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

ORIGINAL DATE 1/11/10
SPONSOR Cravens & Sharer **LAST UPDATED** ______ **HB** ______

SHORT TITLE Limit State Expenditure Increases, CA **SJR** 3

ANALYST Pava

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY10	FY11	FY12	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		$25.0-$100.0*			Nonrecurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)
* See narrative

SOURCES OF INFORMATION
LFC Files

Responses Received From
Dept. of Finance & Administration (DFA)
Secretary of State (SOS)
NM Dept. of Transportation (NMDOT)
Public Education Dept. (PED)

SUMMARY

Synopsis of bill

Senate Joint Resolution 3 proposes a new section of Article 4 of the New Mexico Constitution. It proposes to limit the legislature's ability to increase state expenditures. The formula for the limitation is the previous year's (PY) limitation plus the percentage increase in population plus 3.6% of the PY limitation. This latter factor simulates inflationary pressures.

Money in the General Fund at the end of any fiscal year in excess of the limitation would be distributed 60% to the severance tax permanent fund and 40% returned on an equal per capita basis to taxpayers who filed a tax return for that year .

FISCAL IMPLICATIONS

The proposed amendment would require approval in the next statewide election or have the additional expense of conducting a special election. The SOS notes placing a constitutional amendment on the ballot is costly. The previous 2008 General Election had five constitutional amendments that cost over $520,000. Each amendment cost approximately $104,000. These amendments have to be published in English and Spanish in a newspaper from every county in the state.

Population change is not the only and often not the best indicator of the need to build and maintain the New Mexico's road network, provide schools, regulate commerce, or provide for the health, safety, and human services for taxpayers and all citizens.

DFA indicates the following:

> A profound fiscal impact would be to eliminate General Fund reserve balances. This would make annual financial operations virtually impossible. FY09 was a good example of the chaos that inadequate reserves and deficient structure of reserves caused.
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> The formulae in the joint resolution and the companion implementing legislation (SB-54) would have an extreme impact on legislative processes, but minimal fiscal impact on overall spending. Neither the resolution nor bill adequately defines the key concept of "expenditures". Implicitly, the term means expenditures from the General Fund, but this is not clear.
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> Were this resolution and the companion bill to become law, the Legislature and the Governor would quickly split revenues that are currently considered to be "General Revenues," or "General Fund Revenues" from the General Fund and earmark these revenues for particular purposes that are currently considered to be General Fund programs. The first split would be for education funding. It was earmarked outside of the General Fund until the late 1950s. The Common School Fund and the Current School Fund are still current statute and show up in the General Fund audit, along with other occasional references.

NMDOT indicates the following:

> NMDOT considers the number of vehicle miles traveled, truck load and the percentage of trucks using the road. Its appropriation has been based on revenue generated in the State Road Fund (SRF). For agencies such as NMDOT funded from various types of revenue, their budget would be unnecessarily limited in years when revenues exceed such an expenditure cap.

PED indicates the following:

> The proposed expenditure limit would mean the total state budget could not increase more than 3.6% plus population growth. School enrollment does not track directly with population growth. This could set up a situation where other state agencies must endure budget constraints just so PSS could be increased, or the unit value must be decreased, even if there is enough revenue to cover all.
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> In years of high revenue, this bill could reduce the amount the Legislature could increase the budget, thereby smoothing the increase over a period of years. Also, this bill would take unexpended or unencumbered money as of the end of the fiscal year and mandates what happens to it. This further restricts agencies ability to utilize this money.
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> On the other hand, this legislation would smooth the increase of the state budget, perhaps making the state budget less vulnerable to economic downturns after periods of prosperity.

SIGNIFICANT ISSUES

If the bill was passed it would limit the NMDOT budget in years when SRF revenues exceed the expenditure cap.

DFA provided the following:

> In addition to the policy issues that can be debated, this resolution and bill are clearly technically unworkable and ill advised. There are severe problems with the following concepts: (1) population measurement; (2) what "expenditures" are and federal matching fund requirements (3) the inappropriate nature of a fixed 3.6% inflation factor; (4) the lack of prudent reserves.
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> (1) The U.S. Census has published an estimate of New Mexico's population growth for the decade to date of about 1% per year. The Bureau of Business and Economic Research, using a methodology based on counting housing stock, including new building permits, believes that population in the State has grown about 1.5% per year. This is a difference of about 10,000 persons a year not included in the official population count. Assume that significant portions of this uncounted population are children being educated in the state's schools. The Constitution demands "sufficient" education for our children, but the proposed expenditure limitation formula by not accurately measuring the increases in public school costs driven by school-age population, will force a violation of another Constitutional mandate.
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> (2) As mentioned in the fiscal section, breaking up the General Fund into smaller, earmarked funds would be one method of dealing with passage of this resolution and companion bill. Earmarking is an inefficient means of allocating just the right amount of money for programs. Inevitably, programs with earmarked funding are either overfunded or underfunded, largely because the dedicated revenue source grows due to factors that are unrelated to the factors that determine the needs and demands for the program. Even if earmarked revenue is about right for a program in the beginning, the balance will change over time.
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> The federal government contributes substantial revenues to the state. These funds are budgeted and authorized in HB-2 each year, but the State has very little control over how much revenue will be received each year from federal sources. Many federal grant programs have a requirement for the state to prove matching funds. With the expenditure limitation program as proposed, it would be very hard to find matching funds for any new program. Only by shrinking another program, could the state generate matching funds.
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> (3) Over the years, the index for state and local government costs exceeds the CPI by about .5%. While the average CPI growth has been about 3% over the last twenty years, the State and Local Government cost index has grown by about 3.5%. Thus, the 3.6% inflation factor index in the resolution and bill are about right on average. Unfortunately, fixing the inflation factor to an arbitrary figure would always lead to a mismatch between demand and resources. The double-digit inflation of the Carter years is instructive. Costs of government programs tend to follow the CPI and/or the State and Local Government Cost Index. However, resources pursuant to this bill would have been cut more than 10 percentage in real terms.

(4) The resolution and companion bill would distribute "money in the general fund at the end of fiscal year 2012 or any subsequent fiscal year in excess of the expenditure limit set annually." Assuming that the expenditure limit for 2012 were about $5.8 billion ($5,487.7 million general fund recurring expenditures for FY10 times 1.5% increase in population plus 3.6%), the literal language would not distribute amounts to the severance tax permanent fund or to taxpayers until the balances at the end of the fiscal year exceeded the $5.8 billion level. General Fund balances have ranged from 2.6% of total appropriations to nearly 16% of total appropriations.

PERFORMANCE IMPLICATIONS

NMDOT notes that road construction and maintenance would be delayed in years when the SRF revenues exceed the expenditure cap. There would be no impact in years when the SRF revenues are less then the expenditure cap.

ADMINISTRATIVE IMPLICATIONS

The amendment proposed by this resolution if approved, would be placed on the next general election ballot. The SOS can handle the provisions of this bill with existing staff as part of ongoing responsibilities.

RELATIONSHIP

SB 54, Taxpayer Protection & Expenditure Formula

TECHNICAL ISSUES

This bill does not address if the cap would be reduced if there is a population decline. If NM had “negative growth” then the cap should be reduced, but it’s not addressed.

DFA indicates the most significant issue is that there would never be a distribution from the general fund to the severance tax permanent fund or to taxpayers ever. In fact, this resolution and the companion SB 54 do not allow for prudent reserves before suggesting any distribution out of general fund balances to any other fund.

6-4-2.2 NMSA 1978 established the Tax Stabilization reserve fund. 6-4-5 established the Taxpayer Dividend Fund. These funds were put into statute in 1987 under Governor Garrey Carruthers. In general, there have only been two transfers to the Tax Stabilization Fund and no transfers to the Taxpayer Dividend Fund in the more than twenty years.

ALTERNATIVES

For SB 54 of 2010: The Legislature and Executive could control increase of the budget without legislation.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The NM Constitution would not be changed.

CP/mt