Revised - February 13, 2012

Proposed Spending Cap Could Lock in Current Spending Cuts for a Decade or More

Later this week, Senate President Peter Bragdon is expected to put forward a proposal to amend the New Hampshire Constitution to impose a new and severe constraint on the state budget process. More specifically, the Senator seems likely to offer a proposal that would cap the growth of the state budget from one biennium to the next at the rate of inflation, unless three-fifths of both the House of Representatives and the Senate were to vote to waive such a cap.

If the Legislature were to approve a spending cap along these lines and the voters were to enact it in the fall, the consequences for New Hampshire would be far-reaching and long-lasting. Most notably, in the absence of regular votes to waive the proposed spending cap, Senator Bragdon's amendment would serve to lock in the effect of economic downturns for years at a time, potentially ratcheting down spending levels during recessions, but dramatically slowing their recovery even during periods of economic growth.

Similar constitutional limits on taxes and spending have been proposed in other states over the past several years, but, in each case, they were ultimately rejected, either by state legislators or by voters at the ballot. Only Colorado now has such a cap in place. Importantly, its effect on the public services that foster economic growth and ensure the public welfare was so debilitating that, due in large extent to appeals from business and civic leaders, it was suspended for the latter half of the 2000s.

The remainder of this Issue Brief examines the problems associated with the proposed spending cap in more detail. As it notes:

- The proposed cap would promote gridlock at the State House, as it would empower a very small number of legislators to block action on important priorities.
- The proposed cap would lock in spending cuts enacted during recessions, even as the New Hampshire economy rebounds.
- The proposed cap would likely hold state spending below 2010-2011 levels for a decade or more.
- The proposed cap would have other unintended consequences, likely leading to further cost-shifting and imperiling the state's bond rating.
- The cap's arbitrary formula reflects neither the costs New Hampshire faces, nor its ability to support public services.
- Colorado's experience with its tax and spending cap should serve as a warning, not as a model to emulate.

Proposed Cap Would Promote Gridlock at the State House

Under the proposed spending cap, New Hampshire's budget could not grow by more than the rate of inflation – unless three-fifths of both the House of Representatives and the Senate voted to suspend the cap. As a rule, supermajority requirements of this kind greatly increase the chance of legislative stalemates, as they create incentives for policymakers to attempt to extract concessions on other, unrelated matters in exchange for their votes. Thus, New Hampshire's biennial budget – typically the single most important matter on which legislators act each term they are in office – would become captive to demands for projects in legislators' home districts or for favorable treatment of other legislation, should the state need to increase spending over and above the rate of inflation. In other words, the proposed spending cap would not make state government more responsive to the voting public or more efficient in its use of their tax dollars, but it could end up making it less so.

Proposed Cap Would Lock In Spending Cuts Enacted During Recessions, Even as Economy Rebounds

If the proposed spending cap were to be approved by the voters this fall, it would be instituted immediately following a sharp reduction in state spending, a reduction driven by the 2007-2009 recession and the struggle to recover from it. As a result, that significantly reduced spending level would serve as the starting point for calculating the amount of spending allowed in future budgets. In other words, instituting the spending cap in 2013, would, in the absence of regular supermajority votes to waive it, lock in place economically-suppressed spending levels for years to come, even as the New Hampshire economy rebounds and the state's overall capacity to support public services again begins to rise.

Just as importantly, when New Hampshire experiences another economic downturn in the future – and should it choose to reduce spending in response – the process would be repeated once more. The level of spending permitted under the proposed cap in the years following any future recession would, failing a supermajority vote, be based on that reduced amount. Thus, the spending cap would likely ensure that the state continues to feel the effect of all future economic downturns well after they have passed.

Proposed Cap Would Likely Hold State Spending Below 2010-2011 Levels for a Decade or More

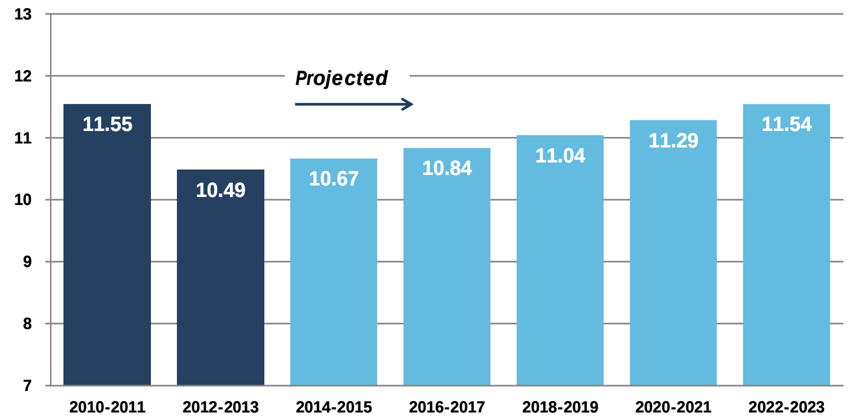
As the figure below indicates, appropriations for the FY 2012-2013 biennium from all sources – the General Fund, the Highway Fund, federal funds, and others – totaled $10.49 billion. This sum is approximately $1.06 billion, or roughly 9 percent, lower than Total Fund appropriations for FY 2010-2011, when they amounted to $11.55 billion.[i]

According to Congressional Budget Office (CBO) projections released on January 31, inflation, as measured by the Consumer Price Index for All Urban Consumers (CPI-U), is expected to range between 1.5 and 2.3 percent annually over the next decade.[ii]

Should those projections hold and barring a supermajority to approve the budget in any given year, then, under the proposed spending cap, total appropriations would not return to their FY 2010-2011 levels until sometime after FY 2022-2023, as the figure at right illustrates.[iii]

Proposed Cap Would Likely Hold State Spending Below FY10-11 Levels for a Decade

Total Fund Appropriations, by Biennium, in Billions of Current Dollars



Source: NHFPI calculations based on data from the Office of the Legislative Budget Assistant and the Congressional Budget Office

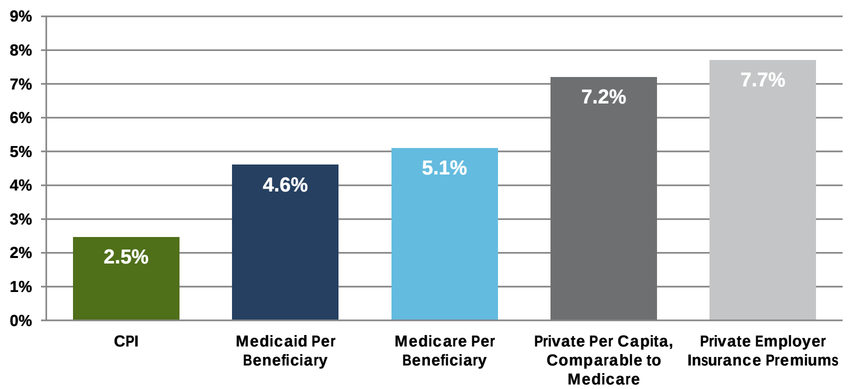
Consequently, it may take the better part of a decade for New Hampshire to restore the spending cuts it enacted as part of the FY12-13 budget, if the proposed cap were incorporated into the Constitution. For instance, to help bring the budget into balance, the state reduced total fund appropriations for uncompensated care payments to hospitals by approximately $230 million and for the University System of New Hampshire by $94 million. Given the limits that the spending cap would impose on future budgets, New Hampshire likely could not bring funding for just these two areas back to prior levels until the FY 2016-2017 biennium, even if economic growth – and, by extension, state revenue growth – were sufficient to permit it. If funding in other areas were restored more quickly or if policymakers created new initiatives in the interim, the delay could be even longer.

Spending Cap's Arbitrary Formula Reflects Neither the Costs New Hampshire Faces Nor Its Ability to Support Public Services

In order to maintain the same level of public services over time, budgets should grow to mirror changes in the number of people receiving such services or changes in the costs associated with providing them. At first glance, the proposed spending cap seems to allow for some growth, but a simple adjustment for inflation each year does not fully reflect the changes state government generally experiences.

Inflation, as measured by the Consumer Price Index or CPI, shows the change in price of a set of goods and services purchased by the typical consumer, such as groceries, housing, or cell phones. State governments, on the other hand, usually purchase a much different set of goods and services. In particular, one of the items that takes up the most space in the governmental shopping cart is health care. As is well understood and as is illustrated in the figure below, the growth in health care costs rose much faster than inflation in the past decade. More specifically, between 2000 and 2009, the CPI – that is, inflation generally – grew by 2.5 percent per year on average. In contrast, costs within Medicaid, the joint federal-state program that

Medical Costs - Particularly in the Private Sector - Grew Much Faster than Inflation in the 2000s
Average Annual Growth Rate, 2000-2009



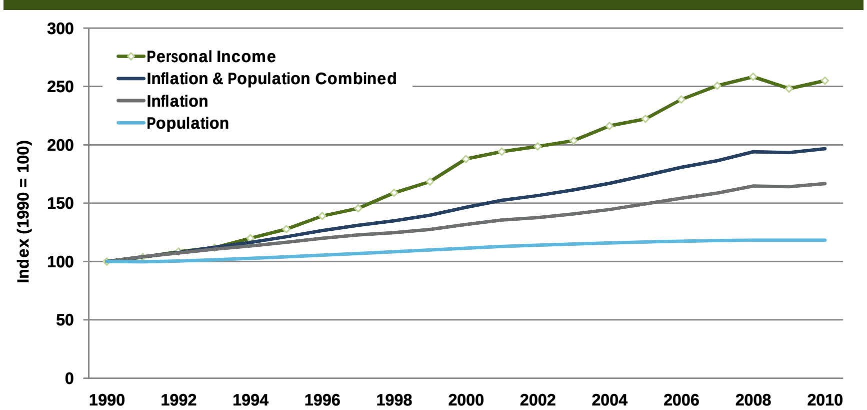
Sources: NHFPI calculations based on US BLS data; Kaiser Commission on Medicaid and the Uninsured; Centers for Medicare & Medicaid Services

provides health care to the poor, the elderly, and the disabled climbed by 4.6 percent per year during that stretch. Critically, though, that degree of cost growth has not occurred solely within public sector health programs; as the figure shows, costs climbed even more rapidly within the private sector during the 2000s.

What's more, the proposed spending cap fails to account for any future increase in the number of people using a specific public service or set of services or even in the number of state residents generally. Over the past decade, New Hampshire's population has grown by roughly 0.4 percent per year on average, with increases of more than one percent in some years. Subsets of the population, such as the elderly, are expected to grow more rapidly in the years ahead. Thus, even if the per person cost of providing a specific service were simply to rise at the rate of inflation, state government might not be able to provide that service to everyone who needs it under the proposed spending cap.

Finally, the proposed spending cap ignores New Hampshire's capacity to support public services and how it may change over time. Ultimately, all state spending – whether as constrained by the proposed cap or as determined by the needs and preferences of the states' citizens – has to come from the economic resources available within the state. Over the last two decades, as summarized in the figure at right, that capacity has expanded much more substantially than the rate of inflation. In fact, personal income in

New Hampshire's Ability to Support Public Services Has Grown Much Faster than Inflation and Population Over Past Two Decades
Inflation, Population Growth, and Personal Income Growth in New Hampshire, 1990-2010

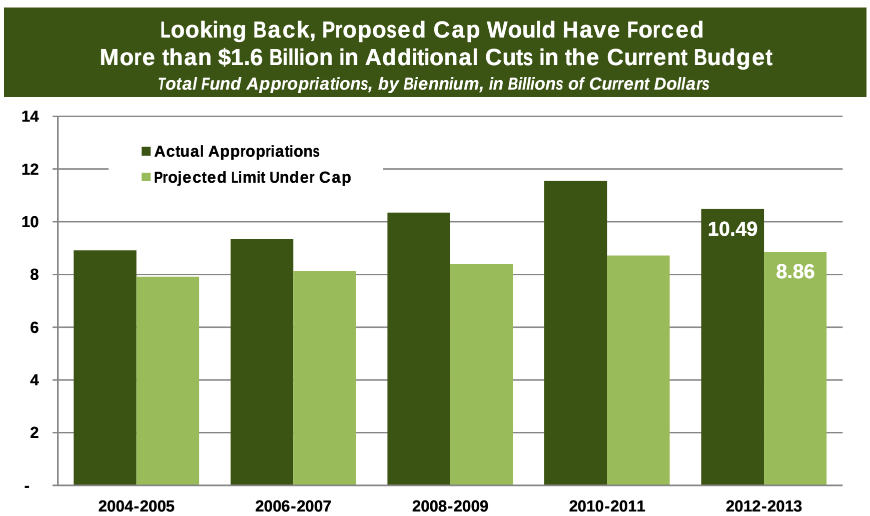


Source: NHFPI calculations based on US Bureau of Labor Statistics, US Bureau of Economic Analysis data

New Hampshire – one proxy for the size of the state's economy – grew by about 4.8 percent per year on average between 1990 and 2010, while inflation climbed at an annual rate of just 2.6 percent over that span.

A Retrospective View: A Cut in Spending of More than $1.6 Billion

Another way to assess the potential impact of the proposed spending cap is to examine what would have happened to state spending had it been in place in prior years. The figure below assumes that the spending cap expected to be offered by Senator Bragdon was written into the Constitution a decade ago and thus in effect beginning with the FY 2004-2005 budget cycle.* As it demonstrates, total spending would have been ***$1.6 billion lower*** in the FY 2012-2013 biennium had the spending cap been put in place a decade ago. To put that into perspective, Total Fund appropriations for the Departments of Transportation and Safety ***combined*** were roughly $1.47 billion for FY12-13.



**NHFPI calculations based on data from the US Bureau of Labor Statistics. Calculations are based on total fund appropriations only and do not incorporate outside sections or capital appropriations. These calculations assume that appropriations were exactly equal to amount allowed by the cap each year and that the cap was not overridden by a supermajority vote in any given year; if appropriations were below the level permitted by the cap in a given year, then the allowable level would be lower in each subsequent year.*

Spending Cap Would Have Other Unintended Consequences, Likely Leading to Further Cost-Shifting and Imperiling the State's Bond Rating

One other consequence of the proposed spending cap to consider is its impact on individual portions of the state budget. That is, with a spending cap in place, should policymakers decide to increase funding for a particular area of the budget – or should the courts mandate an increase in support for a specific program – at a rate that exceeds inflation, funding for the remainder of the budget will have to rise more slowly or to be cut outright. In other words, under the limits imposed by the proposed spending cap, should policymakers choose to embark on a new initiative or to address a long-neglected area of need, the rest of the budget would pay the price, even if total revenue were sufficient to cover those higher costs. Under such circumstances, the state would likely have to shift costs to other levels of government, local businesses and non-profits, and individuals and families throughout New Hampshire.

In addition, the proposed spending cap could imperil the state's bond rating and lead to higher borrowing costs. In creating a hard and fast limit on the amount of funds the state may expend in any given budget, the proposed constitutional amendment increases the likelihood that the funds available to meet the state's obligations, including payments of interest and principal on the bonds it has issued, will be insufficient. The greater the risk that the state is unable to make such payments, the greater the chance bond rating agencies such as Moody's or Standard & Poors will lower the state's rating. If that were to occur, the costs the state would incur in borrowing funds in capital markets would rise.

Colorado's Experience Should Serve as a Warning, Not as a Model

In recent years, a variety of states have considered incorporating some form of a tax or spending cap into their constitutions. In each case, legislators or voters in those states realized the potential effects of such caps and rejected them, leaving just one state – Colorado – with a rigid formula limiting taxes and spending as part of its constitution. Initially adopted in 1992, Colorado's so-called Taxpayer Bill of Rights (or TABOR, for short) limits revenue growth – and, by extension, spending growth – within the state's General Fund to the rate of inflation for the Denver metropolitan area plus state population growth. It also requires voter approval of any tax increase and prohibits the state from levying certain taxes altogether, such as a real property tax or a graduated income tax.[iv]

The consequences of TABOR for essential services in Colorado, including for primary and secondary education, public universities, public health, and health care coverage generally, have been severe. For instance:

- Under TABOR, the share of personal income Colorado devoted to K-12 education fell from 35th out of the 50 states to 49th between 1992 and 2001.

- Likewise, Colorado's national ranking for the share of personal income dedicated to college and university funding dropped from 35th in 1992 to 48th in 2004.

- Between 1992 and 2005, the proportion of low-income children in Colorado without health insurance doubled.[v]

The consequences of TABOR were so far-reaching in fact that, in 2005, Colorado citizens, including a bipartisan group of state legislators and a coalition of business and civic leaders, approved a ballot initiative suspending it for 5 years.

Conclusion

In sum, an amendment to the New Hampshire constitution to cap spending growth at the rate of inflation would represent a dramatic departure for the state. It would replace the deliberative process the New Hampshire Legislature has used for decades to determine the state's budget priorities with an imported and arbitrary formula that reflects neither the needs of the state's citizens, nor their collective ability to support public services. In so doing, it would severely impair the state's ability to make investments, now and in the future, in education, transportation, and other areas critical to sustained and shared prosperity.

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[i] Office of the Legislative Budget Assistant, Appropriation Comparison of FY 2010-2011 and FY 2012-2013 Operating Budgets, June 29, 2011. Appropriations are total fund appropriations and do not include appropriations made via "outside sections" or the capital budget.

[ii] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2012 to 2022,* January 31, 2012

[iii] Calculations assume spending cap implementation in 2013.

[iv] Scanlon, Terry, *The Colorado Budget Primer,* Colorado Fiscal Policy Institute, January 2011.

[v] Lav, Iris J. and Williams, Erica, *A Formula for Decline: Lessons for Colorado for States Considering TABOR*, Center on Budget and Policy Priorities, March 15, 2010.