MINUTES
of the
SECOND MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

August 27-28, 2003
Room 307, State Capitol

The second meeting of the Revenue Stabilization and Tax Policy Committee (RSTPC) for the 2003 interim was called to order by Senator John Arthur Smith, chair, on Wednesday, August 27, 2003, at 10:15 a.m. in Room 307 of the State Capitol.

PRESENT
Sen. John Arthur Smith, Chair (8/27)
Rep. Donald L. Whitaker, Vice Chair
Rep. Janice E. Arnold-Jones (8/27)
Sen. Sue Wilson Beffort (8/27)
Sen. Mark Boitano
Rep. Anna Marie Crook (8/27)
Sen. Joseph A. Fidel
Rep. Roberto "Bobby" J. Gonzales
Rep. George J. Hanosh
Sen. Timothy Z. Jennings
Rep. Ben Lujan
Sen. Roman M. Maes, III
Sen. William E. Sharer
Rep. Daniel P. Silva
Sen. H. Diane Snyder

ABSENT
Rep. James G. Taylor
Rep. Thomas C. Taylor

Designees
Rep. William "Ed" Boykin (*designee for Rep. Thomas C. Taylor)*
Rep. Henry Kiki Saavedra (*designee for Rep. James G. Taylor)*
Rep. Robert White (*designee for Rep. Janice E. Arnold-Jones on 8/28)*

(Attendance dates are noted for members not present for both days of the meeting.)

Staff
Cleo Griffith, Amy Chavez, Pam Ray and Cenissa Martinez

Guests
The guest list is in the meeting file.

Copies of all written testimony are in the meeting file.

Wednesday, August 27

TRANSPORTATION ISSUES: STATUS REPORT AND FUNDING OPTION

Rhonda Faught, secretary of transportation, presented an overview of transportation needs and priorities in New Mexico and discussed possible revenue sources for funding transportation projects.

Secretary Faught discussed the substantial state funding needed to carry out necessary highway and transportation projects and Department of Transportation (DOT) operations. She said she does not think there will be any additional federal funds available until after 2004, and pointed out that federal highway dollars must be matched by state funding, so even if New Mexico is successful in obtaining additional federal funding, state funding will need to be increased. She explained that federal funds are used for construction only, and may be used for maintenance of highways, or for operational items like salaries. She said the DOT already has over 400 vacancies because there is not funding for the salaries.

Secretary Faught summarized the administration's highway improvement program, known by the acronym GRIP, which stands for Governor Richardson's Investment Program. She displayed a map illustrating the different planning and priority levels for the projects in the program. She noted that the projects in red indicate roads and highways with a critical need for repair or maintenance. She explained that if these roads are not repaired soon, there is a risk of deterioration to the point that they will need to be completely rebuilt. She likened the situation to a house with a leaky roof. Fixing the small leaks is a relatively minor expense, but if the leaks are not attended to, eventually the entire roof needs to be replaced. She noted that bridges are in particularly bad shape and estimated that there is a critical need for $90 million in repairs to bridges.

Secretary Faught discussed the public transit projects in GRIP, including commuter rail and park and ride projects. In response to questions, she said that the current Pojoaque park and ride project is being federally subsidized as part of the US 285 project. When that project is finished, state funding will be needed in order for the park and ride service to continue. She said that this need for a subsidy is common and she is unaware of any public transit project in the country that is able to pay for itself.

Secretary Faught answered questions from committee members about specific projects in the GRIP plan and about roads not included in the plan. She said GRIP only covers the most critical needs and said there are many more unmet needs.

There was discussion of the impact that large trucks have on highways and the need to be sure they are paying their share of road taxes. Secretary Faught said that one of these trucks is the equivalent of 38,000 passenger cars in terms of the damage it causes to highways. She discussed the problems with enforcement of taxes and overweight fees on interstate truck traffic, and said she feels it is important to address enforcement when considering increases in these fees. She noted that the Motor Transportation Division is in the Department of Public Safety, not the DOT. In response to questions, she said that in the majority of other states this enforcement is in a department of transportation.

Secretary Faught discussed with committee members the proposal of the Blue Ribbon Tax Reform Commission for a five-cents-per-gallon increase in the gasoline tax and a six-cents-per-gallon increase in the special fuels tax, and what this would mean in terms of increased State Road Fund revenues.

Robert Alcott, DOT staff, discussed problems with the trip tax and cab cards, and the evident abuse and avoidance of the tax by some trucking companies. He said the department is working with the Motor Transportation Division on this issue. There was discussion of possible solutions, including numbered cab cards assigned to single vehicles, and significant penalties for abuse.

Committee members commented on various topics, including the need to fund DOT salaries out of the general fund, rather than the State Road Fund; driver's license fees; and the unpopularity of gasoline tax increases.

The committee recessed for lunch at approximately 12:00 noon and reconvened at approximately 1:30 p.m.

TAXATION OF NEW MEXICO'S OIL AND NATURAL GAS INDUSTRY

Bob Gallagher, executive director of New Mexico Oil and Gas Association, presented an overview of the oil and gas drilling process. He discussed the various costs involved in production of oil and gas, noting that although a company can give average costs, the actual costs will vary for each well, depending on drilling costs, completion costs, operating costs and eventual plugging and abandonment costs.

Mr. Gallagher summarized the taxation of oil and gas by New Mexico. He noted that gross receipts tax is paid on equipment purchases and services. On oil and gas production, the following taxes are paid: the severance tax at 3.75 percent of the value of oil and gas when it is severed from the ground; the emergency school tax at 3.15 percent for crude oil and four percent for natural gas; the conservation tax at .0019 percent; the natural gas processors tax; state royalties; and federal leasing rents and royalties.

Mr. Gallagher and committee members discussed the negative effect of the federal endangered species protection requirements on the oil and gas industry in New Mexico.

Mr. Gallagher displayed charts comparing taxes on the oil and gas industry in New Mexico with those in other states, and concluded that New Mexico taxes are higher. It was pointed out by committee members that the chart does not include the ad valorem taxes paid by the industry, and those are significantly higher in other states.

TAXATION OF NEW MEXICO'S MINING INDUSTRY

David Waugh, president of the New Mexico Mining Association, and Mike Bowen, executive director of the New Mexico Mining Association, gave a presentation on taxation of the mining industry in New Mexico. Mr. Bowen reviewed the many uses of minerals in the modern economy and the increasing percentage of minerals being imported to the United States from other countries. He discussed the different minerals being mined in New Mexico and the areas of the state where these mining operations are occurring. He pointed out that in rural communities, mining operations have a large influence on the economy and employment. He described the operations of the companies that are conducting mining in New Mexico, the value of the products and the jobs created and the taxes paid.

Peter Finie of Vulcan Materials pointed out that the mining industry pays gross receipts tax, ad valorem tax, severance tax and processors tax in New Mexico, and asked the committee to consider fairer taxation of this industry.

In reply to questions from committee members, Tony Trujillo of Phelps Dodge Mining Company said that copper production in Silver City has been scaled down, but the company is still operating there. He said the problem of reduced production is due to world copper inventories being high and prices low.

In reply to questions, Mr. Bowen said Questa molybdenum mine production had declined in the past, but as prices rise and demand increases, the mine is producing more. In reply to a question about uranium mining, he said although there are uranium reserves, there is no uranium mining in New Mexico at this time due to the lack of a market.

There was discussion of the expense of complying with environmental regulations, which increases the cost of doing business. Mr. Bowen noted that since the adoption of the New Mexico Mining Act, no new mining permits have been issued in New Mexico. It was also noted that if a mine closes, it can be very difficult to get a permit to reopen because of environmental regulations.

Some committee members commented that it should be possible to protect the environment but make it easier to open new mines, and that the economic repercussions of the New Mexico Mining Act might not have been clear when it was passed in 1993.

Mr. Waugh said he believes that New Mexico has lots of undeveloped mineral resources, but exploration companies will invest in states where they will be able to operate at reasonable costs, and New Mexico is not one of those states.

The meeting recessed for the day at approximately 4:30 p.m.

Thursday, August 28

The meeting was reconvened at 9:15 a.m. by Vice Chairman Whitaker.

APPROVED WORK PLAN AND MEETING SCHEDULE

Staff presented the committee work plan and meeting schedule as approved by the Legislative Council.

COMPARISON OF STATE PRODUCTION TAXES ON OIL AND GAS

Sam Flaim, chief economist for the Department of Finance and Administration, presented a report comparing severance taxes in New Mexico with those in neighboring states. Mr. Flaim discussed the many economic factors besides taxes that affect production costs, and noted that tax burden is only one item that determines New Mexico's attractiveness as an investment opportunity for oil and gas producers. After reviewing the charts in his report examining the effective tax rates of the neighboring states from several perspectives, Mr. Flaim concluded that New Mexico's severance taxes are neither excessively punitive nor excessively generous. He discouraged changing the taxes without adequate study because uncertainty makes investment decisions more difficult for the producers, and said the best tax strategy is to guarantee producers a good rate of return on their investment.

In response to questions, Mr. Flaim said he thinks that the taxes should not be so high as to discourage continued production. Mr. Flaim said New Mexico taxes in relation to other states are functionally equivalent and fine for the long term. Some committee members commented that Mr. Flaim's charts failed to take into account the tax credits that New Mexico gives, thus making the New Mexico rate look high and not accurately reflecting the effective rate.

There was discussion of the need for New Mexico producers to have better access to premium markets and the need to get a better share of federal royalties.

PRESENTATION ON TAXATION OF OIL AND NATURAL GAS

Tom Clifford, chief economist for the TRD, presented a history of New Mexico oil and gas severance taxes and an analysis of the effect of converting the tax on natural gas to a unit rate, rather than a percentage of price.

There was discussion of the large share that oil and gas revenues contribute to New Mexico's general fund. Mr. Clifford agreed that he thinks the percentage is higher than in other states, and agreed that this is a very important industry in New Mexico's economy.

In reply to questions, Deborah Seligman of the New Mexico Oil and Gas Association said that there are 700 producing companies in New Mexico with a work force of approximately 19,000.

There was discussion of the possible benefits of a new pipeline being built to allow New Mexico to reach other markets, and who would bear the cost of building a pipeline.

Several committee members commented that it is the total cost of bringing the product to market, and not just the tax rate, that the industry considers. Comparisons between states are very difficult because of the many variables.

YEAR-END GENERAL FUND REVENUE REPORT

James Jimenez, secretary of finance and administration, presented the general fund consensus revenue estimates. He explained that this is an abbreviated outlook, for fiscal years (FY) 2003 through 2005 only, rather than the customary in depth five-year estimate. He said this is because the Blue Ribbon Tax Reform Commission may be recommending modifications to the tax system that would need to be taken into account; because the stimulative effects of the recent cut in personal income tax rates have not had time to take effect; and because the executive branch is undertaking initiatives to realize cost savings in state government that should be taken into account in longer term forecasts.

Mr. Jimenez said New Mexico's revenues are in better fiscal shape than other states due to permanent fund earnings, high reserve balances, federal spending and higher oil and gas prices. He said recurring revenue in FY 04 is expected to be higher than previous estimates mainly due to higher oil and gas prices and a distribution from the tobacco settlement fund.

David Abbey, director of the Legislative Finance Committee (LFC), presented a report on the economic and revenue outlook. He noted that although the bottom line of revenue estimates worked out for FY 03, there were huge gaps in certain sectors. Personal income tax revenues were $60 million short, but this was offset by a $42 million gain in resource taxes. He said this is a dangerous pattern for the long term: strength in volatile revenue sources, but weakness in the bread and butter sources. He cautioned against treating the gains due to oil and gas revenues as recurring revenue.

A committee member questioned the inclusion in the general fund forecast of $65 million from the constitutional amendment changing permanent fund revenue distribution, because that additional money was earmarked as new money for school reform. Mr. Abbey said that the new money will go to the common school funds, which are part of the general fund, and although the money will be added to school funding, it is hard to determine how much of an increase it will be over what would otherwise have been allocated to schools.

In reply to questions as to when a full five-year revenue estimate will be available, Mr. Jimenez said this will be presented to the LFC in October.

ADJOURN

The meeting adjourned at 12:10 p.m.