Background on Possible Revenue Options for the 2010 Legislative Session

Presentation to the

Revenue Stabilization and Tax Policy Committee

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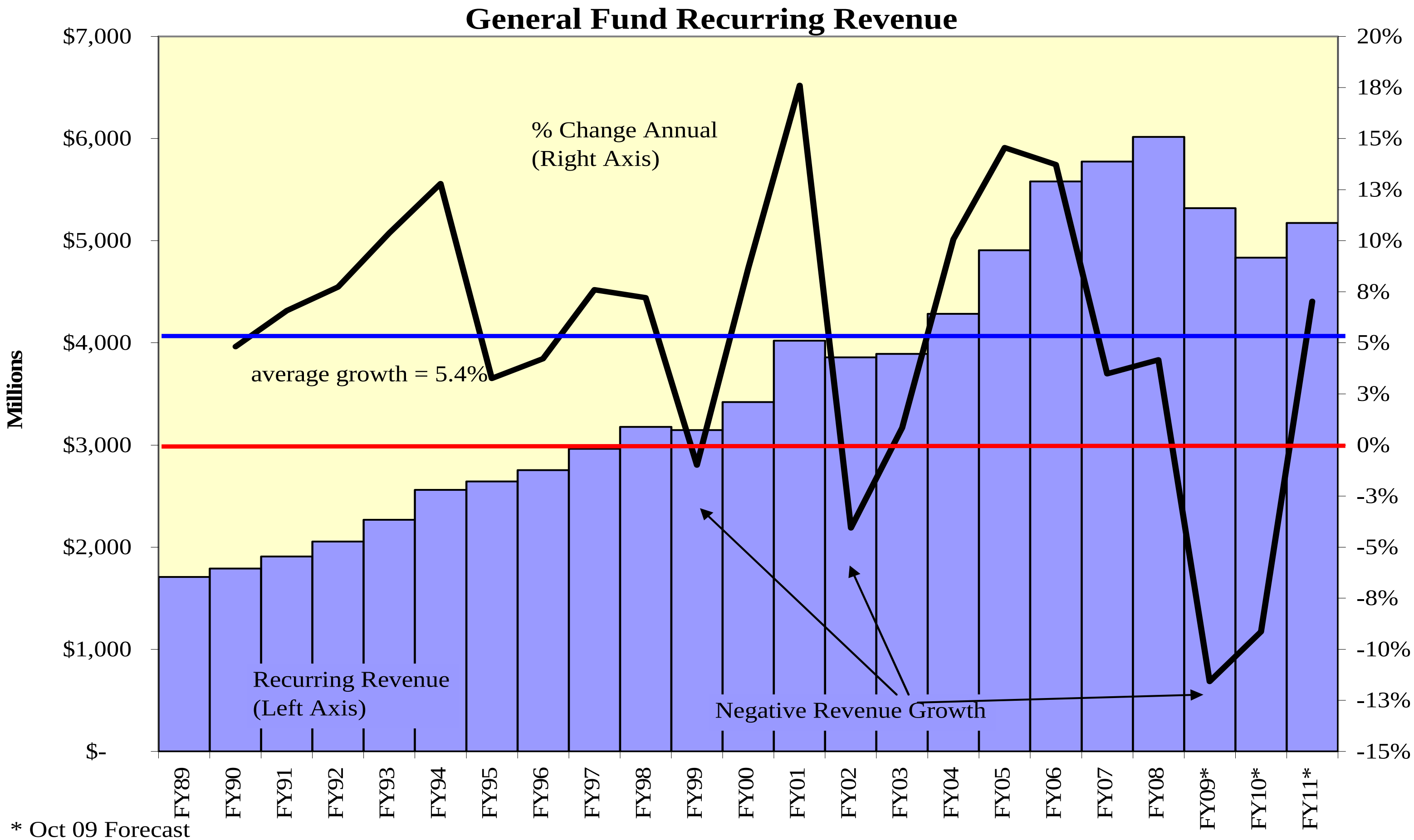
N.M. Legislative Finance Committee



- *After the October revisions, 1989-2010 compound growth rate of general fund revenues is 5.4 percent, personal income growth = 5.6%.*
- *Revenue growth FY03-FY11 = 33% (compound 3.2%), expenditure growth FY03-FY10 = 39% (compound 4.2%);*

GENERAL FUND FINANCIAL SUMMARY
2009 Special Session: Final after all actions
(Dollars in Millions)

	Preliminary FY2009	Estimated FY2010	Estimated FY2011
APPROPRIATION ACCOUNT:			
REVENUE			
Recurring revenue: Oct. 2009 estimate	$5,320	$4,834	$5,174
Total Non-Recurring Revenue*	$650	$359	
TOTAL REVENUE	**$5,970**	**$5,193**	**$5,174**
APPROPRIATIONS			
Total Recurring Appropriations	$6,035	$5,400	$5,174
Total Nonrecurring Appropriations	-$82	$62	
TOTAL APPROPRIATIONS	**$5,954**	**$5,462**	**$5,174**
Transfer to(from) reserves	$17	-$269	
GENERAL FUND RESERVES			
Ending Balances*	**$393**	**$60**	**$77**
Reserves % of Recurring Appropriations	*6.5%*	*1.1%*	*1.5%*

FY11 "New Money"	
	-$226
Plus Replace One-time Funding:	
	-$281
Total:	
	-$508

* Excludes potential non-recurring reversions due to Executive Order which directs agencies to reduce expenditures by $79.0 million. If these savings are realized, FY10 ending reserves increase to 2.6%.

- *FY11 imbalance increased by need to replace one-time money– mostly stimulus funds*
- *Even after $500 million of revenue increase/spending reductions – and assuming revenue growth of 7% -- reserves would still be inadequate*
- *To balance the budget and reach a 5% reserve level would require $600 to $700 million depending on savings realized from Executive Orders*

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	-$948
Net impacts	**-$608**

- *2003 PIT cuts -$400 million per year*
- *Food GRT deduction -$228 million*
- *Medical deductions/credits -$100 million+*
- *Film production credits -$80 million*
- *Low-income tax credits/exemptions -$70 million*

LFC Good Tax Policy Principles

Adequacy: revenue should be adequate to fund government services

Efficiency: broad base with low rates; minimize distortion; avoid reliance on one tax

Equity: fairness to taxpayers in similar circumstances; fairness to taxpayers with different incomes

Simplicity: encourage compliance and minimize administrative costs

Accountability: tax preferences should be easy to monitor and should be reviewed periodically

Implementing principles requires making trade-offs

"Broad Base, Low Rate"

- In economic theory, taxes cause inefficiency – reduce total income -- if they cause individuals to change their behavior
- Since some individuals are less likely to change behavior than others, could argue for higher or lower taxes on some groups – e.g. economic development incentives
- Similarly, some purchases are less price sensitive than others and could be taxed at higher rates – e.g. "sin" taxes
- Equity principle argues against different treatment – both horizontal and vertical equity
- Simplicity also argues against different treatment
- Inefficiency increases with the square of the tax rate – if exceptions reduce the tax base they may increase rates, increasing inefficiency
- Best policy = Broad base, low rate
  - Exception = avoid pyramiding

Adequacy: Revenue Growth

- Compound annual revenue growth FY03-FY11 = 3.2%
- Compound personal income growth = 4.9%
- Compound inflation = 2.3%
- Compound population growth = 1.1%
- Population growth plus inflation = 3.4%

Efficiency: Economic Analysis

- States are "small, open economies", high volumes of cross-border trade (e.g. internet purchases)
- If a state imposes above-average taxes, investment may migrate to other states, reducing growth and shifting the tax burden to those who remain
  - Some businesses are less mobile than others, taxes should have less effect
- Mobility argument applies to skilled labor as well, argues against a highly progressive rate structure
- State comparisons should include all state & local taxes
- Empirical studies provide mixed evidence – a majority show a small negative impact of S&L taxes on economic growth

Multi-state Comparison: Households

State and Local Taxes as Percent of Gross Household Income

City, State	$25,000	$50,000	$75,000	$100,000	$150,000
Albuquerque, NM	9.9%	7.7%	7.7%	7.9%	7.5%
Billings, MT	7.5%	4.4%	5.6%	6.1%	6.5%
Boise, ID	9.0%	6.2%	7.2%	8.0%	8.4%
Denver, CO	11.3%	6.6%	6.7%	7.3%	6.9%
Houston, TX	9.9%	6.1%	5.6%	5.4%	4.4%
Las Vegas, NV	9.8%	6.5%	5.4%	5.0%	4.0%
Los Angeles, CA	10.7%	10.0%	8.6%	8.5%	8.9%
Oklahoma City, OK	10.9%	7.3%	7.9%	8.2%	7.9%
Phoenix, AZ	11.6%	5.9%	5.8%	6.3%	5.9%
Salt Lake City, UT	11.4%	7.2%	7.7%	8.0%	7.7%
Average	**10.2%**	**6.8%**	**6.8%**	**7.1%**	**6.8%**

Source: District of Columbia Government, *Tax Rates and Tax Burdens: 2008*

- *Albuquerque tax burden about average on $25,000 household, above average for other households*
- *NM tax burden is roughly proportional above $25,000. Other states' vary.*

Multi-state Comparison: Households (cont.)

State and Local Taxes: $50,000 Income Household

City, State	Income Tax	Property Tax	Sales Tax	Auto	Total
Albuquerque, NM	1.0%	3.7%	2.7%	0.3%	7.7%
Billings, MT	2.4%	1.4%	0.0%	0.7%	4.4%
Boise, ID	2.1%	2.0%	1.7%	0.5%	6.2%
Denver, CO	1.6%	2.3%	2.0%	0.7%	6.6%
Houston, TX	0.0%	3.5%	2.2%	0.4%	6.1%
Las Vegas, NV	0.0%	4.3%	1.5%	0.7%	6.5%
Los Angeles, CA	0.0%	7.5%	1.7%	0.8%	10.0%
Oklahoma City, OK	2.3%	1.9%	2.6%	0.4%	7.3%
Phoenix, AZ	1.0%	1.7%	2.7%	0.6%	5.9%
Salt Lake City, UT	2.4%	2.1%	2.1%	0.6%	7.2%
Average	**1.3%**	**3.0%**	**1.9%**	**0.6%**	**6.8%**

Source: District of Columbia Government, *Tax Rates and Tax Burdens: 2008*

- *ABQ property and sales tax burdens are above average, income tax below average*

Multi-state Comparison: Households (cont.)

State and Local Taxes: $150,000 Income Household

City, State	Income Tax	Property Tax	Sales Tax	Auto	Total
Albuquerque, NM	3.5%	1.8%	1.9%	0.2%	7.5%
Billings, MT	5.3%	0.6%	0.0%	0.6%	6.5%
Boise, ID	5.6%	1.2%	1.3%	0.3%	8.4%
Denver, CO	3.5%	1.1%	1.5%	0.8%	6.9%
Houston, TX	0.0%	2.4%	1.7%	0.2%	4.4%
Las Vegas, NV	0.0%	2.5%	1.1%	0.4%	4.0%
Los Angeles, CA	3.3%	3.5%	1.4%	0.7%	8.9%
Oklahoma City, OK	4.4%	1.4%	1.9%	0.2%	7.9%
Phoenix, AZ	2.3%	1.0%	2.0%	0.6%	5.9%
Salt Lake City, UT	4.9%	1.0%	1.5%	0.4%	7.7%
Average	**3.3%**	**1.7%**	**1.4%**	**0.4%**	**6.8%**

Source: District of Columbia Government, *Tax Rates and Tax Burdens: 2008*

- *ABQ's combined burden above average*
- *Property about average, sales tax above average, income tax one of lowest*

Multi-state Comparison: Businesses

Direct business taxes as a percent of gross state product

State	Property Tax	Sales Tax	Excise & GRT	CIT	UI	PIT	Other	Total	Total Excl. Other
Arizona	1.8%	1.6%	0.5%	0.4%	0.1%	0.1%	0.3%	4.7%	4.4%
California	1.1%	1.2%	0.5%	0.6%	0.3%	0.4%	0.5%	4.6%	4.1%
Colorado	1.6%	1.3%	0.3%	0.2%	0.2%	0.3%	0.2%	4.2%	4.0%
Idaho	1.8%	0.9%	0.4%	0.4%	0.2%	0.4%	0.4%	4.7%	4.3%
Montana	2.7%	0.0%	0.7%	0.7%	0.3%	0.3%	1.7%	6.4%	4.7%
New Mexico	0.8%	1.9%	0.5%	0.5%	0.2%	0.2%	2.1%	6.0%	3.9%
Oklahoma	1.0%	1.7%	0.4%	0.3%	0.2%	0.4%	1.3%	5.3%	4.0%
Texas	2.2%	1.3%	0.7%	0.0%	0.1%	0.0%	1.0%	5.3%	4.3%
Utah	1.2%	0.9%	0.5%	0.4%	0.2%	0.2%	0.3%	3.9%	3.6%
Average	**1.6%**	**1.2%**	**0.5%**	**0.4%**	**0.2%**	**0.3%**	**0.9%**	**5.0%**	**4.1%**

Source: Ernst & Young, Council on State Taxation, “Total State and Local Business Taxes,” January 2009.

- *NM’s Total burden is one of highest in the region*
- *Excluding severance taxes, NM burden is about average*
- *High sales tax (on purchases not sales) offsets low property tax*
- *Income taxes are about average*

Conclusions

- General Fund revenue grew by 3.2% per year from FY03 –FY11
  - Slower than personal income but about the same as inflation plus population
- Spending grew 4.2% per year; 5.7% when temporary federal funds are included
- $500 million in spending cuts and/or revenue increases are needed to balance the FY11 budget, more is needed to rebuild reserves
- Good tax policy is best served by a “broad base, low rate” approach; Overall tax burdens should be kept near average levels among other states
- New Mexico taxes on some households appear to be higher than those of neighboring states
  - Property and sales taxes are relatively high, income tax relatively low
- NM taxes on most businesses appear to be about average
  - Low property taxes offset high sales taxes on business inputs; income taxes are about average