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issue brief

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Supermajority Requirement to Increase Taxes at Odds with Sound Fiscal Policy

The New Hampshire House of Representatives will soon consider a measure, CACR 1, to amend the state's constitution to require that an increase in any existing tax or license fee or the creation of a new tax or license fee be approved by three-fifths of both chambers of the legislature.

In each of the past two legislatures, the House rejected attempts to amend New Hampshire's constitution in the manner envisioned by CACR 1.[i] Those decisions were well founded, for such constraints not only are at odds with sound fiscal policy, but also erode New Hampshire's democratic institutions. Indeed, the experiences of other states with similar restrictions in place, as well as those of at least one New Hampshire municipality, demonstrate quite clearly the adverse consequences that can result from inflexible supermajority requirements. More specifically:

The proposed amendment would undermine New Hampshire's democratic institutions and empower a very small number of legislators to block action on important priorities.

Proponents of a supermajority requirement have argued that such a requirement would ensure that the decision to increase taxes or fees would reflect broad consensus among members. In reality, a supermajority requirement would increase the likelihood of partisan gridlock at the State House, as it would cede control over any number of important priorities to a minority of the legislature. Ten individuals – the number of Senators required to keep that 24 member chamber from achieving a three-fifths supermajority – could forestall passage of a tax increase. Worse still, they could also delay or halt consideration of other critical legislation, such as the state budget, as they withhold their backing of a tax increase in exchange either for support for state projects in their own districts or for concessions on other, potentially unrelated issues.

Independent analysts and observers in other states have expressed these same concerns. In 1998, the bipartisan California Citizens' Budget Commission assessed the Golden State's budget process and argued that its two-thirds vote requirement for approving a budget:

> places the power to control or block the budget into the hands of a small minority …thereby promoting gridlock and enhancing special interest group influence. It also allows political parties in the Legislature to avoid responsibility for unpopular budget

decisions and blame them on others. The public is left finding it difficult to hold anyone, including the Governor, responsible.[ii]

The proposed amendment may lead to higher borrowing costs for the state.

When New Hampshire borrows money through financial markets, a key determinant of the interest rates that it must pay – and, by extension, the costs it must incur – is the rating assigned to its bonds by agencies such as Standard & Poors or Moody's Investors Service.

The adoption of a supermajority requirement for future tax increases could harm New Hampshire's perceived credit-worthiness, as ratings agencies generally view such requirements as constraining states' abilities to repay the funds they have borrowed. As a result, they may assign less positive ratings to the bonds issued by the states and localities that impose such requirements. For instance, in downgrading Arizona's bond rating in 2010, Moody's Investors Service noted that its assessment reflected, among other factors, "…a requirement for a 2/3 majority vote of the state legislature or vote of the people to increase revenues."[iii] Moody's similarly cited Nevada's two-thirds supermajority requirement in lowering that state's bond rating in 2011, observing that it "presents a hurdle to achieving balance on an ongoing basis going forward."[iv]

Closer to home, in 2012, Moody's downgraded its rating for the City of Dover, NH, which has, as part of its charter, a limit on property tax growth that can only be waived by a two-thirds vote of the City Council. Moody's explained its decision by pointing to "…the city's relatively modest financial position and [its] expectation that reserves will not improve significantly over the near-term given a combination of the city's revenue-constraining local tax levy cap, slower economic growth and rising fixed cost pressures…".[v] Due to this change in its rating, it was reported that Dover would have to spend $50,000 more than it had anticipated to refinance its debts.[vi]

Looking further back in time, a comprehensive 1999 study of the relationship between limits on states' fiscal policy processes and the borrowing costs they incur, conducted by James Poterba of the Massachusetts Institute of Technology and Kim Rueben of the Urban Institute, found that states "that restrict tax increases or require supermajorities to increase taxes face higher borrowing costs." Poterba and Rueben further determined that such states are "likely to face borrowing rates more than seventeen basis points higher than those in other states," a difference that is equal to "an extra $1,750 in interest payments per million dollars of debt issued."[vii]

The proposed amendment would inhibit the reconsideration of costly tax breaks and impair New Hampshire's ability to pursue tax reform.

Every state policy, whether dealing with criminal justice, elections, the environment, or taxation, is worth reevaluating from time to time. For instance, tax cuts that were enacted during a period of economic growth and that appeared affordable at the time, might, during a recession, prove to be too costly. Yet, the proposed

supermajority requirement would pose an enormous obstacle to any such reassessment, since even an effort to restore a given tax rate to its prior level would be deemed a tax increase. Tax incentives created in the name of economic development and later found to be ineffective in fostering employment or bolstering incomes would likely remain enshrined in the state's tax code as well, for precisely the same reason. Indeed, the California Citizens' Budget Commission recognized some time ago the problem that supermajority requirements pose for eliminating wasteful tax incentives. In a 1998 report, the Commission concluded that California's two-thirds supermajority standard for passing tax increases "makes it relatively easy to enact tax breaks but difficult to repeal them" and subsequently recommended that California's constitution be altered so that the legislature could reform or repeal tax incentives by a simple majority vote.[viii]

Recent actions by the New Hampshire Legislature illustrate well the danger of limiting opportunities to reevaluate changes in tax policy. Over the course of the last four years, the Legislature enacted close to a dozen changes to New Hampshire's tax system. Yet, for many of those changes, little definitive information was publicly available from the Department of Revenue Administration about the impact they would have on future revenue streams at the time they were considered.

For example, in 2012, over then-Governor John Lynch's veto, the Legislature eliminated the taxation of trusts under the interest and dividends tax.[ix] In his veto message, Governor Lynch expressed his concerns "about the potential fiscal impact and unintended consequences of … provisions amending our trust laws."[x] Those concerns now appear to have been realized, as collections from the interest and dividend tax fell from about $93 million in FY 2013 to roughly $80 million in FY2014 and, through December 2014, are close to 14 percent below projections for FY 2015. In that context, members of the House of Representatives from both parties have introduced legislation to repeal such changes to the interest and dividends tax. Were CACR 1 part of New Hampshire's constitution, that legislation – even though it is intended simply to return to prior law in the face of additional evidence – would be subject to a supermajority vote.

More broadly, CACR 1 would raise a significant hurdle to more comprehensive changes in tax law even if those changes were intended to be revenue neutral. For example, if the Legislature sought to reduce one or both of the state's business taxes and to compensate for the revenue loss by bolstering a different tax or set of taxes, such a reform would likely need the approval of a supermajority of the legislature if CACR 1 were in place.

The proposed amendment would increase the likelihood that the legislature will resort to one-time fixes or accounting gimmicks to address future budget shortfalls.

State budget deficits tend to emerge during economic downturns: tax collections typically decline while the demand for public services remains constant or grows leading to a gap between revenue and expenditures. Under such circumstances, policymakers face a limited set of choices. They can take steps to reduce spending.

They can adopt measures to generate additional revenue in a sustainable fashion. Alternatively, they can turn to temporary solutions that may lead to larger shortfalls down the road, such as shifting costs from one fiscal year to the next or converting ongoing revenue streams, such as tobacco settlement payments, into lump sums to cover current costs.

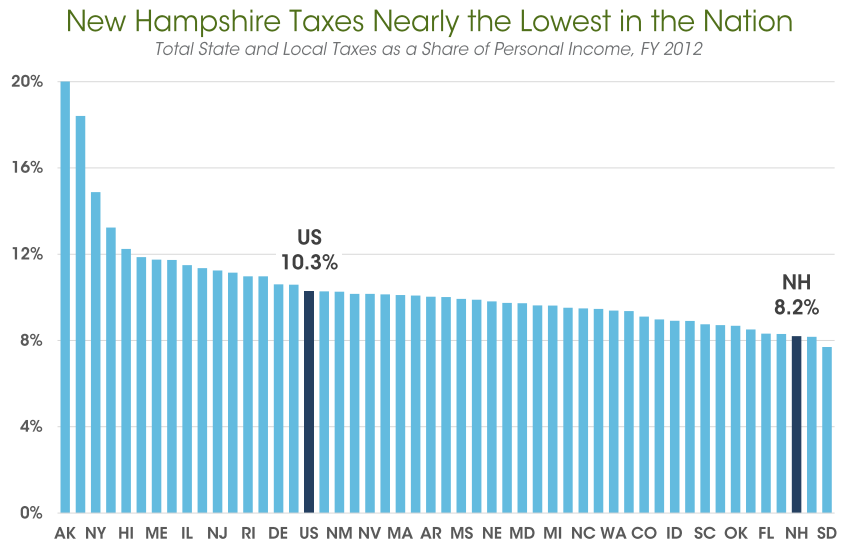
Erecting procedural barriers to tax increases, as the supermajority requirement would do, means that policymakers would either have to enact deeper spending cuts than would otherwise be the case or would have to rely upon short-sighted accounting gimmicks to bring revenue and expenditures into balance. As deep spending cuts can have adverse economic consequences, the pressure becomes that much greater to resort to policy options that offer some fiscal relief in the short-run but that create fiscal stress over time.

The experience of other states with supermajority requirements during the last recession is instructive. Arizona mandates that any tax increase receive the votes of two-thirds of its legislature or be directly approved by the public. In 2010, due in part to the difficulties created by this requirement, the state, in the face of a multi-billion dollar budget deficit, entered into a variety of agreements to sell state buildings, including the Arizona State Capitol and the Arizona Supreme Court, and then to lease them back over time.[xi] While this generated roughly $1 billion in funds to help close its budget gap, Arizona will pay the price for such gimmicks in the form of higher lease costs for years to come. More broadly, a 2009 study by the Pew Center on the States identified ten states under particular fiscal duress in the wake of the recession. Of those states, six – California, Arizona, Michigan, Oregon, Nevada, and Florida – imposed some form of supermajority requirement to raise taxes.[xii]

This proposal attempts to respond to a problem that does not exist.

The ostensible purpose of CACR 1 is to make the enactment of future tax increases more difficult and, by extension, to keep taxes in New Hampshire low. Yet, the level of taxation in the Granite State is already exceptionally low – and has been for some time – even in the absence of a supermajority requirement.

Data from the US Census Bureau and the US Bureau of Economic Analysis indicate that total state and local taxes in New Hampshire equaled 8.2 percent of personal income in FY 2012. By this measure, New Hampshire had nearly the lowest level of taxation in the country in FY 2012, ranking 49th out of the fifty states and the District of Columbia. Only Tennessee and South Dakota had a lower level of taxation, in the aggregate, that year.[xiii]



Source: NHFPI calculations based on data from US Census Bureau, US Bureau of Economic Analysis
Note: Total state and local taxes in Alaska amounted to 24.2 percent of personal income in FY 2012

What's more, New Hampshire's comparatively low level of taxation has persisted for decades. In FY 2012, total state and local taxes for the country as a whole amounted to 10.3 percent of personal income – or more than one and a half percentage points above the corresponding level in New Hampshire. With the exception of the mid-1990s, that difference between New Hampshire and the nation overall has held since the late 1970s. Over the same period of time, only twice – again, in the mid-1990s – did the level of taxation in New Hampshire rise to the point where the state was not among the ten lowest states in the nation.

Conclusion

In sum, the proposed supermajority requirement would unduly constrain the flexibility New Hampshire needs to respond to changing economic circumstances or to shifting public preferences and would likely lead to more frequent legislative stalemates, higher borrowing costs, and a greater reliance upon temporary solutions to future budgetary shortfalls. New Hampshire has one of the lowest levels of taxation in the nation even in the absence of such a requirement. Consequently, instituting a supermajority requirement seems, at best, unnecessary and, at worst, harmful to the state's long-term fiscal condition.

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[i] In 2012, the conference report on CACR 6, by a vote of 220-132, fell short of the three-fifths margin stipulated by the constitution for the amendment to be put before the voters for their consideration. In 2013, the House found CACR 1 inexpedient to legislate by a vote of 206-149.

[ii] Center for Governmental Studies, *A 21st Century Budget Process for California: Recommendations of the California Citizens Budget Commission,* 1998, available at http://www.policyarchive.org/handle/10207/bitstreams/219.pdf

[iii] Moody's Investor Services, Global Credit Research Press Release, "Moody's Downgrades Arizona's Issuer Rating to Aa3 from Aa2", July 15, 2010

[iv] Moody's Investor Services, Global Credit Research Press Release, "Moody's Downgrades State of Nevada's General Obligation Bonds to Aa2 from Aa1", March 24, 2011

[v] Moody's Investor Services, Global Credit Research Press Release, "Moody's Downgrades from Aa3 to AA2 City of Dover's (NH) General Obligation Bond Rating", May 11, 2012

[vi] Ramsdell, Laurenne, "Tax cap, slow economic growth, pensions cited in bond downgrade for Dover," *Foster's Daily Democrat, May 18, 2012*
[vii] Poterba, James M. and Rueben, Kim S., *Fiscal Rules and State Borrowing Costs: Evidence from California and Other States*, Public Policy Institute of California, 1999, p. vi
[viii] Center for Governmental Studies, *A 21st Century Budget Process for California: Recommendations of the California Citizens Budget Commission,* 1998, available at http://www.policyarchive.org/handle/10207/bitstreams/219.pdf
[ix] Chapter 286, Laws of 2012 (SB 326), Department of Revenue Administration Technical Information Release 2012-002, July 10, 2012
[x] Governor's Veto Message Regarding SB 326-FN, Senate Calendar, June 22, 2012
[xi] National Conference of State Legislatures, *Actions & Proposals to Balance the FY 2010 Budget: Other Revenue Actions, Taxes/Fees*, available at http://www.ncsl.org/default.aspx?tabid=17252
[xii] Pew Center on the States, *Beyond California: States in Fiscal Peril*, November 2009, available at: http://downloads.pewcenteronthestates.org/BeyondCalifornia.pdf
[xiii] NHFPI calculations based on data from the US Census Bureau and the US Bureau of Economic Analysis