

Research Report



How Does New Hampshire Do It? An Analysis of Spending and Revenues in the Absence of a Broad-based Income or Sales Tax

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Executive Summary

New Hampshire is unique in New England in that it levies neither a broad-based income nor sales tax. Although high property tax bills, education mandates handed down by the courts, and fiscal crises past and present have led some Granite Staters to question the continued feasibility of this approach, the state has thus far maintained its course.

New Hampshire's ability to avoid a broad-based tax stems partly from the fact that governments there simply spend considerably less, on average, than their neighbors. In fiscal year (FY) 2007, New Hampshire state and local governments combined spent \$6,442 per capita—20 percent less than the New England average. The difference is even starker if we consider state government alone.

Observing New Hampshire's lack of broad-based taxes and low public spending, other states around the region have asked whether they can emulate the state's fiscal model. This paper explores the Granite State's spending and revenues, to shed light on how it has avoided a broad-based income or sales tax. The analysis examines the factors that drive New Hampshire's lower-than-average per capita spending, and the revenue sources the state relies on to pay for that spending in lieu of an income or sales tax.

How New Hampshire does it: The spending side

New Hampshire governments spend less per capita than those in *most* other New England states in *most* areas of government, but particularly in public welfare programs.

New Hampshire does not have uniformly lower per capita spending across all areas of government. However, it does rank at or near the bottom of the region in the vast majority of areas. The Granite State differs most

markedly from the regional average in public welfare expenditures—a category dominated by Medicaid. Lower spending in this category alone accounts for nearly one-third of the gap between New Hampshire's overall spending and the regional average.

New Hampshire's below-average spending is due in part to circumstances beyond government's direct, near-term control.

New Hampshire is a high-income state with a low poverty rate. These favorable circumstances reduce the need for government services. At the same time, the state faces lower underlying input costs than some parts of the region. An analysis of expenditure need—the amount a state would need to pay to provide services on par with the regional average, given its circumstances—reveals that lower underlying need for services and lower input costs account for around 40 percent of the gap between New Hampshire's per capita spending and the New England average. In public welfare—the area where the Granite State's spending diverges most sharply from the region's—those circumstances account for close to 80 percent of the gap.

The Granite State's lower spending is also due partly to policy choices.

The remaining 60 percent of the spending gap stems at least partly from the fact that New Hampshire governments have made choices to limit the size or scope of public services. Although comparing overall service levels is challenging, one can certainly point to areas where the Granite State has chosen to limit the reach of government. Examples include the state's restrictive income eligibility criteria for Medicaid, the absence of state-funded pre-kindergarten education programs, and the limited availability of public hospitals. These

examples give some credence to the conventional wisdom that New Hampshire's low spending reflects a commitment to limited government—even if it is not the full story as pundits might imply. The state has also made choices that have shifted costs away from current (and past) taxpayers in areas such as higher education and public employee pensions. These choices have also reduced the need for more tax revenues without necessarily leading to lower service levels.

How New Hampshire does it: The revenue side

Although property taxes are an important piece of New Hampshire's revenue picture, the state government obtains funds from a diverse set of sources.

While New Hampshire has the lowest total per capita revenues in the region, its per capita property tax collections are high compared with most other New England states. Per capita combined state and local property taxes in the Granite State were more than \$300 (or 16 percent) higher than the regional average in FY 2007. Property taxes also represented a larger share of total state and local revenues than elsewhere in the region.

However, New Hampshire's *state* government revenue system is considerably more diverse than those of its regional counterparts. Indeed, no single revenue source accounted for more than 20 percent of combined unrestricted general and education fund revenues in FY 2007. The statewide property tax was the state's largest revenue source that year (16 percent), followed by the state's two major business taxes, the business profits tax (15 percent) and the business enterprise tax (11 percent). New Hampshire state government also obtains revenue from a variety of other sources, including taxes on meals and rooms, tobacco, communications, real estate transfers, and interest and dividends, as well as various non-tax sources.

New Hampshire does impose a tax on wage and salary income through its unique business enterprise tax.

A distinctive feature of the Granite State's revenue system is its approach to business taxation. While New Hampshire's business profits tax is comparable in structure to corporate taxes in many states, the state's business enterprise tax (BET) is very different. The BET is based on a business's "enterprise value tax base," which is composed of wages and salaries as well as the interest and dividends the business pays. Thus New Hampshire does tax wage and salary income—just not in the typical fashion. The BET differs from a typical income tax in that it is imposed on businesses rather than individuals, and it is a flat tax with a lower rate than most state income taxes.

The state uses a low-tax (or no-tax) strategy on tobacco and liquor to attract non-resident purchases and boost revenues.

New Hampshire has historically had one of the lowest tax rates on cigarettes in the region, and levies no tax on liquor sales. These strategies serve to attract significant cross-border purchases. Because New Hampshire sells all hard liquor through state-owned and state-operated outlets, it nets revenue on liquor sales despite the absence of a tax. Combined revenue from the tobacco tax and liquor sales and distribution accounted for around 12 percent of the state's general and education fund revenues in FY 2007.

New Hampshire has had great historical success bolstering its general fund through creative Medicaid financing arrangements.

Since the early 1990s, states have found ways to capitalize on loopholes in Medicaid funding rules to maximize federal matching dollars. New Hampshire appears to have been more successful than most at using these creative

financing arrangements to bolster its general fund. Although the federal government has tightened its rules, New Hampshire and other heavy users of these arrangements have in some cases been grandfathered into continued higher funding. This funding—known as net Medicaid enhancement revenue—accounted for around 4 percent of the state’s general and education fund revenues in FY 2007.

Implications

This paper reveals no single silver bullet for policymakers in other states who aim to emulate New Hampshire’s fiscal model. In fact, the analysis reveals some impediments. The Granite State’s ability to avoid an income or sales tax and maintain relatively lower spending levels reflects a mix of circumstances and choices. States with higher costs or needier populations may simply need to spend more than New Hampshire does to provide a given level of services. Some choices made by New Hampshire policymakers may also be infeasible in the current environment, or inappropriate in states with different public preferences.

Although the paper does not provide specific policy prescriptions, it can serve as a springboard for discussion among policymakers in states across the region—including New Hampshire—as they grapple with how to provide services in fiscally challenging times.

How Does New Hampshire Do It? An Analysis of Spending and Revenues in the Absence of a Broad-based Income or Sales Tax

Introduction

New Hampshire is unique in New England in that it levies neither a broad-based income nor sales tax. Indeed, New Hampshire is one of only two states in the nation—Alaska being the other—that can currently make that claim.¹

Although high property tax bills, education mandates handed down by the courts, and fiscal crises past and present have led some Granite Staters to question the continued feasibility of this approach, the state has thus far maintained its course. This is undoubtedly due partly to the state's strong anti-tax culture, exemplified by “the pledge”—a longstanding tradition in which candidates for state office promise to oppose any broad-based income or sales tax.²

Unlike Alaska, which remains a high-revenue and high-spending state despite its lack of an income or sales tax, New Hampshire's overall revenues and spending are considerably lower on a per capita basis than both regional and national averages (see Figures 1 and 2).³ According to U.S. Census Bureau data, New Hampshire state and local governments reported \$6,504 in per capita revenues in fiscal year (FY) 2007—22 percent below the New England average—and \$6,442 in per capita direct expenditures—20 percent below the regional average. If we consider state government alone, the differences between New Hampshire and the regional average are even starker.

Observing the Granite State's lack of broad-based taxes and lower spending, New Hampshire's neighbors—some dubbed with monikers such as “Taxachusetts” or “Taxation Land”—have often asked whether the

Figure 1. New Hampshire's overall per capita revenues are low relative to the region and the nation
Combined state and local revenues, FY 2007



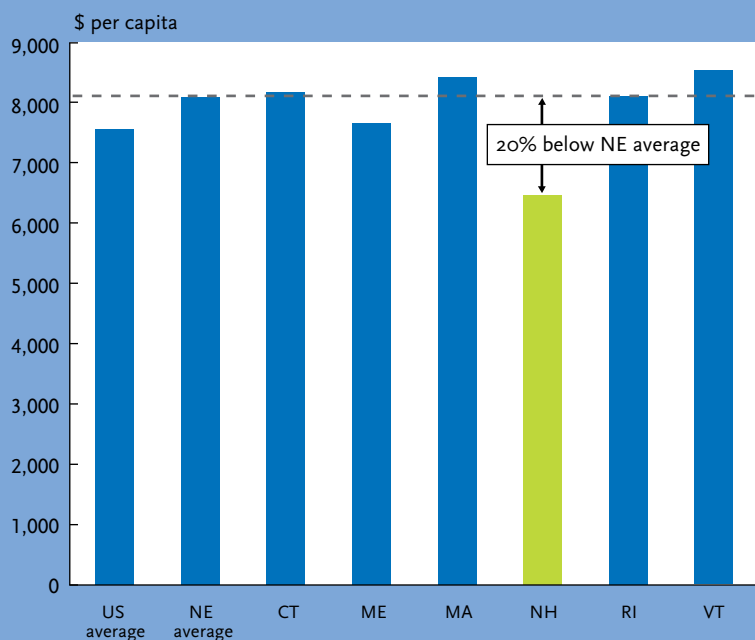
Source: Author's calculations based on data from the US Census Bureau, 2007 Census of Governments and US Census Bureau state population estimates.
Note: Figure excludes revenues associated with utilities, liquor stores, and social insurance trusts. Population data used in per capita estimates are adjusted to reflect the fiscal year. Averages are population-weighted.

state is a model they can emulate. Indeed, fiscal conservatives near and far often hold up New Hampshire—rightly or wrongly—as an example of how a state can keep government small without sacrificing essential public services. Proponents of the 2008 referendum calling for repeal of the Massachusetts personal income tax are a case in point.⁴

This line of thinking is also reflected in a 2009 opinion piece in the *Wall Street Journal*,

Figure 2. New Hampshire's overall per capita spending levels are also low relative to the region and the nation

Combined state and local direct expenditures, FY 2007



Source: Author's calculations based on data from the US Census Bureau, 2007 Census of Governments and US Census Bureau state population estimates. Note: Figure excludes expenditures associated with utilities, liquor stores, and social insurance trusts, as well as intragovernmental expenditures such as pension contributions. Population data used to calculate per capita estimates are adjusted to reflect the fiscal year. Averages are population-weighted.

in which economists Arthur Laffer and Stephen Moore looked to the Granite State to illustrate their arguments for lower taxes:

Those who disapprove of tax competition complain that lower state taxes only create a zero-sum competition where states “race to the bottom” and cut services to the poor as taxes fall to zero. They say that tax cutting inevitably means lower quality schools and police protection as lower tax rates mean starvation of public services.

They’re wrong, and New Hampshire is our favorite illustration. The Live Free or Die State has no income or sales tax, yet it has high-quality schools and excellent public services. Students in New Hampshire public schools achieve the fourth-highest test scores in the nation—even though the state spends about \$1,000 a year less per resident on state and local government than the average state and, incredibly, \$5,000 less per person than New York.⁵

One concern with the example presented by Laffer and Moore is that it fails to account for the variety of factors that contribute to both New Hampshire’s low spending and strong educational outcomes—some of which are beyond the state’s immediate control. It also provides little insight for policymakers in other states who are interested in unraveling the mystery of how the Granite State is able to keep spending low and pay for that spending in the absence of a broad-based tax.

In this paper I explore New Hampshire’s spending and revenues, to provide insight into how the state has succeeded in avoiding a broad-based income or sales tax. I focus on two key questions:

1. What factors drive the state’s low spending?
2. What revenue sources does the state actually rely on to pay for that spending?

To address the first question, I compare New Hampshire’s expenditures with those of the other five New England states and the regional average. Through these comparisons, I seek to determine in which areas the Granite State spends less than its regional peers and why it spends less. In particular, I analyze the degree to which New Hampshire’s spending is influenced by policy *choices* versus *circumstances* that are outside government’s direct, near-term control.

To address the second question, I outline New Hampshire’s major sources of revenue and their relative magnitude. I also point out several features of the Granite State’s revenue system—beyond the absence of an income or sales tax—that help distinguish it from other states in the region.

Note that in this paper I do not address whether—or to what extent—the Granite State’s tax and spending policies drive the state’s relatively strong economic performance. While New Hampshire’s economic success heightens interest in the state’s fiscal approach, quantifying a relationship between the two is challenging. Indeed, a number of factors likely contribute to the Granite State’s economic performance, including, but not

limited to, an educated workforce, the regulatory climate, and quality of life. Isolating the role of the state’s fiscal policies is beyond the scope of this paper.

Finally, although the paper focuses on decoding one particular state’s fiscal structure, it also provides comparative data on all six New England states and offers a framework for considering the factors underlying differences in expenditure levels. By doing so, it aims to inform stakeholders considering fiscal reforms across the region.

Methodological notes

Comparison states. Understanding how New Hampshire has avoided a broad-based sales or income tax requires considering how the state differs—or does not differ—from other states. Many criteria are available for selecting comparison states, such as geographic proximity, comparable demographic profiles, or similar economic growth paths.

For this report I have chosen to compare New Hampshire to the other five New England states. I base this choice on the premise that geographic proximity fosters competition for jobs, businesses, and population, and that states tend to consider the

policies of their regional neighbors as a result. While New England states do share certain characteristics—such as cold winters and a heavy reliance on town and city forms of local government—they also feature various differences beyond their respective revenue and spending patterns.

Some of these are highlighted in Table 1, which compares the six New England states along several socioeconomic, demographic, and geographic measures. This table reveals that New Hampshire had the highest median household income and lowest percentage of residents living in poverty in the region—one indication of how New Hampshire differs from its regional counterparts (though Connecticut’s numbers are similar).⁶ In this paper I examine how some of these differences affect the state’s ability to eschew broad-based taxes.

Data. Comparing financial data from individual states can be challenging, as they can vary in how they organize their activities and accounting structures, both within and across levels of government. Thus, for cross-state comparisons of spending and revenues, I rely predominantly on the U.S. Census Bureau’s

Table 1. New Hampshire has the highest median household income and lowest poverty rate in the region

Selected characteristics of New England states, FY 2007

	CT	ME	MA	NH	RI	VT	NH rank
Population	3,486,898	1,316,136	6,482,837	1,314,619	1,057,603	620,223	4
Land area (square miles)	4,843	30,854	7,801	8,952	1,034	9,217	3
Population density (per square mile)	720	43	831	147	1,023	67	4
Median household income (dollars)	65,976	48,568	60,038	67,508	55,639	51,809	1
Percent below poverty line	8.1	12.5	9.9	7.5	11.6	10.2	6
Percent minority	25.4	4.4	20.1	6.4	20.6	4.5	4
Percent under age 18	23.4	21.2	22.4	22.6	22.1	21.3	2
Percent aged 65 or over	13.5	14.7	13.3	12.5	13.9	13.4	6

Source: US Census Bureau, various sources. Includes some calculations by author.

Note: Minority population calculated as total population minus white, non-Hispanic population. Median household income is from the Current Population Survey. It is the simple average of three inflation-adjusted single-year medians. Data are adjusted to reflect the fiscal year by taking a simple average of 2006 and 2007 estimates.

Table 2. New Hampshire governments spend less per capita than the region in most categories, particularly public welfare

Per capita direct expenditures by state and local governments combined, FY 2007

	CT	ME	MA	NH	RI	VT	NE average	Gap between NH and NE average		NH rank
								Dollars	Percent	
Total direct expenditures	8,142	7,632	8,395	6,442	8,072	8,500	8,064	-1,621	-20.1	6
Education services	3,106	2,373	2,631	2,507	2,686	3,500	2,754	-247	-9.0	5
K-12 education	2,282	1,663	1,862	1,822	1,960	2,118	1,961	-139	-7.1	5
Higher education	605	571	571	582	534	1,147	603	-21	-3.5	3
Libraries	45	25	40	26	41	27	38	-12	-31.1	5
Other	174	115	157	76	151	208	152	-76	-49.8	6
Social services & income maintenance	1,955	2,354	2,286	1,347	2,180	2,249	2,116	-769	-36.3	6
Public welfare	1,366	1,867	1,896	1,176	1,897	1,941	1,700	-524	-30.8	6
Hospitals	368	95	212	43	89	29	207	-164	-79.3	5
Health	196	383	162	106	162	251	189	-83	-43.8	6
Other	24	9	16	22	33	29	20	2	8.9	4
Transportation	371	600	442	560	480	753	466	94	20.1	3
Highways	349	552	350	475	343	704	395	80	20.3	3
Other	22	48	91	85	137	49	71	14	19.1	3
Public safety	619	469	669	519	786	505	626	-107	-17.1	4
Police protection	260	176	281	225	309	228	261	-36	-13.8	5
Corrections	189	151	198	124	208	183	185	-61	-32.7	6
Fire protection	139	95	151	130	234	66	143	-14	-9.7	4
Protective inspection & regulation	30	47	38	40	34	28	37	4	10.0	2
Environment & housing	513	595	603	430	484	557	554	-123	-22.3	6
Natural resources	30	135	48	54	43	117	55	-1	-1.0	3
Parks & recreation	69	60	63	70	63	60	65	6	8.7	1
Housing & community development	196	191	263	133	169	197	218	-85	-39.1	6
Sewerage	110	120	167	86	107	120	135	-49	-36.5	6
Solid waste management	107	89	62	87	102	63	81	6	7.4	4
Government administration	481	387	393	352	559	390	422	-70	-16.6	6
Financial administration	174	144	129	119	197	128	145	-26	-18.2	6
Judicial & legal	178	79	153	93	120	97	142	-48	-34.2	5
General public buildings	36	63	70	36	112	67	61	-24	-40.2	5
Other	94	102	42	104	129	97	75	29	39.0	2
Interest on general debt	418	256	611	352	428	308	481	-129	-26.9	4
Other NEC	677	599	760	375	468	239	645	-270	-41.8	5

Source: Author's calculations based on data from the US Census Bureau, 2007 Census of Governments and US Census Bureau state population estimates.

Note: NEC = not elsewhere classified. The table excludes expenditures associated with utilities, liquor stores, and social insurance trusts, as well as intragovernmental expenditures such as pension contributions. Population data used in per capita calculations are adjusted to reflect the fiscal year. Averages represent population-weighted averages for the six New England states. Please see the data appendix available on the New England Public Policy Center's website for additional years of expenditure data and alternative calculations of the regional average.

government finance statistics for the general government sector for state and local government combined.⁷ These data allow for more of an “apples-to-apples” comparison than data

culled from individual government budget documents—though at the sacrifice of some detail. By focusing on combined state and local data, I can avoid state-to-state variations

in the allocation of funding and service provision responsibilities across state and local governments.⁸

While the Census Bureau's data on government finances are the backbone of this study, I also rely on other federal and non-federal sources of information, including data collected by organizations such as the Kaiser Family Foundation and the Pew Center on the States, as well as the New Hampshire state government.

Time period. Most comparisons in this paper center on one point in time: state FY 2007. Although Census Bureau's government finance statistics for FY 2008 are now available, there are at least two advantages to relying on FY 2007 data.

First, FY 2007 is a census year: the financial figures for that year are based on a survey of all state and local governments. Census years occur every five years. In other years, the Census Bureau collects financial data from only a sample of local governments—a practice that can introduce sampling biases. Second, FY 2007 ended before the Great Recession, and thus may represent a more typical year for state finances.⁹

How New Hampshire does it: The spending side

As Figure 2 shows, New Hampshire state and local governments spent less per capita than governments in all other states in the region in FY 2007, and 20 percent less than the New England average.¹⁰ Table 2 provides a detailed breakdown of combined state and local direct expenditures for each New England state and the region as a whole. The table also shows the gap between New Hampshire's spending and the regional average in both dollar and percentage terms, as well as the Granite State's rank among the six New England states.

New Hampshire governments spend less per capita than those in *most* other New England states in *most* areas of government, but particularly in public welfare programs.

The first thing to note in Table 2 is that New Hampshire does not have uniformly lower per capita spending across all functions of government. While the Granite State outspends all its regional peers in only one area—parks and recreation—the state falls in the middle of the pack in other areas, such as transportation and higher education.¹¹

That being said, the major theme from Table 2 is that the Granite State ranks at or near the bottom in the vast majority of categories, including the two largest areas of combined state and local spending: elementary and secondary (K-12) education, and public welfare. New Hampshire spent \$1,822 per capita on K-12 education in FY 2007. That was lower than all other New England states except Maine (\$1,663 per capita), though only about 7 percent less than the regional average.

With respect to public welfare—a category dominated by Medicaid—the Granite State was more of an outlier. New Hampshire government spent \$1,176 per capita on public welfare, the lowest in the region and more than \$500 (31 percent) below the average. Connecticut ranked fifth, with per capita spending of \$1,366, while all other states in the region approached or exceeded \$1,900 in per capita spending.¹²

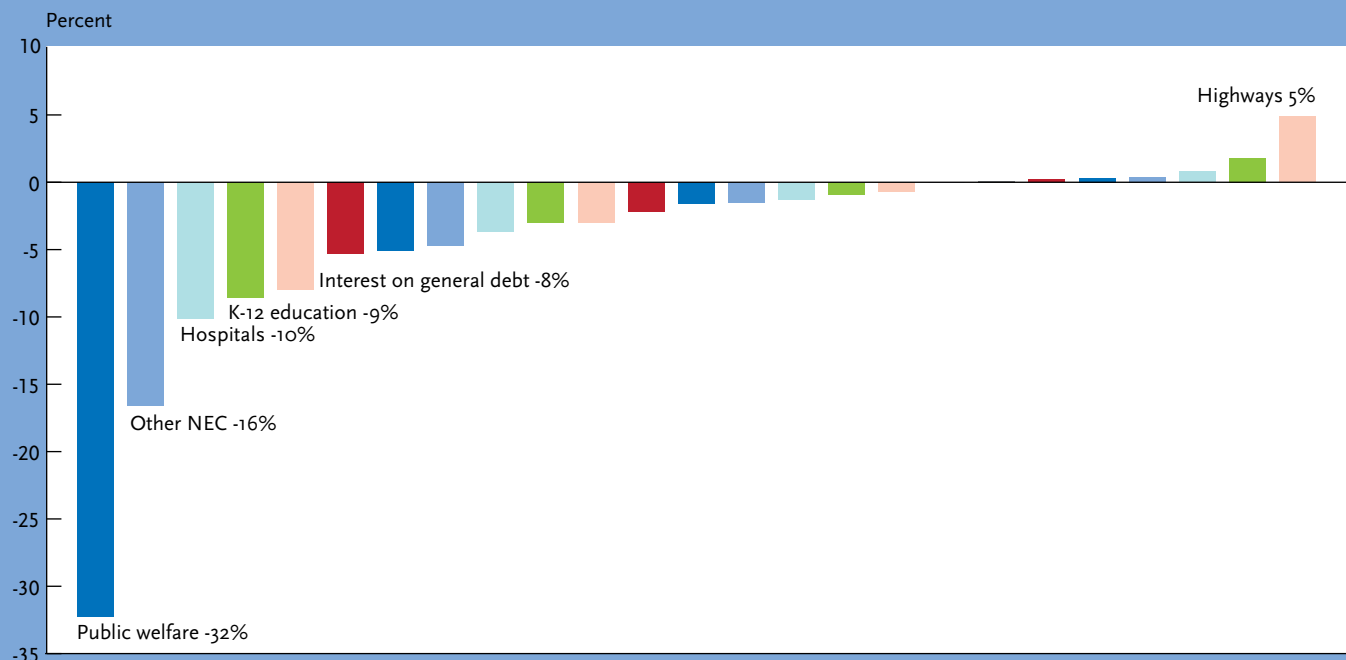
Lower public welfare spending alone accounts for nearly a third of the overall (net) gap between New Hampshire's per capita spending and the regional average (see Figure 3).¹³ The three categories with the largest gaps—public welfare, public hospitals, and elementary and secondary education—together accounted for more than half of the overall gap.

Variations in spending: Choices versus circumstances

The obvious question prompted by Table 2 is this: how does New Hampshire manage to spend less than its regional counterparts in so many areas? Or, more broadly, what causes variation in spending across states? Ultimately, such variation appears to reflect a combination of choices and circumstances.¹⁴

Figure 3. Lower public welfare spending alone accounts for nearly one-third of the spending gap between New Hampshire and the regional average

Share of overall gap between New Hampshire and New England average per capita direct expenditures by category, FY 2007



Source: Author's calculations based on data from the US Census Bureau, 2007 Census of Governments and US Census Bureau state population estimates.

Note: NEC = not elsewhere classified. Negative percentages indicate New Hampshire spends below the regional average and positive percentages indicate New Hampshire spends above the regional average. Population data used in per capita calculations are adjusted to reflect the fiscal year.

Certainly states may have different preferences regarding the role government should play and the level of services they should provide. States that choose to offer fewer services—or services that are less comprehensive or of lower quality—will have lower expenditures than states with higher service levels, all else being equal.¹⁵ States can also choose to enact policies or processes that improve efficiency, which can also lead to lower expenditures.

But beyond choices, states may also differ in their circumstances. For example, states may vary in their underlying need for a particular service, as dictated by socio-economic, demographic, or geographic characteristics outside government's direct, near-term control.

Consider K-12 education. A state with many children would have a greater need for public elementary and secondary education than a state with fewer children, and

thus could be expected to spend more in this area, all else being equal. Similarly, a state with more people living in poverty would have a greater need for welfare programs, and a state with more miles of roadway would have a greater need for highway spending. Although governments can enact policies that affect the number of children, poor people, or road-miles over the longer term, these characteristics are essentially fixed in the short term.¹⁶

Another circumstance that can vary across states is the cost of providing public services. Consider compensation for public employees. Although governments have choices when setting pay and benefit levels for employees, these choices are likely to be influenced by external pressures. If public-sector compensation is set too low relative to the private sector, governments may have difficulty attracting employees. Thus states with higher prevailing wages—or higher costs of other

goods and services—would be expected to spend more than states facing lower input costs, all else being equal.

While the choices-versus-circumstances framework is useful for thinking about state-to-state differences in government spending, other factors do not fall neatly into this dichotomy. Take, for example, participation in government programs. Participation rates may vary from state to state owing to choices made by governments about outreach or enrollment practices. Potential participants may be unaware of a program’s existence or of their own eligibility if outreach is poor. Alternatively, they may be interested in participating but view the enrollment process as too burdensome.¹⁷ Participation could also be low if people simply prefer not to partake of available programs or services, whether because of the availability of private-sector options, fear of stigma or a strong culture of

self-reliance—or as one might say in New England, “Yankee pride.” These attitudes among individuals are another circumstance the government faces.

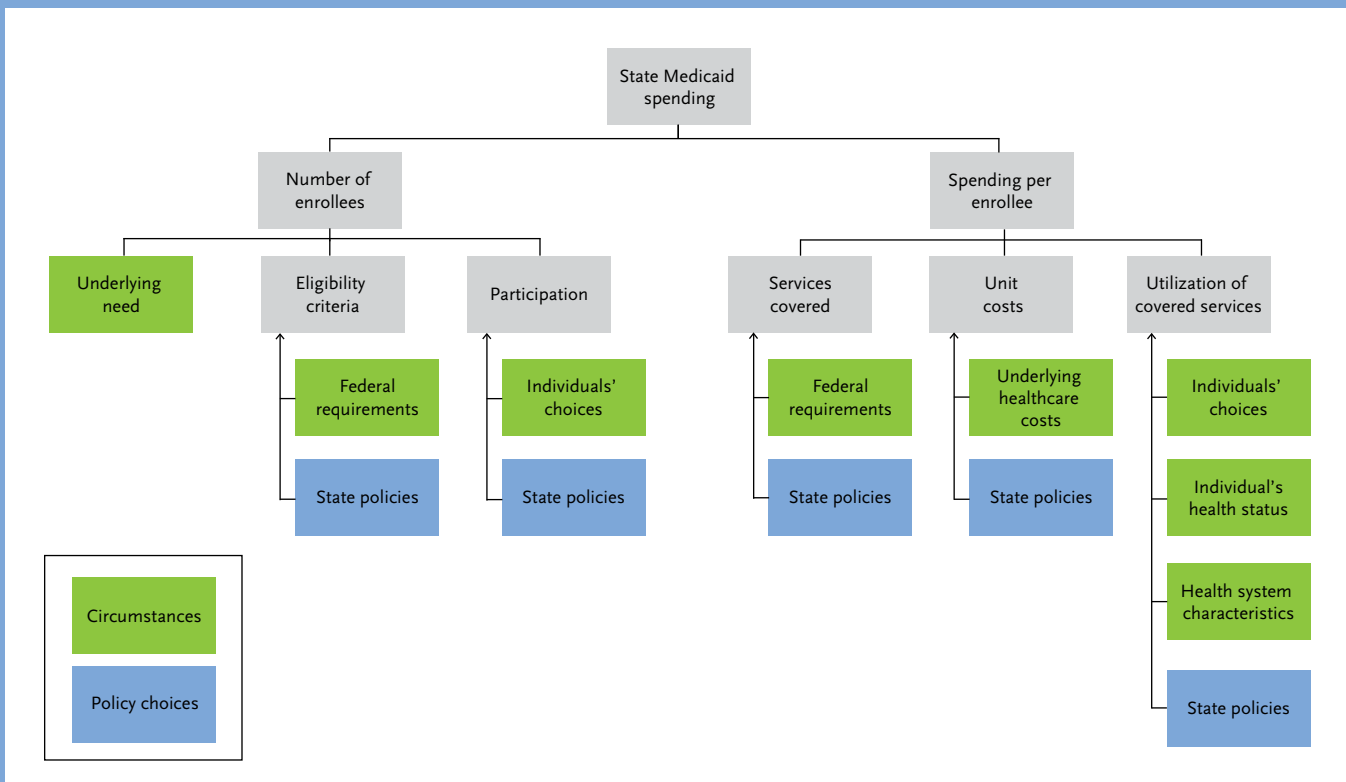
**A systematic approach:
Expenditure need**

Parsing the various factors that drive spending—even for a single government program—can be complex. Take Medicaid as an example. At the most basic level, we can break down the bulk of any state’s overall Medicaid spending into two key components: the number of enrollees in the program, and the spending per enrollee.¹⁸

As Figure 4 shows, a complex patchwork of factors embodying both choices and circumstances influence these two components. State policies influence overall spending through a number of pathways. However, there are factors outside state government’s

Figure 4. A complex patchwork of policy choices and circumstances influences many areas of government spending such as on Medicaid

Underlying components of state Medicaid spending



Note: Diagram implicitly assumes a fee-for-service model and does not consider administrative or Disproportionate Share Hospital spending.

direct control that also affect expenditure levels, including federal requirements, the health status of individuals and their choices about whether to enroll in and seek healthcare, and the characteristics of the health system itself, including underlying medical costs.

The Medicaid example suggests the need for a higher-level, more systematic approach to analyzing the roles of choices and circumstances in determining state spending. To better understand the factors influencing New Hampshire's spending, I use a representative

Table 3. Workload measures attempt to capture factors that drive public costs, but that are out of the direct, near-term control of state and local governments

Spending category	Category description	Variables used to construct workload measure
K-12 education	Includes expenditures associated with the operation, maintenance, and construction of public schools and facilities for grades K-12, including vocational-technical education.	Potential elementary population; potential secondary population; population aged 5 to 17 living in poverty
Higher education	Includes expenditures associated with higher education institutions and auxiliary enterprises.	Estimated college population
Public welfare	Includes expenditures associated with cash payments to individuals contingent upon their need, Medicaid payments to vendors, provision, construction, and maintenance of government nursing homes for veterans or the needy, and public employment for all public welfare activities.	Total population living in poverty; population aged 75 or older living in poverty
Hospitals	Includes expenditures associated with government's own hospitals, including those operated by public universities, as well as provision of care in other hospitals (public or private), excluding payments made under Medicaid.	Total population; number of disabled workers; number of families living below 150 percent of the federal poverty level
Health	Includes expenditures associated with conserving and improving public health, including general health activities, categorical health programs, health-related inspections, community healthcare programs, regulation of air and water quality, and animal control, but excluding hospital care.	
Highways	Includes expenditures associated with the maintenance, operation, repair, and construction of toll and non-toll highways, streets, roads, alleys, sidewalks, bridges, tunnels, ferry boats, viaducts, and related structures.	Total lane-miles; total vehicle-miles-traveled
Police protection	Includes expenditures associated with the preservation of law and order, the protection of persons and property from illegal acts, and the prevention, control, investigation, and reduction of crime.	Total population; population aged 18 to 24; number of murders and non-negligent manslaughters
Corrections	Includes expenditures associated with institutions and facilities for the confinement, correction, and rehabilitation of convicted adults or juveniles adjudicated delinquent or in need of supervision, and for the detention of adults and juveniles charged with a crime and awaiting trial.	
All other direct expenditures	Includes direct expenditures not categorized above, including expenditures associated with the environment and housing, government administration, and interest on general debt, but excluding expenditures associated with utilities, liquor stores, and social insurance trusts, as well as intragovernmental expenditures such as pension contributions.	Total population

Note: Please see the US Census Bureau's *Government Finance and Employment Classification Manual*, 2006, for full descriptions of categories. Please see Rafuse, 1990, as well as the technical appendix available on the New England Public Policy Center's website for further background and details on workload measures.

expenditure system (RES) approach to calculate “expenditure need” for the six New England states.¹⁹

Expenditure need is the amount a state would have to spend to provide a standard level of services—in this case, the regional average—given its underlying need for services and input costs, assuming equal efficiency across states. It is important to stress the regional average does not necessarily reflect the optimal level of services that any state should provide, and expenditure need does not necessarily represent the amount a state should spend. Rather, this approach simply allows us to see how spending would vary across states if we held service levels constant.

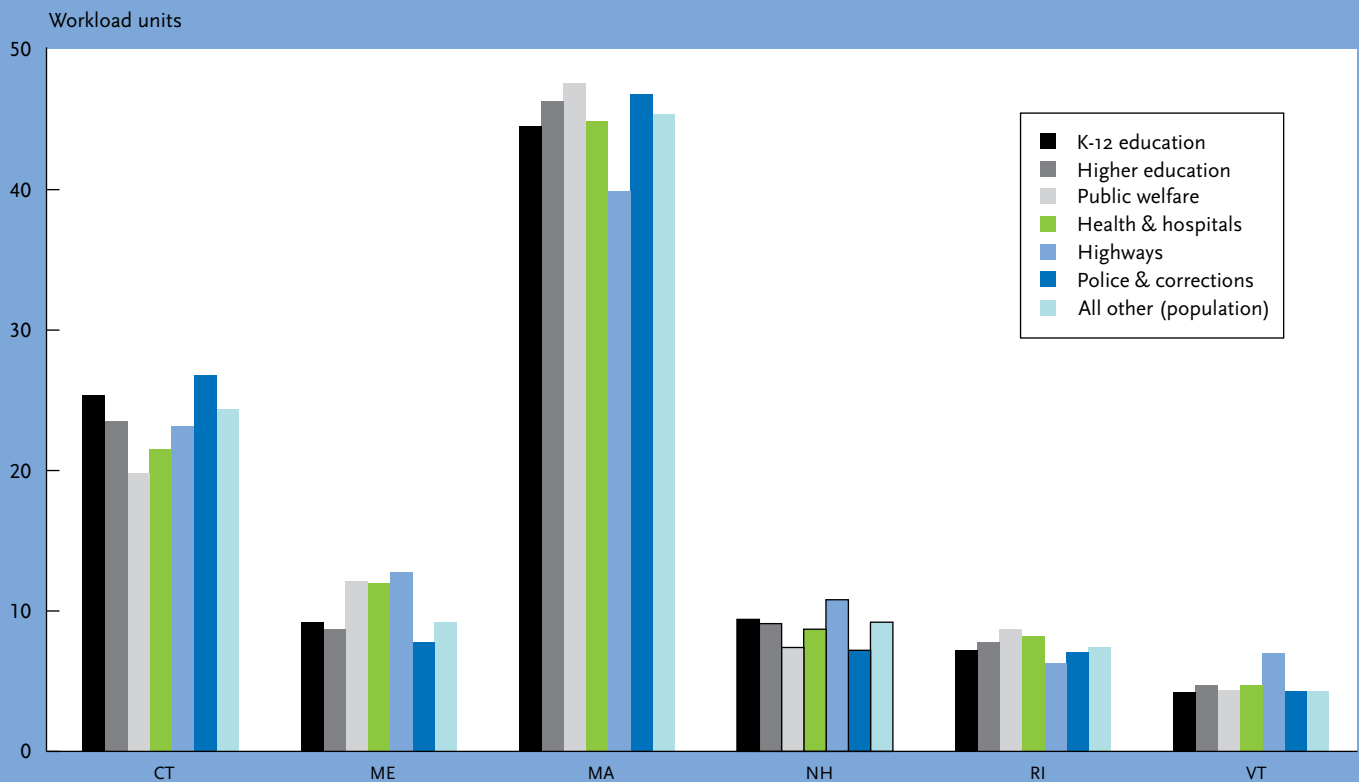
At the heart of the RES approach are so-called “workload measures”—metrics designed to capture the underlying need for a given category of spending. Workload

measures are usually based on socioeconomic, demographic, and geographic characteristics that state policies do not directly influence in the near term. For example, the workload measure for public welfare considers the size of a state’s population living in poverty—something largely outside the government’s direct, near-term control—rather than the number of individuals enrolled in welfare programs, which is affected by eligibility and enrollment policies.

Table 3 presents the variables I used to construct workload measures for eight key spending categories: K-12 education, higher education, public welfare, health, hospitals, highways, police protection, and corrections.²⁰ Together the eight named categories accounted for about 70 percent of total state and local spending in New England in FY 2007. A ninth catch-all category uses total

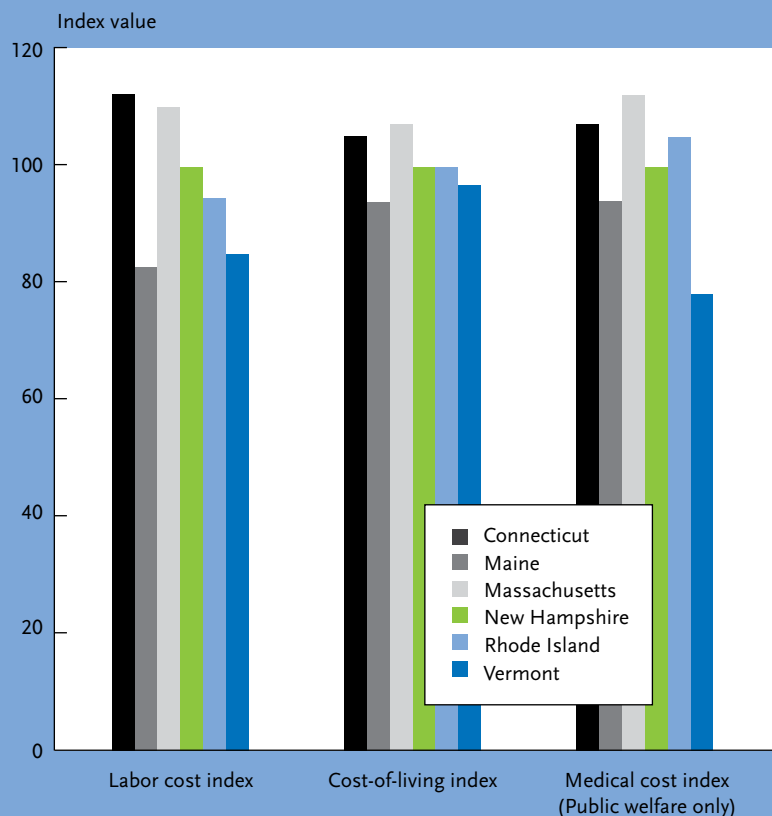
Figure 5. Differences among states in underlying need for services may not always correspond exactly to differences in population size

Calculated workload measures by state and category, FY 2007



Source: Please see the technical appendix available on the New England Public Policy Center’s website for sources and methodology.
 Note: All workload measures are scaled such that the sum across all New England states for a given measure equals 100.

Figure 6. Underlying input costs vary across the New England states, with New Hampshire falling in the middle
Components of input cost indices by state, FY 2007



Source: Please see the technical appendix available on the New England Public Policy Center's website for sources and methodology.
Note: All indices scaled so New Hampshire = 100.

population as its workload measure.

Figure 5 shows the workload measures for each category grouped by state. Grouping the workload measures in this manner allows us to see that underlying need does not always coincide exactly with population which is depicted by the right-hand-most column for each state. For example, while Massachusetts is home to more than 45 percent of the region's population, it is associated with only 40 percent of the region's highway "workload."

Also instrumental to the calculation of expenditure need are indices of underlying input costs. These indices are meant to capture cross-state differences in prevailing labor costs (what state and local governments are "up against" when hiring employees) and general costs of living. I compute a separate input

cost index for each spending category, placing greater weight on labor costs for the categories that rely more heavily on labor inputs. For public welfare—a category dominated by Medicaid payments to healthcare providers—the input cost index also takes into account differences in healthcare costs across states. Figure 6 shows the components of the input cost indices. Connecticut and Massachusetts have the highest input costs, and Maine and Vermont the lowest.

To calculate a state's expenditure need for a given category of spending, I first compute the average expenditure per workload unit for the New England region as a whole. I then multiply this regional average by each state's total workload units for that category, and then by the state's input cost index for the category. I then normalize the expenditure need values across states, so the total regional expenditure need for the category equals total actual expenditures for the category.²¹ Summing a state's expenditure need across all spending categories provides an estimate of the state's overall expenditure need.

Lower expenditure need accounts for just over 40 percent of the overall gap between New Hampshire's per capita spending and the regional average.

Figure 7 shows actual expenditures and calculated expenditure need for each New England state compared with the regional average, all on a per capita basis. Note that the regional average represents both average actual expenditures and average expenditure need. This is by design; the RES methodology ensures that the two are mathematically equivalent.

If lower underlying need and input costs were the *only* factors differentiating New Hampshire's spending from the regional average, we would expect the state's calculated expenditure need to equal its actual expenditures. By contrast, if these circumstances played no role—that is, if New Hampshire had the same underlying need and input costs as the region as a whole—the state's expenditure need would equal the regional average.

As Figure 7 shows, the answer lies in between. New Hampshire's overall

expenditure need is below the New England average (and lower than any other state's but Vermont), but above the state's actual expenditures.²² This implies that underlying need and input costs do account for some of the gap between New Hampshire's actual spending and the regional average, but that other factors are also at play.

We can calculate the portion of the gap that is due to lower expenditure need by comparing the difference between a state's expenditure need and the regional average with the gap between the state's actual spending and the regional average. Doing so tells us that around 41 percent of the actual spending gap is due to the Granite State's lower expenditure need, while the remaining 59 percent is due to other factors. (Note that the y-axis

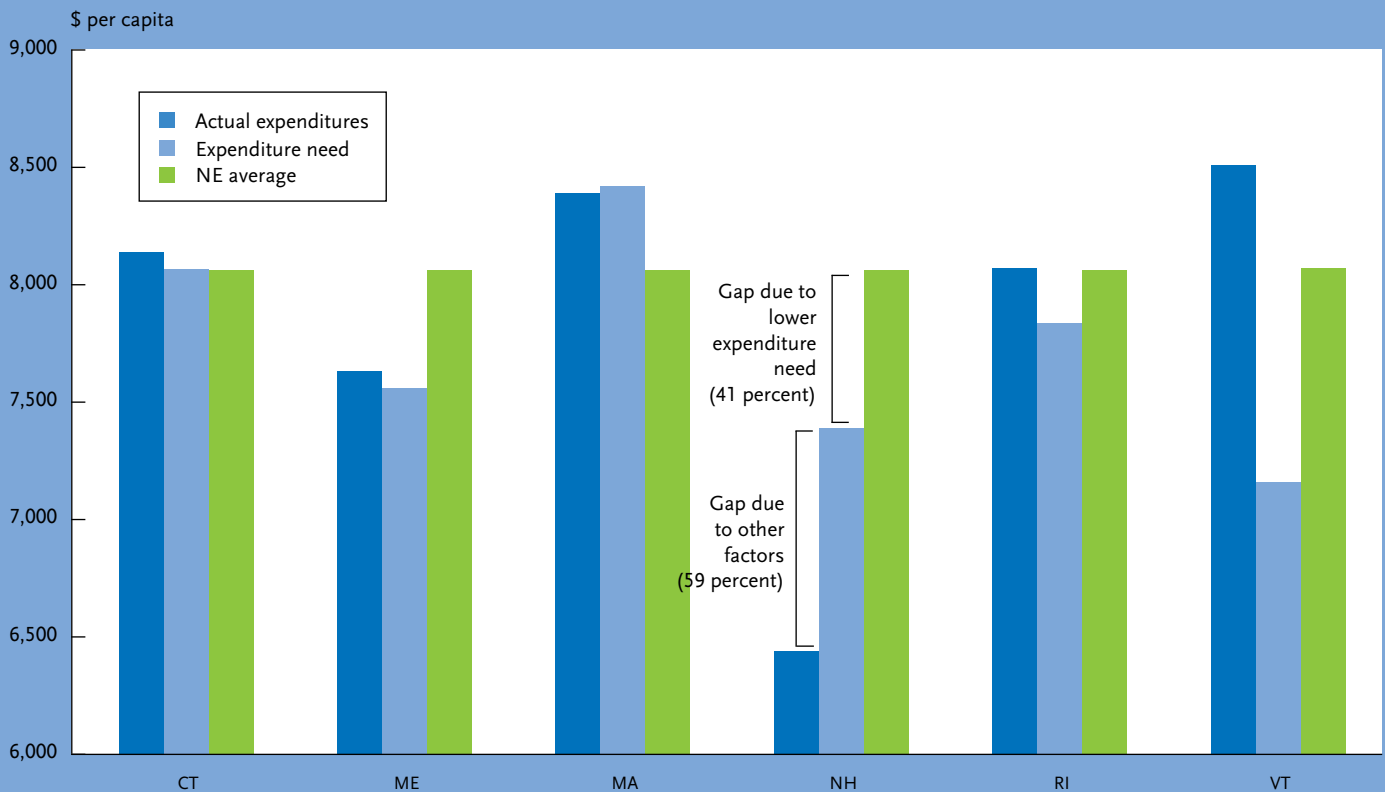
of Figure 7 starts at \$6,000, to accentuate the differences between actual spending and expenditure need.)

Table 4 shows the results of the expenditure need calculation for each of the eight key categories. I also break down the catch-all category to show separate estimates for environment and housing, government administration, interest on general debt, and all other categories.²³ As Table 4 reveals, New Hampshire has lower-than-average expenditure need in almost all categories of public spending, but the difference is most pronounced for public welfare, police protection, and corrections.

Figure 8 shows New Hampshire's actual per capita expenditures and expenditure need relative to the regional average for each

Figure 7. Lower expenditure need explains only a portion of the gap between New Hampshire's spending and the regional average

Overall expenditures and expenditure need by state, relative to the regional average, FY 2007



Source: Author's calculations based on data from the US Census Bureau, 2007 Census of Governments, US Census Bureau state population estimates, and other sources. Please see the technical appendix available on the New England Public Policy Center's website for additional sources and methodology.

Note: Population data used in per capita calculations are adjusted to reflect the fiscal year. Averages represent population-weighted averages for the six New England states.

Table 4. New Hampshire's circumstances would suggest lower per capita spending in certain areas, namely public welfare and public safety

Per capita expenditure need for state and local governments combined, FY 2007

	CT	ME	MA	NH	RI	VT	NE average	Gap between NH and NE average		NH rank
								Dollars	Percent	
Total expenditure need	8,068	7,563	8,423	7,392	7,840	7,154	8,064	-671	-8.3	5
K-12 education	2,156	1,603	2,009	1,914	1,744	1,593	1,961	-47	-2.4	3
Higher education	608	475	640	567	589	560	603	-36	-5.9	4
Public welfare	1,399	1,981	1,879	1,293	1,950	1,352	1,700	-407	-23.9	6
Hospitals	192	228	214	188	213	196	207	-19	-9.1	6
Health	174	211	196	172	196	182	189	-17	-9.0	6
Highways	392	479	364	449	319	573	395	54	13.7	3
Police protection	304	174	280	193	225	208	261	-68	-26.0	5
Corrections	212	130	198	138	163	155	185	-47	-25.7	5
Environment & housing	568	486	574	532	525	501	554	-22	-4.0	3
Government administration	443	353	440	404	391	363	422	-18	-4.4	3
Interest on general debt	481	481	481	481	481	481	481	0	0.0	3
All other categories	1,140	962	1,147	1,061	1,044	992	1,106	-45	-4.0	3

Source: Author's calculations based on US Census Bureau, 2007 Census of Governments data, US Census Bureau state population estimates, and other sources. Please see the technical appendix available on the New England Public Policy Center's website for additional sources and methodology.

Note: Population data used in per capita calculations are adjusted to reflect the fiscal year. Averages represent population-weighted averages for the six New England states.

spending category. Most categories follow the same pattern as overall spending: circumstances explain some, but not all, of the gap between actual spending and the regional average.

The portion of the gap that is due to lower expenditure need varies by category. For example lower expenditure need accounts for 78 percent of the gap for public welfare, but 34 percent for elementary and secondary education, 21 percent for health, and only 11 percent for hospitals. (For a closer look at Medicaid, the largest component of public welfare, see Box 1.) New Hampshire actually spends more per capita on higher education and police protection than its expenditure need, implying that other factors influencing spending more than offset the circumstances embodied in the expenditure need calculation. In the highway category, higher expenditure need accounts for about 68 percent of the positive gap between the state's actual spending and the regional average.

Beyond lower expenditure need: The role of other factors

The preceding analysis showed that close to 60 percent of the gap between New Hampshire's actual per capita spending and the New England average is due to factors beyond differences in underlying need or input costs. The next question is: what are these other factors?

Some, like underlying need and input costs, may be factors outside the government's direct control. In other words, the workload measures and cost indices used to calculate expenditure may fail to account for all circumstances that influence spending levels. For example, states with a larger share of children for whom English is as second language—a factor that the RES analysis does not directly capture—may need to spend more on K-12 education than other states. On the cost side, states with smaller or more dispersed populations may face higher costs in delivering certain services, because they do not enjoy the same economies of scale as larger, more densely populated state.²⁴

However, discrepancies between actual expenditures and expenditure need also stem from differences in *choices* made by state and local governments concerning the level of services they provide. States may also differ in the efficiency with which they provide their chosen level services, or in the compensation they provide to public employees. Let's consider each of these.

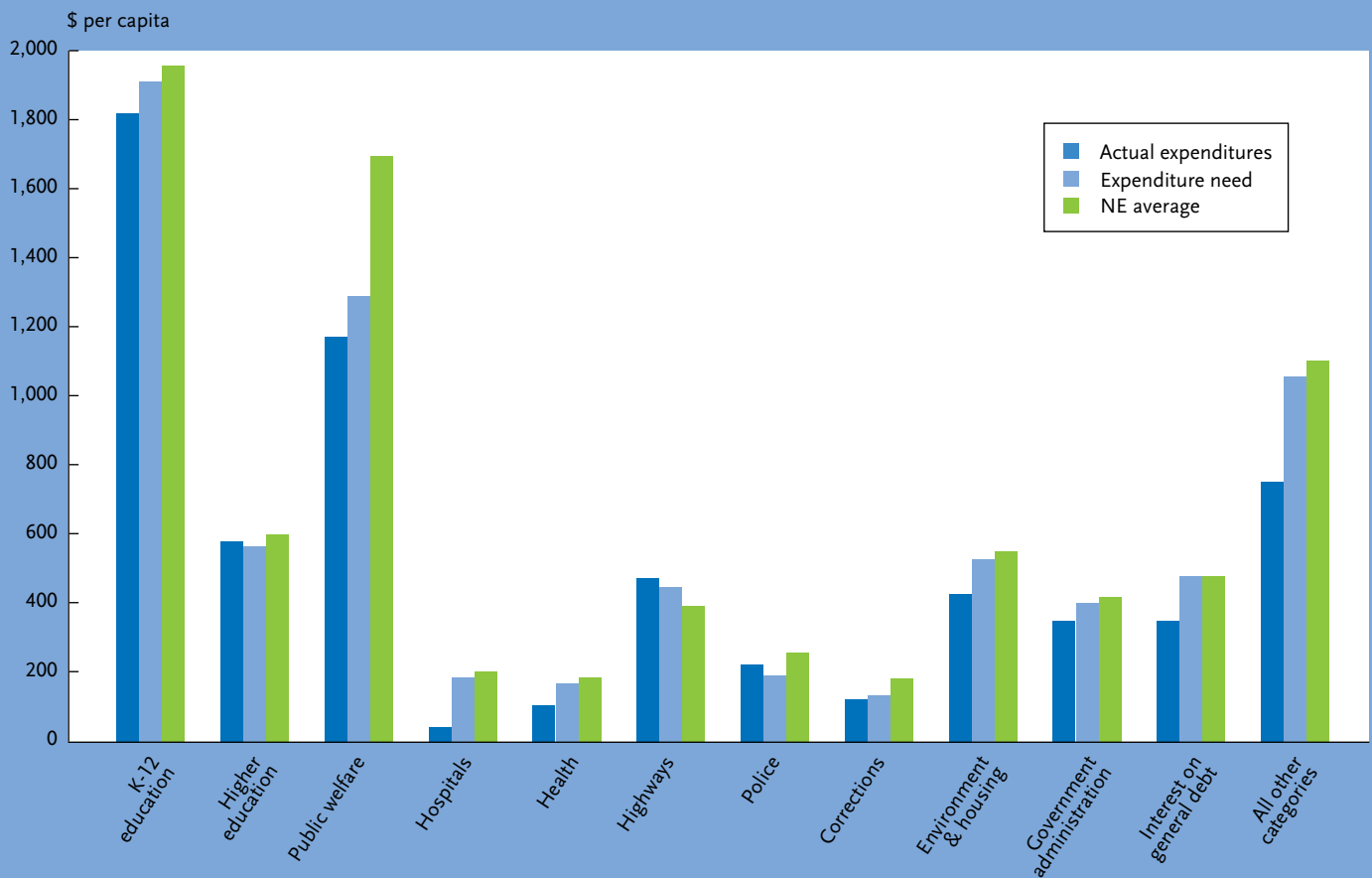
Although comparing aggregate service levels across states is challenging, there is evidence that New Hampshire governments provide fewer services in certain areas. Taking an inventory of *all* services provided

by state and local governments—even within a given spending category—would be a daunting task in most cases. The first challenge would be the sheer number of services to consider. States may also have different ways of reporting the services they provide. For example, they may use different names for similar programs, or house them in different government agencies.²⁵

Once we establish that two or more states offer a particular type of service or program, comparing their scope or quality can also be difficult. Doing so would require meaningful metrics for comparison as well as reliable cross-state data. That being said, we can

Figure 8. The portion of the gap between New Hampshire's spending and the regional average that can be explained by lower expenditure need varies by category

New Hampshire expenditures and expenditure need by category, relative to the regional average, FY 2007



Source: Author's calculations based on the data from the US Census Bureau, 2007 Census of Governments, US Census Bureau state population estimates, and other sources. Please see the technical appendix available on the New England Public Policy Center's website for additional sources and methodology.

Note: Population data used in per capita calculations are adjusted to reflect the fiscal year. Averages represent population-weighted averages for the six New England states. Please see the data appendix available on the New England Public Policy Center website for comparable figures for the other five New England states.

Box 1

Medicaid: A closer look

Lower public welfare spending alone accounts for nearly one-third of the overall gap between New Hampshire’s per capita spending and the regional average. This finding warrants a closer look at states’ largest public welfare program—Medicaid.^A

Figure 4 showed that there are a number of factors that influence Medicaid spending levels. Determining the relative importance of each factor would be a challenging task. However, a few simple comparisons of data can reveal what key factors are driving the Granite State’s lower-than-average Medicaid spending.

Table 1-A shows total per capita Medicaid spending for each New England state, as well as its two key components: enrollment (scaled by population), and spending per enrollee. New Hampshire’s per capita Medicaid spending is by far the lowest in the region—\$653 (or 47 percent) below the regional average. The state’s enrollment as a percent of population is also lower than in any other New England state: 10.9 percent, compared with a range of 15.2 percent (Connecticut) to 26.6 percent (Maine) in the rest of the region.

The Granite State falls more toward the middle of pack in spending per enrollee, ranking fourth, and just 6 percent shy of the regional average. This implies that New Hampshire’s lower enrollment rate is the dominant factor driving the Granite State’s lower Medicaid spending, though differences in spending per enrollee contribute to the state’s lower spending vis-à-vis southern New England states.

Figure 4 also showed that Medicaid enrollment is affected by the underlying need of a population as well as by eligibility criteria and participation rates among those eligible. We know, based

on New Hampshire’s low poverty rate, that the state’s underlying need is likely to be lower than in other New England states. But this is not the full story. Scaling enrollment by the number of people living in poverty shows us that New Hampshire’s Medicaid enrollment is still low even when accounting for differences in poverty rates. Applying the RES methodology to Medicaid spending alone suggests that lower expenditure need accounts for only slightly more than half (52 percent) of the gap in per capita spending. These findings suggest that eligibility criteria or participation—or both—are also playing a role.

Figure 1-A shows income eligibility for selected categories of Medicaid beneficiaries on a state-by-state basis.^B Eligibility is expressed as a percentage of the federal poverty level (FPL), with lower percentages suggesting stricter eligibility guidelines.^C

Based on this figure, New Hampshire’s Medicaid program appears to set particularly strict criteria for parents relative to other New England states. New Hampshire capped eligibility for jobless parents at 45 percent of FPL, as of July 2006. For working parents, the cap was 56 percent. Eligibility limits in other states for these groups ranged from 133 percent to 200 percent of FPL or higher.^D The Granite State’s income limits for pregnant women and the aged, blind, and disabled were also among the lowest in the region, though by less dramatic margins.^E

Gauging the role of participation in New Hampshire’s lower per capita Medicaid spending is less straightforward. Estimating Medicaid participation rates requires simulating the number of individuals who meet the eligibility criteria for enrollment, and comparing that to the number who actually enroll.

One recent study of children’s participation in Medicaid and the State Children’s Health Insurance Program (SCHIP) found

Table 1-A. New Hampshire’s lower per capita Medicaid spending is driven predominantly by lower enrollment

Key components of Medicaid spending by state, FFY 2007

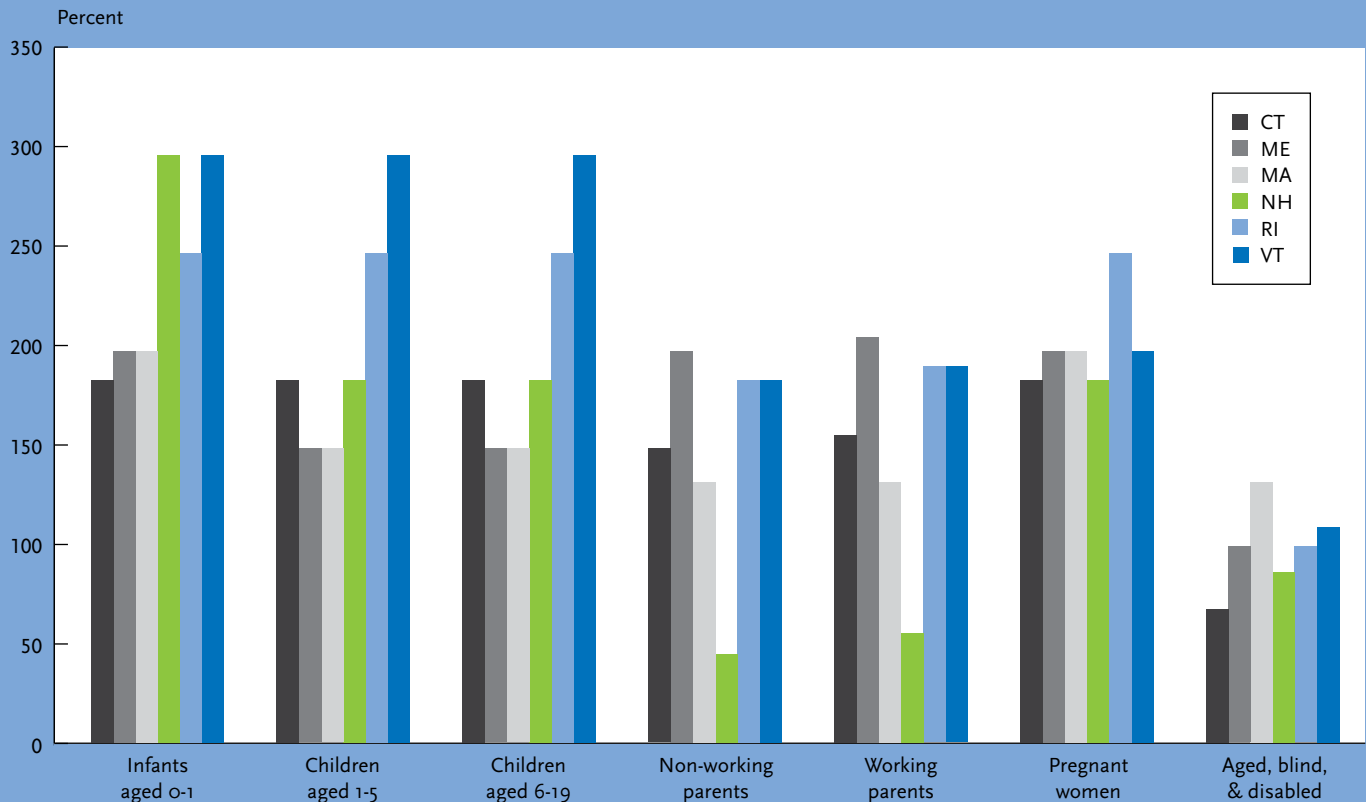
	CT	ME	MA	NH	RI	VT	NE average	Gap between NH and NE average		NH rank
								Dollars	Percent	
Spending per capita	1,118	1,465	1,616	737	1,629	1,370	1,390	-653	-47.0	6
Enrollment as percent of state population	15.2	26.6	21.6	10.9	18.5	25.4	19.4	NA	-44.0	6
Spending per enrollee	7,357	5,514	7,490	6,769	8,796	5,394	7,215	-446	-6.2	4

Source: Kaiser Family Foundation, State Health Facts. Includes calculations by author.

Note: FFY = federal fiscal year. Averages represent population-weighted averages for the six New England states. Data exclude Disproportionate Share Hospital spending.

Figure 1-A. New Hampshire's Medicaid income eligibility criteria for parents are considerably more stringent than elsewhere in New England

Income limit as percent of federal poverty level, by eligibility category



Source: For infants, children, parents, and pregnant women: Ross, Cox, and Marks, 2007; For aged, blind and disabled: Kaiser Commission on Medicaid and the Uninsured, 2010.

Note: Criteria are as of 2009 for the aged, blind and disabled and as of 2006 for other categories. Some states have different income limits for the aged, blind, or disabled based on region of residence, marital status, or age. Values represent the maximum income limit available within the category.

that 85.6 percent of New Hampshire's eligible children not covered by other insurance were enrolled in Medicaid or SCHIP in 2008.^F This was significantly lower than regional leaders Massachusetts (95.2 percent) and Vermont (94.0 percent), but not statistically distinguishable from other New England states. Other studies have attempted to measure Medicaid participation rates among other eligibility groups (such as the elderly and other adults), but have not provided estimates for all states.^G Even with participation rate estimates, disentangling the influence of state policies versus individual (or family) choices is difficult.

What would New Hampshire's per capita Medicaid spending look like if its eligibility guidelines and participation rates more closely mirrored the regional average? To approximate this,

I applied the regional average enrollment-to-poverty ratio to New Hampshire's population living in poverty, and multiplied the result by the state's actual spending per Medicaid enrollee.^H

Based on this calculation, New Hampshire's per capita Medicaid spending would rise by 36 percent if the state's enrollment-to-poverty ratio equaled the regional average: the Granite State would spend \$1,005 per capita rather than \$737. The difference—\$268—is more than New Hampshire state government collected from the BPT in FY 2007. This suggests that lower Medicaid enrollment relative to underlying need plays an important role in explaining the state's ability to maintain its unique tax structure.

certainly point to specific examples where states differ in either the number or comprehensiveness of the services they provide. A few cases in point:

- **Early education** is an area where New Hampshire has historically differed from its regional counterparts. Until very recently, it was the only state in the nation that did not offer universal public kindergarten—leaving it instead as a local option.

In 2007 the Granite State passed a kindergarten law, and the last 10 school districts complied in the 2009–2010 school year.²⁶ Vermont, the last New England holdout before New Hampshire, passed its kindergarten law in 1988. Oregon, the 49th state to make public kindergarten universally available, did so in 1989.

Although New Hampshire has joined other states in offering universal kindergarten, it still lags the region—and much of the nation—in public pre-kindergarten (pre-K), an area where many states have expanded their efforts. Thirty-eight states offered a state-funded pre-K program in 2007, including all states in New England except for New Hampshire and Rhode Island (though the latter has several other initiatives that aim to expand access to early childhood education).²⁷

- **Public hospitals** are another area where it is easy to spot differences among New England states. In Connecticut, the state government owns and operates the University of Connecticut Health Center—a large teaching hospital—as well as several facilities for treating addiction and psychiatric disorders.

Public hospitals in other New England states—including New Hampshire—play a more limited role, usually serving narrower populations, such as those who are mentally ill or indigent.²⁸ This notable difference in government provision of services helps explain why Connecticut’s hospital

expenditures are so high relative to other New England states—and why lower expenditure need explains a relatively small portion of the difference between New Hampshire’s actual hospital spending and the regional average.

- **Medicaid income eligibility** for adults is more stringent in New Hampshire than in other New England states (see Box 1). This is a case where the Granite State has limited the comprehensiveness of a service—Medicaid—by restricting enrollment.²⁹ If New Hampshire’s enrollment relative to its population living in poverty were comparable to the regional average, the state’s per capita Medicaid spending would rise by about \$268.

I should acknowledge that the unavailability of government-provided services does not always imply an unmet need, as the private sector—whether nonprofit or for-profit—may sometimes step in (see Box 2).

It is unclear whether governments in New Hampshire deliver services more efficiently than those in other states. Efficiency is another factor that can affect public-sector spending. We could say that a particular state’s government is more efficient than another’s if it produces a given level and quality of services—or output—with fewer inputs. Unfortunately, because measuring the overall level and quality of government services is challenging, comparing efficiency across states is also difficult.

Some reports have attempted to infer relative efficiency across states by comparing only inputs, such as government employment relative to overall population.³⁰ These types of studies—although interesting—are not a definitive marker of efficiency, because they do not control for the level or quality of services. Fewer employees relative to population could be a sign of greater efficiency, but it could also mean less individualized attention for students, backlogs in applications to safety net programs, or longer lines at the Department of Motor Vehicles.³¹ Fewer employees

Box 2

Filling a void? The role of nonprofits

Some have hypothesized that New Hampshire has kept government spending low, at least in part, because nonprofit organizations provide services typically performed by state or local governments elsewhere. Is this hypothesis valid? While nonprofits are clearly important service providers in the Granite State, it is less obvious whether their presence has been a key contributor to New Hampshire's lower spending vis-à-vis other New England states.

We can use data collected by the Urban Institute's National Center for Charitable Statistics to gauge the size of New Hampshire's nonprofit sector relative to other states.^l These data show there were more than 7,800 registered nonprofit organizations in the Granite State in 2008, or 59.6 per 10,000 residents. While this figure is high relative to the national average—49.8 per 10,000—it is not remarkable compared with the state's regional peers.^l It also tells us nothing about the number or scope of the subset of non-profit organizations that provide substitutes for government services.

Even if New Hampshire did have a large nonprofit sector relative to its regional peers, several explanations could surface. Nonprofit organizations may indeed be stepping in to meet demand for services not supported by the government which could provide an explanation for lower government spending. It could also be the case that nonprofits supplement generous government services, or that governments choose to contract out services to nonprofits rather than rely on public employees. This latter scenario could lead to lower government spending (if nonprofits provide services at lower cost than government agencies), but that is not a certainty. To assess the role of the nonprofit sector in providing services—and the implications

for government spending—analysts would likely need to survey state governments. Unfortunately, such an exercise is beyond the scope of this paper.

In New Hampshire, nonprofits appear to be filling at least two roles: providing services under contract with state and/or local governments, and stepping in to fill unmet needs.^k With regard to the former, the state's Department of Health and Human Services relies heavily on the nonprofit sector, with services for the developmentally disabled one of the foremost examples.

With the closing of the Laconia State School in the early 1990s, New Hampshire became one of the first states with no state institutions for individuals with developmental disabilities. The state instead contracted with nonprofits to provide community-based services.^l This move stemmed from a court mandate, along with changing attitudes about care for the developmentally disabled, not just a simple desire to cut costs. Today services for the developmentally disabled are provided through 10 area nonprofit agencies that contract with the Bureau of Developmental Services in the Department of Health and Human Services.^m

Early education is an example of an area in which nonprofits have stepped in to fill unmet needs. The nonprofit sector played a large role in educating the state's five-year-olds prior to the state's mandate for universal kindergarten. In some towns, an estimated 95 percent of kindergarten-aged students attended private schools. Indeed, some have posited that the heavy presence of private options contributed to the state's slow adoption of universal public kindergarten.ⁿ

relative to population could also mean that independent contractors are performing publicly-funded activities rather than government employees—a practice that may or may not be more efficient.

On the flip side, higher public-sector employment relative to population does not necessarily indicate that government is less efficient. As others have pointed out, it may be rational—that is, cost-effective—for states with low wages to employ more public-sector workers.³² Like expenditures, government employment also reflects underlying need—which, as we saw in the RES analysis, may not always correlate perfectly with population size. Finally, even if employment relative to

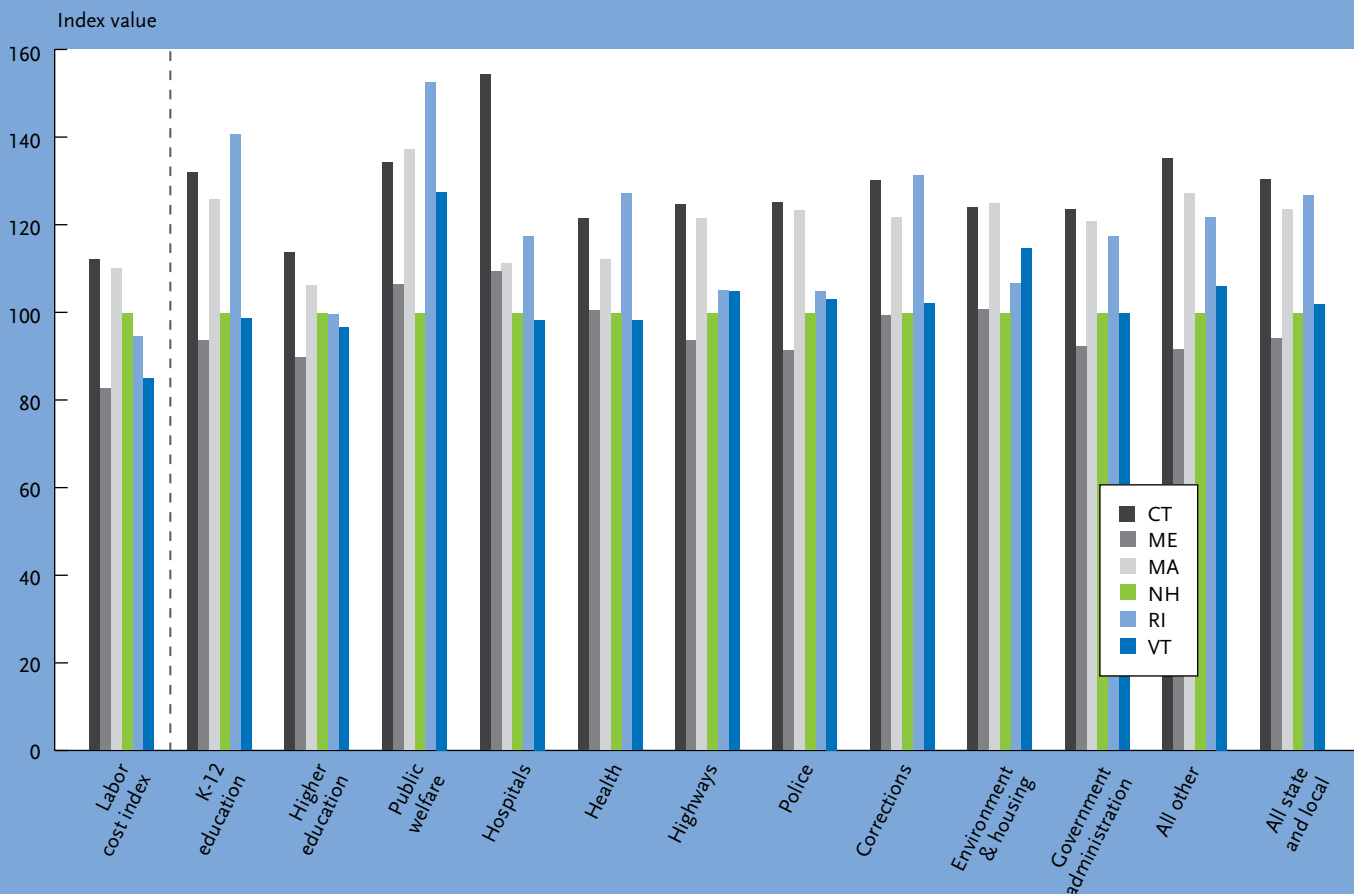
population was by itself a sufficient indicator of efficiency, overall employment numbers may mask significant variations across government programs or departments.

Another method for evaluating efficiency considers *outcomes* relative to spending. For example, an ongoing study of the efficiency of state Medicaid programs developed the following working definition: “An efficient Medicaid program is one that has better outcomes for a given level of spending than another. This is a relative concept; it must be assessed by comparing spending and outcomes of state Medicaid programs.”³³

This approach obviously requires good cross-government outcome measures.

Figure 9. Public employees in New Hampshire are paid less, on average, relative to prevailing wages than their counterparts in other New England states

Pay per full-time-equivalent state or local government employee by category, FY 2007



Source: Author's calculations based on data from the US Census Bureau, 2007 Annual Survey of State and Local Government Employment and Payroll. Please see the technical appendix available on the New England Public Policy Center's website for sources and methodology for labor cost index.

Note: All categories rescaled so that New Hampshire = 100.

Painting an accurate picture of relative efficiency also requires information on other factors that might affect the cost of achieving those outcomes. For example, in the case of Medicaid, failure to adjust for differing circumstances across states could overstate the efficiency—or “bang for the buck”—of a state with lower underlying input costs or a healthier population.

In the *Wall Street Journal* piece noted earlier, Laffer and Moore imply that New Hampshire's education system gets more bang for the buck than other states by citing the Granite State's high test scores and low state and local government spending. However, we cannot draw definitive conclusions without more information. Indeed, anecdotal evidence

suggests that New Hampshire may lag at least one other New England state in educational efficiency. In FY 2007, Massachusetts spent roughly the same amount per capita on K-12 education as New Hampshire, but students in the Bay State had comparable or higher average test scores despite more challenging circumstances, such as a higher proportion of students coming from low-income households or having limited English proficiency.³⁴

A 2008 report from the Pew Center on the States used yet another approach to draw inferences on the efficiency of government operations.³⁵ The report graded each state government on four key dimensions: money, people, infrastructure, and information. Using data from various sources, including surveys,

public documents, and interviews with state officials, the Pew authors awarded each state a letter grade for each individual area, as well as an overall grade. New Hampshire received an overall grade of D+—the lowest in the nation—with the Pew Authors finding that New Hampshire’s government structure hampers the state’s ability to work effectively and efficiently.³⁶

This approach to evaluating efficiency certainly differs from a rote comparison of inputs and outputs or outcomes. However, it also fails to provide a clear explanation of why New Hampshire’s spending looks the way it does in aggregate. Indeed, the approach implies that some of New Hampshire’s attempts to be austere—such as low staffing in certain agencies, and requiring an Executive Council to review all state purchases above a relatively low dollar threshold—may actually impede rather than enhance efficiency, leading to greater costs now or down the road.

On average, public employees in New Hampshire earn less, relative to prevailing wages, than their counterparts in other New England states. Compensation for public employees is one area where we can make at least a high-level state-by-state comparison. While expenditure need attempts to capture cross-state differences in prevailing wages, actual compensation paid to state and local government workers could be higher or lower than prevailing wage rates would suggest.

To examine this factor, I computed average pay per full-time-equivalent public employee by spending category, using data from the Census Bureau.³⁷ Figure 9 presents these averages, along with the labor cost portion of the input cost index used in the expenditure need calculation. To support comparability, I indexed average pay in each category relative to New Hampshire (i.e. New Hampshire’s value equals 100).

The labor cost index—based on median pay among full-time, year-round workers in the private sector—appears on the left-hand side of the chart. This index suggests that underlying labor costs are moderately higher in Connecticut and Massachusetts than in

New Hampshire, while costs in Maine, Vermont, and, to a lesser degree, Rhode Island are lower.

A quick glance at the right side of the chart shows that the pay of government employees does not follow the exact same pattern. Most notably, public employees in Rhode Island and Vermont are paid more, on average, than those in New Hampshire in a number of categories. While state and local employees in Maine are paid less, on average, than those in the Granite State, the gap is smaller than the labor cost index would suggest. At the other extreme, the gaps between Connecticut and Massachusetts and New Hampshire tend to be larger among government workers than the labor cost index would imply.

Figure 9 suggests that lower payroll costs may be one factor that helps explain New Hampshire’s lower spending. Unfortunately, these data do not allow us to say for certain *why* state and local government employees in New Hampshire earn relatively less, on average. It may be that Granite State governments are simply less generous toward their employees.³⁸ However, this is not the only plausible explanation. Differences in the mix of occupations or the characteristics of the employee population could also be at work; for example, an older or more highly educated public workforce could be expected to have higher average pay. Differences in the relative strength of public employee unions or in benefit levels might also explain some of the observed cross-state variations in average pay.³⁹

New Hampshire has reduced its need for a broad-based tax by shifting certain costs away from current taxpayers.

To shed further light on how New Hampshire “does it,” I offer two additional examples where government choices have likely affected the state’s ability to avoid an income or sales tax: appropriations for higher education, and government contributions to pensions for public employees. In each case, the Granite State has lowered its need for tax revenue by shifting costs away from current taxpayers without necessarily providing fewer or less comprehensive services than its regional peers.

State appropriations fund a smaller share of spending on higher education in the Granite State than elsewhere in the region, with tuition and other charges playing a larger role. Table 2 showed that New Hampshire’s per capita spending on higher education is close to the regional average. The RES analysis also revealed that higher education is an area where the state’s actual expenditures slightly exceed expenditure need. These findings would imply that the state’s support for higher education is, at a minimum, comparable to other states in the region. However, this takeaway does not consider financing for those expenditures—in other words, who is paying for the services.

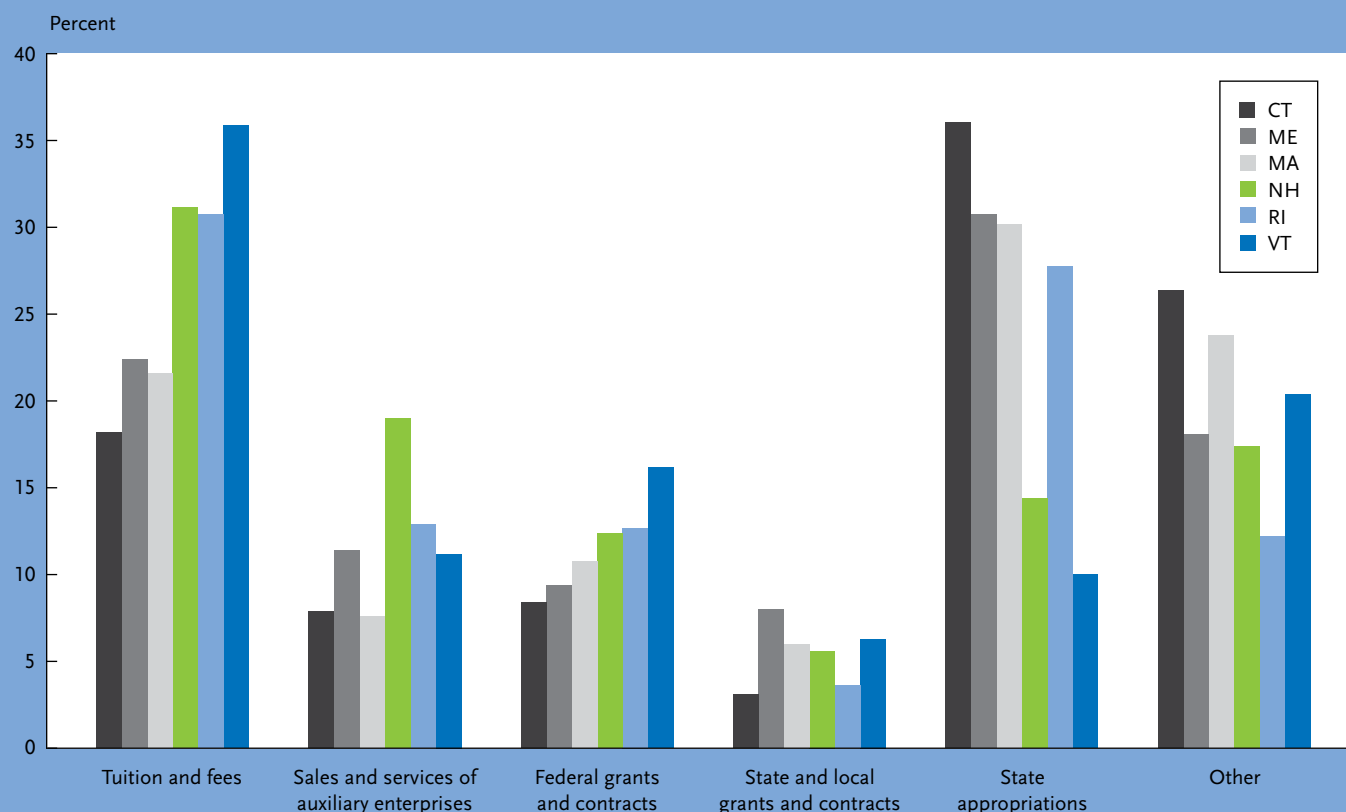
Unlike K-12 education, public welfare, or public safety, public higher education relies heavily on revenue from charges, that is, fees

tied to the use of a particular government service. In the realm of higher education, charges include tuition and fees as well as payments for services such as room and board. Charges usually cover just a portion of the costs associated with higher education, with other sources—such as appropriations from the state’s general fund or federal aid—providing the rest. States that rely more heavily on charges (or other non-state sources such as federal aid) to fund public colleges and universities are essentially shifting more of the costs of higher education away from state taxpayers.⁴⁰

Figure 10 shows the revenue sources used to fund public higher education in New England states, using data from the National Center for Education Statistics. New Hampshire ranks high among its regional peers in

Figure 10. New Hampshire relies more heavily on charges—and less on state appropriations—to fund higher education than most other New England states

Share of public higher education revenues by source, 2006-2007 school year

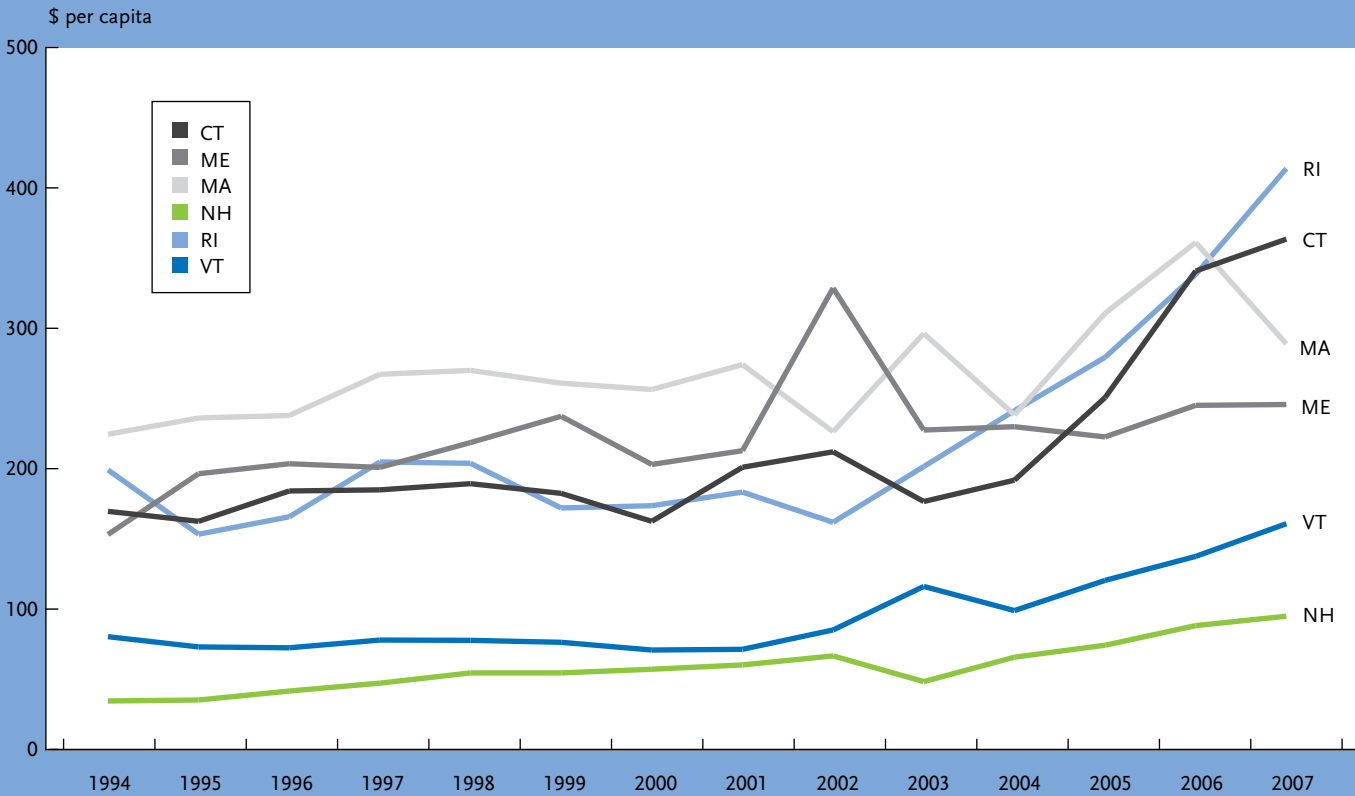


Source: Author’s calculations based on data from the US Department of Education, National Center for Education Statistics, 2006-07 Integrated Postsecondary Education Data System, Spring 2008.

Note: The University of Connecticut is the only public university in New England that owns and operates its own hospital. For purposes of comparability, Connecticut’s revenues exclude those from hospital sales and services.

Figure 11. New Hampshire governments have historically contributed less per capita to public employee pension funds than other New England states

Per capita employer contributions by state and local governments, FY 1994 -2007



Source: Author's calculations based on data from the US Census Bureau, Annual Survey of State & Local Government Employee Retirement Systems and Census of Governments, 1994-2007, and US Census Bureau state population estimates.

Note: Population data used in per capita calculations are adjusted to reflect fiscal years.

the share of revenue from the two largest categories of charges: tuition and fees, and sales and services of auxiliary enterprises such as dormitories, cafeterias, and bookstores.

At the same time, public colleges and universities in New Hampshire obtain less than 15 percent of their revenues from state appropriations. That is higher than in Vermont (10 percent), but considerably lower than in all other states in the region, where appropriations range from 28 percent in Rhode Island to 36 percent in Connecticut.⁴¹ Thus, while spending by public institutions of higher education in New Hampshire is comparable to that elsewhere in New England, the support that these institutions receive from state general revenue is relatively low.

Indeed, in the 2006–2007 school year, New Hampshire state government appropriated \$91 per capita to public higher

education—about half the regional average of \$185.⁴² Applying the RES approach to state higher education appropriations (as opposed to overall higher education expenditures) suggests that lower expenditure need accounts for only about 12 percent of this gap. In other words, low state appropriations appear to be largely a matter of choice.

Granite State governments have commonly contributed less per capita to pension funds for public employees than governments in other New England states. The data in Table 2 do not include intragovernment spending—that is, transfers of funds *within* a level of government. Thus, they do not capture one important area of government spending that has drawn much attention: state and local government contributions to pension funds for public employees.

Box 3

Pension contributions: Saving today by underfunding tomorrow?

Figure 11 showed that New Hampshire governments contributed less per capita to public employee pensions than governments in other New England states from FY 1994 to 2007. A natural question thus is: what factors dictate a government's pension fund contribution?

Each year actuaries compute a government's annual required contribution (ARC). The ARC is the amount needed to fund benefits accrued by employees in the current year (the normal cost), plus the amount needed to retire any unfunded liability over a designated period (the amortization period), taking into account projections of the other two sources of pension fund income: employee contributions and investment earnings.^o

A number of factors influence a government's ARC. On the one hand, some, such as the performance of financial markets and previous policy decisions on the structure and generosity of benefits, are essentially out of the current government's direct control.^p On the other hand, the current government can

more readily influence other factors in the near term, such as employee contribution rates, and the assumptions and methods used to calculate the ARC. Governments also have leeway regarding whether to make the full ARC payment, as doing so is typically not a legal requirement (despite the word "required" in the term).^q

In the Granite State's case, government employers did contribute the full ARC amount from FY 1994 to 2007.^r However, accounting methods adopted by lawmakers in the early 1990s appear to have kept the ARCs themselves—and therefore government contributions—artificially low.^s In 2007 the New Hampshire legislature voted to return to the accounting system used by many state pension systems. According to annual reports from the New Hampshire Retirement System, government contributions rose sharply from FY 2007 to 2010, the most recent year available, presumably influenced both by the change in the accounting method as well as the investment losses suffered during the financial crisis.^t

Figure 11 shows government contributions to state and local pension funds on a per capita basis for the six New England states for FY 1994 to 2007. State and local governments in the Granite State contributed less per capita than every other New England state over the entire period.

In FY 2007, New Hampshire government employers contributed \$95 per capita, compared with a range of \$161 in Vermont to \$414 in Rhode Island. New Hampshire was \$194 below the regional average that year—a gap larger than in any spending area in Table 2, save for public welfare and the catch-all category. To put this in perspective, tax revenues in the Granite State would have had to increase by around 5 percent in FY 2007 to fund contributions at the regional average, assuming no other spending or revenue changes. New Hampshire also contributed less per member of its retirement system than every other state in the region over the period, except Vermont in FY 2000 and 2001.

A variety of choices and circumstances affect the amount that governments contribute to their employee pension funds each

year (see Box 3). As the box notes, New Hampshire kept contributions low for a number of years, at least in part, by using an unorthodox accounting method to shift some of its obligations away from current taxpayers. This choice has likely helped the Granite State avoid an income or sales tax thus far, but has also contributed to the state's large unfunded pension liability: the portion of promised benefits that existing fund assets cannot cover.⁴³

Who bears—or will bear—the cost of this underfunding? Taxpayers and users of government services may be affected if the state needs to raise additional revenue or cut spending elsewhere to pay for higher contributions. Government employees (and future retirees) may also have to contribute more, work longer, or receive fewer retirement benefits. New Hampshire governments have recently raised their contributions in response to underfunding and investment losses, and the state has enacted other reforms to shore up the system, including an increase in the retirement age. However, the Granite State will likely need further measures to restore the health of the fund.⁴⁴

How New Hampshire does it: The revenue side

So far I have compared New Hampshire's spending with that of other New England states, and explored the factors that drive that spending. I now focus on the revenue side of the ledger.

What revenue sources *does* the state rely on to support its spending? Is there truth to the perception that the Granite State relies on property taxes to offset its lack of an income or sales tax? Is it even true that New Hampshire lacks an income tax? Are there other salient features of New Hampshire's revenue system worth noting?

Let us begin the investigation of revenue as we did spending—by comparing New Hampshire with other New England states. As we saw in Figure 1, New Hampshire's overall revenues were 22 percent below the regional average in FY 2007.⁴⁵ Table 5 presents per capita revenue figures by source and state for state and local governments combined. The table shows that more than three-quarters of the overall (net) gap in revenues between New Hampshire and the regional average is due to lower tax collections.

Granite State governments collected a total of \$3,608 in taxes per capita—\$1,424, or 28 percent, below the New England average. New Hampshire's per capita intergovernmental revenue—revenue received from the federal government—was also lowest in the region, at \$1,281. This was 20 percent below the regional average, and 44 percent lower than in Vermont (\$2,310), the region's far-and-away leader.⁴⁶

New Hampshire's combined state and local revenues from current charges and miscellaneous sources were more closely aligned with regional averages. However, as we saw above, the Granite State appears to rely more heavily on charge revenues to finance some areas of spending—including higher education—than other New England states.

Focusing on the tax category, we see that the Granite State's lower revenues are, as expected, driven by limited revenues in the individual income category (i.e. from the state's narrow income tax on interest

and dividend income), and by the lack of a general sales tax. New Hampshire collects higher-than-average revenues per capita in most other tax categories—notably the property and corporate income categories. The next section explores those two categories in greater detail.

New Hampshire per capita property taxes are high relative to most other New England states, and account for a larger share of overall revenue.

Many discussions about the Granite State's revenues focus on the property tax. Property taxes are the largest single source of revenue for New Hampshire state and local governments combined, though this fact by itself does not make the Granite State unique. Indeed, the same is true for every other New England state except Massachusetts. However, New Hampshire sets itself apart in other ways regarding this revenue source.

The Granite State's state and local per capita property tax revenues totaled \$2,215 in FY 2007—higher than in any other state in the region except Connecticut, and \$304 (or about 16 percent) above the regional average.⁴⁷ When combining this with the state's lower-than-average total revenues, we can see that the property tax represents a larger share of overall revenues in New Hampshire than in other states in New England.

Indeed, the property tax represented 34 percent of Granite State governments' overall revenues in FY 2007, compared with 20 percent (Maine and Massachusetts) to 26 percent (Connecticut) in other New England states, and a regional average of 23 percent. The property tax also accounted for more than 60 percent of combined state and local tax revenues in New Hampshire in FY 2007, whereas the regional average was 38 percent.

It is important to note that these findings describe how New Hampshire's collection of, and reliance on, property taxes compare with the rest of the region. They do not necessarily tell us whether New Hampshire residents face a higher property tax burden than residents of other New England states. Property tax

collection per capita is a misleading measure of burden because some tax costs are inevitably passed on to non-residents. Measuring the burden of property taxes on state residents and comparing New Hampshire to the rest of the region in this regard are therefore separate issues beyond the scope of this paper.⁴⁸

Although New Hampshire lacks a traditional income tax, the state does levy a tax on wages and salaries through its business enterprise tax.

Table 5 shows that New Hampshire collected \$453 per capita in the corporate income tax category—more than any other New England state, and \$170 (or 60 percent) above the regional average. While that would seem to suggest that the Granite State taxes business income more heavily than its regional

counterparts, the reality is more complicated.

Unlike other states in the region, New Hampshire has two major taxes on businesses: the business profits tax (BPT), and the business enterprise tax (BET) (see Table 6). The Census Bureau’s corporate income tax category includes both taxes, but this classification is somewhat misleading.

While the BPT is similar in structure to corporate income taxes in other states, the BET is quite different. The BET is a tax on the wages and salaries, interest, and dividends paid by businesses—not a tax on corporate income (i.e. profits). Indeed, the BET was enacted in 1993 partly to address some concerns with the BPT (see Box 4). If we exclude BET revenues from the corporate income category—allowing for more of an apples-to-

Table 5. New Hampshire has lower overall revenues per capita than other New England states, but collects more in property and business taxes per capita

Per capita revenues collected by state and local governments combined, FY 2007

	CT	ME	MA	NH	RI	VT	NE average	Gap between NH and NE average		NH rank
								Dollars	Percent	
Total revenues	8,823	7,873	8,507	6,504	8,315	8,834	8,341	-1,837	-22.0	6
Own-source revenues	7,515	5,956	6,863	5,222	6,326	6,524	6,733	-1,511	-22.4	6
Taxes	6,171	4,363	4,955	3,608	4,525	4,732	5,032	-1,424	-28.3	6
Property	2,314	1,565	1,703	2,215	1,857	1,994	1,911	304	15.9	2
General sales	869	801	629	–	828	548	657	-657	-100.0	6
Selective sales	656	483	323	559	467	832	474	85	18.0	3
Motor fuel	126	177	104	98	125	141	119	-21	-17.3	6
Alcoholic beverages	12	13	11	10	11	31	12	-3	-21.0	6
Tobacco products	73	121	68	105	113	104	82	23	28.2	3
Public utilities	68	20	4	56	97	20	33	23	68.6	3
Other	378	153	137	290	122	537	228	62	27.4	3
Individual income	1,817	1,116	1,758	82	1,026	937	1,469	-1,388	-94.4	6
Corporate income	256	140	325	453	169	134	283	170	60.0	1
Motor vehicle license	58	65	46	65	50	122	56	9	16.0	2
Other taxes	199	193	170	234	128	163	182	52	28.6	1
Current charges	728	871	946	861	826	998	872	-11	-1.2	4
Miscellaneous	616	721	962	754	974	795	830	-76	-9.2	4
Intergovernmental revenues	1,308	1,917	1,643	1,281	1,988	2,310	1,608	-327	-20.3	6

Source: Author’s calculations based on data from the US Census Bureau, 2007 Census of Governments and US Census Bureau state population estimates. Note: NEC = not elsewhere classified. The table excludes revenues associated with utilities, liquor stores, and social insurance trusts. Population data used in per capita calculations are adjusted to reflect the fiscal year. Averages represent population-weighted averages for the six New England states. Please see the data appendix available on the New England Public Policy Center’s website for additional years of revenue data and alternative calculations of the regional average.

Table 6. Summary of New Hampshire's major taxes

State taxes	Description
Business profits tax	8.5 percent tax on income from conducting business activity within the state. Income for multistate businesses is apportioned to New Hampshire based on their level of sales, payroll, and property in the state, with sales receiving double-weight in the apportionment calculation.
Business enterprise tax	0.75 percent tax on the "enterprise value tax base," defined as the sum of all compensation paid or accrued, interest paid or accrued, and dividends paid, after special adjustments and apportionment.
Interest and dividends tax	5 percent tax on interest and dividend income of more than \$2,400 per individual (\$4,800 for joint filers).
Meals and rooms tax	9 percent tax on hotels, campsites, motor vehicle rentals, and restaurant meals.
Tobacco tax	\$1.78 tax per pack of cigarettes.
Real estate transfer tax	Tax of \$0.75 per \$100 of the sales price for any sale or transfer of real property, assessed on both the buyer and seller.
Communications services tax	7 percent tax on all two-way communications services.
Insurance premium tax	1.25 percent tax on premiums for insurance business written in the state.
Utility property tax	\$6.60 per \$1,000 of value of utility property.
State education property tax	Tax rate applied to total equalized valuation; tax is assessed and collected by local municipalities. In 2007, rates ranged from \$1.73 to \$3.29 per \$1,000, with a median of \$2.27 per \$1,000.
Local tax	Description
Property tax	Tax rate applied to assessed valuation; tax is levied, assessed, and collected by local municipalities. In 2007, combined local rates ranged from \$2.28 to \$30.36 per \$1,000, with a median of \$15.50 per \$1,000.

Source: New Hampshire Department of Revenue Administration, Insurance premium tax description based on New Hampshire Statutes, Title XXXVII, RSA 400-A32:1; Tobacco tax rate from The Tax Foundation.

Note: Describes taxes as of March 2010. Table does not include all taxes levied by the state. For example, the state also levies taxes on timber, gravel, and beer. The meals and rooms tax is also referred to as the meals and rentals tax. Statistics on property tax rates exclude municipalities where tax rate was zero or negative. Combined local rates include rates for town, local education, and county taxes.

apples comparison of per capita collections of state corporate income taxes—New Hampshire appears similar to the regional average (see simulated values in Table 4-A).⁴⁹

Given its base, the BET more closely resembles an individual income tax than a corporate income tax, although not a traditional one. A key difference between the BET and most individual income taxes is that the BET is statutorily imposed on businesses. In states with traditional income taxes, businesses play an important role by withholding those taxes from employees' salaries. However, the statutory burden is on individuals, who must file a tax return on their wage and salary income. This process is notably absent with the BET.

The BET also differs from most state income taxes in that it carries a lower rate and lacks exemptions and deductions. The low rate—0.75 percent—is likely one reason why New Hampshire's per capita revenue from the tax is considerably lower than per capita revenue from individual income taxes in other New England states. Another reason is that the BET does not tax wages and salaries paid to individuals employed in the public sector or by other non-business entities—compensation that would be taxed in most states. If we shift BET revenues to the Census Bureau's individual income category, New Hampshire's per capita collections would rise to \$274 (based on the simulation in Table 4-A)—still \$1,213 lower than the regional average.

Box 4

Is New Hampshire really a no-income-tax state? The case of the business enterprise tax

One premise of this paper is that New Hampshire does not levy a broad-based personal income tax on its residents. Some would dispute that notion, pointing to the business enterprise tax, or BET, as evidence.

First, what exactly is the BET and how does it work? The BET is a tax paid by businesses levied on the “business enterprise base,” which includes wages and other compensation, interest, and dividends paid by business. The tax was established in 1993 as part of an effort to reform business taxes in the Granite State.

The tax was designed to be revenue neutral, as it coincided with a decrease in the business profits tax (BPT) and repeal of a bank franchise tax and corporate franchise fees. The BET’s original rate was 0.25 percent, although today it stands at 0.75 percent. An important feature of the tax is that businesses are allowed a credit against any BPT liability equal to the amount of BET taxes paid. For businesses with a large BPT liability, the credit can fully offset any BET payments.^U

Policymakers adopted the BET to increase both the stability and the perceived fairness of New Hampshire’s tax system. Unlike the BPT, businesses must pay the BET whether or not they are profitable. By reducing (slightly) the state’s reliance on the BPT—which by its nature is a volatile revenue source—in favor of the BET, the state sought to make its revenues more stable.

The BPT was also perceived to be an unfair tax, because a small number of corporations made the overwhelming share of payments. The BET, in contrast, applies to all business organizations and types of economic activity, spreading the tax burden more widely. The BET has also been lauded for its simplicity, economic neutrality, and political stability.^V However, some have claimed that by targeting employee compensation, the BET can discourage employers from creating local

jobs—a factor somewhat offset by the tax’s creditability against the BPT.

Is it fair to describe the BET as an income tax? According to Stan Arnold and William Ardinger, two of the tax’s architects, the BET is, in essence, “a multistage consumption tax or value added tax (VAT) imposed and administered on the business level.” New Hampshire economist Daphne Kenyon similarly describes the BET as “an income-type VAT.”^W In this case, value-added is measured by the amount each firms pays to compensate labor and capital.

Nomenclature aside, the bottom line is that the BET is a tax on wages and salaries, and, as such, is a broad-based tax on income, if not an explicit one. Still, the BET differs from most state income taxes in several respects elucidated by Kenyon. First, it is statutorily imposed on businesses rather than individuals. This means that individuals do not have to file a return with the state on their wage and salary income; it also means that the salaries of individuals whose employers are not subject to the BET (e.g. public sector workers) are not taxed. Second, the BET is a flat tax: it has a single rate with no exemptions or deductions, which are common in many personal income taxes. And third, the BET has a lower rate than most personal income taxes, even after accounting for the lack of exemptions and deductions.

How would New Hampshire compare with other New England states if we relabeled the BET as an income tax? Table 4-A shows simulated tax collections if BET revenues were transferred from the corporate income category to the individual income category.^X Even with the BET relabeled as an individual income tax, New Hampshire’s per capita revenues in this category would still fall far behind the regional average. However, removing the BET from the corporate income category brings the Granite State in line with the regional average in that category.

Table 4-A: Excluding the business enterprise tax, New Hampshire revenues from corporate income taxes are similar to the regional average

Simulated per capita revenues from individual and corporate income taxes, FY 2007

								Gap between NH and NE average		NH rank
	CT	ME	MA	NH	RI	VT	NE average	Dollars	Percent	
Individual income	1,817	1,116	1,758	274	1,026	937	1,487	-1,213	-81.6	6
Corporate income	256	140	325	261	169	134	266	-4	-1.6	2

Sources: Author’s calculations based on data from the US Census Bureau, 2007 Census of Governments, US Census Bureau state population estimates and New Hampshire *Comprehensive Annual Financial Report*, FY 2007.

Note: Population data used in per capita calculations are adjusted to reflect the fiscal year. Averages represent population-weighted averages for the six New England states.

New Hampshire state government revenues are fairly diverse.

As noted, property taxes represent about a third of the Granite State’s combined overall state and local revenues, and about 60 percent of combined tax revenues—largely because property taxes constitute the vast majority of revenue for local governments.⁵⁰ However, if we consider only state government, we find that New Hampshire’s revenue system is considerably more diverse than that of other New England states.

Figure 12 shows the composition of state government tax revenues based on Census Bureau categories. On average, New England states obtain close to half of all tax revenues from individual income taxes, and

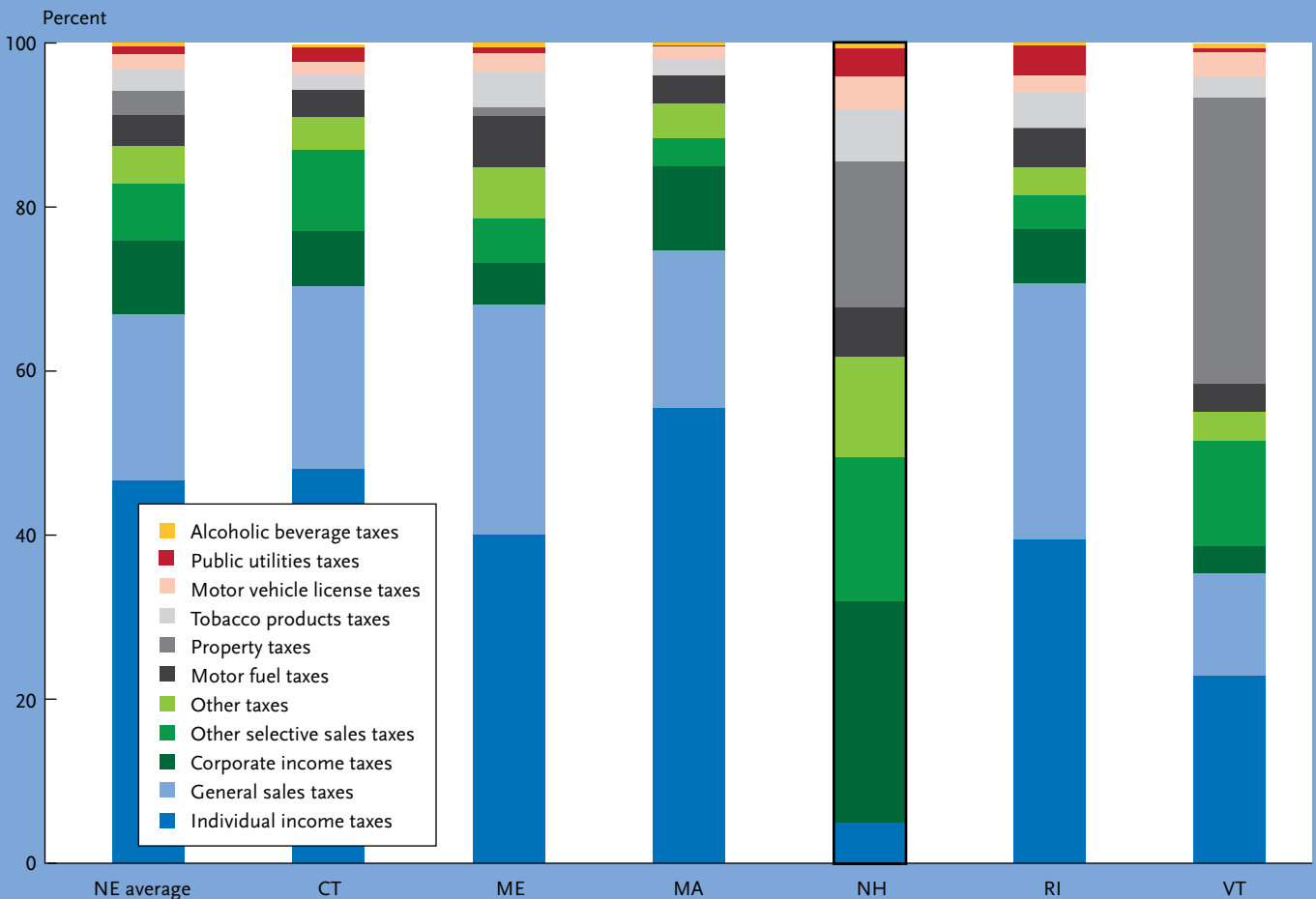
about two-thirds from individual income and general sales taxes combined. In contrast, New Hampshire’s tax revenues are far less concentrated.⁵¹ Indeed, because corporate income—the largest single tax category for state government in New Hampshire—is actually composed of two separate taxes, the state’s revenue system is even more diverse than the figure suggests.

While Census Bureau data are useful for promoting cross-state comparisons, they can mask interesting detail on specific revenue sources—as the corporate income tax example reveals. To get a better sense of New Hampshire’s revenue system, we must turn to state data sources.

Figure 13 shows the relative magnitude

Figure 12. State government tax revenues are more diverse in New Hampshire than elsewhere in New England

Share of state tax revenues by category, FY 2007



Source: Author’s calculations based on data from the US Census Bureau, 2007 Census of Governments.
 Note: The New England average represents a population-weighted average for the six states.

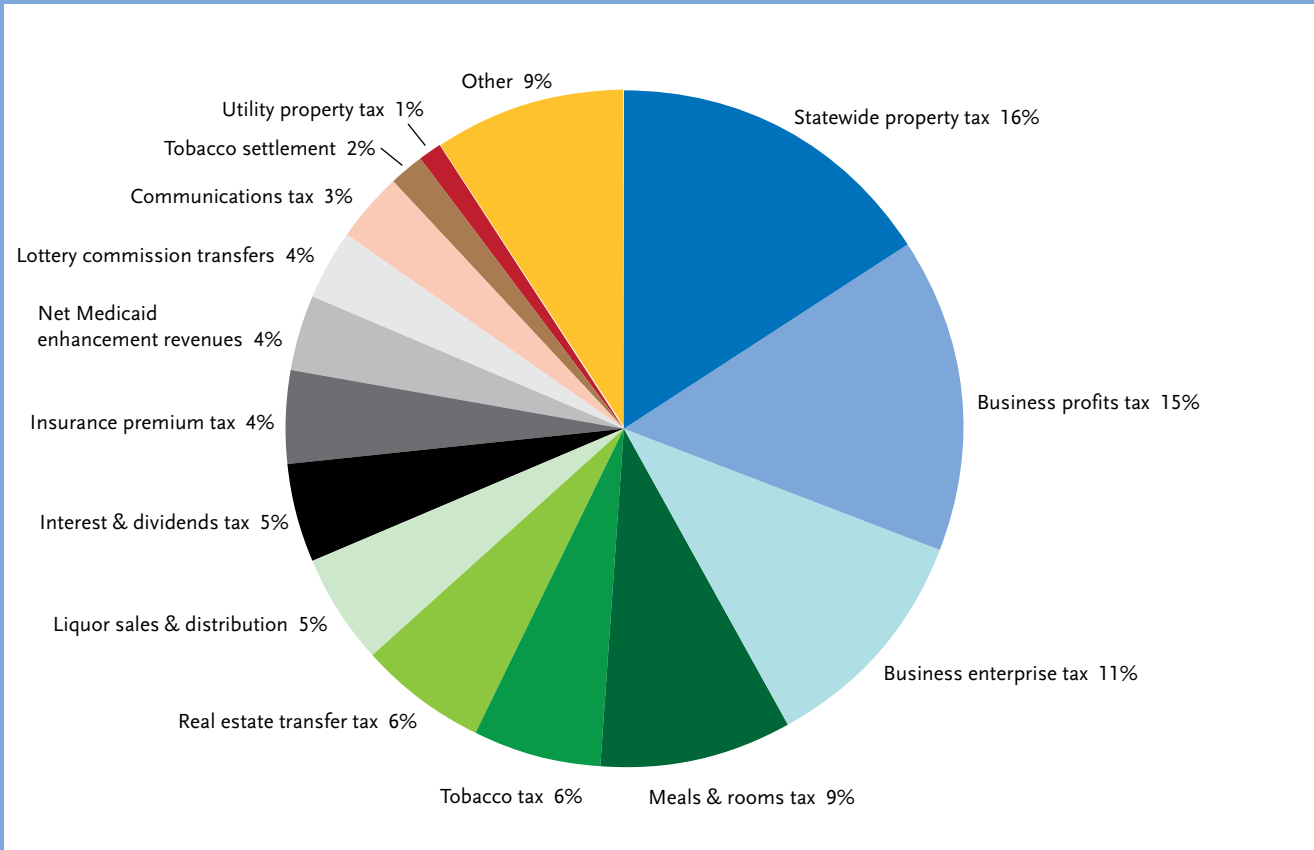
of unrestricted revenues flowing into New Hampshire state government's general and education funds in FY 2007, as captured in the state's annual financial report.⁵² This figure further illuminates the diversity of the state's revenue system: no single source represents more than 20 percent of revenues for the combined funds.

The statewide property tax was the largest revenue source in FY 2007 (accounting for 15.9 percent of the total), followed closely by the BPT (15.1 percent). The BET (11.1 percent) and the meals and rooms tax (9.2 percent) were the third- and fourth-largest revenue sources. The state also obtains revenue from a variety of other taxes, including those on tobacco, communications, real estate transfers, and interest and dividends, as well as from various non-tax sources.

It is interesting to note that New Hampshire, while avoiding a broad-based income or sales tax, has increased revenues from a number of these sources over the years. According to the bi-annual *Fiscal Survey of States*, New Hampshire has enacted one or more increases in the BPT, BET, meals and rooms, tobacco, real estate transfer, and communications taxes since FY 1997.⁵³ Some of these increases—as well as the enactment of the statewide property tax—came in response to a state Supreme Court decision that required New Hampshire to change the way it funded K-12 education (see Box 5). Policymakers enacted other increases—such as the recent expansion of the meals and rooms tax to apply to campsites—to help close budget holes during the latest fiscal crisis.

Figure 13. No single revenue source accounted for more than 20 percent of New Hampshire general and education fund revenues in FY 2007

Share of unrestricted revenues, general and education funds FY 2007



Source: Author's calculations based on data from the New Hampshire *Comprehensive Annual Financial Report*, FY 2007.

Other interesting facets of New Hampshire's revenue structure include the state's unique approach to tobacco and liquor revenues, and its creative (and successful) use of so-called Medicaid enhancement revenues. Though these three revenue sources were not among the state's largest in FY 2007—together they represented the same share of general and education fund revenues as the BPT alone—they serve as interesting examples of how New Hampshire “does it” on the revenue side.

New Hampshire has used a low-tax (or no-tax) strategy on tobacco and liquor to attract non-resident purchases, and thus boost revenues.

Like other states, New Hampshire collects taxes and other revenues not only from its own residents, but also from non-residents. In some cases the mechanisms are direct—such as when a non-resident who owns a vacation home in New Hampshire pays property taxes to state and local governments. In other cases the mechanisms are indirect, such as when a New Hampshire business passes its tax burden to its out-of-state customers.

The Granite State has had particular success in attracting revenues from sales of tobacco and liquor to non-residents. In both cases, New Hampshire has exercised a low-tax (or no-tax) strategy to draw out-of-state purchasers, thereby expanding its revenue base.⁵⁴

Tobacco. New Hampshire has historically had one of the lowest excise taxes on tobacco in the region, and has had the lowest rate since 2002. As of January 1, 2007, New Hampshire levied a tax of \$0.80 per pack of cigarettes, while taxes in other New England states ranged from \$1.51 in Connecticut and Massachusetts to \$2.46 in Rhode Island.⁵⁵

A 2008 study by the Mackinac Center for Public Policy in Michigan attests to heavy cross-border cigarette sales.⁵⁶ The authors estimated that from 1990 to 2006, New Hampshire's cigarette “export rate”—cigarettes purchased for out-of-state use relative to in-state consumption—was 17.2 percent, higher than any other state in the region, and

Box 5

How New Hampshire did it: Response to court decisions on school funding.

Possibly the best example of New Hampshire's will to avoid a broad-based income or sales tax is the state government's approach to court-imposed mandates for education funding. In the 1990s, the New Hampshire Supreme Court ruled that the state was responsible for providing elementary and secondary education, and that the system for financing schools—which relied almost solely on local property taxes—was unconstitutional.

The issue has remained contentious over the years with a variety of ensuing court decisions and legislative responses attempting to comply with the judicial rulings. However, the original decision meant that the state government had to sharply increase its contribution to K–12 education.

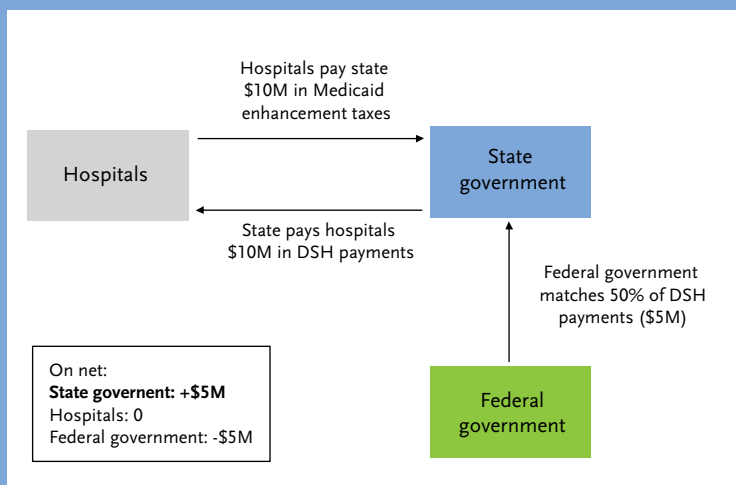
A commission created in 2000 by Governor Jeanne Shaheen was charged with evaluating options for generating the \$825 million that the legislature deemed necessary to fund an adequate education for all students.^Y While the commission—and later the legislature—considered broad-based taxes, the state ultimately chose to rely on a new statewide property tax (first enacted as an interim measure in 1999) and increases in existing taxes and fees to raise the required funds.^Z

Notably, the state raised the business profits tax from 7 percent to 8.5 percent over two years, and the business enterprise tax from 0.25 percent to 0.75 percent. The state also raised taxes on cigarettes, communications, and real estate transfers, and extended the rooms and meals tax to cover rental cars.^{AA} Although the state continues to grapple with how to comply with the court's rulings, it has done so without resorting to a new broad-based tax.

the third highest in the nation.⁵⁷

New Hampshire's per capita revenue collections on tobacco products are not the region's highest, but are nearly 30 percent higher than the average (see Table 5). We saw in Figure 13 that tobacco revenues accounted for 6 percent of the state's general and education fund revenues in FY 2007. There is, however, anecdotal evidence that the Granite State's ability to attract out-of-state cigarette purchasers may be slipping. As noted, New Hampshire policymakers have chosen to raise tobacco taxes in recent years. The most recent increase has coincided with a bump in cigarette sales in Maine, leading some to posit that Mainers no longer feel it is worth a trip to New Hampshire to purchase tobacco products.⁵⁸

Figure 14. Illustration of a New Hampshire Medicaid financing arrangement



Note: DSH = Disproportionate Share Hospital.

Liquor. The Granite State is well-known in the region for its tax-free liquor and flagship state liquor stores near its borders.⁵⁹ The no-tax status of hard alcohol, as well as the strategic placement of stores, has attracted significant purchases by non-residents. Indeed, a 2009 *Wall Street Journal* article reported that nearly half of the state’s liquor sales were made to out-of-state customers.⁶⁰

We can infer the volume of cross-border sales by looking at *apparent* alcohol consumption: by comparing in-state alcohol sales with the state’s population over age 14. High apparent consumption is a potential indicator of high cross-border sales. The National Institute on Alcohol Abuse and Alcoholism puts New Hampshire’s apparent consumption of spirits at 1.76 gallons per person above age 14 in 2006—higher than in any other state in the nation, and more than twice that in any other New England state.⁶¹

Despite the absence of a tax, New Hampshire still nets revenue from hard alcohol sales because profits from the state’s liquor store operations return to the general fund. As Figure 13 showed, revenues from liquor sales and distribution represented 5 percent of general and education fund revenues in FY 2007—as much as the state’s tax on interest and dividends.⁶²

New Hampshire has had great success in bolstering its revenues through creative Medicaid financing arrangements.

As we saw in Table 5, New Hampshire governments received less federal money per capita in FY 2007 than other states in the region. This is not surprising given that New Hampshire is a high-income, low-poverty state, and that many forms of federal assistance are allocated by formulas that take into account the economic well-being of states’ populations. However, lost in the overall intergovernmental aid number is one area in which New Hampshire has been very successful in attracting federal dollars: creative Medicaid financing arrangements.

Since the early 1990s, states have found ways to exploit loopholes in Medicaid funding rules to maximize federal matching dollars. These types of arrangements have taken several forms. Although Congress has passed several laws designed to curb such arrangements, it has in some cases given states transition periods to comply, or even grandfathered heavy users—such as New Hampshire—into continued high levels of funding.

Consider the case of Disproportionate Share Hospital (DSH, pronounced “dish”) allotments. Under Medicaid rules, states can receive federal matching funds for supplemental funding (known as DSH spending) to hospitals serving a disproportionate share of share of low-income patients. In the early 1990s there was no limit on states’ ability to extract federal matching dollars for DSH spending, and a number of states exploited the rules surrounding these payments to increase their federal funding. Although the rules have been tightened, the amount of federal money that a state is currently allotted for its DSH program is partly dictated by the state’s 1992 level of DSH spending. Thus, states that were heavy users of this scheme in the early 1990s are locked in to higher allotments.⁶³ Data from the Kaiser Foundation show that New Hampshire’s per capita allotment was \$114 in FY 2008—second only to Louisiana nationally and well above other

New England states which ranged from \$34 in Vermont to \$75 in Maine.⁶⁴

In New Hampshire, the DSH “arrangement” has essentially worked like this: The state taxes hospitals’ net revenues from patient services (known as the Medicaid enhancement tax), and then returns the funds to the hospitals in the form of DSH payments, which are subject to federal matching. The state then transfers the federal dollars to its general fund (see Figure 14 for an illustration).⁶⁵

New Hampshire’s annual financial reports include net Medicaid enhancement revenue (NMER), which represents transfers from the DSH program to the general fund.⁶⁶ Figure 15 shows NMER by fiscal year starting in 1991, the year the reports began listing this category. NMERs were highest in the early 1990s, peaking in 1994 at \$250 million and then falling and rising again, peaking this time at around \$150 million in 2004. In

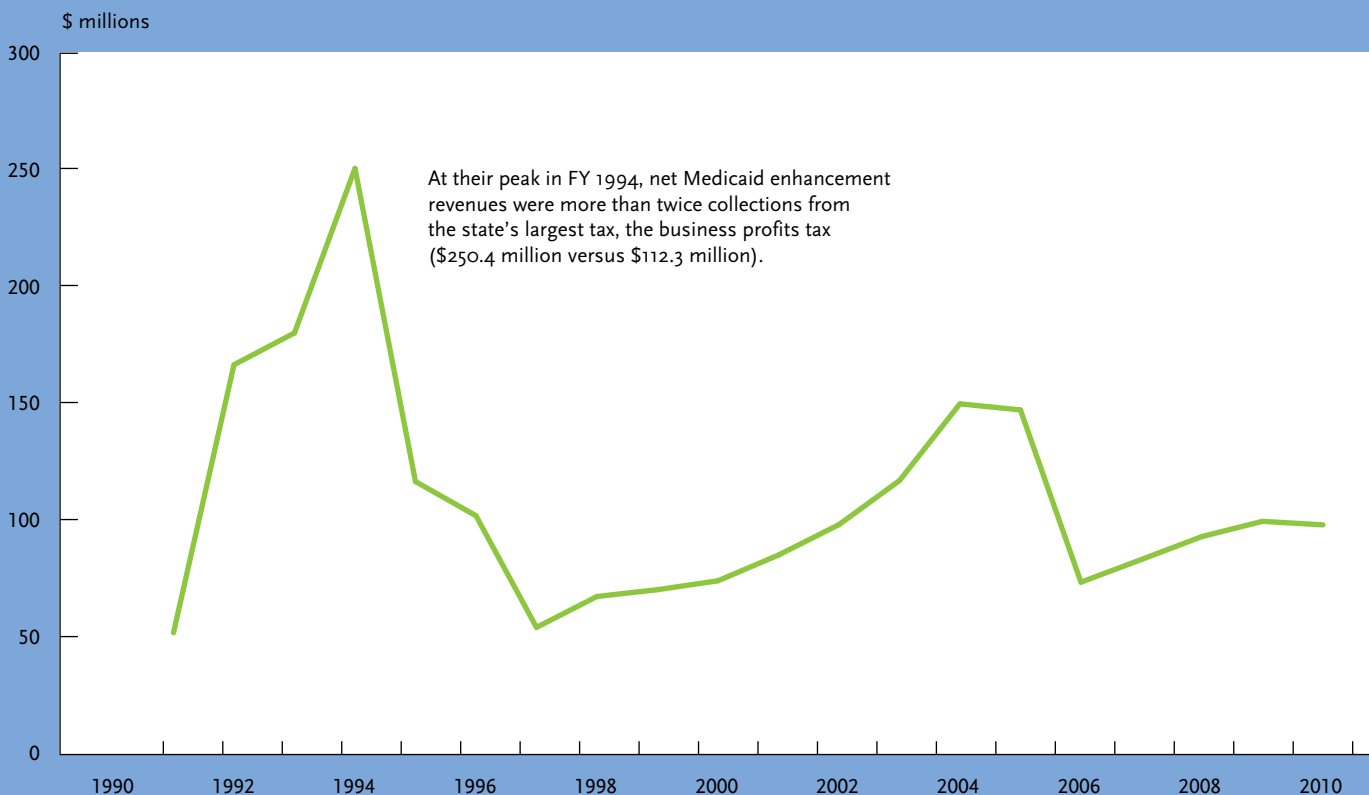
FY 2007, the year captured in Figure 13, NMER was about \$83 million (about \$63 per capita), representing 4 percent of general and education fund revenues.⁶⁷

Some have attributed New Hampshire’s ability to close budget deficits without enacting broad-based taxes to the state’s successful use of Medicaid arrangements.⁶⁸ Others have commented on the fact that the Granite State has historically been more resourceful than other states at tapping this source of federal funding. According to former state legislator Douglas Hall in a 2003 interview with New Hampshire Public Radio, “Our analysis in the early 1990s found that New Hampshire was using these measures on a per capita basis way more than other states—ten times, if not 100 times more than other states.”⁶⁹

While this approach was clearly important in the past, a key question is whether the state can continue to rely on Medicaid

Figure 15. New Hampshire has obtained significant revenue through creative Medicaid financing arrangements, particularly in the early 1990s

Net Medicaid enhancement revenues, FY 1991-2010



Source: New Hampshire Comprehensive Annual Financial Report, various years.

enhancements into the future. In 2010 New Hampshire lawmakers were compelled to alter the way the state calculates DSH payments to hospitals in an attempt to bring the program into compliance with federal standards.⁷⁰ While these changes would not necessarily prohibit the state from continuing to use federal matching dollars to bolster the general fund, they are a sign that New Hampshire's DSH program has been under scrutiny. New Hampshire's use of Medicaid arrangements could also be impacted by federal health reform. This legislation enacted in 2010 aims to reduce DSH payments to states starting in 2014.⁷¹

Summary of findings

In this paper I set out to investigate how New Hampshire has avoided a broad-based income or sales tax. I explored the question of how New Hampshire “does it” from two angles: the factors that drive the state's lower-than-average spending, and the revenue sources that the state actually relies on to pay for that spending.

Pundits tend to offer blanket explanations for why New Hampshire's spending has historically been lower than elsewhere in the region. These explanations—often some variation on a belief-in-limited government theme—are unsatisfactory for at least two reasons. First, they tend to mask variations in government spending across different areas. Second, blanket explanations often do not capture the fact that government expenditures typically result from a complex interplay of choices and circumstances.

New Hampshire does spend less than other New England states in most—although not all—areas of government activity when measured on a per capita basis. A large portion of the gap between New Hampshire's spending and the regional average appears to concentrate in a few key areas, especially public welfare—which includes Medicaid. Lower public welfare spending alone accounts for close to one-third of the overall gap.

A closer inspection of Medicaid revenues and expenditures in New Hampshire

underscores the complexity of attempts to understand the factors driving spending levels. New Hampshire does spend less per capita on Medicaid than any other New England state. However, this is not simply because the Granite State's Medicaid program is less generous (though in some ways it is), nor is it just because there are objectively fewer low-income people who might benefit from government-provided healthcare (though there are). Rather, it is a combination of these—and other—factors.

The RES approach provides a systematic means of gauging the importance of states' underlying circumstances by calculating expenditure need: the amount a state would need to spend to provide the regional average level of services, given its underlying need and input costs. Such an analysis suggests that lower expenditure need accounts for around 40 percent of the overall gap between New Hampshire's per capita spending and the regional average.

There is, however, significant variation across spending areas. For example, state and local governments spent more than their expenditure need for police protection—but considerably less than their expenditure need for public hospitals. That does not necessarily mean that the state spends too much on public safety, or too little on public hospitals. However, it does suggest that painting all of government with a broad brush may not capture the full picture.

On the other side of the ledger, conversations about how New Hampshire compensates for the lack of a broad-based income or sales tax tend to center on the property tax. Property taxes are indeed higher on a per capita basis in the Granite State than in most other states in the region. These taxes represent about one-third of combined state and local revenues in New Hampshire—more than in any other state in New England. This reliance on the property tax does warrant discussion. However, just as spending cannot be explained by a single factor, property taxes are not the whole revenue story in the Granite State. Indeed, the revenue structure for New

Hampshire's state government is considerably more diverse than that of other states in the region. No single source accounted for more than 20 percent of New Hampshire's unrestricted general and education fund revenues in FY 2007.

The state's revenue system has a number of other salient features. For one, New Hampshire has taken a unique approach to business taxes. The state's business profits tax (BPT) is similar to a corporate income tax in many states. The business enterprise tax (BET), in contrast, is a tax on wages and salaries, interest, and dividends paid by businesses. The premise of this paper—that New Hampshire does not levy a broad-based income tax—is therefore somewhat misleading. The state does impose a tax on wage and salary income, albeit not a traditional income tax.

The BPT and BET are both important revenue sources, together comprising about one-quarter of general and education fund revenues in FY 2007. Rate increases for those taxes also played an instrumental role—along with a new statewide property tax—in the state's response to judicial mandates on school funding. The Granite State has also boosted state revenues by relying on a low-tax (or no-tax) strategy that attracts non-residents to buy cigarettes and liquor, and by capitalizing on loopholes in rules for federal Medicaid funding.

Implications for policymakers

This paper does not provide specific policy prescriptions for states interested in emulating New Hampshire's fiscal model. If anything, it shows that there is no single silver bullet—but rather that there are some impediments to replicating New Hampshire's approach.

Some are circumstantial: states with higher costs or needier populations may simply need to spend more than New Hampshire to provide a given level of services. Other impediments relate to choices. Some of New Hampshire's governments' actions may be infeasible, such as the pursuit of Medicaid enhancements in the face of increasingly

stringent federal rules, or inadvisable, such as artificially lowered required pension contributions. Other choices may simply not be in line with the preferences of the populations of other states.

It is my hope that this paper will spur discussion among policymakers in states across the region as they grapple with how to provide services in fiscally challenging times. Although focused on illuminating New Hampshire's fiscal structure, the paper presents comparative expenditure and revenue data for all six New England states and provides a framework for thinking about the factors that drive spending levels.

The paper seeks to be informative rather than normative. I do not judge whether New Hampshire's—or any state's—spending levels are right or wrong or whether the composition of its revenue system is optimal. Policymakers must make choices about what services government should provide and how to carry out—and pay for—those services. However, to better understand the ramifications of their decisions, they should be mindful of the circumstances faced by the state and its citizens. Who will be affected by changes in service levels, and to what degree? Are there ways to improve efficiency so as to reduce spending without sacrificing services? On the revenue side, deliberations should include a careful weighing of not just the fiscal impact of any particular option, but also how it affects the equity, neutrality, stability, simplicity, and competitiveness of the revenue system.

These types of conversations are also essential in New Hampshire. This paper highlights the fact that New Hampshire's overall spending is low relative to that of other New England states, and that its population boasts a lower overall poverty rate and higher median income. However the Granite State has not been immune to cyclical and structural deficits and there are individuals and families in the state who are struggling and in need of support.

Although New Hampshire has managed to stay the course of no explicit broad-based

taxes, the future holds considerable challenges and uncertainties. Federal stimulus funds, which helped plug holes in recent budget cycles, will be disappearing. Federal health reform may also have ramifications for future Medicaid spending, as well as the enhancement revenues the state has relied on to help bridge budget gaps over the years. Unfunded liabilities for pension and other retirement benefits loom large on the horizon. And the state continues to wrestle with how to fund public education in a manner compliant with the Court and acceptable to state residents. New Hampshire's leaders—like their counterparts across the region, and indeed, the nation—thus too face the difficult task of defining and financing a government that best meets the needs and preferences of the citizenry.

Endnotes

- ¹ New Hampshire does have a narrow income tax on interest and dividend income and, as discussed later, the state also taxes wages and salaries through its business enterprise tax. Alaska once had a personal income tax, but repealed it in the early 1980s. See The Tax Foundation, “Facts on Alaska’s Tax Climate.” <http://www.taxfoundation.org/research/topic/11.html>.
- ² For a discussion of some of the political reasons why New Hampshire has avoided an income or sales tax, see Colin D. Campbell, “New Hampshire’s Tax-Base Limits: An Example of the Leviathan Model,” *Public Choice* 78(2) (February 1994):129–144.
- ³ Alaska obtains considerable revenues from severance taxes and royalties associated with the oil industry. See Alaska’s *Comprehensive Annual Financial Report*, FY 2010, Juneau, p. v.
- ⁴ See, for example, Pam Belluck, “Massachusetts Proposal Would Repeal Income Tax,” *New York Times*, September 28, 2008.
- ⁵ Arthur Laffer and Stephen Moore, “Soak the Rich, Lose the Rich,” *Wall Street Journal*, May 18, 2009.
- ⁶ Connecticut often receives attention as the state with the highest per capita income. For this study, however, median income is more relevant, as it is less subject to the extremes of income distribution. For example, a state with a small number of very high income households and a large number of low-income households could have a relatively high per capita income but still require significant public services.
- ⁷ The Census Bureau defines the general government sector as encompassing all governmental activities except utilities, liquor stores, and social insurance trusts. These data represent flows from government to nongovernmental entities, and between levels of government, but exclude intragovernmental transfers—i.e. transfers within the same level of government—such as government contributions to public employee pension funds. The general government sector accounted for more than 85 percent of total government expenditures (excluding intragovernmental expenditures) in New England in FY 2007. For a full description of the Census Bureau’s data on government finance, see U.S. Bureau of the Census, *Government Finance and Employment Classification Manual*, October 2006.
- ⁸ For example, Vermont’s funding of elementary and secondary education differs from other New England states. Unlike other states in the region, in which local revenues play a large role in financing public education, Vermont relies largely on a state property tax and other state sources. See U.S. Department of Education, National Center for Education Statistics, Common Core of Data (CCD), “National Public Education Financial Survey,” 2006-07 and Vermont Transparency, http://www.vttransparency.org/index.cfm?section=all&pg=Education_Finance.
- ⁹ To demonstrate that FY 2007 is not an anomalous year, I provide per capita revenue and spending estimates for additional years in a data appendix which is available on the New England Public Policy Center’s website. The appendix contains data for state governments alone, as well as state and local governments combined.
- ¹⁰ Unless otherwise noted, the New England averages represent population-weighted averages across all six New England states. Simple averages yield similar results. See the data appendix available on the New England Public Policy Center’s website for alternative calculations of the regional average.
- ¹¹ Note that the expenditure figures capture total spending in a particular category regardless of the revenue source, not simply general fund support for that category.
- ¹² To put this in perspective, New Hampshire’s per capita welfare spending was \$724 less than the simple average across Maine, Massachusetts, Rhode Island, and Vermont. The simple average per capita revenue from a general sales tax for those four states was \$702 in FY 2007.
- ¹³ The overall gap—i.e. the difference between New Hampshire’s total per capita spending and regional average total spending—is a net figure in that it includes both categories where the Granite State spends less than the region and categories where it spends more.
- ¹⁴ I would like to give credit to Herman Leonard, whose 1992 study on public spending in Massachusetts helped me conceptualize the choices-versus-circumstances framework. See Herman B. Leonard, *By Choice or By Chance? Tracking the Values in Massachusetts’ Public Spending*, Boston: Pioneer Institute for Public Policy Research, 1992.
- ¹⁵ It is not clear whether governments first determine the level of services they wish to offer or the amount of money they wish to spend. That is, do preferences about services dictate lower spending, or do preferences about spending dictate lower services? In some sense the direction of causality does not matter if the goal is to differentiate between choices and circumstances, as either approach represents a choice.
- ¹⁶ For example, some might argue that New Hampshire’s fiscal policy itself has influenced the state’s economic performance, which in turn has helped keep the poverty rate low. This paper does not attempt to disentangle the causal relationship. By describing the poverty rate as a circumstance, I am simply claiming that for those engaged in setting revenue and spending policies in any given year, the poverty rate is essentially fixed.
- ¹⁷ For a concrete example of how states’ enrollment processes may differ in ways that could affect participation, consider circuit-breaker programs designed to provide property tax relief to low-income residents in New Hampshire and Maine. The New Hampshire program allows only a 2-month application window, whereas Maine allows an 11-month window. See John H. Bowman, Daphne A. Kenyon, Adam Langley, and Bethany P. Paquin, “Property Tax Circuit Breakers: Fair and Cost-Effective Relief for Taxpayers,” Cambridge, MA: Lincoln Institute of Land Policy, 2009.
- ¹⁸ This discussion abstracts from two other components of Medicaid spending: administrative and disproportionate share hospital (DSH) spending. It also implicitly assumes a fee-for-service model in which the state pays a healthcare provider a set rate for each service provided. States in New England and around the nation also employ managed care models to varying degrees. Under this model a state would typically pay a managed care organization a fixed premium per enrollee regardless of the number and mix of services a particular enrollee uses. To the extent that managed care premiums take into account historical and/or expected levels of service utilization, many of the same underlying spending drivers are relevant.
- ¹⁹ The RES methodology was originally developed by Robert Rafuse in the late 1980s for the Advisory Commission on Intergovernmental Relations (ACIR). Its original purpose was to improve characterizations of state fiscal gaps—i.e. the gaps between the revenues states could raise given their underlying tax base and average tax rates and what they would have to spend to provide an average level of services given their underlying circumstances. Rafuse published estimates of expenditure need for the 50 states in 1990. Other researchers have updated his estimates—most recently in a joint effort by the Tax Policy Center and the New England Public Policy Center. See Robert W. Rafuse, Jr., “Representative Expenditures: Addressing the Neglected Dimension of Fiscal Capacity,” Washington, DC: Advisory Commission on Intergovernmental Relations, December 1990; Robert Tannenwald, “Fiscal Disparity Among the States Revisited,” *New England Economic Review* (July/August 1999):3–25;

- Robert Tannenwald, "Interstate Fiscal Disparity in 1997," *New England Economic Review* (third quarter 2002):17–33; Robert Tannenwald and Nicholas Turner, "Interstate Fiscal Disparity in State Fiscal Year 1999," Public Policy Discussion Paper No. 049. Boston: Federal Reserve Bank of Boston, 2004 (updated in 2006); and Yesim Yilmaz, Sonya Hoo, Matthew Nagowski, Kim Rueben, and Robert Tannenwald, "Measuring Fiscal Disparities across the U.S. States: A Representative Revenue System/Representative Expenditure System Approach, Fiscal Year 2002," Occasional Paper No. 74, Washington, DC: Urban Institute, 2006.
- ²⁰ Per earlier RES studies, I use the same workload measure for the health and hospital categories and for the police and corrections categories. Rafuse (1990) discusses the selection of specific variables underlying the workload measures. Two general selection criteria are that the variables be independent of government policies, and that they be readily available on a state-level and annual basis. Of course, even with these criteria some policy endogeneity may exist.
- ²¹ Put another way, the calculation apportions total regional spending in a given category among the six states based on their share of the total regional workload, adjusting for differences in input costs. See the technical appendix available on the New England Public Policy Center's website for details on the methodology, including the construction of state-and category-specific workload measures and cost indices.
- ²² Yilmaz et al. refer to the ratio of a state's actual expenditures to its expenditure need as the state's "expenditure effort."
- ²³ Although these four subcategories rely on the same workload measure, total population, all except interest on the general debt are adjusted by different input cost indices that are sensitive to differences in the proportion of expenditures devoted to labor. See the technical appendix available on the New England Public Policy Center's website for details.
- ²⁴ This factor may have the greatest impact in Maine and Vermont, the region's two most rural states.
- ²⁵ Identifying all programs and services associated with a particular category of spending in a single state can also be challenging. For example, a report by the New Hampshire Center on Public Policy Studies found that the Granite State spread its public health activities across a variety of agencies. See Ryan J. Tappin and Steve Norton, "Public Health and the State Budget, 1999–2009," Concord, NH: New Hampshire Center for Public Policy Studies, April 2009.
- ²⁶ Brian Benson, "NH Is Poised to Offer Kindergarten to All," *Boston Globe*, August 26, 2009.
- ²⁷ W. Steven Barnett, Jason T. Hustedt, Allison H. Friedman, Judi Stevenson Boyd, and Pat Ainsworth, *The State of Pre-school 2007: State Pre-school Yearbook*, New Brunswick, NJ: National Institute for Early Education Research, Rutgers Graduate School of Education, 2007.
- ²⁸ Although the university systems of Massachusetts and Vermont both feature medical schools, their affiliated hospitals are privately owned and operated.
- ²⁹ Another hypothesis put forward to explain New Hampshire's low poverty rate is that the state's higher income threshold for Medicaid eligibility (or other policy choices), might discourage low-income individuals or families from remaining in or moving to the state. I have not come across research specifically examining this phenomenon in New Hampshire. One might expect mobility constraints facing low-income individuals or families to dampen an out-migration effect, if it existed. However, some studies from the welfare reform literature suggest that changes in social service levels can influence interstate migration. See, for example, Gordon F. De Jong, Deborah Roempke Grafe, and Tanja St. Pierre, "Welfare Reform and Interstate Migration of Poor Families," *Demography* 42 (3) (August 2005):469–496.
- ³⁰ For example, see Nick Turner and E. Matthew Quigley, "Do New England State and Local Governments Have Too Many Employees, and Are They Overpaid?" *Fiscal Facts* 34 (Summer 2005), Boston: Federal Reserve Bank of Boston. Turner and Quigley found that New Hampshire state government employment relative to population was slightly below the regional average (158 versus 160 per 10,000 population), while state and local employment combined was slightly above the regional average (529 versus 518 per 10,000 population).
- ³¹ A November 2010 opinion piece on the *Sunapee News* website presents a real-life example of how cutbacks in the New Hampshire court system affected services by delaying the resolution of a parental rights dispute. See Mark Fernald, "Justice Delayed Is Justice Denied," *Sunapee News*, November 22, 2010. Available at: <http://sunapeenews.com/2010/11/22/opinion-justice-delayed-is-justice-denied/>.
- ³² Philip A. Trostel, "Maine's State- and Local-Government Payroll and Expenditure," Washington, DC: Brookings Institution, October 2006.
- ³³ Debra Lipson, Margaret Colby, Tim Lake, Su Liu, and Sarah Turchin, "Defining and Measuring State Medicaid Spending Efficiency: A Literature Review," Washington, DC: Mathematica Policy Research, March 2009.
- ³⁴ On an input cost-adjusted basis, Massachusetts actually spent less per capita on elementary and secondary education than New Hampshire in FY 2007. In the 2006–2007 school year, Massachusetts students achieved higher average scores than New Hampshire students for fourth- and eighth-grade reading and math (though the difference for eighth-grade reading was not statistically significant). That same year, roughly 29 percent of elementary and secondary students in Massachusetts qualified for free or reduced-price lunch, and 6 percent were classified as English language learners. The comparable percentages for New Hampshire were 18 percent and 2 percent, respectively. Test scores are from the National Assessment of Educational Progress, available at: <http://nces.ed.gov/nationsreportcard/>, and student characteristics are from the Common Core of Data, Washington, DC: National Center on Education Statistics, U.S. Department of Education, available at: <http://nces.ed.gov/ccd/bat/>. See technical appendix available on the New England Public Policy Center's website for details on the construction of the input cost index.
- ³⁵ Katherine Barrett and Richard Greene, "Grading the States '08: The Mandate to Measure," *Governing* (March 2008): 24–95. Individual state profiles are available at: http://www.pewcenteronthestates.org/gpp_report_card.aspx.
- ³⁶ Rhode Island did not fare much better than the Granite State, with an overall grade of C-, while Maine and Massachusetts earned C grades. Connecticut and Vermont led the New England pack, matching the national average of B-. In the individual categories, New Hampshire received a C- for money, a D for people, and a D+ for both infrastructure and information. Not surprisingly, some elected officials in New Hampshire disputed these findings. See Garry Rayno and Mark Hayward, "Efficiency Study Says NH Government Worst," *New Hampshire Union Leader*, March 5, 2008.
- ³⁷ The Census Bureau reports state and local government employment and payroll by functional category as of March each year for each state.
- ³⁸ Even if lower compensation is strictly a matter of government choice, this does not necessarily equate to lower-quality public services. While lower pay might only attract lower-quality employees, those willing to accept low pay could also do so because they are especially dedicated to public service.
- ³⁹ Higher benefit levels could offset lower base pay, though this does not necessarily appear to be the case in New Hampshire. Data from the Bureau of Economic Analysis show that wages and salaries represented about 78 percent of total state and local government employee compensation in the Granite State in 2007—roughly the same as the regional

average. See U.S. Bureau of Economic Analysis, Regional Economic Information System, Washington, DC: U.S. Department of Commerce.

⁴⁰ Larger appropriations for higher education would not necessarily result in an increase in taxes, as they could also be funded by reductions in spending elsewhere in the budget. In this case the “cost” of higher appropriations could be shifted to users of other government services.

⁴¹ For comparability I have excluded Connecticut’s hospital-related revenues from the calculation. If hospital revenues are included, state appropriations represent 33 percent of public higher education revenues in Connecticut.

⁴² A similar pattern appears in total expenditures and state appropriations per enrolled student. New Hampshire’s higher education expenditures per full-time-equivalent (FTE) student were slightly lower (by about 6.5 percent) than the New England average. However, appropriations per FTE student were 53 percent lower than the average.

⁴³ A 2010 report from the Pew Center on the States found that New Hampshire was among 19 states whose pension system funding posed “serious concerns.” According to the report, New Hampshire’s system had assets to cover 68 percent of its accrued liabilities—lower than the commonly accepted 80 percent threshold. The report also cited “serious concerns” regarding the pension systems of Connecticut, Massachusetts, and Rhode Island. Vermont’s system was cited as “needing improvement,” while Maine alone among New England states was described as a “solid performer.” On a related note, the Pew report found that New Hampshire had assets to cover only 5.4 percent of its other post-employment benefit (OPEB) obligations (e.g. health insurance for retirees)—another looming cost for states around the nation. While quite low, New Hampshire’s OPEB funding percentage was actually higher than that of other New England states at the time. Pew Center on the States, “The Trillion Dollar Gap: Underfunded State Retirement Systems and the Roads to Reform,” Washington, DC, February 2010.

⁴⁴ A proposal put forward by Republicans in the New Hampshire legislature in January 2011 would raise mandatory contributions by employees, increase retirement ages and required years of service, and reduce the compensation that pension formulas consider. Most changes would apply to employees hired after June 30, 2011. However, some changes, including those in the retirement age, would affect current employees with less than 10 years of service. See Tom Fahey, “GOP Proposes Broad Reforms to Avert Collapse of State Pension System,” *New Hampshire Union Leader*, January 27, 2011; and “Unions Speak Out on State Pension Reform,” *New Hampshire Union Leader*, January 28, 2011.

⁴⁵ I am implicitly assuming that New Hampshire’s low revenue collections are a matter of choice rather than circumstance, as the state has, after all, chosen not to enact a broad-based income or sales tax. One could apply a Representative Revenue System (RRS) approach—the revenue-side analog of the RES—to more formally assess the role that choices and circumstances play in dictating revenue levels. The RRS approach is used to calculate revenue capacity: the amount a state could raise if it applied a standard set of rates to its revenue base. States with larger revenue bases (in income, sales activity, and property values, for example) will have higher revenue capacities than states with smaller bases. Yilmaz et al. calculated revenue capacity for all 50 states for FY 2002. They found that New Hampshire had tied for fifth-highest revenue capacity in the nation (Connecticut and Massachusetts ranked first and second, respectively). However, New Hampshire ranked lowest on “revenue effort”: the ratio of actual revenues to revenue capacity. This seems to confirm that the Granite State has significant untapped revenue sources, and that the state’s low revenues vis-à-vis other states are largely a matter of choice.

⁴⁶ The Brookings Institution attributes part of Vermont’s

success in attracting federal dollars to the state’s generous Medicaid program. Another observer noted that congressional delegations from small states have succeeded in attaching minimum state allotments to various federal programs. Such minimums are more advantageous for Vermont, with its population of around 620,000, than for other New England states, all of which have populations of at least 1 million. See Andrew D. Reamer, “Counting for Dollars: The Role of the Decennial Census in the Geographic Distribution of Federal Funds,” Washington, DC: Metropolitan Policy Program, Brookings Institution, March 2010; and Sam Hemingway, “Vermont Tops in Landing Federal Money,” *Burlington Free Press*, March 11, 2010.

⁴⁷ Vermont’s property tax revenues (and thus total tax revenues) are somewhat overstated in the census data for FY 2007, as well as earlier years, owing to a reporting issue. The figures do not account for a property tax adjustment offered to taxpayers whose property tax bill for their homestead exceeds a statutorily established percentage of household income. Email correspondence with Sara Teachout, Vermont Legislative Joint Fiscal Office, February 8, 2011.

⁴⁸ Kenyon and Bell discuss this issue in greater detail in a 2008 paper. They conclude that New Hampshire ranks lower nationally (that is, has a lower burden) when burden is measured by comparing property taxes to property values than when burden is measured by comparing property taxes to population or state personal income. See Daphne A. Kenyon and Michael E. Bell, “Not as High as You Think: New Hampshire’s Property Tax Burden,” The Committee for Sensible School Funding, March 2008.

⁴⁹ Per capita collections of corporate income tax—actual or simulated—do not, by themselves, tell us about the fairness or competitiveness of New Hampshire’s business taxes. To gauge that, we would need more information on the relative size of the bases from which the taxes are collected. For alternative indicators for assessing business taxes see Robert Tannenwald, “Massachusetts Business Taxes: Unfair? Inadequate? Uncompetitive?” Public Policy Discussion Paper No. 04-4, Boston: Federal Reserve Bank of Boston, August 2004.

⁵⁰ According to the Census Bureau, property taxes represented about 80 percent of local government own-source revenues in New Hampshire in FY 2007. This was comparable to other New England states except Vermont, where all education property taxes are considered state taxes.

⁵¹ Vermont’s revenue system is also notably different from the systems in the rest of the region, again, owing largely to the state’s reliance on state revenues to finance K-12 education.

⁵² The general fund is the state’s primary operating fund, whereas the education fund is used to distribute “adequate education grants” to school districts. The two funds are often viewed in tandem because state law requires that they be balanced together. The state also maintains a highway fund dedicated to the construction, reconstruction, and maintenance of public highways in the state and the supervision of traffic, as well as various enterprises (such as liquor and lottery commissions) and fiduciary (such as the state’s retirement system) funds. Note that total revenues in Figure 13 do not match those in Figure 12 exactly. For example, Figure 13 includes certain non-tax revenues but excludes other tax revenues that do not support the state’s general or education funds (such as the motor fuel tax, which supports the state’s highway fund). Figure 12 captures all tax revenues regardless of which fund they support.

⁵³ These changes include both rate increases and base expansions. See National Governors Association and National Association of State Budget Officers, *The Fiscal Survey of States*, various years. These reports are available at: <http://nasbo.org/Publications/FiscalSurvey/FiscalSurveyArchives/tabid/106/Default.aspx>.

⁵⁴ Another strategy for extracting revenues from non-residents is placing high taxes on goods or services often purchased by

- individuals visiting the state for other reasons. For example, New Hampshire has a fairly high tax on restaurant meals and hotel rooms, which allows the state to capitalize on the wallets of tourists. States that use this strategy are assuming that they will gain more revenue from the higher tax rate than they lose from reducing the base, as the higher rate will likely mean fewer restaurant meals purchased and rooms rented.
- ⁵⁵ The data on tobacco taxes are compiled by the Tax Foundation. As of February 1, 2010, New Hampshire's tax had increased to \$1.78 per pack, while in other New England states it ranged from \$2.00 to \$3.46. Available at: <http://www.taxfoundation.org/taxdata/show/245.html>.
- ⁵⁶ Michael Lafaive, Patrick Fleenor, and Todd Nesbit, "Cigarette Taxes and Smuggling: A Statistical Analysis and Historical Review," Midland, MI: Mackinac Center for Public Policy, 2008.
- ⁵⁷ Among New England states, only Vermont was also a net tobacco "exporter" over the same period. This implies that cigarette purchases in New Hampshire by Vermont residents—if any—are more than offset by cigarette purchases in Vermont by non-residents.
- ⁵⁸ Clarke Canfield, "High NH Cigarette Tax Yields Rising Sales in Maine," Associated Press, August 6, 2010.
- ⁵⁹ New Hampshire is one of 18 "control states," where the state has a monopoly over wholesale and/or retail sales of some or all alcoholic beverages. Retail sales of hard alcohol are confined to state-owned and -operated liquor stores. Maine and Vermont are also control states, but they do not operate state liquor stores, instead contracting liquor sales to other operators. Since 2006 the Tax Foundation has used a methodology developed by the Distilled Spirits Council of the United States to report implied excise tax rates on liquor in control states. Of the three New England control states, only New Hampshire has consistently had an implied excise rate of zero (or less) over this period. As of July 1, 2009, the implied excise rate was \$0.68 per gallon in Vermont and \$5.21 per gallon in Maine. See <http://www.taxfoundation.org/taxdata/show/245.html>. New Hampshire does levy a tax on beer sales. Beer, unlike hard alcohol, is sold by licensed private retailers. Wine is sold both in state stores and by licensed private retailers.
- ⁶⁰ Philip Shishkin, "Tax-Free Liquor Lures Buyers, Stirring Crossborder Tensions," *Wall Street Journal*, September 8, 2009.
- ⁶¹ Nekisha E. Lakins, Robin A. LaVallee, Gerald D. Williams, and Hsiao-ye Yi, "Apparent Per Capita Alcohol Consumption: National, State, and Regional Trends, 1977–2006," Surveillance Report No. 85, Arlington, VA: National Institute on Alcohol Abuse and Alcoholism, Division of Epidemiology and Prevention Research, Alcohol Epidemiologic Data System, November 2008.
- ⁶² As of 2010, the state was considering altering its approach to liquor sales, potentially through a public-private partnership. See Nancy West, "NH Asset Study Eyes Art, Liquor," *New Hampshire Union Leader*, October 24, 2010.
- ⁶³ Christi Provost Peters. "Medicaid Disproportionate Share Hospital (DSH) Payments," Washington, DC: George Washington University, National Health Policy Forum, June 2009.
- ⁶⁴ Data on DSH allotments are from Kaiser's State Health Facts. Available at: <http://www.statehealthfacts.org>. Per capita calculations by the author.
- ⁶⁵ New Hampshire Hospital Association. "Statement Regarding the Medicaid Disproportionate Share Hospital Program, Steve Ahnen, President, New Hampshire Hospital Association." November 15, 2010. Available at: <http://www.nhha.org/WhatsNewFiles/2010%20downloads/DSH%20statement&background.pdf>.
- ⁶⁶ Conversation with Steve Norton, New Hampshire Center for Public Policy Studies, March 24, 2010.
- ⁶⁷ Medicaid revenue enhancements are another means by which the Granite State has extracted revenue from non-residents—in this case federal taxpayers across the country.
- ⁶⁸ Dan Morgan, "Medicaid Windfall Cut N.H. Deficit; State Officials Used Loophole while Bloating U.S. Budget," *Washington Post*, February 28, 1993; Dan Morgan, "Small Provision Turns into a Golden Goose: States Used Subsidy to Balance Budgets," *Washington Post*, January 31, 1994.
- ⁶⁹ "Another Mediscam?" New Hampshire Public Radio, April 4, 2003. Audio available at: <http://www.nhpr.org/node/4641>.
- ⁷⁰ Under the new rules, a hospital's DSH payment would no longer be directly linked to Medicaid enhancement taxes paid, but rather to the amount of charitable care provided. See Shira Schoenberg. "State adjusts hospital reimbursements," *Concord Monitor*, November 16, 2010.
- ⁷¹ The law requires that the largest reductions be aimed at states with "the lowest percentage of uninsured individuals... [that] do not target their DSH payment on hospitals with high volumes of Medicaid inpatients, ...and hospitals with high levels of uncompensated care." See Courtney Burke and Erika Martin, "Health Reform: Uncertainty over Federal DSH Payments Poses Risk for Uninsured," *Observations*, Albany, NY: Rockefeller Institute of Government, October 2010.

Box Endnotes

Box 1

Medicaid: A closer look

^A As most people know, Medicaid provides health insurance to certain low-income individuals and families. The program is jointly funded by federal and state governments, and administered by the states. Generally speaking, the federal government matches a certain percentage of the state's expenditures on healthcare services used by Medicaid enrollees. The percentage—known as the Federal Medical Assistance Percentage—is inversely related to state per capita income.

^B See Donna Cohen Ross, Laura Cox, and Caryn Marks, "Resuming the Path to Health Coverage for Children and Parents: A 50 State Update on Eligibility Rules, Enrollment and Renewal Procedures, and Cost-Sharing Practices in Medicaid and SCHIP in 2006," Washington, DC: Center on Budget and Policy Priorities and Kaiser Commission on Medicaid and the Uninsured, January 2007; and "Medicaid Financial Eligibility: Primary Pathways for the Elderly and People with Disabilities," Washington, DC: Kaiser Commission on Medicaid and the Uninsured, February 2010. Note that states can also set different eligibility criteria for the "medically needy"—individuals whose income after deducting medical expenses falls below a certain threshold—and for people in need of nursing home care.

^C Eligibility guidelines may also vary in other respects. For example, states may allow income "disregards"—some amount of income that the state does not count when assessing an applicant's eligibility—or set limits on an applicant's assets. Thus income limits expressed as a percent of the FPL are not a conclusive indicator of the stringency or generosity of state eligibility guidelines.

^D The health reform law signed by President Obama in March 2010 includes "maintenance of effort" (MOE) requirements which, in general, prohibit states from adopting changes to eligibility standards, methodologies, or procedures that are more restrictive than what was in place at the time the legislation was passed. One exception is that states covering non-disabled adults with incomes over 133 percent of FPL that are facing budget deficits may scale back coverage for that group to 133 percent. MOE requirements are in effect until 2014 for adults and 2019 for children. The health reform law also calls for states with lower thresholds to expand income eligibility for all individuals under age 65 to 133 percent of FPL by 2014. Coverage for newly eligible individuals would be fully funded by the federal government initially, and funded at 90 percent over the long term. See Center on Budget and Policy Priorities and Georgetown University Health Policy Institute Center for Children and Families, "Holding the Line on Medicaid and CHIP: Key Questions and Answers about Health Care Reform's Maintenance of Effort Requirements," Washington, DC: March 26, 2010 and Kaiser Family Foundation, "Summary of the New Health Reform Law," Publication No. 8061, Menlo Park, CA: June 18, 2010.

^E Most states use eligibility criteria at least as generous as the federal Supplemental Security Income (SSI) program to determine Medicaid eligibility for the aged, blind, and disabled. However, Connecticut and New Hampshire are among 11 so-called 209(b) states for which financial and non-financial criteria for these groups can be more restrictive than federal SSI standards, as long as they are no more restrictive than the criteria the states had in 1972, when the SSI program was established.

^F Genevieve M. Kenney, Victoria Lynch, Allison Cook, and Samantha Phong, "Who and Where Are the Children Yet to Enroll in Medicaid and the Children's Health Insurance Program?" *Health Affairs* 29 (10) (2010):1920–1929 (state-specific figures from appendix published online).

^G See, for example, Susan L. Ettner, "Medicaid Participation among the Eligible Elderly," *Journal of Policy Analysis and Management* 16 (2) (Spring 1997):237–255; and A. Davidoff, A. Sommers, J. Lesko, and A. Yemane, "Adult Eligibility and Participation in Public Insurance Programs," Academy Health meeting, Nashville, TN, 2003.

^H In reality if New Hampshire were to expand enrollment it is possible that the state's average spending per enrollee would also change.

Box 2

Filling a void? The role of nonprofits

^I National Center for Charitable Statistics, "Number of Registered Nonprofit Organizations by State, 2008," Washington, DC: Urban Institute. Available at: <http://nccsdataweb.urban.org/PubApps/reports.php?rid=2>.

^J This count includes public charities, private foundations, and organizations ranging from chambers of commerce to social and recreational clubs. When considering only 501(c)(3) nonprofits—a designation including public charities and private foundations—New Hampshire had 41.7 registered organizations per 10,000 residents. This was higher than the national average of 35.3, but was second lowest in the region.

^K Conversation with Richard Ober, New Hampshire Charitable Foundation, March 19, 2010.

^L New Hampshire Public Radio, "The Continuing Challenge of Deinstitutionalization," *The Exchange*, June 15, 2006. Audio available at: <http://www.nhpr.org/node/11022>.

^M New Hampshire Bureau of Developmental Services. See <http://www.dhhs.state.nh.us/dcbcs/bds/index.htm>.

^N Brian Benson, "NH Is Poised to Offer Kindergarten to All," *Boston Globe*, August 26, 2009.

Box 3

Pension contributions: Saving today by underfunding tomorrow?

^O See Keith Brainard, "Public Fund Survey Summary of Findings for FY 2007," Baton Rouge, LA: National Association of State Retirement Administrators, November 2008.

^P For a comparison of New England pension plans, see Richard Woodbury, "Population Aging and State Pensions in New England," Research Report 10-1, Boston: Federal Reserve Bank of Boston, New England Public Policy Center, June 2010.

^Q A policy brief from the Center for Retirement Research at Boston College discusses reasons why governments may not make their full ARC payments. See Alicia H. Munnell, Kelly Haverstick, Jean-Pierre Aubry, and Alex Golub-Sass, "Why Don't Some States and Localities Pay Their Required Pension Contributions?" No. 7, May 2008.

^R New Hampshire Retirement System. *Comprehensive Annual Financial Report*, various years.

^S Lauren R. Dorgan, "\$3.4 Billion Shortfall for NH Pension," *Concord Monitor*, August 3, 2009.

^T New Hampshire was not unique in lowering payments to its pension plan during the early 1990s. A 1991 New York Times article reported that a number of states—including others in New England—were finding ways to lower their contributions, or even borrowing money from their pension funds outright, to plug budget gaps. See Richard W. Stevenson, "States Seeking Aid on Budgets from Pensions," *New York Times*, July 21, 1991.

Box 4

Is New Hampshire really a no-income-tax state? The case of the business enterprise tax

- ^U For an example of how this crediting works, see William Ardinger, “New Hampshire’s Business Enterprise Tax: Practical Experience with an “Entity-Level” Tax,” presentation to the Pennsylvania Business Tax Reform Commission, October 20, 2004, p. 12. Available at: http://www.governor.state.pa.us/portal/server.pt/document/635410/ardinger_pa_tax_structure_commission_pdf
- ^V Stan Arnold and William F.J. Ardinger, “Top Ten Reasons Why New Hampshire’s BET May Provide an Answer to State Tax Reform,” *State Tax Notes*, November 29, 2004.
- ^W Daphne A. Kenyon, “A New State VAT? Lessons from New Hampshire,” *National Tax Journal* 49 (3) (1996):381–399. Interestingly, the BET has also been likened to a sales tax.
- ^X Some have noted that because the BET is creditable against the BPT, attempts to separate the revenue from the two taxes are somewhat inexact. This simulation, as well as the revenue percentages cited elsewhere in the paper, rely on revenues reported in the state’s Comprehensive Annual Financial Report for FY 2007. Note that the simulation assumes that New Hampshire businesses still receive a credit against their BPT liability equal to the amount of their BET payments. In other words, the simulation aims to capture New Hampshire’s traditional corporate income tax *collections*, not gross liability.

Box 5

How New Hampshire did it: Response to court decisions on school funding.

- ^Y See *A Final Report of the New Hampshire Commission on Education Funding*, January 2001. Available at: <http://www.bos.frb.org/economic/neppc/professional/nhcommission.pdf>.
- ^Z The statewide property tax has been described as a “re-labeled” local property tax. Daphne A. Kenyon. “The Property Tax – School Funding Dilemma.” Lincoln Institute of Land Policy, Cambridge, MA, 2007.
- ^{AA} Under the legislation establishing the statewide property tax, the state would assume half of the responsibility of funding the adequate education amount defined by the legislature, with the property tax covering about half of that amount. See Oyebola Olabisi, “New Hampshire’s Quest for a Constitutionally Adequate Education,” Discussion Paper 06-2, Boston: Federal Reserve Bank of Boston, New England Public Policy Center, October 2006 and National Governors Association and National Association of State Budget Officers, *The Fiscal Survey of States*, Fall 1999, 2000 and 2001. These reports are available at: <http://nasbo.org/Publications/FiscalSurvey/FiscalSurveyArchives/tabid/106/Default.aspx>.



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