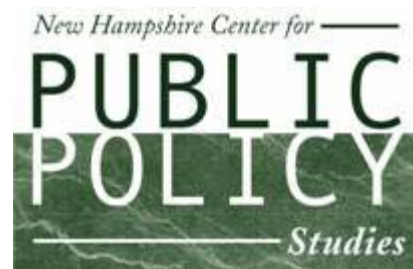


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Heading for a \$300 Million Deficit: The Challenge of the Next Biennium

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Heading for a \$300 Million Deficit: The Challenge of the Next Biennium

The next legislature and governor will need to implement policy changes totaling approximately \$300 million to bring the next New Hampshire General Fund budget into balance. Without such action or other dramatic changes in underlying trends, the gap between state revenues and spending will produce a \$300 million deficit by July 1, 2007.

This paper extrapolates recent trends in General Fund revenues and spending through the end of FY 2007. The paper does not address the Education Trust Fund but assumes that it will remain in balance for each of the years through 2007.

If no changes are made to current laws, programs, or taxes, the Center’s analysis concludes that the General Fund will be \$71 million *in the red* at the end of the current biennium on June 30, 2005. This projection contrasts with the \$70 million *surplus* expected and embodied in the budget passed by the legislature and signed into law by Governor Benson on September 4, 2003.

The Center projects an annual operating deficit of \$119 million in FY 2006 and \$116 million in FY 2007. Absent dramatic changes in the economy or any changes in policy, the sum of three years of deficits would be \$306 million as shown in Figure 1.

Figure 1: Absent other changes, NH will accumulate a \$306 million deficit by June 2007

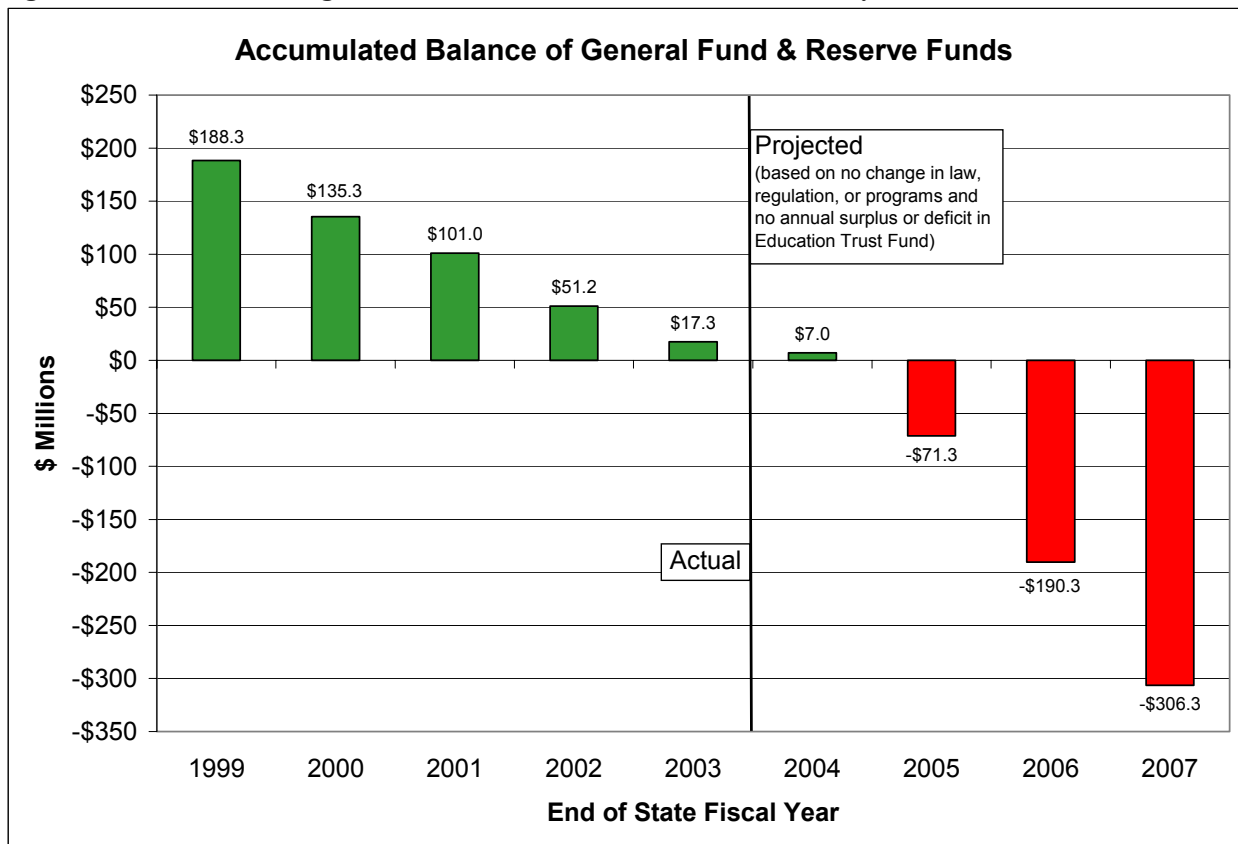


Figure 1 also shows how accumulated surpluses held in reserve funds have been drained in recent years. Table 1 summarizes the Center’s projections for General Fund revenues and spending through FY 2007; the column tracking the size of the accumulated deficit underscores the impact of running a deficit year after year.

Table 1: Projected General Fund revenues, expenditures, and deficits through 2007

General Fund projections in millions of \$	Revenues	Spending	Annual (Deficit)	Accumulated Surplus or (Deficit)
Actual balance at close of FY 2003				\$17
FY 2004	\$1,287	\$1,297	(\$10)	\$7
FY 2005	\$1,282	\$1,360	(\$78)	(\$71)
FY 2006	\$1,288	\$1,407	(\$119)	(\$190)
FY 2007	\$1,336	\$1,452	(\$116)	(\$306)

These projections are based on continuing existing programs without alteration, maintaining all existing laws and regulations requiring various programs, agencies, and functions, and no change in existing tax laws. Thus, this is a measure of the gap that the governor and legislature will face in early 2005 when they begin to construct the budget for the FY 2006-2007 biennium.

The absolute magnitude of this potential deficit is unprecedented in New Hampshire. The potential deficits the state faced during the recession of the early 1990s, however, were a larger percentage of General Fund spending at that time.

1. The Current Biennium: 2004-2005

The first year of the biennium is nearly over and revenue totals for March and April—the two most important months at the NH Department of Revenue Administration—are in, providing a better baseline for projecting the final impact of revenue and spending decisions the legislature made last fall. A table at the end of this paper displays the details behind the Center’s projections.

A. Revenue

Last fall, the legislature forecast \$1,281 million in revenue for 2004 and \$1,260 million for 2005. The Center now projects revenues in each year being slightly higher than in the budget: \$1,287 in FY 2004 and \$1,282 for FY 2005. Thus, we are projecting that revenue will be \$28 million higher than budgeted for the biennium.

B. Spending

The Center expects total General Fund spending to exceed anticipated levels by \$154 million for the biennium. There are two reasons for this. It appears unlikely that the state will be able to achieve all of the “savings” the legislature built into the budget last fall. Statutory requirements will also force additional spending on a small number of items.

The budget law contains \$1,349 million in gross appropriations for FY 2004 and \$1,384 million for FY 2005.

During their final budget negotiations last year, the governor and the legislature agreed to include in the budget certain “savings” or spending reductions. Various reductions from gross budgeted spending were planned to total \$128 million in FY 2004 and \$118 million in FY 2005. We now project that those reductions will achieve only \$84 million and \$63 million in each year respectively, a combined shortfall in “savings” of \$99 million

Each year, the state faces potential statutory spending requirements that are not specifically appropriated in the budget, including, for example, in the Office of the Attorney General and in payments to health care providers for Medicaid services.

The unrealized savings plus the higher-than-anticipated required spending add up to \$154 million for the biennium.

C. General Fund Deficit as of June 30, 2005: \$71 Million

When they passed the current budget in September 2003, the legislature and governor anticipated that the General Fund had ended fiscal year 2003 with a \$32 million surplus that could be applied to any deficit that might occur in 2004 and 2005. The actual surplus was less than that, only \$17 million.

By adding two years of anticipated revenue and subtracting the anticipated net spending to the surplus, the adopted budget projected that the state would end the biennium on June 30, 2005 with a net \$70 million surplus.

In March 2004, the Office of Legislative Budget Assistant projected a \$50 million deficit, based on the *actual* starting surplus, slightly higher revenue during the two years, increased extra-budget spending, and considerably lower estimates of “savings.”

Our projection, based on more recent information, is that the state’s General Fund will end the biennium on June 30, 2005, with a \$71 million deficit.

2. The Next Biennium: 2006-2007

Assuming no change in state tax or spending laws, regulations, and practices, each of the next two years will add to the General Fund deficit.

A. Revenue

The table at the end of this paper begins with separate projections for each of the major General Fund revenue sources. Note that the only projections in the 2006 and 2007 columns are the Center’s. Neither the legislature, the Department of Revenue Administration, the Department of Administrative Services, nor the Revenue Estimating Commission has published such a projection at this time.

The Center bases its forecast on our understanding of the history of each revenue source, the likely effect of changes in law that have already been enacted, and other considerations. The projections assume no changes in any state tax law. Although tax revenues will climb in aggregate, the so-called Medicaid Enhancement Revenue will drop when the federal government

brings New Hampshire into compliance with federal law. We project General Fund revenue of \$1,288 million for 2006 and \$1,336 million for 2007.

B. Spending

We project gross spending in 2006 to be 3.9 percent higher than that of 2005 and for spending in 2007 to be 3.5 percent higher than that of 2006. We do not project individual line items or programs (debt service, school building aid, sewer grants, health insurance, and retirement benefits, etc.) but have reviewed the history of budget increases in times of fiscal constraint as well as known requirements for spending increases under current law. If anything, the percentages we have used may be too low. The difference between 3.5 percent and 3.9 percent in the first year is only \$5 million, so minor differences in this number do not have much impact on our overall projection.

We make some standard adjustments to the gross appropriations. For example, we include an estimate for the amount of budgeted spending that will “lapse” rather than be spent.

The projection that results from these assumptions and adjustments is actual spending of \$1,407 million in 2006 and \$1,452 million in 2007. These spending levels assume no new programs or changes in law that would expand or contract any programs. Any “savings” obtained during the 2004/2005 budget that are not of a one-time nature are assumed to continue and are folded into the overall gross spending. No new one-time savings or reductions are anticipated except for the usual reduction in the judicial branch’s proposed budget.

C. General Fund Deficit as of June 30, 2007: \$306 Million

Our projections show a shortfall of revenue in comparison to spending of \$119 million in 2006 and \$116 million in 2007. When added to the projected deficit of \$71 million accumulated by June 30, 2005, we project a deficit of \$306 million on June 30, 2007.

3. The Meaning of this Projection

The General Fund will end 2007 \$306 million in the red only if the legislature and governor take no action to eliminate the deficit: an outcome that is both fiscally and politically impossible. The Center’s projection is intended to indicate the magnitude of the adjustments that the state’s elected leadership will have to make in the next two years to bring the state’s finances into balance.

State agencies will soon begin developing their proposed spending for 2006 and 2007. The governor will then present his budget proposal to the legislature in February 2005. The legislature will review that proposal and will craft and pass a budget by the end of June 2005. Much of the discussion that will occur in these coming months will be about means to increase revenue and/or reduce spending so that the budget is brought into balance.

The annual gap between projected revenue and spending in both 2006 and 2007 is about 8.5 percent of spending, but 0.25 percent of the Gross State Product, a standard measure of overall economic activity. Not since the recession and collapse of the housing and banking industries in the early 1990s has the state faced a gap of that relative magnitude.

In absolute terms, \$306 million amounts to about \$235 per New Hampshire resident.

Within the two-year budget, approximately \$153 million per year of spending reductions and/or revenue increases from this baseline will need to take place to bring the budget into balance. By way of comparison, that is the total amount raised annually by the communications tax (\$66 million) *plus* the General Fund share of the real-estate transfer tax (\$88 million). On the spending side, it is equivalent to all the General Fund spending on the University System of New Hampshire (\$85 million) *plus* all the Treasury Department's general revenue sharing with towns and cities (\$67 million).

4. The Precision of this Projection

No projection of this sort can be expected to be precise; it is simply a well-educated estimate.

Events could affect future revenues: business growth with profits increasing faster than projected could lead to higher business profits tax revenue; increasing interest rates could dampen the real estate market, reduce the number of properties being transferred, and result in lower revenue from the real-estate transfer tax; federal legislation could undermine the communications tax.

Events could also affect future spending: smaller than expected rate increases for health insurance could reduce the spending for state employees and retirees below the amount estimated here; higher drug prices could cause Medicaid spending to be higher than we now expect; higher gasoline and heating oil prices could cause energy costs to be higher than projected for all state agencies.

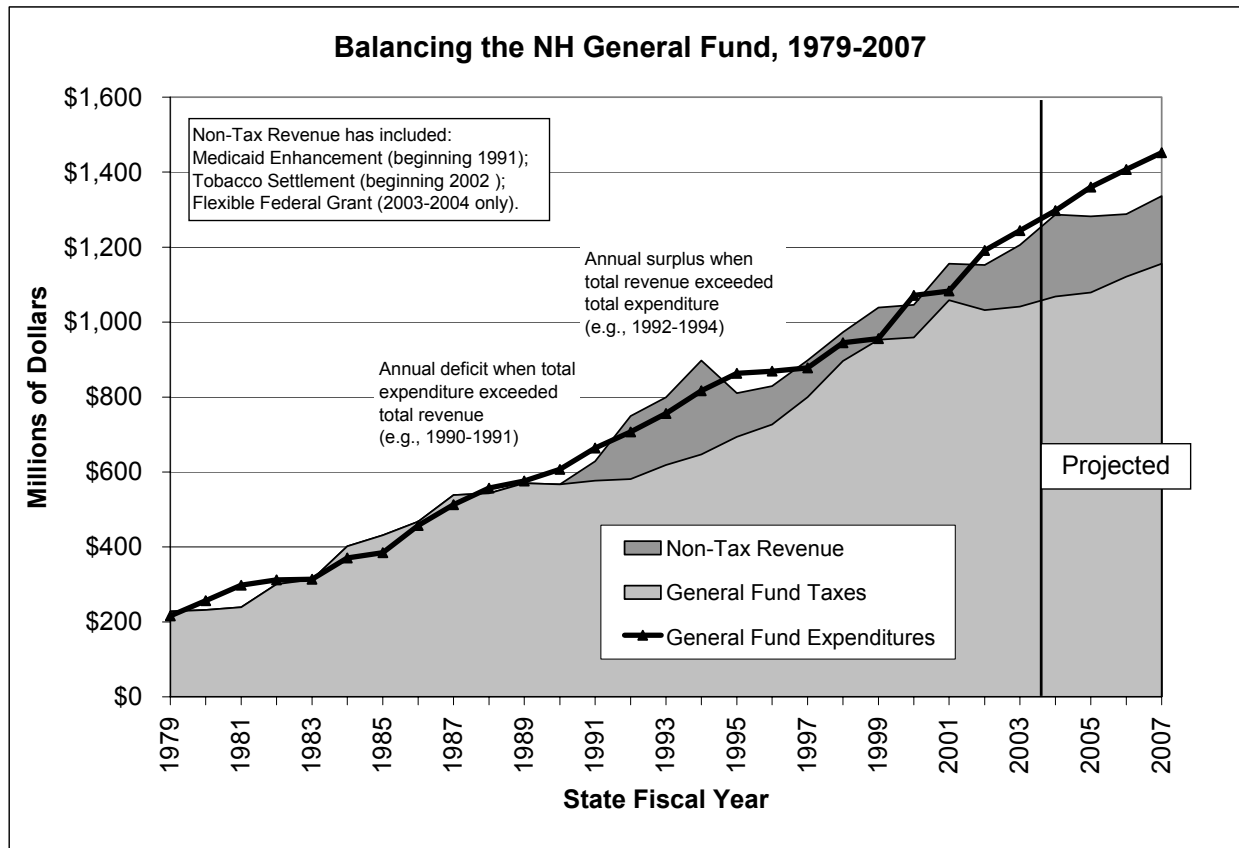
Policy makers should expect to receive news every week or two that will indicate that the budget situation is getting a little better or a little worse. They should not expect the problem to go away by itself, however, nor should they either fret or take much solace in small changes affecting the projection. Even if our projection proves to be \$30 million too high or too low, the magnitude of the challenge facing New Hampshire remains essentially the same.

5. General Fund 1979-2007

Our projection for the next few years can be combined with historical revenue and spending figures from various annual editions of the state's *Comprehensive Annual Financial Report* to display the changes in the General Fund budget over a longer period of time and to provide a sense of how and when budgets have been balanced.

Figure 2 displays such a long-term view of the General Fund budget, including our projections through 2007. The white space under the heavy black line indicates deficit spending; the few peaks above the curve were times of surplus. The darker ridgeline that emerges in 1990 illustrates the growth in non-tax revenues, especially the federal "Medicaid Enhancement Revenue," which began to be added to tax revenue in 1991. Between that year and 2003, non-tax revenues contributed a total of \$1,599 million toward the overall balancing of revenue and expenditures.

Figure 2: NH's structural deficit has grown over three decades



Non-tax revenues will decline, beginning in 2005, contributing to the growing gap between General Fund expenditures and total revenue. We assume that Congress will continue to make a considerable amount of Medicaid Enhancement Revenue available to New Hampshire. If, however, that remaining amount were to be wholly eliminated by congressional action or federal regulation, the General Fund deficit would increase by \$150 million to \$180 million annually.

As the figure shows, it was the federal government's provision of millions of dollars of Medicaid Enhancement Revenue in 1991 and the years that followed that allowed New Hampshire to balance its budget without making fundamental changes in tax policy or spending. The Center does not foresee a federal bailout of that magnitude this time.

NH General Fund (\$ millions)										
		2003	2004			2005			2006	2007
	Revenue	CAFR Actual	HB 3 Budget	LBAO 3/3/04 Projected	NHCPPS Projected	HB3 Budget	LBAO 3/3/04 Projected	NHCPPS Projected	NHCPPS Projected	NHCPPS Projected
1	Meals and Rooms Tax	\$168.7	\$176.7	\$176.7	\$177.0	\$184.3	\$184.3	\$185.0	\$193.0	\$202.0
2	Business Profits Tax	\$137.8	\$188.3	\$188.3	\$180.0	\$193.4	\$193.4	\$188.0	\$195.0	\$202.0
3	Business Enterprise Tax	\$96.7	\$58.4	\$58.4	\$64.0	\$60.0	\$60.0	\$67.0	\$69.0	\$71.0
4	Liquor Revenue	\$99.0	\$108.1	\$108.1	\$109.0	\$114.5	\$114.5	\$112.0	\$121.0	\$126.0
5	Tobacco Tax	\$67.1	\$67.5	\$68.5	\$71.0	\$67.5	\$69.0	\$70.0	\$70.0	\$68.0
6	Interest and Dividends Tax	\$55.1	\$61.0	\$56.0	\$54.0	\$64.0	\$59.0	\$56.0	\$62.0	\$65.0
7	Estate and Legacy Tax	\$59.1	\$19.4	\$32.5	\$36.0	\$11.4	\$11.4	\$12.0	\$6.0	\$3.0
8	Insurance Taxes	\$82.2	\$82.9	\$82.3	\$86.0	\$85.6	\$84.6	\$91.0	\$99.0	\$106.0
9	Real Estate Transfer Tax	\$78.9	\$80.3	\$89.5	\$88.0	\$82.3	\$89.5	\$90.0	\$92.0	\$94.0
10	Communications Taxes	\$62.5	\$66.5	\$65.5	\$65.0	\$69.0	\$68.0	\$66.0	\$69.0	\$71.0
11	Securities Revenue	\$25.8	\$26.7	\$26.7	\$26.0	\$28.0	\$28.0	\$27.0	\$28.0	\$30.0
12	Court Fines & Fees	\$22.1	\$25.9	\$23.6	\$25.0	\$25.9	\$23.6	\$25.0	\$26.0	\$27.0
13	Beer Tax	\$12.3	\$12.9	\$12.9	\$12.0	\$13.2	\$13.2	\$12.0	\$12.0	\$12.0
14	Board and Care	\$11.2	\$10.8	\$11.8	\$12.0	\$11.4	\$11.8	\$12.0	\$12.0	\$12.0
15	Utilities Tax	\$7.1	\$6.1	\$6.1	\$6.0	\$6.2	\$6.2	\$7.0	\$7.0	\$7.0
16	Dog & Horse Racing Revenue	\$4.0	\$3.5	\$3.6	\$4.0	\$3.5	\$3.6	\$4.0	\$3.0	\$2.0
17	Federal Flexible Grant	\$25.0	\$50.0	\$25.0	\$25.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
18	Net "Medicaid Enhancement"	\$133.6	\$170.2	\$178.5	\$180.0	\$169.4	\$182.8	\$188.0	\$152.0	\$165.0
19	Medicaid Recoveries		\$13.3	\$15.0	\$14.0	\$15.8	\$15.8	\$15.0	\$15.0	\$15.0
20	Other Revenues	\$58.1	\$52.9	\$54.0	\$53.0	\$54.4	\$56.8	\$55.0	\$57.0	\$58.0
21	Total Revenue	\$1,206.3	\$1,281.4	\$1,283.0	\$1,287.0	\$1,259.8	\$1,275.5	\$1,282.0	\$1,288.0	\$1,336.0
	Spending								3.90%	3.50%
22	Gross Appropriations in Budget		\$1,348.6	\$1,348.6	\$1,348.6	\$1,383.5	\$1,383.5	\$1,383.5	\$1,437.0	\$1,487.0
	Spending Additions									
23	Legislative Specials		\$12.3	\$12.4	\$12.4	(\$0.9)	(\$1.0)	\$1.0	\$5.0	\$2.0
24	Statutory Spending (AG \$)		\$0.0	\$5.0	\$5.0	\$0.0	\$5.0	\$5.0	\$5.0	\$5.0
25	Liquor to A&D fund		\$0.0	\$0.0	\$0.0	\$0.0	\$5.7	\$5.7	\$6.0	\$6.0
26	Retirement/HI shortfall		\$0.0	\$4.0	\$4.0	\$0.0	\$4.0	\$4.0	\$0.0	\$0.0
27	Medicaid Provider shortfall		\$0.0	\$0.0	\$4.0	\$0.0	\$0.0	\$8.0	\$0.0	\$0.0
28	Change in Pro-share Medicaid		\$0.0	\$0.0	\$4.0	\$0.0	\$0.0	\$4.0	\$0.0	\$0.0
29	30% increase in health insurance rates		\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$9.0	\$0.0	\$0.0
30	GAAP Adjustments		\$3.0	\$3.0	\$3.0	\$3.0	\$3.0	\$3.0	\$3.0	\$3.0
31	Total Spending Additions		\$15.3	\$24.4	\$32.4	\$2.1	\$16.7	\$39.7	\$19.0	\$16.0
	Spending Reductions									
32	Lapses (2.95%)		(\$39.9)	(\$39.9)	(\$39.9)	(\$40.8)	(\$40.8)	(\$40.8)	(\$43.0)	(\$45.0)
33	Judicial Branch reduction		(\$6.0)	(\$6.0)	(\$6.0)	(\$5.5)	(\$5.5)	(\$5.5)	(\$6.0)	(\$6.0)
34	DH&HS reductions		(\$10.0)	(\$10.0)	(\$10.0)	(\$10.0)	(\$10.0)	(\$10.0)	\$0.0	\$0.0
35	DoE Federal funds flexibility		\$0.0	\$0.0	\$0.0	(\$2.4)	\$0.0	\$0.0	\$0.0	\$0.0
36	IT Savings from consolidation		(\$3.0)	(\$0.8)	(\$0.8)	(\$8.0)	(\$1.0)	(\$1.0)	\$0.0	\$0.0
37	Securities Settlements		(\$8.7)	(\$3.7)	(\$3.7)	(\$0.2)	(\$0.2)	(\$0.2)	\$0.0	\$0.0
38	Self-insured health savings		(\$5.0)	\$0.0	\$0.0	(\$20.0)	\$0.0	\$0.0	\$0.0	\$0.0
39	DoC budget reduction		(\$1.7)	(\$1.7)	(\$1.7)	(\$1.7)	(\$1.7)	(\$1.7)	\$0.0	\$0.0
40	Enhanced Medicaid rate		(\$26.8)	(\$19.0)	(\$19.0)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
41	Tobey School reductions		\$0.0	\$0.0	\$0.0	(\$0.1)	(\$0.1)	(\$0.1)	\$0.0	\$0.0
42	Budget cut classes 20,26,80		(\$1.9)	(\$1.9)	(\$1.9)	(\$2.0)	(\$2.0)	(\$2.0)	\$0.0	\$0.0
43	Access program		(\$6.5)	\$0.0	\$0.0	(\$6.5)	\$0.0	\$0.0	\$0.0	\$0.0
44	Preferred drug list		(\$7.5)	\$0.0	\$0.0	(\$7.5)	\$0.0	\$0.0	\$0.0	\$0.0
45	Means testing Medicaid services		(\$2.5)	\$0.0	\$0.0	(\$2.5)	\$0.0	\$0.0	\$0.0	\$0.0
46	Provider payment flexibility		(\$1.0)	\$0.0	\$0.0	(\$1.0)	\$0.0	\$0.0	\$0.0	\$0.0
47	Hiring delay		(\$1.5)	\$0.0	\$0.0	(\$1.5)	\$0.0	\$0.0	\$0.0	\$0.0
48	Admin charge to special funds		(\$1.0)	\$0.0	\$0.0	(\$1.0)	\$0.0	\$0.0	\$0.0	\$0.0
49	DES change to other funds		(\$2.5)	(\$0.7)	(\$0.7)	(\$2.5)	(\$1.6)	(\$1.6)	\$0.0	\$0.0
50	Liquor store in Nashua		(\$2.5)	\$0.0	\$0.0	(\$5.0)	\$0.0	\$0.0	\$0.0	\$0.0
51	Total Spending Reductions		(\$128.0)	(\$83.7)	(\$83.7)	(\$118.2)	(\$62.9)	(\$62.9)	(\$49.0)	(\$51.0)
52	Annual Operating Surplus (Deficit)		\$45.5	(\$6.3)	(\$10.3)	(\$7.6)	(\$61.8)	(\$78.3)	(\$119.0)	(\$116.0)
53	GF Surplus Available June 30, 2003	\$17.3				\$31.8	\$17.3	\$17.3		
54	Projected GF Surplus (Deficit) June 30, 2005					\$69.7	(\$50.8)	(\$71.3)		

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