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**New Mexico: The Lost Decade**

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**Abstract**

In January 2018, the New Mexico State Legislature convened for its regular session, a thirty day budget session, per its constitutional mandate. Thirty days later the legislative session ended quietly and the state of New Mexico closed the book on the great recession and a decade of financial and political strife. The 2018 legislature passed a \$6.38 billion dollar budget, re-supplied dangerously low general fund reserves, and provided small raises to teachers and state employees. Oil and gas revenues are up, unemployment is slowly coming down and legislative-executive political battles have muted. The balanced budget, signed by the governor in early March, brings the state back to where it began almost 10 years before, leading one observer to refer to the time as the “lost decade in New Mexico” (Cole 2018).

## **Introduction**

On the third Tuesday in January 2018, the New Mexico State Legislature convened for its regular session, a thirty day budget session, per its constitutional mandate. Thirty days later the legislative session ended quietly and the state of New Mexico closed the book on the great recession and a decade of financial and political strife. The 2018 legislature passed a \$6.38 billion dollar budget, re-supplied dangerously low general fund reserves, and provided small raises to teachers and state employees. Oil and gas revenues are up, unemployment is slowly coming down and legislative-executive political battles have muted. The balanced budget, signed by the governor in early March, brings the state back to where it began almost 10 years before, leading one observer to refer to the time as the “lost decade in New Mexico” (Cole 2018).

## **New Mexico Demographically, Politically and Economically**

New Mexico is a geographically large and predominantly rural, southwestern state with a 2017 population of 2.08 million people. It is considered a minority-majority state with 48.5 percent of the population Hispanic, 38.1 percent “white alone” and 10.6 percent of the population American Indian. It is sparsely populated with a census estimate of 17 people per square mile (compared with 33.6 in Utah and 56.3 in Arizona). Its population is growing slower than any other western state, resulting in a population growth of 1.4 percent since the beginning of the decade (Census Quick Facts).

Politics in New Mexico is moderately blue with Democrats holding both United States Senate positions and 2 of the 3 United States House of Representative seats. The state voted for Hillary Clinton by 8 points and a majority of New Mexicans are registered Democrats. That said, state politics are regional, statewide politics are divided and slightly unpredictable and the 2018 elections promise a complete change of faces and perhaps parties. Regionally, most of the population is found on the banks of the Rio Grande or along the Rio Grande/ I-25 corridor. The three largest population centers: Santa Fe, Albuquerque and Las Cruces, are predominantly Democratic. The sides, or more accurately the opposite corners (NW and SE), are more conservative and reliably Republican. The corners are also home to the major industries of oil and gas and, in many ways, home to the highs and lows of the New Mexico economy.

The New Mexico economy is in a difficult place. The state has recovered from the great recession of 2007, but much slower than other western states. Unemployment remains stubbornly high, and above the national average. In January 2018, the national unemployment rate was 4.1 percent. In New Mexico it was 6.1 percent. By fall of 2018 the unemployment rate had fallen but was still roughly 1 percent above the national average. Young workers and many jobs left the state during the great recession and the lack of a skilled work force appears to keep those jobs from returning or new jobs from coming to the state. (Reynis 2018). Poverty is high (19.8 percent), the median household income is low (\$45,676) and the number of children living in poverty is the highest in the country (Census Quick Facts). United States Census Bureau data released in the fall of 2017 found that New Mexico led the nation for child poverty with 36.2 percent of children under 5 living in poverty. That is 5 percent more than Mississippi, which is in 2<sup>nd</sup> place (Nathanson 2017).

While for several years the United States as a whole has experienced low unemployment and solid economic growth, New Mexico has struggled. In 2017, the United States economy grew at 2.3 percent with two quarters exceeding 3 percent growth. By comparison, the GDP growth in New Mexico for the fourth quarter of 2017 was 1.7 percent (Reynis 2018). This was the slowest growth among the continental western states (Hawaii was 1.3 percent). By 2018, GDP growth was improving to 1.8 percent in the first quarter (BEA 2018); forecasters estimate growth topping 3 percent in the second quarter.

Unemployment rates and gross domestic product indices show a slowly improving New Mexico economy. Economic research also shows a changing economy. The state expanded Medicaid under the Affordable Health Care Act, spurring growth in health and education jobs. Expanding insurance coverage to over 200,000 low income New Mexicans made the health care sector show some of the strongest employment gains at a difficult time. Health care accounted for two-thirds of job growth in New Mexico between 2014 and 2016 (Krasnow 2018). That trend is now moderating showing significantly slower growth; mining jobs have shown a bit of recovery and construction, transportation and utilities and tourism and leisure all showed growth in the final quarter of 2017 (Mitchell 2018).

Health care jobs have been important in New Mexico and the tourism industry continues to bring jobs to New Mexico but the real elephant in the room is oil and gas production. While other states recovered from the great recession, New Mexico struggled, in large part as a result of its tremendous reliance on oil and gas production and the impact of those markets on the overall state budget. Volatile oil prices, a glut of natural gas and losses in manufacturing wreaked havoc on New Mexico's financial stability. When oil and gas prices plummeted in 2014, the state economy experienced a significant downturn. Continued low prices led to 0 percent average growth in New Mexico's gross state product between Fiscal Year 2016 (FY 16) and Fiscal Year 2017 (FY 17) and the loss of 8500 mining sector jobs (LFC 2018 vol. 1). As of March 2018, the oil and gas sector appears to be rebounding. Oil production in the state reached a record high and the number of active drilling rigs has almost doubled in two years. Oil prices have also stabilized with December consensus revenue forecasts estimating between \$47 and \$52 per barrel in the near future. Gas production has experienced a long period of decline but production is now up and shows possibility for growth, though forecasters predict a downward trend from FY 19 forward.

Though oil is up and gas is down, overall production and price have improved providing needed injections into the state economy. Unfortunately, New Mexico remains stubbornly dependent on a volatile resource. Economic forecasters warn that energy volatility remains the greatest risk to the New Mexico revenue forecast. Sharp price declines in 2015 and 2016 had a direct impact on severance taxes and an indirect, but significant impact on wages, gross receipts and worker spending (LFC 2018 vol. 1).

Looking to the future, forecasters think that the New Mexico economy is rebounding though forecasters warn that risks to the economy still exist. Primary risks include the effects of federal tax reform, outstanding taxpayer protests and/or refund claims and continued energy volatility. Federal tax reform poses a possibly significant risk. Citing estimates from the Congressional

Budget Office, legislative forecasters warn that large federal deficits resulting from recent tax cuts could trigger automatic spending cuts under the Federal Pay As You Go Act of 2010. Such triggers could result in cuts to Medicaid and federal mineral leasing payments to the states. Federal mineral leasing payments represented 7 percent of recurring general fund revenues in FY 17. To lose any or all of those payments would have a devastating impact on the state budget. Similarly, the state tax and revenue department reports that over \$400 million in taxpayer claims (disputes, assessments and denied refunds) were pending. Should the state lose these disputes, the losses would have similar affect, significantly reducing state reserves. Finally, and perhaps most importantly, energy volatility continues to provide the greatest risk to revenue forecasts. Despite repeated discussion about the need to diversify New Mexico's economic base, the state continues to rely on oil and gas for a significant portion of its annual revenue. As go those markets, so goes the state (LFC 2018 vol. 1).

Economic forecasts provide a window into New Mexico's economic health. They also provide the foundation for budget development and are vital in the generation of both legislative and executive budget proposals. In New Mexico, economic forecasts are generated by both branches of government combining forces in a joint economic forecast group. In January 2018, the Consensus Revenue Estimating Group (CREG) presented its forecast to the Legislative Finance Committee. The group predicted FY 19 revenues of \$6.374 billion dollars. The January prediction was an increase from the December prediction and the group commented on the remarkable increase in the forecast, an increase mostly attributable to oil and gas. While projecting increased revenues, the consensus group urged caution with economists (citing Moody's) stressing the need to grow the state's dwindled general fund reserves. The group stated that a 17 percent general fund reserve would be necessary to withstand a severe recession. Based on those forecasts, New Mexico legislators embarked on their annual budget session.

### **The Legislative Session**

Like many rural, western states, New Mexico is a part-time legislature. The body convenes for annual sessions each January with the Constitution of New Mexico dictating that even numbered years are 30-day budget sessions in which legislation is restricted to budgets, revenue-related legislation and bills submitted pursuant to special message of the governor (Constitution of New Mexico). The legislative body itself is governed by Democrats with Democrats holding the majority in both chambers. The governorship is held by Republican Susana Martinez. Martinez is finishing her eighth and final year in the governorship and her relationship with the legislative branch has been less than peaceful. Consensus is rarely a word used to describe the legislative-executive relationship in the last decade. Nonetheless, revenue forecasts, developed by each institution's professional staff working together, are a consensus affair. Both the legislature and the executive use these consensus numbers to independently prepare annual budgets. Per tradition, the legislature introduces the governor's budget first as House Bill 2; the legislature's budget recommendations become the Committee Substitute for HB2.

Members of the legislature's finance committees usually gather in Santa Fe in advance of the beginning of the legislative session. At this time, the Legislative Finance Committee hears the most recent revenue estimates and puts forward its budget proposal for the upcoming fiscal year.

In January 2018, the Legislative Finance Committee (a joint permanent interim committee) recommended the passage of a \$6.26 billion dollar budget, an increase of 2.9 percent from FY 18 spending levels. The proposal provided for rebuilding depleted reserves to 8.4 percent. The FY 19 proposal recommended increases in spending for early childhood and K-12 education and Medicaid. The committee also recommended increases in spending for the judiciary of 2.7 percent and public safety agencies of 1.1 percent. Finally, the committee recommended another \$47.9 million from the general fund for a 1.5 percent average increase for all state employees. Similarly, the legislature advocated raising the minimum salary for teachers as well as providing raises for teacher salaries averaging roughly 2.7 percent (Oxford 2018 (a)).

The legislature rolls out its state budget recommendations in early January. About that time the governor, too, issues her budget plan. In January 2018, the governor promoted a \$6.32 billion dollar budget that included a 1 percent raise for state employees and a 2 percent raise for teachers. Like the legislature, the governor advocated increasing teacher salaries though she also proposed targeted bonuses for teachers scoring well on annual evaluations. She also advocated boosting general fund reserves to almost 10 percent (Oxford 2018 (a)).

The legislature began its annual session on January 16. Unlike recent prior sessions, the session began quietly and ended quietly with little evidence of the previously vicious legislative-executive battles (Boyd 2018). Whether it was the lame-duck status of the governor, the improving fiscal picture or just pure weariness, the session was marked by the smallness of its fights. The legislature and the executive debated the size and administration of small teacher and public employee raises, differing less than a percentage point in their proposals; the two bodies agreed to fund bigger raises for police officers and public safety employees. The bodies agreed on an overhaul of the state guardianship system, providing additional financial help to the spaceport and agreed on a crime package. The House and the Senate debated how much money to return to school district reserves, money raided in last year's attempt to keep the state solvent. The legislative and executive continued to express differences about how and to whom to distribute teacher salary increases (Oxford 2018 (b)).

In the end and on time, the legislature forwarded a balanced \$6.33 billion dollar budget to the governor. Public schools accounted for the greatest share of the budget with legislators appropriating \$2.7 billion (an increase of 2.6 percent) in core school funding. The health and human services department was allocated \$1.7 billion under the General Appropriation Act, the majority of which is used to meet Medicaid expenditures. Higher education will receive \$792 million in funding (an increase of 1.6 percent). These three expenditures account for the lion's share of the entire state budget (over 80 percent) (LFC 2018 (b)). The budget included 2 percent raises for state employees and school staff, as well as 2.5 percent raises for teachers. The budgets also included bigger raises for state police, prosecutors, public defenders and others. The document included additional funding for early childhood education and public schools. Overall, the budget amounts to about a 4.3 percent increase in spending over the prior year, and it restores the state's general fund reserves to about 10 percent (Oxford 2018 (b)).

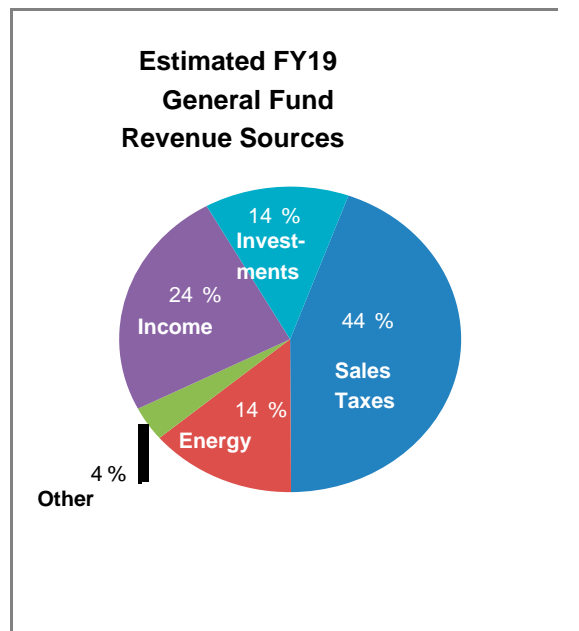
Though the 2018 legislative fights were relatively small, some battles were recurring ones. At the heart of these battles are the two sides of the financial equation - how revenue is generated and how it is spent.

## New Mexico Revenue

The general fund is the primary fund from which the state's ongoing expenses are paid. New Mexico generates revenue primarily from four big sources. These are general and selective sales taxes (primarily the gross receipts tax); personal income taxes; investment income; and energy revenue/severance taxes (See Figure 1). Energy revenue (mineral taxes and rents and royalties) account for more than 14 percent of the state revenue base (17 percent in FY18). This makes the state incredibly vulnerable to fluctuations in market prices (LFC 2017). Such fluctuations not only impact the amount of taxes received, it also affects the amount of investment income the state reaps. Interest on investments is another 14 percent of the pie. When oil and gas production and price are high, New Mexico coffers are healthy. When prices are low, the result is devastating on state budgets. Since the beginning of the great recession in 2007, the state has been particularly vulnerable to low oil prices and low production. While other western states were rebounding from the great recession, low oil and gas prices kept New Mexico state budget administrators in cost-cutting mode.

Figure 1. Estimated FY19 Revenue Sources

General Fund



Source: December 2017 Consensus Revenue Estimate.

One of the biggest political questions in recent years has been the question of how to diversify the state's revenue base. The governor has advocated diversifying the state's economy by increasing the number of private sector jobs, successfully getting money for business incentives and worker training. Since the beginning of the great recession, private sector jobs are up (2,700 jobs, less than 1 percent) but state government jobs have dropped with state government shedding 6,300 jobs (Cole 2018). In January 2018, there were fewer jobs in New Mexico than there were at the beginning of the great recession. Thus, ten years after the start of the great recession, the state has become even more reliant on and vulnerable to fluctuations in the price of oil and gas (Cole 2018).

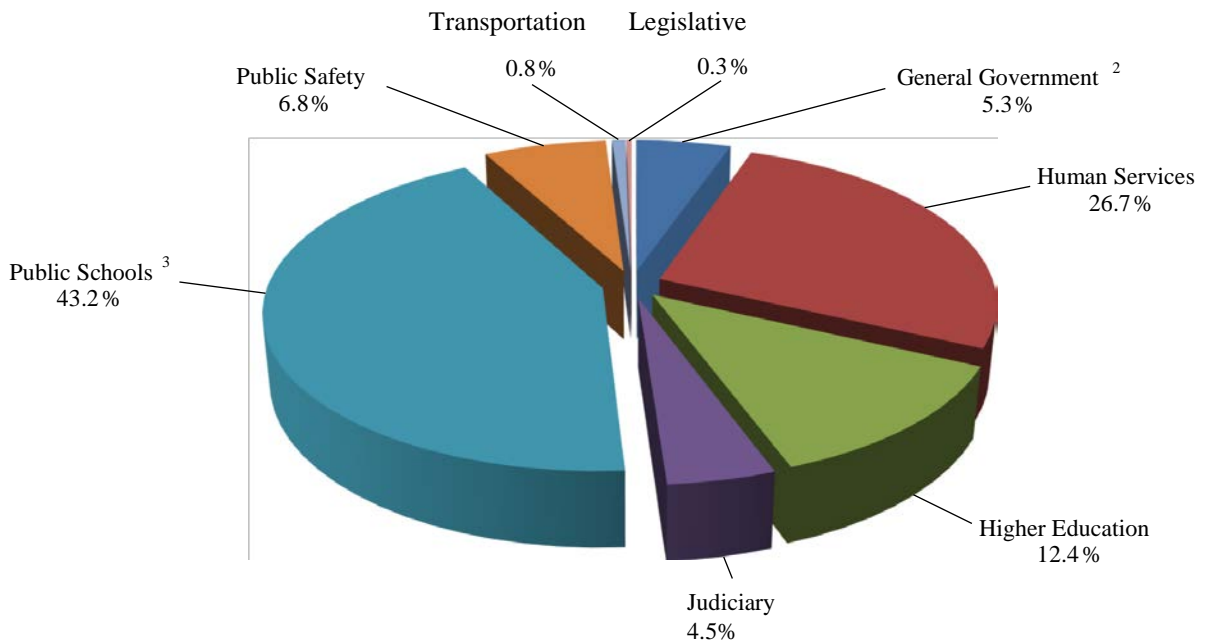
New Mexico's public coffers remain very dependent on a healthy oil and gas economy (Mitchell 2018). The state is also very dependent on federal funds. Once again, New Mexico leads the nation in its dependence on federal funds (ABQ Journal News staff, 2018). Two national labs, four military bases and multiple national forests, parks and monuments lead to the state being fifth for federal funding as a share of state revenue and fifth for its share of federal jobs. In recent years, federal sequestration reduced federal spending in the state. Fewer state jobs, combined with fewer federal jobs has helped keep New Mexico's unemployment rate stubbornly high. Higher unemployment means lower personal income taxes. Since personal income tax is roughly one-quarter of the state's revenue base, this revenue source, too, has suffered.

### **New Mexico Expenditures**

The other side of the budget equation is expenditures. Expenditures or appropriations from New Mexico's general fund are also fairly easy to track. The biggest state expenditure, year in and year out, is public schools (K-12). This expenditure accounts for approximately 43 percent of the state General Appropriations Act. Higher education (colleges and universities) is funded separately accounting for about 12 percent of the overall budget. Human services is the next big ticket item taking 27 percent of the state budget. Public Safety and the judiciary combined are less than 12 percent. The remaining "general government" category accounts for the last 5 percent of the general fund budget. (See Figure 2)



Figure 2. General Fund Appropriations  
 Fiscal Year 2019<sup>1</sup>  
 \$6,385,196,602



1 Includes appropriations in Sections 4, 5 and 8 of Chapter 73 (GAA) and Chapter 2 (Feed Bill/legislative appropriations).

2 General Control; Commerce and Industry;

Agriculture, Energy and Natural Resources.

3 Other Education and Public School Support.

and

Source: Legislative Council Service Highlights 2018

### Revenue and Expenditure Political Disputes

Revenue generation and expenditure choices are fights in any state legislature but two big policy questions come before the New Mexico legislature year after year. These issues have generated heated debate in recent years. One issue is the desire by some legislators and advocacy groups to divert more proceeds from the state permanent funds to pay for additional early childhood education programs. The second issue is the appropriate funding path for K-12 education salary boosts and special projects.

Like many western states, New Mexico has sizeable permanent funds. The Land Grant Permanent Fund was founded after New Mexico's entry into the union and the Severance Tax Permanent Fund was created in the 1970's by legislators interested in providing financial stability for future generations. Together these funds account for 95 percent of New Mexico's permanent funds and both funds showed substantial growth in FY 17. The funds are substantial

with a combined value of \$22.33 billion in June 2017 (Robinson-Avila 2017). Every year, money from these funds is paid out into the general fund and used for the annual state budget. The land grant fund pays out 5 percent of its average 5 year value annually; the severance tax fund pays out 4.7 percent. Combined, these payouts account for about 15 percent of the state budget (Robinson-Avila 2017).

Since the beginning of the great recession, New Mexico has experienced significant budget pressures. As might be expected, the existence of a \$22.3 billion nest egg has caught the eye of many advocates dismayed by years of significant education cuts. For many years, advocates have pushed for the passage of a ballot measure to increase the annual distributions of the land grant permanent fund for the purpose of funding early childhood education programs. Supporters of the proposal say that applying the money to early childhood education programs would help break the cycle of poverty that places New Mexico at the bottom of many childhood wellness indices (Oxford (c) 2018). Fiscal conservatives, both Democratic and Republican, argue that taking a greater share of the fund would deplete it. Nonetheless, in 2018, House Joint Resolution 1 called for spending 1 percent of the land grant permanent fund for early childhood programs. The measure cleared the House of Representatives by a razor-thin margin, only to die in the Senate Finance Committee without a hearing (Simonich 2018). Advocates, including the New Mexico Conference of Catholic Bishops, criticized the failure of the legislature to consider the matter stating that deep poverty is strangling the state and leading to more abused and neglected children. Nonetheless, the Senate Finance Committee chairman opposed the measure finding it to be “financially irresponsible”. Advocates lost the 2018 fight. Nonetheless, like many a political bout, there are undoubtedly more rounds to come.

A second financial fight in recent years has involved the distribution of education funds. New Mexico distributes the bulk of its K-12 funding through a statutory formula, the state equalization guarantee. The formula removes much of the power of the state Public Education Department to allocate money as it statutorily calculates student costs by grade, program, teaching faculty and location (among other things) resulting in formulaic school district allocations . During the Martinez administration and the rocky tenure of her former Public Education Secretary, Hanna Skandera, the executive has often promoted programs and funding “outside the formula”, a proposal not supported by the majority of legislators. Whether the issue is teacher raises or program funds, the dispute has exerted a major influence on executive-legislative negotiations for years. But, 2018 is an election year and whether this fight continues depends on the outcome of those elections.

In the summer of 2018, the New Mexico State District Court handed the legislature a third educational finance issue. In *Yazzie v. State of New Mexico* and *Martinez v. State of New Mexico*, families and school districts challenged the sufficiency of public education mandated by the state’s constitution. In July 2018, the state district court ruled in favor of the plaintiffs finding that the state failed to provide adequate funding, particularly for at-risk students. The judge gave the state until April 2019 to take steps to ensure sufficient resources were available (McKay 2018). The Yazzie case will undoubtedly shape future education finance discussions.

## **The Political Future**

The 2018 election season promised to shake-up the political map of New Mexico. Governor Susana Martinez is finishing her eighth year in office. She is term limited out and she has not declared her intentions to seek other political offices. Five Democrats and one Republican entered the political fray and both the primary and general election promised to be a battle of election-tested and well-financed candidates. First Congressional District incumbent Michelle Lujan Grisham lead the pack of Democratic contenders, joined by Joseph Cervantes, a sitting state senator from southern New Mexico and Jeff Apodaca, a former Univision executive and the son of a former governor. On the Republican side, sitting Second Congressional District United States Representative Steve Pearce was the lone candidate. Congresswoman Grisham prevailed in the June Democratic primary and she faced Congressman Pearce in the November election. Both Grisham and Pearce were seasoned political candidates with well-known names in New Mexico. Their campaigns were well-financed and they had a contentious battle for governor. Pearce had served in the state legislature before and he had run a previously unsuccessful campaign for governor. Grisham had served in the executive branch as a long-time cabinet secretary for the state Agency on Aging. She was also elected to the Bernalillo County Commission (Albuquerque) before being elected to the United States House of Representatives in 2012. In the November general election, Congresswoman Grisham prevailed soundly beating Congressman Pearce to become the Governor Elect.

While the battle for governor may have been the most visible New Mexico election during the 2018 midterms, it was not the top of the election ticket. New Mexico had one United States Senate seat on the ballot in the fall of 2018. Incumbent United States Senator Martin Heinrich, the state's junior senator was seeking reelection to his second term. The popular, Albuquerque-based, moderate Democrat did not face stiff opposition and he won his race handily. Finally, in a surprise win, New Mexico's lone Republican congressional district flipped to the Democratic column with newcomer Xochitl Torres Small winning the southern congressional seat in a very close race.

Similar to much of the nation, the November 2018 general election was good for Democrats in New Mexico. Democrats swept all statewide offices and all United States Senate and Congressional races on the ballot. It is now those leaders who will be faced with difficult questions about how to raise and how to spend public money.

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