

About Think New Mexico

Think New Mexico is a results-oriented think tank serving the citizens of New Mexico. We fulfill our mission by educating the public, the media and policy makers about some of the most serious problems facing New Mexico and by developing effective, comprehensive, long-term solutions to those problems.

Our approach is to perform and publish sound, non-partisan, independent research. Unlike many think tanks, Think New Mexico does not subscribe to any particular ideology. Our focus is instead on promoting workable solutions. We use advocacy and, as a last resort, legal action but only within the constraints of Federal tax law.

Consistent with our non-partisan approach, Think New Mexico's board is composed of Democrats, Independents and Republicans. They are statesmen and stateswomen, who have no agenda other than to see New Mexico succeed. They are also the brain trust of this think tank.

As a results-oriented think tank, Think New Mexico measures its success based on changes in law or policy that it is able to help achieve and which improve New Mexico's quality of life.

Think New Mexico began its operations on January 1, 1999. It is a nonprofit, tax-exempt organization under section 501 (c) 3 of the Internal Revenue Code. Contributions to Think New Mexico are tax-deductible.

Think New Mexico's Board of Directors



Edward Archuleta, a 13th generation New Mexican, is the Director of the Santa Fe office of 1000 Friends of New Mexico, a nonprofit organization that advocates responsible land-use planning, growth management and sustainable development. Edward previously served as the top assistant to the New Mexico Secretary of State.



Paul Bardacke served as Attorney General of New Mexico from 1983-1986. Paul is a member of the American College of Trial Lawyers. He currently handles complex commercial litigation with the firm of Eaves, Bardacke, Baugh, Kierst & Kiernan.



David Buchholtz has served on a long list of New Mexico boards and commissions and has advised several New Mexico governors on fiscal matters. David recently served as Chairman of the Association of Commerce and Industry. He is a senior shareholder and former President of Sutin, Thayer & Browne.



Garrey Carruthers served as Governor of New Mexico from 1987-1990. Currently, Garrey is President and CEO of Cimarron Health Plan. He is a member of the Board of Directors of the U.S. Chamber of Commerce, the National Center for Public Policy and Higher Education and the New Mexico Foundation for Educational Excellence.



Elizabeth Gutierrez is an organizational development consultant who is pursuing a doctoral degree in public policy. Liz was a marketing executive with IBM for nearly two decades. She has also served as Director of Administrative Services Department for the city of Santa Fe.



LaDonna Harris is an enrolled member of the Comanche Nation. LaDonna is President and Founder of Americans for Indian Opportunity, a national nonprofit organization that serves as a catalyst for new concepts and opportunities for Native peoples. She was a leader in the effort to return the Taos Blue Lake to Taos Pueblo.

Rebecca Koch is the owner of Rebecca Koch & Associates which provides management consulting services in the areas of development and strategic planning to local and national nonprofits. Rebecca was the organizational development consultant for the Santa Fe Business Incubator, Inc. She is a former President of the Board of New Mexico Literary Arts.



Fred Nathan founded Think New Mexico and is its Executive Director. Fred served as Special Counsel to New Mexico Attorney General Tom Udall from 1991 to 1998. In that capacity, he was the architect of several successful legislative initiatives and was in charge of New Mexico's successful 1.25 billion dollar lawsuit against the tobacco industry.



Frank Ortiz, a career Foreign Service Officer of the United States, has served as United States Ambassador to several countries, including Argentina, Guatemala and Peru. Frank serves on many boards throughout New Mexico.



Roberta Cooper Ramo is the first woman elected President of the American Bar Association. Roberta is a former President of the Board of Regents of the University of New Mexico. She is a shareholder with the Modrall law firm and serves on many national boards.



Stewart Udall served as Secretary of the Interior under Presidents Kennedy and Johnson. Prior to that, Stewart served three terms in Congress. He is the author of [The Quiet Crisis](#) (1963) that tells the story of humankind's stewardship over the planet's resources, and [To the Inland Empire: Coronado and Our Spanish Legacy](#) (1987) which celebrates Hispanic contributions to our history.



Photo Credit for Mr. Archuleta, Ms. Gutierrez and Ms. Koch: Kathleen Dudley

Letter From the Executive Director



Fred Nathan

When we founded Think New Mexico three years ago, it was inspired by a desire to improve New Mexico's low standing in a large number of national rankings.

With this report, Think New Mexico takes aim at several of those rankings. For example, by phasing out New Mexico's food tax, we can make food more affordable and begin to reduce New Mexico's ranking as the state with the greatest percentage of households suffering from hunger.

Likewise, by increasing New Mexico's tax on tobacco and granting localities the authority to tax alcohol to compensate for the lost food tax revenue, we can decrease New Mexico's teen smoking and drinking rates. Over time that will reduce a host of preventable diseases related to alcohol and tobacco and lower New Mexico's skyrocketing health insurance premiums for individuals and businesses. That, in turn, would begin to improve New Mexico's ranking as the state with the greatest percentage of the population not covered by health insurance.

In preparing this report, we examined dozens of articles and books on state tax policy. We analyzed the most significant New Mexico tax studies since statehood. We reviewed every publication of the now defunct Taxpayers Association of New Mexico to obtain an historical perspective on the food tax. We scrutinized the tax code and other relevant statutory provisions. All of these resources are listed in the Bibliography.

In addition, we consulted a wide collection of New Mexico state fiscal and tax policy experts. We interviewed national experts from organizations like the National Conference of State Legislatures and the Center for Budget and Policy Priorities to learn about national trends related to the food tax. Each one of these experts is listed in the Acknowledgments section at the back of this report.

Finally, we conferred with Kelly O'Donnell, Ph.D, a highly regarded former Senior Economist at the New Mexico Taxation and Revenue Department. We asked Kelly to perform three specific tasks. First, estimate the annual revenue generated by the food tax in New Mexico. Second, calculate the percentage of household income in New Mexico spent on groceries for various income

categories to determine its regressivity. Third, project how increases in the excise tax on cigarettes in New Mexico would affect cigarette consumption and the tax revenue that it produces.

We extend our gratitude to four outstanding New Mexico private foundations which have underwritten Think New Mexico's food tax project. They are the Azalea Foundation, the EMA Foundation, the Frost Foundation and the McCune Charitable Foundation. (The rest of our distinguished group of investors are listed each year in our Annual Report and will be again this year.)

Many thanks as well to Carol Balkcom, who moonlights as a volunteer researcher for Think New Mexico when she is not serving as the First Lady at St. John's College. We would also like to thank Kristina Fisher, our other talented researcher, a senior at Williams College and New Mexico's sole Truman Scholar recipient for 2001.

I would be remiss if I failed to note here that Think New Mexico's unpaid graphic designer, Arlyn Nathan, whose work is prominently featured throughout this report, gave birth on June 26th 2001 to our daughter, Arielle. Naturally, we have already put Arielle to work for Think New Mexico. You will find her captivating photograph on page 16 of this report, where she helps us to make an important comparison between horse feed (not taxed) and baby food (fully taxed) in New Mexico.

If you like what you read here, you may want to make a tax-deductible contribution. Think New Mexico has never had a development director or a fundraising event. We are thus entirely dependent on the quality of reports like this, and people like you who find our work worthwhile, to generate our operating support.

Fred Nathan

Fred Nathan
Founder and Executive Director

October 15, 2001

BACKGROUND:

THE FOOD TAX'S REGRESSIVE IMPACT ON LOW AND MODERATE INCOME NEW MEXICANS

"A good prince will tax as lightly as possible those commodities which are used by the poorest members of society; for example, grain, bread...clothing and all other staples without which human life could not exist."

ERASMUS (1516)

This statement is as true today as it was nearly half a millennium ago when Erasmus wrote it in Latin.

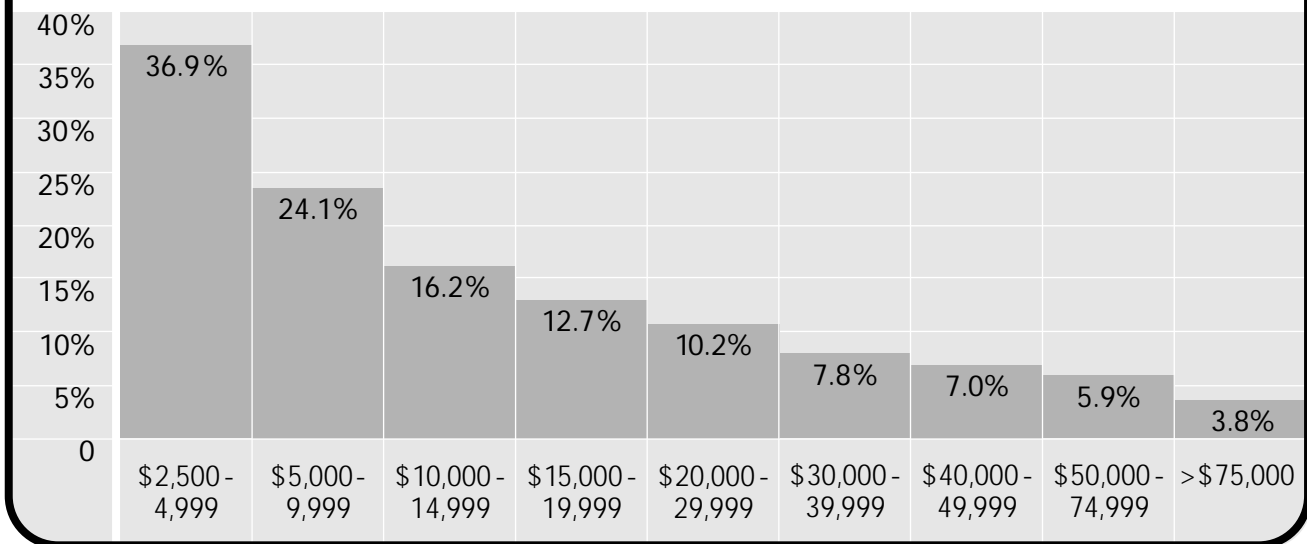
Yet, New Mexico in 2001 continues to impose a gross receipts tax¹ on food, as it has continuously since 1933. Today, the gross receipts tax on food in New Mexico costs a typical family of four approximately \$225 annually, according to Dr. Kelly O'Donnell, former Senior Economist at the New Mexico Tax and Revenue Department. Because all of us eat, everyone in New Mexico would receive some benefit by making food tax exempt.

The vast majority of states, as discussed later, have responded to this issue by exempting groceries, or "food for home consumption," from taxation. (Throughout this report, when we refer to the "food tax," we are using a short hand term for the gross receipts tax on food for home consumption.) No state exempts restaurant food from tax. The distinction between food bought from retailers for home consumption and food bought at restaurants is an especially important one in New Mexico, where it is estimated by the Taxation and Revenue Department that 30% of restaurant sales are to non-residents, mostly tourists.

A food tax exemption would be especially beneficial to low-income families in New Mexico. In fact, the food tax's regressive impact is one of the best reasons to end it. As the nearby chart, created by Dr. O'Donnell, indicates, low-income families in New Mexico, defined as an income of less than \$10,000,

¹ *New Mexico is one of a relatively few states which has a gross receipts tax. Most states have a sales tax instead, which designates the buyer as the legal taxpayer. The gross receipts tax, on the other hand, is imposed on the seller, although the seller generally recovers the tax from the buyer, as in the case of groceries.*

Percent of Income Spent on Groceries in NM by Income Range



Source: Dr. Kelly O'Donnell. Former Senior Economist, New Mexico Taxation and Revenue Department

spend between 36.9% and 24.1% of their income on groceries. By contrast, high-income families in New Mexico, defined as an income of \$75,000 or greater, spend only 3.8% of their income on groceries.

Eliminating the food tax in New Mexico would also support the State's struggling effort to move families from welfare to work. Families would be better able to support themselves with a low wage job if they did not also have the burden of paying the tax on food.

It is important to recognize that the food tax is not just a hardship for low-income families. It also has a harsh effect on moderate-income families, particularly those families with lots of children. Generally, the more children, the more groceries that are required, the more food tax these families pay. Thus, the benefits of exempting food from the gross receipts tax would be highly beneficial to New Mexico's middle class.

The food tax also hits Native American and Hispanic households harder on average than Anglo households in New Mexico because Native American and Hispanic households are larger on average than Anglo households. According to figures from the 2000 Census, Native American ("American Indian") households are nearly 50% larger than Anglo ("White") households and Hispanic households are more than 20% larger than Anglo households on average in New Mexico.

The food tax is an especially cruel tax because it is difficult to escape paying and one, of course, needs food in order to survive. If you eat, you pay. By contrast, the rest of New Mexico's gross receipts tax is avoidable by purchasing goods and services from the Internet. Likewise, the income tax can be partially avoided through various shelters, credits and deductions.

HUNGER IN NEW MEXICO AND THE FOOD TAX

In addition to its regressive effect, taxing food seems especially counterproductive in New Mexico, the State with the highest rate of hunger, according to the United States Department of Agriculture (USDA). In its most recent national report on the prevalence of hunger, the USDA ranked the states in 1999 by the percentage of households suffering from "limited or uncertain access to enough safe, nutritious food for an active and healthy life."

That figure is 15.1% of households in New Mexico, more than 50% higher than the national average of 9.7%. (North Dakota had the lowest percentage at 4.6% of households.)

Prevalence of Food Insecurity and Hunger by State		
STATE	RANK	PERCENTAGE
New Mexico	1	15.1
Mississippi	2	14.0
Texas	3	12.9
Arizona	4	12.8
Louisiana	5	12.8
Arkansas	6	12.6
Oregon	7	12.6
Washington	8	11.9
Oklahoma	9	11.9
Florida	10	11.5
North Dakota	51	4.6
NATIONAL AVERAGE		9.7

Source: United States Department of Agriculture, "Prevalence of Food Insecurity and Hunger, by State; 1996 - 1998" (September 1999)

The USDA figures do not distinguish between adults and children. However, according to other USDA figures, 192,379 New Mexico students at public and private schools, Bureau of Indian Affairs schools and residential child care institutions in the 2000-2001 school year met the eligibility guidelines to receive free and reduced price lunches under the National School Lunch program. That is, astonishingly, 54.84% of the total enrollment.

While the Federal government provides school lunches and, in some cases, school breakfasts, we wonder how and whether these children in New Mexico, who receive these services, manage to get access to safe and nutritious food for dinner and for meals on weekends. Do they skip meals, eat too little or just go without?

This should be a matter of great concern as a Tufts University School of Nutrition Science and Policy study in 1998 concluded that even mild under nutrition experienced by young children during critical periods of growth may adversely impact physical growth and brain development.

Recently, we sought the perspective of Melody Wattenbarger, Executive Director of the Roadrunner Food Bank, an Albuquerque non-profit which collects donated and surplus food from the public and from the food industry. With the help of funding from the New Mexico Legislature, Roadrunner distributes more than 40,000 pounds of food each working day throughout New Mexico to local food banks, soup kitchens and emergency shelters.

Wattenbarger explained that "increasingly in New Mexico, it is working families and their children who need emergency help. Even some families in which

both parents have good (forty hour per week) jobs sometime struggle to afford groceries.”

Ending the food tax, of course, will not end hunger in New Mexico. It will, however, “make food substantially more affordable which is part of the solution,” Wattenbarger told us.

THE PROBLEMS WITH FOOD STAMPS IN NEW MEXICO

The issue of hunger in New Mexico would be even worse without the Food Stamp program, which provides low-income people with coupons to cover a portion of a household’s budget. However, Food Stamps rarely, if at all, cover the full cost of a low-income family’s basic diet. Thus, most of the families who participate in the Food Stamp program would benefit greatly by exempting food from tax in New Mexico because they must still pay for a significant portion of their groceries. The \$10 monthly minimum Food Stamp benefit, for example, has not increased since 1977.

It is interesting to note here that Congress amended the Food Stamp law in 1985 to prevent states from participating in the Food Stamp program if the state collected state or local sales taxes on Food Stamp purchases. This measure was designed to encourage states to exempt food from state and local tax. New Mexico, however, chose instead to comply with the Federal amendment by passing a regulation that simply exempts food purchased with Food Stamps from the gross receipts tax.

This regulation does not cure the problems created by the food tax in New Mexico because, in addition to its inadequacy, the Food Stamp program fails to

reach more than seven out of every ten people that it is intended to serve. Only about 29% of eligible New Mexicans take advantage of Food Stamps to feed their families, according to a New Mexico Associated Press story of April 24, 2000, entitled “Federal Anti-Poverty Aid Largely Untapped.”²

Several reasons explain why relatively few eligible New Mexicans take advantage of the Food Stamp program. First, many of them are simply unaware of the program despite a campaign by the New Mexico Human Services Department to increase enrollment.

Second, some New Mexicans who are eligible for Food Stamps and are aware of the program, choose not to use Food Stamps because of pride or embarrassment.

Third, the application process associated with the Food Stamp program in New Mexico discourages others who are eligible from enrolling. Although eligibility and benefit levels are derived from Federal law, states administer the program. The Food Stamp application in New Mexico is six pages and asks dozens of questions. It also asks many “nonessential questions,” according to America’s Second Harvest, a national non-profit that recently conducted a state by state review of Food Stamp applications entitled, “The Red Tape Divide.”

In addition to the application, a personal interview at the local Income Support Division of the Human

² Federal law also prohibits taxation of food purchased with vouchers from the Supplemental Nutrition Program for Women, Infants and Children (WIC). However, WIC vouchers cover a tiny fraction of food compared to the Food Stamps program.

Services Department is required in New Mexico. That in turn may involve a three-hour drive each way for an eligible applicant who may not have access to a car or who cannot afford the gas. If the applicant owns a car, or other items whose value exceeds the program's strict limits on assets, the applicant may be disqualified even if the family's income is low enough to qualify.

Meanwhile, and perhaps not surprisingly, participation in the Food Stamp program has declined by 25.3% in New Mexico between 1995 and 1999, according to the Food, Nutrition and Consumer Services unit of the USDA.

In sum, the Food Stamp program only reaches a small proportion of those New Mexicans who are eligible for food assistance. For those it does reach, it is too often inadequate to meet their food needs. As a result, the vast majority of low and moderate-income New Mexicans are still paying the food tax and would benefit from a food tax exemption.

THE VAST MAJORITY OF STATES DO NOT TAX FOOD

Rather than just exempt Food Stamps from the sales or gross receipts tax, two thirds of states simply do not tax food for home consumption.

Thirty-three states and the District of Columbia do not tax food, as the accompanying chart demonstrates. (Alaska, Delaware, Montana, New Hampshire and Oregon do not even have a sales tax.) However, while Alaska, Arizona, Colorado, Georgia, and North Carolina do not tax food, they do permit localities in their states to tax food.

In addition to the states that do not tax food, three states tax food at lower rates than other goods. They are Illinois, Missouri and Virginia at 1%, 1.225% and 3.5%, respectively. Missouri also permits localities to tax food.

Another five states fully tax food, but provide a specific food tax credit or rebate on income taxes to partially offset the taxes paid on food by some portions of their population. (New Mexico permits a Low Income Comprehensive Tax Rebate, that applies more broadly than food, and had a specific food tax rebate but that rebate was repealed in 1993. Both of these policy mechanisms will be discussed in the following section.)

That leaves nine states, including New Mexico, that fully tax food without any specific tax rebate or credit. Of the nine states that fully tax food, only Arkansas, Mississippi, Tennessee and West Virginia have a higher food tax at the state level than New Mexico's statewide five percent gross receipts tax on food.

Over the past half-century, states have moved firmly in the direction of exempting food from tax. In mid-1958, for example, only nine states exempted food for home consumption from tax, according to the May/June, 1958 Tax Bulletin of the Taxpayers Association of New Mexico.

That trend accelerated in the 1990s. In the last five years alone, five states have acted to abolish, phase out or reduce their tax on food. Georgia phased out its food tax between 1996 and 1998. North Carolina phased out its food tax between 1997 and 1999. Missouri reduced its food tax from 4.225% to 1.225% in 1997. Virginia began a series of reductions in

How States Tax Food

STATES THAT DO NOT TAX FOOD (33 AND THE DISTRICT OF COLUMBIA)

Alaska	Minnesota
Arizona	Montana
California	Nebraska
Colorado	Nevada
Connecticut	New Hampshire
Delaware	New Jersey
District of Columbia	New York
Florida	North Carolina
Georgia	North Dakota
Indiana	Ohio
Iowa	Oregon
Kentucky	Pennsylvania
Louisiana (as of 7/1/02)	Rhode Island
Maine	Texas
Maryland	Vermont
Massachusetts	Washington
Michigan	Wisconsin

STATES THAT TAX FOOD AT LOWER RATES THAN OTHER GOODS (3)

Illinois (1%)
Missouri (1.225%)
Virginia (3.5% as of 4/1/01)

STATES THAT FULLY TAX FOOD BUT PROVIDE A SPECIFIC FOOD TAX CREDIT OR REBATE ON INCOME TAXES (5)

Idaho	South Dakota
Kansas	Wyoming
Oklahoma	

STATES THAT FULLY TAX FOOD (9)

Alabama	South Carolina
Arkansas	Tennessee
Hawaii	Utah
Mississippi	West Virginia
New Mexico	

Sources: Federation of Tax Administrators, The National Conference of State Legislatures, and the Center on Budget and Policy Priorities. Compiled by Think New Mexico. Note: Effective January 1, 2001, except as noted.

January of 2000 that will lower its sales tax on food from 4.5% to 1.5% by 2003. Louisiana law indicates that it intends to abolish its food tax by July 1, 2002.

(By contrast, we could find only one instance since the Depression of a state that had eliminated its food tax and then later acted to fully re-impose it. West Virginia gradually phased out its tax on food until it was completely eliminated in 1981, but then repealed the food tax exemption in 1989 during a severe fiscal crisis.)

A BRIEF HISTORY OF THE FOOD TAX IN NEW MEXICO

How did New Mexico get to the point where it is now one of only nine states in the nation that fully taxes food? The origins of the food tax can be traced back to the Depression. At that time, state and local governments in the United States relied heavily on the property tax. The Depression, however, caused a collapse in property values across the nation and in New Mexico .

EMERGENCY SCHOOL TAX/GROSS RECEIPTS TAX

To make up for the lost tax revenue, many states began to impose a sales tax. In 1930 Mississippi became the first state to levy a general sales tax. Twenty-three other states followed suit before the decade was over, according to the National Conference of State Legislatures. Today, all but five states levy some form of a sales tax or a gross receipts tax.

New Mexico was among the states in the first wave to pass a sales tax, which eventually became known as the "Emergency School Tax." The April, 1952 edition of the Tax Bulletin of the Taxpayers Association of New Mexico describes the evolution of the Emergency School Tax in New Mexico:

After the Depression started in the early 1930's ... the average tax rate in the State reached the high figure of \$36 per \$1,000 of assessed valuation of property. The requirements for schools constituted one half of this rate, and, at that, teachers were not paid the very modest salaries that were budgeted for them. Property owners rebelled, local taxpayers associations sprang up in every county of the State, 600 representatives converg[ed] upon the Capitol to interview the legislators of 1931, to demand a sales tax to relieve the burden of property taxes under valuation and rates that were piling up delinquent taxes and reducing the value of lands, so that the State assessment fell from \$405 million to \$285 million in a period of ten or twelve years.

The solution for the problem of the school support proposed was the enactment of the sales tax for the public elementary and high schools. This was endorsed by the school people and also by the property owners, as a replacement for part of the heavy taxes on property. At that

time, the tax rate for schools reached its limit of \$18 per \$1000 of assessed value. A bill was prepared for the sales tax in the 1933 Legislature for the support of the schools. It passed the House, but failed to pass the Senate by a narrow margin.

It was felt in the Senate that the sales tax would be just an additional tax, superimposed upon the high property tax, as has been the case in other states.

The Senate, the House and the Governor eventually compromised in a Special Session that year on a maximum 2.5% "license and occupation" tax imposed on retail sale of merchandise. The law exempted liquor, oil, natural gas, motor fuels and new and used automobiles, but not food.

In 1934 the law was reenacted as the Emergency School Tax, a temporary gross receipts tax on goods and services. In 1935, it was reenacted as a permanent gross receipts tax. (Please see footnote 1 on page 6 for a description of the distinction between a sales tax and the gross receipts tax.)

The emergency apparently lasted until 1962 when the Emergency School Tax was de-earmarked from the schools. The tax proceeds were sent instead to New Mexico's General Fund to which they continue to be distributed today. In 1966, the Emergency School Tax was replaced by a gross receipts tax on goods and services. Thus, food was taxed initially to fund the public schools, at least in theory, but now funds state government generally.

The statewide gross receipts tax rate has steadily increased in recent times. In 1966, the gross receipts tax increased from 2.5% to 3%. In 1969, it increased to 4%. In 1986, it increased to 4.75%. In 1990 it

NM Food Tax Timeline	
1933-1935	Emergency School Tax Enacted. Food not exempted.
1962	Emergency School Tax de-earmarked and flows to General Fund
1966	Statewide Gross Receipts tax rate increased from 2.5% to 3%
1969	Statewide Gross Receipts tax increased to 4%
1972	Low Income Comprehensive Tax Rebate enacted
1979	Food Tax Rebate enacted
1986	Statewide Gross Receipts tax increased to 4.75%
1990	Statewide Gross Receipts tax increased to 5.0%
1993	Food Tax Rebate repealed

Source: "History of New Mexico Taxes. Selected taxes –1909 to 2000," Tax Research and Statistics Office, New Mexico Taxation and Revenue Department. Compiled by Think New Mexico.

increased to 5% where it remains today. The statewide tax rate on food in New Mexico has, therefore, doubled from 2.5% to 5% between 1933 and 1990.

Meanwhile, New Mexico municipalities and counties got into the act with their own local "option gross receipts taxes." In 1955, the State authorized cities of over 75,000 residents to impose a sales tax

of up to 1%, which was extended to all cities in 1957. In 1968 the State authorized counties to have a county sales tax of .25% for the support of medical indigent funds.

Cities now receive an automatic distribution of 1.225% of the 5% State gross receipts tax, based on where the transaction occurred. In addition, cities can add up to 2.5625% on top of the statewide gross receipts tax. Counties can add up to 0.9375% on top of the 5% statewide gross receipts tax plus there is authority for special purpose rates for select counties on top of that. (The total gross receipts tax is paid to the State. The State keeps its portion and then distributes the counties' and municipalities' portions to them.)

This has resulted in a checkerboard pattern for gross receipts tax in New Mexico. Statewide, it ranges from a 5.125% rate in that portion of Catron County not within Reserve (6.0625%) to a 7.1875% rate in Ruidoso.

In the nearby chart, we show the effective gross receipts tax rate in New Mexico's ten largest cities where most New Mexicans live and buy their groceries. In Albuquerque, New Mexicans pay \$5.81 extra in taxes for every \$100 of groceries because of Albuquerque's effective tax rate of 5.8125%. In Raton, New Mexicans pay an \$7.00 extra in taxes for every \$100 of groceries because of Raton's effective tax rate of 7%. Just across the eastern border of New Mexico in Texas, however, \$100 of groceries costs \$100 because there is no food tax.

Like the cities and counties, special interests also got into the act, unfortunately. Over the years they have established a wide variety of exemptions and deductions for themselves from the gross receipts

Gross Receipts Tax Rate in New Mexico's Ten Largest Cities

Alamogordo	6.3125%
Albuquerque	5.8125%
Carlsbad	6.3125%
Clovis	6.375%
Farmington	6.0625%
Hobbs	6.00%
Las Cruces	6.375%
Rio Rancho	6.1875%
Roswell	6.5%
Santa Fe	6.4375%

Source: Gross receipts tax rate schedule from the New Mexico Taxation and Revenue Department effective July 1, 2001 through December 31, 2001. New Mexico's ten largest cities from New Mexico Blue Book 1999-2000 from the New Mexico Secretary of State's Office. Compiled by Think New Mexico.

tax. A Special Report by the Tax Research and Statistics Office of the Taxation Revenue Department in 1997 described each gross receipts deduction and exemption and estimated the cost of each. We counted 87 such deductions and exemptions in the report at a total cost to New Mexico taxpayers of between \$520,000,000 and \$770,000,000 annually.

Some opponents of exempting food from the gross receipts tax argue that it would "open the floodgates." But judging from the report from the Taxation and Revenue Department, one can only conclude that those floodgates have not been particularly effective at preventing the flood that seems to have already taken place.

Exemptions from the gross receipts tax include an exemption for the sale of boats ten feet or longer and an exemption for Jockey's and Horsemen's purses and race track commissions.

Deductions from the gross receipts tax include the sale of materials used in constructing or reconstructing railway roadbeds, the sale of chemicals to any mining, milling or oil company for use in processing ores or oil in a mill, smelter or refinery as well as the sale of chemicals in lots in excess of 18 tons. The sale of lottery tickets is also tax deductible.

In many cases these exemptions and deductions are simply subsidies to favored special interests disguised as tax relief which is why they are sometimes referred to as "tax expenditures." (For a more thorough discussion of "tax expenditures" in New Mexico, readers may wish to consult Think New Mexico's 1999 report, entitled "Setting Priorities: How to Pay for Full-Day Kindergarten.")



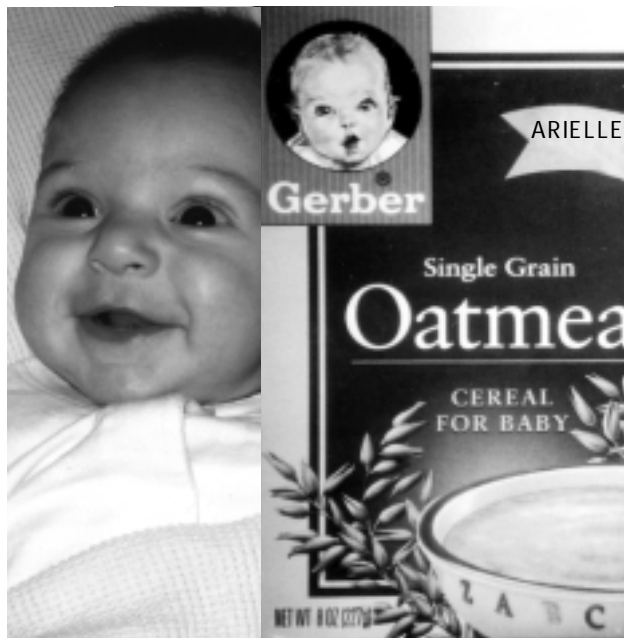
Horse feed is not taxed under the New Mexico gross receipts tax.

Of particular relevance to this report is the deduction for horse feed from the gross receipts tax, while baby food receives the full hit from the gross receipts tax. What does this suggest about our values and priorities in New Mexico?

THE LOW INCOME COMPREHENSIVE TAX REBATE PROGRAM

To address the regressive nature of the rising gross receipts tax in New Mexico as well as the property tax and the excise tax on gasoline, the Legislature considered a bill in 1971, suggested to them by University of New Mexico Economics Professor Jerry Boyle, to establish a "negative income tax."

The Legislature rejected the bill because as Bruce King, who was Governor in 1971, explained in his recent autobiography, *Cowboy in the Roundhouse*, a negative income tax "turned out to be a tough con-



Baby food is fully taxed under the New Mexico gross receipts tax.

cept for many people to master.” King said that after the 1971 legislative session:

...we took great pains to inform the citizens why poor people were entitled to a rebate from the state, even if they hadn't paid any tax at all. They had been paying more sales tax [gross receipts tax] in proportion to their incomes than any other group. It hit them harder. So we proposed refunding the money to them. In 1972, we changed terminology and called it a 'low-income [comprehensive] tax rebate,' or tax credit and this time the legislature passed the bill.

It is important to understand that the Low Income Comprehensive Tax Rebate (LICTR) program, as it is titled in law, was designed to offset all regressive state and local taxes in New Mexico, not just food. These included the gross receipts tax on prescription drugs (which was later exempted from the gross receipts tax by the Legislature and Governor Johnson in 1998), medical services, utilities like electricity, gas and telephone service, clothes and other goods and services, in addition to food. Hence, it is called a “comprehensive” rebate.

One major problem of the LICTR program is that historically it has over promised and under delivered. It promises to be “comprehensive,” yet the rebate itself covers less than half of the gross receipts taxes on groceries annually paid by a typical low-income New Mexico family. That, of course, leaves nothing to offset the gross receipts taxes paid by that same family on medical service, electric, gas and telephone bills, clothes etc. Moreover, because the rebate is not adjusted for inflation auto-

matically, it has eroded in value over time. The LICTR program, therefore, is limited in its scope.

Even after the Legislature and Governor Johnson expanded the LICTR program by \$10.5 million in 1998, it only totaled about \$25.3 million annually, according to figures compiled by Dr. O'Donnell, the former Taxation and Revenue Department economist. Because that pot of money is distributed to about 260,000 tax filers, according to Dr. O'Donnell, it translates to a rebate of slightly less than \$100 per filer. (The rebate can be as low as \$10 for some eligible filers with modified gross income between \$21,000 and \$22,000.)

Therefore, even if food were exempted tomorrow from the New Mexico gross receipts tax, the LICTR program would still be inadequate to neutralize the regressive impact of medical services, electric, gas and telephone bills, clothes and other goods and services. If food were exempted from the gross receipts tax, however, the LICTR program would have more money left over to address the regressive impact of those items. That way, LICTR would at least come closer to becoming “comprehensive.”

The LICTR is treated as an income tax rebate for administrative convenience. Many low-income households in New Mexico, however, have no income tax liability. If low-income taxpayers fail to file a tax form, they cannot claim the rebate. Thus, like Food Stamps, some eligible New Mexicans never receive the benefit of the LICTR program. Embarking on an outreach program to inform low-income filers of the benefit is a double-edged sword because it drives up the administrative expenses of the program and leaves less to distribute.

Forty-eight percent of low-income New Mexicans, who do file a tax form, pay someone to prepare their tax form for them, according to an October, 2000 study by the New Mexico Advocates for Children and Families (NMACF). This can be attributed to the fact that New Mexico's income tax form is complicated and intimidating. Illiteracy poses an additional barrier for some low-income filers. NMACF notes that many low-income filers opt for a "rapid refund" whereby the tax preparer pays the rebate to the low-income filer immediately. In Gallup, for example, a "rapid refund" costs 15% extra and the turnaround time on a tax refund filed electronically is three weeks. Fifteen percent of the principal on a three-week loan is equivalent to an annual percentage rate of 180%, more than ten times the extremely high rates charged on a credit card cash advance. The bottom line is that many low-income New Mexicans who file an income tax form only receive a fraction of the LICTR to which they are entitled.

In terms of food, a better and more efficient strategy would be to simply exempt groceries from the gross receipts tax altogether. That way every time you paid for groceries, you would, in effect, receive your tax rebate automatically and instantly at the check-out line without having to file a tax form or paying someone an exorbitant amount to do so on your behalf.

THE FOOD TAX REBATE AND ITS REPEAL

The Legislature enacted a food tax rebate in addition to the LICTR program in 1979 because it recognized the inadequacy of the LICTR program to offset the regressive effect of the food tax as well as the regressive impact of other taxes. Governor Bruce King, then serving his second term, explained in

Cowboy in the Roundhouse how the food rebate originated:

I wanted to do away with the gross receipts tax on food, but many legislators including Senator [Aubrey] Dunn were concerned about how that would affect the state's tax structure, so we compromised on a \$45 person tax rebate and a double rebate for citizens over 65 years old. The legislature reduced our proposed \$45 rebate to \$40, kept the doubling factor for those over 65, and passed the bill. The rebate went to every resident of the State, reimbursing them for sales tax they had paid for food, and it was a first in the nation.

In 1993, the Legislature and Governor King, then serving his third term, repealed the food tax rebate. Governor King did not comment on this action in his autobiography and the New Mexico Legislature does not maintain a legislative history. It is likely, however, that the food tax rebate was repealed because it suffered from the same public policy problems that plague the LICTR program.

OBSTACLES TO ENDING THE FOOD TAX IN NEW MEXICO AND HOW TO OVERCOME THEM

It is important to recognize that benign neglect is not to blame for the continued existence of New Mexico's food tax. In fact, in the last three years alone a half dozen bills have been introduced in the New Mexico Legislature to either end the food tax or to lessen its effect.

Significantly, the prime sponsors have been both Democrats and Republicans, rural and urban, Anglo, Hispanic and Native American and from both chambers of the Legislature. They include Senator Manny Aragon (D. Albuquerque), Senator Patrick Lyons (R. Cuervo), Representative Don Tripp (R. Socorro) and Representative Leo Watchman Jr. (D. Navajo).

We analyzed the obstacles confronting passage of these bills, which are outlined below. In each instance, we discuss how those obstacles might be overcome, sometimes using a different approach.

ADMINISTRATIVE INCONVENIENCE

One of the reasons given for not exempting food from tax in New Mexico is the difficulty of administration when you exempt food. That is, it is easier to tax everything than to make distinctions between goods, some of which are taxed and others that are not taxed at the checkout counter.

Here, it would be wise to study the experience of states that have recently acted to end the food tax. Georgia and North Carolina have simply adopted the definition of "food for home consumption" in Federal law used by the Food Stamp program in order to determine which foods will qualify for tax exemption. Thus, under this approach, food made exempt from tax in New Mexico would be the same foods that are eligible under the Food Stamp program.

The Food Stamp law excludes, of course, alcoholic beverages and tobacco products from the definition of "food for home consumption." It also excludes hot foods "ready for immediate consumption," essentially food one would be

served in a restaurant. The vast majority of foods found in a grocery store would be covered.

States that have not adopted the Food Stamp definition and have left the definition of food up to civil servants in the state tax department, have later regretted it. Usually the conflicts surround whether to exempt snack foods from tax. For example, in 1998 New York finally abolished its rule that marshmallows were subject to the state sales tax, but mini-marshmallows were not. The theory apparently was that mini-marshmallows were more like food in that they are used for cooking, whereas regular marshmallows, eaten alone were considered junk food and, therefore, worthy of tax. Now all marshmallows in New York are no longer deemed to be food and bear the sales tax.

Another advantage of piggybacking on the Food Stamp definition is that food retailers in New Mexico, as in every state, have for the most part already programmed their bar code scanners and cash registers to comply with the Food Stamp law. Therefore, if they adopt the Food Stamp definition, then they already know which items to tax and which not to tax. Thus, exempting food from the gross receipts tax and using the same Food Stamp law definition, would only require minimal one-time changes. After the changes are implemented, food retailers would only have to administer a single set of rules for everyone.

EFFECT ON STATE TAX REVENUES

By far the largest obstacle to ending the food tax is the lost food tax revenue.

We must rely on estimates for food tax revenue because the New Mexico Tax and Revenue Depart-

ment does not routinely break out gross receipts tax revenue for food. That would be virtually impossible to do since grocery stores sell both food and non-edible items like paper napkins. Meanwhile, general retailers, like Walmart (which recently entered the food retail business in New Mexico) and convenience stores, like Allsups, sell both food and other products. The total gross receipts are then reported to the State without regard to whether the products sold were food or something else.

Therefore, we asked Dr. Kelly O'Donnell, the former Senior Economist for the Taxation and Revenue Department, to calculate how much revenue the food tax will generate for the State as well as for cities and counties during the current fiscal year beginning July 1, 2001.

Dr. O'Donnell concluded that the food tax will generate about \$89.3 million for state and local government combined during the current fiscal year. As the nearby chart indicates, approximately 56% of that figure is the State's share, or about a little more than \$50 million. The cities, meanwhile, will collect about \$34 million, or 38% of the total. The counties' share is a little more than \$5 million or about 6% of the total.

To arrive at these estimated figures, Dr. O'Donnell obtained data from the 1998/1999 Consumer Expenditure Survey (CES), which is administered by the Bureau of the Census for the United States Bureau of Labor Statistics. The CES is an ongoing survey that provides detailed information on spending patterns for different types of American households. Dr. O'Donnell also obtained aggregate 1998 state personal income tax data for New Mexico. The combined data was then entered into a computer model that calculated the gross receipts tax paid on food. The estimate was then adjusted to reflect Food

Estimated Food Tax Revenue in New Mexico for Fiscal Year 2002

State	\$50,033,550	56%
City	\$34,099,299	38%
County	\$5,178,632	6%
Total	\$89,311,480	

Source: Dr. Kelly O'Donnell, former Senior Economist, New Mexico Taxation and Revenue Department. Compiled from a computer model using data from the 1998/1999 Computer Expenditure Survey of the United States Bureau of Labor Statistics and the New Mexico Taxation and Revenue Department.

Stamp purchases, on which no gross receipts tax is paid, and adjusted to 2002 dollars using food-specific inflation rates for the consumer price index.

During the 2001 regular session of the Legislature, Representative Leo Watchman introduced legislation to abolish the food tax. As it does with all tax legislation, the Taxation and Revenue Department submitted a Fiscal Impact Report to notify the Legislature of the bill's fiscal impact. The department concluded that there would be a \$94.6 million revenue loss. \$52.9 would be the State share and \$41.7 would be the local government share. These figures are remarkably close to the figures developed by Dr. O'Donnell for Think New Mexico.

The small difference can be explained, in part, by the fact that the department's estimate is based on the 1997 Census of Retail Trade (CRT) data, which is older than the CES data that Dr. O'Donnell used.

In the remainder of this section, we will address our approach to compensate the State for its portion of

the food tax revenue. In the next section, we will address how to make up the local government's portion of food tax revenue.

With regard to the State revenue portion, it is important to first place the potential lost food tax revenue in perspective. While \$50 million is certainly a lot of money, by any standard, it represents only slightly more than 1% of New Mexico's \$3.85 billion General Fund for the current fiscal year.

There are essentially three approaches for policy makers to compensate for the state portion of the revenue generated by the food tax.

One approach would be to simply phase out or end the food tax without replacing the revenue if policy makers decided that a tax cut was appropriate given the State's revenue forecast. This was the approach, for example, that the Legislature and Governor Johnson adopted when they exempted prescription drugs from the gross receipts tax in 1998.

A second approach for policy makers would be to cut spending to compensate for the revenue that would be lost once the tax on food is ended or phased out. That approach is difficult because nearly two of every three dollars of New Mexico's General Fund supports either the public schools, kindergarten through 12th grade, or higher education. (Think New Mexico adopted this approach when it suggested cutting specific non-essential and duplicative state government services in its 1999 report entitled, "Setting Priorities: How to Pay for Full-Day Kindergarten.")

A third approach for policy makers would be to obtain more revenue from other tax sources and, in effect, shift the revenue burden from the food tax to

a different tax or taxes. One advantage of a revenue neutral approach, such as this, is that it can be enacted during good or bad fiscal times. For that reason, we recommend that policy makers adopt this approach.

There are three obvious tax alternatives for a revenue neutral approach, all of which have major drawbacks.

One alternative is the property tax. However, only about 5.8% of property tax revenue goes to the State, according to the Taxation and Revenue Department. The remainder supports local governments, school districts, water control districts, hospital and health districts and community colleges. The property tax is also especially unpopular in New Mexico where land issues have been a hot and divisive topic for centuries. This owes in part to the history of the Spanish Land Grants, the Santa Fe Ring, which took advantage of Spanish speaking farmers and ranchers to steal their land during Territorial days and the Depression when many more New Mexicans lost their land. New Mexico's "Big Mac" tax revolt legislation (sponsored by State Representative Colin McMillan) built on this frustration and since then New Mexico's property tax has been among the lowest in the nation.

A second alternative is the income tax. However, New Mexico's highest income brackets, at 8.2% and 7.9%, are already very high relative to other states. They are also counterproductive in that they chase away doctors, entrepreneurs and others that New Mexico desperately needs to attract and retain in order to improve our economy and health care. Virtually no one supports raising income taxes on low and middle income New Mexicans.

A third alternative is the gross receipts tax. New Mexico, however, already has the sixth highest rate of state and local sales/gross receipts tax per capita in the nation at \$1,268 in 1997 dollars, according to the National Conference of State Legislatures. As a percent of income, New Mexico's per capita gross receipts tax paid ranks fourth. Moreover, New Mexico's tax system is already imbalanced in that it is too reliant on the gross receipts tax which, including the food tax, contributed 41% of General Fund revenues last year, according to the Taxation and Revenue Department

Taxes, indeed, are almost never good in themselves. An income tax, for example, is really a penalty on hard work and economic success. That is, the harder you work, the more you pay generally. The gross receipts tax is a drag on New Mexico's economy because by its nature the gross receipts tax discourages buying and selling. Also, it tends to be regressive.

An exception to this general rule, however, is the excise taxes on alcohol and tobacco. Like the other alternatives, they meet the first goal of any tax in the sense that they raise money to pay for government services, but they also do tangible good by reducing health problems, particularly among kids.

Of all the alternatives that we reviewed with regard to compensating the State for the tax revenue that would be lost by abolishing the food tax, raising these excise taxes made the most sense to us on a number of different levels, as discussed below. Thus, we recommend a proportionate increase in the cigarette tax earmarked to compensate the General Fund for the revenues that would be lost by ending the food tax.

The Tax on Cigarettes in New Mexico is Very Low for a Non-Tobacco Growing State

Under current New Mexico law, the State taxes by the cigarette, rather than by the pack. The tax is “one and five-hundredths cents (\$.0105) for each cigarette,” or slightly more than a penny per cigarette. That comes to twenty-one cents per package of twenty cigarettes. As the chart on the following page indicates, New Mexico’s cigarette tax rate is the 15th lowest in the nation.

However, we were curious to determine how many of the states that tax cigarettes more lightly than New Mexico, also grow tobacco. We consulted data from the Economic Research Service of the USDA and determined that ten of the fourteen states with lower taxes on cigarettes than New Mexico are states that grow tobacco. New Mexico, therefore, has the fifth lowest cigarette tax among non-tobacco growing states. That is reflected in our chart on the following page.

Think New Mexico Recommends Increasing the Cigarette Tax by Three Pennies per Cigarette, or Sixty Cents per Pack, to Compensate the General Fund for the Lost Food Tax Revenue

Specifically, we propose increasing the tax on cigarettes by three pennies per cigarette. That represents an increase from its current rate of one and five-hundredths cents (\$.0105) to a rate of four and five-hundredths cents (\$.0405). This is the equivalent of raising the tax on a package of cigarettes in New Mexico from twenty-one cents per pack, where it

has been since 1993, to eighty-one cents per pack. Because we have no expertise in economic modeling and specifically how much an increase in the cigarette tax will reduce consumption and increase the number of purchasers from tribal retailers, who are not subject to the tax, we asked Dr. Kelly O’Donnell to assist us in this endeavor.

Dr. O’Donnell analyzed studies by the U.S. Centers for Disease Control and Prevention, and based on those studies determined that a 1% increase in the price, including tax, of a pack of cigarettes, induces approximately a .25% decrease in tobacco consumption. So, for example, a 100% increase in price would lead to a 25% decline in consumption.



The impact of tax increases on cigarette sales by sellers not subject to the tax, like tribal retailers, has not been thoroughly researched. So Dr. O’Donnell made an assumption designed to err on the side of lower tax revenues generated by the tax increase. Dr. O’Donnell assumed that tax avoidance behavior is twice as price-sensitive as consumption. Therefore, Dr. O’Donnell assumed that a 1% increase in the price of taxed cigarettes would induce a .5% increase in sales by tribal retailers and out-of-state

retailers. So for example, a 100% increase in price would lead to a 50% increase in sales by tribal retailers or out-of-state retailers.

Next, Dr. O'Donnell determined from the Taxation and Revenue Department that there were 97,677,654 packs of cigarettes sold in New Mexico during the

How States Tax Cigarettes

STATE	CENTS PER PACK	STATE	CENTS PER PACK
New York	111.0	Florida*	33.9
Alaska	100.0	South Dakota	33.0
Hawaii	100.0	Arkansas	31.5
Maine	100.0	Pennsylvania *	31.0
Rhode Island	100.0	Idaho	28.0
California	87.0	Delaware	24.0
Washington	82.5	Kansas	24.0
New Jersey	80.0	Louisiana	24.0
Wisconsin *	77.0	Ohio *	24.0
Massachusetts *	76.0	Oklahoma	23.0
Michigan	75.0	New Mexico	21.0
Oregon	68.0	Colorado	20.0
Maryland *	66.0	Mississippi	18.0
District of Columbia	65.0	Montana	18.0
Arizona	58.0	Missouri *	17.0
Illinois	58.0	West Virginia *	17.0
New Hampshire	52.0	Alabama *	16.5
Utah	51.5	Indiana *	15.5
Connecticut *	50.0	Tennessee *	13.0
Minnesota	48.0	Georgia *	12.0
North Dakota	44.0	Wyoming	12.0
Vermont	44.0	South Carolina *	7.0
Texas	41.0	North Carolina *	5.0
Iowa	36.0	Kentucky *	3.0
Nevada	35.0	Virginia *	2.5
Nebraska	34.0		

* States with greater than \$1,000,000 in cash receipts from growing tobacco in 1997, according to the Economic Research Service of the U.S. Department of Agriculture.

Source: Federation of Tax Administrators "State Cigarette Tax Rates" as of March 31, 2001 and the Economic Research Service of the U.S. Department of Agriculture. Compiled by Think New Mexico.

2000 calendar year. Dr. O'Donnell also calculated the current average price of a pack of cigarettes in New Mexico at \$3.22. Then Dr. O'Donnell ran estimates for hypothetical cigarette tax increases from a penny to \$1.00 per pack, given the demonstrated sensitivity of cigarette consumption to increases in price and the availability of tax free cigarettes from some tribal retailers.

Dr. O'Donnell found that an increase of sixty cents per pack, or three pennies per cigarette, would increase the price of cigarettes by nearly 20% and would lead to an approximate 14% decline in the number of packs sold.

However, the increase would also generate \$50,416,230 in new revenues. That is enough to more than fully compensate New Mexico's General Fund for the revenue that would be lost by exempting food for home consumption from the state portion of the New Mexico gross receipts tax. That figure, as stated earlier, is \$50,033,550. That leaves a cushion in excess of \$350,000.

Dr. O'Donnell's prediction that an increase of sixty cents would cause a decline in consumption of 14% is consistent with the experience of Alaska when it recently implemented a seventy-one cent tax increase on a pack of cigarettes. In 1997 Alaska's Legislature increased the cigarette tax from twenty-nine cents to a dollar per pack and observed a decline in cigarette sales of 17% and an increase in tobacco tax revenue from \$1.5 million to \$4.3 million, according to a study by the Alaska Department of Revenue. This is a particularly apt comparison because Alaska, like New Mexico, has a large Native American population.

Think New Mexico Recommends a Proportionate Phasing In of the Cigarette Tax Increase, While Phasing Out the State Portion of the Food Tax

Rather than imposing this three-penny tax increase on each cigarette sold in New Mexico all at once, we recommend phasing it in over three years. In other words, we would increase the tax on a cigarette by a penny per year or twenty cents per pack for three consecutive years. That would generate about \$16.8 million per year in new revenue for the General Fund.

Simultaneously, we would decrease the state tax on food by equal installments of one third or about \$16.7 million per year each for three consecutive years until the state portion of the food tax is completely phased out.

The major advantage of phasing in the tax increase on cigarettes while phasing out the state portion of the food tax is that it permits mid-course corrections, if necessary. (This is also the preferred approach of the states that have acted recently to implement tax exemptions for food, like Georgia and North Carolina. Both took three years to phase out the food tax. Virginia is also currently in the process of phasing out its food tax over several years, rather than all at once.)

If, for example, the lost food tax revenue in the first year was outstripping the additional cigarette tax revenue and the cushion, then the deficit could be made up by a modest tax increase on other tobacco products. These include chewing tobacco, pipe tobacco, cigars, snuff, smokeless tobacco and loose

tobacco. Another alternative would be to repeal the volume discount on taxes paid by tobacco distributors, who are mostly out of state businesses. (This, incidentally, is the only instance of a volume discount that we could find anywhere in New Mexico's tax code.) In this way, it can be insured that the net effect of our proposal is revenue neutral.

The Proposed Cigarette Tax Increase Would Stop as Much as 20 Percent of New Mexico Youth from Starting to Smoke

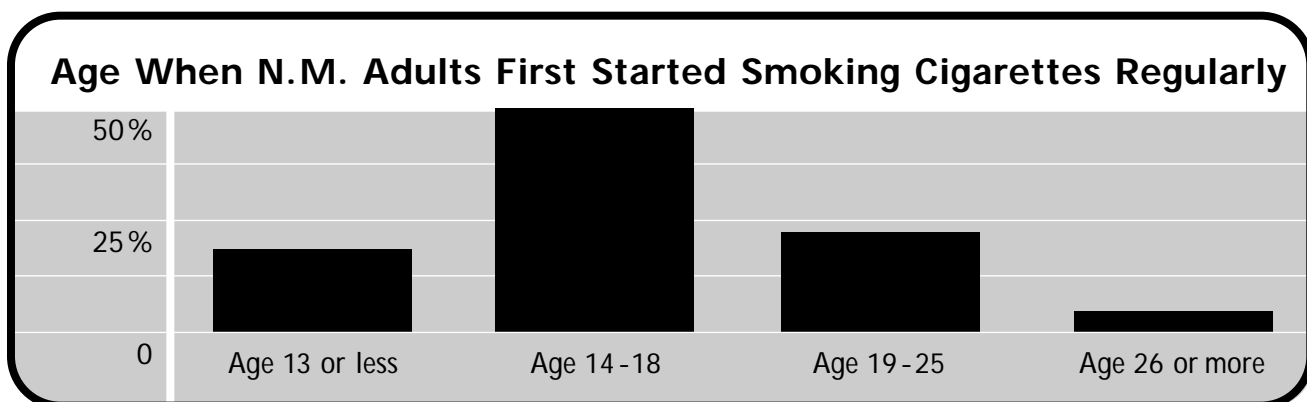
Even with this proposed cigarette tax increase, New Mexico's tax on cigarettes would still be lower than the current cigarette tax in at least seven other states, according to the chart on page 24. (That assumes too that no other state raises its tax above eighty-one cents per pack of cigarettes during our proposed three-year phase-in period.) At the end of three years, New Mexico would then have the eighth highest tax on cigarettes in the nation. However, New Mexico would no longer have the fifth highest tax on food and could join the ranks of the overwhelming majority of states, which do not tax food. If the choice for New Mexico is between hav-

ing a high tax on food or a high tax on cigarettes, we would select the latter.

That is because in addition to its ability to offset the state portion of the food tax, an increase in the tax on cigarettes will reduce overall consumption which will positively impact a variety of public health problems in New Mexico that are adversely affected by tobacco. The most important effect would be a dramatic decrease in the number of kids starting to smoke.

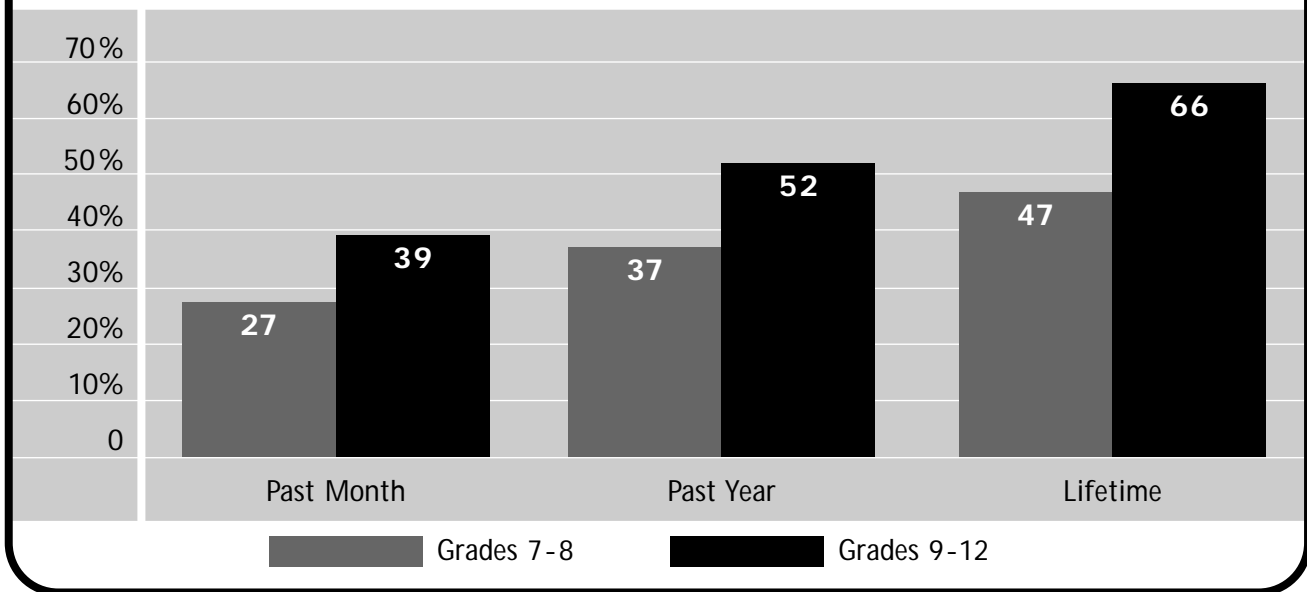
That would be a welcome development. A poll of New Mexico adult smokers by the Department of Health indicates that more than half started smoking between the ages of 14 and 18. Nearly one quarter reported starting at age 13 or younger. That is particularly troubling when you consider this in conjunction with the fact that 52% of New Mexico high school students and 37% of middle school students reported smoking in the prior year, according to a recent New Mexico Department of Health study. The Department also states that if current trends continue, 33,000 New Mexico youth alive today will die prematurely from smoking.

The demographic group that would be most economically sensitive to a sixty cent per pack increase



Source: New Mexico Department of Health and Research Polling, Inc. Random telephone survey of 905 New Mexico adults statewide who are current smokers; conducted March, 2001.

New Mexico Youth Smoking Rates



Source: New Mexico Department of Health. 1997 School Survey. Note: excludes Albuquerque Public Schools.

in a pack of cigarettes is teens. Why? Because teens have the least amount of disposable income of any demographic group and are therefore the most price sensitive to increases in the price of tobacco. (The sales rate of cigarettes to underage persons in New Mexico, is 23%, according to the National Office on Smoking and Health in 1998.) The Health Science Analysis Project estimates that youth are about three times more sensitive to price than adults.

A ten percent increase in price of a pack of cigarettes will decrease the odds of teenagers starting to smoke by as much as ten percent, according to a April, 2001 national study of 12,000 8th and 10th graders over a seven year period by researchers at the University of Michigan's Institute for Social Research and the University of Illinois. A sixty-cent tax increase on a three-dollar pack of cigarettes would raise the price by about 20% and could then be

expected to reduce teen smoking by as much as 20%. Given that about 75% of adult smokers in New Mexico began smoking regularly before they were 18, it is not difficult to understand how effective increasing the cigarette tax could be in discouraging a substantial number of youth from starting to smoke in New Mexico.

The bottom line of the study, as the researchers noted, is that the laws of economics do apply to youth smoking and increasing the price of cigarettes will decrease the number of youths who start smoking.

The Cigarette Tax Should be More Like a User Fee that Reflects the Actual Social Costs of Smoking

It is important to recognize that there is nothing magical or scientific about where the tax on ciga-

rettes is set in New Mexico. From what we can discern, the amount of the current cigarette tax seems to represent a rough sort of political equilibrium between the relative political power of the tobacco industry and the anti-tobacco activists in New Mexico.

What Think New Mexico is proposing instead is something like a user fee in which the consumer pays a tax that is closer to the actual social costs of smoking. Otherwise, the costs of treating heart attacks, emphysema and lung cancer will continue to be borne by the nonsmoker through higher taxes and, to some degree depending on the circumstances, higher health care premiums.

The direct and indirect costs of smoking totaled over \$432 million in New Mexico in 1996, the last year for which it was calculated, according to the New Mexico Department of Health's 2000 Annual Report. That includes \$170 million in health care costs and \$262 million in lost productivity from illness and premature death.

In contrast to these figures, the tobacco industry will pay approximately \$25 million per year for 25 years to New Mexico as part of a multi-state settlement. Tobacco consumers spend another approximately \$25 million in taxes on cigarettes and other tobacco products, according to the Legislative Council Service's "Index to Revenue Sources of New Mexico." In fairness to the tobacco industry, there is also some merit to the argument that Philip Morris recently made to the Czech Republic that because cigarettes cause premature death by an average of 5.23 years, these "indirect positive effects" allow the government to spend less on public services. The same logic applies in New Mexico.

Even with an increase of sixty cents per pack of cigarettes, however, tobacco will still not be paying its way, but at least it will be somewhat closer.

The Likely Tobacco Industry Arguments Against a Tax Increase are not Persuasive

If history is any guide, we expect that our proposal will cause the tobacco lobbyists to raise the scary specter of black markets and smuggling. This is generally done through the American Legislative Exchange Council, a lobbying group with significant financial ties to the tobacco industry. It should be understood, however, that most of the tobacco smuggling in the world takes place outside of the United States for the simple reason that tobacco prices are cheaper here and, therefore, smuggling is more lucrative elsewhere. On taxes alone, "most developed countries have at least double the average tax in the United States," according to "Reducing Tobacco Use: The Report of the Surgeon General (2000)."

It should be noted that cigarettes are less expensive in Mexico than in New Mexico, but the Surgeon General states, "no empirical evidence supports the contention of significant smuggling of cigarettes from Mexico into the United States." The Surgeon General explains that it is quite difficult to smuggle large quantities of a bulky product like cigarettes across a heavily guarded border.

Ironically, one of the largest sources of tobacco smuggling comes from the tobacco industry itself. Senior tobacco industry executives have been convicted of smuggling-related offenses in Hong Kong and Canada. A wholly owned subsidiary of R.J.

Reynolds Tobacco Company pleaded guilty to charges related to its involvement in smuggling cigarettes from the United States into Canada, according to the World Conference on Tobacco or Health. In addition, Columbia's provincial governments have filed suit against Philip Morris alleging that Philip Morris defrauded them of billions of dollars in revenues through a complicated smuggling and money-laundering scheme. Ecuador has filed a similar suit against both Philip Morris and R.J. Reynolds.

Interstate smuggling of tobacco is regulated by the Federal Trafficking in Contraband Cigarettes Act of 1978 and has led to a significant reduction in interstate smuggling by prohibiting the transportation, receipt, shipment, possession and distribution of cigarettes without the tax indicia of the state in which the cigarettes are found. Indeed, the Alaska Department of Revenue reported that smuggling did not increase as a result of Alaska's 71 cent per pack tax increase in 1997.

There are other specific steps that New Mexico can take to reduce the potential threat of smuggling. For example, Think New Mexico's proposed three-year approach to phase-in a penny increase per cigarette per year should mitigate any price spikes significant enough to engender smuggling. Second, Think New Mexico recommends increasing the penalties under New Mexico law for selling cigarettes without tax stamps (indicating the tax has been paid to the state) from a fine of between \$100 and \$500 and up to 90 days in county jail to something a little more severe. We would also move jurisdiction from Magistrate Court, where judges are not required to be law school graduates, to State District Court. Third, Think New Mexico recommends appropriating \$100,000 from the cigarette tax increase to the

Taxation and Revenue Department to increase enforcement and audit and compliance measures to deter smuggling.

The other likely line of attack tobacco lobbyists will employ is to question why just one product is being singled out to make up the revenue lost by eliminating the food tax. One answer to that question is that tobacco is the only legal product on the market that, when used as intended, causes death. It is, therefore, deserving of a special tax status.

EFFECT ON LOCAL GOVERNMENT TAX REVENUE

Opposition from local governments has been another major obstacle to abolishing the food tax. Ending the food tax could negatively affect the cities and counties in two ways.

First, cities currently receive about \$34 million and counties currently receive about \$5 million from the gross receipts tax on food, as our chart on page 21 documents. If that revenue is not replaced somehow, then cities and counties across New Mexico would be forced to either cut services or raise taxes.

Second, a drop in a particular local government's tax revenue caused by elimination of the food tax could affect that local government's bond rating. Many cities and counties in New Mexico bond against gross receipts tax revenue, including food tax revenue, to pay for new capital projects. Lower ratings on bonds by bond-rating agencies lead to higher interest rates that localities must repay.

These are legitimate concerns. The solution to both issues is to give cities and counties a new source of tax revenue. That way, cities and counties could both

replace the revenues that would be lost from the food tax revenue and have an alternative revenue stream that they can bond against.

Here, Think New Mexico recommends that cities and counties be given the statutory authority to raise tax revenue by taxing alcohol. Currently, New Mexico law forbids cities and counties in New Mexico from taxing alcohol without the specific permission of the New Mexico Legislature. Such authority, however, should be made contingent on a city or county acting to make food exempt from the local gross receipts tax in its jurisdiction.

Under our proposal, every city and county government in New Mexico would, therefore, have a choice as to whether to tax food or alcohol. A city or county government could choose to stick with the status quo if they prefer their current tax structure. The bottom line, however, is that it would be voluntary and the decision would be made locally on the basis of local interests. Conceivably, a local government could even choose not to tax either food or alcohol. Some portions of Roosevelt County and Curry County, for example, are dry.

It is not unusual nationally for localities to have tax authority over alcohol. Seventeen states currently give localities the authority to tax alcohol, according to the National Conference of State Legislatures.

It is both logical and reasonable for local governments to have this authority because they incur the full variety of direct social costs from alcohol abuse. These costs include substance abuse prevention programs, local treatment centers, local law enforcement, local courts, jails, alcohol detoxification centers, emergency personnel and local public healthcare.

The Albuquerque Journal estimated the statewide cost of alcohol abuse at approximately \$1 billion—



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roughly the cost to operate Los Alamos Labs - in a 1995 series, entitled, "Hitting Bottom: Alcohol in New Mexico." Some of these expenses are borne by state taxpayers, but a lot is borne by local taxpayers too.

Alcohol-related social costs are especially high in New Mexico because we rank at the top of a variety of national alcohol abuse indicators. For example, New Mexico ranks highest in the nation for our rate of chronic liver disease and cirrhosis deaths per capita, according to a 1999 survey by the University of Missouri. New Mexico ranks fourth highest in the nation for our rate of alcohol-involved highway deaths per capita, according to the National Highway Traffic Safety Administration.

In addition, the Office of the Medical Investigator estimates that alcohol is involved in about 47% of all suicides and 55% of all homicides in New Mexico. Likewise, alcohol is estimated to be involved in 80% of emergency room admissions and 90% of domestic violence incidents in New Mexico, according to the Albuquerque Journal series.

Again, as with cigarettes, the most likely demographic group to be affected by a tax increase on alcohol would be youth since they have the least



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amount of disposable income. The 1997 New Mexico School Survey of about 27,000 New Mexico youth found that 29% of 7th through 12th grade students had the kinds of problems with drinking that are typical of alcohol abuse or dependence. A local tax increase on alcohol will stop some teens from drinking, which is when many alcohol abuse problems begin.

At almost every legislative session for the past decade, a parade of local mayors and county commissioners have petitioned the Legislature to allow their communities the right to hold a local option election to enact a tax to address some of these problems.

That permission has only been granted once in 1989 when the Legislature enacted the Local Liquor Excise Tax Act, essentially restricted to McKinley County. It granted the county permission to conduct a local option tax election on the sale of alcohol to combat one of the highest DWI rates in the nation. Local voters approved it overwhelmingly. Since the tax was enacted DWI rates have declined dramatically. The local option tax is still in effect today.

In 1993, the Legislature also set aside a small portion of the state alcohol excise tax to be distributed back to local communities through a grant program at the state level. This was done at the behest of the liquor lobby, which does not want to potentially fight tax proposals in 102 New Mexico municipalities and 33 New Mexico counties.

The liquor lobby, of course, can be counted on to oppose our proposal. They frequently complain about the level of taxation on their clients' products, but even with those taxes a sixteen ounce can of beer still sells for about 30 cents less than a 16 ounce carton of milk and about 60 cents less than a 16 ounce carton of orange juice in New Mexico.

In fact, all of the usual arguments against raising taxes of alcohol-or tobacco- do not apply within the context of pairing them with abolishing the food tax. For example, the liquor lobby will argue that alcohol taxes are regressive. However, the alcohol tax, like the tobacco tax, if they are regressive, are much less regressive than the food tax. Moreover, the low-income population is the most harmed by tobacco and alcohol, which impose massive costs on them in terms of death, health care expenses and lost wages. The low-income are also more likely to benefit because they are more likely to quit or cut back in response to a tax increase.

Another argument that the liquor lobbyists will make is that Mom and Pop retailers will lose sales of alcohol and tobacco to neighboring states with lower taxes. But what about all the Mom and Pop grocers on the New Mexico side of the border who have to compete against Texas grocers who have no state or local food tax to impose, and Arizona and Colorado grocers who only impose a local food tax, if any?

CONCLUSION

"The government taxes us from cradle to grave. The least it can do is give us a break for dinner."

ZELL MILLER, former Governor of Georgia and food tax opponent

Who would benefit from exempting food from tax in New Mexico? Low and moderate income New Mexicans who pay a large percentage of their income on groceries would be winners. So would large families, which in New Mexico tend to be disproportionately Hispanic and Native American. Those on fixed incomes, like the elderly, would also benefit. Another big winner would be New Mexico's agricultural community. An exemption for food from the gross receipts tax would lower the price of fruits and vegetables relative to the price of other goods. That would increase consumption of their products.

The biggest winners, perhaps, would be the thousands of hungry New Mexicans, particularly children, who have fallen through the rather large cracks of the Food Stamp Program and for whom the Low Income Comprehensive Tax Rebate does not go far enough.

Who would benefit from increasing the tax on cigarettes and giving local governments the authority to tax alcohol? First, all of the same groups listed above since these measures will pave the way for ending the food tax. Second, New Mexico's youth would enjoy lower rates of addiction to alcohol and tobacco, better health and longer lives. Third, small businesses, often noted for being the backbone of New Mexico's economy, would benefit because lower smoking and alcohol abuse rates would make health insurance more affordable and reduce premiums that are currently skyrocketing in New Mexico. This is absolutely critical to our future and our economic viability as a state.

This report poses a choice between food on one hand and alcohol and tobacco on the other. If alcohol and tobacco paid all of the social costs that they impose on society, it would no longer be necessary to impose a tax on food. Another way to look at it is that food tax revenue has been implicitly subsidizing the alcohol and tobacco industries in New Mexico for a long time.

New Mexico needs a bold strategy like the one described in these pages if it is going to change its position in the national ranking of states, such as New

Mexico's ranking as the state with the highest percentage of households suffering from hunger.

It should be emphasized that our proposals are revenue neutral. Therefore, they do not need to compete with or get in the way of pending proposals by others to cut income taxes or to increase spending on the public schools.

Because so many New Mexicans live paycheck to paycheck, it is likely that an exemption for food would be spent immediately. That would stimulate other segments of New Mexico's economy.

Given the events of September 11, 2001 and the difficult economic times facing New Mexico, like the rest of the nation, now is the time to begin to end the food tax.

In concluding, it is worthwhile to ask, if our governor and our legislature were creating our tax system anew to generate sufficient revenues to provide government services, would they tax food?

That brings us back to the quote by Erasmus with which we began this report and the role of the "Good Prince."

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