General Fund Revenue Update
and
Outlook for 2010 Legislative Session

Presentation to the

New Mexico Tax Research Institute

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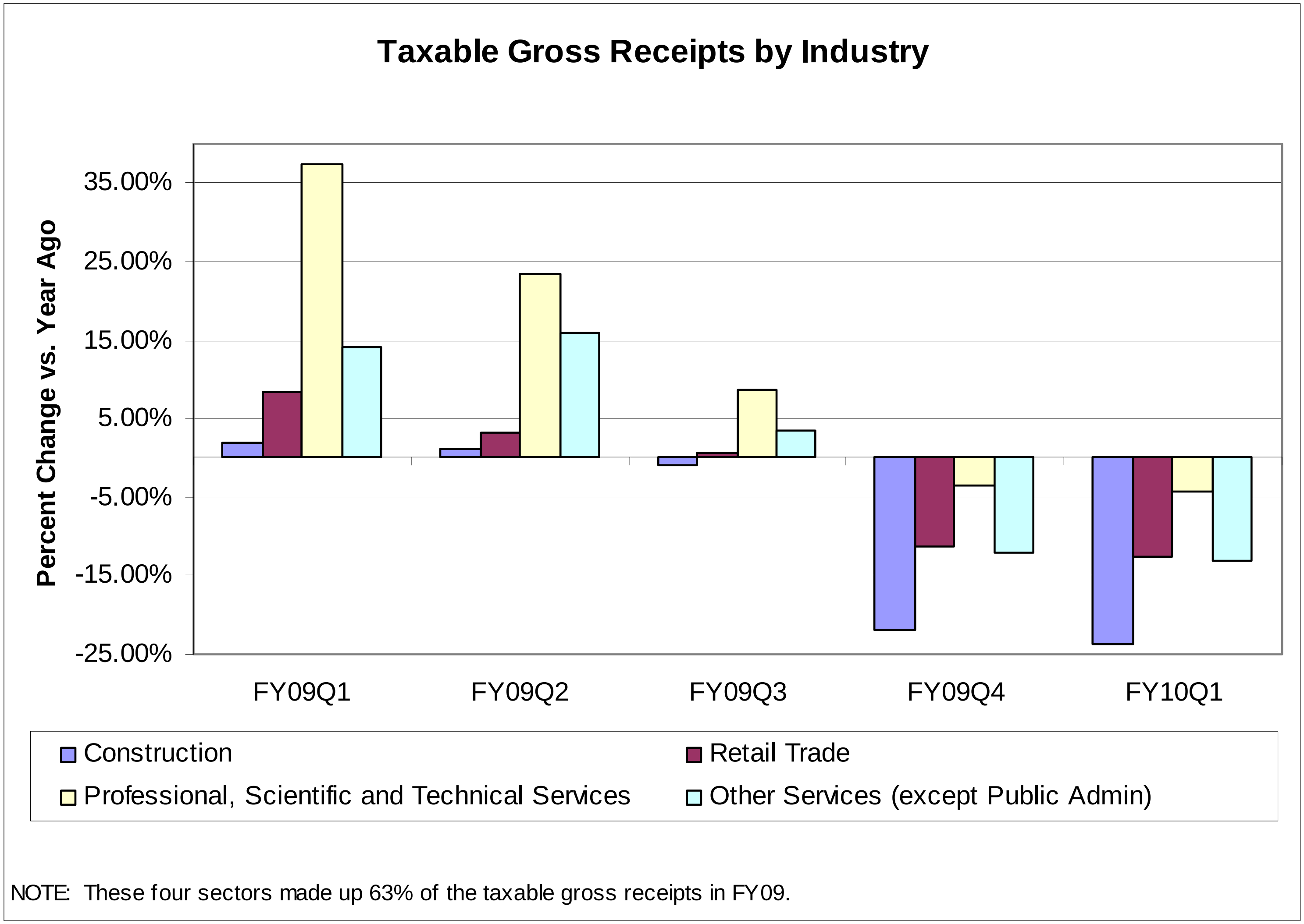
N.M. Legislative Finance Committee

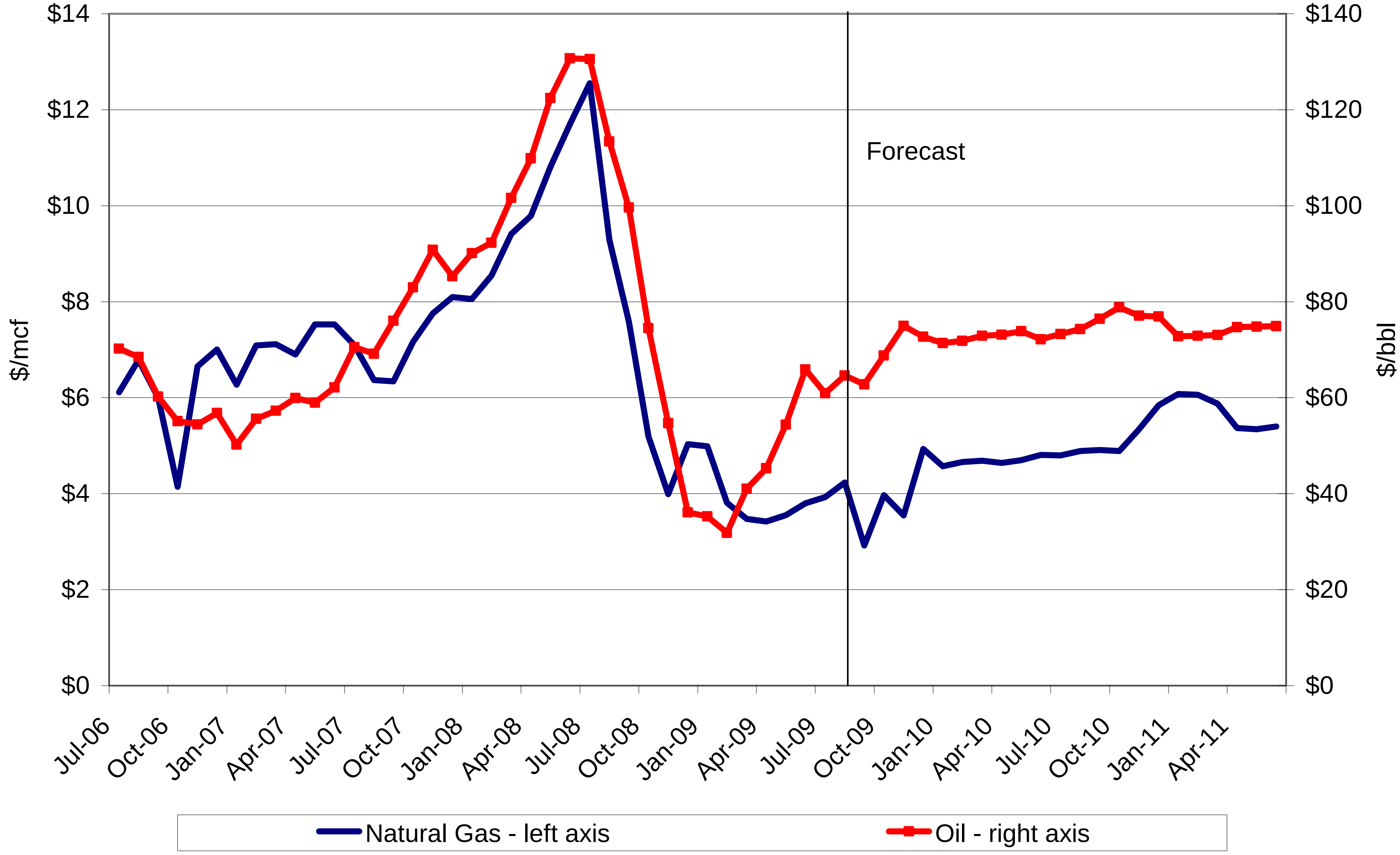
Economic Outlook

- 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

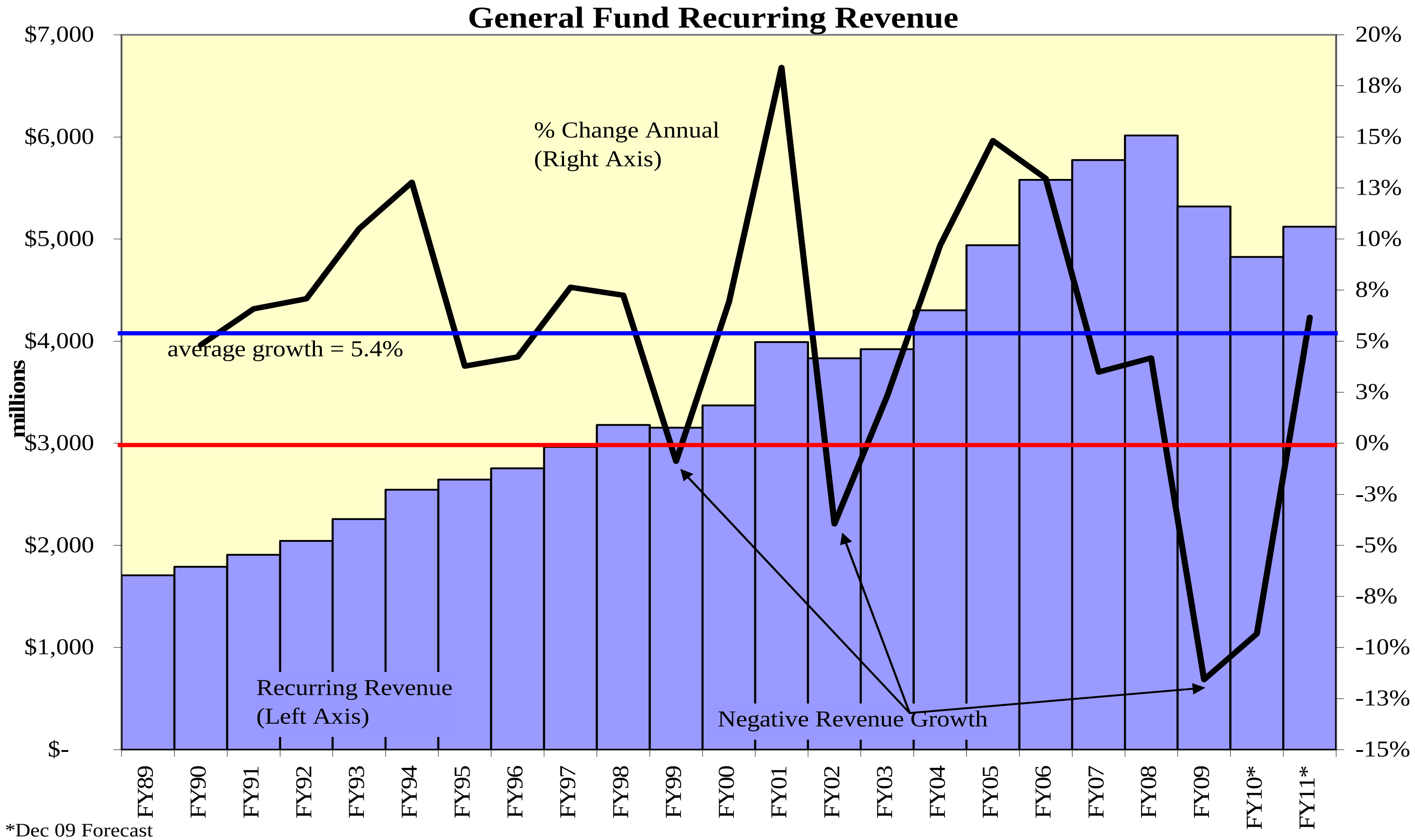


December 2009 Consensus General Fund Revenue Outlook

(million dollars)

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

- *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*



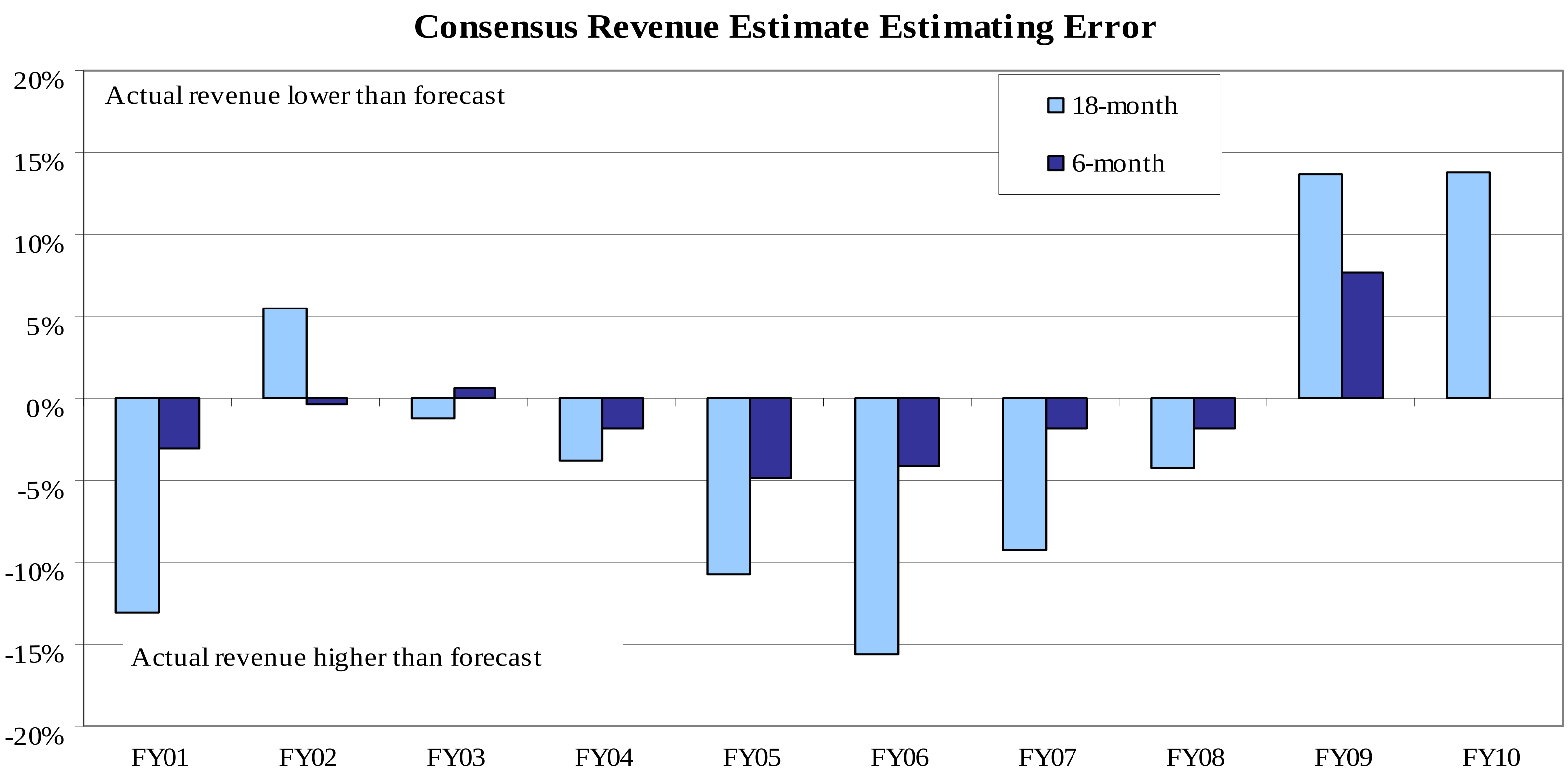
- *Long-term growth rate through FY10 = 5.1%, personal income growth = 5.7%.*
- *Revenue growth decelerated since 2003, from 6.1% to 3.4% annual average*

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

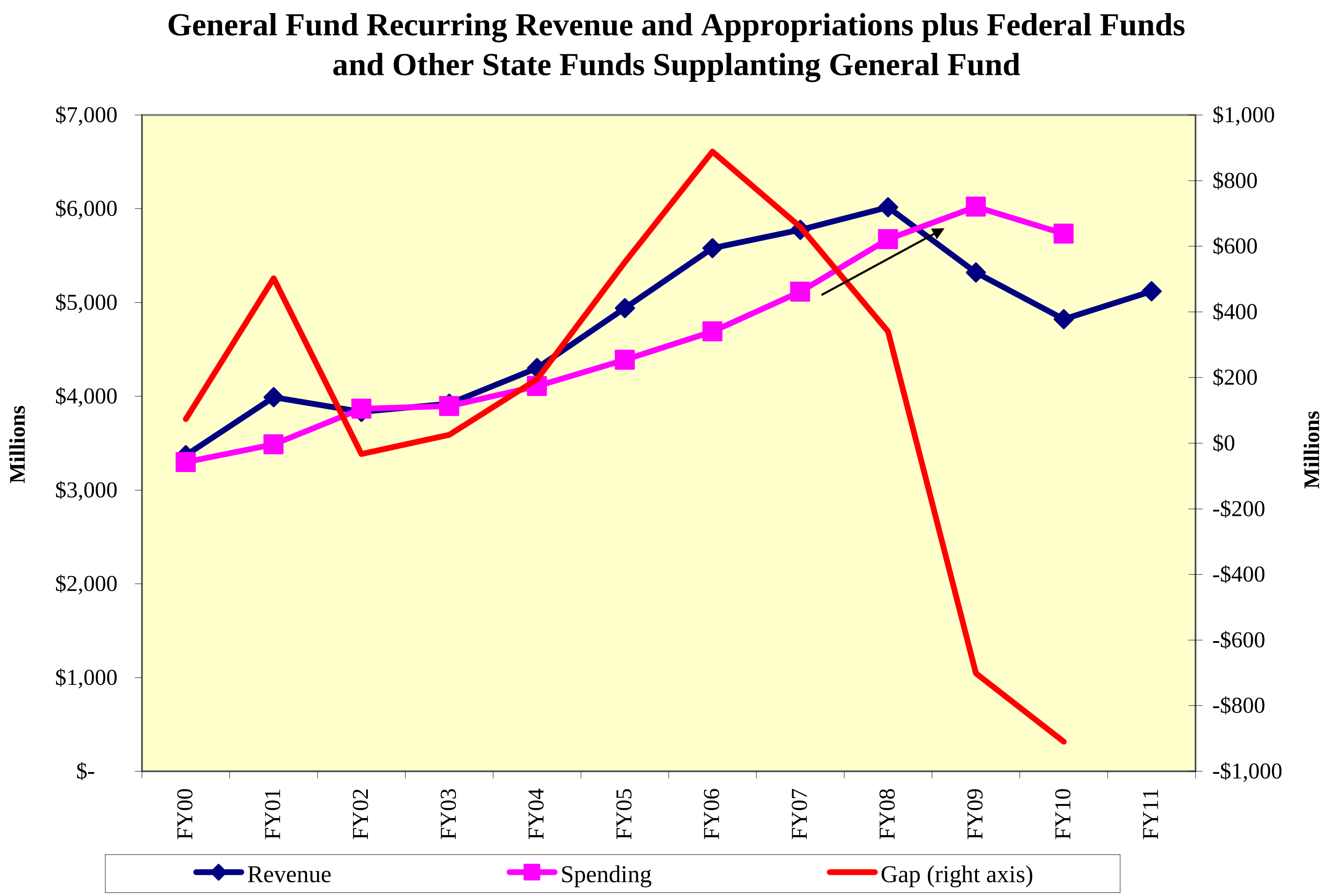
Risks (continued)

- 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



Source: LFC files

- 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

	FY 2011
	($ millions)
Revenue increasing provisions	$340
Revenue decreasing provisions	-$939
Net impacts	**-$600**

- *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)

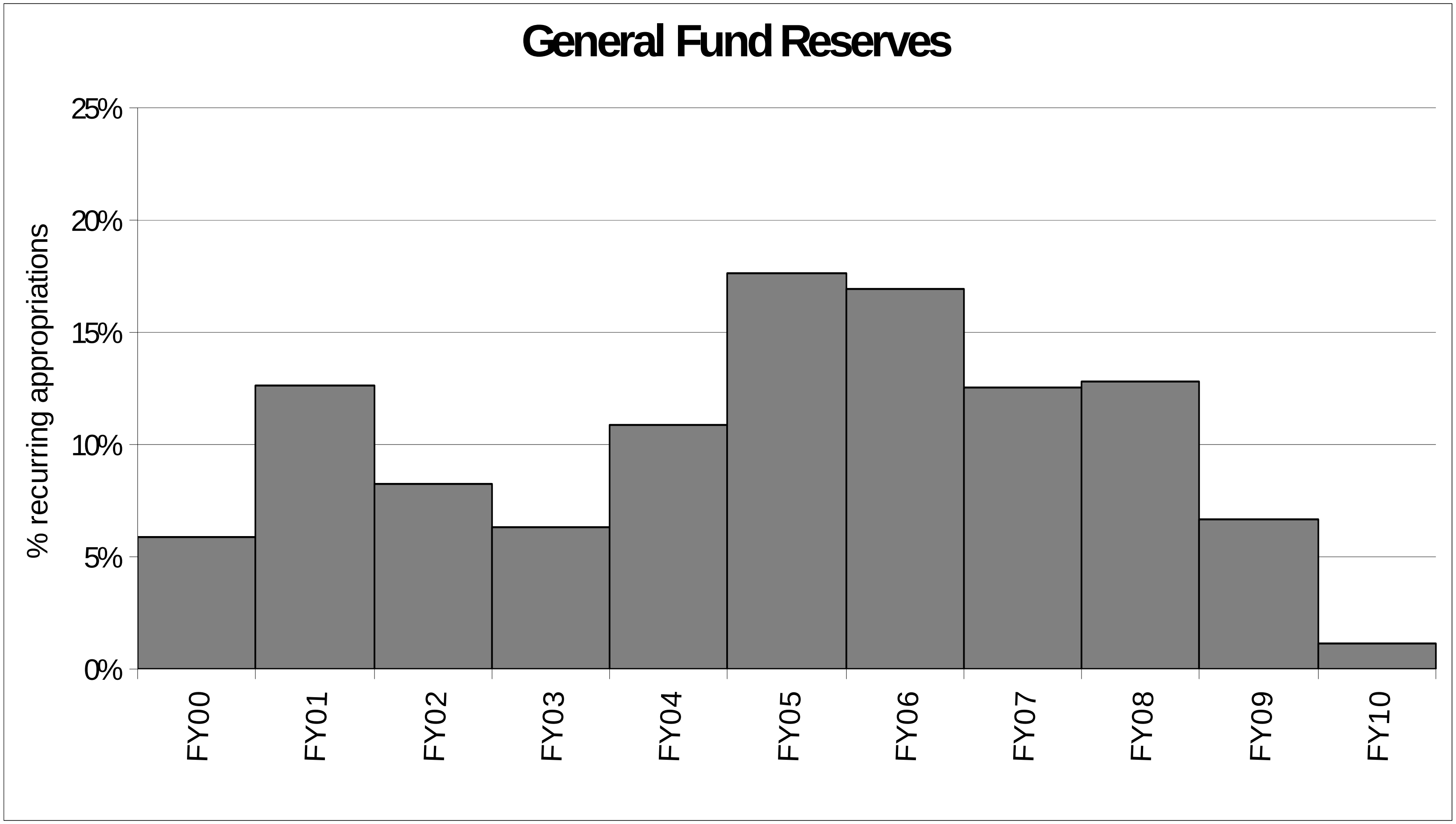
Tax Policy Principles (cont.)

- 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)

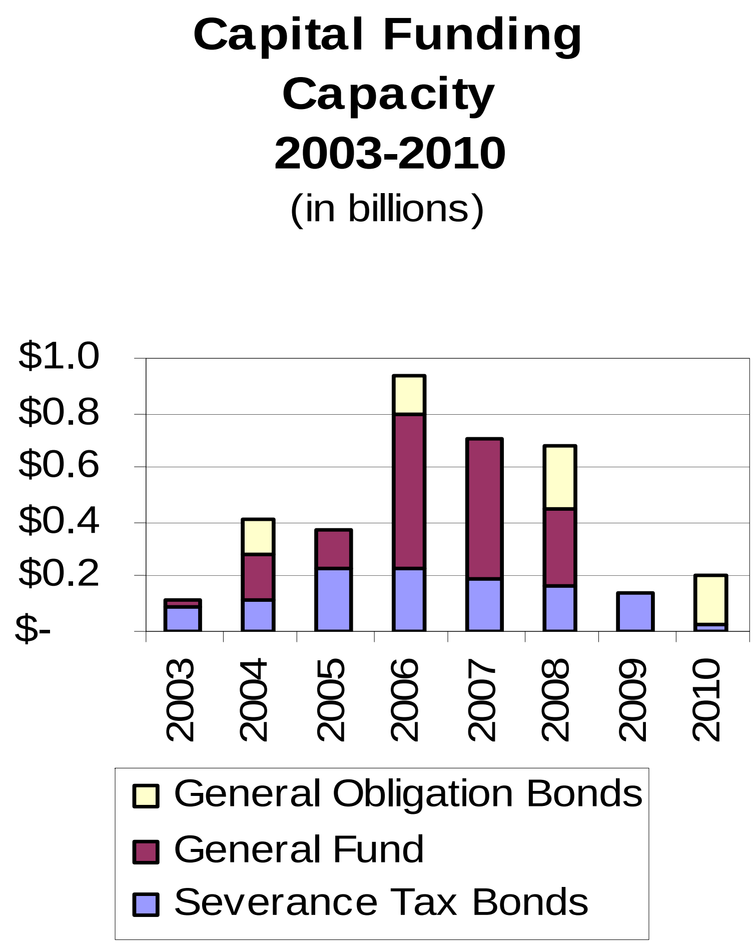
Income tax options:	Effect. Date	FY10	FY11	FY12
1% income tax increase on current top bracket (married $24,000/single $16,000)	Tyba 1/1/2010	25.5	170.0	179.4
1% income tax increase over $100,000 (single), $150,000 (married)	Tyba 1/1/2010	5.0	56.1	59.4
Addback income tax deduction for state & local taxes	Tyba 1/1/2010	-	40.0	42.0
Reduce deduction for capital gains from 50% to 25%	Tyba 1/1/2010	-	18.0	20.0
Corporate income tax options:				
Require combined reporting for corporate income tax	Tyba 1/1/2011	-	12.0	30.0
Increase corporate franchise tax from $50 to $250 per year	Tyba 1/1/2010	-	7.5	7.5
Gross receipts tax options:				
Repeal GRT deduction for food	7/1/2010	-	228.0	238.9
Repeal GRT food deduction and reinstate 0.5% GRT credit in muni areas	7/1/2010	-	48.0	48.0
Repeal GRT deduction for medical services	7/1/2010	-	65.0	69.9
Apply compensating tax to in-state sales currently exempt from all tax	7/1/2010	-	13.2	13.8
Increase statewide GRT rate by 0.25%	7/1/2010	-	126.0	132.0
Excise tax options:				
Increase motor vehicle excise tax by 1.0%	4/1/2010	7.7	34.3	37.7
Increase O&G Emergency School Tax on oil by 1%	4/1/2010	10.1	40.4	41.8
Increase O&G Emergency School Tax on gas by 1%	4/1/2010	10.8	52.8	53.8
Increase liquor excise tax by 5 cents per drink	4/1/2010	10.0	40.0	40.7
Increase insurance premiums tax on health insurance by 1%	1/1/2011	-	22.0	47.0
Increase cigarette tax by $1 per pack from $0.91 to $1.91 per pack	4/1/2010	7.5	30.0	30.0
Increase cigarette tax by $1 with no exemption for tribal sellers for increase	4/1/2010	24.8	99.0	99.0
Increase tobacco products tax from 25% to 40%	4/1/2010	0.8	3.0	3.0
Options to reduce tax expenditures:				
Repeal angel investor tax credit	Tyba 1/1/2010	-	0.8	0.8
Reduce film production credit rate from 25% to 15% of expenditures	Tyba 1/1/2010	6.5	26.0	28.6
Reduce rate of high wage jobs tax credit from 10% to 7% of wages	7/1/2010	-	5.0	5.5
Reduce rate of technology jobs tax credit from 8% to 6% of expenditures	7/1/2010	-	1.5	1.7
Reduce rate of investment credit from 5% to 4% of expenditures	7/1/2010	-	1.6	1.8
Reduce renewable energy production credit by 20%	Tyba 1/1/2010	-	1.0	1.1
Freeze hospital GRT credit at FY10 level	7/1/2010	-	4.0	8.0
Reduce rate of credit for NMMIP assessments by 20%	7/1/2010	-	10.0	14.0
Eliminate GRT back to school tax holiday	7/1/2010	-	2.7	2.7
Reduce lab small business partnership credit by 50%	7/1/2010	-	2.0	2.1

"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



Source: LFC

- 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.