The Economic and Fiscal Effects of a Proposed Millionaires’ Tax in Massachusetts*

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THE BEACON HILL INSTITUTE FOR PUBLIC POLICY RESEARCH
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EXECUTIVE SUMMARY

House Bill 86 (H.B. 86) would amend the Massachusetts constitution by imposing a 4 percent surtax on income over $1 million. If the legislature assents to this amendment (also known as the “millionaire’s tax”), voters will get their chance to vote yes or no on the state ballot in November 2022. As the measure makes its way through the state’s amendment process, several studies have warned of its harmful effects.¹ Missing from these studies, however, has been any attempt to quantify its economic and fiscal effects. This report attempts to fill that vacuum.

Specifically, we find, using our in-house computer model (MA-STAMP) that the effects on the economy will be as follows:

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<td>Real Gross Domestic Product ($ million)</td>
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Table E-1: Economic Effects of a 4percent Millionaires’ Tax

In its first year of implementation, the amendment will cause the state to lose 4,388 working families due to outmigration. This outmigration plus a reduction in labor hiring and labor-force participation will cause a loss of 9,329 jobs. The

best overall measure of the state economy, real (inflation-adjusted) gross
domestic product, will shrink by $431 million according to the STAMP model.

Advocates of the measure claim that it will make possible a $2 billion annual in
state spending. The amendment specifies that this spending will go to education
and roads. Instead, we find that the revenue yield of the tax will be far less, the
result of the expected shrinkage in economic activity. (See Table E-2.) In its first
year of implementation, combined state and local revenues will rise by only
about $1.2 billion.

Table E-2: Fiscal Effects of the Millionaires’ Tax ($, millions)

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<td>Subtotal</td>
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<td>Total State and Local Taxes</td>
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To make a fully informed decision, voters should understand what the tax
changes embedded in the law will mean in terms of costs to the state’s economy.
Below, we explain our findings and take up the question of whether the new
spending promised by advocates is needed or even meaningful.
INTRODUCTION

The Commonwealth of Massachusetts has been prohibited from imposing a graduated income tax since 1915, when the constitution was amended to permit the taxation of income but only at a flat rate. Since 1962, there have been six attempts to amend the constitution to institute a graduated rate – all failing. It now appears, however, that the latest and 7th attempt, filed as House Bill 86 (H.B. 86), may well succeed, this time through a constitutional amendment that would impose a 4 percent surtax on a filer’s income over $1 million. Income less than $1 million would continue to be taxed at the existing 5 percent. The tax on income exceeding $1 million would rise to 9 percent.

Under the current proposal, filed as House Bill 86 (H.B. 86), funds raised by the surtax would go “for quality public education and affordable public colleges and universities, and for the repair and maintenance of roads, bridges and public transportation.”

The amendment was approved in a constitutional convention of the state legislature in June 2019 and will appear on the 2022 ballot if approved by the state legislature for a second time. If approved by the voters in November 2022, the measure will become law in January 2023.

The measure enjoys widespread popular support, matched by an equal volume of criticism directed at the threat it poses to the state economy, particularly through the increased taxation of business profits. The new rate would provide an incentive for households levied with the surtax to leave Massachusetts.
Missing so far, however, has been an accounting of the nature and magnitude of the expected economic harm.

H.B. 86 is the successor to an earlier, similar measure that was advanced as a citizens initiative petition and was slated to appear on the 2018 ballot. This measure failed, however, when the Massachusetts Supreme Judicial Court ruled that it violated a feature of the citizens’ initiative process that requires ballot questions to include only subjects that are “related” or “mutually dependent.”

The inclusion of two unrelated spending provisions – one on schools, the other on transportation – proved to be fatal.

After the failure of the original measure, lawmakers and advocates took a different approach to get the tax passed, this time through the legislature’s amendment process, which insulates the measure from the “relatedness” test. Now Massachusetts is poised to join 32 states with progressive graduated state income tax codes, in which the rate increases for higher earners. Had the measure been in effect in Fiscal Year (FY) 2019, the state’s coffers would have increased between $1.6 billion to $2.4 billion in new revenue.

However, these estimates are “static”: They assume away any effects the tax might have on the state economy. What voters must know, is how the surtax would affect the state economy and then the amount of revenue it would actually yield, given the expected negative effects on the state economy. The discipline of


3 For a description of the STAMP model see https://beaconhill.org/how-stamp-works/
economics shows that income taxes create a wedge between what individual economic agents (i.e., workers and savers) receive as before-tax income and what they get to keep as after-tax income for providing the services of labor and capital. The greater the tax rate, the greater this wedge. The cost to private firms of obtaining the services of economic agents equals the before-tax income that agents must receive to provide their services. The greater the tax, the greater this cost and the smaller the reward received by worker and savers from providing the services of labor and capital.

The proposed surtax would decrease the demand for labor services and the quantity of labor services supplied, the latter through a reduction in labor-force participation and out-migration of high-income workers. It would further increase the cost of obtaining capital services by reducing the after-tax profits that business owners could plan on receiving from their investments in their businesses. This would manifest itself as a decrease in business investment and, concomitantly, a decrease in hiring and wages. These effects would further manifest themselves as a reduction in private sector jobs, in disposable income, and in state gross domestic product.

**ECONOMIC & FISCAL EFFECTS**

BHI used its State Tax Analysis Modeling Program MA-(STAMP) – an economic model that estimates how tax changes affect the state economy -- to determine the economic and fiscal effects of the proposed surtax.⁴ (See Appendix below). The Massachusetts STAMP (MA-STAMP) model is a five-year, dynamic Computable General Equilibrium (CGE) model that simulates the economic and

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⁴ For details, see [https://beaconhill.org/how-stamp-works/](https://beaconhill.org/how-stamp-works/)
fiscal effects of changes in tax law. As such, it provides a mathematical description of the economic relationships among producers, households, governments, and the rest of the world and of how those relationships are affected by changes in state tax policy.\(^5\)

BHI assumes that the proposed tax would be fully implemented beginning in Calendar Year (CY) 2023. Table 1 displays the economic effects.

The first effect reflects how Massachusetts residents would vote with their feet once the amendment was implemented. The number of working households (households with at least one employed person) would fall by 4,388 in 2023 and by 4,431 in 2027. Private sector jobs would fall by 9,329 in 2023 and by 9,045 in 2027. Real (inflation-adjusted) disposable income in Massachusetts would fall by $963 million in 2023 and by $968 million in 2027. The amendment would cause investment to fall by $7 million in 2023 and by $11 million in 2027. Real gross domestic product (GDP) in Massachusetts would fall by $431 million in 2023 and $542 million in 2027.

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Table 1: Economic Effects of a 4percent Millionaires’ Tax

\(^5\) Ibid.
MA-STAMP also calculates the “dynamic” revenue effects of tax changes. These effects are distinct from static effects, which are calculated on the assumption that there is no change in underlying economic activity in response to a change in tax law. One of the principal purposes of STAMP is to capture the effects of tax-law changes, on tax revenues, given the resulting changes in underlying economic activity.

Under the amendment, tax revenue from personal income would increase by $1.233 billion in 2023 and by $1.511 billion in 2027. Sales tax revenues, at the state level, would fall by nearly $1.5 million in 2023 and by nearly $1 million in 2027. Overall, total state taxes would increase by $1.231 billion in 2023 and by $1.510 billion in 2027. Local property tax revenues would fall by $480,000 in 2023 and by $690,000 in 2027. Other local tax revenues would fall by $510,000 in 2023 and by $310,000 in 2027. As a result, total state and local taxes would increase by $1.230 billion in 2023 and by $1.510 billion in 2027.

Table 2: Fiscal Effects of the Millionaires’ Tax ($, millions)

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The Economics Effects of a Massachusetts Millionaire’s Tax
EXPENDITURES

Equally important in understanding the proposed tax hike is the expenditure provisions of the amendment. Will the legislature be faithful to the intent of the law as written? They will not and, for that matter, cannot do anything of the kind.

As noted, advocates for the amendment promise that the revenue derived from the surtax will fund education and transportation. In so promising, however, they attempt to perpetrate a fraud on voters. They want voters to believe that if funding for these purposes from existing sources is $X and if the surtax raises $1.3 billion, then funding of education and roads will rise to $X + $1.3 billion. There is nothing in the amendment, however, that prevents legislators from diverting some of the $X already applied to education and transportation to other purposes and thus undermining the intent of the amendment.

As George R. Crowley and Adam J. Hoffer at George Mason University’s Mercatus Center detail, “Since tax revenues are fungible—or perfectly substitutable for one another—there is no reason to expect that raising an additional dollar of revenue targeted to a specific expenditure category should have any effect other than adding an untargeted dollar to the general fund.” Additionally, when studying whether “earmarked” spending went towards the cause it was aimed for, the researchers found, “(1) the majority of dedicated tax revenues are ineffective at increasing spending on their targeted expenditure category, and (2) the majority of those earmarks that fail to stick are, in fact,

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effective at increasing both spending on other expenditure categories—ones not related to their intended target—and overall government size.”

An important question not adequately answered by the advocates of H.B. 86 is whether Massachusetts needs additional funding in education and transportation. Let’s first consider school spending.

Currently, Massachusetts ranks 7th among states in school spending. The Commonwealth has one of the highest per-pupil spending levels at $17,058. Due to this substantial investment in education as well as underlying factors that foster student success (income, parent’s education level, socioeconomic factors, etc.), Massachusetts ranks third in the nation in standardized test scores. There is no assurance that increased spending would improve this ranking.

Spending more on education is always going to be a politically popular avenue for lawmakers to take and there is good evidence that as Massachusetts has increased education spending, its standardized tests scores and overall educational performance have improved (though there is not necessarily a direct correlation between short-term per-pupil spending increase and performance on standardized testing).

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By any reasonable analysis, Massachusetts is performing exceptionally well at its current rate of education spending. Therefore, taxing millionaires to pay for more education spending, with the resulting harm to the state economy, is unnecessary. Spending is already adequate. In 2019, Massachusetts passed a landmark education reform bill that increases education funding for the next seven years. In addition, the House and Senate Ways and Means committees are likely to secure a $219.6 million increase in Chapter 70 funds for fiscal 2021, bringing the total amount to $5.503 billion for local public schools (targeting spending on lower-income communities). Given the current rate of spending, arguments that the millionaires’ tax would improve education outcomes begin to fade.10

Now, let us turn to the proposal to increase funding for transportation and transportation-related infrastructure. The amendment does not indicate which roads, bridges, or public transportation systems the tax revenue would be used to repair or maintain, apart from a vague reference by its proponents to “[underfunded] transit systems in the state’s working-class gateway cities.”11 Furthermore, many of Massachusetts’ transportation-related issues are due to overspending and the ever-present progressive desire to increase the size and scope of government.

11 Ibid.
We do know, however, that the state spends badly on transportation. According to Reason Foundation’s 25th Annual Highway Report, “Massachusetts’ highway system ranks 47th in the nation in overall cost-effectiveness and condition.” The foundation provides detailed analyses of how states spend their transportation funds and how well they provide infrastructure maintenance.

Baruch Feigenbaum, lead author of the Annual Highway Report and senior managing director of transportation policy at the Reason Foundation writes:

“To improve in the rankings, Massachusetts needs to decrease spending, improve arterial pavement condition, and reduce traffic congestion. The state is in the bottom 15 for all four disbursements metrics and the bottom five for urban arterial pavement condition and traffic congestion. Compared to neighboring states, the report finds Massachusetts’ overall highway performance to be worse than Rhode Island’s (ranks 46th), Connecticut’s (ranks 35th), and Vermont’s (ranks 30th).”

Outside of general repairs and maintenance, the case for higher spending on transportation in Massachusetts is weak.

MASSACHUSETTS TAX REVENUES

Do we need new revenue? In short, the answer is a resounding no. Despite the pandemic and the associated lockdowns, Massachusetts revenues are robust and currently growing at historic levels. For example, through May 14th of FY 2021, Massachusetts collected $27.639 billion in tax revenues, which is $3.945 billion or 16.7 percent higher than year to date in FY 2020. As the full reopening of the state

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13 Ibid.
economy approaches, BHI expects even stronger revenue growth to continue throughout the current and following fiscal year.

CONCLUSION

Households and firms respond to tax changes. It is unrealistic and inconsistent with the evidence to believe that households and firms will not change their behavior if they face higher taxes.

Applying MA-STAMP allows us to see, with some exactitude, how much it would cost the Massachusetts economy in terms of jobs, production, and investment. Moreover, once we take into account those economic losses, we find that the revenue yield would be far less than claimed. Pledges to earmark spending on education and transportation are dubious; there is no guarantee that the revenue yielded by the tax will manifest itself in new spending for the purposes outlined in the amendment.

Voters should take into account these economic effects if they have the opportunity to vote on the matter in November 2022.
APPENDIX: METHODOLOGY

The highest income bracket used to determine the effects generated by the STAMP model is $150,000 and above. The model does not contain a personal income bracket of $1,000,000 or higher. To fit these realities, we adjusted our model accordingly.

First, we used the IRS’s Statistics of Income (SOI) database for Massachusetts to determine the amount of income received by Massachusetts taxpayers earning between $150,000 and $1 million per year. Since the SOI data does not have a bracket at $150,000, we used half of the income in the $100,000 to $200,000 SOI bracket.

Next, we calculated the total income that Massachusetts taxpayers earned above $150,000 and divided this by the total income earned in the $1,000,000 and over bracket. The result is 31 percent of total income equal to $150,000 and above was earned in the $1,000,000 and over bracket.

We applied the 31 percent to the rate increase of 4 percent to get a proportional rate increase of 1.22 percent for the $150,000 and above. We then applied the 1.22 percent to the existing 5.0 percent Massachusetts income tax rate to get a 6.22 percent rate and applied it to the $150,000 and above bracket in the model in CY 2023 – CY 2027. We made no new assumption about future income tax rate reductions. Finally, we directed the new tax revenue to the state education and transportation spending.

William F. Burke is the director of research and David G. Tuerck is president of the Beacon Hill Institute. Both authors acknowledge the valuable assistance of Frank Conte, director of external relations and Nicholas Sammarco, research assistant.
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