# *FACTS AT A GLANCE*

JULY 2005

## The Senate's Phased-In Personal Income Tax Cut

On July 14, 2005, the Senate approved its own version of the tax loophole bill that passed the House of Representatives last month. During its consideration of the bill (S. 2156, An Act Relative to Tax Laws), the Senate adopted an amendment that would reduce the personal income tax rate from 5.3 percent to 5.0 percent over three years, contingent upon the restoration of appropriations for three types of local aid – Chapter 70 education aid, additional assistance, and lottery aid – to their FY 2002 levels. Once fully implemented, the income tax rate reduction would likely drain away more than $550 million in tax revenue each year, thereby undermining the ability of the state to restore the deep cuts that have been made to public higher education, public health, environmental affairs, and other critical services.

### Other Vital Public Services – Not Just Local Aid – Have Been Cut Dramatically

The Senate amendment would ignore the overwhelming majority of budget cuts made during the fiscal crisis and use only three out of the 787 separate line-items in the budget to decide when to trigger an automatic tax cut. The amendment also disregards the fact that deep cuts were made in many areas between 2001 and 2002. If the proposed tax cut is triggered, it would make it far more difficult to restore deep cuts in such areas as housing, public safety, safety net programs, and others:

***Public Higher Education:*** Adjusted for inflation, public higher education has been cut by $266 million dollars since fiscal year 2001. <u>This is a cut of 22 percent.</u> The Senate's own Task Force on Public Higher Education identified higher education as critical to the future of the state economy and found "that (a) Massachusetts is in urgent need of a world class system of public higher education, and (b) that inadequate and unpredictable financial support has thwarted our efforts to build such a system." Implementing a new $550 million tax cut would significantly impair Massachusetts ability to address these problems.

***Public Health:*** Adjusted for inflation, public health spending has been cut by $151 million since fiscal year 2001. <u>This is a cut of 26 percent.</u> This has led to deep cuts in health protection programs that serve people in communities across the state. For example, the state's anti-smoking program – a model copied by many other states because of its demonstrated success – had its funding reduced from $51 million to just $4 million a year. The program had successfully contributed to a decline in the state's smoking rate, and when funding for smoking prevention dropped, the smoking rate appeared to stop declining.[1]

***Environmental Protection:*** Adjusted for inflation, funding for environmental affairs has been cut by $64 million since fiscal year 2001. <u>This is a cut of 24 percent.</u> The *Boston Globe* recently reported on an internal memo from the Department of Environmental Protection which stated, "Over the long term … these budget and staffing cuts cannot be sustained without significantly increasing risks to public health and the environment." A new $550 million tax cut could force these budget cuts to be sustained.

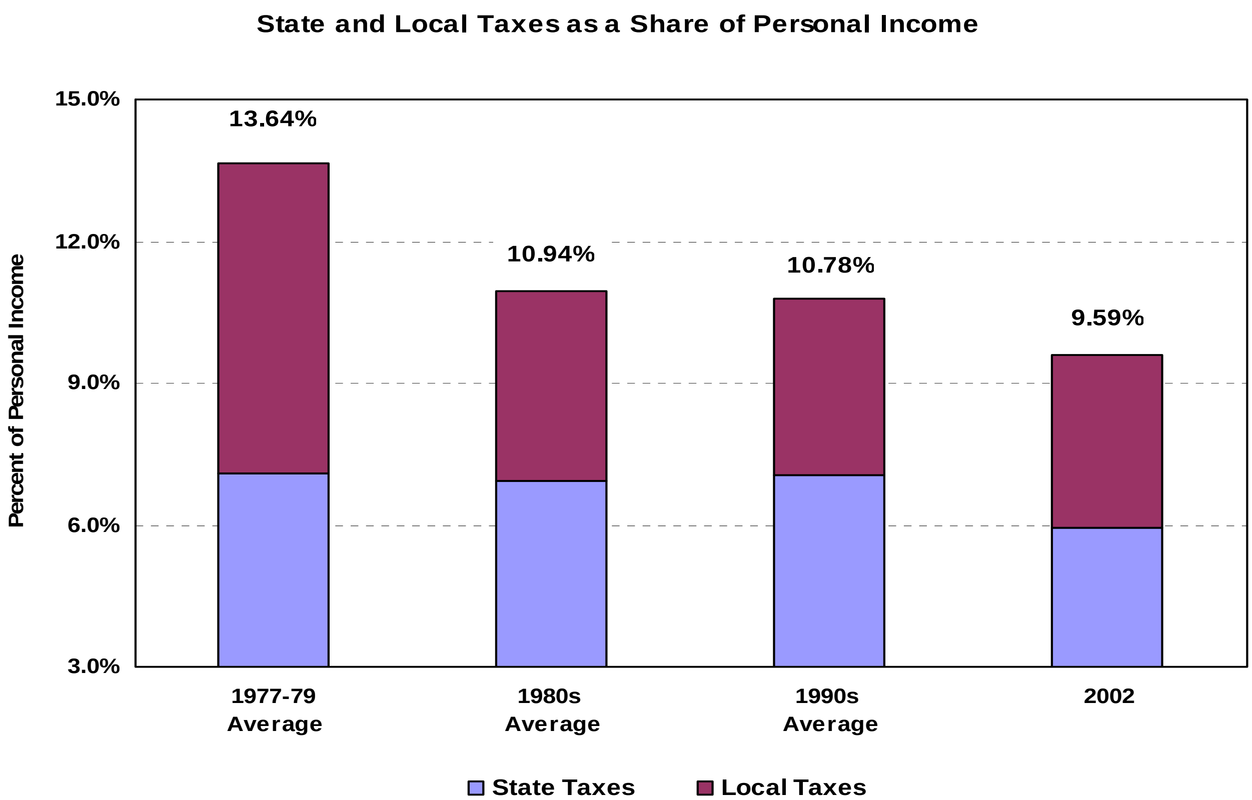
[1] Na'im, Alyssa and Wagman, Nancy, *Real Cuts – Real People – Real Pain: The Effects of the Fiscal Crisis on Women and Girls in Massachusetts*, Massachusetts Budget and Policy Center, December 2004, p. 65.

## Senate's Phase-In Fails to Account for Inflation and Other Cost Increases Since FY2002

Simply restoring those local aid accounts that the Senate amendment does address to their FY 2002 levels does not mean that cities and towns would be able to provide the same level and quality of services that they did that fiscal year. For example, lottery aid in FY 2002 (in nominal dollars) was $778.1 million, while appropriations for FY 2006 are $761.4 million. Thus, to trigger the Senate's personal income tax rate reduction, lottery assistance would only have to rise by $16.7 million (assuming additional assistance and Chapter 70 were also restored). Yet, in real or inflation-adjusted dollars, lottery aid would still be $63 million below its 2002 level.

Adjusting only for general inflation may, in fact, understate the real differences between FY 2002 and FY 2006 funding. Many costs, such as healthcare, have grown faster than inflation in recent years.

## Even in 2002 Taxes, as a Share of Income, Were at Their Lowest Level in 25 Years




During the 1990s Massachusetts cut taxes by over $3 billion. The state cut corporate taxes, capital gains taxes, taxes on dividends, taxes on income, taxes on banks and insurance companies, estate taxes, and other taxes. The largest of these tax cuts came late in the decade. As a result of these cuts, state and local taxes, as a share of income, declined from 10.78 percent in the 1990s to 9.59 percent in 2002. Since personal income is Massachusetts is approximately $250 billion, this reduction of 1.2 percent of income translates into a tax cut of about $3 billion a year. Because of the economic boom of the 1990s it appeared that the state could afford those tax cuts without cutting any programs. But after the bubble burst, it became clear that to pay for these tax cuts billions of dollars would have to be cut out of education, healthcare and other public services. The Senate amendment could lead to yet another deep tax cut that would leave the state without the resources needed to restore essential services that have been cut.

## Prior Tax Cuts Have Not Stimulated Economic Growth

Proponents of reducing the personal income tax rate to 5.0 percent have suggested that such a reduction would help to stimulate economic growth. For instance, earlier this year, Governor Romney claimed that, "Lowering the personal income tax rate from 5.3 percent to 5.0 percent will make Massachusetts more attractive to both employers and employees." This argument suggests that the pain of cuts to education, healthcare, public safety and other vital services should be endured because tax cuts could help our economy. It is important to consider whether this claim is accurate. When tax cuts lead to cuts in public education and higher education, they risk doing lasting damage to our economic future. When tax cuts lead to the Medicaid program underpaying healthcare providers, those providers are forced to shift costs to the private sector which can make Massachusetts a more costly place to do business. The effect of tax cuts is addressed in *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development*, a comprehensive review of hundreds of econometric analyses, business surveys, and representative firm studies on the topic of state and local tax policy and economic development. That study finds that there are "…little grounds to support tax cuts and incentives – especially when they occur at the expense of public investment – as the best means to expand employment and spur growth."[2]

Another recent report by the Center on Budget and Policy Priorities, *Tax Cuts and Consequences*, compared states that cut taxes deeply in the 1990s and those that did not. The study found that during the latest economic downturn, in the aggregate, the six states that cut taxes the most during the late 1990s (including Massachusetts) witnessed larger job losses, slower growth in personal income, and a larger increase in unemployment, than the other 44 states.[3]

| Indicator | Sixteen States with Tax Cuts Greater than 7% of Revenue in the 1990s | Other 34 states |
|---|---|---|
| Jobs lost: Percent change in average annual payroll employment, 2001 to 2003. | -1.5% | -0.5% |
| Unemployment: Change in annual unemployment rate, 2001 to 2003. | 1.4 | 1.0 |
| Personal Income: Change in total state personal income, 2001 to 2003. | 4.4% | 5.8% |
| | **Six States with Tax Cuts Greater Than 10% of Revenue in the 1990s** | **Other 44 states** |
| Jobs lost: Percent change in average annual payroll employment, 2001 to 2003. | -2.3% | -0.6% |
| Unemployment: Change in annual unemployment rate, 2001 to 2003. | 1.8 | 1.0 |
| Personal Income: Change in total state personal income, 2001 to 2003. | 2.8% | 5.7% |
| Sources: Center on Budget and Policy Priorities calculations of data from Bureau of Labor Statistics and Bureau of Economic Analysis. | | |

[2] Lynch, Robert G., *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development*, Economic Policy Institute, March 2004, p. vii.
[3] Zahradnik, Robert, *Tax Cuts and Consequences: The States That Cut Taxes the Most During the 1990s Have Suffered Lately*, Center on Budget and Policy Priorities (Washington, DC), January 12, 2005.