

Taxes, Competitiveness and the New Hampshire Business Climate

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Thank you for the opportunity to talk with you today about New Hampshire's tax and business climate and discuss what reforms could improve the state's competitiveness and prospects for long-term economic growth.

The Tax Foundation brings more than 70 years of experience to state public finance issues. We were founded in 1937 to produce credible data and sound economic research on public finances at the federal, state, and local levels of government. Our goal is to make taxes easy to understand in order to raise the tax IQ of the public, legislators, and our friends in the media. Our research is guided by the core principles of tax policy: neutrality, simplicity, transparency, and stability.

New Hampshire, like virtually every state in the Union, is struggling to weather the twin fiscal stresses of the weak economy – lower tax revenues and higher demand for public services. The challenge must seem particularly difficult for a state like New Hampshire which does not have all of the major taxes such as an income tax or general sales tax.

It is not surprising that many parties in your state are calling for New Hampshire to have a “normal” tax system that relies on the three legged stool approach to public finance by having a wage tax, a corporate income tax, and a general sales tax.

Based upon the collective wisdom of researchers at the Tax Foundation over the past 70 years, I would suggest that giving in to such pressure would be a huge mistake. The economic equivalent to unilateral disarmament, to use a military phrase. It would be like taking the electric motor out of a Prius – making New Hampshire just like any other state.

What might seem like a curse to you right now is actually your competitive advantage within the Northeast region and even nationally. As appealing as it might be to have new sources of revenues to tap, let me point out that when we look across the country, the states that are in the biggest financial trouble are the “three-legged stool” states such as New York, California, Pennsylvania, Illinois, and Connecticut.

You do not want to end up like Connecticut which was once a low-tax state like New Hampshire without a personal income tax. Eighteen years ago they enacted an income tax for many of the same reasons interest groups are now calling for one here. In less than a generation Connecticut went from having one of the lowest tax burdens in the nation to having the third highest. Even with such a high tax burden

the state still faced a fiscal crisis this year, prompting the governor to propose a new “millionaire’s” tax close their budget gap.

And keep in mind that in today’s global economy – where capital is extremely mobile but workers are not – tax changes are not made in a vacuum. Earlier this year, Dell Computers moved its European operation out of Ireland – which has one of the most favorable tax climates in Europe – to Poland in order to lower costs. 1900 Irish workers lost their jobs as a result. If Ireland is vulnerable to capital flight then everyone is.

So my message to you today is simple, don’t mess up a good thing. New Hampshire’s tax burden is low and your tax climate ranks very highly nationally. These are advantages that you certainly want to protect at all costs.

As competitive as New Hampshire’s tax system is, there is still room for improvement. In particular, your corporate tax system is out of step nationally and globally. Lowering your corporate income tax would make New Hampshire one of the most attractive places to do business in and do business from in the United States.

In my remaining time, I would like to first provide some perspective on New Hampshire’s comparative advantage and then do a brief 360 review of how your tax system stacks up nationally. I’ll conclude by making the case for cutting your corporate taxes and positioning the state as an economic powerhouse.

New Hampshire is a Magnet for People and Income

Let me show you a couple of charts that show vividly how New Hampshire’s reputation as a low-tax state has made it a magnet for attracting other state’s people and tax bases.

The first slide shows the net migration of taxpayers between New Hampshire and Massachusetts over the past 15 years. In every year, the direction of the movement is in one direction – to New Hampshire at the expense of Massachusetts.

The next slide shows the net migration of taxpayers between New Hampshire and the rest of the country over the past 15 years. In every year but one, 2007, New Hampshire has gained citizens at the expense of all other states.

The next slide shows why this is so important for the state’s finances – you have been attracting income from other states. In other words, your tax base has been growing at the expense of other states. Over that 15 year period, the net migration of new citizens into New Hampshire has brought an average of \$220 million in new adjusted gross income into the state each year, even in the year in which you saw a net outflow of people to other states. (Which means you attracted people with higher incomes than those who left the state.)

If you were heading Wal-Mart and were attracting customers and profits at this pace from other retailers, would it make any sense to raise your prices? Of course not.

However, because roughly 16 percent of your residents work in another state, a traditional income tax is likely to be ineffective in raising the kind of revenue many lawmakers would hope for. Indeed, only Maryland and the District of Columbia have a higher percentage of residents who work in another state. So unless you were able to have a reciprocal arrangement with Massachusetts, for example, you would not have first claim on those income tax revenues and your total income tax collections would be much less than you may anticipate.

New Hampshire is a Low-Tax State by Any Measure...

Now let's see how your taxes compare regionally and nationally.

First, you have one of the lowest state/local combined tax burdens in the nation – fifth lowest in fact. Moreover, you are surrounded by states who impose among the highest tax burdens in the nation. Of your neighbors, Massachusetts has the lightest tax burden and yet it ranks 23rd in the nation. New York is number 2 and Vermont has the 8th highest burden.

Naturally, when it comes to individual income taxes and sales taxes New Hampshire is to the Northeast what Switzerland is to Europe, a refuge from oppressively high tax rates. The next two slides show this quite dramatically.

1. New Hampshire is one of the 9 states that do not tax wages.
2. New Hampshire one of the 5 states that have no general sales tax. The others being Alaska, Delaware, Montana, and Oregon.

This is why New Hampshire ranks so well on the Tax Foundation's State Business Tax Climate Index, our annual measure of how business-friendly each state's tax system is based on more than 100 factors affecting business decisions.

In our recently released ranking of the states for 2010, New Hampshire ranked 7th best in the Nation. Maine ranked best among your neighbors at 34th. Vermont and New York are, of course, in the bottom 10 worst tax climates for business.

The next slide shows all the states' rankings. As you can see, New Hampshire and Delaware are the only two states in the Northeast to rank in the top 10 best. As the yellow highlight indicates, from a tax perspective, New Hampshire is a beacon of light in a sea of darkness.

...Except for Corporate Taxes

In case you are feeling a bit full of yourselves right now, New Hampshire's tax system is not perfect. Your corporate tax system is the one blemish on what is an otherwise pretty picture.

As the next slide shows, your 8.5 percent corporate income tax rate is high, as are all of the Northeast states, and is high compared to all other states that have a corporate income tax. Of course, New Hampshire compounds this high rate with added complexity of also imposing the Business Enterprise

Tax (BET). The cost to businesses of complying with one system is bad enough, but to ask them to comply with two is adding insult to injury.

High corporate taxes are a problem for the state because in a global economy, business taxes matter more than ever and the rest of the globe is moving toward lower business taxes. A recent study by economists at the Organization for Economic Cooperation and Development in Paris (OECD) found that corporate taxes are the most harmful tax for long-term economic growth, followed by high personal income taxes, then consumption taxes and property taxes. (New Hampshire's high property taxes may be painful but they are the least economically damaging tax you can impose).

While countries across the globe have been cutting their business taxes, the U.S. has been standing still. We now have the second-highest overall corporate income tax rate among industrialized nations, second only to Japan by a fraction of a percentage point. The next two slides show how dramatically the U.S. rate has fallen behind the rest of the world.

These national rates are actually the combination of the federal rate and the average of the state rates. In fact, 24 U.S. states effectively have combined rates above Japan's #1 rate – New Hampshire happens to be one of them as this slide shows. In other words, when it comes to corporate income taxes, New Hampshire's is one of the highest in the industrialized world. I would suggest that this is not where you want to be.

Improving New Hampshire's Business Climate

I know the purpose of this hearing is to solicit ideas on how to increase revenues for the state to solve your fiscal problems. I'm afraid I can't help you. The Tax Foundation is routinely asked by legislators for advice on how they can raise taxes with the least impact on their economy. It's not that simple. There are tradeoffs and consequences with every tax system.

But here is what we would recommend for New Hampshire:

First, avoid enacting a wage tax at all cost. You don't want to end up like Connecticut in ten years.

Next, eliminate the Business Enterprise Tax as the first step toward broader corporate tax reform. Then, lower the corporate income tax rate dramatically. As you do so, you should broaden the tax base where possible by eliminating your various economic development and business subsidy programs. Lower rates for all are better than incentives for some.

If, if, if you absolutely have to replace those lost revenues the economic research tells us that property taxes and consumption taxes (sales) are less harmful than income taxes.

At the end of the day, New Hampshire's goal should be to be Wal-Mart in a land of Neiman Marcus. You want everyday low taxes every day and let the customers come to you because you are the most competitive place to do business.

Thank you for the opportunity to share with you the 7 decades of knowledge the Tax Foundation has accumulated on state finances and how New Hampshire can become the most competitive state in the Union.