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

December 15-16, 2008
Room 322, State Capitol
Santa Fe

The seventh meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) was called to order by Representative Edward C. Sandoval, chair, at 9:30 a.m. at the State Capitol in Room 322 in Santa Fe.

Present
Rep. Edward C. Sandoval, Chair
Sen. Carlos R. Cisneros, Vice Chair
Sen. Mark Boitano
Rep. Anna M. Crook
Sen. Dianna J. Duran
Rep. Keith J. Gardner
Rep. Roberto "Bobby" J. Gonzales
Rep. William J. Gray
Rep. Ben Lujan
Sen. Bernadette M. Sanchez
Rep. Daniel P. Silva
Sen. John Arthur Smith
Sen. James G. Taylor
Rep. Thomas C. Taylor

Absent
Sen. Kent L. Cravens
Rep. George J. Hanosh
Sen. Timothy Z. Jennings
Sen. H. Diane Snyder

Designees
Sen. Sue Wilson Beffort (12/15)
Sen. Cisco McSorley
Sen. Nancy Rodriguez
Rep. Henry Kiki Saavedra

Rep. Janice E. Arnold-Jones
Rep. Donald E. Bratton
Rep. Nathan P. Cote
Sen. Phil A. Griego
Sen. John T.L. Grubesic
Sen. Stuart Ingle
Sen. Gay G. Kernan
Sen. Steven P. Neville
Rep. Andy Nuñez
Rep. John Peña
Sen. John C. Ryan
Sen. William E. Sharer
Rep. Don L. Tripp

Guests Legislators
Sen. Rod Adair (12/15)
Sen. Howie C. Morales
Rep. Debbie A. Rodella
Rep. Luciano "Lucky" Varela

(Attendance dates are noted for those members not present for the entire meeting.)

Staff
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Doris Faust, Staff Attorney, LCS
Tim Crawford, Historian, LCS
Tom Pollard, Economist, LCS

Guests

The guest list is in the meeting file.

Copies of all handouts and written testimony are in the meeting file.

Monday, December 15

Consensus Revenue Forecast

Katherine Miller, secretary of finance and administration, Rick Homans, secretary of taxation and revenue, and David Abbey, director, Legislative Finance Committee (LFC), presented the consensus revenue forecast completed in the first week of December.

Secretary Miller began with an overview of the present economic conditions, which appear to be grim, but not as grim as in other states. The national economy is seeing reduced revenues due to lower oil and gas prices as well as the national economic crisis. Other states are severely affected by the collapse of the housing bubble. The 40% decline in value of shares on the New York Stock Exchange and the $700 billion federal financial institutions bailout are rippling throughout every state's economy. It was noted that the country has been in a recession since December 2007. Economists are predicting at least four quarters of negative growth from third quarter 2008. An additional federal bailout for states is proposed in the amount of $500 billion to $700 billion, and this might help to relieve some of the decline in revenue for the states.

Oil and gas prices have taken a nosedive since July 2008. The December 2007 estimate for oil was $75.00 per barrel. In July 2008, the price of New Mexico crude oil rose to $143.30 per barrel. By August, the estimate was $122 per barrel, but now the estimate has dropped to $59.00 per barrel. The cost of New Mexico crude was $37.35 per barrel on December 5, 2008. New Mexico natural gas was anticipated to average $6.60 per million cubic feet (mcf), but spiked to $12.31 per mcf in June 2008 and was down to $3.00 per mcf in October 2008. The price of natural gas per mcf is now up around $5.30 per mcf. Secretary Miller noted that it is difficult to say if the bottom prices in the oil and gas markets have been reached or if prices will fall further. To maintain 10% reserves, it is necessary to receive $385 million in revenue. The governor has asked for each agency to submit a list of where and how much the agency's budget can be cut. It appears that $384.4 million will need to be cut from the budget to retain 10% reserves for fiscal year 2009. Nationally, jobs have been steadily lost over the last 11 months, and the consumer price index is falling.

Secretary Homans gave a fiscal year 2008 revenue update. He stated that general fund revenues will most likely come in at about $92.5 million above the December 2007 forecast. Broad-based taxes and investment income will show weakness but will be balanced by the strength of severance revenues. Gross receipts will come in at approximately $1.9 million, which is $64,700 below the December 2007 estimate. Selective excise taxes will be down about $11,000. Personal and corporate income taxes combined will be about $14,000 above the December 2007 projections. Mineral production taxes, federal mineral leasing and State Land Office income will be $139,800 above December 2007 projections. Investment income will come in $23,300 below the December 2007 numbers. All other sources of revenue are expected to bring in $37,800 above the December 2008 estimate. Expected revenues will be $6.04 million. The main concern right now is that there is likely to be slower growth in most taxes than was forecast, but some growth nonetheless. It is clear that fiscal year 2009 budgets will need to be adjusted downward to balance the state's budget and rebuild the reserves.

New Mexico saw employment *growth* in fiscal year 2008. Employment was 3% above fiscal year 2007. Those figures indicate New Mexico is somewhat behind the nation in job loss. New Mexico's unemployment insurance claims are lagging behind the national trend. Secretary Miller suggested that New Mexico's residential foreclosure rate has not risen as quickly as in many other states. Reserves as the state entered fiscal year 2009 were at 12.6%. It appears that oil and gas prices peaked in October 2008 and now are sliding quickly.

Mr. Abbey noted that the legislature has no authority to use the $454 million from reserves. It is critical that the legislature provide the authority necessary to move money out of reserves for use to cover the shortfall of revenue that is expected. Mr. Abbey is suggesting a three-pronged approach to plugging the shortfall:

1. increase the revenue to the general fund by bringing in additional revenue;
2. cut appropriations; and
3. de-authorize stalled capital outlay projects.

He noted that federal fiscal relief from stimulus funds will not be available for state use until after fiscal year 2010 begins on July 1, 2009. To maintain 10% reserves, $384 million will be needed in fiscal year 2010. The shortfall is actually $454 million, and the stimulus money will be around $30 million.

Committee members noted that:

- corporate liquidity is poor, and the fourth quarter estimated corporate income tax (CIT) payments would most likely be down from the projected revenue level;
- the magnitude of the current economic downturn has not been experienced in 30 to 50 years, and it possibly will prove to be the worst drop in a century;
- the price of metals and other extractive commodities will remain low for the foreseeable future, including oil and gas prices; and
- mining jobs are now decreasing.

So far, the credit worthiness of the state is solid, according to Secretary Miller. She noted that the legislature and the executive branch will have to work together to identify where budgets can be cut and to replace or retain the tax stabilization reserve. Noting that prior requirements for reserves were half the current perceived need, the committee discussed the need to maintain at least 10% reserves. Nothing was definitively agreed upon, but due to the unpredictability in the current revenue outlook, the committee thought it more prudent to maintain a higher level of reserves. It was noted that higher reserves may be extremely necessary in the near future to provide operational money for the state. It was also noted that most forecasts still are predicting the revenue outlook will improve and that this may be only wishful thinking. It would be most prudent to set budgets below the targets assumed in the forecast to accommodate any further slippage in the revenue.

The committee further noted that CIT estimated payments would come in earlier if the legislature were to adopt a fourth quarter reporting date. Corporations have had a three-period reporting schedule since 2003 that was adopted in spite of the error, and now, with the addition of a fourth-reporting date, money will come in more quickly and before the first quarterly report in April. In response to a committee question, Secretary Miller also noted that state employee health care costs increased by 8% and will cost the state an additional $7.5 million to $8 million. Her department and the General Services Department are working together to identify ways to decrease costs. There was a $45 million increase in the budget from fiscal year 2007 to fiscal year 2008, and now the state has to reduce expenditures even below that point. It will be difficult to make cuts in programs such as public safety, health care and education. Pit rules were identified by some members of the committee as creating an atmosphere in which oil and gas developers were encouraged to leave the state. Governor Richardson's Investment Partnership (GRIP) is reflecting a $400 million shortfall in needed revenue to complete projects.

Oil and Gas Revenue Distribution in the State

Jim Nunns, tax policy director, Taxation and Revenue Department (TRD), noted that in spite of the recent price declines, the production price of oil and gas is still relatively high. Production is projected to decline in the future, and natural gas will show a greater decrease in production than oil over the same short-term forecast period. As a percent of general fund revenue, oil and gas revenue will be lower than it has been in the last three years, but it should still be higher than in the years preceding that three-year period. New Mexico is the fifth-highest oil producer and the sixth-highest natural gas producer in the nation. New Mexico has the eighth-highest royalty rates out of the nine greatest oil and gas producing states.

Lab Partnership with Small Business Tax Credit

Mariann Johnston, manager, Small Business Assistance Program, Los Alamos National Laboratory (LANL), and Jackie Kerby Moor, manager, technology and economic development, Sandia National Laboratories, presented an update on the laboratory partnership with small business tax credit. David Meurer, owner of a small business working in the program with the labs, was scheduled to speak, but he was unable to do so due to the weather. No data handouts were presented.

The lab partnership program promotes economic development in the state through cooperative efforts of the national laboratories working with small businesses to resolve technological problems, develop technologies and leverage money from the labs to provide other needed technical assistance.

The program has increased its capacity from eight projects in 2008 to 12 in 2009. LANL began its program in 2007. It worked in 22 counties in New Mexico. In 2008, the funds were divided between Sandia and LANL, with Sandia receiving $2.4 million and LANL $1 million. Projects are being sought in Guadalupe and Quay counties to provide the first projects for those counties. Projects vary in character from bovine waste mitigation, algae biofuels using lipids or oil content of the algae, watershed management in which irrigation flow systems are analyzed, electrical power usage for the community of Santa Teresa and solar-powered security systems for small businesses.

Quality Data for Better Tax Policy

The presenters of this topic were Beverlee McClure, Ph.D., director, Association of Commerce and Industry; Richard Anklam, president and executive director, New Mexico Tax Research Institute (NMTRI); Tom Clifford, Ph.D., research director, NMTRI; and Jim O'Neill, consultant.

Mr. Clifford began by noting that sound data are necessary for all governments to make sound decisions. Reporting of data provides accountability and a means to measure success. Good data also promote better revenue tracking and more accurate forecasting. As made more apparent by the efforts to enact combined reporting, there is a lack of information needed to assess the value of making such a change from the current CIT system allowing businesses to choose unitary, combined or consolidated reporting, whichever fits their business model. The state cannot develop the resources and staff time needed to gather adequate information to allow for collection of the data needed for the legislative session. Reporting should be monthly. Data for effective use of funds distributed, such as distributions of $2 billion or more annually from the road fund, need to be accessible for legislators and staff to determine the effectiveness of the distribution.

Use of property taxes also is not fully reported. In addition, there is a lack of external input for economists, and analyses are many times completed in isolation. Dynamic scoring could still be developed in a useful manner and would help provide models for tax incentives and other tax expenditures. Among the things that cannot be fully analyzed due to lack of data are:

- pyramiding;
- streamlined sales tax;
- corporate income reporting;
- competitiveness of the tax system in New Mexico with other states; and
- local government revenue adequacy.

Additional resources are needed to provide web-based dissemination of data, to review and document the accuracy of the data gathered and to provide accurate economic analyses and periodic reports. An office of financial accountability is needed to pull together information for oversight of agencies and expenditure of funds that is independent of the process to create fiscal impact reports and revenue estimates. Mr. Clifford suggested that the LCS be the data collection agency and receive an appropriation determined by the legislature on an annual basis. He suggested that a business tax advisory committee be created by memorial and that an office of fiscal accountability be created by statute. The office would seek the best tax policy for the state and look at how to rebuild and maintain the needed tax base for the state. It would be necessary to build the credibility of the data collected. He noted that the elimination of the gross receipts tax on food narrowed the base considerably.

The committee noted that:

- the Department of Finance and Administration (DFA) stopped publishing a general fund report, which was the result of not having adequate staffing, such as an economist, on board and the beginning of accrual accounting, which required intensive staff time to get up and running;
- businesses need a tax environment that is clear and laws and regulations that are easily understood;
- near-term goals for data collection need to be set so that the legislature can move beyond talking about data collection to implementing a plan that results in data collection;
- a web site for public scrutiny of data should be available;
- appropriation of nonrecurring funds would allow the legislature to review and oversee the distribution of money for effectiveness and need;
- the TRD and NMTRI should be in close communication;
- there should be a monthly distribution (or web availability) of tax distributions and other tax revenue distribution reports and an annual report from each agency;
- money needs to be made available to establish a workable web site; and
- there would be an additional burden on the TRD to aggregate data.

Severance Tax Permanent Fund Revenue Trends

Olivia Padilla-Jackson, director, State Board of Finance, ran through the sequence of events that occurs when severance tax bonds (STBs) are issued and the proceeds distributed. She noted that both senior and supplemental bonds are issued and in June, STBs are sold. The size of the issue depends on the magnitude of the revenue from severance taxes collected by the state. If $100 million comes into the Severance Tax Bonding Fund, $95 million will be made available for debt service and $5 million will be distributed to the Severance Tax Permanent Fund. If the revenue is declining, there will not be enough money to use 95% of the fund to cover new STBs. In this climate, less will be placed in the Severance Tax Permanent Fund, and all of the money will be used for debt service. In fiscal year 2008, $600 million was placed in the Severance Tax Bonding Fund. This was the highest amount ever set aside for bonding. The money not held to pay debt service is "sponged", or invested in short-term or overnight securities to generate more cash.

State Investment Officer Gary Bland noted that market values of the Severance Tax Bonding Fund are determined based on a five-year rolling average from the money in the fund on December 31 of each year. To date, he has seen a 27.5% decline in fund performance. He predicted that the market would rebound within 18 months. He said film programs generated at least $1 million per year and 4,100 full-time employment jobs, such as electrical workers and other professions.

Yield Control Formula Changes

Mr. O'Neill and Mr. Clifford spoke about property tax shifting and yield control. Mr. Clifford noted that:

- yield control guarantees that local revenue will increase by 5% annually;
- the 3% annual limit on residential property value increases;
- the yield control target is not reduced in response to the reduced residential values due to the 3% limitation; and
- the money lost to the limitation must be made up by other taxpayers, non-residents and purchasers of new construction or newly purchased residential property.

Mr. Clifford suggested two options to reduce the disparities between long-term homeowners and purchasers of new construction or existing housing and to reduce or eliminate tax burden shifting to those whose properties are not covered by the 3% limit:

1) repeal the 3% limit completely, and value all homes at current and correct values, although this option may require a constitutional amendment; and

2) limit the value of all homes, including those that are re-sold, and new construction.

As a partial solution to the tax shifting, Mr. Clifford suggested:

- retaining the difference in assessed value between existing and newly purchased homes; and
- equalizing the rate of assessed value growth with the rate of revenue growth allowed in yield control by:
  - ♦ raising the allowed growth of assessed value from 3% to the yield control rate of 5%; and
  - ♦ lowering the growth rate in yield control to 3%.

The potential fiscal impact of eliminating the 3% value limit would cause:

- an immediate large increase in property values for 60% of residential property owners and therefore an increase in the total assessed values in a county;
- yield control to adjust rates downward so that total revenue is unchanged;
- debt service rates to adjust downward; and
- households whose current assessed value/correct value is below average to see a net tax increase and those with residential values that are high due to a change in property ownership since 2001 to see a decrease in property tax values.

The potential fiscal impact of limiting all values would cause:

- reduction in growth of assessed values over time;
- yield control to adjust the rates so that revenue remains the same with the anticipated 5% increase;
- debt service rates to adjust upward and new debt capacity to grow, but at a slower rate; and
- new construction and transferred values to be artificially kept down.

The potential fiscal impact of raising the value limit to 5% would cause:

- assessed value to grow more quickly;
- reduced tax rates so that revenue is unaffected; and
- debt service rates to adjust downward and new debt capacity to increase.

The potential fiscal impact of reducing the yield control increase to 3% would cause revenue growth rates to be reduced and debt service to be unaffected.

A bill draft presented by Mr. O'Neill would amend Section 7-37-7.1 NMSA 1978 to replace the growth control factor, which is used to limit the amount of revenue growth from one year to the next. The new formula would adjust the tax rate directly using an inflation factor. The handout in the meeting file contains more details of the formula.

Chile Producers Tax Credit

Charles Marquez presented information from the New Mexico Chile Association. The association is concerned that the number of acres of chile production in New Mexico is decreasing, from 37,000 acres in 1993 to 11,000 acres in 2007. High labor costs and an insufficient supply of labor appear to be part of the reason that acreage is decreasing. Higher production per acre also has caused reduction in acreage. Mechanical harvesters are being tested in the state, and newer varieties of chile that can be mechanically harvested are being developed at New Mexico State University. Mr. Marquez requested that the legislature consider providing a tax incentive in the form of tax credits for chile growers to attract more growers back into chile production. His goal is to increase the number of acres of green chile produced in New Mexico while keeping New Mexico as the chile-growing capital of the nation.

The committee recessed at 4:30 p.m.

Tuesday, December 16

The meeting was reconvened at 9:30 a.m. by Representative Sandoval.

Tax Expenditure Budgeting

Dr. Thomas Pogue, professor emeritus of economics, University of Iowa, presented a report he compiled for the TRD on tax expenditure budgeting. The study provides information that will help the executive and legislative branches evaluate tax expenditures. It is a component of the department's ongoing effort to analyze New Mexico's tax structure and to help inform tax policy decision-making.

Dr. Pogue began with an overview of the concept of tax expenditures. He noted that a tax expenditure occurs when tax policy is used to pursue social or other objectives not specifically limited to revenue generation by altering provisions of the tax code rather than using other instruments such as direct spending, regulation, loans or grants. Tax expenditures take the form of tax preferences that are directed at targeted actions or recipients, i.e., taxes are lowered for taxpayers who meet specific criteria. The TRD administers the tax expenditure, and the parameters of the expenditure are set out in law in the tax code. Essentially, revenue that would have been raised by a tax is not generated, giving a benefit to the qualified taxpayer. The state's tax revenue is reduced as a result, and the state should derive a benefit in increased production or an activity that will improve society. Tax credits are tax expenditures.

It is necessary to establish the baseline tax system, then expenditures can be measured against the baseline. Tax expenditures can be estimated but cannot be exactly determined. The estimates can be used to evaluate and control the magnitude of tax expenditure use and to compare the relative effectiveness of tax expenditure programs with other policy instruments. A tax expenditure budget is a set of estimates of a government's tax expenditures and can provide data to:

- support specific activities that are replacing direct expenditures;

- show revenue allocated to specified desired results of the tax expenditures; and
- aid in decision-making about taxes and spending.

Page 19 of the handout in the meeting file provides details on how to create a tax expenditure budget. Evaluation of tax expenditures entails determining how the tax expenditure changes the economic outcome, including resource allocation and income distribution, and whether the changed outcome is an improvement over what would have occurred in the absence of the tax expenditure. The evaluation should determine whether the tax expenditure has brought about the best possible outcome. Changes made in response to a tax expenditure, such as increased purchase of health insurance due to a tax credit for purchase of health insurance, and changes that follow from the loss of the revenue that is not received due to the tax expenditure, such as increases in other taxes necessary to generate the needed revenue, result in borrowing increases or spending decreases. These changes would have indirect effects that must be determined and measured, although these are far more speculative, and direct effects are relied upon to provide the main evaluation of the tax expenditure. Questions that need to be answered include the following:

- Is the additional production more valuable than the private sector and/or government production that is necessarily foregone?
- Is the redistribution of income fair or otherwise appropriate?

Simply increasing the level of activity is not a positive outcome unless production also increases and substantial benefits to the state are realized. Government activities should be decreased as a result of the tax expenditure, or the production should increase the total amount of taxes generated in excess of the value of the tax expenditure. If neither condition is met, the state will be worse off than without the tax expenditure.

Data to evaluate tax expenditures are difficult to obtain. Comparison of the tax expenditure as a mechanism to obtain a result should always be made with other policy instruments that would achieve the same objective.

Advantages of tax expenditures over direct expenditures are that tax expenditures are more likely to cause changes in private behavior and respond more readily to changing activity levels and economic conditions.

Disadvantages of tax expenditures when compared to direct expenditures are that tax expenditures:

- may continue indefinitely, when not beneficial, if there is no sunset date affixed to the expenditure and if the tax expenditure is not reviewed periodically;
- do not receive year-to-year oversight and fine tuning;
- do not allow for the flexibility of direct expenditures;

- do not provide for public needs such as defense, law enforcement, a judicial system, etc.; and
- can add to the complexity of a tax system.

Also, data collection is difficult and many times inaccurate due to faulty estimating.

Telecommunications Update

Leo Baca, government affairs director, Qwest, and Roman Maes, lobbyist, Qwest, apologized that Loretta A. Armenta, president, Qwest-New Mexico, was unable to attend the meeting. Mr. Baca discussed Qwest's investment in New Mexico and noted that the employee base in New Mexico has decreased. Qwest continues to have concerns about regulations adopted by the Public Regulation Commission that inhibit Qwest's ability to compete with unregulated telephonic signal carriers. Qwest is now challenging a special tariff and is seeking to do away with regulations that put Qwest at a competitive disadvantage with unregulated carriers. Qwest will present legislation in the upcoming session, and Mr. Baca and Mr. Maes informed the committee about the proposed legislation. Mr. Maes discussed the loss of employees, now at 800 from a high of 2,000 in 1985. In addition, he mentioned that Qwest is losing lines each month to cellular carriers — about 5,000 per month, or a total of 60,000 fewer customers in 2008.

The proposed legislation would allow Qwest greater flexibility and faster response to market changes. Promotions, discounts and special rates or bundling would be allowed on short notice without hearings to allow Qwest to operate in the market to attract customers.

Legislative Endorsements

A total of 43 bills were heard throughout the interim. Several were eliminated prior to review for various reasons. Twenty-three bills were endorsed. The chart showing endorsed and not-endorsed bills is attached.

Educational System Support for Economic Development

Secretary of Economic Development Fred Mondragon presented information to the committee regarding work force needs of businesses in New Mexico. It was noted that jobs increasing in the economy are high tech jobs, which require special skills and abilities that are not easily obtained with only a public school education. In addition to Secretary Mondragon, Melissa Lomax, Public Education Department, and Bill Flores, Higher Education Department, were present to discuss the programs offered in their sectors of the educational system that prepare young people for jobs in New Mexico.

Programs that are keeping high school students engaged in their education include the dual-credit classes, where a student can attend a two- or four-year educational institution while still in high school and obtain college credit, and also programs developed specifically to produce trained members of the work force for specific jobs in the community. Students may be exposed to college course work as early as eighth grade.

Military Retiree Incentive — Tax Exemption

Joe Cantergiani, legislative liaison, Military Officers Association, spoke about the benefits of attracting retired military officers to New Mexico. He proposed that the legislature consider adopting a tax deduction from military retiree pay or an exemption for all military pay. Such a benefit would encourage more retired military officers to retire in New Mexico and provide the state with a skilled and knowledgeable work force from which to draw.

Adjournment

The committee adjourned at 1:39 p.m.