

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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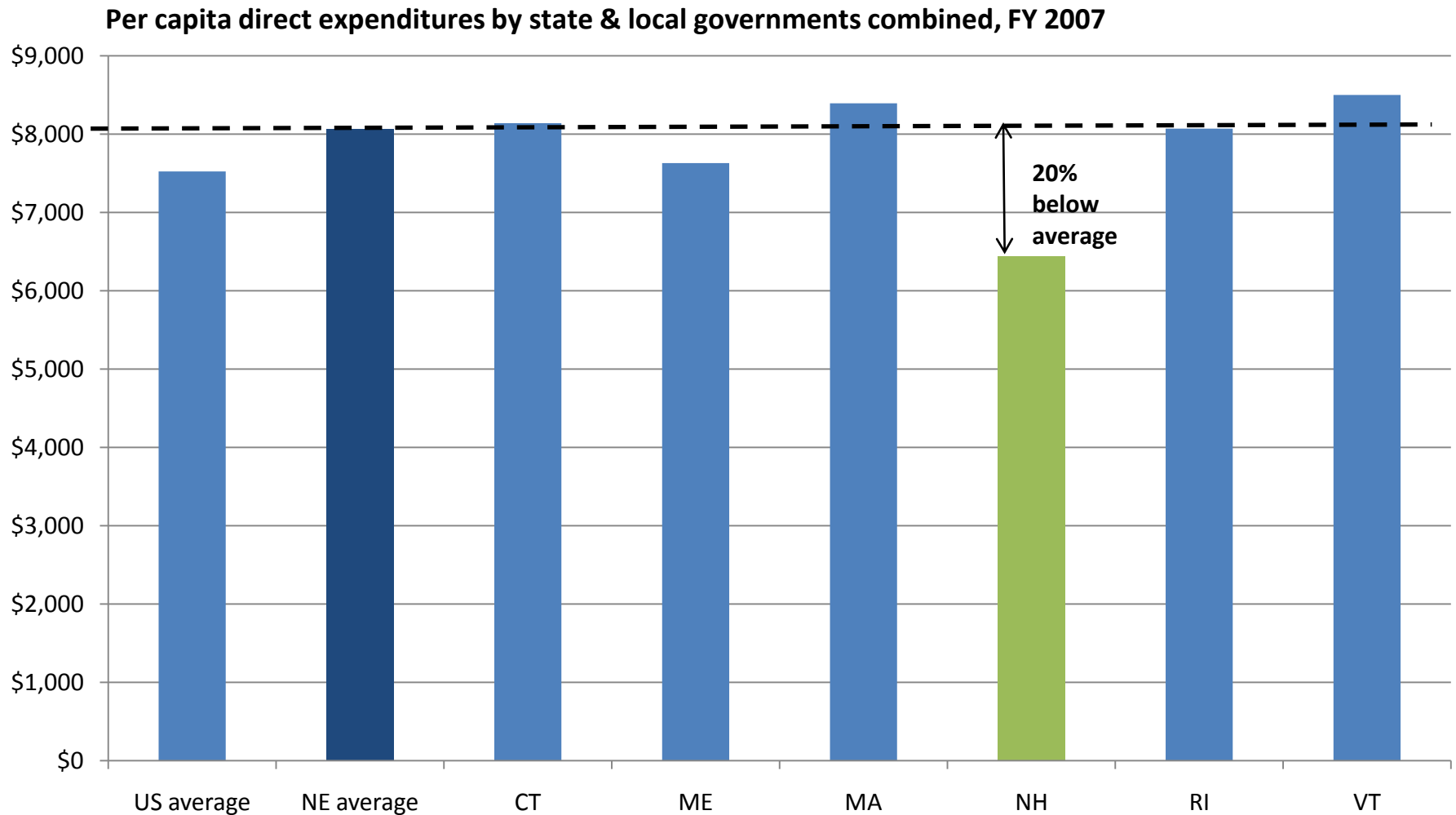


Introduction

- New Hampshire is the only state in New England—and one of two in the nation—without a broad-based income or sales tax
- New Hampshire also spends less (per capita) than other states in the region and below the national average
- **How does New Hampshire do it?**
 - What factors drive the state's below-average spending?
 - What revenue sources does the state rely on to pay for that spending in lieu of an income or sales tax?

What factors drive New Hampshire's
below-average spending?

New Hampshire's overall spending levels are low relative to the region and the nation



The state spends less than the region in most areas of government (particularly public welfare)

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

	CT	ME	MA	NH	RI	VT	NE average	NH \$ gap	NH % gap	NH rank
K-12	2,282	1,663	1,862	1,822	1,960	2,118	1,961	(139)	(7)	5
Higher ed	605	571	571	582	534	1,147	603	(21)	(3)	3
Public welfare	1,366	1,867	1,896	1,176	1,897	1,941	1,700	(524)	(31)	6
Hospitals	368	95	212	43	89	29	207	(164)	(79)	5
Health	196	383	162	106	162	251	189	(83)	(44)	6
Highways	349	552	350	475	343	704	395	80	20	3
Police	260	176	281	225	309	228	261	(36)	(1)	5
Corrections	189	151	198	124	208	183	185	(61)	(33)	6
Environ & housing	513	595	603	430	484	557	554	(123)	(22)	6
Gov administration	481	387	393	352	559	390	422	(70)	(17)	6
Interest	418	256	611	352	428	308	481	(129)	(27)	4
Other	1,112	937	1,254	754	1,099	645	1,106	(352)	(32)	5
Total	8,142	7,632	8,395	6,442	8,072	8,500	8,064	(1,621)	(20)	6

Factors that drive spending: choices versus circumstances

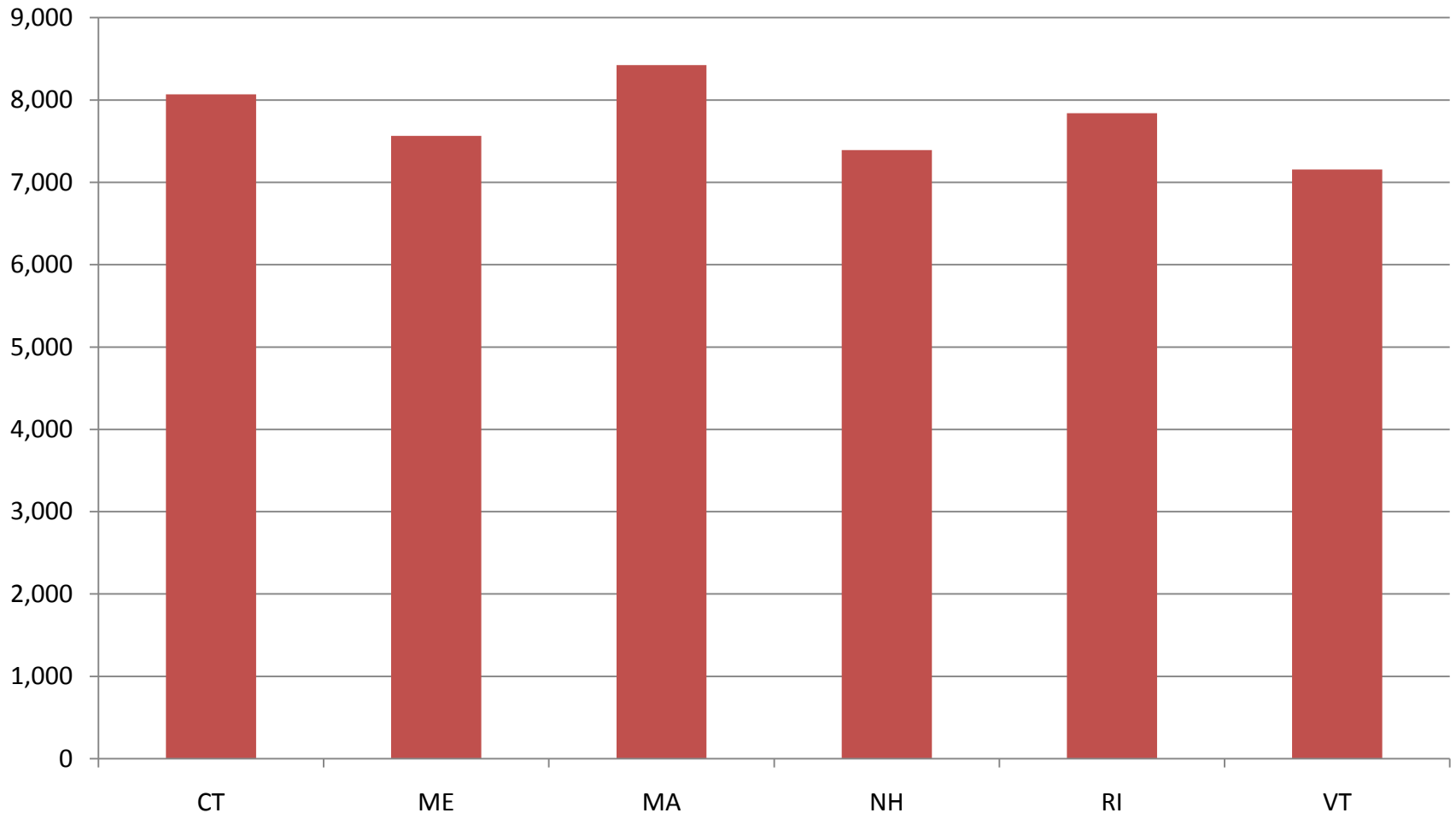
- Choices: factors within the government's direct near-term control
 - Examples: whether or not to provide a certain service or the comprehensiveness or quality of that service, employing practices that enhance or reduce efficiency
- Circumstances: factors outside the government's direct near-term control
 - Examples: underlying need for services (e.g. number of children, poverty rate, road miles), input costs

Gauging the role of circumstances: Expenditure need

- **Expenditure need** represents the amount a state would need to spend to provide a standard level of services given its underlying need and input costs
 - **Tells us** how much New Hampshire and the other New England states would each spend if they all provided the same level of services (the regional average) with the same level of efficiency.
 - More challenging circumstances = higher expenditure need
 - **Does not necessarily tell us** how much New Hampshire (or any other New England state) *should* spend

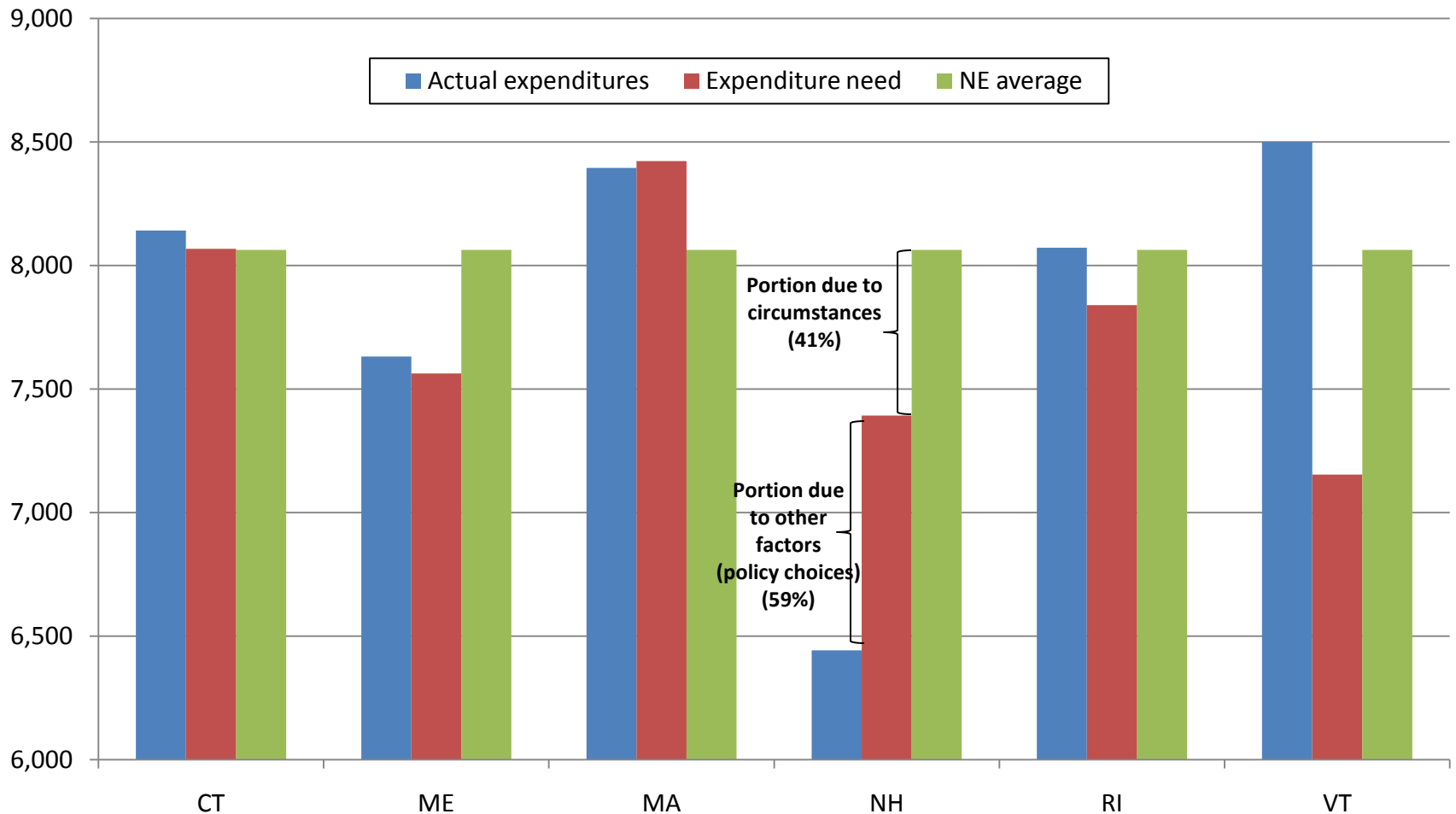
New Hampshire has less challenging circumstances than most other New England states

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



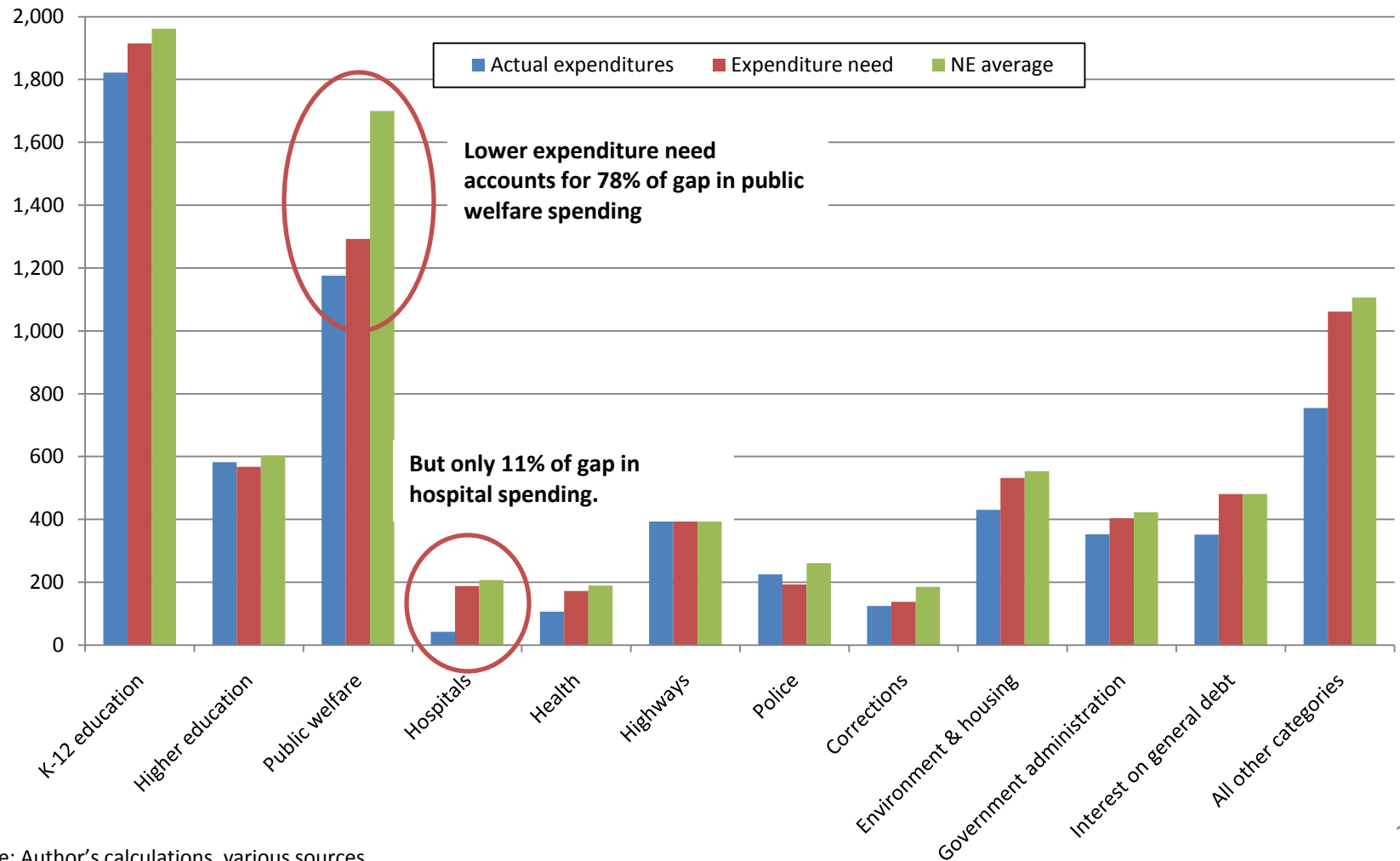
Circumstances account for around 40 percent of the overall gap between New Hampshire's actual per capita spending and the regional average

Overall per capita expenditures and expenditure need by state, relative to the NE average, FY 2007



But the portion of the gap that can be explained by circumstances varies by category of spending

NH per capita expenditures and expenditure need by category, relative to the NE average, FY 2007



Examples of how New Hampshire's policy choices have led to differences in public service levels

- **More restrictive Medicaid eligibility criteria for parents**
 - In 2007 parents in New Hampshire faced income caps of 45 to 56 percent of the federal poverty line (next lowest in region was Massachusetts at 133 percent)
- **No public pre-K** (and only recently universal kindergarten)
 - In 2007 all New England states but New Hampshire and Rhode Island offered some form of public pre-K
- **Limited scope of public hospitals**
 - New Hampshire Hospital versus Connecticut with UCHC and five inpatient facilities for addiction and psychiatric disorders

New Hampshire has also made policy choices that have shifted costs away from taxpayers

- **Higher education**

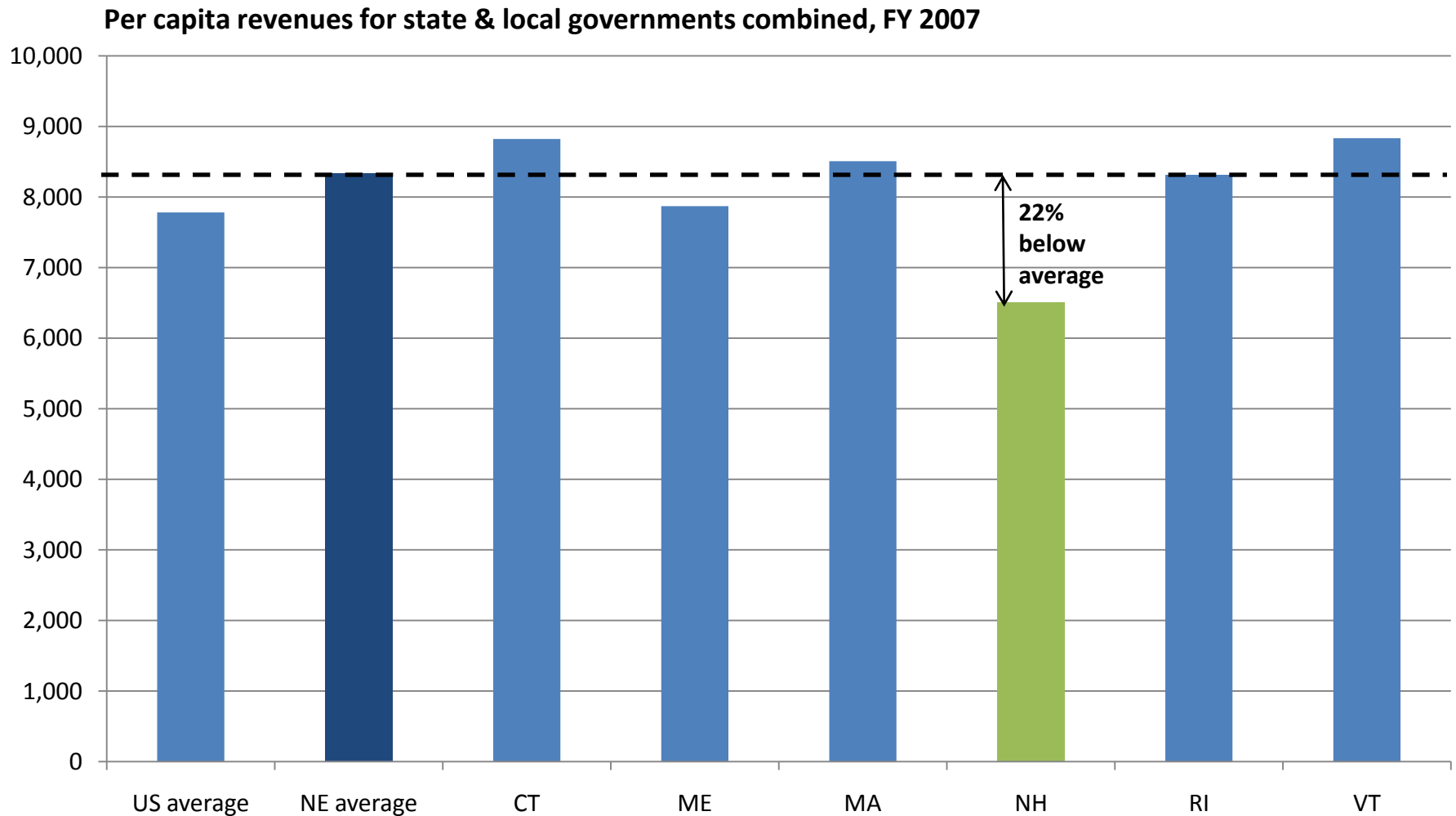
- Overall per capita higher education spending in New Hampshire is comparable to other New England states
- But the state relies more on tuition and other charges and less on state appropriations to fund that spending

- **Public employee pensions**

- New Hampshire governments contribute less per capita to public employee pensions than other New England states
- For some years low contributions were at least partly due to accounting methods that led to underfunding

What revenue sources does
New Hampshire rely on in lieu of an
income or sales tax?

Like spending, New Hampshire's overall revenue levels are low relative to the region and the nation



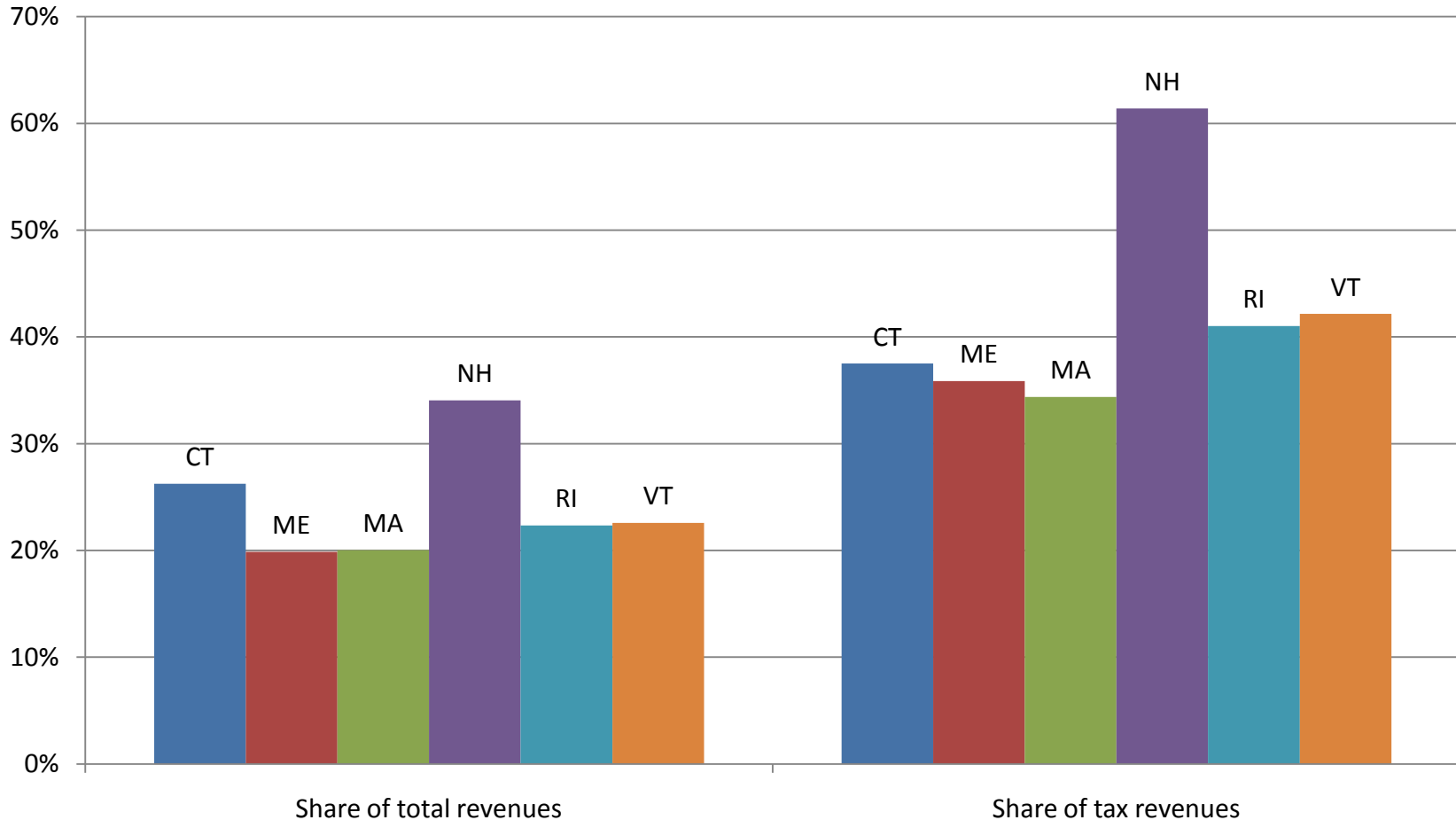
New Hampshire's lack of broad-based income and sales taxes is partially offset by higher revenues in other areas

Per capita revenues for state & local governments combined, by category, FY 2007

	CT	ME	MA	NH	RI	VT	NE average	NH \$ gap	NH % gap	NH rank
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
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
Misc. own-source	616	721	962	754	974	795	830	-76	-9.2	4
Intergovernmental	1,308	1,917	1,643	1,281	1,988	2,310	1,608	-327	-20.3	6
Total	8,823	7,873	8,507	6,504	8,315	8,834	8,341	-1,837	-22.0	6

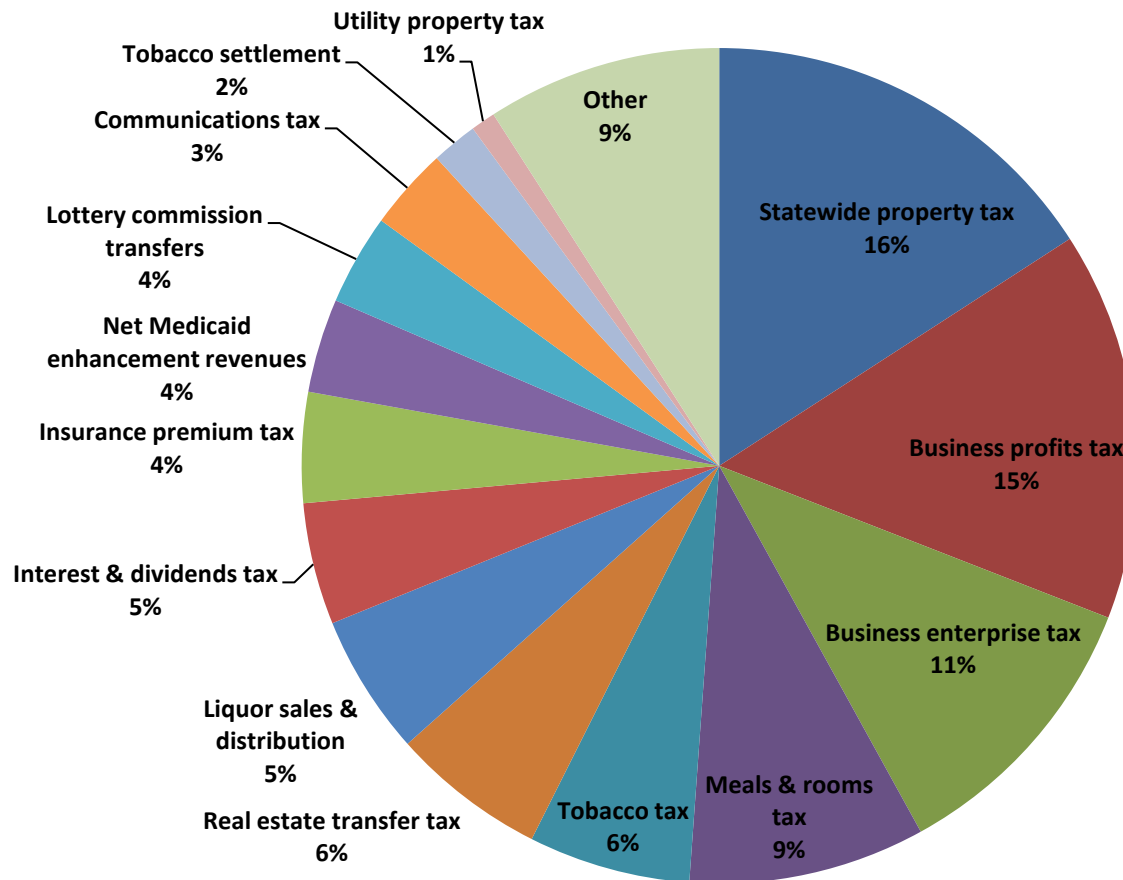
Property taxes account for a larger share of combined state and local revenues in New Hampshire than elsewhere in New England

Property taxes as share of combined state and local revenues, FY 2007



But New Hampshire *state* government obtains revenues from a diverse set of sources

Share of unrestricted revenues, NH general and education funds, FY 2007



Unique features of New Hampshire's revenue system: The business enterprise tax (BET)

- The BET is a 0.75 percent tax on the “enterprise value base:” wages, interest, and dividends paid by businesses that meet certain thresholds. **For banks, the base includes interest paid to depositors.**
 - Enacted to counter the instability and perceived inequity of the state's business profits tax (BPT)
 - Must be paid whether or not business turns a profit, but is creditable against the BPT
- Similar to an individual income, but with key differences:
 - Statutorily imposed on businesses, not individuals
 - Flat tax with lower rate than most state income taxes

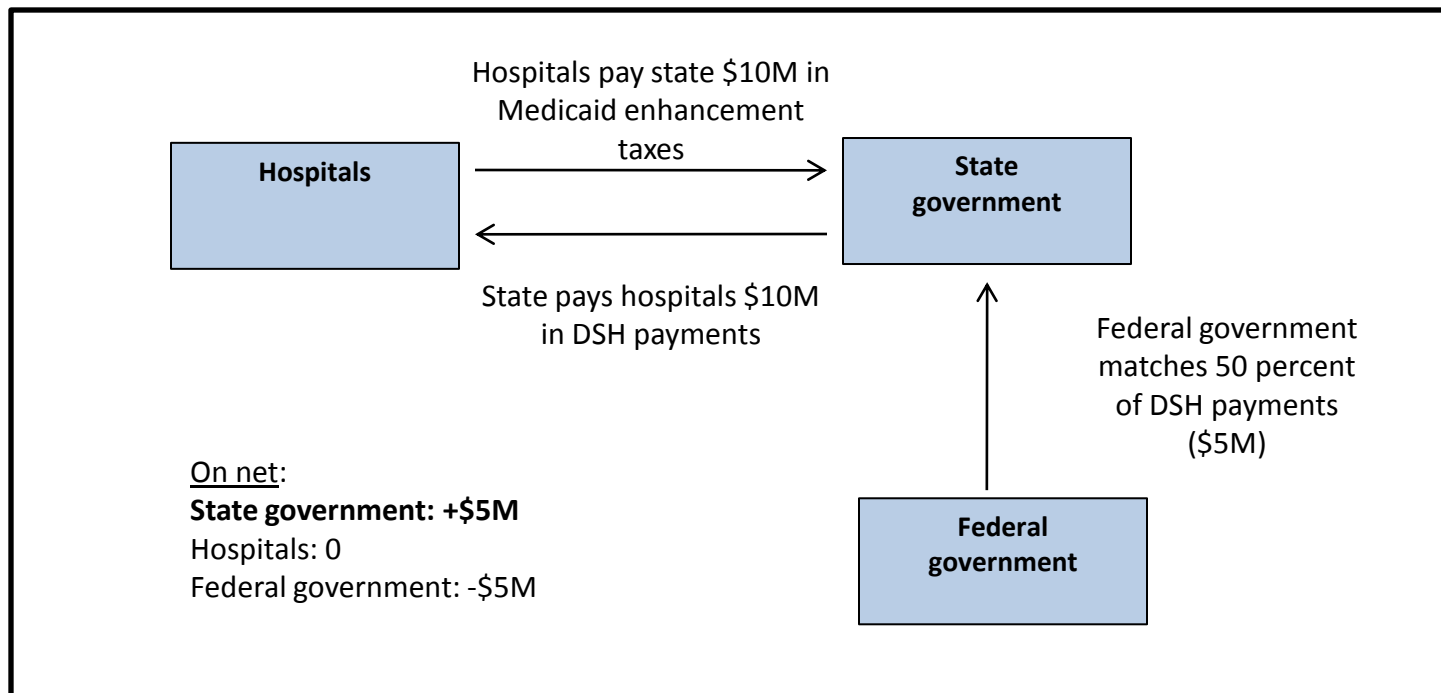
Unique features of New Hampshire's revenue system: Low-tax (or no-tax) approach to tobacco and liquor

- New Hampshire has historically had one of the lowest tax rate on tobacco in New England and levies no tax on “hard alcohol,” leading to significant cross-border sales
 - One study found the state to have the highest cigarette “export rate” (purchases for out-of-state use relative to in-state consumption) in the region and third highest in the nation (Mackinac Center for Public Policy, 2008)
 - Liquor is sold exclusively through state owned-and-operated stores, the profits from which are returned to the state (thus yielding revenues despite no taxes); nearly half of all liquor sales are reportedly to out-of-state customers (*Wall Street Journal*, 2009)

Unique features of New Hampshire's revenue system: Medicaid enhancement revenues

- New Hampshire has had great historical success bolstering its general fund by capitalizing on Medicaid funding rules to maximize federal matching dollars.

Illustration of a New Hampshire Medicaid financing arrangement



Conclusions and implications

- New Hampshire is able to “do it,” in part, because the state faces favorable **circumstances**
 - States with needier populations or higher costs will likely need to spend more to provide a given level of services
- New Hampshire has also made **policy choices** to keep spending low and avoid broad-based taxes
 - Some choices may be infeasible in the current environment or inappropriate in states with different preferences for public services

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Extra Slides

Expenditure need: Key components

- **Workload measures:** socioeconomic, demographic, and/or geographic characteristics not directly influenced by government in the near term. Examples include:
 - **K-12 education:** elementary- and secondary-aged children, children living in poverty
 - **Public welfare:** people living in poverty, elderly living in poverty
 - **Highways:** lane miles, vehicle miles traveled
- **Input cost indices** that account for differences in both the labor and non-labor costs of providing the same service across different states

Calculating workload (public welfare example)

	ME	NH
State share of regional population living in poverty (A):	12.0%	7.2%
State share of regional elderly population living in poverty (B):	12.5%	7.8%
State share of regional public welfare workload (C) = $(0.75 \times (A)) + (0.25 \times (B))$:	12.1%	7.4%

Calculating expenditure need (public welfare example)

	ME	NH
Total regional public welfare spending (A):	\$24.3 billion	\$24.3 billion
Share of regional public welfare workload (B):	12.1%	7.4%
Unadjusted expenditure need (C) = (A) x (B):	\$2.9 billion	\$1.8 billion
Public welfare input cost index (D):	0.934	1.000
Expenditure need (cost-adjusted) (E) = (C) x (D):	\$2.7 billion	\$1.8 billion