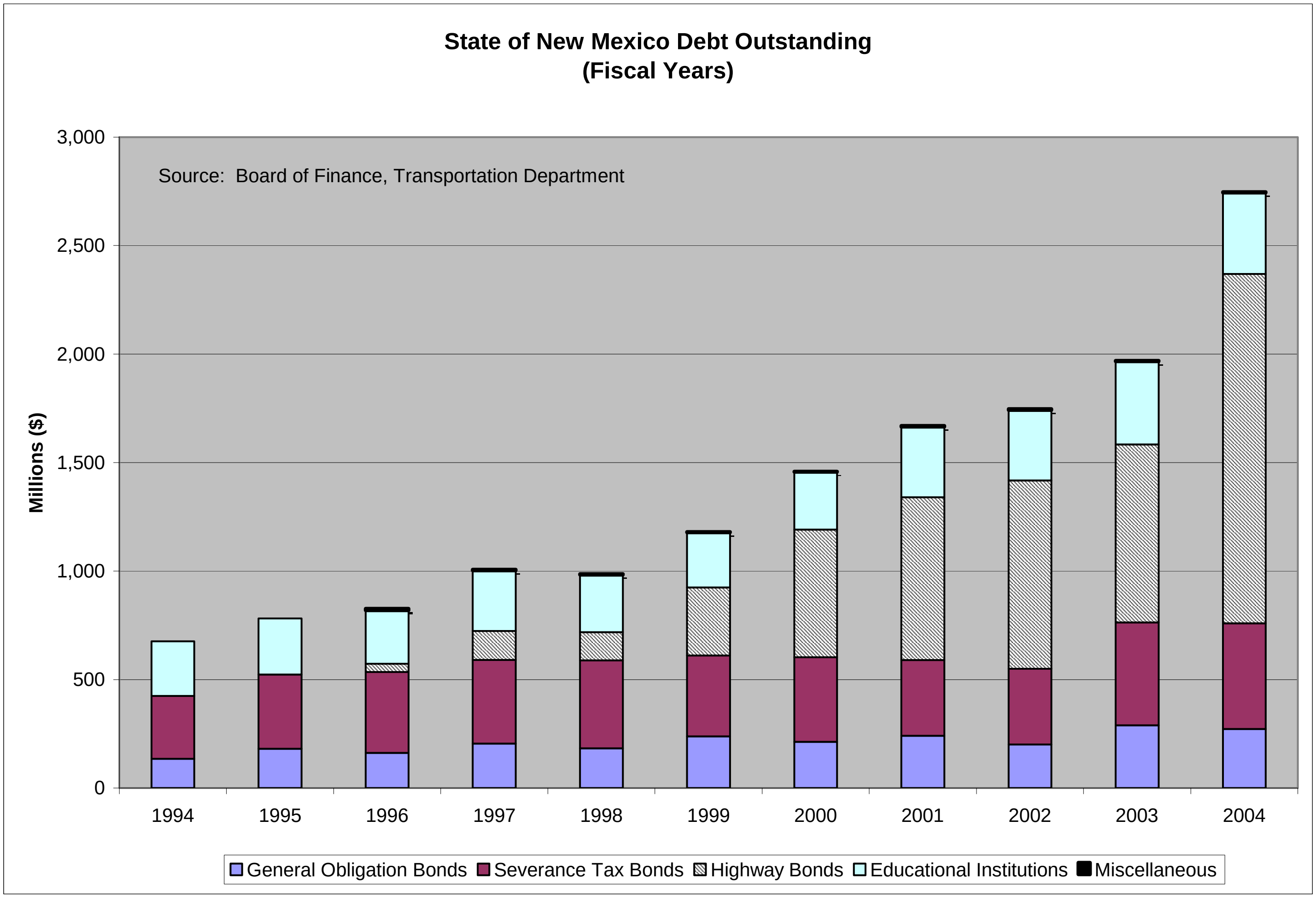


State Debt. Outstanding state debt for New Mexico has increased significantly over the past decade, reaching $2.7 billion in 2004, with annual growth averaging about 16 percent (see **exhibit 6.11**). This compares to the national average growth rate of 7 percent. Historically low interest rates, state fiscal downturns, and several large jumbo deals (i.e. pension obligation bonds) have prompted states' and local government's debt issuance to rise rapidly in recent years. Two common ways of measuring debt levels include debt per capita and debt as a percentage of personal income. According to a report by a major bond rating agency, New Mexico's net tax-supported per capita debt in 2003 was $962 compared to the national median of $701. New Mexico's net tax-supported debt as a percentage of 2002 personal income was 4.1 percent compared to the national median of 2.4 percent.

New Mexico's general obligation bonds have grown modestly over the past decade compared to revenue bonds. State transportation bonds account for most revenue bond growth. Starting in 1996, the state's issuance of transportation bonds increased dramatically to build badly needed infrastructure improvements. Secondarily, policymakers saw the increased infrastructure expenditures, accommodated by debt issuance, as a way to further economic development. Innovative financing techniques introduced by the Federal Highway Administration, which included a direct pledge of federal funds for bond repayments, also encouraged the issuance of transportation bonds.

In addition, the Legislature has established several revolving loan funds and grant programs to assist local government with their capital needs by providing zero to low-interest loans or grants. For example, the New Mexico Finance Authority administers an annual distribution of 75 percent of the state's governmental gross receipts tax deposited into the public project revolving loan fund to make low-cost, low-interest loans for infrastructure, equipment emergency projects to state and other governmental entities or grants to disadvantaged entities.

EXHIBIT 6.11



LOCAL GOVERNMENT FINANCES

Municipalities. There are currently one hundred and one incorporated municipalities in New Mexico, with the distribution by population indicated in **exhibit 6.12**.[5] New Mexico municipalities are very different with respect to size and economic base. Few of the thirty-five towns with a population of less than 1,000 can be considered to have a strong economic base. Small city fiscal problems are quite distinct from those faced by large cities such as the city of Albuquerque, with almost 450,000 people in 2000.

EXHIBIT 6.12

New Mexico Incorporated Municipalities
by Population, 2000

Population Size	Number
Under 1,000	35
1,000–5,000	33
5,000–10,000	15
10,000–25,000	8
Over 25,000	10
TOTAL	101

Source: U.S. Bureau of the Census, 2000 Census of Population and Housing.

Despite the obvious scale differences, New Mexico law offers very similar financial options to all municipalities.[6] Major sources of revenue for all New Mexico cities are shown in **exhibit 6.13**. The gross-receipts tax, including both the state-shared distribution to cities of 1.225 percent of the state gross-receipts tax and the local-option gross-receipts taxes, account for a vast share of total General Fund revenues. Indeed, gross receipts taxes amounted to over 70 percent of total General Fund revenues in fiscal year 2003. The statewide gross-receipts tax rate is 5.0 percent; this includes a 1.225 percent distribution to municipal governments. Prior to January 1, 2005, the state rate was 5.0 percent, but a 0.5 percent credit was provided on goods and services purchased in municipalities, implying an effective rate of 4.5 percent within municipal boundaries. As noted earlier, the credit was ended to offset the revenue loss associated with the elimination of the gross receipts tax on food and certain medical services in 2005.

The state distribution of the 1.225 percent of the statewide gross-receipts tax to municipalities is based on transactions in each municipality.[7] The first local-option municipal gross-receipts tax was authorized in 1955, repealed in 1969, and again authorized in 1975. Currently municipalities may impose at their option a rate of up to 1.25 percent in 0.25 percent increments on top of the effective statewide rate.[8] Over the years, the state also has authorized various special purpose gross receipts taxes, such as the “quality-of-life” fund in Albuquerque. Special purpose gross receipt taxes often require that municipal governments put the proposed tax increase and use of the proceeds to a vote. The second largest revenue raiser for municipal governments' is property taxes, but the property tax accounts for less than 6 percent of Municipal General Fund revenues. In short, New Mexico municipalities' have an unbalanced revenue structure, and are extremely dependent on a single tax—the gross receipts tax.

EXHIBIT 6.13

Revenues of New Mexico Municipalities
FY 1990
(in millions of dollars)

General Fund	
Property (current)	40.5
Franchise	30.5
Gross Receipts-State Shared	283.5
Gross Receipts-Local Options	199.5
License and Permits	14.9
Gasoline Taxes	3.0
Motor Vehicle	2.2
Small Cities Assistance	2.9
Other	108.1
Subtotal	685.1
Correction	41.7
Environmental Gross Receipts	4.4
Fire Protection	7.5
Law Enforcement	8.4
Lodgers' Tax Act	23.6
Municipal Street	31.2
Recreation	6.2
Intergovernmental Grants	153.1
Capital Project Funds	813.6
General Obligation	71.5
Revenue Bonds	7.9
Debt Service Other	19.2
Enterprise Funds	1,433.0
Other Funds	310.7
TOTAL REVENUES	$3,617.1

Source: New Mexico Department of Finance and Administration, Financial and Property Tax Data, Fiscal Year 2003 Annual Report.

Expenditures by New Mexico cities follow the national pattern Major expenditures support police protection, fire protection, streets, and sanitation. Other services, most importantly water and sewer often are provided by cities and financed as government enterprises.

County Governments. There are thirty-three counties in New Mexico, including the Los Alamos city/county. Fiscal Year 2003 revenues are summarized in **exhibit 6.14**. The property tax is the major source of tax revenue for county governments, accounting for about two-thirds of total General Fund revenues. In 1983 the county gross-receipts tax was enacted, authorizing counties to impose a gross-receipts tax by ordinance of a maximum of 0.375 percent (in three increments of 0.125 percent). Gross receipts taxes raise about 15 percent of General Fund revenues. Proceeds from the first increment can be used for general county purposes. The additional two increments replaced the prior county sales tax, and a portion of the proceeds must be dedicated to indigent health care.[9] There are also a number of limited county local option taxes available for earmarked purposes such as county hospitals and jails. These are often limited to specific counties under special circumstances, however. Counties also received a distribution of the state gasoline tax, which goes to a county road fund. Major expenditures by the counties are for hospitals, streets and roads, and law enforcement.

EXHIBIT 6.14

New Mexico County Revenues
FY 1990
(in millions of dollars)

General Fund	
Property Tax--Current	193.4
Property Tax-Other	48.5
Gross Receipts Taxes	57.2
Other	68.6
Subtotal	367.7
Correction	15.9
Environmental Gross Receipts	11.6
Road Fund	38.5
Fire Protection	14.0
Intergovernmental Grants	9.6
Indigent	37.2
County Fire Protection	10.6
Community DWI Program	6.1
Jail-Detention	6.3
Capital Project Funds	105.0
General Obligation	14.6
Revenue Bonds	9.8
Debt Service-Other	11.8
Enterprise Funds	44.3
Other Funds	125.0
TOTAL	828.0

Source: New Mexico Department of Finance and Administration, Financial and Property Tax Data, Fiscal Year 2003 Annual Report.

Notes

1. This chapter was written by staff from the New Mexico Legislative Finance Committee. Participants included David Abbey, Director, Cathy Fernandez, Deputy Director, Bill Taylor, Assistant Director, Arley Williams, Linda Kehoe, Gary Chabot and Mark Weber, Principal

Analysts, and Olivia Padilla-Jackson, Economist. It represents an update of the 1989 version authored by Brian McDonald and Juliana Boyle of the University of New Mexico Bureau of Business and Economic Research and the 1981 chapter authored by professor Gerald J. Boyle, who passed away in July 1991.

LFC staff would like to acknowledge a debt of gratitude on behalf of the entire state to professor Gerald Boyle, the initial author of this article, and for many years a guiding force in New Mexico public finance. Professor Boyle left a lasting imprint by training and helping to place numerous distinguished fiscal professionals with the state, including John Gasparich, John Kormanik, James O'Neil, Aug Narbutus, Charles Turpen, Janet Peacock and others.

2. U.S. Department of Commerce, *Governmental Finances: FY 2001–02*, Table 1. State and Local Government Finances.

3. Comparative 2004 tax data extracted from CQ's State Fact Funds