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## Funding for Transformation: A Strategy for New Mexico

### *Overview*

The current situation is unacceptable. New Mexicans deserve better in terms of their immediate circumstances and future possibilities. Delivering fundamental systemic change requires that we rethink the way government is funded. Action is needed now to reform our tax system and put the state's permanent funds to more beneficial use. Immediate actions include:

#### Tax Reform

- Repeal Governor Martinez's corporate tax cuts
- End preferential treatment of capital gains
- Provide tax relief to small businesses that pay a living wage
- Enact a carbon pollution tax
- Ensure that low-income New Mexicans know about refundable tax credits.

#### Permanent Funds

- Identify in-state investment opportunities for permanent funds
- Establish a flexible cap on annual distributions from the Land Grant Permanent Fund (LGPF) and Severance Tax Permanent Fund (STPF)
- Dedicate STPF distributions to infrastructure development
- Plan for and initiate essential Economic Stimulus Packages

### *Context*

New Mexicans know that the status quo is not working. Over 20% of our residents live in poverty. Ten percent of New Mexicans lack access to health care. Our teachers are underpaid and many schools are in disrepair. And our unemployment is one of the highest in the nation.

New Mexicans deserve transformational change, *now*. Residents need a single-payer health care system that covers *all* New Mexicans. We need a world-class education system that ensures that *all* children—regardless of zip code—obtain the knowledge and skills they need to thrive in the modern economy, starting in early childhood. We need a robust economy, in which anyone who is willing to work hard can find a job that pays a living wage. And we need state-of-the-art infrastructure—including roads that are safe and well-maintained, an electric grid that is efficient and reliable, and state-wide internet service that allows residents in rural and urban areas alike to participate fully in the modern economy.



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Delivering this transformative change will require us to rethink the way we fund government. We will need to update our tax code to eliminate loopholes and ensure that revenues are sufficient to pay for essential public services. We should consider changes to how we manage our permanent funds to ensure they are providing the greatest possible benefit to the people of New Mexico. And we need to have a serious discussion about how to design and fund a stimulus package that will get our state back on track.

## ***Tax Reform***

Tax policy should be guided by three basic principles. First, the total amount of revenue generated by taxes should cover the cost of government services. Second, everyone should pay a fair share on a progressive basis according to income. And third, strategic adjustments may be made to overall tax structure in order to support specific public policies.

Significant change is needed to bring the New Mexico tax structure into conformance with these principles. ***Comprehensive reform based on objective assessment of the system is overdue.*** However, adjustments can be made now that would make the system more adequate and equitable. They include the following five actions:

- **Repeal Governor Martinez's corporate tax cuts.** Congress recently slashed corporate tax rates from 38.9% to 25.7%. This dramatic change in federal law creates a tremendous opportunity for states, which can now increase their own corporate taxes by 13.2% without causing corporations operating within their jurisdictions to experience any effective tax increase. We should take advantage of this opportunity to reverse Governor Martinez's corporate tax cuts, which [cost the state \\$114 million](#) in their first year alone and led to a situation in which corporate taxes constitute [a mere 1.2%](#) of total state revenue.

Because of the new federal tax structure, state taxes on New Mexico corporations could be raised to 19.1% without effectively increasing their total tax obligation. A more modest state tax rate of 10% is appropriate for our largest corporations so long as the tax savings are used either to improve employee salaries or invest in business development within the state. Coupled with repeal of the special tax break for manufacturers included in the 2013 bill, these changes will increase state revenues [by hundreds of millions of dollars](#) per year.

- **End the preferential treatment of capital gains.** The federal tax code is notorious for its special treatment of investment income, which is taxed at a significantly lower rate than wages and other earned income. This unequal treatment exacerbates income inequality, because the wealthiest Americans tend to rely more on investment income, while middle and working-class Americans rely almost exclusively on earned income.

New Mexico's tax code compounds this problem by allowing taxpayers to exclude half of their capital gains. Closing this loophole will increase revenue by up to [\\$48 million](#) per year.



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- **Provide tax relief to small businesses that pay a living wage.** As Lieutenant Governor, I will recommend increasing the minimum wage to \$15 an hour by 2022. At a time of record corporate profits, large companies can easily afford to pay a living wage. However, small businesses may have more difficulty achieving this target. To facilitate the transition to a living-wage economy, we should allow small businesses to apply for relief from the state's portion of the gross receipts upon showing that such relief is necessary to maintain profitability or prevent layoffs.
- **Enact a carbon pollution tax.** Climate change threatens life in New Mexico as we know it. Responding to this existential threat will require us to take bold, aggressive action. One of the first things we should do is enact a tax on carbon pollution. Such a tax will lead to significant reductions in harmful air pollution while incentivizing clean energy and providing the state with a significant new source of revenue. A modest tax of \$15 per ton, applied to emissions from the electric power, commercial, and industrial sectors, would generate about \$1 billion every year—well in excess of the amount needed to provide early childhood education to all New Mexican children.
- **Initiate a public education campaign to ensure that low-income New Mexicans are taking advantage of refundable tax credits.** Both state and federal law establish refundable tax credits for low-income individuals. These credits make certain individuals eligible to receive a refund even if they did not make any income tax payments during the prior year. Unfortunately, many low-income New Mexicans are not aware of these credits and do not claim them. We should implement a public education campaign, targeted at low-income individuals (including those who do not speak English), to ensure that all New Mexicans are receiving the benefits to which they are entitled.

### *Permanent Funds*

New Mexico is fortunate to have an endowment valued at \$23 billion—one of the largest endowments of any state. The endowment is spread across four permanent funds, the largest of which are the Land Grant Permanent Fund (LGPF) and the Severance Tax Permanent Fund (STPF). Every year, these funds accrue hundreds of millions of dollars of interest. In 2017, the funds contributed over [\\$875 million](#) to the treasury, about 14% of the state's revenue. Of this money, [\\$638 million](#) went to New Mexico's public schools.

These funds are sometimes referred to as “rainy day” funds, but that is a misnomer. Our endowment is not a savings account, designed to be drawn down in times of need. Rather, it is a *trust* fund, designed to maintain in perpetuity a steady stream of revenue for our public schools and other state institutions. Changes to the way we operate, distribute, or invest our permanent funds must be consistent with our obligation to maintain their long-term earning potential.



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*However, given national rankings of conditions within our state, we must ask ourselves if a major infusion from the trust funds is warranted if the result is a more sustainable future for all New Mexicans. In other words, would improved conditions—including new sources of revenues—compensate for a reduction in annual distributions from the funds?*

Alternatives to current management of the trust funds include: (a) investment of a larger percentage of trust funds in New Mexico institutions, (b) allowing variable rates of annual distribution, and (c) allowing a one-time strategic drawdown of a fund's principal.

- **Establish a blue-ribbon panel to identify in-state investment opportunities.** In general, the State Investment Council (SIC) is not required to invest in ventures that have a connection to New Mexico. In fact, a significant percentage of current investments are in foreign companies. While a diverse portfolio of assets is desirable, investment opportunities in New Mexico should not be overlooked. Prudent in-state investments have the potential to generate interest for our permanent funds while providing a suite of other benefits for our state, including increased employment and tax revenue.

A blue-ribbon panel could assess a variety of in-state investment opportunities (in both public and private sectors) that may be suitable for our permanent funds. A state bank is one such option that has been much discussed in progressive circles. Recommendations of the panel would be presented to the Governor, SIC, and Legislature for their consideration.

- **Amend the Constitution to establish a flexible cap on annual distributions.** The New Mexico Constitution provides that no more than 5% of the LGPF, and no more than 4.7% of the STPF, shall be distributed in a given year. The purpose of these distribution caps is to prevent the Legislature from raiding the corpus of the funds. An unintended consequence is that the Legislature is not able to take full advantage of the interest generated by the funds.

For example, in 2017, the funds had [a return of about 13%](#). Because of the distribution caps, more than half of that return—nearly a billion dollars—was reinvested. While this approach might be appropriate in some years, in other years, this money might better be spent on transformational initiatives. To take advantage of this alternative funding source, the New Mexico Constitution must be amended so that the Legislature can access more of the interest generated by the permanent funds.

- **Require that STPF distributions go to infrastructure development.** Under the New Mexico Constitution, all distributions from the LGPF must go to the permanent school fund. Distributions from the STPF, however, are treated as “general operating revenue,” and can be used for any purpose. However, the STPF is based on revenues from a non-renewable resource (oil and gas), and are more appropriately used to help New Mexico move to a “clean energy economy.” Associated costs include retraining of workers, economic development of “oil-patch” communities, and research in next generation solar



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and wind technology. Legislative action along these lines would dedicate approximately \$240 million per year toward a new economic foundation for the state.

- **Economic Stimulus Packages.** Improving current living conditions and putting New Mexico on track to a substantially better future will require fundamental changes to our educational system, healthcare system, infrastructure, economy, and governmental operations. Many of these changes can be achieved through steady incremental steps. However, some changes are best accomplished or initiated by large-scale, capital-intensive initiatives.

In order to maximize benefits from a rapid expenditure of public funds, stimulus packages must be strategic, adequately funded, and carefully managed. The first step in such a process is to open up discussions with change agents throughout New Mexico who have a proven record of accomplishment in areas that need improvement on a statewide basis. Coupling their experience and ideas with economic and financial specialists will provide answers to such questions as: how much stimulus is needed, what programs and projects should be supported, can the stimulus be phased, and how much of a stimulus can the state afford.

Special attention should be paid to projects that have the proven potential to generate returns for New Mexico taxpayers—like improving energy efficiency in state buildings. The framework should also consider various funding options, including use of general revenue, issuance of state bonds, and use of a strategic amount of money from the permanent funds. Recommendations should be forwarded to the Governor, SIC, and Legislature for their consideration and implementation.