

A First Look at the Governor's Proposals on Education, Transportation, and Revenue

In recent days, the Governor has introduced three major policy initiatives. 1) Increased funding for education, from early ed. through college. 2) Fixes and improvements to strengthen our transportation system. 3) A revenue plan that would pay for these initiatives. Taken together, these proposals represent a significant new effort to invest in our people, our infrastructure, and the long-term economic prospects of our state.

Among other things, the Governor's proposals include:

- Significantly more funding for Early Education & Care, to help ensure that lower-income families have access to the kind of high-quality child care that helps prepare young children for success in school and in life.
- A combination of sales taxes decreases and income tax increases that would help fund these investments in education and transportation with \$1.9 billion in new revenues--while also making the state's tax system more fair.

What follows is a first analysis of the Governor's proposals, including how they would affect Early Education & Care, K-12, Higher Ed., Transportation, the Sales Tax, and the Income Tax.

EARLY EDUCATION & CARE

The Governor's proposal includes \$131 million for early education and care in FY 2014 growing to nearly \$350 million for early education by FY 2017. Early education and care is an essential resource for parents with young children who hope to work. In addition, a growing body of research finds that high quality early education plays a critical role in preparing young children for success in school, and in life.¹ But between FY 2001 and FY 2012, the early education and care budget was cut \$174 million. During this period, the state contribution dropped by more than 50 percent (\$114 million).² This proposal would leave the FY 2014 early education and care budget just below previous highs in FY 2001. The \$350 million proposed increase by FY 2017 would see the budget approach \$850 million, over \$100 million more than FY 2001 levels.

¹ For more information about the economic gains of high quality early education and care on both parents and children, see [Economic Gains from Early Education and Care](#).

² For more information about funding for early education and care, see [Declines in Spending on Early Education and Care in Massachusetts](#)

The proposal recommends:

- Providing an early education and care subsidy to all infants, toddlers and pre-school children currently on the *Income Eligible* wait list in Massachusetts.³ The Income Eligible line item provides care for children of low-income parents who are working, disabled or in an education or job training program. Because of funding cuts many children and families who meet eligibility requirements have not received a subsidy in recent years. Currently these children are placed on a growing waiting list that includes around 30,000 infants, toddlers and pre-school children.
- Increases in provider quality by supporting more training for teachers, and through expansion of the Quality Rating and Improvement System (QRIS). The QRIS system assesses the current level of early education and care delivered by providers and supports initiatives that will raise quality for children in Massachusetts.⁴ Details on exact initiatives were not included in the Governor's proposal.
- Services aimed at supporting families and increasing parent engagement. Specific programs were not identified in the Governor's proposal.
- Significant increases in funding for the early education and care of pre-school students through reforms in the state's school funding formula.

K-12 EDUCATION

Education plays an important role in helping grow state economies. In Massachusetts, as with most states in the nation, there is an increasingly strong connection between improving the skills of the state workforce and creating a high-wage economy.⁵ Recognizing this connection, the Governor proposes increasing K-12 education support in FY 2014 by about \$84 million and by significantly more in future years. This proposal includes new funding for a couple of targeted grant programs and for increasing Chapter 70 education aid, an important source of revenue for public school districts across the state. Specifically, the Governor proposes increasing:

Chapter 70 Aid by about \$59 million, which is on top of \$167 million in maintenance increases. All combined, this \$226 million increase over FY 2013 levels funds:

- Phasing-in fully the formula reforms planned in the 2007 budget, but slowed due to the ongoing fiscal crisis. For more information on the reforms of 2007, please see MassBudget's [Demystifying](#)

³ For information about recent increases in the number of children on the waitlist, see [Declines in Spending on Early Education and Care in Massachusetts](#).

⁴ See <http://www.mass.gov/edu/birth-grade-12/early-education-and-care/provider-and-program-administration/quality-rating-and-improvement-system-qris.html>

⁵ See "The Wage-Education Link" within MassBudget's *The State of Working Massachusetts 2012*, available online at: http://www.massbudget.org/report_window.php?loc=swma_2013.html

[the Chapter 70 Formula.](#)

- Providing a minimum \$25 per pupil increase over FY 2013 aid.
- Increasing the assumed cost of out-of-district special education students in the foundation budget. The foundation budget's current assumed cost for providing appropriate services has lagged well behind actual cost growth, and this proposal appears designed to address this problem, at least in part. For more information on how increasing special education costs have affected school budgets please see MassBudget's [Cutting Class](#) report.
- Including all pre-kindergarten students now attending public schools in district foundation budgets.

While the Governor's press statement describes this funding as a \$226 million increase above FY 2013 levels, much of this money would be needed to meet maintenance cost growth (reflecting enrollment changes and the increasing cost of providing baseline services), rather than enabling local districts to expand educational services. MassBudget projects that maintenance costs for FY 2014 would total \$167 million, leaving about \$59 million of the Governor's proposed increase to fund expanded services.⁶

Extended Learning Time funding by \$5 million (and by \$70 in future years). This proposal builds on the state's current expanded learning time program by targeting additional supports students in high-needs middle schools.

Gateway Cities Supports by \$20 million. Specifics on how this money would be spent in Gateway Cities schools remain unclear.

It is important to emphasize that while the Governor's office has released some information outlining these education investment proposals, full detail will not be available publicly until the Governor's FY 2014 budget is released on January 23, 2013. The Governor has, however, indicated that when fully phased in his education initiative would increase investments in education by \$1 billion annually.

HIGHER EDUCATION

Since 2001, Massachusetts has cut higher education spending by 30% when adjusting for inflation.⁷ At the same time, the economic evidence increasingly suggests that a well-educated workforce is critically important for the creation of a strong, high wage, state economy.⁸ Under the Governor's proposal, an additional \$152 million would be available for Higher Education in Fiscal Year 2014 and \$274 million in the following year. Funding would be allocated to public institutions of higher education and specific programs. These programs include:

⁶ See MassBudget's *A Preview of the FY 2014 Budget*, available online at:

http://www.massbudget.org/report_window.php?loc=budget_preview_2014.html

⁷ For more information, see the Education Section of the FY13 Budget Monitor by the Massachusetts Budget and Policy Center:

http://www.massbudget.org/report_window.php?loc=budget_monitor_gaa_fy13.php§ion=2

⁸ For more information, see "The Wage-Education Link" within MassBudget's *The State of Working Massachusetts 2012*, available online at:

http://www.massbudget.org/report_window.php?loc=swma_2013.html

MASSGrant- This program provides need-based financial assistance to Massachusetts undergraduates who enroll in any approved public or independent college, university, school of nursing or any other institution of higher education. The amount of funding per student varies based on need and length of program.

Completion Incentive Grant Fund- The program provides incentive grants of up to \$1000 to low-income students for persisting and completing their degree or certificate program of study over a maximum of four years.

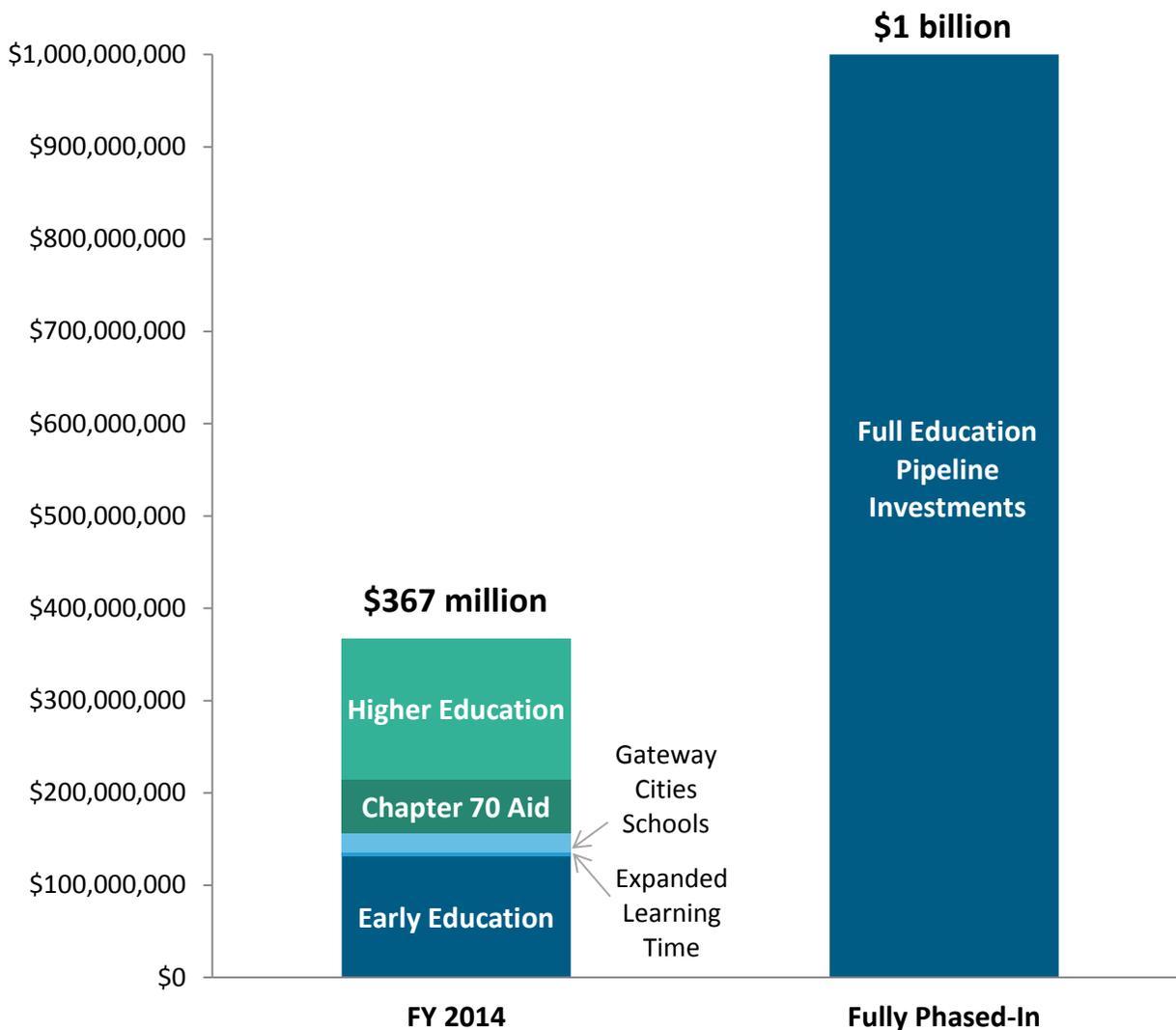
Community Colleges- Massachusetts would provide an annual increase for community colleges, based upon a new formula passed last year. This would total \$20 million in FY 2014. Even with this extra money, state support would still fall short of FY 2009 pre-recession levels.⁹ Additional money would be allocated to public institutions of higher education, including the UMass system, the State university system and community colleges, to support the goal of Massachusetts covering 50% of all public higher education costs. While this investment would represent a significant increase over FY13, it is important to note that, when adjusted for inflation, this investment would bring Massachusetts approximately back to pre-recession funding levels. Even with this proposed new funding, the state would still be about \$250 million short of what it invested in college students twelve years ago.¹⁰

⁹ See MassBudget's FY 2013 GAA Budget Monitor: http://www.massbudget.org/report_window.php?loc=budget_monitor_gaa_fy13.php

¹⁰ Includes a two percent cost growth over FY2013 funding and the addition of the proposed \$152 million.

Gov's Proposal Increases Education Funding, Early Ed. to College

Projected increases over maintenance funding for FY 2014, based upon Governor's press



TRANSPORTATION INVESTMENTS

Just as investments in education help boost state economic strength, a growing body of research makes the case for the economic development benefits of investing in Massachusetts's transportation system. A significant portion of revenue raised through the Governor's tax reform proposal would be dedicated to repairing and maintaining the state's existing transportation infrastructure as well as to making long-delayed network expansions and improvements. Investing in modernizing the state's subway, bus, road, and bridge networks would help stimulate the economy both by creating new construction jobs

and by reducing travel times statewide, providing residents more reliable access to work and helping businesses bring goods to market more efficiently.¹¹

The Governor proposes investing \$231 million for transportation in FY 2014, \$600 million in FY 2015, and \$700+ million for FY 2016 and beyond (in addition to indexing various transportation-specific revenue sources to inflation as described below).

Specific projects funded under this proposal include improving highway interchanges; increasing annual funding for Regional Transit Authorities; resurfacing several major roadways; completing the Green Line extension into Somerville and Medford; connecting rail service between Springfield and Boston, Boston and Hyannis, and Pittsfield and New York City; replacing outdated buses and Red, Orange, and Green Line cars; completing the South Coast rail extension; and expanding South Station.

NEW REVENUE FOR TRANSPORTATION

The Governor proposes targeting new revenue for transportation in two different ways. First, he proposes dedicating all of the new, lower 4.5% state sales tax to a **Commonwealth Public Infrastructure Fund** for transportation and infrastructure investments. Under this proposal, revenue from the 4.5 cent per dollar sales tax would be allocated as follows:

- 1 cent would remain dedicated to the **School Modernization and Reconstruction Trust Fund**.
- 1.12 cents would remain dedicated to the **MBTA**.
- 2.38 cents would be dedicated to other transportation and infrastructure projects, rather than sending this revenue to the state's general fund. The new \$700+ million a year in Transportation funding would come from here.

In addition to directing significant sales tax revenue to transportation, the governor proposes a new regular schedule for adjustments to the state gas tax, tolls, MBTA fares, and RMV fees so that the value of these taxes and fees would more automatically keep up with regular cost growth. These revenue sources would remain dedicated to transportation-related investments and services. Specifically, the Governor proposes:

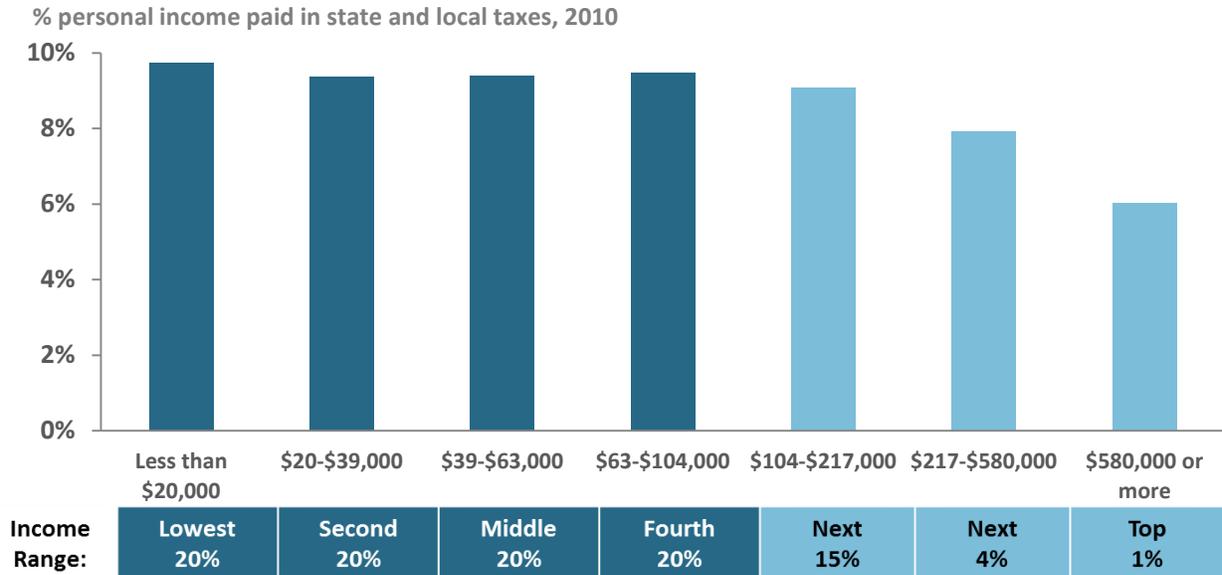
- Indexing the **Gas Tax** to inflation, first rising in July of 2013 and generating about \$13 million next year. The gas tax would then rise from 21 cents per gallon to 24.6 cents in 2021, resulting in \$118 million in new revenue. Since the flat per gallon gas tax has not been adjusted for cost growth since 1991, these future inflation adjustments would only serve to fend off additional real declines in future years.
- Increasing **tolls** by 5 percent every two years, beginning in FY 2016.
- Increasing **MBTA fares** by 5 percent every two years starting in fiscal 2015.
- Increasing **RMV fees** by 10 percent every five years starting in fiscal 2016.

¹¹For more information on the economic development effects of infrastructure investments in New England states, see Jeffrey Thompson's *Prioritizing Approaches to Economic Development in New England: Skills, Infrastructure, and Tax Incentives*, available online at: <http://www.peri.umass.edu/236/hash/3f1bd7d2221409d39332894e8e2e0c72/publication/422/>

REVENUE

The current tax structure in Massachusetts is regressive; middle and lower-income people pay a larger share of their household income in taxes than do higher-income people. (See: http://www.massbudget.org/report_window.php?loc=FactTaxFairness.html)

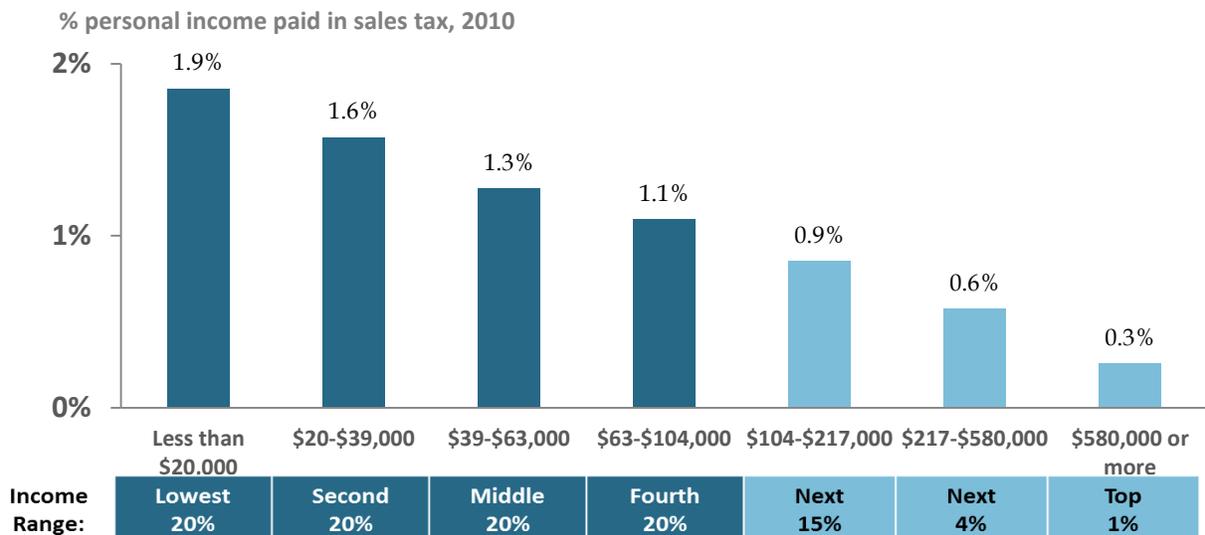
State and Local Taxes are Regressive



Source: Institute for Taxation and Economic Policy.

This flaw in our tax system is in part due to the regressive nature of the sales tax (see chart below).

The Sales Tax is Regressive

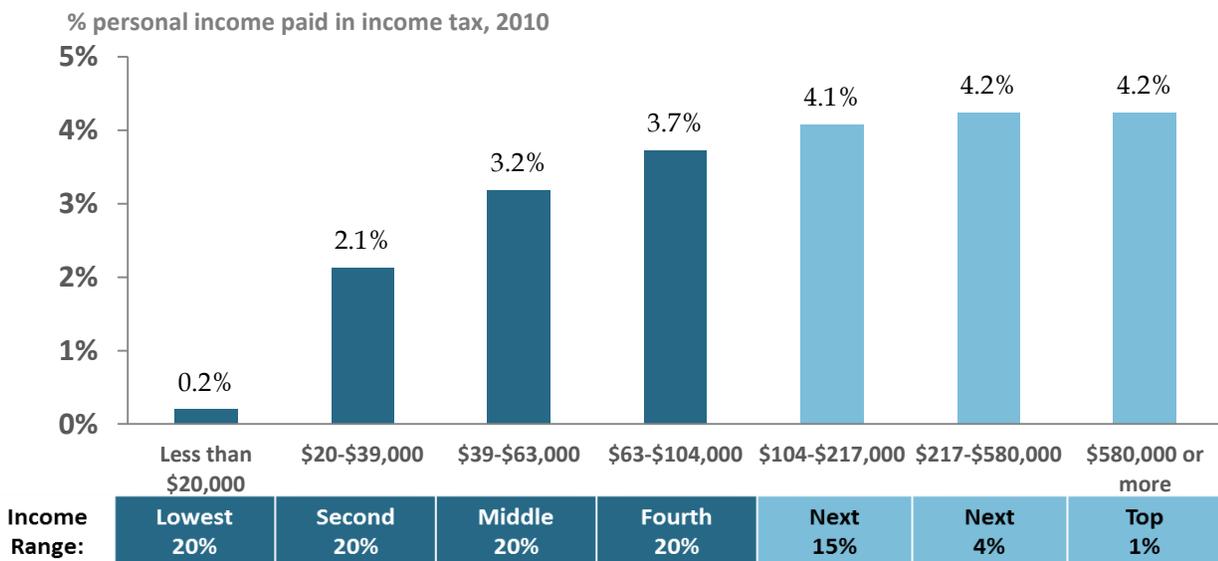


Source: Institute for Taxation and Economic Policy.

While higher-income households are able to save a portion of their income, lower income households typically must spend all they earn simply to make ends meet, with the result being that a much larger share of their income is subject to the sales tax. (See: http://www.massbudget.org/report_window.php?loc=Tax_Primer_83110.html)

The income tax is the only major component of our tax system that functions to reduce overall regressivity (See: http://www.massbudget.org/report_window.php?loc=Facts_Income_Dec_14_2010.html).

The Income Tax is Progressive



Source: Institute for Taxation and Economic Policy.

While Massachusetts applies a flat 5.25 percent rate to taxable income regardless of the income level of the taxpayer, a number of features of the Massachusetts income tax produce the markedly progressive net effect seen in the chart above. Two of the more notable of these features are the "Low Tax/No Tax" status, which exempts households with very low income from the income tax, and the automatic personal exemption (PE). The PE applies to all tax filers and removes a set amount of income from taxation (\$4,400 for single filers and \$8,800 for married couples). This means that for low and moderate income families, a relatively large share of household income is not subject to the income tax. For high-income filers, however, the fixed value of the personal exemption removes only a small share of their total income from taxation. The net effect of the PE is therefore progressive.

The Governor's Proposal

The Governor's newly announced plan for increased public investments in education and infrastructure includes a proposal to raise an additional \$1.9 billion in annual revenues, and to do this in a way that reduces the tax system's overall regressivity. As a result, the system would move somewhat closer to a flat-tax structure, where people at all income levels pay the same share of their income in taxes – and away from the current, markedly regressive structure. While the Governor's full

revenue package is composed of many pieces, in this factsheet we look briefly at just a few of the major elements of the plan.

The Governor has proposed decreasing the sales tax from the current 6.25 percent to 4.5 percent. Costing the Commonwealth roughly \$1.4 billion annually, this change will lower the taxes of people in all income groups. Given that the sales tax is regressive, as discussed above, any reduction in the sales tax rate will disproportionately benefit low and moderate income households. As a result, this change will reduce the regressivity of the tax system.

The Governor also has proposed increasing the tax rate on personal income from 5.25 percent to 6.25 percent. This change will generate an estimated \$2.6 billion in new, annual revenue for the state. Because the Massachusetts personal income tax is progressive in its effects, as discussed above, this change will be progressive.

Additionally, the Governor proposes doubling the automatic personal exemption (PE), from \$4,400 to \$8,800 for single filers and from \$8,800 to \$17,600 for married filers. This change will cost the state an estimated \$1.1 billion annually and will help reduce overall tax regressivity.

The Governor's proposal also eliminates a number of specific existing personal income tax exemptions and deductions. The eliminations of tax expenditures recommended by the Governor would raise approximately \$1.3 billion. Together with the proposed increase to the personal exemption, the net revenue gain from these two reforms would be about \$240 million – a relatively small portion of the overall tax reform package.

The Governor proposes a number of changes to business taxes as well:

- Elimination of the FAS 109 deduction, a tax break that affects a small number of large corporations and would cost the state an estimated \$76 million annually.
- Clarification of apportionment rules governing the sourcing of the sale of certain services by companies headquartered outside of Massachusetts to customers inside the state. Currently, some multistate companies are asserting that they do not need to count these as Massachusetts sales when they calculate their Massachusetts taxes. The new rules would require them to count these as Massachusetts sales when calculating their income for tax purposes. The flip side of this tax code clarification is that Massachusetts-based companies selling these services to out-of-state customers would *not* have to count them as Massachusetts sales in their tax calculations.
- Elimination of a special tax classification for "security corporations" that currently are taxed a lower rate than other businesses.
- Elimination of a separate classification and tax rate for utility companies, instead taxing these businesses at the standard corporate rate.
- Application of the sales tax to custom modifications made to "canned software" and to computer services (many of the consumers of which are businesses).

In addition, the proposed reduction in the general sales tax rate will reduce the sales taxes paid by businesses on many of their purchases.

Finally, the Governor proposes indexing the gas tax rate to inflation, preventing further erosion in its value.