

Lessons for Massachusetts from California's “blank check” tax on high earners

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Introduction

California and Massachusetts often move on parallel policy tracks. On taxes, the evidence is strong that the Bay State should consider switching tracks and going in its own direction.

The direction that Massachusetts takes may be decided as early as this spring, when legislators may choose to vote on a proposed amendment to the state constitution that would institute a surtax of 4 percent on annual personal income above \$1 million. If approved, the petition will appear on the statewide ballot in November 2022. In their promotional statements, proponents have told legislators and voters that any new surtax revenue would be spent on public education and public transportation.¹ Without factoring in behavioral responses from businesses and high earners, the Massachusetts Department of Revenue estimated that it might raise between \$1.6 and \$2.2 billion per year.²

What proponents have not told voters is that the Massachusetts Attorney General's counsel submitted a brief to the Supreme Judicial Court of Massachusetts in 2018 stating that "the Legislature could choose to reduce funding in specified budget categories from other sources and replace it with the new surtax revenue."³ At oral arguments, the late Chief Justice Ralph Gants asked the Attorney General's counsel whether she agreed that, if the graduated income tax passed, it "may or may not result in any increase in education or transportation or education spending." Counsel responded that the Chief Justice's understanding was correct.⁴

This means that the legislature would not be required to appropriate any additional funding for education and transportation if the proposed surtax is adopted, so long as the legislature appropriates a minimum of \$1.6–\$2.2 billion for those purposes. Currently, education and transportation are collectively funded by the legislature at a level fluctuating between \$10 billion and \$11 billion. The fact is that the legislature could reduce total funding for education and transportation and still be in full compliance with the proposed constitutional amendment.

In its decision, the SJC added: "We are not entirely unaware of the possibility that, as the plaintiffs argue, these "broad areas of public concern" [i.e. funding for education and transportation] were added to the initiative petition as a means to "sweeten the pot" for voters."⁵

California's Fiscal Gymnastics

The strategy of "sweetening the pot" for voters on initiative petitions, as noted by the SJC in reference to the Massachusetts surtax proposal, was used successfully in California when voters approved Proposition 30 on November 6, 2012. Proposition 30 proposed a temporary (seven-year) income tax hike for high-income individuals, with revenues dedicated to K–12 education and community colleges. Voters approved Proposition 30 by a margin of 55.4 percent to 44.6 percent.⁶ Proposition 30 increased income taxes on single filers in California to the highest in the nation, including imposing a 13.3 percent marginal tax rate on income over \$1 million—an increase of 29.1 percent over the previous "millionaires tax" rate of 10.3 percent.⁷ Voters later extended the income tax hike by 12 years when they approved Proposition 55 on November 8, 2016.⁸

The promised bounty did not arrive. A review of the record in California makes clear that since the passage of Proposition 30, the state has funded K–12 education and community colleges at or near the minimum funding amounts previously established by a much older constitutional initiative petition, Proposition 98 (1988).

Proposition 98 uses a complicated series of formulas to establish a minimum amount of the state's revenues that must be allocated to education in a given year. According to the California Legislative Analyst's Office (LAO), the constitutional minimum funding level has closely defined actual appropriations by the legislature: "Although the state can provide more funding than required, in practice it usually funds at or near the guarantee."⁹

Kevin Gordon, a California policy consultant and expert on Prop 98, says that "as soon as [the legislation] got implemented, the legislature was always trying to figure out, what does it take just to do the minimum—and once they do the minimum, check the box, we're done. And that's what happened: it became a funding cap instead of a funding floor."¹⁰

Proponents have falsely told voters that the new surtax revenue must be spent on public education and public transportation

"The Legislature could choose to reduce funding in specified budget categories from other sources and replace it with the new surtax revenue."

- Counsel to Attorney General Maura Healey, 2018

In the 2012 voter guide for Proposition 30, proponents said: “The money raised for schools is directed into a special fund the legislature can’t touch and can’t be used for state bureaucracy. Opponents said “it allows the politicians to take money currently earmarked for education and spend it on other programs. We’ll never know where the money really goes.”¹¹

With the benefit of hindsight, it is easy to determine the extent to which proponents and opponents were correct in their assessments. The answer is that proponents were technically right in saying that the revenue from the income tax hike for K–12 and community colleges would be put in a special fund dedicated exclusively to those programs. But the opponents were also right in saying that Proposition 30 funds could be spent on other programs for the same reason stated by the Massachusetts Attorney General in Massachusetts to the SJC in relation to the Massachusetts surtax proposal. As previously cited, “the Legislature could choose to reduce funding in specified budget categories from other sources and replace it with the new surtax revenue.”¹² In California, the legislature applied Proposition 30 funds to K–12 and community colleges to the minimum funding requirements of Proposition 98. This replacement effectively freed up state funds that otherwise would have been obligated to minimum funding.

Given that Proposition 98 effectively established the annual funding levels for K–12 and community colleges in California, one might expect that revenues from Proposition 30 would be used to increase funding above the minimum level. In fact, about 40 percent of Proposition 30 revenues have gone to K–12 and community colleges, but about 60 percent have not. In 2019–20, for example, test 1 of Proposition 98 was operative, guaranteeing that K–12 and community colleges would receive a fixed share (about 40 percent) of state General Fund revenue.¹³ Because Proposition 98 minimum funding in 2019–20 was based on total state revenue and because Proposition 30 revenues were included in total state revenue, approximately 40 percent of Proposition 30 revenues went to K–12 and community colleges. The rest effectively went to the General Fund.

Specifically, in the nine year period from 2013 to 2021, the California state legislature appropriated 40.4 percent of general fund revenues to Proposition 98, providing \$453.7 billion of a total of \$1.122 trillion total general fund revenues, as shown in Figure 1.

Figure 1. Proposition 98 share of California general fund revenues (millions of \$) and applicable funding test (FY13–FY21)

Fiscal Year	Total General Fund Revenues	Prop 98 share of General Fund Revenues	Prop 98 share as percentage of General Fund Revenues	Applicable funding requirement
2013	\$96,447	\$41,799	40.9%	Test 1
2014	\$101,838	\$43,145	42.4%	Test 2
2015	\$113,356	\$50,011	44.1%	Test 1
2016	\$119,975	\$49,433	41.2%	Test 2
2017	\$122,054	\$50,240	41.2%	Test 3
2018	\$132,827	\$52,951	39.9%	Test 1
2019	\$142,912	\$54,746	38.3%	Test 1
2020	\$139,745	\$54,470	39.0%	Test 1
2021	\$153,594	\$56,942	37.1%	Test 1
TOTAL	\$1,122,748	\$453,737	40.4%	

Source: Document provided by California Legislative Analyst’s Office; California Comprehensive Annual Financial Report for Fiscal Years ended June 30, 2013 to 2019, https://www.sco.ca.gov/ard_state_cafr.html; Legislative Analyst’s Office, 2020–21 Budget Overview of the California Spending Plan (Final Version); <https://lao.ca.gov/Publications/Report/4263>; Governor’s Budget Summary, Summary Charts, 2020–21 <http://www.ebudget.ca.gov/2020-21/pdf/BudgetSummary/SummaryCharts.pdf>, California Legislative Analyst’s Office Reports 4174, 3930, 3355, and 3526, <https://lao.ca.gov/Publications>; Analysis by Pioneer Institute.

Proposition 30 became a funding cap instead of a funding floor

Approximately 40 percent of Proposition 30 revenues went to K–12 and community colleges. The rest effectively went to the General Fund

In six of the nine years shown in Figure 1, the applicable funding formula was Test 1, which requires that approximately 40 percent of general funds revenues be appropriated for K–12 schools and community colleges. During these six years, 39.9 percent of general fund revenues were appropriated for these purposes. During the other three years, Test 2 and Test 3 formulas applied, which adjust prior-year Proposition 98 funding for changes in student attendance and California per capita personal income and allows the state to provide a lower level of funding than the Test 2 level when state revenue growth is relatively weak. During these three years, 41.5 percent of general fund revenues were appropriated to fund Proposition 98.

Total funding of Proposition 98 in the nine year period from FY2013 to FY2021, including funding from local property taxes and state general funds, was \$641.488 billion. This is 0.08 percent more than the Proposition 98 constitutional minimum requirement of \$640.992 billion over this period, as shown in Figure 2.

Figure 2. Percentage of Prop 98 Minimum funding (millions of \$) provided (2013–21)

Fiscal Year	Prop 98 Minimum Guarantee	Prop 98 funding from General Fund	Prop 98 funding from Local Property Tax	Actual Prop 98 funding – Total	Percentage of Prop 98 Minimum funding provided
2013	\$57,888	\$41,799	\$16,297	\$58,096	100.36%
2014	\$59,041	\$43,145	\$15,896	\$59,041	100.00%
2015	\$67,125	\$50,011	\$17,114	\$67,125	100.00%
2016	\$68,942	\$49,433	\$19,679	\$69,112	100.25%
2017	\$71,643	\$50,240	\$21,403	\$71,643	100.00%
2018	\$75,459	\$52,951	\$22,625	\$75,576	100.15%
2019	\$78,522	\$54,746	\$23,776	\$78,522	100.00%
2020	\$79,544	\$54,470	\$25,073	\$79,544	100.00%
2021	\$82,828	\$56,942	\$25,887	\$82,828	100.00%
TOTAL	\$640,992	\$453,737	\$187,750	\$641,488	100.08%

Source: Document provided by California Legislative Analyst's Office; California Comprehensive Annual Financial Report for Fiscal Years ended June 30, 2013 to 2019, https://www.sco.ca.gov/ard_state_cafr.html, Legislative Analyst's Office, 2020-21 Budget Overview of the California Spending Plan (Final Version) <https://lao.ca.gov/Publications/Report/4263>; Analysis by Pioneer Institute.

In the nine-year period from FY2013 to FY2021, California collected \$61.259 billion in tax revenues from Proposition 30 and deposited the funds into the Education Protection Account for K–12 schools and community colleges, as required by Proposition 30. Over this same period, Proposition 98 required that 40.4 percent of total state revenues be appropriated for K–12 schools and community colleges. Because of this requirement, Proposition 30 revenues had the effect of increasing the preexisting Proposition 98 minimum funding requirement by \$28.348 billion over this period, i.e. 40.4 percent of \$61.259 billion.

The 59.6 percent balance of the \$61.259 billion in revenues from Proposition 30 that were deposited into the Education Protection Account amounts to \$41.798 billion. Essentially, this money reduced the amount of preexisting revenues that the state legislature had to appropriate for K–12 and community colleges from state general funds. Thus, \$41.798 billion of the \$61.259 billion in Chapter 30 tax revenue collected over this period and deposited into the Education Protection Account, i.e., the amount in excess of the 40.4 percent Proposition 98 minimum requirement, had the direct effect of freeing up \$41.798 billion in general funds that the state legislature was able to use for any other purposes that it chose. This is demonstrated in Figure 3.

Figure 3. Proposition 30 revenues (millions of \$) used to replace General Funds (FY13–21)

Fiscal Year	Prop 30 revenues	Prop 98 share of General Fund Revenues	Amount that Prop 30 increased Prop 98 minimum funding	Prop 30 revenues used to replace General Funds
2013	\$7,314	40.9%	\$2,995	\$4,319
2014	\$7,061	42.4%	\$2,992	\$4,069
2015	\$8,712	44.1%	\$3,844	\$4,868
2016	\$8,092	41.2%	\$3,334	\$4,758
2017	\$7,538	41.2%	\$3,103	\$4,435
2018	\$6,809	39.9%	\$2,714	\$4,095
2019	\$7,697	38.3%	\$2,949	\$4,748
2010	\$8,036	39.0%	\$3,132	\$4,904
2021	\$8,887	37.1%	\$3,295	\$5,592
TOTAL	\$70,146	40.4%	\$28,348	\$41,798

Source: California Department of Education Audit Report - Education Protection Account recorded in the state general fund, July 1, 2012, through June 30, 2015, https://trackprop55.sco.ca.gov/AuditReport/CDE_EPA_AuditReport2012to2015.pdf; California Department of Education Audit Report - Education Protection Account recorded in the state general fund, July 1, 2015, through June 30, 2017, https://trackprop55.sco.ca.gov/AuditReport/CDE_EPA_AuditReport_FY2015-17.pdf; Department Detail of Appropriation and Adjustments, California State Budget 2019–20, <http://www.ebudget.ca.gov/2019-20/pdf/Enacted/GovernorsBudget/6000/6100RWA.pdf>; Department Detail of Appropriation and Adjustments, California State Budget 2020–21, <http://www.ebudget.ca.gov/2020-21/pdf/Enacted/GovernorsBudget/6000/6100FCS.pdf>. Analysis by Pioneer Institute.

The mechanism demonstrated in Figure 3, i.e. replacing funding in specified budget categories with new surtax revenue, could happen in Massachusetts, as attested to by counsel for the Massachusetts Attorney General before the Massachusetts Supreme Judicial Court in 2018.¹⁴ In California, the state legislature was able to use only 59.6 percent of revenues from a dedicated tax increase for other purposes because of the funding requirements mandated by Proposition 98. In Massachusetts, 100 percent of revenue from the proposed graduated surtax, ostensibly dedicated to funding of transportation and education, could be used for any purpose that the legislature may choose.

A Spending Glut Elsewhere

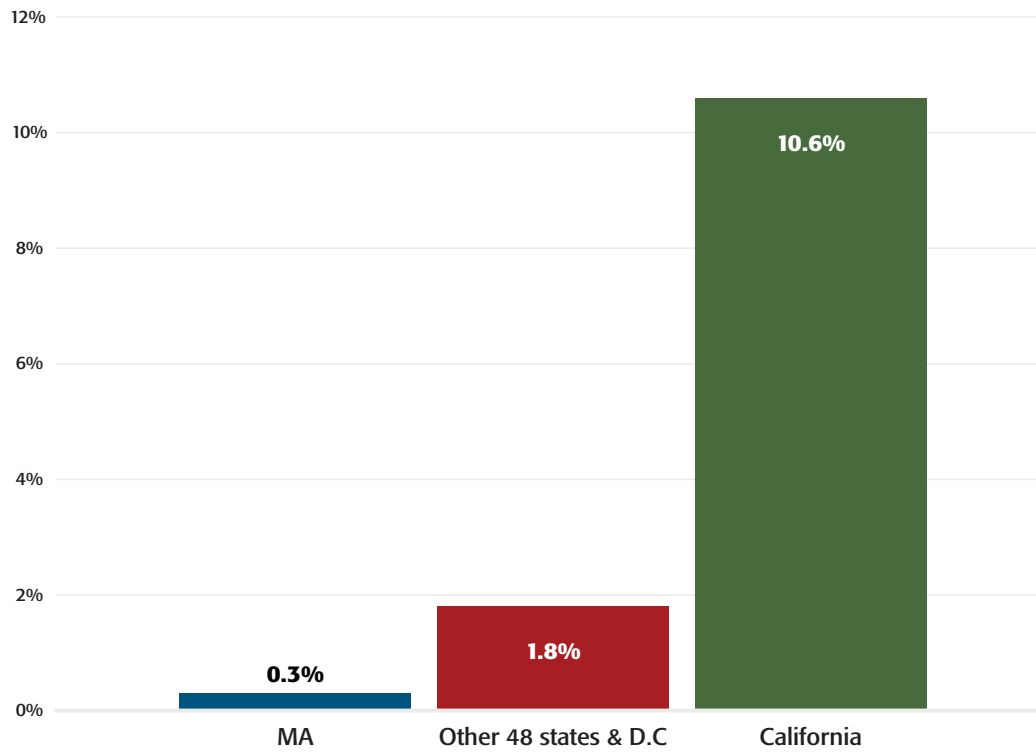
The infusion of discretionary revenue from Proposition 30 has allowed the California state legislature to increase spending in other areas. Figure 4 shows that state government employment increased by 10.6 percent between FY2013, when Proposition 30 passed, and FY2020. During the same period, Massachusetts' state payroll grew by just 0.3 percent. The other states on average added 1.8 percent over that time, according to data published by the federal Bureau of Labor Statistics.¹⁵

Over the same period of FY2013 to FY2020, California's state government payroll grew by 50.3 percent, while Massachusetts' grew by 24.0 percent, as shown in Figure 5.¹⁶ The payrolls of the other 48 states and the District of Columbia grew by 24.4 percent.

Despite the funding increase for K–12 schools, California's student-teacher ratio has actually risen since Proposition 30 passed, according to data published by the National Education Association.¹⁷ In 2013, prior to its passage, California ranked 48th out of the 50 states and D.C. in enrolled students per teacher. By 2019, its ranking had fallen to 51st, the worst in the nation. The same trend occurred in enrolled students per instructional staff, including teachers and related direct education providers. California ranked 49th in the nation in this regard in the Fall of 2013. In the Fall of 2019, it had fallen to 50th, behind only Utah, as shown in Figures 6 and 7.

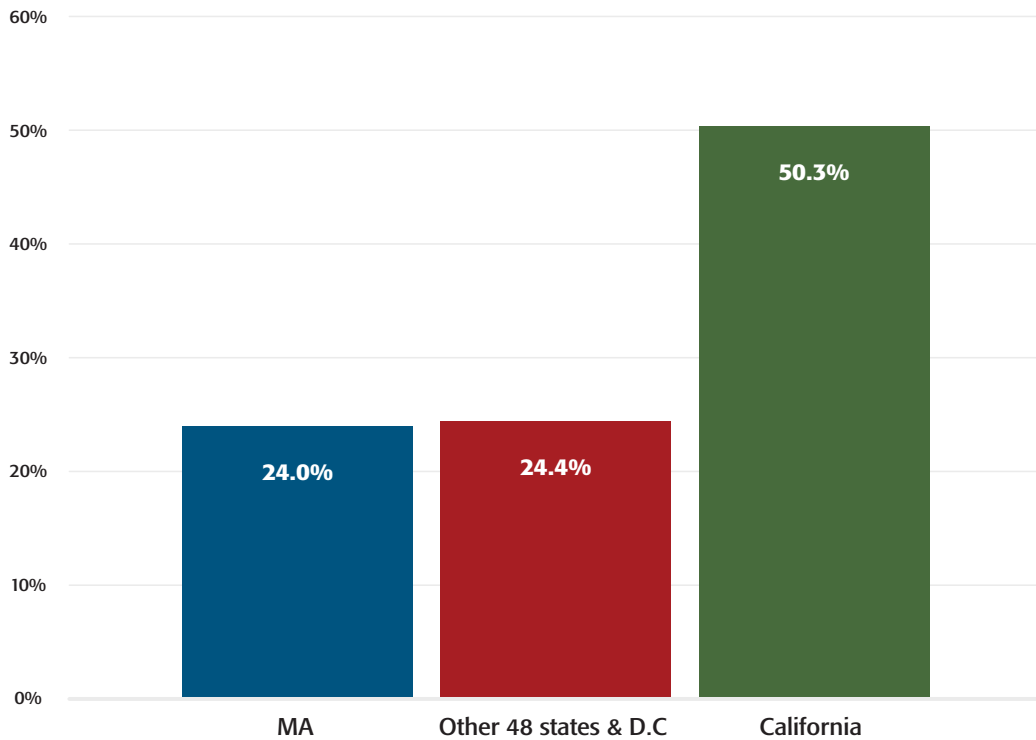
Despite the funding increase for K-12 schools, California's student-teacher ratio has actually risen since Proposition 30 passed

Figure 4. Percent increase in state government employment (FY13–FY20)



Source: BLS Quarterly Census of Employment and Wages (QCEW) quarterly data files 2013–20. Pioneer Institute analysis.

Figure 5. Percent increase in state government wages (FY13–FY20)



Source: BLS Quarterly Census of Employment and Wages (QCEW) quarterly data files 2013–20. Pioneer Institute analysis.

Figure 6. Change in California K–12 public school students, teachers, and instructional staff after Proposition 30

	2013–2014	2019–2020	Difference	Percent Difference
Public school enrollment	6,236,672	6,415,254	178,582	2.9%
Number of teachers	292,505	293,619	1,114	0.4%
Number of instructional staff	333,766	374,003	40,237	12.1%
Enrolled students per teacher	21.3	21.8	0.5	2.3%
Enrolled students per instructional staff	18.7	17.2	-1.5	-8.0%
State rank - enrolled students per teacher	48	51	-3	N/A
State rank - enrolled students per instructional staff	49	50	-1	N/A

Source: National Education Association. Rankings and Estimates Rankings of the States 2013 and 2019. Pioneer Institute analysis.

Figure 7. NEA state rankings of enrolled students per teacher and instructional staff (Fall 2013–Fall 2019)

State	Enrolled students per teacher				Enrolled students per instructional staff			
	2013	Rank 2013	2019	Rank 2019	2013	Rank 2013	2019	Rank 2019
Alabama	15.9	34	15.6	32	13.8	33	13.5	35
Alaska	16.2	38	17.0	42	14.5	41	15.6	45
Arizona	18.2	45	17.5	43	16.7	45	16.1	47
Arkansas	15.2	26	14.8	24	13.1	28	12.8	26
California	21.3	48	21.8	51	18.7	49	17.2	50
Colorado	15.4	31	15.8	35	13.0	25	12.9	27
Connecticut	13.0	11	12.6	8	10.3	3	10.2	5
Delaware	14.7	22	14.6	21	13.1	27	13.1	33
D.C.	12.3	6	12.9	11	10.9	7	11.4	12
Florida	16.0	35	20.0	48	14.6	42	14.6	41
Georgia	15.8	33	15.1	28	13.7	32	12.9	30
Hawaii	16.7	41	15.9	36	14.4	39	13.7	36
Idaho	19.8	47	18.5	46	17.7	47	16.1	46
Illinois	16.1	37	15.3	30	14.4	40	11.2	10
Indiana	17.1	42	16.9	41	14.9	43	14.7	42
Iowa	14.3	19	13.7	15	12.4	17	11.8	15
Kansas	14.1	17	13.9	17	12.6	20	12.3	21
Kentucky	16.5	40	16.3	40	14.4	38	14.1	38
Louisiana	16.0	36	15.0	25	12.9	23	11.8	14
Maine	12.1	5	12.5	6	10.3	4	10.6	8
Maryland	14.6	20	14.7	22	11.9	12	11.9	16
Massachusetts	13.5	15	12.7	9	12.0	13	10.9	9
Michigan	22.6	51	17.7	45	18.6	48	14.9	43
Minnesota	15.6	32	16.2	37	14.3	37	14.6	40
Mississippi	15.2	27	14.7	23	13.6	31	12.9	28
Missouri	13.5	14	11.6	5	12.0	14	10.3	6
Montana	13.3	12	13.9	18	11.6	11	12.1	17
Nebraska	13.0	10	13.6	14	11.5	10	12.1	18

Nevada	17.9	44	20.8	49	15.1	44	16.8	48
New Hampshire	11.9	3	10.4	1	9.5	2	9.8	4
New Jersey	11.8	2	11.6	4	11.0	8	9.5	2
New Mexico	15.1	24	15.6	33	13.5	29	14.0	37
New York	12.8	9	12.9	10	12.0	15	11.5	13
North Carolina	15.2	25	15.1	26	13.0	26	12.9	29
North Dakota	12.1	4	11.0	3	10.4	5	9.6	3
Ohio	17.2	43	15.7	34	14.0	36	12.3	20
Oklahoma	16.2	39	16.3	39	13.8	34	14.2	39
Oregon	21.5	49	19.4	47	19.1	50	17.0	49
Pennsylvania	14.6	21	14.1	20	12.7	22	12.4	23
Rhode Island	13.4	13	13.1	12	12.2	16	11.3	11
South Carolina	15.3	28	15.2	29	13.0	24	12.7	25
South Dakota	13.8	16	13.8	16	12.4	18	12.6	24
Tennessee	15.0	23	16.2	38	12.7	21	13.1	32
Texas	15.3	29	15.1	27	13.6	30	13.1	34
Utah	22.5	50	21.5	50	19.3	51	17.3	51
Vermont	10.0	1	10.5	2	8.2	1	9.1	1
Virginia	12.5	8	12.5	7	10.8	6	10.6	7
Washington	19.4	46	17.6	44	17.2	46	15.5	44
West Virginia	14.3	18	14.0	19	12.5	19	12.1	19
Wisconsin	15.4	30	15.6	31	14.0	35	13.0	31
Wyoming	12.4	7	13.5	13	11.1	9	12.3	22
United States	15.9		15.7		13.9		13.2	

Source: National Education Association. Rankings and Estimates Rankings of the States 2013 and 2019. Pioneer Institute analysis.

Revenue from Proposition 30 has also helped facilitate sizable pay raises and increased retirement and health contributions for employees of California state departments. In FY2019, California's expenditures for wages, retirement contributions, and health care contributions were \$8.2 billion higher than they were in FY2013 before voters approved Proposition 30, according to data published by the State Controller.¹⁸ In FY2019, Proposition 30 generated less than that, \$7.7 billion, in tax revenue.

Figure 8. Change in California state employee wages, retirement benefits, and health benefits (2013–19)

State Departments	Employees	Total Wages	Total Retirement & Health Contribution	Total Wages, Retirement & Health Contribution
2019	255,380	\$19,138,635,937	\$8,944,171,442	\$28,082,807,379
2013	235,249	\$14,613,713,360	\$5,244,670,686	\$19,858,384,046
Increase/decrease	20,131	\$4,524,922,577	\$3,699,500,756	\$8,224,423,333
Increase/decrease %	8.6%	31.0%	70.5%	41.4%

Source: California State Controller – Government Compensation in California <https://publicpay.ca.gov>. Pioneer Institute analysis.

Conclusion

The proposed constitutional amendment to institute a 4 percent surtax on Massachusetts income over \$1 million is being marketed by proponents as critically needed funding for transportation and education. They further represent to voters that revenue from the new surtax, which they estimate as between \$1.6 and \$2.2 billion per year, will be directed to public education and public transportation.¹⁹ But counsel for the Massachusetts Attorney General told the Massachusetts Supreme Judicial Court the opposite in 2018 when they wrote in the state's brief that "because the proposed amendment does not require otherwise, the Legislature could choose to reduce funding in specified budget categories [i.e. education and transportation] from other sources and replace it with the new surtax revenue...As long as total spending in these combined categories did not fall below the revenue generated by the surtax in any particular year, the Legislature would be in compliance with the proposed amendment."²⁰ By exactly the means described by the Attorney General's office, the legislature would be authorized effectively to spend all of the expected tax revenue on anything it desires.

In California, that is essentially what happened after voters approved Proposition 30 in 2012, forming the highest marginal individual income tax rate in the nation. Proposition 30 created what in essence is a \$41.8 billion discretionary fund that the state legislature could spend on whatever it chose. In part because of Proposition 30, California's state employee payrolls increase by more than twice the national average between FY2013 and FY2020.²¹

The proposed Massachusetts graduated tax surcharge is a close cousin to California's Proposition 30. The selling point of both proposals is that the new funds would be used for specific purposes. It's up to voters to decide whether these ostensible earmarks "sweeten the pot" enough, or whether there's a better way to guarantee funding to core services. When advocates tell you that the funds from the surtax will be used for education and transportation and not to pad the state bureaucracy, be warned. Padding bureaucracy is the likely outcome.

The proposed Massachusetts graduated tax surcharge is a close cousin to California's Proposition 30

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