New Hampshire's Economic Recovery
Better Than Expected

By Logan Kolas

ECONOMIC RESEARCH CENTER
at THE BUCKEYE INSTITUTE

THE JOSIAH BARTLETT *Center for* PUBLIC POLICY

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INTRODUCTION

New Hampshire's economy and budget were well-positioned entering 2020 before the pandemic drove the state's unemployment to record highs, sank economic output, and poked holes in the tax revenue needed to sustain state spending.[1] Seemingly overnight, the New Hampshire General and Education Trust Fund cratered from a projected $27.1 million surplus at the end of the 2020 fiscal year to an $81.5 million deficit heading into the 2021 fiscal year that started in July.[2]

The Granite State is now on the long and uneven road to economic recovery, but reasons for optimism abound: New Hampshire wisely saved more than $115 million in its rainy day fund since the last recession, which could cover 7.4 percent of general fund expenditures; tax revenues are consistently beating estimates; and the gap between spending commitments and the revenue needed to fund them is shrinking.[3] Even so, state officials should continue to find ways to cut government spending or make it more efficient so that New Hampshire can avoid debilitating tax increases and maintain its low-tax environment moving forward.

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[1] Bureau of Labor Statistics, **Seasonally Adjusted Local Area Unemployment Statistics** (Last visited January 14, 2021; Bureau of Economic Analysis, **Annual Gross Domestic Product (GDP) by State**, Real GDP in Chained Dollars (Last visited January 14, 2021); and Michael Kitch, **Coronavirus Set to Slam New Hampshire's Fiscal Picture**, *New Hampshire Business Review*, March 23, 2020.

[2] Garry Rayno, **Annual Audit Shows COVID's Impact on N.H. Finances**, *The Eagle Tribune*, December 28, 2020.

[3] Jared Walczac and Janelle Cammenga, **State Rainy Day Funds and the COVID-19 Crisis**, Tax Foundation, April 7, 2020; New Hampshire Department of Administrative Services, **State of New Hampshire Monthly Revenue Focus**; and Phil Sletten, **Updated Revenue Projections Suggest Much Smaller Budget Shortfall**, New Hampshire Fiscal Policy Institute, November 30, 2020.

New Hampshire's Fiscal Advantage

Tax revenues bridge sustainable government spending and healthy government budgets, so it is important to get the right tax combination. The absence of state sales and income taxes features prominently in New Hampshire's competitive tax code and helps keep government small and spending restrained. Property taxes, which account for about 14 percent of state revenues and the bulk of local government revenues, have held up fairly well since the start of the pandemic. But state business tax revenues, which account for 28 percent of state revenues, have been understandably less reliable.[4] Fortunately, the state stockpiled a $115.3 million rainy day fund to help weather economic downturns that tend to decrease tax revenues and pressure increased spending.[5]

Thus far, New Hampshire's tax combination has fared well and results have been encouraging. Unemployment across the state fell to a meager 2.4 percent before the pandemic in March 2020, 1.1 percentage points below the lowest national rate in 2020.[6] Inflation-adjusted annual economic output rose unabated each year for the past decade and New Hampshire showcased the lowest poverty rate in New England.[7] The most resounding endorsement of New Hampshire's efficient tax code and broad economic freedoms may be its exceptional job attracting young talent from other states even as its peers lost residents—despite lacking a major metropolitan center or prominent natural resources to fuel economic growth.[8]

[4] New Hampshire Department of Revenue Administration, **Overview of New Hampshire Taxes** to the House Ways and Means Committee, January 26, 2021.
[5] Michael Kitch, **Coronavirus Set to Slam New Hampshire's Fiscal Picture**, *New Hampshire Business Review*, March 23, 2020.
[6] Bureau of Labor Statistics, **Seasonally Adjusted Local Area Unemployment Statistics** (Last visited January 14, 2021); and Federal Reserve Bank of St. Louis, **Unemployment Rate**, Seasonally Adjusted (Last visited January 15, 2021).
[7] Bureau of Economic Analysis, **Annual Gross Domestic Product (GDP) by State**, Real GDP in Chained Dollars (Last visited January 14, 2021).
[8] Kenneth Johnson, **Migration Gains to New Hampshire From Other U.S. States Are Growing, With the Largest Gains Among Young Adults**, University of New Hampshire Carsey School of Public Policy, December 20, 2020; and Chris Edwards, **Is Tax-Driven Interstate Migration Increasing?**, Cato Institute's Cato at Liberty Blog, November 5, 2020.

NEW HAMPSHIRE'S MOSTLY RIGHT RESPONSE

Maintaining successful economic policies can be especially difficult during economic downturns. But as calls for policy change grew louder, adequate preparation and some fiscal luck bolstered New Hampshire's economic response.

Governor Christopher Sununu rightly prioritized fiscal thrift and resisted calls to raise taxes that would have burdened families and businesses already struggling in the pandemic. The most egregious tax proposal called for a paid family leave policy that would have introduced a "payroll deduction" on wages in their no-income-tax state.[9] Raising taxes that lower take-home pay during a pandemic would have risked elevating a falling state unemployment rate, opened the spigot to future tax increases, placed a larger tax burden on those that have seen their wages stagnate, and raised efficiency concerns as taxes on income tend to fall more during recessions than other types of taxes.[10] The governor instead wisely opted for hiring freezes, spending restraints, and more novel ideas to streamline agency budgets.[11]

Unfortunately, compromise legislation between Governor Sununu and the state legislature created a tax rule whereby falling tax revenues—a likely result of an economic downturn—could "trigger" business tax hikes to fill fiscal holes in the state's budget.[12] Raising taxes on businesses, many of which see their revenues evaporate during downturns, is poor fiscal policy from both a conservative supply-side and a Keynesian spending perspective and should be avoided as a general rule. New Hampshire's tobacco tax revenue, however, buoyed the budget and the latent tax increase has not been triggered.[13]

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[9] Josh Rogers and Casey McDermott, **Sununu Vetoes Bills On Paid Family Leave, Absentee Voting**, New Hampshire Public Radio, July 10, 2020.

[10] Bureau of Labor Statistics, **Seasonally Adjusted Local Area Unemployment Statistics** (Last visited January 14, 2021); Federal Reserve Bank of St. Louis, **Total Wages and Salaries in New Hampshire** (Last visited January 14, 2021); Jared Walczak, **Income Taxes Are More Volatile Than Sales Taxes During an Economic Contraction**, Tax Foundation, March 17, 2020.

[11] Josh Rogers, **New Hampshire Governor Say's COVID-19's Effect on Budget is 'Devastating'**, National Public Radio, August 3, 2020; Garry Rayno, **Annual Audit Shows COVID's Impact on N.H. Finances**, *The Eagle Tribune*, December 28, 2020; and Garry Rayno, **Sununu Touts State Position Heading into Next Budget Season**, InDepthNH.org, November 19, 2020.

[12] Andrew Cline, **Smokers, Mass. Lawmakers May Have Saved N.H. Businesses from Tax Hike**, The Josiah Bartlett Center for Public Policy, July 17, 2020.

[13] *Ibid.*

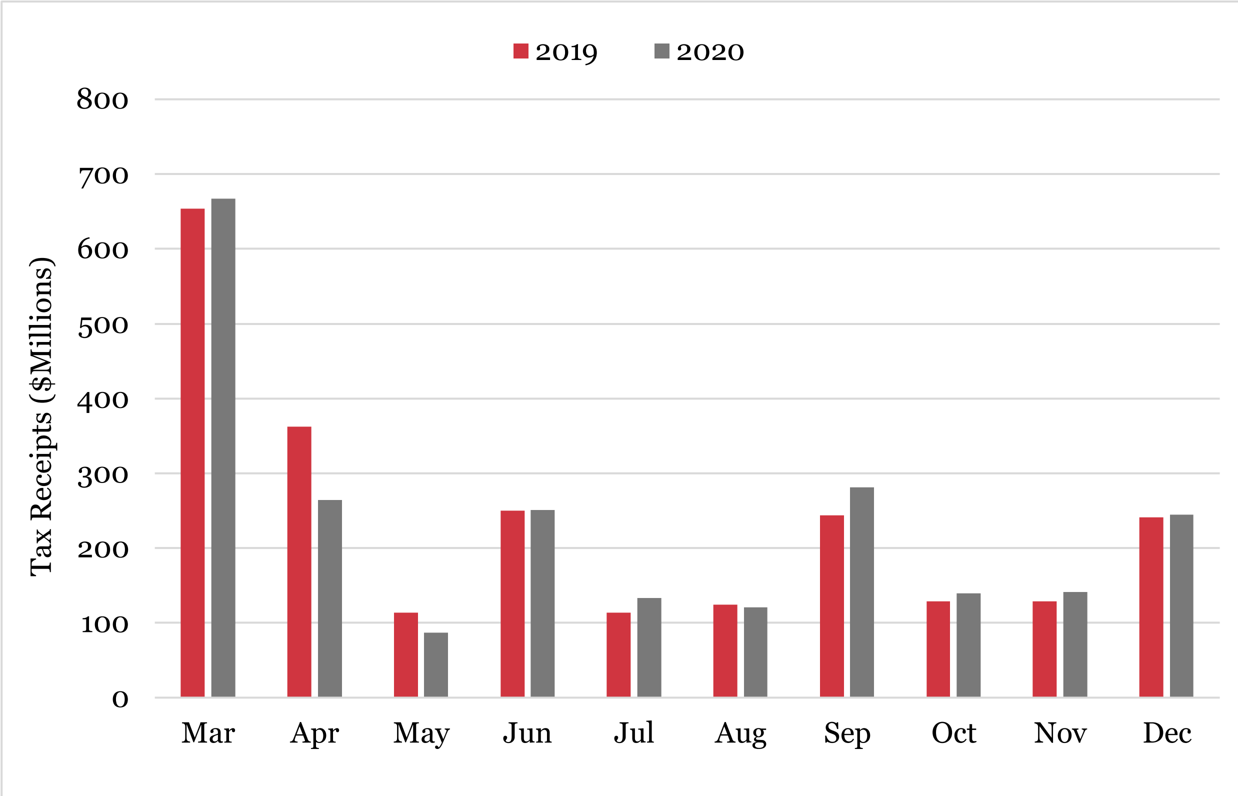
New Hampshire's Good News

Early in the pandemic, many states feared that without large sums of federal assistance they would either face painful cuts to government services just when they were needed most or else need to raise taxes to keep pace with state spending. New Hampshire prudently resisted the temptation to raise taxes—a prescient move in light of the state's better-than-expected tax revenues and improving economic forecast heading into biennial budget discussions.

Tax revenue in New Hampshire's General and Education Trust Fund for the pandemic-affected months of 2020 is only down $31 million—or just 1.3 percent—over the same period in 2019.[14] (See Figure 1.) The majority of this decline occurred in the early months of the pandemic as New Hampshire shut down large parts of its economy, with tax revenue then recovering to beat estimates every month since August.[15] Some revenue sources have held up better than others. Tobacco taxes, for example, have proven resilient, while the business enterprise tax and the rooms and meals tax have lagged—down $32.2 million and $67.4 million, respectively, over the same period.[16]

[14] The March revenue data is much larger than other months since New Hampshire records state-level property tax data in that month's revenue focus report.
[15] Total receipts were $8.4 million below plan in August. New Hampshire Department of Administrative Services, **State of New Hampshire Monthly Revenue Focus**, August 2020.
[16] Authors calculations from New Hampshire Department of Administrative Services, **State of New Hampshire Monthly Revenue Focus**.

Figure 1. General and Education Fund Revenues in 2019 and 2020[17]



New Hampshire has already weathered the pandemic's initial revenue shock and its economic footing will likely continue to improve. Already, dire economic forecasts have proven less dire than anticipated. New Hampshire agencies, for example, expected a $319 million shortfall in the General and Education Trust Fund in May for the July 2020-June 2021 fiscal year.[18] That estimate fell to $242 million in July, and the governor's budget recently projected that revenues would face a shortfall of only $29.8 million.[19] Although that amount could easily be covered by New Hampshire's rainy day fund, it is likely the deficit will be wiped out by better-than-expected tax revenue as New Hampshire continues its economic

[17] Source: Authors calculations from New Hampshire Department of Administrative Services, **State of New Hampshire Monthly Revenue Focus**; Notes: This analysis reflects cash basis results before accrual adjustments.
[18] Phil Sletten, **Updated Revenue Projections Suggest Much Smaller Budget Shortfall**, New Hampshire Fiscal Policy Institute, November 30, 2020; and **Governor's Executive Budget Summary: Fiscal Years Ending June 30, 2022-2023**, Office of Governor Christopher T. Sununu and the State of New Hampshire Department of Administrative Services, February 11, 2021.
[19] *Ibid*; and Garry Rayno, **NH Revenues Are a Mixed Bag for This Fiscal Year**, InDepthNH.org, November 23, 2020.

recovery. In fact, the most recent monthly budget report showed that tax revenue in January had beaten estimates by the exact amount—$29.8 million—as the projected deficit for the whole the fiscal year ending in June.[20]

Compared to its peers, New Hampshire's tax revenue picture looks even better. On average in the United States, roughly 42 percent of state and local tax revenue derives from local sources, compared to about 59 percent in New Hampshire.[21] This matters because local tax revenue has held up well during the pandemic. According to the Tax Foundation, the median state saw January-September 2020 state tax collections fall 3.6 percent compared to 2019, but state and local tax revenue dropped only 0.7 percent.[22] Thus, state and local governments with a mix of local tax sources, like New Hampshire, are more likely to have better fiscal footing.

The housing market also provides good news for New Hampshire's government revenue (if not for people looking to enter the housing market for the first time). As in most states, local tax revenue in New Hampshire largely flows—99 percent—from property taxes.[23] Home values have risen throughout the United States during the pandemic and are projected to rise another 10.3 percent over the next year.[24] New Hampshire expects to beat even that lofty forecast and is projected to rise 10.9 percent.[25] Property taxes comprise roughly two-thirds of New Hampshire's state and local taxes, as compared to a 31 percent national average, so rising home values should help the state's bottom line.[26]

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[20] New Hampshire Department of Administrative Services, **State of New Hampshire Monthly Revenue Focus**, January 2021.
[21] Chris Edwards, **New Hampshire's Fiscal Advantages**, Cato Institute's Cato at Liberty Blog, October 12, 2020.
[22] Jared Walczak, **State Tax Collections Down 4.4 Percent Through September, While Local Tax Collections Rise**, Tax Foundation, December 17, 2020.
[23] Phil Sletten, **How We Fund Public Services in New Hampshire**, New Hampshire Municipal Association.
[24] **United States Home Values**, Zillow, Data through November 30, 2020.
[25] **New Hampshire Home Values**, Zillow, Data through November 30, 2020.
[26] Phil Sletten, **How We Fund Public Services in New Hampshire**, New Hampshire Municipal Association; and Chris Edwards, **New Hampshire's Fiscal Advantages**, Cato Institute's Cato at Liberty Blog, October 12, 2020.

New Hampshire's Rainy Day Fund

New Hampshire entered the pandemic-induced economic downturn with a $115.3 million rainy day fund balance built up over the past decade.[27] State officials wisely rebuffed earlier calls to withdraw from the reserves during more prosperous times in order to remain prepared for times of crisis.[28] That prudence has paid off and New Hampshire's rainy day fund now exceeds the projected deficit in the General and Education Trust Fund by more than $85 million. Thus, the state has more than enough room to fill fiscal holes in both the General and Education Trust Fund and the Highway Fund, if necessary.[29]

As New Hampshire continues to recover and re-establish its financial footing, policymakers should first look to trim some spending, strategically use the rainy day fund, and then rebuild those reserves as finances improve. The state should not grow the rainy day fund too large, however. An oversized rainy day fund signals that the state can afford to lower taxes or otherwise return money to taxpayers and keep it in the more productive sectors of the economy. As a general rule, healthy rainy day funds should cover around 10 percent of state expenditures. Currently, New Hampshire's reserves would meet roughly 7.4 percent of its general fund expenditures.[30] Not bad under the circumstances. The state should rebuild the fund after the current crisis passes to the optimal 10 percent level. If New Hampshire accumulates cash reserves beyond that level, it should return that surplus to taxpayers.

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[27] Michael Kitch, **Coronavirus Set to Slam New Hampshire's Fiscal Picture**, *New Hampshire Business Review*, March 23, 2020.

[28] The Associated Press, **N.H. Senate Rejects Tapping Rainy Day Fund for Drug Crisis**, New Hampshire Public Radio, February 18, 2018.

[29] Phil Sletten, **Updated Revenue Projections Suggest Much Smaller Budget Shortfall**, New Hampshire Fiscal Policy Institute, November 30, 2020.

[30] Jared Walczac and Janelle Cammenga, **State Rainy Day Funds and the COVID-19 Crisis**, Tax Foundation, April 7, 2020.

NEW HAMPSHIRE'S BUDGET DEFICIT

The pandemic sent New Hampshire's General and Education Trust Fund freefalling from a $271 million surplus at the end of fiscal year 2019 to an $81.5 million deficit.[31] But the state has regained its footing and the economic consequences could have been much worse. Governor Sununu smartly froze government hiring and stopped spending on new programs and capital projects when the state's revenue picture was unclear, saving $102.7 million—nearly double the expected savings—and putting New Hampshire in a much better position than it would have been.[32] More work remains to be done and the state should avoid common pitfalls on its road to a full recovery.

With business taxes and the rooms and meals tax accounting for much of the net drop in New Hampshire's tax revenue, it may be tempting to raise tax rates to restore revenues from those sources to their pre-pandemic levels. But that would be an avoidable mistake. Business taxes in New Hampshire contributed less to the state's revenue outlook because businesses themselves took an economic hit early in the pandemic when lockdowns and other health orders hurt their bottom lines. Those business have not yet fully recovered. There were 21.8 percent fewer small businesses open in New Hampshire at the end of December 2020 than there were in January 2020, and of the remaining small businesses, their revenue is over 25.1 percent lower than before the pandemic.[33] And now the state's unemployment rate—although better than many other states—is up 1.2 percentage points higher than it was in January.[34] Raising taxes on the remaining, struggling businesses would only do further economic and employment damage.

Recent forecasts for New Hampshire anticipate a much smaller budget gap than originally feared, but a $106 million revenue shortfall from the previous fiscal year

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[31] Garry Rayno, **Annual Audit Shows COVID's Impact on N.H. Finances**, *The Eagle Tribune*, December 28, 2020.
[32] *Ibid.*
[33] Raj Chetty, John N. Friedman, Nathaniel Hendren, Michael Stepner, and the Opportunity Insights Team, **Opportunity Insights: Economic Tracker**, Percent Change in Small Business Revenue and Percent Change in Number of Small Businesses Open (Last visited January 14, 2021); and Raj Chetty, John N. Friedman, Nathaniel Hendren, Michael Stepner, and the Opportunity Insights Team, The Economic Impacts of COVID-19: Evidence from a New Public Database Built Using Private Sector Data, latest version November 2020; and Bureau of Labor Statistics, **Seasonally Adjusted Local Area Unemployment Statistics** (Last visited January 14, 2021).
[34] *Ibid.*

can complicate the budgeting process heading into the next biennium.[35] Washington is already sending more than $2 billion to the Granite State, with even more federal relief on the horizon, making short-term revenue demands less dire.[36] Rather than raise taxes to boost revenue, New Hampshire should look for areas to cut spending.[37] Maintaining the state's current government hiring freeze, streamlining agency tasks to reduce redundancies and overlap, avoiding less effective capital spending projects, and exploring Governor Sununu's "efficiency budgets" proposal are all good places to start.[38]

Additionally, New Hampshire could cut costs by making its current spending more efficient and effective. A compromise in New Hampshire's 2019 budget, for example, made temporary and permanent increases to public education funding. That compromise restored funding for "stabilization grants" that give schools money even when enrollment declines.[39] Inflation-adjusted per-student spending on public education in New Hampshire has far outpaced student enrollment in recent years.[40] Thus, a less expensive, more effective program would fund students directly instead of school systems, as Governor Sununu recently suggested.[41]

Another savings can come from the governor's proposal to consolidate the University System of New Hampshire and the Community College System of New Hampshire. Merging the systems and cutting the bureaucracy could produce real savings. The governor's budget projects a two-year savings of $17.8 million.[42]

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35 **Department of Revenue Administration Revised Revenue Estimates**, December 16, 2020, **State of New Hampshire 2020 Comprehensive Annual Financial Report**.

36 Sarah Gibson, **New Covid Relief Package To Send $2 Billion to N.H.**, New Hampshire Public Radio, December 28, 2020.

37 Ethan Dewitt, **What the New Covid Relief Package Means for New Hampshire**, *New Hampshire Business Review*, January 3, 2021.

38 Garry Rayno, **Sununu Touts State Position Heading into Next Budget Season**, InDepthNH.org, November 19, 2020.

39 Andrew Cline, **State Education Spending Sees Significant Increase in Compromise Budget**, The Josiah Bartlett Center for Public Policy, October 4, 2019.

40 Benjamin Scafidi, **Public School Staffing in New Hampshire**, The Josiah Bartlett Center for Public Policy and EdChoice, March 2018.

41 Andrew Cline, **Sununu: Focus Education Funding on Kids, Not Systems**, The Josiah Bartlett Center for Public Policy, December 18, 2020.

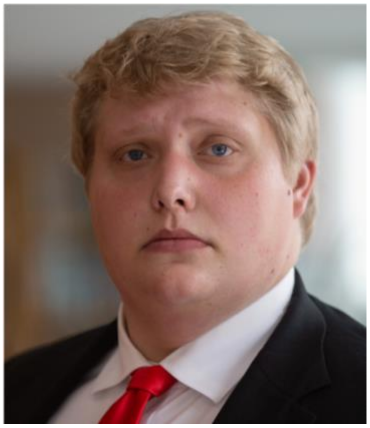
42 **Governor's Executive Budget Summary: Fiscal Years Ending June 30, 2022-2023**, Office of Governor Christopher T. Sununu and the State of New Hampshire Department of Administrative Services, February 11, 2021.

CONCLUSION

The pandemic of 2020 has done untold economic damage to households, businesses, and state and local governments across the country. Fortunately, New Hampshire's fiscal house was in order before the pandemic, with low taxes and a healthy reserve fund that made it easier for state policymakers to respond well to the unexpected economic challenges at-hand.

Buoyed by better-than-expected tax collections during the pandemic, New Hampshire's budget deficit remains much smaller than initially feared, making the road to economic recovery less treacherous. But New Hampshire households and businesses continue to struggle under the strain of public health lockdowns and uncertainty. Raising taxes would only make that struggle more difficult and the recovery less certain. Instead, New Hampshire should close its budget gap by looking for fiscally prudent ways to cut government spending and reduce expensive redundancies. As the economy rebounds, the state should replenish its rainy day fund to reasonable levels and avert avoidable policy pitfalls. Compared to many other states, New Hampshire is in an enviable financial position. But there is always room to improve. The state should continue to seek efficiencies on the spending side while pursuing tax and regulatory policies that are conducive to greater economic growth.

About the Author



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Prior to joining Buckeye, Kolas was a research associate at the Herbert A. Stiefel Center for Trade Policy Studies at the Cato Institute, where his research focused on how employment is impacted by international trade, the effect of international trade taxes on state and federal government policies, and the regulatory burden imposed by government on American businesses and families. He has authored and coauthored book chapters, blog posts, and op-eds, and his commentary has been published by the *St. Louis Post Dispatch*, Daily Signal, and the Foundation for Economic Education, amongst others.

Kolas is native of Cincinnati and throughout his career has focused on researching Ohio-related policies. He earned his Bachelor of Science in economics and political science from George Washington University and holds a Master of Science in applied economics from the University of Maryland.

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