nhfpi New Hampshire Fiscal Policy Institute

issue brief

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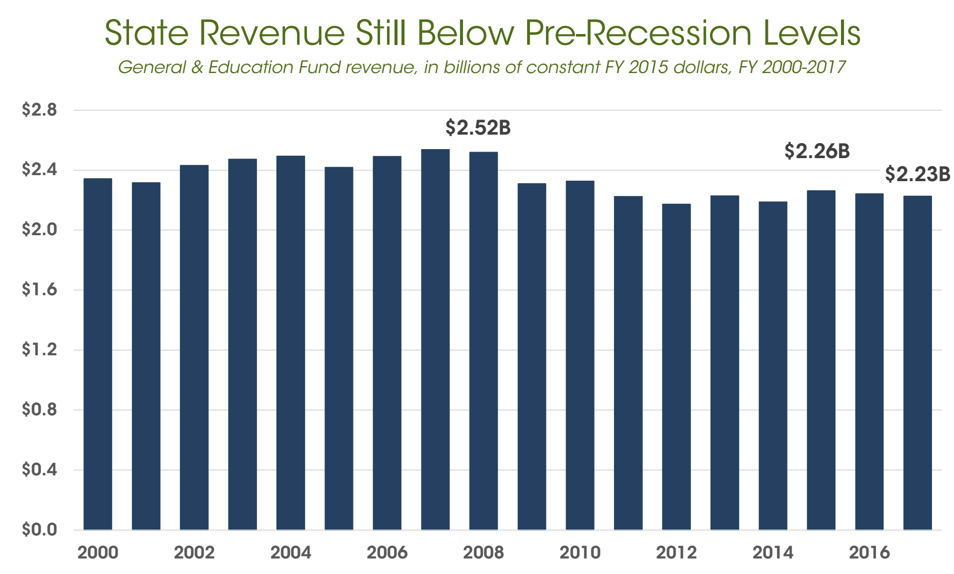
New Hampshire's Revenue Problem Persists; Business Tax Rate Reductions Would Impede Full Recovery

New Hampshire's ongoing budget debate hinges, in part, on current and future revenues, yet collections continue to fall short of pre-recession levels and appear unlikely to recover fully in the immediate future. Preliminary data from the Department of Administrative Services suggest that, while General and Education Fund revenue is poised to exceed initial expectations for fiscal year 2015, it will likely remain some $250 million less in FY 2015 than it was in FY 2008, after taking inflation into account. Furthermore, proposed reductions in the rates of the business profits and business enterprise taxes would help to perpetuate this revenue problem. If such rate reductions became law, business tax collections, after adjusting for inflation, would stay well below their FY 2008 peak through at least FY 2021, even assuming sustained economic growth.

General and Education Fund Revenue: Positive Short-Term Developments, Troubling Long-Term Trends



Source: NHFPI calculations based on data from NH DAS, HB 1, US Bureau of Labor Statistics
Note: Figures exclusive of Board & Care, MET revenues, and net of Liquor Commission administrative expenses

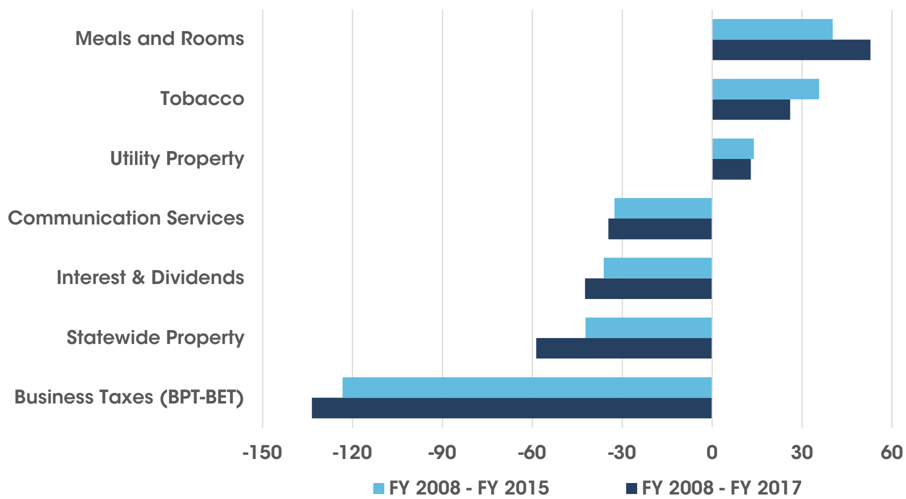
Earlier this month, the Department of Administrative Services released preliminary data on total General and Education Fund collections for fiscal year 2015.[i] Those data indicate that revenue from taxes, fees, and other sources flowing into the General and Education Funds equaled $2.26 billion in FY 2015. While those figures are likely to change somewhat as the state closes its books on FY15, they appear at this stage to exceed the levels originally projected in the spring of 2013, when the FY 2014-2015 budget was created.

More specifically, the state's General and Education Fund revenue plan anticipates FY 2015 revenue of $2.22 billion; actual collections appear to be roughly $42 million or 1.9 percent higher than that amount.

While such news is certainly welcome, the longer term trend in state revenue that these data affirm is quite troubling. As the graph above illustrates, after adjusting for inflation, New Hampshire's two main budgetary funds still have yet to recover fully from the national recession that began in FY 2008. That year, the General and Education Funds collected $2.518 billion in constant, inflation-adjusted FY 2015 dollars; thus, over the course of the recession and the recovery that has followed, the amount of resources flowing through the General and Education Funds has dropped by roughly $255 million or 10 percent.[ii]

Despite Better Economic Times, Business Taxes Yet to Recover

Change in select New Hampshire taxes in millions of FY 2015 dollars



Source: NHFPI calculations based on data from NH DAS, US BLS, CBO

The failure of General and Education Fund revenue to rebound since the economic downturn in inflation adjusted terms can largely be attributed to declines within four discrete revenue sources: New Hampshire's twin business taxes, the business profits tax (BPT) and business enterprise tax (BET); the statewide property tax; the interest and dividends tax; and the communications services tax. As the figure above reveals, each of these sources has dropped substantially in inflation adjusted-terms since FY 2008; in fact, taken together, this subset of revenue sources accounts for $234 million of the entire $255 million inflation-adjusted shortfall in General and Education Fund revenue over that span.

Existing tax policy, as well as changes to it over the past several years, have contributed to this decline. For instance, the amount of revenue the statewide property tax generates each year is set in law at $363 million; the inflation adjusted value of that figure declines with each passing year. In addition, charges for internet service were removed from the base of the communications services tax in 2012. Multiple changes to the BPT and BET, such as an increase in filing thresholds for the latter tax, were also made over this time frame. In contrast, three sources of revenue –

the meals and rooms tax, the tobacco tax, and the utility property tax – have all climbed since FY 2008, though, in the latter two instances, those increases are largely due to higher rates that were put in place in 2009.

Barring future changes in tax policy, this trend does not appear likely to reverse itself in the near future. In setting their baseline revenue estimates, members of the budget conference committee assumed that General and Education Fund revenue will grow, in the aggregate, by 1.4 percent in FY 2016 and 1.6 percent in FY 2017. However, the Congressional Budget Office projects that the Consumer Price Index will rise by 2.3 percent in each of those years. If both the conferees' and CBO's forecasts hold, General and Education Fund revenue will fall to $2.23 billion by the end of FY 2017, after adjusting for inflation. That figure represents a roughly $36 million decline from the likely FY 2015 level.

In examining trends like these over time, it is critical to take the impact of inflation into account, since, simply put, one dollar today buys less than it did seven years ago. Due to inflation, the general level of prices, as measured by the Consumer Price Index, is roughly 11 percent higher today than it was in FY 2008. In other words, someone would need $111 today to purchase something that cost $100 in FY 2008.

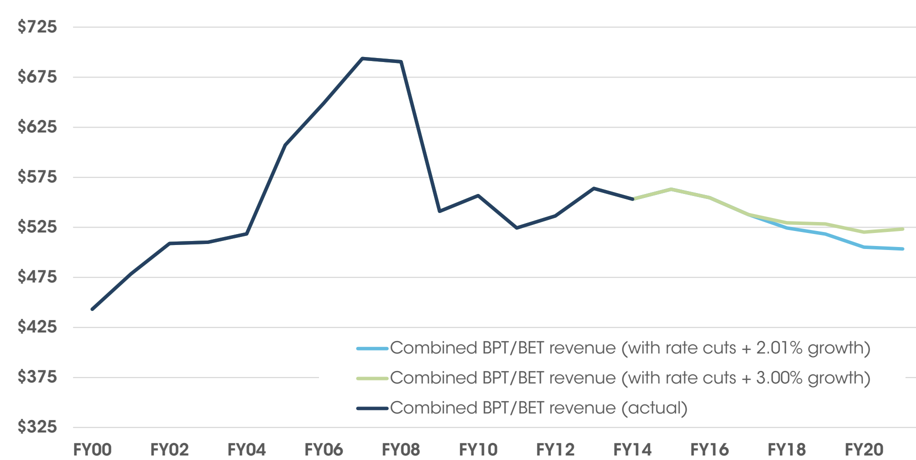
Consequently, to understand how the purchasing power of the General and Education Funds has changed in recent years, one must correct for inflation by converting past revenues into today's dollars. So, in nominal terms, New Hampshire's General and Education Funds collected $2.25 billion in FY 2008; however, to acquire the same volume of goods and services that $2.25 billion could buy in FY 2008, the State of New Hampshire would need about $2.52 billion in FY 2015. Unfortunately, as noted above, at the end of FY 2015, the General and Education Funds totaled only $2.26 billion or $255 million less.

Reducing Business Tax Rates Likely to Perpetuate Long-Term Revenue Trend

Proposed reductions in the rates of the BPT and BET would likely extend the preceding trend into the next decade. As approved by the House of Representatives and the Senate on June 24, HB 2 would lower the BPT rate from 8.5 to 7.9 percent in three steps,

Proposed Rate Reductions Would Leave Business Tax Collections Below Current Levels

Combined BPT-BET revenue in millions of constant FY 2015 dollars, FY 2000-2021



Source: NHFPI calculations based on data from NH DAS, NH DRA, US BLS, and CBO beginning at the end of 2016 and finishing at the end of 2019. It would also drop the rate of the BET over the same period, from 0.75 to 0.675 percent. While proponents maintain that future economic growth – and by extension, underlying growth in the BPT and BET – would be sufficient to compensate for any revenue loss associated with such rate reductions, lowering the rates of the BPT and BET to the degree envisioned by HB 2 would serve to "lock in" the real decline in BPT and BET revenue through at least FY 2021, as the graph above makes clear.

More specifically, budget conferees assumed in June that, absent any rate reductions, combined BPT and BET revenue, in constant FY 2015 dollars, will total $558.6 million in FY16 and $557.0 million in FY17. This latter sum reflects a nominal growth rate of 2.01 percent. If one were to assume that business taxes were to continue to grow by 2.01 percent per year (before adjusting for inflation) and that the rate changes found in HB 2 were written into law, by FY 2021, combined BPT and BET revenue would amount to just $503.4 million in inflation-adjusted terms.[iii] Even if one were to assume more robust growth of 3.0 percent per year, business tax revenue would still only amount to $523.2 million in FY21. Indeed, if the rate reductions included in HB 2 were enacted into law, the underlying base of the BPT and BET would have to grow by just over 10 percent per year between FY 2018 and FY 2021 in order for business tax revenue to return to its FY 2008 level in inflation-adjusted terms by FY 2021.

While some proponents of lower business tax rates assert that such changes will allow companies to retain more of their earnings and create greater incentives to invest and expand in New Hampshire, the weight of the empirical evidence suggests that across-the-board rate reductions are not an effective way to stimulate economic growth.[iv] One reason is that state and local taxes paid by corporations are a very small share of their total expenses. Moreover, businesses' investment decisions are mostly driven by anticipated demand for their products, not by small reductions in their marginal tax rates. Finally, surveys of business executives suggest that what is most important to them in locating their businesses is the quality of the local labor force and physical infrastructure, rather than corporate tax rates. Accordingly, claims that lowering business tax rates would spur faster growth in the underlying base of the BPT or BET and thus help to counter the trend depicted here have little merit.

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[i] State of New Hampshire, *Monthly Revenue Focus*, June 2015 available at http://www.admin.state.nh.us/accounting/FY%2015/Monthly%20Rev%20June.pdf

[ii] The data presented in this section are taken from the State of New Hampshire's Comprehensive Annual Financial Report for fiscal years 2000 through 2014, from the June 2015 *Revenue Focus* for fiscal year 2015, and from the version of HB 1 approved by the legislature on June 24 for fiscal years 2016 and 2017. All amounts are expressed in constant FY 2015 dollars using the Consumer Price Index for All Urban Consumers (CPI-U), adjusted to New Hampshire's fiscal year. Future inflation assumptions are predicated on the June 2015 edition of the Congressional Budget Office's *Long-Term Budget Outlook*. CBO projects that the CPI-U will rise by 2.3 percent in both calendar years 2016 and 2017; consequently, NHFPI assumes inflation will be 2.3 percent in FY 2016 and FY 2017. The data exclude both Board and Care revenue and the Medicaid Enhancement Tax to ensure the same sources of revenue are compared over time; in addition, revenue from the Liquor Commission has been modified to exclude administrative expenses.

[iii] To arrive at these figures, NHFPI adapted the analysis conducted by the Department of Revenue Administration in its June 2, 2015 letter to Governor Hassan estimating the likely revenue loss from the BPT

and BET rate reductions included in HB 2. In deriving those estimates, DRA assumed that the bases of the BPT and BET would remain constant at the level implied by the FY 2015 revenue plan through FY 2020. NHFPI instead assumed, in a manner consistent with the forecast of the budget conference committee, that the tax bases for both the BET and BPT will rise by 1.5 percent in FY 2016 and by 2.01 percent per year between FY 2017 and FY 2021.

[iv] See, for instance: William G. Gale, Aaron Krupkin, Kim Reuben, "The Changing Relationship between Taxes and Growth at the State Level: New Evidence," *National Tax Journal*, forthcoming; Lynch, Robert G., *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development,* Economic Policy Institute, 2004; Donald Bruce, John Deskins, and William F. Fox, "On the Extent, Growth, and Efficiency Consequences of State Business Tax Planning," in Alan J. Auerbach, James R. Hines, Jr., and Joel Slemrod, Editors, *Taxing Corporate Income in the 21st Century*, Cambridge University Press, 2007.