Testimony of Jeff McLynch,
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Before the Senate Ways and Means Committee
Regarding SB 1 and SB 2, Reducing BPT and BET Rates
January 20, 2015

Chairman Boutin, Members of the Committee, thank you for the opportunity to appear before you today.

For the record, my name is Jeff McLynch and I am the Executive Director of the New Hampshire Fiscal Policy Institute. NHFPI is an independent nonprofit organization dedicated to exploring, developing, and promoting public policies that foster economic opportunity and prosperity for all New Hampshire residents, with an emphasis on low- and moderate-income families and individuals.

I am here this morning to express NHFPI's concerns about both SB 1, reducing the business profits tax (BPT) rate, and SB 2, reducing the business enterprise tax (BET) rate, and to urge you to recommend the pair of measures inexpedient to legislate.

As the Members of the Committee know well, New Hampshire will face a number of daunting challenges as it crafts its budget for the FY 2016-2017 biennium, challenges that could jeopardize the public services vital to New Hampshire's high quality of life and on which residents and businesses alike depend. SB 1, and its companion measure, SB 2, would make it nearly impossible for New Hampshire to meet those challenges, forcing deep and permanent spending cuts and severely impairing the state's ability to invest in education and other areas critical to our shared economic future. Worse still, SB 1 and SB 2 would yield such results in order to pursue an ineffective economic development strategy; as a general matter, business tax cuts have proven to have little impact on companies' decisions to locate or expand in a given state.

In the time I have remaining before you this morning, I'd like to expand on each of these points in turn.

New Hampshire Has a Revenue Problem

Chief among the challenges before you and your colleagues as you assemble the state budget for the next two years is the fact that New Hampshire's revenue system has yet to fully recover from the national recession of 2007 through 2009. At the close of FY 2014, General and Education Fund revenue amounted to $2.17 billion. After adjusting for inflation, that sum is approximately 12 percent or roughly $290 million less than what the state collected from the same sources in FY 2008. New Hampshire's twin business taxes – the business profits tax and the business enterprise tax – follow the same trend, albeit to a greater degree. Between FY 2008 and FY 2014, the combination of those two taxes, after adjusting for inflation, has dropped almost 20 percent or just over $136 million.

SB 1 – and SB 2 – would simply add to the revenue problems now before New Hampshire. According to the fiscal notes accompanying the two bills, SB 1 would reduce BPT revenue by $20 million over the course of the FY 2016-2017 biennium and by $40 million in the FY 2018-2019 period. Similarly, SB 2 would reduce BET revenue by at least $7.6 million in the coming budget cycle and by $38 million in future biennia. In other words, these two bills, once fully implemented, would drain roughly $78 million in BPT and BET revenue out of every future budget.

SB 1 and SB 2 Would Force Deep Cuts in Spending

To put the magnitude of the revenue losses that SB 1 and SB 2 would produce into perspective, it is worth considering the level of the General and Education Fund support provided to key departments in the current FY 2014-2015 budget. For example, the FY2014-2015 budget appropriates roughly $18 million in General Funds for the Department of Justice – that is, an amount slightly less than the revenue loss that SB1 alone would produce in FY2016-2017, before it is fully implemented.

As noted earlier, should both SB 1 and SB 2 be enacted, they would reduce state revenue by roughly $78 million per biennium once they completely take effect. By comparison, in the FY14-15 budget, the Departments of Resources and Economic Development and Environmental Services combined received $67 million from the General Fund. Alternatively, $78 million is nearly the entire amount of General Fund support provided to the state's Community College System in the current budget; it is just over half the amount provided to the University System.

This is not to suggest that passage of SB 1 or SB 2 would result in the direct elimination of a particular department, but rather to underscore the very real tradeoffs that business tax reductions would entail. Given the fiscal challenges now before New Hampshire – and the exceedingly dim prospects for a budget surplus in the coming biennium – passage of SB 1 or SB 2 would almost certainly force substantial reductions upon key parts of state government and diminish the quality of life for the people they serve.

Importantly, New Hampshire's Business Tax Study Commission, which just completed its work this fall after four years of deliberation, recognized this reality in offering its recommendations for changes to that system. While NHFPI maintains that the Commission's final report suffers from a number of shortcomings, the report nevertheless acknowledges that New Hampshire could not reduce business taxes without significant consequences for the state budget. It finds that:

> Any reduction in the BPT rate would result in a loss of revenue to the State which would make such a reduction impractical for the foreseeable future.[i]

What's more, the report notes that:

> The Commission had no basis for concluding that any effect of attracting new businesses or business expansion as a result of a rate reduction would generate additional tax revenue sufficient to compensate for the revenue loss that would result from the rate reduction.[ii]

Cutting Business Taxes Will Not Spur Stronger Economic Growth

Finally, the Commission's report provides another important context for the Committee's consideration of SB 1 and SB 2, as it calls into question the effectiveness of business tax cuts as a means of improving New Hampshire's overall economic performance.

For instance, the report states:

> In view of the positive and highly competitive overall business tax climate with which New Hampshire is credited, our view is that the current 8.5% rate does not materially affect New Hampshire's competitiveness in terms of attracting and retaining businesses. The testimony heard by the Commission suggests that business tax rates are typically a secondary and not a primary consideration for businesses making expansion or location decisions. [iii]

It goes on to add that:

> Additionally, testimony received both from the New Hampshire Department of Economic Development and other business groups indicated that the hierarchy of priorities for businesses focused more on energy, educated work force, transportation, and the overall cost of doing business. The predictability of the tax rate and a stable tax policy was more of a focus than was New Hampshire's current BPT and BET rates.[iv]

These conclusions are in keeping with extensive economic research on the relationship between business taxation and economic growth. Such research suggests that business taxes have, at most, a relatively modest impact on companies' location, investment, or expansion decisions, an impact that is likely outweighed by other factors and influences. As one summary of the literature, conducted by Stephen Mark, Therese McGuire, and Leslie Papke, puts it:

> …while most researchers find taxes to be a statistically significant factor in business location and expansion decisions, the economic effect of taxes tends to be both small and less important than other factors. Labor force availability and quality, for example, appear to be more important for explaining differences across locations in economic activity.[v]

Therefore, they conclude, economic research on this subject:

> ...make[s] clear that a policy of cutting taxes to induce economic growth is not likely to be efficient or cost-effective in the general case.[vi]

Timothy Bartik, Senior Economist at the Upjohn Institute, puts the relationship between taxes and economic growth even more succinctly, concluding that:

> If ...state and local tax cuts are financed by cutting public services, the result may be lower business activity.[vii]

Indeed, it's easy to see how Bartik could arrive at such a finding. Over the course of the last 15 years, New Hampshire has reduced aid to cities, towns, and school districts by roughly $270 million, after adjusting for inflation. Should passage of SB 1 or SB 2 lead to further reductions in assistance to municipalities, the likely result would be still greater pressure on local property taxes. Local property taxes, in turn, constitute the single largest tax paid by New Hampshire businesses, comprising 45 cents out of every tax dollar paid by businesses in the aggregate in FY 2013, according to research by the Council on State Taxation.

In conclusion, SB 1, taken in combination with its companion measure, SB 2, would ultimately and permanently reduce state revenue by $78 million on a biennial basis. Given the fiscal challenges now before New Hampshire, tax cuts of this magnitude would endanger the public services on which Granite State residents and business rely and curtail the sorts of investments critical to a brighter economic future for all. Consequently, I ask the Committee once more to recommend both bills inexpedient to legislate.

Again, I thank you for the opportunity to testify this morning and would be happy to try to answer any questions you may have.

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[i] State of New Hampshire, Commission to Study Business Taxes, Final Report, October 30, 2014, p. 19
[ii] Ibid.
[iii] Ibid, p. 15-16
[iv] Ibid.
[v] Mark, Stephen T., et. al. "The Effect of Taxes on Economic Development," *District of Columbia Tax Revision Commission: Taxing Simply, Taxing Fairly,* September 1998, p. 45-46.
[vi] Ibid., p. 46.
[vii] Bartik, Timothy J., "Solving the Problems of Economic Development Incentives," *Growth and Change*, Spring 2005, p. 142.