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

Summary of Findings

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Views expressed in this presentation are the author’s and are not necessarily those of the Federal Reserve Bank of Boston or the Federal Reserve System.
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

Source: Author’s calculations based on US Census Bureau data.
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

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

Source: Author’s calculations based on US Census Bureau data.
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
Expenditure need: Key components

- **Workload measures**: socioeconomic, demographic, and/or geographic characteristics not directly influenced by government in the near term
  - **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)

<table>
<thead>
<tr>
<th></th>
<th>ME</th>
<th>NH</th>
</tr>
</thead>
<tbody>
<tr>
<td>State share of regional population living in poverty (A):</td>
<td>12.0%</td>
<td>7.2%</td>
</tr>
<tr>
<td>State share of regional elderly population living in poverty (B):</td>
<td>12.5%</td>
<td>7.8%</td>
</tr>
<tr>
<td>State share of regional public welfare workload (C) = (0.75 x (A)) + (0.25 x (B)):</td>
<td>12.1%</td>
<td>7.4%</td>
</tr>
</tbody>
</table>
# Calculating expenditure need (public welfare example)

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

Source: Author’s calculations, various sources.
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

Circumstances account for around 40 percent of the overall gap between New Hampshire’s actual per capita spending and the regional average. The chart illustrates the actual expenditures, expenditure need, and NE average for various states. The portion due to circumstances (41%) and the portion due to other factors (policy choices) (59%) are indicated.

Source: Author’s calculations, various sources.
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

- Lower expenditure need accounts for 78% of gap in public welfare spending.
- But only 11% of gap in hospital spending.

Source: Author’s calculations, various sources.
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

<table>
<thead>
<tr>
<th>Category</th>
<th>CT</th>
<th>ME</th>
<th>MA</th>
<th>NH</th>
<th>RI</th>
<th>VT</th>
<th>NE average</th>
<th>NH $ gap</th>
<th>NH % gap</th>
<th>NH rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property</td>
<td>2,314</td>
<td>1,565</td>
<td>1,703</td>
<td><strong>2,215</strong></td>
<td>1,857</td>
<td>1,994</td>
<td>1,911</td>
<td>304</td>
<td>15.9</td>
<td>2</td>
</tr>
<tr>
<td>General sales</td>
<td>869</td>
<td>801</td>
<td>629</td>
<td>-</td>
<td>828</td>
<td>548</td>
<td>657</td>
<td>-657</td>
<td>-100.0</td>
<td>6</td>
</tr>
<tr>
<td>Selective sales</td>
<td>656</td>
<td>483</td>
<td>323</td>
<td>559</td>
<td>467</td>
<td>832</td>
<td>474</td>
<td>85</td>
<td>18.0</td>
<td>3</td>
</tr>
<tr>
<td>Individual income</td>
<td>1,817</td>
<td>1,116</td>
<td>1,758</td>
<td>82</td>
<td>1,026</td>
<td>937</td>
<td>1,469</td>
<td>-1,388</td>
<td>-94.4</td>
<td>6</td>
</tr>
<tr>
<td>Corporate income</td>
<td>256</td>
<td>140</td>
<td>325</td>
<td><strong>453</strong></td>
<td>169</td>
<td>134</td>
<td>283</td>
<td>170</td>
<td>60.0</td>
<td>1</td>
</tr>
<tr>
<td>Motor vehicle license</td>
<td>58</td>
<td>65</td>
<td>46</td>
<td>65</td>
<td>50</td>
<td>122</td>
<td>56</td>
<td>9</td>
<td>16.0</td>
<td>2</td>
</tr>
<tr>
<td>Other taxes</td>
<td>199</td>
<td>193</td>
<td>170</td>
<td>234</td>
<td>128</td>
<td>163</td>
<td>182</td>
<td>52</td>
<td>28.6</td>
<td>1</td>
</tr>
<tr>
<td>Current charges</td>
<td>728</td>
<td>871</td>
<td>946</td>
<td><strong>861</strong></td>
<td>826</td>
<td>998</td>
<td>872</td>
<td>-11</td>
<td>-1.2</td>
<td>4</td>
</tr>
<tr>
<td>Misc. own-source</td>
<td>616</td>
<td>721</td>
<td>962</td>
<td><strong>754</strong></td>
<td>974</td>
<td>795</td>
<td>830</td>
<td>-76</td>
<td>-9.2</td>
<td>4</td>
</tr>
<tr>
<td>Intergovernmental</td>
<td>1,308</td>
<td>1,917</td>
<td>1,643</td>
<td><strong>1,281</strong></td>
<td>1,988</td>
<td>2,310</td>
<td>1,608</td>
<td>-327</td>
<td>-20.3</td>
<td>6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8,823</strong></td>
<td><strong>7,873</strong></td>
<td><strong>8,507</strong></td>
<td><strong>6,504</strong></td>
<td><strong>8,315</strong></td>
<td><strong>8,834</strong></td>
<td><strong>8,341</strong></td>
<td><strong>-1,837</strong></td>
<td><strong>-22.0</strong></td>
<td><strong>6</strong></td>
</tr>
</tbody>
</table>

Source: Author’s calculations based on US Census Bureau and New Hampshire FY 2007 CAFR data.
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

Source: Author’s calculations based on US Census Bureau data.
But New Hampshire *state* government obtains revenues from a diverse set of sources

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

- **Statewide property tax**: 16%
- **Business profits tax**: 15%
- **Business enterprise tax**: 11%
- **Meals & rooms tax**: 9%
- **Tobacco tax**: 6%
- **Real estate transfer tax**: 6%
- **Tobacco settlement**: 2%
- **Communications tax**: 3%
- **Lottery commission transfers**: 4%
- **Net Medicaid enhancement revenues**: 4%
- **Insurance premium tax**: 4%
- **Interest & dividends tax**: 5%
- **Liquor sales & distribution**: 5%
- **Net Medicaid enhancement revenues**: 4%
- **Lottery commission transfers**: 4%
- **Real estate transfer tax**: 6%
- **Tobacco tax**: 6%
- **Communications tax**: 3%
- **Tobacco settlement**: 2%
- **Utility property tax**: 1%

Other 9%

Source: New Hampshire FY 2007 CAFR.
Unique features of New Hampshire’s revenue system: The business enterprise tax (BET)

- The BET is a 0.75 percent tax on “enterprise value base:” wages, interest, and dividends paid by businesses
  - 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
  - Creditable against the BPT
- Similar to an individual income, but with key differences:
  - Statutorily imposed on businesses, not individuals (and thus does not apply to wages of non-business employees)
  - 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**

- Hospitals pay state $10M in Medicaid enhancement taxes.
- State pays hospitals $10M in DSH payments.
- Federal government matches 50 percent of DSH payments ($5M).

**On net:**
- State government: +$5M
- Hospitals: 0
- Federal government: -$5M
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