

## **A Roadmap for a More Economically-Competitive New Mexico**

By Paul J. Gessing

### **Introduction**

There has been a fair amount of discussion recently about ways to make New Mexico's economy more competitive with other states. Albuquerque Mayor Richard Berry, in a March 28, 2011 a speech to the Economic Forum, outlined plans to spur the City's economy and bemoaned his difficulties in attracting companies to the Duke City.<sup>1</sup> Berry's plans included a mix of streamlining government processes and incentives designed to spur economic growth.

*Albuquerque Journal* columnist Winthrop Quigley, writing on the same overall theme in a March 20, 2011, front page story, questioned "What Holds Us Back?" in terms of economic development (as a state).<sup>2</sup> Quigley cited outdoor recreation activities, large numbers of college students, and available real estate as positives for the area and cited the gross receipts tax and our failing K-12 education system as cons.

Even Sam Bregman who, at the time was running for Chairman of the Democratic Party, offered his two-cents in an opinion piece taking Gov. Martinez to task for the supposed crime of not creating any jobs during her first three months in office.<sup>3</sup> Of course, Bregman failed to grasp what Berry and Quigley clearly understand – that "jobs" and "economic development" are two different things, but a debate over turning New Mexico's economy around is indeed a worthy one and it is great to see so many New Mexicans engaged in the debate.

The discussion over how to spur economic development is not a mere academic exercise. Narrowly-targeted incentives have a spotty track record while economic freedom is associated with rising income levels and economic growth. Economic growth in turn improves the quality of life for all of New Mexico's 2 million residents in the form of improved health, longer life spans, and a cleaner environment.<sup>4</sup> Even if you are not the owner of a business, you benefit from economic freedom and a stronger New Mexico economy.

The Rio Grande Foundation believes that the task of government and state policy are, of course, not to "create jobs" but to assure tax, regulatory, and legal conditions that enable businesses to thrive. It is not what resources we already have, but how to change the rules so that these resources can be

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<sup>1</sup> Mayor Berry Suggests Changes to Spur Economic Growth, <http://www.cabq.gov/mayor/news/mayor-berry-suggests-changes-to-spur-economic-growth/>.

<sup>2</sup> Winthrop Quigley, "Growing Our Economy: What Holds Us Back?" *Albuquerque Journal*, March 20, 2011, <http://www.abqjournal.com/biz/20231515811biz03-20-11.htm>.

<sup>3</sup> Sam Bregman, "Still Waiting for Martinez to Show Some Leadership," *Albuquerque Journal*, March 31, 2011, [http://www.abqjournal.com/opinion/guest\\_columns/312115241321opinionguestcolumns03-31-11.htm](http://www.abqjournal.com/opinion/guest_columns/312115241321opinionguestcolumns03-31-11.htm).

<sup>4</sup> James Gwartney and Robert Lawson, "Economic Freedom and Human Betterment," Santa Clara University, April 23, 2003, <http://www.scu.edu/civilsocietyinstitute/events/upload/EconFreedom.pdf>.

more efficiently used by individuals and firms as well as creatively combined with new capital (human and financial) from out of state.

### **Where Does NM Stand?**

Historically, New Mexico has relied disproportionately on government at all levels to create what limited jobs and economic activity were available. In fact, since at least 1981, New Mexico has been number one in the nation in the ratio of federal tax dollars received in that state to tax dollars paid to the federal government by that state.<sup>5</sup> New Mexico has also had a bloated state and local government for many years.<sup>6</sup>

Reliance on federal was a recipe for poverty and, this is exactly what New Mexico had for many years. According to New Mexico's Bureau of Business and Economic Research, personal incomes in New Mexico hovered in the bottom five nationally for decades.<sup>7</sup> Starting in 2003 with personal income taxes implemented during the Richardson Administration, there was a relatively dramatic uptick in personal income.

Currently, New Mexico is ranked 43<sup>rd</sup> in per capita personal income.<sup>8</sup> The Rio Grande Foundation has further analysis of this issue in our policy paper: "Governor Richardson's Positive Economic Legacy: New Mexico Personal Income Growth Shows Upward Prosperity since 2003 Tax Cuts."<sup>9</sup> Better still, according to the federal Bureau of Economic Analysis, New Mexico actually led the nation in personal income growth during 2010.<sup>10</sup>

Of course, New Mexico's 43<sup>rd</sup> ranking in personal income is not great. There is a lot of room for improvement. Not surprisingly, along with its low personal income level, New Mexico also performs rather poorly in terms of economic freedom. According to the Canada-based Fraser Institute's "Economic Freedom of North America 2010," New Mexico is tied for 39<sup>th</sup> in economic freedom among the US states.<sup>11</sup> New Mexico scored most poorly in the index in "size of government" and "discriminatory taxation" on the report. Creating more economic freedom is integral to improving New Mexico's economy.

### **Specific Ideas for Improving New Mexico's Economy**

#### **1) Reform New Mexico Labor Laws to make the state's work force more competitive;**

This includes eliminating New Mexico's Davis-Bacon "prevailing wage law," adopting "Right to Work" legislation, and keep minimum wage at federal level.

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<sup>5</sup> Tax Foundation, "Federal Taxes Paid vs. Taxes Received," <http://www.taxfoundation.org/research/show/22685.html>.

<sup>6</sup> J. Scott Moody and Wendy Warcholik, "The Government Gravy Train," Rio Grande Foundation, December 2009, [http://www.riograndefoundation.org/downloads/rgf\\_private\\_vs\\_public\\_compensation.pdf](http://www.riograndefoundation.org/downloads/rgf_private_vs_public_compensation.pdf).

<sup>7</sup> New Mexico's Bureau of Business and Economic Research, "Per Capita Personal Income by State," <http://bber.unm.edu/econ/us-pci.htm>.

<sup>8</sup> *Ibid.*

<sup>9</sup> [http://www.riograndefoundation.org/downloads/rgf\\_personal\\_income\\_study.pdf](http://www.riograndefoundation.org/downloads/rgf_personal_income_study.pdf)

<sup>10</sup> Bureau of Economic Analysis, "State Personal Income in 2010," March 23<sup>rd</sup>, 2011, [http://www.bea.gov/newsreleases/regional/spi/sqpi\\_newsrelease.htm](http://www.bea.gov/newsreleases/regional/spi/sqpi_newsrelease.htm).

<sup>11</sup> Fraser Institute, "Economic Freedom Index of North America 2010," <http://www.fraserinstitute.org/uploadedFiles/fraser-ca/Content/research-news/research/publications/EconomicFreedomofNorthAmerica2010.pdf>.

For starters, just by repealing SB 33 which expanded the impact of New Mexico's law relating to the Prevailing Wage Rate on Public Works Projects, New Mexico taxpayers could save \$60 million annually.<sup>12</sup> Even more savings are likely from repealing Davis-Bacon entirely and allowing work to be done at market rates, but \$60 million in annual savings is a great start.

The adoption of Right to Work legislation would also be incredibly helpful for New Mexico's economy. These laws prohibit employers and unions from making membership in a union or payment of union dues a condition of employment. In other words, if you want to be in a union, you can, but you can't be forced to be in a union, either.

According to economist Richard Vedder, both population and income growth have been significantly faster in the 22 states with right-to-work laws than in those states that allow forced-unionism. Texas, Oklahoma, Arizona and Utah all have right-to-work laws in place.<sup>13</sup>

Vedder's conclusion on Right to Work laws is that they "increase economic growth rates by 11.5%."<sup>14</sup>

Lastly, there is the simple step of refusing to raise New Mexico's minimum wage above the federal level. Currently, New Mexico's minimum wage is \$7.50 or 25 cents above the nationally-mandated wage.<sup>15</sup> While the law's current impact is likely minimal, artificial wage mandates inevitably cut the bottom rungs of the job ladder out from under low-income and young workers. There is no reason to exacerbate this problem.

## **2) Eliminate the state's personal income tax;**

States that have the strongest economies limit taxes on entrepreneurship and productive activity. According to Arthur Laffer and Stephen Moore:

From 1998 to 2007, more than 1,100 people every day including Sundays and holidays moved from the nine highest income-tax states such as California, New Jersey, New York and Ohio and relocated mostly to the nine tax-haven states with no income tax, including Florida, Nevada, New Hampshire and Texas. We also found that over these same years the no-income tax states created 89% more jobs and had 32% faster personal income growth than their high-tax counterparts.<sup>16</sup>

New Mexico has already experimented (successfully) with income tax rate reductions. For many years, New Mexico has been an impoverished state with personal incomes hovering in the

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<sup>12</sup> New Mexico's Legislative Finance Committee, "Prevailing Wage Rate on Public Works Projects," March 19, 2009, <http://www.nmlegis.gov/Sessions/09%20Regular/firs/SB0033.pdf>.

<sup>13</sup> NRTW Committee Staff, "Right to Work Laws 'Have Positive Economic Impact,'" March 26, 2010, <http://www.nrtwc.org/right-to-work-laws-%E2%80%98have-a-positive-impact%E2%80%99/>.

<sup>14</sup> NRTW Committee Staff, "The Single Most Important Step in Putting Hoosiers Back to Work: Right to Work," January 31, 2011, <http://www.nrtwc.org/tag/richard-vedder/>.

<sup>15</sup> US Department of Labor, Minimum Wage Laws in the States, <http://www.dol.gov/whd/minwage/america.htm>.

<sup>16</sup> Arthur Laffer and Stephen Moore, "Soak the Rich, Lose the Rich," *Wall Street Journal*, May 18, 2009, <http://online.wsj.com/article/SB124260067214828295.html>.

bottom 5 nationwide.<sup>17</sup> In 2003, Governor Richardson and the Legislature agreed to reduce taxes on productive economic behavior including personal income and capital gains taxes. Over the next five years, New Mexico's top personal income tax rate dropped from 8.2 percent to 4.9 percent.<sup>18</sup>

To reinforce the points made by Laffer and Moore, New Mexico's personal incomes began rising swiftly (relative to other states') and, now sit at 43<sup>rd</sup> in the nation. It is better to be 43<sup>rd</sup> than 47, but New Mexico has a long way to go before it is anywhere near

Clearly, elimination of the personal income tax is a powerful economic development tool, but several New Mexico-specific issues make elimination of the personal income tax especially important for the state's economy. Specifically, this is the gross receipts tax which is a uniquely robust form of taxation endemic to New Mexico.

As the Rio Grande Foundation pointed out in, "New Mexico's Harmful Gross Receipts Tax: A Warning to Other States," the state's gross receipts tax is applied at uniquely broad and high rates. As the paper points out, "the GRT differs dramatically from a sales tax because practically all goods and services are taxed."<sup>19</sup>

Over time, the tax base has been narrowed and raised dramatically. Groceries and some medical payments have been exempted from the GRT and rates have risen to approach 9 percent in some areas of the state. Nonetheless, the tax applies to all services including accountants and lawyers (making setting up a small business more costly), electricity, medical deductibles and co-pays, and dozens of other goods and services that are simply not taxed in other states.

Among the unique features of the GRT is that it actually enables New Mexico to tax certain spending by the federal government that is done within the borders of the state. Since New Mexico arguably has the largest federal presence of any state in the nation,<sup>20</sup> it is unfortunately, highly unlikely that policymakers will abolish the GRT and go to a straight sales tax.

### **3) Reform New Mexico's Educational System to Improve Results and Reduce Costs;**

While difficult to quantify, there is no doubt that having a good education system can contribute to a particular state's economic prosperity. Several factors would come into play in making education relevant to economic growth including:

- Relocating businesses want to have good educational systems available to their employees. In the CNBC report, "America's Top State for Business 2010," education

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<sup>17</sup> New Mexico's Bureau of Business and Economic Research, "Per Capita Personal Income by State," <http://bber.unm.edu/econ/us-pci.htm>.

<sup>18</sup> Paul Gessing, "Stimulating New Mexico's Economy by Phasing Out its Personal Income Tax," Rio Grande Foundation, April 21, 2008, [http://riograndefoundation.org/downloads/rgf\\_eliminating\\_the\\_income\\_tax.pdf](http://riograndefoundation.org/downloads/rgf_eliminating_the_income_tax.pdf).

<sup>19</sup> Paul Gessing and Harry Messenheimer, "New Mexico's Harmful Gross Receipts Tax: A Warning to Other States," Rio Grande Foundation, January 29, 2007, [http://www.riograndefoundation.org/downloads/combined\\_grt.pdf](http://www.riograndefoundation.org/downloads/combined_grt.pdf).

<sup>20</sup> Tax Foundation, "Federal Taxes Paid vs. Taxes Received," <http://www.taxfoundation.org/research/show/22685.html>.

alone counts for 7 percent of each state's score along with other, more traditional measurements such as "cost of doing business."<sup>21</sup>

- "Workforce," the second-most heavily-weighted portion of the survey. Clearly, a high quality education system contributes greatly to workforce quality.<sup>22</sup>
- Lastly, an effective, well-managed K-12 education system should be able to do the job at a lower cost to taxpayers than a poorly-managed and ineffective system. Keeping education costs down will inevitably make the tax burden lower for those states as well.

Unfortunately, New Mexico's K-12 system is a failure on nearly all counts.

- According to the 2010 "Diplomas Count" report, 54.9 percent of New Mexico students graduate. This compares poorly with the national graduation rate of 68.8 percent. According to the report, New Mexico's graduation rate was the second-lowest in the nation.<sup>23</sup>
- According to the Alliance for Excellent Education, halving the dropout rate of the largest school district in the state (Albuquerque Public Schools) would generate \$38 million in additional annual earnings, an estimated 300 new jobs, and overall economic growth of \$46 million.<sup>24</sup>

Spending is not the issue. According to data from the US Census Bureau, "K-12 spending has grown 54 percent faster than the rate of inflation on a per-pupil basis."<sup>25</sup>

The Rio Grande Foundation brought one successful education reform model to New Mexico from Florida.<sup>26</sup> This led to Gov. Martinez attempting to push a few parts of the "Florida Model" like A-F grading of schools (successfully) and elimination of social promotion (unsuccessfully) that led to educational success in Florida for implementation in New Mexico.

Much more needs to be done to make New Mexico's education system an effective one. These might include additional emphasis on early childhood reading, virtual schools, greater school choice, and increased incentives and accountability for teachers, but there must be bi-partisan understanding that K-12 educational success is important for New Mexico's children and those improvements will have a salutary impact on New Mexico's economy.

Improving K-12 must be policymakers' first priority, but it is also imperative that New Mexico's higher education system become more competitive and less expensive.

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<sup>21</sup> Scott Cohn, "CNBC's Top States For Business 2010—And The Winner Is Texas," CNBC, July 13, 2010, <http://www.cnbc.com/id/37642856>.

<sup>22</sup> *Ibid.*

<sup>23</sup> Editorial Projects in Education, "Graduation by the Numbers 2010," June, 2010.

<sup>24</sup> Alliance for Excellent Education, "The Economic Benefits from Halving Albuquerque's Dropout Rate," January, 2010, [http://www.all4ed.org/files/AlbuquerqueNM\\_leb.pdf](http://www.all4ed.org/files/AlbuquerqueNM_leb.pdf).

<sup>25</sup> Paul J. Gessing, "K-12 Spending in New Mexico: More Spending, Few Results," Rio Grande Foundation, February 7, 2011, [http://www.riograndefoundation.org/downloads/rgf\\_k-12\\_spending.pdf](http://www.riograndefoundation.org/downloads/rgf_k-12_spending.pdf).

<sup>26</sup> Matthew Ladner, Ph.D, "Florida's K-12 Lesson for New Mexico," Rio Grande Foundation, July 29, 2010, [http://www.riograndefoundation.org/downloads/rgf\\_florida\\_lesson.pdf](http://www.riograndefoundation.org/downloads/rgf_florida_lesson.pdf).

According to New Mexico's Legislative Finance Committee, no other state dedicates more of its citizens' personal income to higher education.<sup>27</sup> New Mexico pays for seven four-year institutions, ten branch campuses and eight community colleges. By comparison, Arizona's post-secondary enrollment is nearly five times that of New Mexico's and has fewer state supported institutions.<sup>28</sup>

As higher education researcher Kevin Rollins pointed out in a recent study, there are wide discrepancies between New Mexico's most and least efficient/cost-effective universities and community colleges.<sup>29</sup> There is no sound reason for these dramatic differences. A community college in Las Vegas, NM should not cost more than a community college in Las Cruces, but Rollins found that Luna Community College in Las Vegas cost \$13,515 per full time student while NMSU-Doña Ana cost a mere \$6,796.<sup>30</sup>

Rollins conservatively estimates that if the "high cost" providers at both the university and community college level were to become as cost-effective of their "low-cost" counterparts, taxpayers could save \$80 million annually.<sup>31</sup>

Rollins' \$80 million in savings and the "right-sizing" discussed by the Legislative Finance Committee are good starting points for higher education reform and making the system as it currently exists more efficient, but they do not represent truly innovative delivery of education. Charles Murray is just one prominent thinker who has questioned the Bachelor of Arts as a degree and much of what goes on in today's higher education system.<sup>32</sup>

Ideas for thorough reforms of New Mexico's higher education system are beyond the scope of this paper, but Colorado has taken a tentative step towards reform with its "College Opportunity Fund," which set up a limited system of vouchers in higher education.<sup>33</sup> New Mexico policymakers should consider adopting and expanding upon a similar system in order to spur innovation and cost-savings in higher education.

#### **4) Keep reasonable regulations and repeal those that are unnecessary;**

Regulations are complicated. Their economic impact, while significant, can be difficult to understand when compared to other states. The most important thing to keep in mind when dealing with regulations is to understand that making them fair and reasonable when in comparison to other states (and nations) will result in the best economic results. Implementing

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<sup>27</sup> Legislative Finance Committee, "Higher Education New Mexico State University & University of New Mexico," August 11, 2010, <http://www.unm.edu/president/documents/lfc-report-unm-and-nmsu-2010-08-11.pdf>.

<sup>28</sup> *Ibid.*

<sup>29</sup> Kevin Rollins, "Poor Performers in New Mexico Higher Ed: Budget Increases and Inefficiency," Rio Grande Foundation, June 15, 2010, [http://www.riograndefoundation.org/downloads/rgf\\_nm\\_higher\\_ed.pdf](http://www.riograndefoundation.org/downloads/rgf_nm_higher_ed.pdf).

<sup>30</sup> *Ibid.*

<sup>31</sup> *Ibid.*

<sup>32</sup> Charles Murray, "Down with the Four-Year College Degree," Cato Unbound, October 6th, 2008, <http://www.cato-unbound.org/2008/10/06/charles-murray/down-with-the-four-year-college-degree/>.

<sup>33</sup> Barry W. Paulson, PhD, and John Merrifield, PhD, "Colorado's College Opportunity Fund: A Critical Appraisal," [http://www.pubchoicesoc.org/papers\\_2011/Poulson\\_Merrifield.pdf](http://www.pubchoicesoc.org/papers_2011/Poulson_Merrifield.pdf).

regulations that deviate dramatically from practices in other states will inevitably result in economic activity either leaving or ceasing altogether (if, for example, it cannot leave).

The Small Business-Friendly Task Force did all New Mexicans a big favor when it took a carefully-reasoned approach to New Mexico's regulatory framework in its task force report.<sup>34</sup>

Among the specific recommendations that the Task Force came up with is:

- Making state rules and regulations no more stringent than federal ones. While the federal government's rules and regulations (like the minimum wage and other labor regulations as mentioned elsewhere in this paper) are not always justified, enacting New Mexico-specific rules and regulations only makes it more difficult and complex to do business in the Land of Enchantment.
- Eliminating the New Mexico-specific carbon cap. This cap will raise the prices of energy production and processing in New Mexico, thus pushing energy production and processing into other states like Texas and into Mexico.

Another regulatory issue that will have a major, long-term impact on New Mexico's economy if it is not addressed is the state's "Renewable Portfolio Standard." This mandate will, over the next decade, force utilities to increase the amount of electricity they generate with various so-called "renewable" sources like wind and solar.

Currently, as of 2011, New Mexico's mandate calls for 10% renewable generation. By 2020, that requirement rises to 20%.<sup>35</sup> Included in that mandate are additional prescriptions which mandate the amounts that must be provided from each "renewable" energy source.

According to a recent study from the American Tradition Institute and the Rio Grande Foundation, New Mexico's Renewable Portfolio Standard will cost \$2.3 billion over the next decade with a majority of that expense to kick in as the mandated percentages rise in later years.<sup>36</sup> The market, not central planners in government, should decide how electricity is generated. A costly Renewable Portfolio Standard will make doing large-scale business or manufacturing far more expensive in New Mexico.

## **5) Right-size New Mexico's government work force and reform government pensions;**

According to research by J. Scott Moody and Wendy Warcholik: in 2008, New Mexico's state and local governments employed 25.3 people for every 100 people employed in private sector

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<sup>34</sup> Economic Development Department, "Small Business-Friendly Task Report," April 1, 2011, <http://www.edd.state.nm.us/publications/smallBusinessTaskForceReport.pdf>.

<sup>35</sup> New Rules Project, "Renewable Portfolio Standard – New Mexico," March 2007, <http://www.newrules.org/energy/rules/renewable-portfolio-standards/renewable-portfolio-standards-new-mexico>.

<sup>36</sup> David Tuerck, Paul Bachman, and Michael Head, "The Economic Impact of New Mexico's Renewable Portfolio Standard," American Tradition Institute and Rio Grande Foundation, February 2011, [http://www.riograndefoundation.org/downloads/rgf\\_nm\\_rps\\_study.pdf](http://www.riograndefoundation.org/downloads/rgf_nm_rps_study.pdf).

versus the national average ratio of 16.72. If New Mexico's state and local government ratio was reduced to the national average, then the workforce would be reduced by 56,970 people.<sup>37</sup>

For every position eliminated, state and local governments would immediately save an average of \$49,711 in compensation which includes wages and salaries as well as benefits. Overall, state and local governments could save up to \$2,596,600,137 in annual budget savings.<sup>38</sup>

New Mexico faces \$25.8 billion in unfunded pension and retiree health care liabilities. In addition to reducing the overall size of the government work force, policymakers must transform the state's defined benefit system into a defined contribution system. Additionally or perhaps as a means of supplementing the switch from a defined benefit to defined contribution system, the state must continue to increase employee/retiree contributions to the retiree healthcare system.<sup>39</sup>

### **Conclusion**

New Mexico has a great opportunity in the years ahead to break its reliance on federal largesse and generate economic growth and opportunity from within. Unfortunately, targeted incentives are largely a "zero-sum game." They merely transfer tax revenues from taxpayers to tax eaters. Sound tax policies expand the economic pie rather than redistributing it.

All of the reforms outlined above will lead to more efficient and market-friendly government in New Mexico. And, while it is impossible for policymakers to know exactly what businesses will succeed or fail and what jobs will be created, having a competitive economy will inevitably lead to job creation and economic growth.

With the federal government in Washington facing worsening budget deficits and inevitable cuts, New Mexico cannot rely on Washington for massive, ongoing economic support.

To be fair, the aforementioned list is not exhaustive. There are many positive policy ideas – like government transparency – that can and should be enacted and will have positive impacts. This list is designed to have the highest impact through the use of targeted policy initiatives.

### **About the Author**

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<sup>37</sup> Moody and Warcholik, "Fixing New Mexico's \$25.8 Billion Unfunded Retiree System," Rio Grande Foundation, February 2010, [http://www.riograndefoundation.org/downloads/rgf\\_nm\\_unfunded\\_retiree\\_system.pdf](http://www.riograndefoundation.org/downloads/rgf_nm_unfunded_retiree_system.pdf).

<sup>38</sup> *Ibid.*

<sup>39</sup> *Ibid.*