

Remarks of
LISA K. SHAPIRO, Ph.D.
Chief Economist
Gallagher, Callahan & Gartrell, P.C.

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Thank you, and thank you for the opportunity to participate in this panel. I think it's terrific that you're all spending so much time to talk about the challenges that we face as a state, and to assist the Ways & Means Committee to come up with some approaches and ideas. I'm going to take a little bit different tack. I came in this morning with three ideas that I wanted to talk about, and then studiously took notes throughout the nine previous economists that spoke before me, to try and give you some comments on some of the other ideas that were here, and my take on it. I know that Brian [Gottlob] will follow me with another excellent presentation and some more statistics for you, so I'll take a little different tack.

I'd like to address three issues. First, this concept between the mix of taxes that we have in NH, if you will, the portfolio of taxes that we have here, and fees, versus the overall level of taxation. We've heard a lot of comments on that today, and I'd like to add my two cents to the relationship between those two issues.

Second, in particular, I'd like to focus on the business taxes. I did provide for the Committees a copy of a study I did on business taxes in 2002 for the New Hampshire Bankers Association. In looking at it recently, it was remarkable how little has changed in terms of the fiscal challenges of the state—facing forecasts of high deficits, the prospect of increasing taxes, and what were going to be the best options to deal with it.

And the third area I want to just make a few comments on is the outlook, given where we are in the economic cycle, and building on some of the previous comments about the outlook for the future.

First, let's just talk about this issue of the specific taxes and how they fit together versus the overall level of taxation. As a Ways & Means Committee, and I've certainly been before these committees, often you see one tax, one idea— either lowering, or raising, or a credit—and you're not seeing it all together, or you do over the course of a whole session, but not in one place. And I would take the position, based on research that I did before and my own underlying observations, that it's not so much that the structure drives spending. It's that the underlying rationale that you bring to the table as you go through the individual choices is often the underlying rationale that you bring as legislators to the decision of how much to spend. And it's really, in many cases, while in theory one type of tax will not automatically lead to more spending or less spending, and you've heard some competing views on whether our lack of an income or sales tax actually restricts spending or not, and there is competing economic literature

and academic literature on that, but from my view and the studies that I've done on different states' structures, it's the underlying cause. . . the underlying approach that you take in picking taxes often is the same values that you bring in deciding how much to raise.

I've been here for 18 years looking at taxes as one of the areas (that's what my doctorate was in—tax policy), and I personally have never seen a proposal to increase, or change, or add a new tax that was purely a substitution for something else. There is always, that I have seen, some element of increased spending tied to it. You had a budget deficit last year toward the end you were trying to close, and the increases in fees and taxes that you came to a consensus to pass were related to spending, and what you were looking to spend.

I was intrigued this morning with Ross Gittell's comments. Because we've heard a lot about the problem of business taxes being a very high burden in our state. That's one of our weaknesses countered by our strengths in an overall low burden, but even in Mr. Gittell's presentation, where he was very concerned (and I agree with him) about the level of business taxes in the state, and he talked about and proposed introducing a sales tax. He didn't just say to lower business taxes; he also said to increase spending or investments in education. So my recommendation to the committee is that, when you are considering and looking at the individual options that come before you, it's very important to think about how they fit into the overall level of taxation. I would be very wary of any proposal that is a pure substitution. In theory, it may be possible but we rarely see those options. It's usually part of something else.

One thing I also saw that was interesting was I think the public is in a similar situation. When we saw the polling numbers on Dr. Kenyon's presentation, she referred to the fact that every time we've hit a recession support for an income tax goes down. I think it has more to do with the fact that *any* tax increase in a recession is what people are responding to. It's very difficult for people to distinguish between these types because overall when we're under more pressure and businesses are under more pressure we're looking for relief or certainly not increases across the board. And so if you are looking at some type of down-the-road major changes in tax structure, like what was proposed by some of your speakers earlier today, it is very important, in my view, to look at that as part of a dialogue about overall spending—because it really is the same question. I know right now there are two studies out there going on—one on a gas tax, one on gambling—and I think both of those approaches are trying to look at those holistically. They're not just looking at it in a vacuum, but trying to look at how they impact and I think that's really the only way to look at those issues because the overall competitiveness of the state is related not just to the individual taxes and how they affect individual types of businesses. . . types of development. . . types of people that move here. . . that stay here. . . that raise their families here. . . that retire here, but also the overall level of tax burden. That's a very important issue to look at. We have seen a lot of charts about how our overall tax burden has declined in terms of percent of wealth, percent of income. I caution you again that our spending has a lot to do with the demand for services and the type population that's here. And so if you have, and I know one of the other speakers commented on that, our percent of population that's in poverty is much lower than many other states. That's going to impact your spending and so really some of these simple comparisons—you're not really getting at underlying how efficient we are in spending. We might spend more per prisoner than the country average, but that's not going to come up in our overall spending. We might spend more on K through 12 education, but

that might not come up in the way you compare the data because of the types of students and the mix of young population versus old. So it's useful to look at those simple comparisons, but when you're considering changes—lowering, changing, substitution—I'd encourage you to think about it in the broader context.

The second topic I wanted to comment on is business taxes in particular. And again, I've made available the study and it will be up on the website for this group I'm sure by tomorrow or whenever you folks are getting to that, and one of the things that I looked at in the business taxes, and you've heard repeatedly today that our ranking of 50th . . . we have among the highest corporate business tax burden in the country . . . is a drag, but it's offset by some other issues. So in total we stay, in most rankings, in the top ten (and I'll come back to some issues where we're not in the top ten that Ross talked about, that I think are important to keep in mind).

I absolutely disagree with Dr. Kenyon's proposal in her handout to increase the BET tax. That is just a nonstarter to look at increasing taxes, especially in a recession. It just makes absolutely no sense to take more money out of the economy, as difficult as it is on the spending side, to take it from businesses. And when you look at our combination of business taxes, the two main ones, it's a Business Profits Tax and a Business Enterprise Tax, and they're really two different approaches. They were designed to work in tandem because the BPT only really applied to some subset of businesses, so it was a narrow base and also it was purely on income. The BET broadened that base, but if you end up taxing those businesses who would be subject to the BPT to also pay the BET, so they're paying *both* taxes, you're really increasing taxes. And what I'm talking about in particular here is right now our tax structure from the day that second business tax came into effect, there was a credit of one against the other. So for all practical purposes businesses are paying the higher of the two, the ones that are subject to both. If you take away that credit, in essence you're taking that 8 ½ corporate income tax that's among the highest in the country, and you're turning it into a 10, 11 or even 12% corporate income tax. It just doesn't make any sense to be looking at that as an approach. I'm talking about that because it's easy to come in from out of state and talk about getting rid of credits, and getting rid of incentives, and flattening the structure, but on a NH specific basis, there's a reason those two taxes are linked. The study that I've handed out talked about the thousands of jobs that are related to that level of taxation, and what happens.

The other thing that's important people often think of the BET tax as a tax on wages and it is a much broader base than a BPT. There are two points here. It's a tax on wages in the private sector. It's not a tax on wages in the public sector. Second, it's not just on wages and salaries; it's also on interest and dividends. And one sector in particular—the DRA Commissioner, toward the end of last session, was talking about the disproportionate impact of the BET tax on our banking sector providing credit. In essence, the tax on interest for the BET is really a tax on the cost of doing business for banks. So if you eliminate the credit of these two, working in tandem for the last 18 years, you're raising the cost of capital—and you'll see capital flee from the marketplace . . . hundreds of millions of dollars is my estimate. The study goes through a lot of these issues, but I think it's just important when we look at the overall relationship among our main business taxes.

Finally, the third area I wanted to comment on is recession and recovery. Your presentation, Russ [Thibeault], was really on point. We really are in a different world that started before this recession. Ross's set of indicators this morning. . . about the indicators having to do with an innovative economy, whether it's small business startups with percent of entrepreneurs. . . those set of indexes have all declined significantly, and not just in the last two years. This has been over this decade. That is the most troubling set of statistics that I've seen all day, and what we watch as economists, because that has been our source of growth—our innovativeness—and we're losing that edge.

Now in large measure this is a demographic phenomenon. I know Brian has his own take on this, and we heard from Mr. Francese this morning who has his take on it, but the driver has been, in our state, people coming in that are highly educated, and that's stopped. . . and we're going to have to find another formula. . . but taxing businesses is clearly not the source of it.

My final comment is our revenues. We heard this morning the revenues that are coming in to the state are still on decline. The DRA Commissioner Clougherty testified before the Senate Ways & Means earlier this week and for this year compared to last year, on a fiscal year basis—and that's really what we're looking for as an economist. I know you have your plan issues. How are we on our revenue compared to plan? But how are we doing? We really want to look at how are we doing this year compared to last year, and we're still in decline. If we take the first 3 1/2 months of the year, business taxes are down 5.5 %, interest and dividends are down 15.5 %, and the real estate transfer tax is down almost 17%. Now this is not a surprise to you folks who spend a lot of time trying to forecast revenues this year. We know that we're predicting some level of recovery by the end of the biennium. So you'd expect, early in this biennium, we're going to be lagging and hopefully made up over time. But any way you look at it, we are not going to grow our way out of the budget challenges in this state. The existing revenues are not going to grow your way out of these problems, especially because of the one-time revenue. Now that one time revenue, primarily from the federal government through ARRA (but some other issues I won't tackle this morning), has created significant jobs. As I was coming in this morning, I saw a recent study estimated 3,000 jobs in NH were created by the federal stimulus. I don't know if they were direct or indirect or saved. I'm assuming that's just direct. Some of the industries I work with, I did have a chance to look at it, and they only looked at new jobs, not saved jobs or indirect. So if those 3,000, including everything that's been saved, and indirectly has been saved because those 3,000 people are working, and still going to the convenience store and buying things more than they would be, and they didn't cancel their cable so your communication service tax didn't go down as much, then we're looking at about 7 or 8 thousand jobs that we would be worse off, so that instead of a 7.3% unemployment, we could be over 8% without that stimulus. These are just some back of the envelope, kind of looking at the big picture. So this stimulus that's come in—good, bad, indifferent— because you didn't decide. . . that happened in Washington. . . is putting people to work now, and helping you with your budget now. In two or three years from now, for the next biennium, what you do now to set up so that we come out of this recession with stronger economic growth . . . how much longer that we keep declining jobs. . . how much longer are the revenues going to decline until we get that turn, and then how strong is that turn going to be out of it. . . really depends on it.

So my final thought—and I know this is the Ways & Means Committee not the Finance Committee—in my view as an economist, there is no way that we cannot look at changing the way we deliver services in government. We've heard the statistics of 4,000 different vendors for HHS. We've heard the back office operation in every community that's dealing with schools. Not the front... I understand that Mr. Francese's position is not to consolidate school buildings, but to consolidate back office operations. These are the things that we're going to have to look at. All of the challenges that's happened in the private sector are coming to the public sector. And it happened in the private sector because of top line pressure. And when there's top line pressure, you look at how you do your business and try and find innovative ways to do it. And whatever revenue sources you're looking, and the incentives, and what those options are, we really...as a state... are going to have to look at how we deliver services, and bringing changes to make those more efficient and that's what's going to help us grow the economy— not by staying the same.

Later in the program, Dr. Shapiro (among other presenters) responded to the following question from Representative William Hatch (D-Gorham) of the House Ways & Means Committee.

REP. HATCH: In doing some research, and looking at some areas of economic development and economic growth—and I think that's very important for the state. . . very important for the revenue structure—there were often indicators that there are very strong criteria that come into their developing or expanding or choosing where to go to is not just tax structure. A lot of the more important factors are things like infrastructure, things like power costs, things like workforce availability, and those kinds of areas. Now we're talking about a time where, going forward, apparently because of the reduction in primary motivators, our working individuals that age group is declining, we need to have, obviously, economic development. So my question is, that being so, how can we continue to maintain our infrastructure? How can we continue to educate the work force to have them available for the industry that might move here? How can we do all these things if in fact we need to decrease, or eliminate, or do certain things to our revenue streams, or maintain it as it is? I'm just not sure how all those things can occur at once.

DR. SHAPIRO: I have two additional comments on that. We're posing this as a major new revenue source versus spending cuts. As economists, it is everything on the margin. So if there are options within major to minor, there are options within major restructuring to minor restructuring. So there is a continuum. I'm not saying I agree with the continuum, but I'm just saying that, as a matter of the choices that you face, if you're going to completely ignore any changes, then you're talking major. You can conceive of a situation where we have significant restructuring of government services, but there are also some modest appropriate changes in taxes, or the fees, or the opportunities. I don't know what that exact mix would look like, but I would encourage you to consider the range.

The only other point I want to make about infrastructure is we are in a hugely opportunistic time with the federal stimulus program. The amount of money coming into this state for roads, and

bridges, and energy efficiency infrastructure investments is really extraordinary. I think one area that we hear a lot about is that only 20% of the federal money has been spent so far. I think we can applaud in NH, on the road side, we were the second fastest state in the country to get that money out. If the money is sitting in the bureaucracies, it's not putting people back to work. The nice thing about some of these opportunities on energy efficiency, and the roads, and there's some broadband money that's come in, is that you're investing in infrastructure. It's already within the budget. It came from somewhere else. Whether we're paying for that or not is not something that really matters. But the answer is because it's here—we've accepted the money—it's here. The question is—how efficiently are we going to spend it? How quickly are we going to get it in?—because this is the most important time to get that money out the door and to invest it in the type of infrastructure opportunities—with that in-the-ground development, including broadband—we're improving our efficiency long term. So when we have better highways and better roads, we reduce the cost of travel, we increase the efficiency of how much it costs to get to work and how much money you have to spend on repairs, in addition to obviously putting people to work. On energy efficiency, to the extent we're changing our buildings, making them more efficient, that's going to pay dividends down the road. Ironically, in one of our weakest times—and this is really standard Keynesian fiscal policy—we do have a great opportunity to have solid investments in the state that are going to pay off. This is beyond the scope of the Ways & Means Committee, but as legislators, you are the people, along with the governor, that hold the executive branches accountable, and that's great that they're coming in and giving reports. I think being second in the country to do things is great. It's a great place to be. So there are some shining opportunities. It's not all bad news.

Dr. Shapiro also responded to the following question from Representative Dennis Vachon (D-Northwood) of the House Ways & Means Committee.

REP. VACHON: If you're talking about cutting government services at the state level, what you're talking about doing is down shifting that responsibility to some other government entity that's going to have to provide the services. Or if you're talking about raising revenue without a sales tax or an income tax, and without increasing business taxes, you're talking about downshifting responsibility onto the real estate property tax. In both cases, you're talking about increasing local property taxes. Is that the best place for us to shift the burden of government?

DR SHAPIRO: I do not accept the contention that there are not significant opportunities to restructure and be smarter in the way we deliver services. I just do not accept it. As a business person, I work in a company where five years ago, we had 23 administrative people. We have half of that now and we do significantly more business. I know how difficult it is to make change . . . as Chairman of the Retirement System . . . to make changes in your procedures. You know, it was unbelievable! All of a sudden, there's a \$200,000 savings if you mail something once a year instead of every month . . . and if you give people opportunities. In our workforce, in this state, at the local level, they know so many opportunities of where to go. My children are in public school . . . my older son. I went to a parent teacher conference the other night . . . an open house . . . and one teacher got up and her entire delivery was, "I don't have enough money. I can't do anything." Then, I walked into an engineering class where this fellow won the best teacher of the year award a few years ago—and Belmont is not a wealthy school district in the

state of NH. What I saw is transformation over the last ten years there . . . with parents getting involved . . . redoing the whole curriculum. They didn't just build a new high school; they got involved. They changed the curriculum. Yes, it would be nice to have laptops that worked faster. At the same time, my son has the opportunity to become an expert in fixing out of date machinery. So I think there are opportunities. They're not easy and it's very difficult. I think that the agency heads are doing an incredible job in working it through. It is not easy. I just don't accept that there are not opportunities to change the way we deliver services. That's not going to be the whole solution, but we really have to put some more effort into it. That has started and I think it's going to continue.