



LFC Newsletter

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Senator John Arthur Smith, Chairman

Representative Patricia Lundstrom, Vice Chairwoman

David Abbey, Director

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From the Chair **Monsters**

Just about a month ago, we started to get hints about how bad things were going to get. New Mexico reported its first COVID-19 case and oil prices imploded. Rough estimates of the financial loss to the state were in the hundreds of millions, and it was clear the Legislature would have to meet in special session to cut back planned spending for the 2020-2021 fiscal year.

Then it got worse. COVID-19 cases doubled in days. Thousands of small businesses were forced to shut down and lay off their employees. The stock market took a fast, cliff-diving plunge. Estimates of losses to the state grew past \$1 billion and planning for a special session became more urgent when forecasters questioned whether the state could make it to June in the black.

It's like we're all in a shared nightmare, and no matter how fast we run, we can't gain any ground.

Fortunately, New Mexico has had strong leadership on the pandemic, and the Legislature ensured we are financially better prepared than we were for either the Great Recession or the oil-bust crisis of just a few years ago. We stashed savings that will soften the landing; we set up endowments that will continue to cover some costs without the need for the depleted general fund. We still need a special session before the end of this budget year, but we can wait a few weeks for circumstances, including federal aid, to settle.

But make no mistake, New Mexico will face some very, very difficult decisions. Without yet knowing how deep this hole is going to get, we must first make sure the state can pay its bills. That will mean cuts, plain and simple. Second, we must ensure healthcare is accessible to all New Mexicans even as healthcare services come under tremendous pressure, and we must take care of the healthcare providers at the front lines of this unprecedented event. Finally, business owners and their employees are going to need help. Many of these businesses and their jobs are not coming back. We will need jobs, not just for the displaced workers but for the business-less business owners as well.

This is a huge mess and it's going to take effort and sacrifice from all New Mexicans. Advocates, legislators, and agency directors are going to have to see the big picture and recognize that special interests are not the only interests.

*Senator John Arthur Smith
Chairman*

Experience Suggests Options

Fund swaps, agency budget “sanding,” and canceled capital outlay projects were among the approaches used to balance state budgets during the Great Recession and the last oil price collapse, LFC records show.

The Legislature entered the 2009 legislative session, impacted by the worldwide recession and plummeting fossil fuel prices, with a projected shortfall for FY09 of about \$500 million and little authority to pull from general fund reserves, the committee’s post-session review says.

In response, lawmakers canceled tens of millions of dollars of capital outlay projects, sanded 1 percent from appropriations to Medicaid and the public schools and cut spending 5 percent for the rest of state government, and reinstated estimated corporate income tax payments.

Despite drafting a conservative budget for FY10 during the 2009 session, deteriorating economic conditions brought legislators back to Santa Fe in October. They cut state agencies further, canceled additional projects, substituted state funds with federal stimulus funds, traded lower employer contributions to

state pension plans for higher employee contributions, and swept cash balances in specialty funds into the general fund. In addition, the governor ordered a five-day furlough of state employees.

A collapse in oil prices – which dropped precipitously in late 2014, recovered slightly in early 2015, then hit bottom in early 2016 – led the state to end FY16 in the red and drove three rounds of budget cuts for FY17.

During the 2016 session, legislators cut budgets, swept cash balances, and drew down the general fund reserve.

In an October special session, the Legislature again cut budgets, raised revenue partly by closing tax loopholes, transferred more than \$200 million from the tobacco settlement permanent fund into the operating reserves, swept cash balances, and tapped the public school capital outlay fund for instructional materials and transportation costs.

With the economy continuing to decline, lawmakers during the 2017 session were again forced to address solvency, with action during the third round of budget cuts including reducing funding to public school districts by amounts school districts had in savings.

Economic Downturn Expected to Linger

New Mexico’s recovery from the oil price bust and the coronavirus-related economic downturn could be slow, LFC analysis indicates.

U.S. oil producers have cut back 2020 spending plans because of low prices, and if no new wells are drilled in New Mexico, state production could drop 45 percent in six months, staff report.

Low oil prices and declining production will lead to losses in severance taxes and federal royalties, gross receipts taxes from drilling activity, and income taxes from oil-field workers.

Further, unemployment in New Mexico, driven by the shutdown of thousands of businesses, could reach 15 percent or more this quarter, particularly in the hospitality and tourism, consumer services, and energy sectors, analysis indicates.

LFC economists say recovery could be slow, with consumers reluctant to resume normal activities and the permanent loss of businesses that could not weather the shutdown.

While the nation could bounce back

early next year, New Mexico tends to lag behind the nation in economic recoveries, and the state may take years to regain the lost economic activity, they say.

IHS Markit, an international forecasting company and one of two used by the legislative and executive economists of the state Consensus Revenue Estimating Group, expects a 26.5 percent decline in the U.S. gross domestic product this quarter, while Goldman Sachs is projecting a decline of 25 percent. In comparison, the lowest quarterly decline during the Great Recession was 8.4 percent.

IHS projects per barrel oil prices to remain in the low \$20s through the end of this year, possibly rising to the low \$30s in 2021.

If true, LFC analysis shows, New Mexico’s realized oil price would average about \$25 per barrel in FY21 and \$35 per barrel in FY22. The price used in the December 2019 forecast, the most recent produced by the state revenue estimating group, was \$50 for FY21.

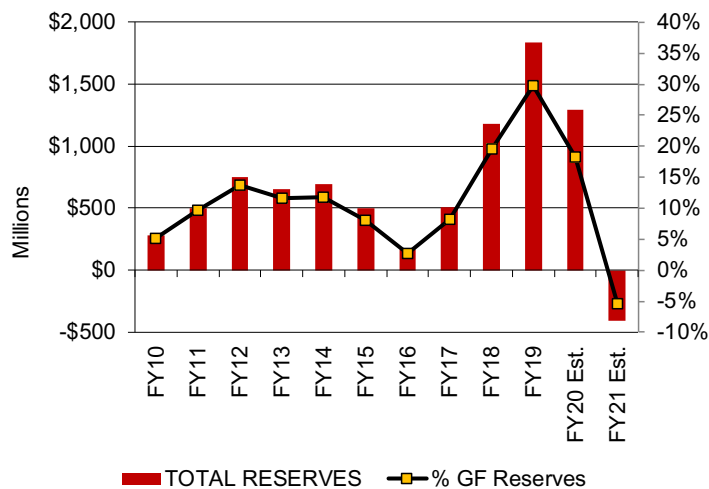
Spending Could Wipe Out Reserves

Planned spending for the budget year that starts July 1 could wipe out the state's reserve funds.

Rough projections of the impact of the oil price decline and the pandemic shutdown indicate state revenues could drop by more than \$1 billion. Without cuts in spending, or receipt of federal stimulus revenue, the \$1.3 billion in reserves likely will not be enough to cover approved spending.

Notably, more than \$1 billion of the state's approximately \$1.3 billion in reserves is in the tax stabilization reserve, the so-called rainy day fund. The state cannot draw on tax stabilization funds without approval from the governor and a majority of legislators or, without gubernatorial approval, the support of three-quarters of the Legislature.

General Fund Reserve History and FY20-FY21 Scenario
Total and Percent of Recurring Appropriations



Note: Reserve estimates for FY20 and FY21 are based on a revenue scenario produced on April 6, 2020, by LFC staff; the reserve estimates assume no changes to budgets or spending levels approved in the 2020 session.

On the Table

State Funds React

The land grant and severance tax permanent funds are about half as volatile as the stock market, according to the State Investment Council, meaning a 30 percent drop in the market translates to a loss in the net value of the permanent funds of about 15 percent. LFC staff estimates the land grant fund has lost about \$2.9 billion of its \$19.69 billion January net value and the severance tax fund has lost about \$840 million of its net value \$5.59 value in the last two months.

The state's tax stabilization reserve, the so-called rainy day fund, is not subject to stock markets gains or losses because it has no exposure to equities. However, the recent federal funds interest rate cut to zero will hit returns from short-term assets, about a third of the fund.

Health Department Plans Virus Spending

The Health Department's plans for \$6.4 million in federal coronavirus-related grants includes \$1.9 million for personnel. Funds for tents, thermometers, personal protective equipment, and other equipment are other major expenses in the budget adjustment request needed for the agency to spend the funds. The \$6.4 million does not include the funds the department expects to receive from the \$2 trillion virus response bill called the CARES act.

ECECD Implements Emergency Policies

The Early Childhood Education and Care Department reports it is implementing a number of emergency temporary changes to Childcare Assistance policy. They include expanded eligibility for the families of first responders and healthcare workers, temporary authorization of family, friends and neighbors as childcare providers, assistance for expanded hours, reduction in copays, and higher payments per child.

Counties Will Get Second Census Grants

The Department of Finance Administration is planning a second round of \$2.4 million in Census 2020 grants to counties. Legislators appropriated \$8 million to the census effort during the legislative session. Counties must have spent at least some of the grant they received last year to be eligible for a new grant. All 33 counties have established "complete count committees."

State Orders Work-From-Home Tech

The Department of Information Technology ordered 1,000 laptop computers for state employees working from home; however, the computers were no longer in stock by the time the \$820 thousand order was processed and the computers won't start arriving until early April. The Children, Youth and Families Department plans to spend \$1.3 million on 700 laptops and docking stations for workers continuing to work on the comprehensive child welfare information system.

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Staff Editor - Alison Nichols Writer, Editor - Helen Gaussoin

Questions, comments: 505-986-4550
www.nmlegis.gov/Entity/LFC/Default

Please contact Adreena Lujan at adreena.lujan@nmlegis.gov if you would prefer to receive this newsletter electronically.

Legislative Finance Committee
325 Don Gaspar Street Ste101
Santa Fe NM 87501