

New England Fiscal Facts

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How Will New Hampshire Solve Its School Funding Problem? Part 2 of 3

By Daniel G. Swaine

Ever since the New Hampshire Supreme Court decided in *Claremont II* that the local property tax used to fund K-12 public education was unconstitutional, policymakers have struggled to find a permanent solution to the school finance problem. In 1999, the legislature enacted an interim funding plan centered around a temporary statewide property tax. The price tag of providing New Hampshire students with an “adequate” education was set at \$825 million in spending, but the funding plan raised revenues of only about \$725 million. Thus, lawmakers were aware that they would have to revisit the funding issue. In June 2001, after a rancorous two-year public debate, and nearly four years after the *Claremont II* decision, policymakers enacted a second plan that makes the statewide property tax permanent and adds sufficient supplemental revenues to fund an “adequate” education.

However, the school funding debate is far from over. First, the statewide property tax is extremely unpopular with many. At the moment, a number of property-rich “donor” towns are threatening to secede from the state over the amount of property tax revenue they must share with property-poor “receiver” towns.¹ Second, the statewide property tax remains vulnerable to legal challenges, despite a recent state Supreme Court ruling upholding its constitutionality. Third, opponents of the statewide funding of education have argued in favor of amending the constitution in order to restore local control over education. These opponents may fail to realize

that such an attempt is bound to raise additional constitutional questions. In this issue of *Fiscal Facts*, we summarize constitutional arguments that have been raised concerning the statewide property tax and proposed constitutional amendments.

Several policymakers, including Governor Shaheen, have proposed introducing other broad-based taxes, such as a sales tax, other forms of a consumption tax, or a personal income tax to help solve the school funding problem and reduce the state’s reliance on the property tax. Last year, the Governor appointed a blue-ribbon commission — the New Hampshire Commission on Education Funding — to evaluate an array of tax alternatives. A subsequent issue of *Fiscal Facts* will discuss the Commission’s analysis.

Two School Funding Reforms

The 1999 interim funding plan consisted of two pieces of legislation. HB999, enacted in November 1999, established a statewide property tax at a rate of \$6.60 per \$1,000 of equalized property value. This measure was designed to raise about \$440 million in revenues, a little more than half of the \$825 million deemed necessary. HB999 also contained a provision to end the statewide property tax in 2003. HB117, enacted in May

¹ The statewide property tax raises more funds than are necessary to finance the educational expenses of property-rich towns. The excess is funneled to property-poor towns in which the statewide property tax is insufficient to fund these communities’ educational expenses. This has led to the term “donor” towns being applied to property-rich communities, and the term “receiver” towns being applied to property-poor communities

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State Budget Timetables

Annual Budgets

Massachusetts
Rhode Island
Vermont
FY00: July 1, 1999
to June 30, 2000
FY01: July 1, 2000
to June 30, 2001

Biennial Budgets

Connecticut
Maine
New Hampshire
FY00-01: July 1, 1999
to June 30, 2001

1999, increased the business profits tax rate from 7 percent to 8 percent, the business enterprise tax rate from 0.25 percent to 0.5 percent, and the real estate transfer tax from \$5 per \$1000 of appraised value to \$7.50 per \$1000. The law also imposed an 8 percent tax rate on car rentals. This combination of taxes was designed to raise \$150 million. HB117 also allocated to local education \$40 million from the \$43 million in tobacco settlement revenues for that year and \$100 million from pre-existing education aid, for a grand total of \$730 million in revenues — leaving a budget gap of about \$100 million for the FY2000-FY2001 biennium. In the FY2002-FY2003 biennium, this budget gap was forecasted to increase to \$170 million.

The 2001 plan, HB170, enacted at the end of June, repealed the sunset provision of HB999, making the statewide property tax a permanent feature of New Hampshire's tax landscape. The bill also cut the state property tax rate from \$6.60 per \$1000 to \$5.80 per \$1000, compensating for the dramatic rise in equalized property values over the last two years; but it left unchanged the property tax's share of the educational price tag. In a manner reminiscent of HB117, HB170 raised the business profits tax rate from 8 percent to 8.5 percent and boosted the business enterprise tax from 0.5 percent to 0.75 percent; these two tax increases were designed to raise \$116.5 million. In addition, the telecommunications services tax rate was increased from 5.5 percent to 7.0 percent, an exemption from the real estate transfer tax was eliminated, and a general tax amnesty was declared; these three measures were expected to raise \$56 million. Altogether, these five secondary tax increases were designed to raise enough to fill the \$170 million budget gap determined by the conference committee.

A number of legal questions remain, most of which arise from uncertainty about whether the state property tax is a state tax, or is, in effect, a local tax. We now turn to a discussion of these issues.

Ambiguous Features of New Hampshire's Property Tax System

New Hampshire has a long tradition of maintaining a small, centralized state government while choosing to deliver public services through decentralized local governments. This tradition led to a system of financing public schools that, until the *Claremont II* decision, relied almost exclusively on local property taxes. Even though lawmakers subsequently replaced a large component of the local education property tax with a statewide property tax, some people have argued that the statewide property tax is really a local property tax, albeit one with a uniform statewide tax rate.

Prior to the *Claremont II* decision, statewide educational spending totaled approximately \$1.3 billion, with about \$1.16 billion (or 89 percent) raised through the local property tax. Subsequent to *Claremont II*, policymakers set a state funding level of \$825 million, leaving \$475 million of the \$1.3 billion educational expenditure to be funded through the local property tax. Thus, it appeared that the state was financing about 62 percent of educational expenditures through state government revenue sources — primarily the \$440 million raised through the statewide property tax.

However, \$418 million of this \$440 million stayed within the communities from which it was raised, without any redistribution by the state. In other words, about 95 percent of the statewide property tax was raised locally and stayed in that locality. Furthermore, except for the determination of the uniform statewide tax rate, the statewide property tax is administered at the local level — property values are appraised and assessed at the local level of government, tax bills are computed using locally assessed valuations, and taxes are collected at the local government level. In effect, some argue, the statewide property tax is a local property tax. If so, local property taxes actually funded \$893 million (\$475 million plus \$418 million), or about 70 percent, of the \$1.3 billion educational expense. Essentially, state policymakers solved the *Claremont* challenge by setting a uniform statewide property tax rate for educational purposes, but decided to maintain decentralized, local control over the vast majority of the education funds that were raised.

Is the statewide property tax a state government tax or a local government tax? The ambiguity in this question has been seized upon by New Hampshire's "donor" towns. Because local governments administer the statewide property tax, the donor towns assert that the statewide property tax is a local property tax. They resent having to remit, on average, 5 percent of what they

consider to be their revenues to the state treasury. If the statewide property tax is, in fact, a state revenue source, and the legislature has the right to redistribute the funds any way it sees fit, then they ask, why is the tax administered at the local level rather than at the state level? These are the questions the donor towns attempted to get the court system to answer in the case of *Sirrell, et al. v. State of New Hampshire, et al.* (see *Fiscal Facts*, Spring 2001).

Lingering Implications of the *Sirrell* Case

Although the donor towns assert that the statewide property tax is, in effect, a local property tax, they challenged the constitutionality of the tax under the assumption that it is a state government revenue source. The tax is administered locally, using local assessment methods that vary dramatically across communities. Thus, they argued, locally assessed property values, from which statewide property tax payments are calculated, are not “equal in valuation” across the state of New Hampshire as required by Part II, Article 5, of the New Hampshire constitution. Because property assessments are not equivalently valued across the state and, in fact, vary widely across the state in relation to a property’s true market value, the supposedly uniform statewide tax rate is not really uniform.

On January 17, 2001, Rockingham Superior Court Judge Richard E. Galway ruled in the case of *Sirrell, et al. v. State of New Hampshire, et al.*, that the statewide property tax violated Part II, Articles 5 and 6, of the New Hampshire constitution. Four months later, in early May, a majority of the New Hampshire Supreme Court reversed Judge Galway’s decision.² The Supreme Court tightened the burden of proof that plaintiffs must meet in such a constitutional challenge. However, the primary reason the court gave for overturning the lower court ruling was that the statistic the plaintiffs used to demonstrate variation in assessed-to-market-value ratios across the state (see *Fiscal Facts*, Spring 2001) actually showed variation across taxpayers within a municipality, and not across taxpayers from different municipalities across the state.³

The court again stated that the appropriate taxing jurisdiction for the statewide property tax is the entire state of New Hampshire, reaffirming its *Claremont II* decision. In this regard, the court appears to be taking the view that the statewide property tax is actually a state

government revenue source, despite the fact that it is administered locally. Furthermore, the court agreed that flaws in the statewide property tax system pointed out in *Sirrell* raise serious concerns about the constitutionality of the tax. In view of these concerns, the court left open the possibility of eventually upholding Judge Galway’s decision if the increased burden of proof specified by the court could be met through appropriately calculated statewide statistics. Thus, the state of New Hampshire remains vulnerable to future constitutional challenges on grounds similar to *Sirrell*.

Because the court system refused to declare the statewide property tax unconstitutional, the donor towns are now threatening to secede from the state in order to retain control over the disputed 5 percent of “excess” property taxes currently remitted to the state treasury.

Both Judge Galway and the state Supreme Court addressed the matter of property revaluation. Judge Galway ruled that the state was in violation of Part II, Article 6, of the state constitution, which states that “there shall be a revaluation of all properties within the state once in every five years.” Evidence presented in *Sirrell* demonstrated that many communities failed to revalue their property this frequently. The Supreme Court agreed with Judge Galway on this point. The court said that the state must set up proper enforcement procedures to ensure that municipalities revalue their properties every five years. The state was given until 2003 — the original date of expiration of the statewide property tax — to design and implement these enforcement procedures.

In the matter of property revaluation, a key question is again: Is the statewide property tax a state revenue source, or a local revenue source? Either way, the issue is problematic:

- By declaring the appropriate taxing jurisdiction to be the entire state of New Hampshire, the state Supreme Court appears to be endorsing the view that the statewide property tax is a state revenue source. If this is true, then the state government is responsible for administering it, including conducting a statewide property revaluation every five years. If the state continues to delegate this task to local governments, it risks running afoul of the unfunded mandate provision of the state constitution (Part I, Article 28-a). This provision says that the state government must provide local governments with the funds necessary to finance state-mandated programs. The state-mandated program, in this case, is to conduct a property revaluation every five years.

- On the other hand, if the statewide property tax is

² A divided Supreme Court issued a 3 to 2 decision to reverse Judge Galway’s ruling in *Sirrell* on May 3, 2001.

³ The statistic that the plaintiffs used to measure variation was the coefficient of dispersion (COD). However, the plaintiffs presented CODs that were calculated for each community in the state, with each COD measuring variation across taxpayers within a given municipality. The plaintiffs did not compute a COD for the entire state of New Hampshire using both locally assessed valuations and equalized valuations.

a local revenue source, then many local governments are clearly in violation of Part II, Article 6. In this case, the Supreme Court order can be seen as requiring corrective action to counter local governments not strictly adhering to Part II, Article 6.

Future court challenges may well arise in order to clear up this particular ambiguity left by the *Sirrell* decision.

Judge Galway's ruling seems to imply that, in order for the state to live up to the *Claremont* mandate, the statewide property tax must be fully administered by the state. "To meet constitutional requirements," he wrote, "the administrative system for any property tax must change to correspond to the applicable taxing district. . . The fatal flaw of HB999 is the state's failure to acknowledge that the taxing district is the state." Although Judge Galway was overruled by the state Supreme Court, the court did reaffirm that the appropriate taxing jurisdiction is the entire state of New Hampshire. Duties the state would have to take on to accomplish property revaluation are extensive: compiling and maintaining a property tax roll, conducting an initial baseline property valuation to equalize assessed property values across the state, performing a revaluation of property values every five years, updating property assessments between property revaluations, setting a uniform statewide property tax rate, calculating and sending out tax bills, and enforcing compliance with the tax laws. The costs associated with these responsibilities are an obvious concern.

The Case of Maryland

The State of Maryland has a constitutional requirement that all property be assessed and taxed uniformly across the state. All property is revalued on a rolling three-year cycle, with one-third of the two million properties in the state revalued in any given year. Thus, each property is revalued once every three years. The number of properties revalued annually is comparable to the number of properties that New Hampshire would need to revalue once every five years.

The budget for property revaluation in Maryland was \$32.5 million in FY2000. These funds were used to revalue 659,238 properties, for an average cost of \$49.37 per property. According to estimates of the U.S. Census Bureau, there were 546,700 properties in New Hampshire in 2000; at a cost of \$49 per property, a statewide property revaluation in New Hampshire would cost approximately \$27 million, spread over five years. This estimate excludes the up-front capital cost of an investment in both computers and the sophisticated software required for the mass appraisal techniques necessary to perform an extensive statewide property revaluation.

The manner in which Maryland revalues property is also instructive. Maryland employs professionally trained assessors in each of the 23 counties in the state. These county-based assessors perform the actual physical inspections of properties. Statewide samples of recent property sales are compiled and maintained by the state tax office. These sales samples can be accessed by both state and local government officials through a state-run computer system. Local assessors use the data to inform their appraisal calculations. After the appraisals are completed, property assessments are entered into the statewide computer system. Auditors, employed by the state government, review and certify the work of the local assessors.

Thus, in Maryland, the property revaluation process, including the compilation and maintenance of computerized statewide data bases, is funded and administered by the state, while local assessors do the actual work of physically inspecting all properties and performing the necessary statistical calculations. If state government in New Hampshire were to take on responsibility for property revaluation, duties might be similarly split. New Hampshire would not necessarily have to abandon the use of local assessors. The state government might manage the overall process, harmonize locally conducted property revaluations, and compile and maintain the requisite statewide computerized data bases, with local governments doing the rest.

A Constitutional Amendment?

Since the *Claremont II* decision, many critics of the Supreme Court's rulings have talked about enacting a constitutional amendment to allow local funding of schools. Some have suggested inserting a clause establishing the legislature's right to set educational finance policy and banning the court system from ruling on educational finance matters. No one disputes the legislature's right to set educational finance policy. However, Part I, Article 35, of the constitution gives the judiciary the right to interpret these laws relative to the constitution, and Part II, Article 37, provides for a separation of powers between the three independent branches of state government: legislative, executive, and judicial.

Opponents of such initiatives suggest that a proposed amendment along these lines could create a constitutional crisis by attempting to restrict the powers of one of the three separate and independent branches of government. The constitution does give the legislature the power to establish a system of lower courts (Part II, Article 4). But once these courts have been established, they become part of the separate and independent judicial branch of government. Any attempt to assert legislative authority over

the court's constitutional duty to interpret the laws would create a conflict with the constitutionally mandated separation of powers.

Some have suggested nullifying one or both of the two clauses in the constitution central to the *Claremont II* decision: the proportional taxation clause (Part II, Article 5), and the education clause (Part II, Article 83). The state Supreme Court interpreted the education clause as mandating the state government to provide all residents with a constitutionally guaranteed "adequate" education. "As we held in *Claremont I*," the court wrote, "Part II, Article 83, imposes a duty on the state to provide a constitutionally adequate education to every educable child in New Hampshire and to guarantee adequate funding." This clause has left the Supreme Court little choice but to rule that the appropriate taxing district is the entire state of New Hampshire. One way to allow for local financing of the public schools would be to eliminate this clause.

If this mandate were to be eliminated, the financial burden could constitutionally be shifted to local governments. Such a change would effectively overturn *Claremont II*, since the appropriate taxing district would then become the municipality, and local property tax rates were uniform within each particular municipality prior to the *Claremont II* decision. Removing this constitutional provision, however, would be a dramatic step: Local governments would not have to provide any form of public education unless they explicitly chose to do so.

A second approach would be to eliminate the word "proportional" from the "reasonable and proportional" taxation clause. "Proportional" has been interpreted by the courts to mean "equal in valuation" and "uniform in rate" across the appropriate taxing district — in this case, the entire state of New Hampshire. Removing the word "proportional" from the "reasonable and proportional" clause would enable property tax rates to be different across municipalities. However, this would also allow state and local governments to discriminate among taxpayers for other purposes, setting different tax rates across different groups of taxpayers. Municipalities would be able to assess the properties of different groups of taxpayers at varying percentages of true market value. In the words of the Supreme Court in the *Claremont II* decision, "this is precisely the kind of taxation and fiscal mischief from which the framers of our State Constitution took strong steps to protect our citizens."

Thus, any attempt to amend the constitution in order to overturn the *Claremont II* decision could unleash serious, unintended consequences by denying certain groups

of taxpayers their currently existing constitutional rights in other contexts. Only New Hampshire residents can decide whether overturning *Claremont II* is worth infringing upon these rights.

Conclusions

The *Claremont II* decision of the state Supreme Court created a crossroads in terms of educational finance policy in the state of New Hampshire. After an extremely rancorous four-year debate, policymakers responded to this challenge by enacting a reform that relies heavily on a property tax with a statewide uniform tax rate. Administratively, however, the statewide property tax resembles the local property tax that it was designed to replace, with the only exception being that a uniform tax rate is applied statewide. Because of this ambiguity, the education funding plan currently in force remains vulnerable to future constitutional challenges. Amending one of the two constitutional clauses that are central to the *Claremont II* decision would effectively overturn *Claremont*, but this path opens up potentially serious, unintended consequences.

The state is left with two alternatives. First, the state government can accept responsibility for the statewide property tax and administer this tax in a manner that adheres to the constitution; this would entail conducting statewide property revaluations every five years. Alternatively, the state can replace the property tax with some other broad-based tax. The blue-ribbon commission appointed by Governor Jeanne Shaheen in 2000 specifically analyzed the issue of alternative taxes. In the next issue of *Fiscal Facts*, the final article in this series will examine the implications of introducing alternative broad-based taxes. **FF**

Vermont

continued from page 8

surplus to the education fund, which will be used to fund an increase of \$65 per student in education outlays. The substitution of state revenues allows for a one-time cut in property taxes.

- The allocation of an additional \$1.75 million to promote tourism, bringing the total budget for tourism to \$6.75 million.

- The earmarking of an additional \$1 million for job training funds.

- The termination of the piggybacking of Vermont's income tax on the federal income tax liability of Vermont taxpayers. This measure was enacted to prevent a loss in state income tax revenues due to the recent cut in income taxes at the federal level. **FF**

Across *the* Region

Personal income tax revenues grew strongly across the region through June 2001, creating surpluses for FY2001, albeit smaller ones than in the recent past. However, other tax components performed relatively poorly, exhibiting the first signs of a slowdown in economic activity. The early information on revenues in FY2002 is not encouraging — the three New England states with the largest economies (Connecticut, Massachusetts, and Rhode Island) reported that tax revenues during July and August, the first two months of FY2002, declined from the same period last year. And with the terrorist attacks of September 11 in New York and Washington expected to further slow economic activity, FY2002 appropriations are likely to exceed revised revenue projections. Consequently, many states will confront tough fiscal choices during the ensuing year. *Fiscal Facts* will monitor these developments throughout the year.

Enacted Appropriations for FY2001 and FY2002^a

(Excluding Federal Dollars)

	FY2001	FY2002	Percent
	Millions of Dollars	Millions of Dollars	Change
Connecticut	9,916.6	10,563.7	6.5
Maine	2,792.5	2,872.2	2.9
Massachusetts	17,788.9	18,767.3	5.5
New Hampshire	2,083.3	2,306.6	10.7
Rhode Island ^b	3,221.2	3,509.7	9.0
Vermont ^c	1,473.4	1,563.2	6.0

^a Unless otherwise noted, includes general fund and transportation fund appropriations only.

Excludes expenditure of federal grants and reimbursements.

^b Includes general revenue and other unrestricted funds.

^c Includes Act 60 education fund spending.

Sources: Official budget documents, state financial statements, and conversations with state budget officials.

Six State Review

Connecticut

Connecticut collected tax revenues of \$8.5 billion in FY2001, up 4.8 percent from FY2000, but below the 5.5 percent growth forecasted by the Office of Fiscal Analysis. Tax collections were led by income taxes, which recorded revenue growth of 12.9 percent. Other revenue components displayed generally lackluster growth consistent with a slowdown in the economy. Sluggish revenue growth has affected the state's fiscal position. Although the state was expecting an operating budget surplus of \$600 million for FY 2001, preliminary figures issued by the state comptroller's office in early August suggest that the state may have ended FY2001 with an operating budget *deficit* of \$128.1 million. The deficit is attributable partially to the enactment of \$669 million in supplemental appropriations — \$69 million more than the expected surplus — and partially to \$59.1 million in addi-

tional revenues that were expected but did not materialize.

At the end of June, the legislature enacted an own-source expenditure budget for FY2002 of \$10.6 billion, up \$647.1 million, or 6.5 percent, from initial FY2001 appropriations.¹ No major changes in spending priorities and only a few new spending initiatives were enacted with the budget. Highlights are as follows:

- The sales tax on hospital services was eliminated, costing the state an estimated \$111.4 million in revenues.
- New mental health programs were enacted, costing the state \$40 million.
- The cap on Educational Cost Sharing grants is being phased out, at a cost of \$25 million.

¹ The term own-source expenditure budget connotes expenditures that are financed with revenues raised at the state level. Looking just at own-source expenditures eliminates expenditures financed with federal funds. Such revenues are not decided upon, nor controlled by, state policymakers. State policymakers do have control over all expenditures that are financed out of the state's own revenues.

Maine

by Amanda Lydon

Maine collected \$2.6 billion in total general fund revenues in FY2001, the same amount that was collected in FY2000. Income tax collections rose 8.7 percent. As a result of a cut in the sales tax rate from 5.5 percent to 5.0 percent, sales tax collections declined 3.5 percent. Had the sales tax rate not been cut, total tax collections would have grown by 3.3 percent. Other tax collections generally performed poorly, with collections of corporate income taxes faring the worst, falling 36 percent below FY2000 levels.

In June, the legislature finalized spending plans for FY2002. An own-source expenditure budget of \$2.9 billion was enacted, a 2.9 percent increase over FY2001. Highlights of the FY2002 budget include:

- A 3 percent increase in collective bargaining agreements with state workers, effective July 1, 2001.
- An increase in the excise tax rate on cigarettes from \$0.68 to \$1 per pack and an increase from 5 percent to 7 percent in the meals tax rate for restaurants that do not serve alcohol. These two tax increases are expected to raise \$53 million over the next two years.
- A decrease of \$23 million in funding for the “lap-top” program, which is intended to buy computer devices for every seventh-grade student in Maine. The project will still have \$30 million in funds.
- A 4 percent increase in FY2002, and a 2.5 percent increase in FY2003, in state spending for Maine’s higher education, costing the state \$14 million over the biennium.

Massachusetts

The Commonwealth collected \$16.65 billion in tax revenues in FY2001, up 6.6 percent from FY2000. This was above the official revenue estimate of \$16.14 billion, leaving the state with a tax revenue surplus of \$502.1 million. Supplemental appropriations of about \$200 million are expected to leave an operating budget surplus of about \$300 million for the fiscal year. Income tax collections grew by 9.5 percent from the prior year, leading all tax revenue components in FY2001. However, overall revenue growth in the fourth quarter of FY2001 slowed to 4.0 percent from the third quarter’s 8.8 percent pace. This slowdown has continued in the first two months of FY2002. The Massachusetts Department of Revenue announced that total tax collections in the months of July and August actually declined by 3.1 percent from their levels in FY2001.

Reminiscent of the budget battle that occurred in 1999 over the FY2000 budget, the House and Senate enacted different FY2002 budgets that are now in con-

ference committee. As *Fiscal Facts* goes to press, there is no sign that the differences are close to resolution. The two budgets are not very far apart in terms of overall spending — the House enacted own-source spending of \$18.7 billion, while the Senate enacted own-source spending of \$18.8 billion. However, the budgets embody different priorities. Three issues are being cited as the most contentious: (1) the use of the tobacco settlement funds, (2) funding for state pensions, and (3) funding for the Clean Elections Law.

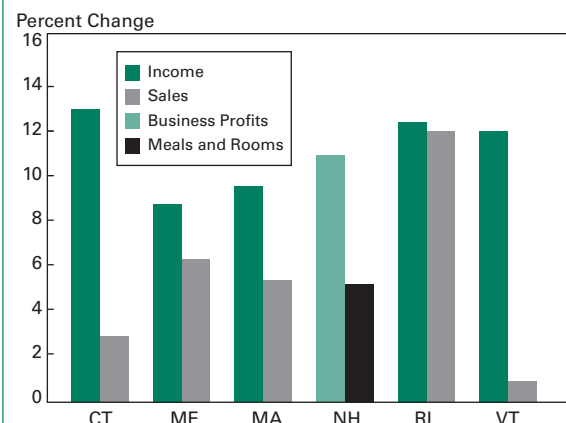
The House budget proposes to keep allocation of the tobacco settlement funds the same as agreed upon two years ago: 30 percent to be spent, and 70 percent to be placed in a trust fund to finance future health care expenditures. The Governor and the Senate have proposed increasing the percentage that is spent and decreasing the percentage that is invested. Similarly, for funding of state pensions, the House budget proposes no change in the previously agreed upon schedule for eliminating the state’s unfunded pension liability, while the Governor and the Senate have both proposed reductions in this funding. Finally, both the Governor’s and the Senate budgets provide some public funding to candidates running for state offices, known as the Clean Elections Law, while the House budget provides for no such funding.

New Hampshire

New Hampshire collected \$1.14 billion in tax revenues in FY2001, up 4.1 percent over FY2000 levels and ahead of the 1.2 percent growth rate predicted by revenue forecasters. As a result of the better-than-expected results, New Hampshire should realize a \$32.2 million revenue surplus. Collections from the combined business profits

Revenues from the Two Largest Taxes in Each New England State

FY2001 Compared with FY2000



Source: Official budget documents, state financial statements, conversations with state budget officials.

and business enterprise taxes led revenue collections in FY2001, growing by 11 percent, far ahead of the 4 percent decline predicted by revenue forecasters. Revenues from the meals and rooms tax grew 5.1 percent in FY2001, slower than the official growth estimate of 7.2 percent.

At the end of June, state lawmakers passed a \$2.3 billion own-source revenue budget for FY2002, up 10.7 percent from FY2001. The budget is similar to the proposal made by Governor Shaheen in February (see *Fiscal Facts*, Spring 2001). However, the major debate over the budget concerned how to fund K-12 school spending, with the funding plan enacted by the legislature being very different from the plan proposed by the Governor in February (see the cover story in this issue for details).

Rhode Island

Rhode Island collected \$2.0 billion in tax revenues in FY2001, up 10.7 percent from FY2000 and ahead of the 8.6 percent growth forecasted by revenue estimators earlier in the year. Personal income tax collections and sales tax collections led the revenue growth, increasing by 12.4 percent and 12.0 percent, respectively. Since the official revenue estimate incorporated into the FY2001 budget forecasted revenue growth of 1.8 percent, the state should realize a \$162.0 million tax revenue surplus when the books are closed for the fiscal year. After enacting \$65.2 million in supplemental appropriations in FY2001, the operating budget surplus in the general fund should approach \$71 million. Although Rhode Island finished FY2001 on a strong note, tax collections in FY2002 have slowed dramatically. Through the first two months, tax collections were down 6.0 percent from the same period last year — significantly below the 2.2 percent growth that had been forecasted.

In early July, state lawmakers enacted a \$3.5 billion own-source expenditure budget for FY2002, up 9.0 percent, or \$288.5 million, from FY2001 initial appropriations. There were no major changes in spending priorities and only a few minor new spending initiatives. The legislature did make a few tax-law changes:

- First, lawmakers ended the “piggybacking” of the state’s income tax on the federal income tax. Before the change, Rhode Islanders paid an income tax equal to 25 percent of their federal income tax liability. With the income tax cut recently enacted by the U.S. Congress, Rhode Island stood to lose millions of dollars in income tax revenues. State lawmakers felt that it was prudent to break the direct link between state and federal income taxes. The change they made will not add any additional money to state coffers.

- Second, lawmakers increased the cigarette tax from 71 cents per pack to \$1 per pack, a change expected to raise \$25 million.

- Third, lawmakers enacted a law to phase out the capital gains tax by 2008.

Vermont

by Amanda Lydon

Vermont collected \$974.2 million in tax revenues during FY2001, up 4.8 percent from FY2000. Estimates made earlier in the year suggested that revenues would increase by 0.4 percent. Personal income tax collections led the way, increasing 12 percent from FY2000, far ahead of the forecasted 1.2 percent gain. Collections of consumption taxes (sales taxes and meals and rooms taxes) did not fare as well — up 0.9 percent, below the 3.0 percent increase forecasted earlier in the year. Corporate tax collections were essentially flat for the year — slightly ahead of the forecast. Thus, except for income tax collections, Vermont revenue data exhibit evidence of the widely reported slowdown in economic activity. The better-than-expected income tax results led to a tax revenue surplus of \$40.6 million.

At the beginning of June, Vermont’s legislature enacted an own-source expenditures budget for FY2002 of \$1.6 billion, an increase of 6.0 percent from FY2001. The budget includes \$35.2 million in one-time expenditures from the FY2001 revenue surplus. Highlights of the FY2002 budget are as follows:

- The dedication of \$6.5 million from the FY2001

continued on page 5

New England Fiscal Facts

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