

Statement of Jim Peach
Legislative Finance Committee
Cloudcroft, NM
July 15, 2020

Mr. Chairman and Members of the Committee: Thank you for this opportunity to comment on the state of the New Mexico economy and other issues. I am genuinely honored to be here. I apologize for not appearing in person but given my age and mileage, it is best that I appear electronically. My remarks should be taken with a grain of salt. Optimism is in my DNA. I will be happy to answer questions.

Let me begin by congratulating the entire legislature for a remarkable special session. The legislature and the people of New Mexico are lucky to have had the leadership of Chairman Smith and Director Abbey during these very difficult times. As Senator Smith noted during the special session, the full session in January 2021 is likely to be even more challenging.

We all want to reopen the economy and to do so safely and as quickly as possible. The virus and our reaction to it will determine how quickly that happens. A common question is: how soon can we return to a 'pre-covid' economy? The simple answer is that we cannot and will not return to a pre-covid economy. Some things are not reversible. The world will be different. Our lives will be different. The effects of the current crises are likely to be as profound as those seen as a result of WWII, the 1970s oil crisis, 9/11, or the Great Recession. None of this means that we are doomed. It means that life in general and the economy, in particular, will be very different.

The severity of the crisis in New Mexico can be confirmed with a quick look at the labor market during the Great Recession¹ and 2020². During the Great Recession, NM lost 51.6k jobs. This occurred from December 2007 (849.5k jobs) to January 2012 (797.9k jobs). NM did not reach its December 2007 level of jobs again until November 2018 (849.8k jobs) –more than a decade later. In Feb 2020 NM had 867.7k jobs but this had decreased to 767.8k jobs by May 2020. This year's loss of 99.9k jobs is nearly twice as large as the job loss during the Great Recession and this occurred in only three months. Despite some impressive job gains in 2018 (12.3k) and 2019 (13.1k), NM's job creation record is not enviable. The state's net increase in jobs from Dec 2007 to February 2020 was only 18.5k jobs or about 1.5k per year. How long will it take for NM to regain the nearly 100k jobs lost so far in the Covid crisis? No one knows for certain, but it is unlikely to be during FY21 or FY 22. The Congressional Budget Office (CBO) forecasts that the national unemployment rate will remain above the pre-covid level (3.5%) through 2030.

The oil and gas industry is unlikely to create enough new jobs to offset recent declines in NM employment. In large part, this is a result of increasing labor productivity in the industry. In June 2014, the WTI price for a barrel of oil was \$105.79, the nation was producing 8.7 million barrels of oil per day,

¹ The National Bureau of Economic Research (NBER) is the organization that officially designates business cycles. The NBER designated December 2007 as the peak of the previous business cycle and June 2009 as the trough of the business cycle.

² The data in this paragraph are from the US Bureau of Labor Statistics (www.bls.gov) State and Area Employment (SAE) database. The data refer to non-farm payroll employment. The data presented are seasonally adjusted but the story does not change in any important way when non-seasonally adjusted (NSA) data are used.

and the industry (oil and gas extraction plus support activities for oil and gas operations) employed 519.7 k workers. In June 2019, WTI was \$54.66 per barrel and the industry produced 12.1 million barrels per day with only 970 active rigs and 416.1 k jobs. In short, by June 2019, the industry produced about 40% more oil than it did in June 2014, with slightly over half number of active rigs and 20 % fewer employees.

In NM, the story is similar but even more remarkable. In June 2014 NM produced 10 million barrels of oil with 89 active rigs and 22,716 jobs. In June 2019, NM produced 26.6 million barrels of oil with 100 active rigs and 21,852 workers. In brief, the state produced 2.7 times as much oil with a few more rigs and slightly fewer jobs.

Even if the oil and gas industry recovers, it is unlikely to generate a lot of employment in New Mexico. Will the industry recover soon? History offers some guidance. The last major downturn in oil prices began in June 2014 and by March 2016 WTI was at \$26 per barrel. During that downturn, NM active rigs declined from 100 in June 2014 to only 13 in one week in March 2016. The industry began to recover shortly after that but the downturn lasted 2 to 2.5 years. In fact, the typical downturn in the oil industry lasts for a couple of years. That was the case of downturns beginning in 1986, 1997, and 2008.

Price volatility has been an inherent part of the history of the oil industry since its origins as a commercial industry when Colonel Drake (who was not a Colonel) drilled the first commercial well near Titusville, Pennsylvania in 1857. Fortunes have been won and lost betting on the future price of oil. It is an inherently risky business. Anyone who tells you that they know what the price of oil will be next month or next year does not know what they are talking about. Still, the legislature needs to have some reasonable estimates of future oil prices and the Consensus Revenue Estimating Group (CREG) does a nice job of providing the estimates. Within the industry oil price forecasts are essential for production and drilling decisions. It takes time to drill a well and bring it into production. The recent price of oil is not likely to be the price of oil when a well comes on-line. Anyone drilling a well is placing a risky bet on the future price of oil.

In early March, 2020 NM had a record 117 active rigs even though oil prices had begun to fall. As of July 10, 2020 NM had 49 active rigs. Given the nature of fracking and horizontal drilling, this will mean a decline in production, if the rig count does not increase. In early July, WTI prices had recovered to just under \$40 per barrel. The price needed to spud new wells depends on location, geology, firm characteristics, and many other factors. The Dallas Federal Reserve Bank surveys exploration and production companies on a regular basis to answer several questions including the price it takes to start a new well. The survey (conducted in March 2020) indicated that the mean price needed to drill a new well in the Delaware was \$52 with a great deal of variability. Prices reported ranged from the high \$30s to the high \$60s. To cover operating costs of existing wells, the mean price reported was \$36. (<https://www.dallasfed.org/-/media/Documents/research/energy/energycharts.pdf?la=en>). The current price of crude may keep some firms out of bankruptcy, but it does not suggest a substantial increase in drilling activity. The oil industry faces major challenges and one consequence is that so does the New Mexico budget but other industries are also important.

The Hospitality and Tourism sector in NM, which typically accounts for 11 percent of total non-farm payroll employment in the state, has been hit hard by the current crisis. Jobs in this sector decreased from 96.6k in January to 62.3k in May –a decrease of 34.3k. (May was up 4.8k from April). While this sector may improve some over the course of the next year, full recovery will depend on the spread of the virus and the potential development of a vaccine. People need to feel safe before they will be willing to eat indoors in a restaurant or to stay in hotels. The devastating effects of opening too soon are apparent in other states. In NM and the rest of the nation major entertainment events and conferences have been canceled including the Albuquerque Balloon Fiesta, the State Fair, the Hatch Chili Festival, the Santa Fe Opera, and many others. New Mexico will be lucky if it has 75 or 80 percent of employment in this sector by late next year.

The Retail Trade sector was in trouble long-before the Covid crisis. In January 2020, the retail trade sector reported 88.7k jobs, a decrease of 1,000 jobs from January 2000. By May 2020 this sector reported 81.0k jobs, decrease of 7.7k. Many of these jobs may never return. Changes in consumer behavior and the ease of buying on the internet suggest that retail trade will not be a growth sector anytime soon.

Education at all levels is a major industry. According to the Public Education Department, there were 333k students enrolled in grade 12 and below. The Higher Education Department reports that fall 2019 headcount enrollment in the state's institutions of higher education was 121k. Combined k-12 and higher ed enrollments are more than 20% of the NM population. Reopening the state's schools at all levels is incredibly important. The PED should be congratulated for its systematic reopening plans released on June 20. The state's higher education institutions have also done a great deal of work on reopening plans.

Whatever reopening education in New Mexico looks like in the fall, it will look and feel vastly different than it did in fall 2019. At best, educational institutions will open with some students attending some of the time in person. Social distancing requirements mean that there is not enough space for all students to be in class all the time. Some form of hybrid or entirely remote learning is likely. This will be true at all levels of education. Increasingly, even a partial reopening of in-person classes appears problematic. Nationally and in New Mexico, virus case trends are not favorable. As Governor Lujan Grisham indicated in her July 9 press conference, no final decision has been made and reopening may need to be delayed or modified. NMSU President Floros indicates that the plan is to have in-person classes and students back on campus. But he also suggested that it is too early for a final decision on what the fall looks like. For both K-12 and higher ed, the fall semester will be much more expensive and budgets have not expanded to accommodate the increased costs.

Sporting events at all levels deserve some comment. Minor League baseball has been cancelled, so the Isotopes will not play this year. Governor Lujan Grisham has appropriately, I think, cancelled high school contact sports (football and soccer) for the fall. Professional sports plan to reopen without fans and with severe restrictions, if they open at all. At the college level, the Ivy League has cancelled all fall sports. The Big 10 and the PAC12 will play only conference games. NMSU was scheduled to open its football season at UCLA on August 29 for a \$1.2 million payday. That game will not take place. Other football conferences will announce their plans soon. There is a growing consensus among university

presidents, Athletic Directors, and sports journalists that there may not be a college football season in the fall. This means reduced revenue and very likely that there will be furloughs, layoffs, and salary reductions in athletic departments across the nation –including in New Mexico.

Some concluding thoughts:

New Mexico's fiscal crisis will not magically disappear by the January 2021 session. The Legislature and the Executive will need to implement some combination of draconian budget cuts or revenue enhancements. Please do not let \$40 oil in early July or the possibility of higher oil revenue estimates in August or December convince you that "things" will be ok. Things are not ok and that is especially true in the oil industry. Oil price volatility will not disappear. In the first four months of 2020, the price of oil varied by more than \$100 per barrel. It will continue to be risky, very risky, to rely on oil and gas for a substantial portion of state revenue.

Late last week I told an oil industry friend I was preparing this statement for the Committee and asked him what the state needed to know about oil. My friend has been in the industry for more than 50 years and is a very knowledgeable observer. His emailed response was: "The State needs to know this is not a downturn. This is a collapse. Many Cos will follow CHK." (CHK refers to Chesapeake which just filed for Chapter 11 bankruptcy.)

Like it or not, the Legislature will need to find some new sources of revenue in the next session. This would be a very good time to consider serious tax reform that could put the State on a sound fiscal trajectory for many years to come. There are any number of ways to do this. I wish you the best and I will be happy to answer questions.