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

SPONSOR Youngberg **DATE TYPED** 02/22/05 **HB** HJR 10

SHORT TITLE Limit State Expenditure Limits **SB**

ANALYST Taylor

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY05	FY06			
		See Narrative	See Narrative	

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files
Department of Finance and Administration (DFA)
National Conference of State Legislatures (NCSL)
Public Education Department (PED)

SUMMARY

House Joint Resolution 10 proposes a constitutional amendment that would limit the legislature's ability to increase state expenditures and would require refunds of revenue in excess of state expenditure limits.

Expenditure growth would be limited to inflation as determined by the U.S. department of labor plus population growth in the prior year based upon estimates provided by the University of New Mexico's Bureau of Business and Economic Research. The legislature could adjust state expenditures for revenue increases related to the issuance of general obligation bonds, severance tax bonds or revenue bonds authorized by the legislature prior to January 1, 2007.

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 passed, was put to a vote and approved, the fiscal implications could be large in years where revenues grow faster than inflation plus population.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Joint Resolution is almost identical to House Joint Resolution 5 and Senate Joint Resolution 13. The only difference is that the latter resolutions specifically require that excess revenues be refunded to taxpayers.

TECHNICAL ISSUES

The Department of Finance and Administration submitted the following technical issue:

> HJR10 specifies that the formula will use the inflation rate as determined by the federal Department of Labor, but does not specify which inflation rate will be used. The federal Department of Labor publishes several inflation indices, including the CPI for all urban consumers, the CPI for all urban wage earners, and regional indexes. It also does not clearly state what time period should be used, the prior fiscal year or the prior calendar year. Using the inflation rate from the prior fiscal year would be impossible because the prior fiscal year data is not available until about 3 months after the next fiscal year begins. It should also be noted that the Bureau of Labor Statistics routinely revises the CPI. Would a downward revision require spending cuts in a fiscal year that has already begun?
>
> The resolution does not clearly define the base on which the expenditure cap is calculated. The sponsor may have intended "state expenditures" to mean those contained in the General Appropriation Act (GAA). However, limiting GAA expenditures could lead to an increase in special appropriations or capital outlay expenditures. Also, the GAA contains federal funds and other non-state sources.
>
> The resolution does not specify if revenues deposited in the state's reserve funds will count as expenditures. If that is the case, reserves would be in competition with all other state spending.
>
> The resolution specifies that population estimates will be estimated by UNM's Bureau of Business Research. The formal name of the intended organization is the Bureau of Business and Economic Research.

Further, the resolution does not specify how revenues in excess of the expenditure cap should handled. Would funds be deposited into the state's reserve for use in years when revenues fall? This would protect the expenditure base during down years. Or would excess revenues be returned to taxpayers through tax refunds? Would either of these uses count as expenditures?

OTHER SUBSTANTIVE ISSUES

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 has implemented this type of limit, years of declining revenues forced budget reductions, which could not be made up when revenues started to grow again.

Situations like the one above are causing the Colorado legislature to re-examine this 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 decline in future years.

DFA provided this analysis

The table below shows inflation rates (Consumer Price Index for all urban consumers; Global Insight, January 2005) and population growth rates (BBER, January 2005). These figures suggest the expenditure growth limit would average about 3.5 percent annually.

	CPI-U	Population Growth	TOTAL
1997	2.3%	1.3%	3.6%
1998	1.6%	1.1%	2.7%
1999	2.1%	0.8%	2.9%
2000	3.3%	2.6%	5.9%
2001	3.4%	1.6%	5.0%
2002	1.3%	1.5%	2.8%
2003	2.2%	1.5%	3.7%
2004	2.8%	1.5%	4.3%
2005	2.1%	1.5%	3.6%
2006	1.5%	1.4%	2.9%
2007	1.9%	1.4%	3.3%
2008	1.9%	1.4%	3.3%
2009	2.3%	1.4%	3.7%

Limiting expenditure growth to inflation plus population growth leaves little space to

create new programs or expand existing programs. Further, the costs of many existing state programs will grow faster than allowed under this expenditure limit: Medicaid's costly disabled and elderly populations are already a substantial pressure on the state's budget, and as the baby boomer generation ages, this pressure will grow. Medicaid expenditures grew by 19.4 percent in FY 2005. Similarly, the state's overall population growth may not reflect population growth in our school systems, or increased use of our roads. Public education grew by 6.3 percent in FY 2005. Many of these expenditures are federally mandated.

Colorado's Taxpayer Bill or Rights (TABOR) is similar to the measures found in HJR 5, except that it limits revenue collections to the previous year's population growth rate and inflation instead of expenditures. TABOR also requires that revenues in excess of this limit be refunded to taxpayers. As a result of TABOR, Colorado's fiscal crisis has been 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 a 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 refunding mechanism contained in the expenditure limit would eliminate New Mexico's ability to build and maintain prudent 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.

BT/yr