Our Vanishing Budgets

Iowa's Response to the Fiscal Crisis in the States

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The Iowa Fiscal Partnership is a joint initiative of the Iowa Policy Project and the Child & Family Policy Center, two nonprofit, nonpartisan Iowa-based organizations that cooperate in analysis of tax policy and budget issues facing Iowans.

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Introduction

A brief but deep recession in 2001 caught almost all states by surprise. A booming economy and rising state revenues in the 1990s had encouraged them to both increase general fund spending and cut taxes substantially. In a more difficult economy, states found new and severe budget problems, widely referred to as a "fiscal crisis in the states."

The Iowa Fiscal Partnership analyzed in detail Iowa's response to that fiscal crisis. Before the recession, Iowa had been slower than most states to expand spending. At the same time, it had been quicker than most to cut taxes and did not assure an adequate investment in its rainy day fund to cover the inevitable downturn of a business cycle. Confronted with deficits each year since 2001, Iowa balanced the budget by cutting services and borrowing from trust funds.

Iowa now is left with a chronic or "structural" deficit. As Iowa looks to the future, its government faces the challenge of restoring services and replenishing borrowed funds at the same time that a changing economy and outdated tax system will further strain the state's finances. This volume of reports explains in detail how Iowa has arrived at a state of chronic budget crisis; analyzes the impact of the resulting state cuts on education, local governments and human services; and finally, offers recommendations to put Iowa back on the road to recovery.

The first chapter, ***Out of Step*****,** shows that Iowa's response to the fiscal crisis differed dramatically from that of most other states. From 2001 to 2004, most states increased taxes or rolled back unsustainable tax cuts to cope with budget deficits. While the average state raised taxes by 4.3 percent, Iowa continued to cut taxes by 2.2 percent. While most states could still afford some minor increases in general fund spending, Iowa was forced to dramatically cut spending by 8 percent. Iowa's response to the fiscal crisis clearly was out of the mainstream.

The second chapter, ***Eroding Support for Education,*** shows that Iowa reduced state funding for education at all levels — at the state universities, at the community colleges, and for primary and secondary education. Real (inflation-adjusted) cuts of over 20 percent to state universities caused tuition and fees to increase 70 percent between 2001 and 2004, making higher education less affordable. Support for community colleges declined by 30 percent, forcing them to increase tuition by over one-third. This raised Iowa's community college tuition rates to among the highest in the country, 39 percent higher than the national average. In effect, Iowa balanced the state budget on the backs of college and university students.

Across-the-board cuts and meager "allowable growth" resulted in real cuts to K-12 education, which is the largest part of the state budget. Moreover, Iowa's ranking slipped in 50-state comparisons of per-pupil spending and average teacher salaries.

The third chapter, ***Holes in the Safety Net,*** describes the impact of Iowa's response to the fiscal crisis on the Department of Human Services (DHS) budget and services. Despite increased demand for human services during a recession, Iowa cut funding or held it steady for DHS programs, and eliminated a number of discretionary programs. While Iowa retained its commitment to Medicaid and kept up with increased health-care costs, the state severely curtailed other services. One-third of all mental health institute beds closed; child welfare funding declined despite a 20 percent increase in confirmed child-abuse cases; and emergency assistance funding was eliminated. The result: Many important aspects of the safety net are substantially weaker, and others (particularly those provided through Medicaid) face severe budget challenges in future years.

The fourth chapter, ***Passing the Buck*****,** shows that city and county governments in Iowa have made tough choices as they struggled to deal with cuts in state support, a stagnant property tax base, and rising health insurance costs for their employees. State support was cut by 42 percent and heath insurance costs increased substantially (78 percent for counties). At the same time, state assessment rules severely limited the capacity of local governments to generate property tax revenue. Local governments had to take drastic measures. The City of Keokuk eliminated nine jobs, Cedar Rapids eliminated 23 jobs, and Des Moines eliminated 140 jobs. Growing numbers of cities and counties also increased fees and property tax rates, turning to special levies when general fund levies were maxed out. Cities and counties also spent down reserve funds that will need to be replenished. Local governments face new challenges if they are to maintain the same level of public services in future years. Clearly, one impact of the state fiscal crisis has been an increase in property taxes.

The fifth chapter, ***A Chronic Crisis*****,** shows that Iowa's actions have deepened the fiscal crisis for two reasons. First, state government borrowed $2 billion from trust funds and one-time revenue sources to finance continuing services. Permanent sources of revenue will be required to sustain services in future years and trust funds will also need to be replenished. Second, the state failed to address the underlying cause of the fiscal crisis — inadequate revenue for meeting ongoing budget needs. Budget deficits will persist until state leaders modernize the tax system to reflect dramatic changes in Iowa's economy. Changes in the economy that demand tax modernization include: the move toward a more service- and information-based economy from a physical goods economy, the broadened boundaries of business, the growth of the internet and e-commerce, the aging of society and growth in retirement income, recent but major trends toward the concentration of wealth and income, the growth in tax expenditures, and federal and other actions that place more responsibilities on state government. Tax reform and modernization, based upon widely recognized tax principles, is needed to provide an adequate and sustainable funding base for essential public services.

Each chapter of this volume is taken from a five-part series from the Iowa Fiscal Partnership (IFP), "Our Vanishing Budgets: Iowa's Response to the Fiscal Crisis in the States." Full reports are available on the IFP website, www.iowafiscal.org <http://www.iowafiscal.org>. The Iowa Fiscal Partnership is a joint initiative of two Iowa-based nonprofit policy analysis organizations, the Child & Family Policy Center in Des Moines and the Iowa Policy Project in Mount Vernon.

Chapter 1.

Out of Step

The State Fiscal Crisis, 2001-2004:

Comparing Responses of Iowa and Other States

By Charles Bruner and Mike Crawford

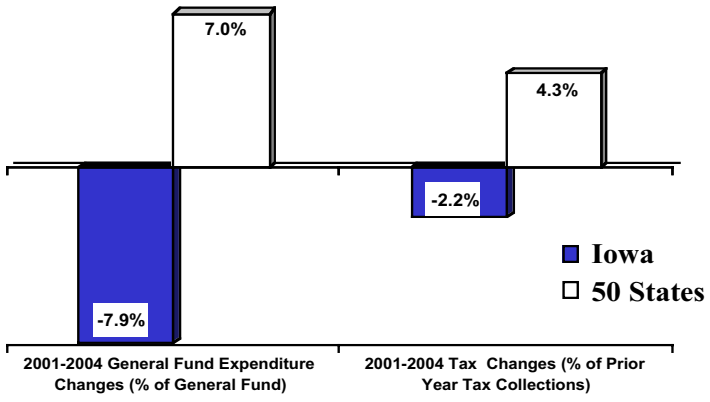
Like most states in the country, the recent economic recession has put severe strains on Iowa's budget and ability to fund services. The last three years (fiscal years 2002 through 2004) have often been referred to as years of "fiscal crisis in the states." After an eight-year economic boom in which states generally were able both to cut taxes and increase general fund spending, the abrupt economic slowdown sharply reduced most states' revenues for the last three fiscal years, requiring major budget adjustments such as:

- cutting spending.
- tapping reserve funds, including rainy day funds, or other non-general funds.
- raising taxes.

This report compares Iowa's response to that of other states, in terms of general fund expenditures, K-12 expenditures, and tax changes. It shows conclusively that Iowa has been at the extremes of state policy, cutting spending more than all but two other states and actually cutting taxes at a time when most states raised taxes. How far Iowa has been out of the mainstream is depicted in Figure 1.1, which shows the percentage change in general fund spending and tax law changes for Iowa and for the 50 states as a whole from 2001 (which we take as the base year) through the fiscal crisis years of 2002-2004.[1]

While Iowa is often perceived as "about average" among states, Figure 1.1 shows that the responses to the state fiscal crisis in terms of tax and expenditure policies in Iowa have been far from the mainstream. For all states in the aggregate, fiscal 2004 general fund spending was 7 percent higher than it had been in 2001, but Iowa actually cut spending almost 8 percent during that period. Similarly, the states as a whole raised taxes 4.3 percent between 2001 and 2004, while Iowa cut taxes 2.2 percent.

Figure 1.1. Iowa Changes in Taxes and Expenditures Compared with Changes in the 50 States, 2001-2004



[1] The National Association of State Budget Officers, in conjunction with the National Governors Association, does an annual report of state general fund and other expenditures for the 50 states. The National Conference of State Legislatures does a similar report on enacted tax policies and their impacts upon state tax collections.

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Since overall 50-state and Iowa data was available for general fund expenditures back to 1995 and for tax changes back to 1996, this report also provides a longer term perspective on Iowa taxing and spending in comparison with other states. Over the longer period, the same differences in taxing and spending remain, with Iowa enacting substantially greater tax cuts over this period while constraining spending substantially more than almost all other states.

State General Fund Expenditure Changes

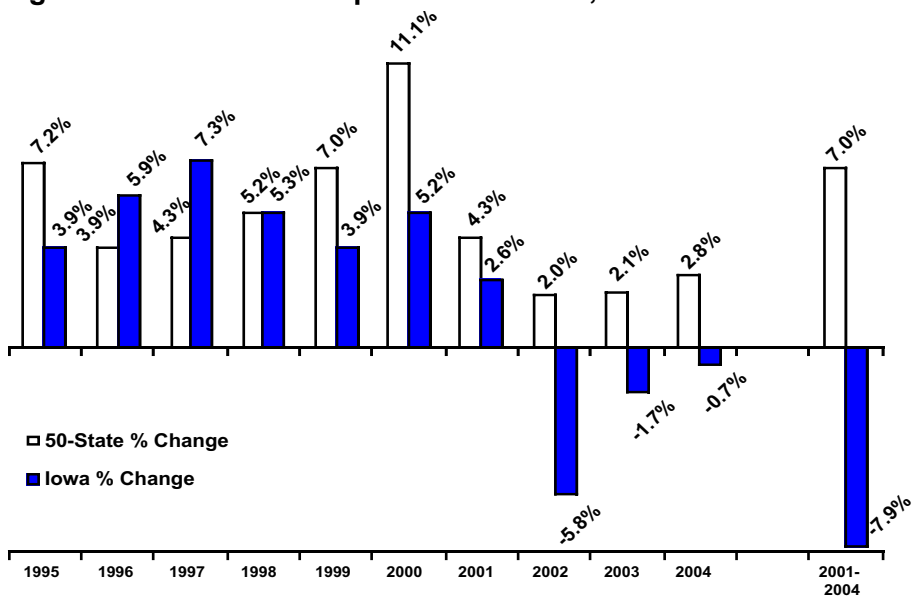
The National Association of State Budget Officers and the National Governors Association produce an annual report on state general fund expenditures.[2] This report is recognized as the best source for comparative state budget information across the 50 states. While different state general funds may include different state expenditures, these data are the best available for comparing state budget responses over time.[3]

Figure 1.2 shows, for both Iowa general fund expenditures and the aggregate of all state government general fund expenditures, the year-to-year percentage changes in spending over the last decade (1995-2004). Iowa's general fund expenditures, like those in states across the country, increased every year between 1995 and 2001. Iowa increased spending by 39.5 percent over this seven-year period, but this amount was much less than the 51.6 percent increase for all states combined. [See full data in Table A-1 in Appendix.]

In fiscal years 2002, 2003 and 2004, however, Iowa's general fund expenditures actually declined each year, while for the 50 states, spending rose over 2 percent each year. If Iowa had been able to keep pace with other states in its overall general fund expenditure growth in the past three years, its 2004 expenditures would have been $730 million greater.

Table A-2 in the Appendix provides state-by-state figures for the period from FY2001-2004. During this period, Iowa was one of

Figure 1.2. Gen. Fund Expenditures: Iowa, All States 1995-2004



Source: National Association of State Budget Officers

[2] The information provided in this section of the report is from annual reports from the National Association of State Budget Officers. All figures except the 2004 figures are actual final reported figures; figures for fiscal 2004 are estimated figures, based upon enacted state budgets, but not on audited state expenditures (which will not be available for a number of months).

[3] States establish different non-general funds in addition to the general fund. In Iowa, for instance, transportation expenditures are largely through the road use tax fund, which is not part of the state general fund. Similarly, the tobacco trust fund, the senior living trust fund, and the rainy day funds all constitute trust funds outside the

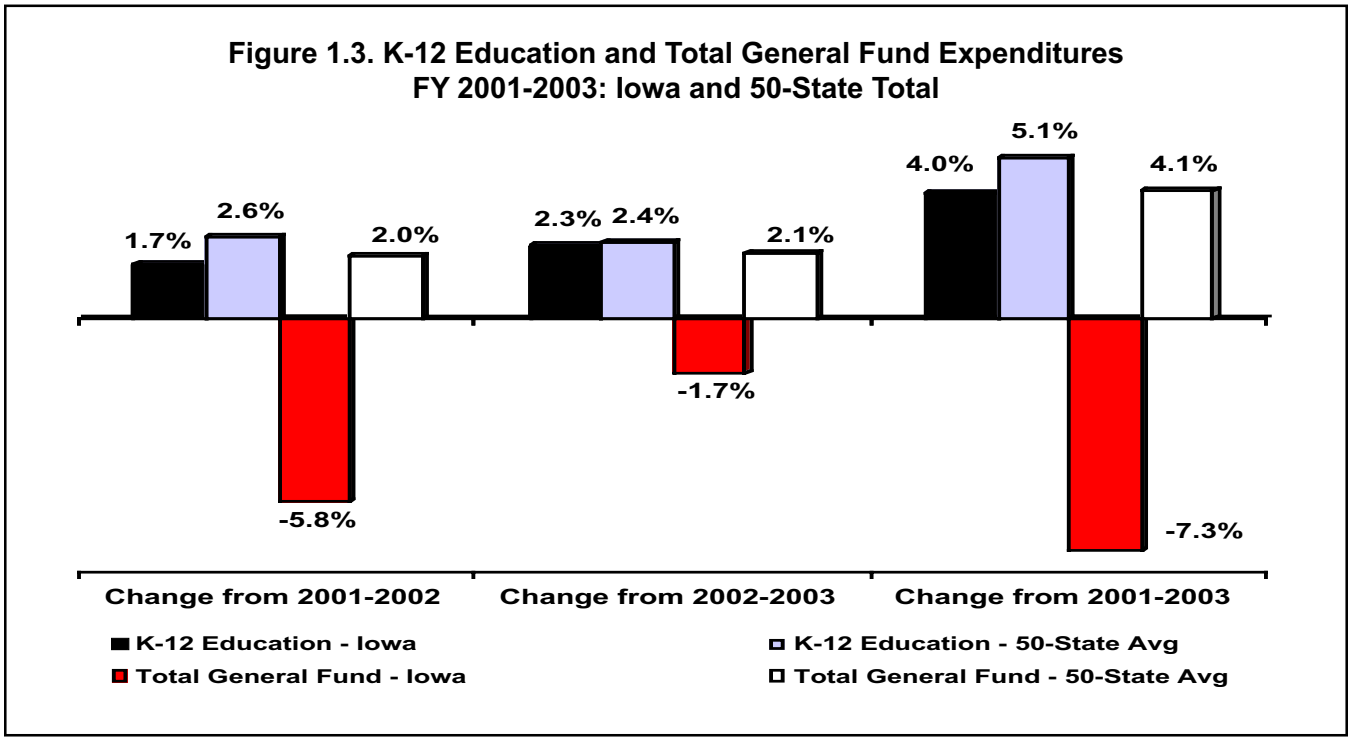
only 10 states with actual reductions in state general fund spending. At 7.9 percent, Iowa's decline was exceeded by only two states, Michigan (10.6 percent) and South Carolina (9.6 percent).

State K-12 Education Expenditures

Expenditures on public primary and secondary (K-12) education constitute the largest single part of most state general fund budgets. Comparative state data also are available on state general fund K-12 expenditures through the National Association of State Budget Officers, but only through FY2003.

Figure 1.3 shows changes in K-12 general fund expenditures over the 2001-2003 period for Iowa and the total of all 50 states. Education expenditures are contrasted with overall general fund expenditures (overall state-by-state data are provided in Table A-3 in the Appendix).

As Figure 1.3 shows, while Iowa's K-12 general fund expenditure growth was lower than that for the country, K-12 expenditures fared significantly better than the general fund expenditures as a whole. Overall, states made generally greater commitments to K-12 education than to



Source: National Association of State Budget Officers

general fund. Some states rely more heavily than Iowa, and some rely less heavily, on non-general funds to support services. This report only addresses general fund expenditures, but these should be largely comparable within a state, over time, unless the state made major changes to its non-general fund expenditures. Further, state general fund expenditures only cover state expenditures, and not federal funds (including funds matching state general fund expenditures under Medicaid or Title IV-e) or local expenditures such as those covered for schools and community colleges to match state aid formulas. Differences in the manner in which states fund education, and K-12 education in particular, mean that state-only general fund comparisons do not necessarily reflect state commitments to K-12 education, although they can generally give a good indication of relative changes in funding commitments over time.

other parts of the budget, but the spread between general fund and K-12 expenditures was most pronounced in Iowa.

While Figure 1.3 shows that Iowa protected K-12 education from reductions in general fund expenditures, Iowa's overall K-12 growth still fell below that of other states. In addition to comparisons by general fund expenditures, the National Education Association reports on state public education programs in terms of per-pupil spending and in terms of average teacher salaries, two measures of public commitment to education.[4] Table 1.1 shows changes over this period both in Iowa's actual per pupil expenditures and average teacher salaries, as well as Iowa's ranking among the 50 states on each.

Table 1.1. Iowa Per Pupil Education Expenditures (based on Fall enrollments) and Average Teacher Salaries, with National Average and Iowa State Rank

	2001-2002	2003-2004
Per Pupil Expenditure		
Iowa	$ 6,819	$ 7,098
National Average	$ 7,548	$ 8,156
Iowa Below Average By	$ 729	$ 1,058
Iowa's Rank Among States	33rd	36th
Average Teacher Salary		
Iowa	$ 38,230	$ 39,432
National Average	$ 44,683	$ 46,826
Iowa Below Average By	$ 6,453	$ 7,394
Iowa's Rank Among States	34th	37th

Source: National Education Association. Rankings of the States and Estimates of School Statistics, 2001-2 and 2003-4

Table 1.1 indicates that, while Iowa has increased its overall per pupil expenditures and salaries have risen, its increases have not kept pace with those in the country as a whole over these "fiscal crisis" years. Iowa remained well below the national average in both categories, and the gap between Iowa spending and the national average spending, and between Iowa salaries and national salaries, actually widened substantially. As a result, Iowa's rank slipped three places on both measures.

State Tax Actions

As stated at the beginning of this report, states have taken a variety of actions to respond to the state fiscal crisis – cutting programs and expenditures, tapping reserve funds and other sources outside the general fund, and making changes in tax and revenue structures.

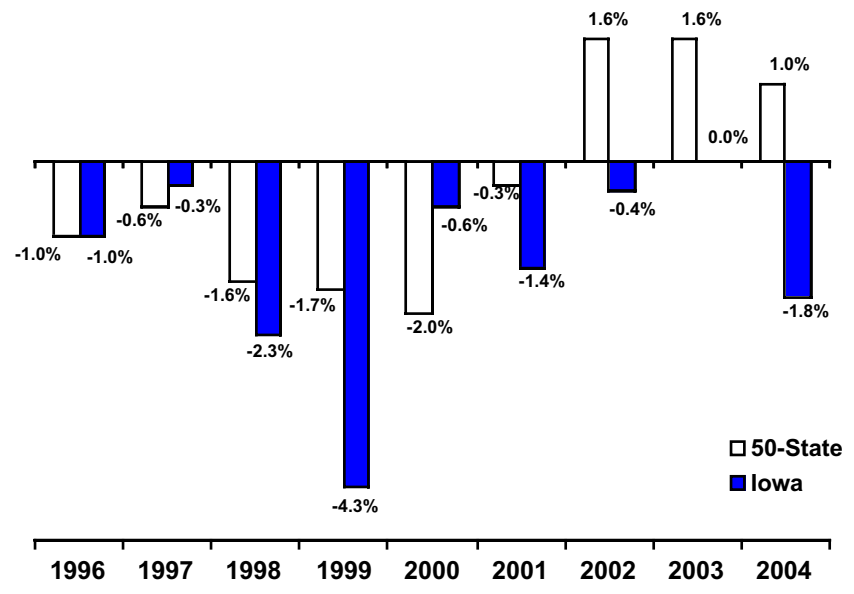
The National Conference of State Legislatures annually provides a special fiscal report on *State Tax Actions* that represents the best source for current information on tax law changes

[4] National Education Association. *Rankings of the States and Estimates of School Statistics, 2001-2002 and 2003-2004*.

by each state. Complete reports are available for tax actions taken in 2002 and 2003, and a preliminary report is available for 2004.[5] Tax actions taken in a particular year generally have their impact in the next fiscal year, with the percentages used by NCSL based upon the prior year's overall tax collections.

Figure 1.4 shows the changes in state taxes as a percentage of overall tax collections for the years 1996 through 2003, for both Iowa and the composite of all 50 states.[6] Both Iowa and other states enacted a substantial number of tax cuts over the period from 1996 through 2001, though Iowa cut taxes to a significantly greater degree than the average state. The cumulative effect of these tax cuts was to reduce tax collections by 8.9 percent for Iowa over this period and by 7.0 percent for states as a whole, compared to what they would have been had there been no change in tax law. Despite the cuts in taxes and tax rates, general fund revenue still grew because of the robust economy. [See Table A-4 in Appendix for complete Iowa information.]

Figure 1.4. Changes in State Taxes as a Percent of Overall Tax Collections 1996-2003, Iowa and 50-State



The figures for 2002 and 2003 (and preliminary figures for 2004) show Iowa at much greater variance with other states, however. Iowa reduced its overall taxes at the same time that states, as a whole, were enacting quite significant tax increases. States raised taxes in these years so as to nearly offset the tax cuts in the earlier period, while Iowa continued to cut taxes. Between 1995 and 2004, the cumulative effect of all tax changes was to reduce taxes by just 2.3 percent across all states, but by 10.9 percent in Iowa.

Table A-5 in the Appendix provides summary data for the 50 states on net tax changes for 2002 and 2003, both in millions of dollars and as a percentage of tax collections. Sixteen states enacted tax increases in 2002 in excess of 1.0 percent of prior tax collections and 19 states enacted such tax increases in 2003. When the tax changes of the two years are combined, 42 states showed overall tax increases, while only four states showed tax declines, with Iowa in the latter category. The majority of states enacted significant tax increases over this

[5] Rabol, M. (January, 2003). *State Tax Actions 2002.* Denver, CO: National Conference of State Legislatures. Rabol, M. (March, 2004). *State Tax Actions 2003.* Denver, CO: National Conference of State Legislatures. National Conference of State Legislatures (July, 2004). *State Budget and Tax Actions 2004: Preliminary Report.*
[6] Iowa data in this instance were not available through the National Conference of State Legislatures for all the years, so was adapted from an Iowa Department of Management report on tax cuts enacted since 1996. Iowa figures are shown in fiscal years, as shown in that report. These data are provided in a table in the Appendix.

period. Nationally, the average increase was 3.2 percent of tax collections. Overall, $17.9 billion in net state tax increases occurred over this period.

While there is only preliminary data on 2004, with reports from 40 of the 50 states, Iowa was identified as the only state with a tax reduction of 1 percent or more, and seven states raised taxes by 1 percent or more.[7] Among the reporting 40 states, over $2.8 billion in revenue was raised by tax increases. Clearly, between 2001 and 2004, Iowa not only failed to raise taxes to address the state fiscal crisis, as the vast majority of states did, but actually stood as one of a very few states reducing taxes over this period.

The National Conference of State Legislatures' reports also show the locus of the tax changes by type of tax. These are shown in Table 1.2, by both total dollar amount and percent of total, for each of the three years (with 2004 still preliminary).

Table 1.2. Net Tax Increases Enacted in the 50 States by Type of Tax

Type of Tax	2002		2003		2004	
	Millions of $	% of Total	Millions of $	% of Total	Millions of $	% of Total
Personal Income	$ 1,603.3	18%	$ 2,720.2	31%	$ 833.1	30%
Corporate Income	$ 2,315.6	25%	$ 958.0	11%	$ 214.0	8%
Sales and Use	$ 969.5	11%	$ 2,715.1	31%	$ 525.8	19%
Health Care	$ 338.7	4%	$ 400.7	5%	$ 487.1	17%
Cigarette/Tobacco	$ 3,018.1	33%	$ 891.3	10%	$ 330.4	12%
Motor Fuel	$ 136.6	2%	$ 338.7	4%	$ -3.0	0%
Alcohol	$ 7.0	0%	$ 35.6	0%	$ 0.0	0%
Other	$ 708.7	8%	$ 702.8	8%	$ 413.2	15%
Total Net Increase	$ 9,097.7	100%	$ 8,762.8	100%	$ 2,800.6	100%

Source: National Conference of State Legislatures

As Table 1.2 shows, states made use of a variety of tax sources to address their fiscal crises. Over the three-year period, increases in state personal income taxes represented the largest source of additional revenue, with cigarette and tobacco taxes next, followed by sales and use and corporate income taxes. States used no single source of tax revenue, nor did states fail to tap any available tax sources.

[7] *Preliminary Report, op.cit.* The seven states raising taxes by more than one percent were: Alabama, Arkansas, Louisiana, Maine, New Jersey, Rhode Island, and Virginia. The ten states not yet reporting were: California, Delaware, Illinois, Massachusetts, Michigan, New York, North Carolina, Ohio, Oklahoma, and Tennessee.

Discussion and Implications

The data presented here clearly show that states experienced fiscal crises in the last three fiscal years and responded by containing overall general fund expenditures and, in most instances, raising taxes. These actions occurred in sharp contrast to the previous seven years, during which states cut taxes significantly and concertedly and still experienced significant general fund revenue growth.

Iowa had already contained its general fund growth more than other states during the period from 1995 through 2001, enacting tax cuts from 1996 to 2001 that were somewhat larger than those in other states in the country as a whole.

Between 2001 and 2004, however, Iowa was at the extreme end among states both in:

- reducing general fund expenditures
- reducing (rather than raising) taxes.

Other states tackled their fiscal crises in an overall different manner and re-examined their tax systems and made tax changes. These involved increases in a variety of tax areas.

The result has been a near decade-long combination of tax cuts and expenditure containment in Iowa that has put Iowa well out of step with other states.

While this report clearly shows that Iowa's actions were out of step with those in other states, it does not go into the specific merits of the actions Iowa took. It does suggest, however, that Iowa has a great deal of room to adjust and raise taxes as a means to respond to state general fund expenditure needs, if those needs represent state services and obligations important to Iowa residents.

Chapter 2.

Eroding Support for Education

Iowa's State Fiscal Crisis and Its Impact on Education

By Jeremy Varner and Elaine Ditsler

A detailed examination of the fiscal situation of state and local government in Iowa appropriately begins with education. Education – the Board of Regents institutions, community colleges and K-12 school districts – accounts for 60 percent of the state general fund budget. Furthermore, public school systems are the single largest local entity in terms of property taxes.

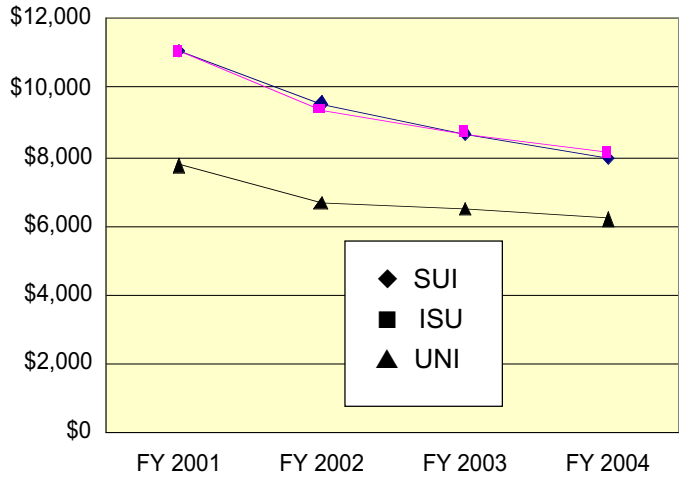
This report examines how the lingering state fiscal crisis has affected the Regent universities (University of Iowa, Iowa State University and University of Northern Iowa), the community college system, and Iowa's K-12 public school districts. We look at the period from fiscal year 2000-01 (FY2001), before the major drop-off in state revenues, through fiscal year 2003-04 and, in some cases, through fiscal 2004-05 budgets. We find that the fiscal crisis has weakened state support at all levels.

The Regent Universities

The Regent universities pay for the lion's share of faculty/staff salaries, benefits, and other core activities out of the general operating fund. More than 90 percent of general operating fund revenue comes from two sources: (1) state general fund appropriations and (2) tuition and fees.

Between FY2001 and FY2004, state funding of the Regent universities declined 14 percent at the University of Iowa (SUI), 16 percent at Iowa State (ISU), and 15 percent at Northern Iowa (UNI). These reductions totaled nearly $94 million (in nominal dollars). In FY2001, state funding accounted for two-thirds of Iowa Regent universities' general operating revenue; by FY2004, this proportion had fallen to just over half. The three public universities have struggled to adjust to fewer funds and to unpredictable revenue streams. Often the cuts in state funding have not only been severe, but have come in the middle of fiscal years, creating a host of problems for university administrators.

Figure 2.1. Per Pupil State Operating Funds at Regents Universities, FY2001-04, Constant Dollars



Source: Iowa State Board of Regents

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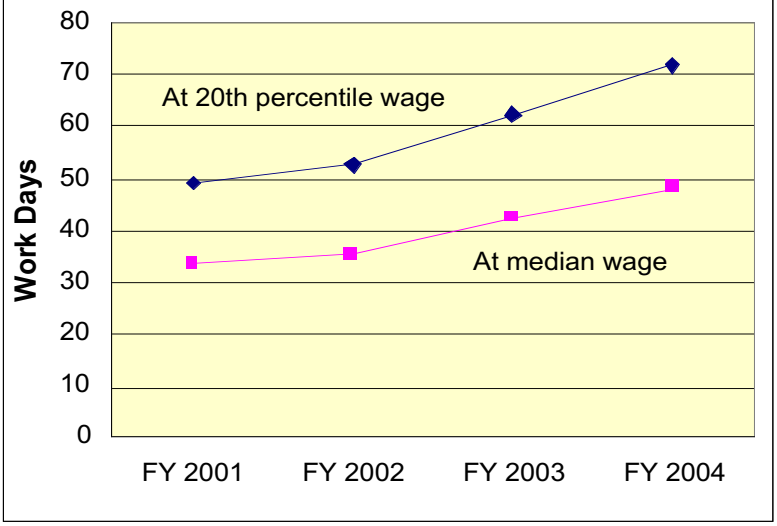
The real impact of these cuts becomes apparent only after adjusting for inflation. The Higher Education Price Index (HEPI) is typically used to adjust for inflation in university expenses. Since 1999, the HEPI has outpaced the Consumer Price Index (CPI) nearly two to one. In 2001 HEPI-adjusted dollars, state appropriations actually declined 22 percent at SUI, 24 percent at ISU, and 23 percent at UNI between FY2001 and FY2004. Per pupil funding declined by about a quarter in just three years as a result of cuts in state appropriations.

Since FY2001, the state has consistently under-funded salary increases, forcing the universities to take funds from elsewhere to pay for those increases. Compounding the problem has been the rapid rise in the cost of fringe benefits, which has consumed much of the institutions' salary funds. In response to funding cuts, the universities have relied increasingly on temporary staff (ISU), part-time staff (UNI), or both (SUI). Student/faculty ratios have risen as well.

To replace state revenue cut from their budgets, the Regent universities raised tuition and fees at unprecedented rates. From FY2001 to FY2005, resident undergraduate tuition at Iowa's Regent universities rose 62 percent, from $2,906 to $4,702. Fees, which vary by institution, rose even more rapidly, with the result that resident tuition and fees together rose 68 percent at SUI, 73 percent at ISU, and 72 percent at UNI in just four years. Non-resident tuition and fees over this same period rose 40 percent at SUI, 52 percent at ISU, and 57 percent at UNI. Tuition and fees rose from 27.9 percent of total operating funds in FY2001 to 41.3 percent in FY2005.

Both resident and nonresident tuition rates at SUI and ISU historically have compared favorably to national and peer group averages. In FY2001, Regent institution tuition and fees were less than 79 percent of the national average. Since then, tuition and fees have risen more rapidly in Iowa than nationally. Resident undergraduate tuition and fees grew to 89 percent of the national average in FY2003. In FY2004, undergraduate tuition and fees at SUI were 85.1 percent of its peer group average for residents and 87.5 percent for non-residents. At ISU, resident tuition and fees were 87.5 percent of its peer group average and nonresident tuition and fees were 85.7 percent of the group average. UNI's tuition rates were even higher – resident undergraduate tuition was 102.7 percent of the peer group average, and nonresident tuition was 91.3 percent of the peer group average.

Figure 2.2. Work Days Needed to Pay Average Tuition and Fees at Regents Universities



Sources: Iowa College Student Aid Commission, Legislative Services Agency, U.S. Bureau of the Census

University officials cite rising tuition as the major reason for the decline in enrollments in recent years, particularly at UNI. A public university education has, indeed, become significantly less affordable in the past four years. Between FY2001 and FY2004, the median wage in Iowa (half

of workers earn less, half earn more) rose just 9.4 percent, while average tuition and fees at the Regent universities rose almost 58 percent. As a result, a person earning the median wage would have had to work 48 days to pay tuition and fees in FY2004, 44 percent longer than in FY2001. By FY2005, it is likely that, for a person with the median annual earnings of about $27,000, the burden of financing a public university education for one of his or her children will have increased over 50 percent in just the four years since FY2001.

State funding for financial assistance has not increased to mitigate problems of college affordability. General fund appropriations for the Iowa College Student Aid Commission (ICSAC) and its grant and scholarship programs have been reduced 10 percent from FY2001 to FY2004 (without adjusting for inflation).

In FY2001, the Iowa Work Study Program was appropriated $2.75 million and served more than 4,000 needy students. In FY2002, funding for this program was eliminated altogether. Other smaller ICSAC grant programs including the Iowa Grant (similar to the Pell Grant) have also been reduced in recent years despite tuition inflation.

While federal financial aid increased FY2001 to FY2005, it has not kept up with rising tuition. In particular, the federal Pell Grant Program, which is critical for low-income students, has not grown fast enough to keep pace with the increasing cost of post-secondary education. The cap on individual Pell Grants increased just 8 percent – from $3,750 to $4,050 – between FY2001 and FY2004. The maximum Pell grant fell from about 120 percent of tuition and fees at Iowa Regent universities in 2001 to about 75 percent in 2004. Similarly, loan limits in the Federal Direct Stafford loan program have not increased during the past 10 years, leading to a greater reliance on alternative loans. As a result of all these factors, the total financial need of all those undergraduates who file the Free Application for Federal Student Aid (FAFSA) that was *not* met by grant aid grew 23 percent from FY2001 to FY2003 at Iowa Regent universities, from $159.1 million to $195.8 million. Average student indebtedness at graduation also rose over that two-year period, by 10.7 percent at SUI, 14.5 percent at ISU, and 11.9 percent at UNI.

In summary, the budget crisis of the past four years has reduced services at Iowa's public universities while drastically increasing its cost. The affordability of a university education has been seriously eroded, as financial aid resources (including tax benefits) have not increased sufficiently to offset the large increases in tuition and fees. Iowa's universities are no longer a good deal for many out-of-state students, reducing nonresident enrollment and cutting into the surplus tuition those students generate.

The Community Colleges

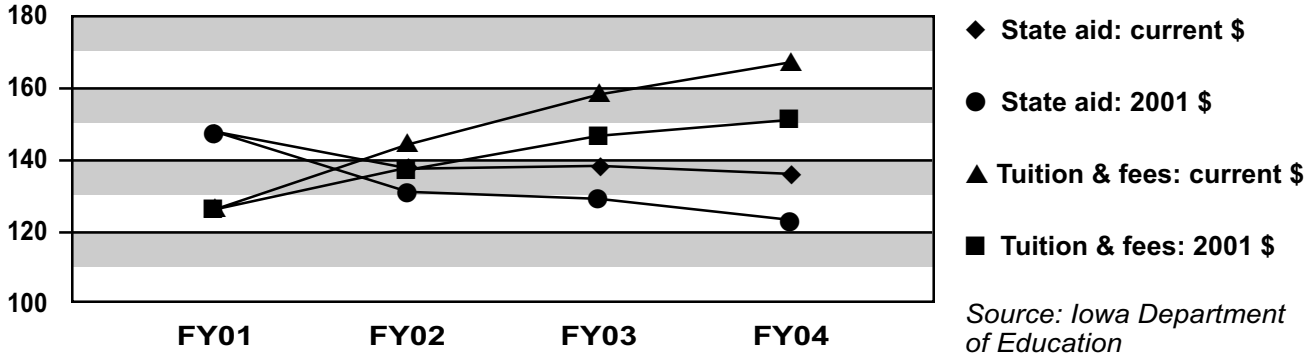
The State of Iowa is divided into 15 multicounty merged areas, each served by a single community college. These two-year comprehensive community colleges each serve from four to 12 counties; enrollment ranges from just over 1,000 full-time students at Northwest Iowa Community College to more than 15 times that number at Kirkwood Community College. The State Board of Education sets standards for the community college system and approves each of the institutions' budgets. The operating budgets of the community colleges are funded through a combination of student tuition and fees, state aid, federal funds, local property taxes, and other income. Together, state funding and tuition and fees account for over 80 percent of community colleges' unrestricted general fund revenue.

In current dollars, state funding was reduced in fiscal years 2002 and 2004, and rose a little in

2003. (For the community colleges, fiscal year 2004 figures are budget figures, adjusted for the state aid cuts; re-estimated figures were not available, and actual figures will be available in late 2004 or early 2005). In FY2004, however, state appropriations were $11.5 million less than they were in 2001. In constant dollars (adjusted using the HEPI), funding was reduced each fiscal year from 2001-2004, leaving state aid in FY2004 $24.6 milion lower (almost a 17 percent reduction) than it was in FY2001. Facing a decline in state revenue coupled with increasing enrollment and limited funding options, community colleges opted to raise tuition to balance their budgets. Tuition and fee revenue exceeded state aid for the first time in FY2002, and the gap has widened ever since. As a proportion of total unrestricted general operating fund revenues, state general aid slipped from 46 percent in FY2001 to 38 percent in FY2004, while tuition and fees rose from 39 percent to 46 percent.

While state and local funding has been falling off, community college enrollments increased 19 percent from FY2001 to FY2004, and are expected to increase again in FY2005. The result has been sharply reduced per-pupil state appropriations. Between FY2001 and FY2004, state funding per pupil sank 30 percent, from $1,909 to $1,342. One of the state's largest community colleges, Des Moines Area Community College, has faced particularly difficult challenges managing rapid growth coupled with reduced revenue from the state. The cuts have been sharp — state general aid is down 8 percent from FY2001 to FY2004. Adjusted for inflation (HEPI), it slipped 17 percent. With enrollment up 19 percent during the same time period, per-pupil state general aid slid 30 percent when adjusted for inflation.

Figure 2.3. Community College State Aid and Tuition, FY2001-04
(Millions of Current and Constant 2001 Dollars)



Source: Iowa Department of Education

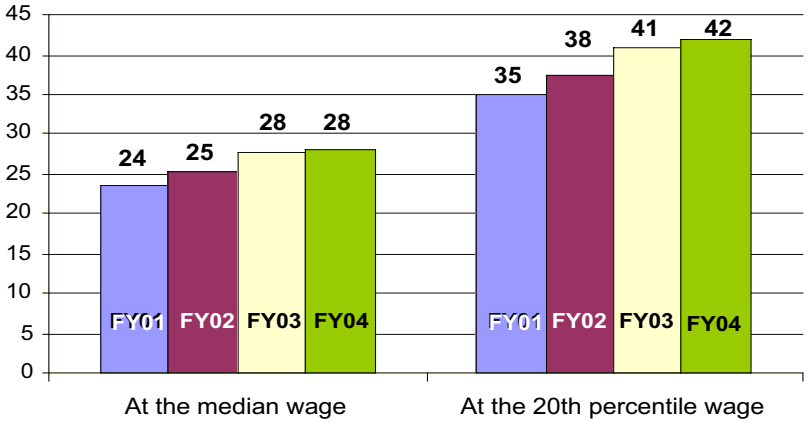
Local support, in the form of property taxes, accounts for just 6 percent of total unrestricted general fund revenue for Iowa's community colleges. Several property tax levies are allowed under Iowa law, some of which require voter approval. The Iowa Code caps the larger levies and significantly restricts the use of the remaining levies. Most of the colleges have exhausted their ability to raise levies or impose new ones. All 15 colleges are at the 20.25-cent limit for the general operating levy. Most of the remaining levies cannot be increased without voter approval. Furthermore, the property tax base has been growing slowly in recent years for all local governments, as the rollback on residential property continues to reduce residential valuation growth.

The average tuition at Iowa community colleges has risen by a third (in current dollars) from $1,937 in FY2001 to $2,571 in FY2004 (and rose again to $2,754 for FY2005). The cost of

attending Iowa's community colleges last year was 39 percent higher than the national average. The College Board reported that the national average resident tuition and fees (based on 30 credit hours, nine month semester) was $2,097 in FY2004. By comparison, Iowa's average tuition and fees were $2,919. A study by the Midwest Higher Education Compact found Iowa's tuition and fees to be third highest in the region (behind Minnesota and Wisconsin), and $875 (43 percent) above the average of 11 Midwestern states ($2,044). The MHEC also found that in 2002, Iowa had a higher proportion of its revenue generated from tuition and fees, and thus a lower proportion from state appropriations, than any adjacent state except South Dakota.

As average tuition and fees at Iowa community colleges climbed 30 percent from FY2001 to FY2004, the median hourly wage for Iowa workers rose only 9.4 percent (to $13.01). An individual at the median hourly wage would need to work about 28 days to pay tuition and fees in FY2004, 19 percent longer than in FY2001. For those with wages in the 20th percentile (20 percent of workers earn less than this wage, 80 percent earn more), wages rose only 8.3 percent, to $8.72. At the 20th percentile, an individual would need to work about 42 days to pay tuition and fees in FY2004, 20 percent longer than in FY2001.

Figure 2.4. Number of Work Days Needed to Pay Average Tuition & Fees at Iowa Community Colleges, FY2001-04



Source: Iowa Department of Education, U.S. Bureau of the Census

Financial aid has not kept pace with rising tuition. Funding for the Vocational Technical Tuition Grant Program, which provides access to vocational programs at community colleges, was $2.48 million in FY2001 but slipped to $2.32 million in FY2004 despite the rapidly increasing cost of tuition. While over 16,000 students with financial need applied for Vocational Technical Tuition Grant help in FY2004, only 2,800 were projected to receive assistance.

Federal Pell Grants, the cornerstone of aid for low-income students, have not risen fast enough to keep pace with the increasing cost of post-secondary education. The average Pell Grant covers only about a third of tuition and commuter room and board at the average public two-year college nationally. While total federal financial aid (including increasingly popular tax credits that disproportionately help those with less need) increased 23 percent between FY2001 and FY2003, it has fallen well short of meeting the rising cost of two-year public education in Iowa.

As a consequence of tuition hikes and insufficient increases in grant assistance, student indebtedness has grown substantially. The number of Stafford loan borrowers at Iowa colleges rose dramatically, from 35,567 to 48,787, between FY2001 and FY2003 – up 37 percent, far ahead of increased enrollment. In 2001, the average indebtedness of graduating community college students was already $4,521. While no later figures are available, community colleges are reporting higher borrowing levels and increased student indebtedness.

From FY2001 to FY2003, community colleges attempted to cut costs by shifting from full-time faculty to adjunct faculty when possible. The number of full time instructional positions fell 2.3 percent during this period, from 2,024 to 1,977, despite rapidly increasing enrollment. Meanwhile, the total number of adjunct instructional positions grew 10.8 percent, from 4,088 to 4,528. Nearly half of part-time instructional positions have been cut. In the aggregate, the number of instructional positions was reduced 6 percent, from 7,416 to 6,985. At Eastern Iowa Community College (EICC), for example, 62 full-time positions have been cut or replaced by part-time or adjunct staff since FY2001. North Iowa Area Community College (NIACC) reduced 33 positions, representing about 12 percent of the college's total faculty and staff. This shift to adjunct faculty and the cuts in positions amounts to a reduction in the level of services provided to students. While no measure of full-time equivalent instructors is available, the number of full time equivalent students per full-time instructional position grew from 32 to nearly 43.

Budget constraints have also impacted academic programming. At EICC, for example, two AA degree programs and one high school program were eliminated between FY2001 and FY2004. DMACC has closed several programs and others have not been expanded and now have waiting lists as long as three years. At NIACC, several programs have been reduced, including partnerships and programs with four high schools, the optometric assistant program, and an electronics program. Additionally, the college has implemented periodic hiring freezes, restricted travel budgets, scrutinized professional development requests, reduced supply orders, decreased security hours, decreased library hours, and discontinued federal depository library services.

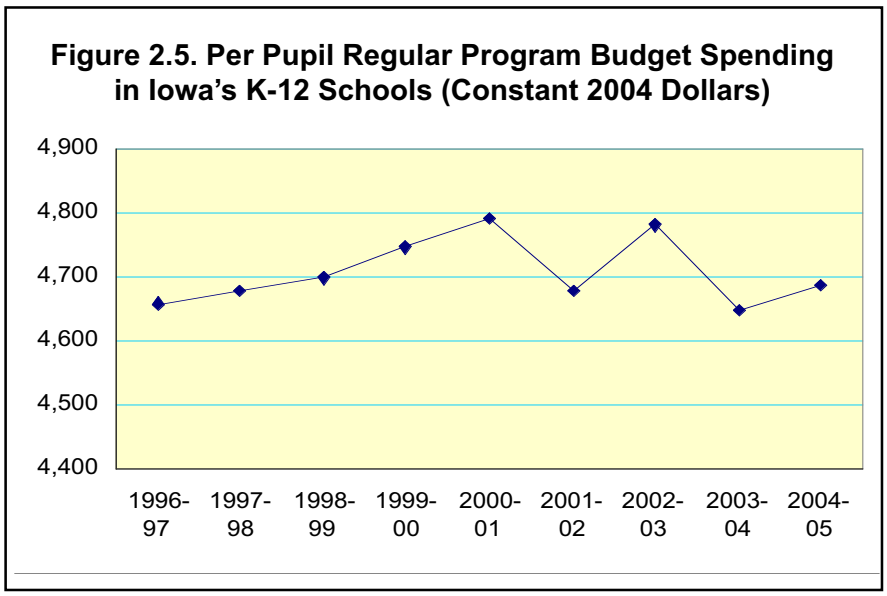
At the same time, salary increases have been held below the rate of inflation. The average base salary rose only about 1 percent from FY2001 to FY2003, from $39,454 to $40,028, while the CPI-U rose approximately 4 percent. The average faculty salary at two-year public colleges in Iowa is 13 percent lower than in other states in the region.

Community college enrollment is growing rapidly, yet state funding has not kept pace. If state appropriations continue to wane and short-term cuts become long-term realities, Iowa's community college students will continue to pay more for less and many may be priced out of the market, at a time when the economy is demanding an increasingly educated workforce.

Iowa's K-12 School System

K-12 education accounts for about 46 percent of Iowa's General Fund budget. Like most states, Iowa relies on a combination of property taxes and state aid to finance elementary and secondary education. The foundation aid formula is the principal mechanism for allocating costs between state aid and property taxes, and for determining the regular program budget for all school districts. The regular program budget must cover the cost of salaries, benefits, utilities, maintenance, school supplies and other purchases that keep the school district operational on a daily basis.

Recent state budget problems have reduced funding to Iowa's K-12 public schools. Between 1996-97 and 2000-01, real spending on regular K-12 programs rose 1.6 percent, or 2.8 percent on a per-pupil basis. In the fiscal crisis years since then, however, spending decreased 4.8 percent, or 2.1 percent on a per-pupil basis. In real (constant) dollars, the state budget crisis has forced per-pupil spending lower than it was in 1998-99.



Source: Iowa Department of Management

Each year, the Legislature determines the amount of allowable per-pupil spending through the "allowable growth" rate. For the 2001-02 school year, legislators set allowable growth at 4 percent. However, a 4.3 percent across-the-board cut in the middle of the school year forced schools to cut spending or to shift $74.1 million to property taxes. For the 2002-03 school year, legislators revised allowable growth downward from 4 percent to 1 percent due to revenue problems. In FY2004, allowable growth was set at 2 percent, but a 2.5 percent across the board cut forced schools to cut spending or to shift $43.6 million to property taxes. In total, schools received about $161 million less than the Legislature originally committed. The state has also faltered on another commitment to the K-12 education. The state is only funding about 11 percent of the Instructional Support Program instead of the 25 percent originally promised.

School districts are also being hit by sluggish or even negative growth in taxable property valuations. This forces schools to raise property tax rates in order to generate the same amount of revenue. Additional sources of financing for schools, such as the Local Option Sales Tax and the Physical Plant and Equipment Levy, are primarily only available for capital expenditures or have other strict limitations.

Some schools have been able to spend more than the amount authorized by allowable growth because of a special provision called the budget guarantee. The budget guarantee allows schools with declining enrollments to maintain the same regular program budget as the previous year by levying additional property taxes. The guarantee was put in place in recognition that schools have costs that do not decline at the same rate as enrollment. The number of school districts utilizing the budget guarantee increased from 68 in FY1996 to 242 in FY2005.[1]

Beginning in the current school year, 2004-05, the budget guarantee is being phased out. As a result, 170 school districts received cuts in regular program funding and 52 school districts received cuts in per pupil regular program funding.[2] With the phaseout of the budget guarantee, all 242 schools lose the funding allotted by the guarantee and will have to cope with smaller budgets. Cost-cutting measures could include whole-grade sharing, increased class sizes, reduced course offerings and decreased instruction time.

[1] State of Iowa, Legislative Services Agency.
[2] Author's calculations based on data from the Iowa Association of School Boards

Iowans value their education system and Iowa students achieve high marks as a result. However, the recent years of state budget problems have taken their toll on K-12 education. Since FY2001, per pupil spending increases have not even kept pace with inflation. The 2003 allowable growth factor was set at the lowest level in history (1 percent), and the across-the-board cuts in 2002 and 2004 cut state aid to schools, which forced schools to cut spending and/or raise property taxes. These cuts were further damaging because they came in the middle of the school year, which did not allow schools to plan for how to absorb the cuts. The allowable growth rate of 2 percent for FY2005 did not make up the ground already lost: Real per-pupil spending is less than it was in FY1999.

The cost of providing a quality, modern and equitable education for each student rises each year. Minimally, legislators must set allowable growth above the rate of inflation. Otherwise, the quality of Iowa's educational system will steadily deteriorate and with it so will the quality of life of all Iowans.

Chapter 3.

Holes in the Safety Net

Iowa's State Fiscal Crisis and Its Impact on Human Services

By Charles Bruner and Victor Elias

Overview

During a recession, the demand for public services increases. More people need public assistance to support their families; fewer people are covered by health insurance through their employer; family stress causes an increase in child abuse and mental health and chemical dependency problems. Most of the state programs and services that address these needs are provided through funding that goes to the Iowa Department of Human Services (DHS).

This report analyzes how both state and overall appropriations for programs under the supervision of the Iowa Department of Human Services changed between state fiscal year 2001 and state fiscal year 2004. Outside of education, the DHS budget is the largest share of the state budget and its appropriations, but state appropriations tell only a part of the story. State general fund appropriations in FY2004 of $707.3 million for the DHS covered only 25 percent of the funding used by the department, with non-general fund expenditures totaling $2.835 billion, primarily from federal funds administered by the department.

Table 3.1 (page 20) shows the changes in general fund appropriations and non-general fund expenditures and authorized FTEs (full-time equivalent workers) for the DHS for fiscal years 2001 and 2004, by major department category (with the exception that state expenditures for child care have been moved from the child and family services section to the economic assistance section).

As Table 3.1 shows, overall general fund appropriations declined dramatically during this period (by 9.7 percent), while non-general fund expenditures rose even more dramatically (by 51.9 percent). Despite increased demand, the department's workforce declined substantially during the period.

Total general fund appropriations and non-general fund expenditures rose by 29.8 percent over the three-year period, which would appear as a healthy overall growth, well above the rate of inflation. This figure is deceptive, however, as it includes substantial new state expenditures established to draw down additional federal funding. As will be discussed later, the major reason for the increase in overall expenditures was the state's Medicaid program.

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Victor Elias *is a senior associate at the CFPC, where his responsibilities include research, budget and policy analysis on various issues.*

Table 3.1. Iowa Department of Human Services
General Fund Appropriations and Non-General Fund Expenditures and FTEs
FY2001 and FY2004, by Major Categories

	Actual 2001	Estimated Net 2004	% Change FY01-04
GENERAL FUND APPROPRIATIONS			
Economic Assistance and Child Care	$ 47,424,192	$ 49,123,135	3.6%
Medical Services	433,610,949	373,711,547	-13.8%
Child and Family Services	128,440,386	114,892,580	-10.6%
Mental Health, Mental Retardation, Developmental Disability, and Brain Injury (MH/MR/DD/BI)	104,631,003	105,222,096	0.6%
Managing and Delivering	68,909,400	64,318,185	-6.7%
Total General Fund Human Services	**$ 783,015,930**	**$ 707,267,543**	**-9.7%**
NON-GENERAL FUND EXPENDITURES			
Economic Assistance and Child Care	$ 142,410,580	150,969,095	6.0%
Medical Services	70,734,333	228,891,521	223.6%
Child and Family Services	29,935,270	34,565,543	15.5%
MH/MR/DD/BI Total	9,692,376	8,108,843	-16.3%
Managing and Delivering Services	18,290,783	19,556,433	-6.9%
Other DHS Federal (Grants and Match)	1,153,395,820	1,713,018,158	48.5%
Total Non-General Fund Human Services	**$ 1,424,459,162**	**$2,155,109,593**	**51.3%**
TOTAL HUMAN SERVICES EXPENDITURES (General and Non-General Funds)			
Economic Assistance and Child Care	$ 189,834,772	$ 200,092,230	5.4%
Medical Services	504,345,282	602,603,068	19.5%
Children and Family Services	158,375,656	149,458,123	-5.6%
MH/MR/DD/BI	114,323,379	113,330,939	-0.9%
Managing and Delivering Services	87,200,183	83,874,618	-3.8%
Other DHS Federal	1,153,395,820	1,713,018,158	48.5%
Total Human Service Expenditures	**$ 2,207,475,092**	**$ 2,862,377,136**	**29.7%**
TOTAL AUTHORIZED FTEs[1]			
Economic Assistance and Child Care	339.00	437.00	28.9%
Medical Services	21.00	21.00	0.0%
Child and Family Services	366.07	349.07	-4.6%
MH/MR/DD/BI	2,420.06	2,367.30	-2.2%
Managing and Delivering Services	2,457.66	2,094.00	-14.80%
Total Human Services Authorized FTEs	**5,603.79**	**5,268.37**	**-6.0%**

[1] These are Iowa Department of Human Services figures, and differ somewhat from those from the Legislative Fiscal Bureau figures. The Department also has provided information on actually funded and filled positions, which are shown in the Appendix. While the authorized figures are somewhat higher than the filled figures, the relationships across the years are consistent across most categories, except for Child and Family Services, which will be discussed later.

Source: Legislative Services Agency, Fiscal Division, unless noted otherwise

Over this period there were significant cutbacks in certain discretionary and often more preventive services, and there were major transfers of funds and uses of time-limited funding sources to meet ongoing program needs. The result has placed strains on most parts of the DHS budget and on the workers and providers who deliver services to those in need.

Summary of Impacts by Department of Human Services Appropriations Areas

The following summarizes what the report found for each of the service areas.

Economic Assistance and Child Care Summary

Over the last three years, while the state's economic position has worsened and Iowans generally have greater needs for economic assistance:

- Overall state general fund expenditures have remained virtually unchanged over the three-year period (although non-general fund expenditures have increased).
- Two state-supported efforts to help families – emergency assistance and individual development accounts – have been eliminated.
- Iowa has not raised its payment benefits under TANF to reflect the impacts of inflation. Additionally, although Iowa has adopted standards for FIP hardship exemptions, a number of TANF recipients have reached their five-year eligibility limits and no longer quality for assistance at all.
- Iowa's child-care subsidy program remains among the least well-funded in the country, with major cliff effects due to the low eligibility limits for participation, and Iowa has done the minimum in meeting its maintenance of efforts requirements for child care.
- A declining share of state funding has been devoted to economically supporting families with children, when child care subsidies and payment benefits are combined, a trend that has continued from 1980 to the present.

Medical Services

Iowa is a major source of medical care for Iowa's children and for the elderly and persons with disabilities and must contend with the same medical cost issues that affect private employers and insurers. Medical services:

- represent the largest and fastest growing part of the DHS overall budget;
- have become the source for medical coverage for a large share of children from Iowa's working families whose health coverage needs are not being met by the private, employer-based health care system, yet are needed to enable those families to work;
- increasingly have been funded by resources that will not be there in the future;
- in some places (dental care and EPSDT services, in particular) do not provide sufficient financial incentives for comprehensive or accessible care; and
- will require significant and ongoing new general fund expenditures if needs are to be met.

Child and Family Services

While Iowa's child welfare system is generally considered to be underfunded and to face challenges in meeting federal expectations related to protecting children and achieving permanency and well-being goals:

- Overall child welfare expenditures declined, even though demand increased;
- Specific elements of the system were cut back, with the decategorization reserve funding eliminated, and the adoption subsidy program subject to new restrictions;
- Support for both purchase-of-service providers and institutions has forced real cuts in services and availability; and
- Federal funding under Title IV-E and particularly under Medicaid, and the flexibility of that funding, remained a major, unresolved issue with the federal government.

Mental Health, Retardation, Developmental Disability, and Behavioral Services

Over the last two decades, the state has taken increasing financial responsibility for financing mental health, retardation, developmental disability, and behavioral services. Between 2001 and 2004, however,

- Mental health services have not received increased funding to reflect inflation nor to address unmet need or increased demand as exists during recessions;
- Mental health institutes have been able to cope with reduced funding only by instituting major reductions in bed capacity;
- Several small and more discretionary services have been eliminated; and
- Services remain fragmented and of variable availability and quality throughout the state.

Managing and Delivering Services

The department needs staff to administer and manage the $2.3 billion budget and its many programs. Generally, demand increased for most DHS programs from 2001 to 2004, but the managing and delivering services component of the Department of Human Services has:

- been dramatically reduced at the general administration level;
- experienced reductions in administrative staff at the local level; and
- not kept pace at the direct field operations level with increases in caseloads, with caseload levels far above recommended levels in child welfare services, in particular.

Conclusion

DHS clients have felt the impact of the state fiscal crisis from 2001 to 2004 as resources have been held constant or reduced while service needs have increased. The resource reductions would be even greater if the figures were expressed in inflation-adjusted terms.

Overall state general fund expenditures have declined, but non-general fund expenditures have increased dramatically, almost exclusively the result of medical services expenditures and largely due to increased federal funding. A good share of this federal funding increase, however, is from time-limited funding sources or is under federal review and challenge.

There has been elimination of a number of small, discretionary services, such as emergency assistance and family assistance, and some cutbacks in others, such as adoption assistance, and a departmental reorganization has very significantly reduced general administration. Decategorization reserves were eliminated in order to address the budget crisis, removing one incentive to more community-based and prevention-focused service delivery. The state's commitment to more prevention-oriented services represents a very small part of the overall department's budget, but it has experienced very real cutbacks.

Most of the Department of Human Services budget is involved in administering services that are supported, at least in part, by federal funding, with attendant federal regulations and requirements with which the state must comply. The state has been successful in leveraging significant additional federal funding, particularly under Medicaid (through RTS services, the Senior Living Trust Fund, and the Hospital Trust Fund), but these have come with restrictions and with challenges. Maintaining the existing funding base, particularly related to intergovernmental transfers (the Senior Living Trust Fund and the Hospital Trust Fund) and RTS, will be a challenge in subsequent years.

While Iowans experienced significant cutbacks in certain services through the 2001 to 2004 fiscal years, and found others to be simply unavailable (such as dental care under Medicaid), the next few years will be critical in determining how much the state will commit to meeting child, family and senior health care and social needs, and how much support can be secured from the federal government to this end. The enhanced federal Medicaid match has expired, and no salary adjustments were built into the department's budget, effectively resulting in future staff cutbacks or other reductions in program.

At the same time that Iowans were affected by the recession and in greater need of the services the Iowa Department of Human Services provides, the state effectively cut back on many of the services being provided. Much repair and restoration work needs to be done if the Iowa Department of Human Services is to meet its mandates over the next several years.

Chapter 4.

Passing the Buck

Iowa's State Fiscal Crisis and Its Impact on Local Government

By Peter S. Fisher, Victor Elias and Jeremy Varner

The State of Iowa has experienced severe revenue shortfalls every year since fiscal 2001, creating budget problems that have impacted Iowa's local governments as well as state government. The capacity of Iowa's 99 counties and 949 towns and cities to provide basic local public services — police and fire protection, parks and recreation, planning and zoning, street and secondary road maintenance, and public health services — has been compromised. Cities and counties have been forced to lay off workers and increase service fees. They have spent down fund balances and increased property tax levies, in many instances to the maximum levy allowed by law.

One of the reasons that local governments have struggled is that the State of Iowa has passed them its own financial problems. The state has cut support for local governments by 42 percent — or $119 million — since FY2001. The financial troubles of cities and counties were compounded by another problem: sluggish growth in the property tax base. Total non-TIF valuation rose just 6.5 percent between FY2001 and FY2005 (1.6 percent per year), while inflation in the cost of state and local government services was 9.4 percent (2.3 percent per year). With a stagnant tax base, rising costs, and reduced revenue from the state, many cities and counties increased property tax rates to maintain services. Between FY2001 and FY2005, the number of counties that had reached or exceeded their general fund levy limit increased from 70 to 97, and the percent of cities at the general fund limit rose from 71 percent to 78 percent. Seventeen counties now exercise their authority to exceed levy limits due to unusual circumstances, while only one county did so in FY2001.

The spiraling cost of heath insurance has increased the cost of doing business for all employers, and local governments are no exception. From FY2001 to FY2004, the cost for county health insurance premiums increased by 78.4 percent. With general fund levies constrained, cities and counties turned to special levies to finance the rapidly increasing cost of health insurance. While other city property tax rates changed very little between FY2001 and FY2005, the average tax rate for employee benefits grew 32 percent. Meanwhile, the number of counties using the general supplemental levy rose from 72 to 92. On average, about three-fourths of the increase in overall city property tax rates is attributable to employee benefit levies.

More cities and counties have adopted local option sales taxes. This has not solved the financial problems facing local governments. Sales tax revenue has grown much more slowly than property taxes over the past four years. The local option sales tax, like the state tax, suffers from an eroding base due to the rising share of untaxed services and the shift to untaxed internet sales.

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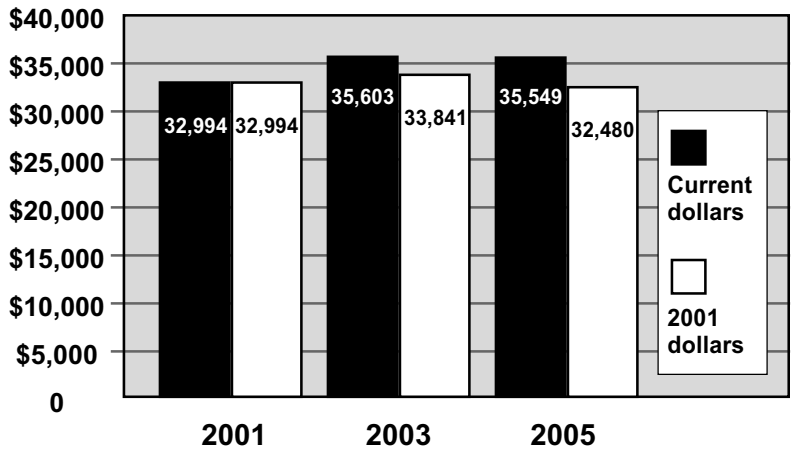
The Property Tax Base

Real property (land and buildings) remains the principal tax base for local governments in Iowa, despite the growth in local option sales taxes. While population and income growth drives increased demands for city and county services, and more revenue is needed to keep up with higher costs, the property tax base has not generally grown proportionately. This is primarily due to the state system of rollbacks, which has had the effect of reducing residential valuation to less than half its market value, and to the system of agricultural valuation (based on productivity rather than market value).

Overall gross taxable valuation in the state increased 8.3 percent between FY2001 and FY2005. Residential taxable value increased 16.4 percent over this period despite the rollback, and commercial and industrial property value grew almost 28 percent. Other classes of property — primarily agricultural land and buildings, and utility property — decreased. The fastest growing component of gross valuation was Tax Increment Financing (TIF) valuation, which grew in part because of the creation and expansion of TIF areas. TIF valuation grew by almost 50 percent over the four-year period (though it still accounted for just 5.7 percent of total value). Much of TIF valuation is dedicated to economic development or rebated to the property owner. Non-TIF valuation, which is a better measure of the tax base available to local governments to fund general city and county services, grew more slowly than total gross valuation — just 1.6 percent per year. The growth in total non-TIF valuation — 6.5 percent for the four years — is well below the rate of inflation as measured by the federal government's index for the cost of state and local government purchases, which increased 9.4 percent over that four-year period.

Combined with the tax rate limits, this slow growth in taxable valuation has clearly constrained the ability of cities and counties to finance services. For tax rates to remain constant while costs rise and population expands, taxable property values must increase enough to maintain a constant valuation per capita, after adjusting for inflation. Real (inflation-adjusted) per capita taxable valuation statewide did increase from FY2001 to FY2003, but has declined each year since, and in FY2005 was 3.6 percent below its 2001 level.

Figure 4.1. Per Capita Property Tax Base, Statewide

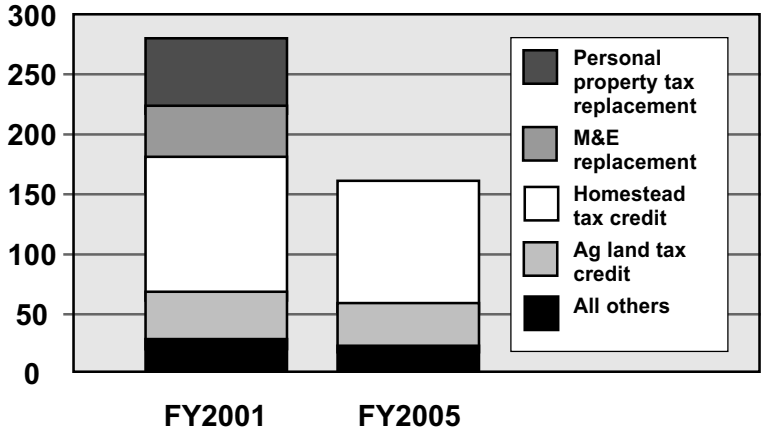


Property Tax Replacement Funds

All local governments, including cities, counties, school districts and community colleges, rely to a significant extent on state property tax replacement funds as a source of revenue. These replacement funds represent state revenue provided to local governments to compensate them for the state eliminating a local source of revenue (such as the property tax on machinery and equipment, livestock, or personal property) or to compensate for state mandated property

tax breaks (homestead credit, military credit, and elderly and disabled credit). In FY2001 these property tax replacement funds accounted for $280 million in revenue to all of Iowa's local governments. By FY2005 these replacement funds from the state had been reduced by 42.4 percent to $161 million, a loss of $119 million in revenues to Iowa's local governments. By FY2005, the only remaining property tax replacement money provided to local governments was to compensate for state-mandated property tax breaks. The state addressed its revenue shortfalls by transferring the problem to local governments.

Figure 4.2. Total Property Tax Replacement Funds to Local Governments ($ millions)



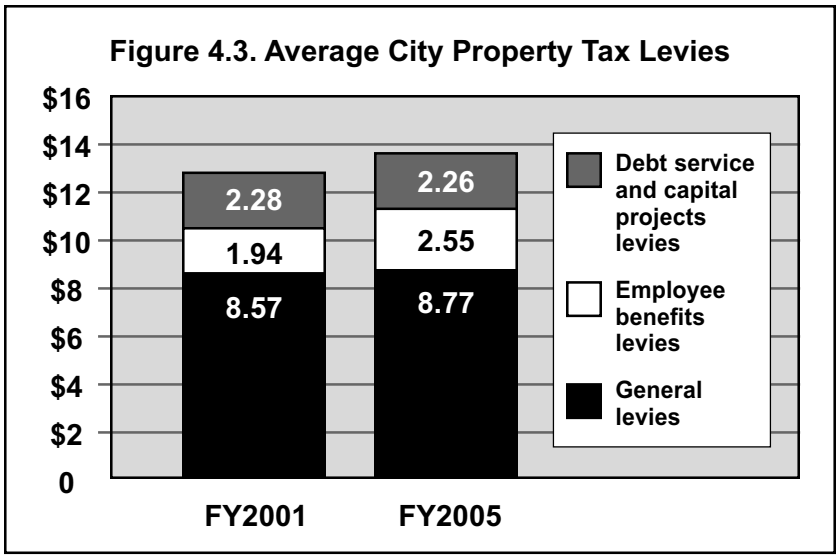
The City of Keokuk was probably the hardest hit by the elimination of machinery and equipment from the property tax base (and now the elimination of the reimbursement), losing over 10 percent of total valuation. This contributed to budget problems that led Keokuk to eliminate 10 full-time positions, or 9 percent of the city's workforce. Among counties, Clinton lost 12 percent of its property tax revenue (second only to Monroe County's 26 percent loss). Scott County lost $3.1 million in state tax replacements between FY03 and FY05, making up for the lost revenue by increasing property taxes $3.2 million.

City Revenues

One measure of the stress that the fiscal crisis has put on city governments is the actions that cities have taken to raise additional revenue. In Iowa, the property tax levy used to support the bulk of services, which are financed out of the city's "general fund," is effectively limited to $8.37 per thousand dollars of assessed valuation (the general fund levy of $8.10 plus the 27-cent emergency levy). In FY2001, 71 percent of Iowa municipalities were at the $8.10 limit, and 23 percent also levied all, or nearly all, of the allowable emergency levy. By FY2005, those proportions had increased; 78 percent of cities are now at the $8.10 limit, and 31 percent use at least 90 percent of the emergency levy.

Most cities have had little room to raise tax rates to offset the declining real per capita tax base, since most have been at the general fund levy limit for some time and many are using the entire emergency levy as well. Still, average property tax rates increased 6.2 percent from FY2001 through FY2005. However, 78 percent of that increase was attributable to the employee benefits levies, which are not subject to limit. These levies fund health insurance coverage and pension fund contributions. The City of Guttenberg, for example, has experienced increases in health insurance costs of 12 percent to 14 percent every year for the past several years, and has had to increase employee contributions, in addition to raising the property tax rate, to pay for these increases. Employee benefit costs have increased in Council Bluffs by 24 percent to 35 percent each of the past four years. Other cities have also passed on part of the cost increase to employees in the past two years: Cedar Rapids and Mason City are two examples.

On average for all cities, the employee benefits levy was raised almost 32 percent over the past four years. General levy rates, in contrast, increased only 2.3 percent over this period.



Despite an increase in the number of cities employing the local option sales tax, budgeted real per capita local option tax revenue increased just 3 percent from 2001 to 2005 for all cities. Among Iowa's 34 largest cities, local option tax revenue actually grew more slowly than the cost of producing services, so that actual real per capita revenues declined from FY2001 to FY2003, and were expected to decline further in the next two years. These trends reflect two factors: (1) the long-term decline in the sales tax base as purchases shift from goods to services (which are less likely to be subject to the sales tax) and as consumers rely more on mail order and internet purchases, on which state sales tax is rarely paid; and (2) the effects of the recession, which reduced consumer spending, particularly on goods subject to the local sales tax.

Intergovernmental aid also fell during the past four years. As a result, cities turned to increases in property tax rates and increases in fees, fines and charges to make up for the lost revenue. In percentage terms, the largest revenue growth was in fees, which increased 41 percent per person from FY2001 to FY2005. The City of Des Moines, for example, raised every one of the nearly 50 fees it charges.

City Expenditures and Fund Balances

In the face of declining revenues and a declining property tax base, cities have generally tried to preserve the most essential public services, such as police and fire protection. Cuts have been concentrated on public works and cultural and recreational programs. Overall, city government spending increased $10 in real per capita terms, a 1.8 percent increase, from 2002 to 2005. Most of this increase is attributable to the $14 increase in per capita spending for public safety, an area that accounts for about a third of city operating budgets. Because of rising costs, particularly of employee benefits, increased spending has often been accompanied by program cuts and elimination of positions, and many cities over this period reduced spending. Cedar Rapids cut over $3 million from its budget in the past two years, and eliminated 22.5 full-time-equivalent positions. Des Moines has eliminated 140 positions since FY2002.

One means of maintaining services as much as possible and minimizing layoffs is to draw down fund balances. This is a one-time source of money and cannot be relied upon for more than two or three years in succession. When and if revenues recover, some of the increased revenue may be needed to restore fund balances as well as restore services. While cities are wary of digging too large a hole for themselves, many in the past two years have decided to deplete fund balances rather than lay off more city employees and cut services further. Council

Bluffs, however, had to spend down its general fund balance from $6.8 million in FY2001 to $4.6 million by the end of FY2003, leaving little flexibility to deal with revenue shortfalls in FY2004. As a result, the city eliminated eight positions that year in the fire and police departments, and cut one of the four ambulances, and then was forced to lay off eight additional workers mid-year when it was hit with $754,000 in cuts in state revenue. The city followed with further cuts in FY05: 12 more positions were eliminated, including eight in public safety.

Of the 34 cities with populations over 10,000, increasing numbers have drawn down fund balances to make up for revenue shortfalls. By FY2004 and FY2005, about three-fourths of these cities had dipped into their fund balances. Twenty-nine had declining general fund balances in FY2004, and the median change during that fiscal year among the 34 was -7.6 percent. Twenty-three of the cities project balances to decline again in FY2005. During this period, the median city among the 34 largest saw its general fund balance at the start of the fiscal year decline from 27.0 percent of fiscal year expenditures in FY2003 to 25.6 percent in FY2004 and a projected 22.7 percent in FY2005.

County Revenues

As is the case with cities, the recent economic recession has impacted the capacity of county governments to meet the needs of their residents. During an economic contraction, there is a continued demand on county services, but not a commensurate growth in property values, which is the primary source of county revenue. As a result, counties have struggled with a mismatch between revenue and services demands over the last few years.

As with city governments, state actions have exacerbated county financial troubles. Cuts in state tax replacements have put pressures on counties to draw upon their reserves or to increase property taxes. From FY2001 to FY2005, state tax replacement payments to counties declined by $38.6 million, or 25.4 percent. With this decline in county revenue, counties were forced to look at their major revenue source, the property tax, in order to meet continued need for county services including public safety, human services, elections and recording mortgage transactions. County property taxes increased by 19.4 percent from FY2001 to FY2005. In FY2001, 29 counties were below their general fund levy limit of $3.50 per $1,000 valuation. Currently only two counties are below that limit. In FY2001, 72 counties used their general supplemental levy. Currently, 92 of Iowa's 99 counties are using that levy. Currently 17 counties are exercising their authority to exceed levy limits due to unusual circumstances, while only one county did so in FY2001.

County Expenditures and Fund Balances

Counties have worked to hold the line on county expenditures as they have dealt with declining state tax replacements and an increasing demand and cost for services. County total expenditures increased by a modest 8.8 percent between FY2001 and FY2005, below the 9.4 percent inflation rate as measured by the index for the costs of state and local government services. Even while trying to hold the line on expenditures, counties still saw an increase in the cost of public safety services, including law enforcement, jails, and criminal prosecution from FY2001 to FY2005. Over this period, county public safety costs increased by 22.9 percent, or $7.6 million. A significant portion of the increase in county cost is the increase in health insurance. From FY2001 to FY2004, the cost for county health insurance premiums increased on average

by 78.4 percent. Winneshiek County saw its health insurance premiums for single coverage rise 240 percent between FY2001 and FY2004.

In an attempt to limit the need for property tax revenue, counties have spent down their balances by $31.7 million, so that in FY2005 those balances are expected to be below 25 percent of county expenditures. Maintaining at least a 25 percent balance to avoid cash flow problems is considered important for good fiscal management, since county expenses occur throughout the year, while property tax revenues come in during the spring and fall.

Conclusion

Both city and county governments faced budget challenges from FY2001 to FY2005 that stemmed from common sources:

- An overall tax base (primarily property taxes) in which growth has not kept pace with the economy or demands upon local governments;
- Rapidly expanding health care costs for employees that represent an increasingly large part of local expenditures; and
- Declines in state property tax replacement funding, as a result of state efforts to deal with the state fiscal crisis.

While different city and county governments acted differently, in general city and county governments acted to maintain essential services, particularly police and fire protection, through:

- Raising property tax levies to the maximum rate allowed and, when necessary, adopting emergency levies;
- Spending down their budget reserves; and
- Raising fines, permit fees and charges for services.

Even with these actions, city and county budgets grew more slowly than the inflation rate, and the result has been some elimination of services and laying off of local government employees. The loss of state property tax replacement funds, totaling over $110 million, produced particular challenges. In many instances, these state actions had the effect of raising local property tax levies.

As cities and counties look into the future, many must replenish their budget reserves and seek sustainable funding bases for local services, with the current property tax base unlikely to be able to fully play that role.

Chapter 5.
A Chronic Crisis

Can Iowa Keep Its Promises?

By Elaine Ditsler, Charles Bruner and Peter S. Fisher

For state legislators, there is no more important responsibility than passing a yearly budget. The budget determines the investments that Iowa will make in education, health care, public safety, infrastructure, the justice system and the workforce, all of which underpin a healthy economy. Iowans are rightly proud of the quality of life in this state, and understand that it depends in no small part on the quality of our public education system, our roads, and other public services. Yet Iowa is now at a crossroads; the state's ability to keep its promises in the coming years will depend crucially on how clearly we recognize the problems we face and take responsibility for solving them.

From 1996 until 2001, Iowa and the entire country experienced an economic boom, which increased personal income and caused state tax collections to swell. During this period, Iowa was quicker than most states to enact tax cuts and slower than most to expand spending. In fact, tax cuts enacted during that time – when fully phased in – will reduce general fund revenue by $700 million annually.

Since the economy routinely cycles between periods of growth and retraction, budget discipline must apply equally to tax cuts and to spending increases. In the late 1990s, legislators enacted unsustainable tax cuts based on temporary surges in revenue. This failure to budget over the full economic cycle is the primary reason for the state's shaky financial situation over the last several years. The tax cuts, combined with Iowa's changing economy and demographics, have resulted in a mismatch between revenues and expenditures, which the recent recession has only amplified.

As this and other reports in this budget series show, Iowa's response to the financial crisis – cutting services, adopting new tax cuts, and raiding special funds – has likely extended the state's financial problems into the future. Few, if any, government services were left unscathed by the budget cuts and the severely curtailed spending deepened the recession by pushing up unemployment. Cuts in state spending caused layoffs in the public sector, in the companies that operate under contracts with the state, and in other companies due to the multiplier effect of more unemployed Iowans with less income to spend. As Nobel Laureate economist Joseph Stiglitz has noted, reductions in state spending during a recession can be more harmful than tax increases. By enacting additional tax cuts *during the recession*, Iowa worsened its own financial position.

Instead of seeking permanent sources of revenue, Iowa turned to finite revenue sources. The Senior Living Trust Fund, the Healthy Iowans Tobacco Trust, the Endowment for Iowa's Health Account and 38 other funds, most of which were intended for vastly different purposes, were raided to shore up general fund budget gaps. These dollars are no longer available for their intended purposes, and many funds – most notably the Senior Living Trust Fund – are precariously close to broke.

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Peter S. Fisher *is research director of the Iowa Policy Project.*

As we look to the future, we face the challenge of replenishing the funds that were raided, at the same time that shifting demographics, a changing economy, and an outdated tax system are likely to put further strains on the state's finances. Iowa's sales tax has not adjusted to the new economy, corporate income tax collections have declined substantially, and we may well face declining federal revenue in the near future. Furthermore, as Iowa's population ages, a greater share of Iowans will be drawing primarily on income from pensions and Social Security, which already is taxed at a substantially lower rate than the same amount of earned income, reducing revenues at the same time that strains on the Medicaid system increase. Seniors account for a large share of total Medicaid expenditures, primarily because of nursing facility costs, and Iowa's population over age 65 is projected to grow 57 percent between 2000 and 2025.

These trends suggest that the state will continue to be hobbled by budget deficits in the future unless Iowa takes corrective action now. In order to meet its responsibilities to all Iowans, the state needs to modernize its tax system by closing tax loopholes, broadening the sales tax base and fixing the personal income tax.

How Iowa Balanced the Budget: FY2001- FY2005

Like a family, state government must live within its means. As with almost all states, the Iowa Constitution prohibits deficit spending. A projected deficit requires that Iowa increase revenues, reduce spending or take other measures before it adopts a budget. The general fund is the primary operating budget for state government. In addition, there are other funds that are typically dedicated for specific purposes. For example, the Road Use Tax Fund collects gasoline tax revenues, which, according to the Iowa Constitution, can only be spent for road construction, maintenance, and related purposes. Other non-general funds, such as the Senior Living Trust Fund, the Rebuild Iowa Infrastructure Fund and the Endowment for Iowa's Health Account were established for specific purposes, but the General Assembly can depart from those original intentions.

Faced with cumulative general fund budget gaps of over $3 billion between fiscal 2001 and 2005, the state cut $1.4 billion in services and made $2 billion in transfers from sources outside of the general fund (see Figure 1).[1] In turn, services that were funded by these other (non-general fund) sources had to be scaled back. In Figure 1, Iowa's fully funded budget for 2001 is based on fiscal 2000 appropriations plus built-in costs for 2001, as estimated by the Legislative Services Agency.[2] Following the same methodology, each year's fully funded budget is estimated based on the previous year's actual appropriations plus built-in costs and an amount sufficient to pay for all of the services that were shifted to non-general funds during the previous year.[3] This method provides a conservative estimate, since it automatically ratchets down the base if there are cuts in the previous year. This is why a "fully funded budget" required fewer dollars in 2004 and 2005.

During this period, the state permanently eliminated some of its responsibilities, including part of the Educational Excellence program and two property tax replacement credits, which cut a com-

[1] About $657 million of the $2 billion were revenue transfers, which are transfers of money from a special fund to the general fund (see Figure A-3 in the Appendix). The rest were expenditure transfers, which are transfers of funding responsibilities (programs and services) from the general fund to special funds (see Figure A-1 in the Appendix).The state also de-appropriated $85.2 million from the general fund for the Endowment for Iowa's Health Account, which is not counted as a transfer but has the same effect as a revenue transfer.
[2] Built-ins are estimated by the Legislative Services Agency. They are a standing appropriation required by the Code of Iowa, an entitlement program, or an appropriation for a future fiscal year that increases or decreases compared to the prior year.
[3] Programs and services shifted to non-general funds are known as expenditure transfers. The authors took care to ensure that some expenditure transfers were not double counted as built-ins.

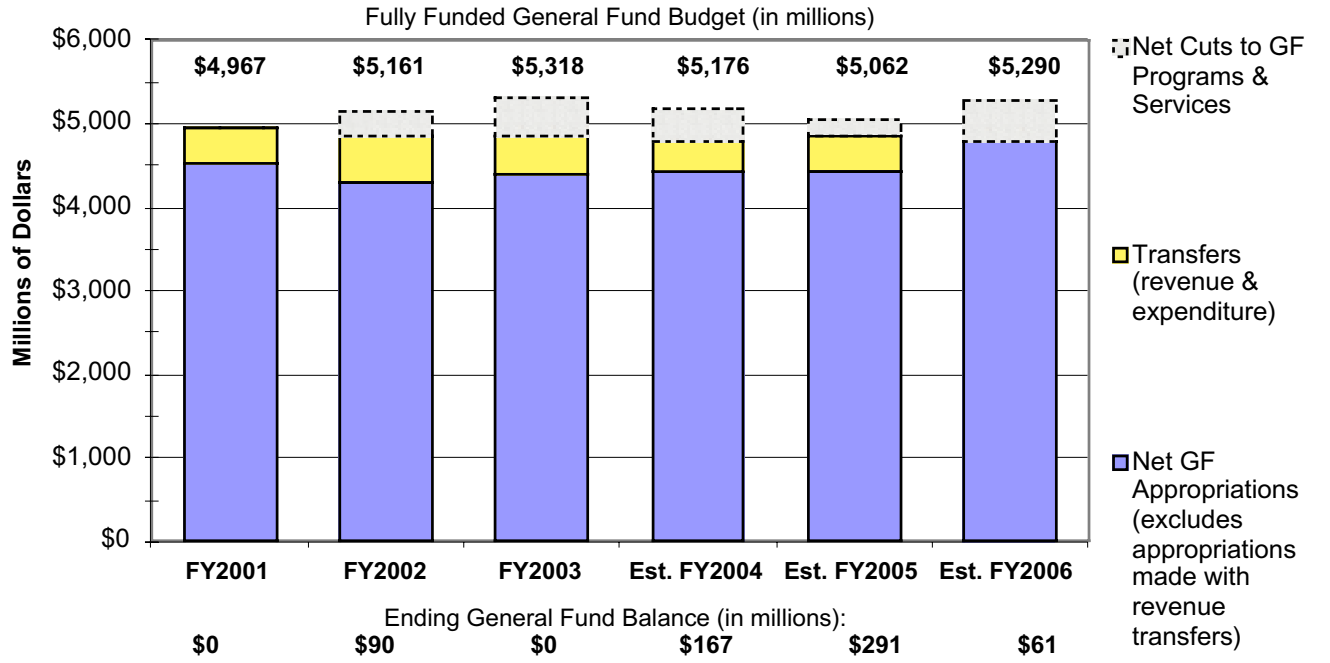
bined total of $119 million from the budget.[4] The number of full-time state workers decreased by 1,585 employees between FY2001 and FY2003, and additional workers were laid off by private contractors and providers due to the state budget crisis.

By 2005, cuts to key programs and services were still not fully restored in such areas as education and child and family services:

- Higher education spending is $124 million short of its 2001 level;
- The state match for the K-12 Instructional Support Program continues to be capped at $14 million, forcing property taxpayers to pick up the balance;
- Over one-third of the state's mental health institutes' beds have been closed;
- The state ended its long-time emergency assistance program;
- Despite a 20 percent increase in child abuse cases, the child welfare budget remained flat.

Furthermore, of the money that was borrowed from special funds (represented by the "transfers" in Figure 5.1), none has been replaced. State law requires that a portion ($118 million) be reimbursed

Figure 5.1. How Iowa Balanced the Budget, FY2001-FY2005 (and a projection for FY2006)



Source: Legislative Services Agency, Fiscal Services Division

Notes: Revenues are based on December 2004 Revenue Estimating Conference projections. A fully funded budget is equal to the previous fiscal year's GF appropriations (before reversions) + net built-in increases + an amount to pay for all of the GF services that were shifted to non-general funds during the previous year. Since a "fully funded budget" is based on the previous year's actual GF appropriation, cuts in one year can reduce the base budget in the next year. School aid and other standing appropriations and entitlement programs are automatically added back as built-ins. However, other cuts, such as the across the board cuts, and cuts to higher education and property tax credits ratchet down the base, and therefore reduce the amount that constitutes a fully funded budget in the next year.

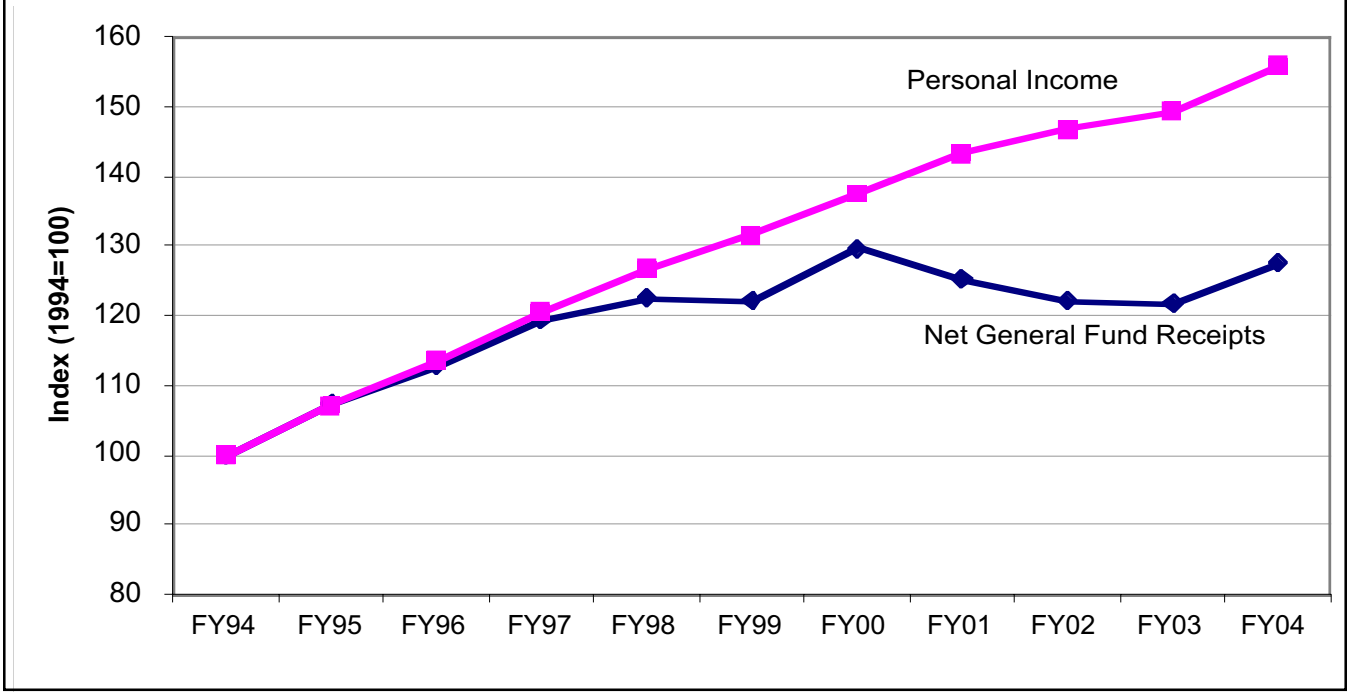
[4] The Machinery & Equipment Property tax credit replacement was permanently eliminated, cutting about $42 million from the budget between 2001 and 2005. The Property Tax Replacement credit was also permanently eliminated- cutting $52 million from the budget between 2001 and 2004.

to the Senior Living Trust Fund and $172 million be reimbursed to the Endowment for Iowa's Health Account. With the state already facing a projected shortfall for 2006, revenues will be insufficient to repay these amounts in 2006.

What Happened to Revenues?

A comparison of personal income growth with revenue growth shows that tax cuts, rather than a weak economy, are the main culprit for the fall-off in revenues in the last several years. Between 1994 and 1997, personal income and general fund receipts grew together. However, since 1997, personal income has continued to climb while general fund revenues declined (see Figure 2).

Figure 5.2. The Divergence of Personal Income Growth and General Fund Revenue Growth



Source: Legislative Services Agency, Fiscal Services Division, State of Iowa; Bureau of Economic Analysis.

Notes: Numbers are indexed to 100 in order to provide relevant units of comparison. General fund receipts are on an accrual basis. In order to make comparisons over time, the FY2001-FY2004 figures do not include revenue transfers into the general fund from non-general fund sources.

After suffering through three of the toughest budget years since the 1980s, revenues have begun to recover slightly. However, revenues are growing from the depressed level they reached in the depths of the fiscal crisis. Despite the moderate turnaround, Iowa still is projected to have a budget shortfall for 2006.

Ideally, the tax system should generate excess revenue during economic boom times, with the excess placed in reserves – a rainy day fund. This fund should be sufficient to sustain government services during a recession. Demand for many government services is actually higher during a recession, due to increased need for so-called "safety net" services. When the tax system does not generate sufficient revenue over the course of the business cycle to maintain public services in good times and bad, a state is said to have a "structural deficit." Iowa's tax system and rainy day

fund did not permit the state to maintain services and local government support during the current prolonged downturn, and they will not do so in the future without reform.

As it stands now, Iowa needs to collect about $514 million more than is currently projected by the Revenue Estimating Conference in order to afford a fully funded budget in FY2006. The state must replenish its two rainy day funds with $292 million and reimburse $290 million to the Senior Living Trust Fund and the Endowment for Iowa's Health Account. Ideally, the state should also, but is not required to, reimburse all special funds for the $2 billion taken since 2001.

The raiding of the Senior Living Trust Fund will be particularly damaging in future years. The Senior Living Trust Fund was established in 2001 and was originally intended as a source of funding to help the elderly to stay in their homes instead of going into nursing facilities. With the fiscal crisis, it has become a popular source of money for programs that previously had been funded by the general fund. Between FY2001 and the end of FY2005, the trust fund will have paid for $490 million in general fund programs, the vast majority of which ($448 million) was for Medicaid. About 88 percent of total trust fund expenditures were spent on Medicaid, while only 3 percent were spent on conversion grants for in-home care (which was the original purpose of the trust fund).

The trust fund was capitalized with deposits from the federal government. However, the federal government is discontinuing these transfers, and the trust fund will no longer receive deposits. As a result, the fund is likely to be depleted by FY2006. Going forward, the important funding that the Senior Living Trust Fund has provided to the Department of Human Services (over $485 million, primarily for Medicaid) and the Department of Elder Affairs (over $31 million between FY2001 and FY2005) will have to be replaced with general fund money.

Outlook and Policy Recommendations

Iowa's response to the state fiscal crisis over the last four years has not addressed the underlying cause of that crisis – the structural deficit that in large measure was the result of large tax cuts enacted from 1995 to 2000 (and exacerbated by further cuts since 2001, despite the recession and budget shortfalls). This structural deficit will worsen, as previously enacted tax cuts continue to be phased in, while service needs and costs continue to rise. Iowa must address this structural deficit and, in doing so, must also recognize that changing demographics and a changing economy require tax modernization. The following is a very broad-brush description of these changes and their implications for tax policy.

1. Changes toward a more service- and information-based economy

The country has moved from a goods-based manufacturing economy to a much more service-based economy. One of the consequences has been that a sales tax based upon goods no longer collects revenue in an amount that reflects consumer spending. Extending the sales tax to a much broader range of consumer purchasing activities is needed to sustain the sales tax as a revenue source that reflects such purchasing.

2. The broadened boundaries for business

In recent years, multi-state businesses have found new and very effective ways of exploiting loopholes in state tax codes. These loopholes allow them to shift taxable income from one state to another to minimize their corporate income tax bill. Moving to combined reporting is one necessary way to ensure that firms conducting business in Iowa are subject to taxation here.

3. The internet and its impact

The growth of the internet as a means for handling commerce has been huge and is expanding. Iowa has taken steps to collect sales taxes on internet sales to Iowans, and this is an important first step. Other forms of commerce, such as telephone service, will also increasingly be handled through the internet. It is critical that states have the authority to tax internet commerce simply for reasons of tax equity, since traditional Main Street retailers must continue to collect the tax from their customers. Failure to do so, moreover, is likely to have significant impacts upon state tax collections.

4. The aging of society and the growth in retirement income

Iowa is continuing to age. In 2000, there were four working-age people (18-64) for every person over 65; by 2020, that figure will decline to fewer than three working-age people. Not only does that put a greater responsibility on those working to support their families, it also places challenges on the state tax system. Those over 65 receive most of their income through Social Security and pension fund benefits. However, this income is taxed at a lower rate than income from work. Iowa law currently exempts from taxes the first $6,000 of pension income ($12,000 if married filing jointly). And because of generous exemptions for Social Security income, over two-thirds of Social Security recipients pay no tax on their benefits, and the remaining recipients pay tax on, at most, 50 percent of their benefits. Tax policies should not exempt more of this income from ever being taxed, at the risk of severely eroding Iowa's income tax base as the population ages. The same holds for a total repeal of the inheritance tax, as, in many inheritances, much of the wealth has never been taxed. Like the situation for the tax on Social Security and pension income, there is a wide misunderstanding of the actual impact of the existing inheritance tax and about who would benefit from repeal.

5. Trends toward the concentration of wealth and income.

Those who have benefited most from economic growth over the last 20 years have been individuals at the very top of the income and wealth scale. Because Iowa's overall state and local tax system is regressive, taking a smaller share of income from those at the top of the scale, most of the income gains have gone to those paying the smallest share of their income in taxes. A flat (proportional) or progressive overall tax system is needed to ensure that state government continues to collect the revenues needed to support basic services. The individual income tax remains the only progressive tax in Iowa's overall tax structure. If the goal is an overall proportional system, the income tax needs to be more progressive in order to compensate for the much larger regressive parts (sales and property) of the tax code.

6. The growth in tax expenditures as a tool for economic development

Particularly when there was strong state revenue growth, the state enacted a number of tax "incentives" marketed as supporting economic growth and development. Unlike appropriations, these tax expenditures are not reviewed annually and do not require re-enactment, nor are they limited in terms of their overall expense to the treasury. Some of the estimates of their cost to the treasury were far below what they eventually cost. Additionally, it has been hard to track their overall costs, let alone determine whether they achieved their economic development justification. The decline in corporate tax revenues is one sign that these tax expenditures have reduced tax collections substantially. These expenditures need to be reviewed on a periodic basis and held up to much greater public scrutiny. They need to be much more transparent than they are currently, with required disclosures of the tax filers who make use of them and the size of their benefits. They should receive at least as much scrutiny as line item expenditures in the state budget.

7. Other trends that will reduce revenues or increase spending needs

- Nationally, the federal deficit is creating new calls to restrict domestic spending and take such actions as block granting Medicaid and Title IV-E (foster care), which is likely to translate into reduced revenues to state governments.
- Federal actions may be taken to restrict state authority to tax – from e-commerce to definitions of taxable connection (nexus) to determinations of taxable income under corporate and individual income taxes.[5]
- The rapid rise in health insurance costs will continue to drive inflation in the cost of state and local government well above increases in the general cost of living and require government to take a larger share of personal income just to maintain services.
- The "sin tax" revenues that Iowa has counted on to balance budgets are not likely to grow with the economy, as tobacco consumption declines and the state reaches the saturation point in gambling revenues.
- The continuing rise in prison populations due to sentencing legislation in the 1990s will continue to drive up corrections expenditures.
- City, county and school budgets will continue to be strained by the urbanization of the population combined with urban sprawl, which leaves rural areas with an aging and expensive infrastructure with excess capacity, while demands for urban services in developing suburbs continue and the fiscal capacity of central cities and older suburbs declines.

It's time for a long-range look at Iowa taxes. The current Iowa tax system requires modernization to reflect dramatic changes in the economy if it is to continue to provide the revenues, in a fair and competitive manner, that state government needs to fulfill its responsibilities. If we do not confront our long-term budgetary problems now, state and local governments will not be able to keep their promises to the citizens of Iowa to maintain the quality of life that they cherish, for themselves and their children.

[5] While Iowa can choose not to couple with federal tax changes regarding deductions and taxable income, this complicates tax filing and is often difficult to achieve politically. Further, it places additional responsibilities on sole state enforcement rather than adherence both to state and IRS regulations and laws.

Appendix

Table A-1
Net Tax Increases Enacted in the 50 States by Type of Tax

	United States		Iowa	
	General Fund Expenditures ($ in millions)	Yearly Change	General Fund Expenditures ($ in millions)	Yearly Change
1994	$322,162		$3,503	
1995	$345,216	7.2%	$3,641	3.9%
1996	$358,664	3.9%	$3,855	5.9%
1997	$374,099	4.3%	$4,138	7.3%
1998	$393,736	5.2%	$4,359	5.3%
1999	$421,470	7.0%	$4,529	3.9%
2000	$468,216	11.1%	$4,763	5.2%
2001	$488,458	4.3%	$4,887	2.6%
2002	$497,997	2.0%	$4,605	-5.8%
2003	$508,450	2.1%	$4,529	-1.7%
2004	$522,492	2.8%	$4,499	-0.7%
Change from 1994 - 2001	51.6%		39.5%	
Change from 2001-2004	7.0%		-7.9%	
Change from 1994-2004	62.2%		28.4%	

Source: National Association of State Budget Officers

Table A-2

General Fund Expenditures in the 50 States, 2001-2005 ($ millions)

	2001 Actual Expenditures	2002 Actual Expenditures	2003 Actual Expenditures	2004 Est. Expenditures	2005 Rec. Expenditures	2001-04 %Change	2001-05 %Change
NEW ENGLAND							
Connecticut	$11,883	$12,187	$12,120	$12,562	$13,154	5.7%	10.7%
Maine	2,571	2,584	2,533	2,556	2,662	-0.6%	3.5%
Massachusetts	22,133	22,800	22,439	21,930	22,979	-0.9%	3.8%
New Hampshire	1,070	1,174	1,336	1,376	1,390	28.6%	29.9%
Rhode Island	2,483	2,650	2,682	2,796	2,899	12.6%	16.8%
Vermont	867	881	888	905	939	4.4%	8.3%
MID-ATLANTIC							
Delaware	2,429	2,454	2,454	2,650	2,785	9.1%	14.7%
Maryland	10,238	10,572	10,347	10,262	11,234	0.2%	9.7%
New Jersey	20,811	21,997	23,568	23,854	25,708	14.6%	23.5%
New York	36,840	38,324	37,613	42,071	41,896	14.2%	13.7%
Pennsylvania	19,862	20,429	20,400	21,462	22,334	8.1%	12.4%
GREAT LAKES							
Illinois	17,961	17,831	21,893	22,766	23,416	26.8%	30.4%
Indiana	10,018	9,708	10,309	11,437	11,357	14.2%	13.4%
Michigan	9,859	9,298	8,735	8,813	8,655	-10.6%	12.2%
Ohio	21,143	21,627	22,653	23,778	24,752	12.5%	17.1%
Wisconsin	11,078	11,259	11,033	10,566	11,563	4.6%	4.4%
PLAINS							
Iowa	4,887	4,605	4,529	4,499	4,759	-7.9%	2.6%
Kansas	4,429	4,466	4,138	4,332	4,615	-2.2%	4.2%
Minnesota	12,755	12,333	13,894	13,966	14,108	9.5%	10.6%
Missouri	6,610	6,626	6,382	6,597	7,097	-0.2%	7.4%
Nebraska	2,479	2,599	2,619	2,603	2,757	5.0%	11.2%
North Dakota	819	862	860	884	920	7.9%	12.3%
South Dakota	793	848	884	934	976	17.8%	23.1%
SOUTHEAST							
Alabama	5,213	5,325	5,473	5,566	5,699	6.8%	9.3%
Arkansas	3,242	3,213	3,251	3,526	3,652	8.8%	12.6%
Florida	19,779	19,044	20,514	21,260	23,785	7.5%	20.3%
Georgia	14,644	15,014	16,025	16,175	16,125	10.5%	10.1%
Kentucky	6,969	7,082	7,179	7,281	7,418	4.5%	6.4%
Louisiana	6,280	6,484	6,617	6,505	6,711	3.6%	6.9%
Mississippi	3,398	3,304	3,458	3,591	3,540	5.7%	4.2%
North Carolina	13,446	13,741	13,856	14,799	15,505	10.1%	15.3%
South Carolina	5,422	5,179	4,995	4,901	4,996	-9.6%	7.9%
Tennessee	7,293	7,779	7,914	8,295	8,955	13.7%	22.8%
Virginia	11,270	11,129	12,118	12,301	13,148	9.1%	16.7%
West Virginia	2,547	2,817	2,933	3,226	3,078	26.7%	20.8%
SOUTHWEST							
Arizona	6,372	6,339	6,026	6,541	7,165	2.7%	12.4%
New Mexico	3,595	3,918	4,051	4,503	4,384	25.3%	21.9%
Oklahoma	4,770	4,882	4,653	4,699	4,716	-1.5%	1.1%
Texas	28,427	29,890	30,656	29,434	29,460	3.5%	3.6%
ROCKY MOUNTAIN							
Colorado	5,641	5,742	5,913	5,662	5,916	0.4%	4.9%
Idaho	1,829	1,980	1,926	1,994	2,084	9.0%	13.9%
Montana	1,268	1,353	1,283	1,290	1,323	1.7%	4.3%
Utah	3,906	3,625	3,536	3,614	3,770	-7.5%	3.5%
Wyoming	368	390	788	788	1,023	114.1%	178.0%
FAR WEST							
Alaska	NA	2,392	2,496	2,301	2,252	-3.8%	*5.9%
California	78,053	76,752	77,482	78,028	76,062	0.0%	2.6%
Hawaii	3,365	3,656	3,806	3,823	4,058	13.6%	20.6%
Nevada	1,691	1,817	2,037	2,320	2,545	37.2%	50.5%
Oregon	4,825	5,822	3,825	5,251	4,945	8.8%	2.5%
Washington	10,827	11,214	11,330	11,219	11,700	3.6%	8.1%
TOTAL	$488,458	$497,997	$508,450	$522,492	$536,970	7.0%	9.9%

* Alaska's Percent Change is from 2002

Source: National Association of State Budget Officers

Table A-3

Actual, Estimated Education Expenditures in the 50 States, 2001-2003 ($ millions)

	2001 Actual Expenditures	2002 Actual Expenditures	2003 Est. Expenditures	2001-03 %Change
NEW ENGLAND				
Connecticut	$2,173	$2,002	$1,994	-8.2%
Maine	954	926	956	0.2%
Massachusetts	3,884	4,155	4,085	5.2%
New Hampshire	883	949	988	11.9%
Rhode Island	670	708	746	11.3%
Vermont	735	784	NA	6.7%
MID-ATLANTIC				
Delaware	1,130	1,202	1,245	10.2%
Maryland	3,026	3,172	3,395	12.2%
New Jersey	6,787	7,234	7,832	15.4%
New York	14,219	15,145	15,626	9.9%
Pennsylvania	6,482	6,714	6,995	7.9%
GREAT LAKES				
Illinois	6,035	6,025	6,397	6.0%
Indiana	4,210	3,891	4,231	0.5%
Michigan	11,297	11,268	11,399	0.9%
Ohio	6,669	7,164	7,378	10.6%
Wisconsin	4,948	5,125	5,359	8.3%
PLAINS				
Iowa	2,048	2,082	2,129	4.0%
Kansas	2,307	2,361	2,363	2.4%
Minnesota	4,382	4,478	5,647	28.9%
Missouri	3,522	3,614	3,699	5.0%
Nebraska	781	866	870	11.4%
North Dakota	313	321	343	9.6%
South Dakota	327	343	342	4.6%
SOUTHEAST				
Alabama	3,155	3,314	3,391	7.5%
Arkansas	1,770	1,790	1,894	7.0%
Florida	7,944	7,654	8,229	3.6%
Georgia	6,034	6,238	6,331	4.9%
Kentucky	2,952	2,990	3,061	3.7%
Louisiana	2,558	2,784	2,865	12.0%
Mississippi	1,756	1,772	1,891	7.7%
North Carolina	5,732	5,880	5,904	3.0%
South Carolina	2,459	2,432	2,505	1.9%
Tennessee	2,557	2,607	2,733	6.9%
Virginia	4,363	4,447	4,399	0.8%
West Virginia	1,448	1,491	1,587	9.6%
SOUTHWEST				
Arizona	2,557	2,955	3,002	17.4%
New Mexico	1,668	1,870	1,821	9.2%
Oklahoma	2,504	2,482	2,431	-2.9%
Texas	13,508	13,166	13,966	3.4%
ROCKY MOUNTAIN				
Colorado	2,278	2,553	2,763	21.3%
Idaho	974	1,005	1,020	4.7%
Montana	515	566	579	12.4%
Utah	1,637	1,735	1,699	3.8%
Wyoming	493	497	501	1.6%
FAR WEST				
Alaska	NA	NA	NA	NA
California	28,548	28,515	27,744	-2.8%
Hawaii	1,310	1,545	1,467	12.0%
Nevada	719	816	883	22.8%
Oregon	2,293	2,737	2,373	3.5%
Washington	4,845	5,077	5,197	7.3%
TOTAL	$194,359	$199,447	$204,255	5.1%

* Vermont's Percent Change is 2001-2002

Source: National Association of State Budget Officers

Table A-4

Iowa Tax Cuts in Millions of Dollars and as a Percentage of Previous Year's Tax Collections Contrasted with Percentage Changes as the Result of Tax Law Changes in the 50 States

	1996	1997	1998	1999	2000	2001	2002	2003	2004
10% Income Tax Cut			$103.0	$102.0					
Insurance Premium									$12.2
Pension Tax	$ 22.2			$ 24.4					
Inheritance/Estate								$15.2	$12.5
Personal Exemption				$ 28.8					
Capital Gains Increase				$ 18.0					
Dependent Credit	$ 16.5								
Health Ins. Deduct		$11.8							
Chapter S				$ 9.8					
Index Brackets	$ 6.0								
Tuition/Textbook				$ 3.8		$ 7.9			
IPERS Pretax			$ 4.4	$ 4.4					
Other *		$ 0.6	$ 1.2	$ 8.0		$ 3.0			
Sales Tax on Utilities						$ 45.0			
Sales Tax Holiday					$ 5.8				
Hospitals Exemption				$ 15.0	$ 15.0	$ 15.0			
Internet Sales					$ 5.8				
M & E			$ 4.0		$ 1.4				
Other **	$ 2.0	$ 0.4	$ 0.5	$ 1.4	$ 0.5				
New Cuts in Year	$ 46.7	$ 12.8	$113.1	$215.6	$ 28.5	$ 70.9		$ 15.2	$ 24.7
Iowa Calculations									
Pvs Year Tax Coll.	$4,193.1	$4,424.2	$4.683.8	$4,894.4	$4,946.0	$5,213.9	$5,315.9	$5,127.3	$5,208.7
Cuts as % Pvs Year	98.9%	99.7%	97.6%	95.6%	99.4%	98.6%	99.6%	100.0%	98.2%
Cumulative % Red.	98.9%	98.6%	96.2%	92.0%	91.5%	90.2%	89.8%	89.8%	88.2%
Reduction 01-04									-2.2 %
50-State Calculations									
Cuts as % Pvs. Year	99.0%	99.4%	98.4%	98.3%	98.0%	99.7%	101.6%	101.6%	101.0%
Cumulative % Red.	99.0%	98.4%	96.8%	95.2%	93.3%	93.0%	94.5%	96.0%	97.0%
Increase 01-04									4.3 %

Notes on Table: The Iowa tax reductions are based upon an Iowa Department of Management report and are used to calculate the percentage tax reductions for the years 1996 through 2001. The gross tax collection data is taken from an Iowa Department of Revenue Report. While the tax changes from the Iowa Department of Management report are shown for 2002-04, the % changes are drawn from the National Conference of State Legislatures' report and are slightly different as to timing. The federal data are taken from the National Conference of State Legislatures' report, with the 2004 data only representing 40 of the 50 states. These figures do not reflect a legislative change that occured after FY2004 in a special session to allow a bonus depreciation for certain business purchases.

Table A-5

State Tax Changes, 2002-2004 ($ millions)

	2002 Actions		2003 Actions		2004 Actions
	Net Tax Change	% of 2001 Taxes	Net Tax Change	% of 2001 Taxes	% State Tax Change
NEW ENGLAND					
Connecticut	$ 73.6	0.7%	$ 613.0	6.8%	No Change
Maine	25.7	1.0%	57.2	2.2%	+ 1 - 5%
Massachusetts	962.0	5.6%	140.0	0.9%	Not Applicable
New Hampshire	0.0	0.0%	- 58.2	- 3.1%	No Change
Rhode Island	30.1	1.3%	37.7	1.8%	+ > 5%
Vermont	39.8	2.6%	42.2	2.8%	No Change
MID-ATLANTIC					
Delaware	0.0	0.0%	119.6	5.5%	Not Applicable
Maryland	93.9	0.9%	52.3	0.5%	No Change
New Jersey	1,073.0	5.6%	452.4	2.5%	+ > 5%
New York	279.8	0.6%	2,979.9	6.9%	Not Applicable
Pennsylvania	729.6	3.2%	747.5	3.4%	No Change
GREAT LAKES					
Illinois	372.0	1.6%	453.0	2.0%	Not Applicable
Indiana	925.1	9.1%	-11.7	-0.1%	No Change
Michigan	231.4	1.0%	17.1	0.1%	Not Applicable
Ohio	404.0	2.1%	1,516.6	7.7%	Not Applicable
Wisconsin	-9.0	-0.1%	3.8	0.0%	No Change
PLAINS					
Iowa	-18.9	-0.4%	1.3	0.0%	- 1% or More
Kansas	270.0	5.4%	6.5	0.1%	No Change
Minnesota	16.2	0.1%	27.2	0.2%	No Change
Missouri	60.0	0.7%	8.6	0.1%	No Change
Nebraska	107.1	3.5%	29.4	1.0%	No Change
North Dakota	0.0	0.0%	1.5	0.1%	No Change
South Dakota	0.0	0.0%	6.4	0.7%	No Change
SOUTHEAST					
Alabama	126.5	2.0%	0.0	0.0%	+ 1 - 5%
Arkansas	0.0	0.0%	120.9	2.4%	+ > 5%
Florida	141.4	0.6%	-51.0	-0.2%	No Change
Georgia	-12.2	-0.1%	122.9	0.9%	No Change
Kentucky	0.0	0.0%	2.6	0.0%	No Change
Louisiana	-3.0	0.0%	0.0	0.0%	+ 1 - 5%
Mississippi	0.0	0.0%	-1.0	0.0%	No Change
North Carolina	129.6	0.8%	81.8	0.5%	Not Applicable
South Carolina	10.0	0.2%	-1.0	0.0%	No Change
Tennessee	755.6	9.7%	0.0	0.0%	Not Applicable
Virginia	1.0	0.0%	10.5	0.1%	+ 1 - 5%
West Virginia	-18.0	-0.5%	99.0	2.8%	No Change
SOUTHWEST					
Arizona	101.4	1.2%	69.7	0.8%	No Change
New Mexico	-5.6	-0.1%	45.3	1.2%	No Change
Oklahoma	101.0	1.6%	68.0	1.1%	Not Applicable
Texas	0.0	0.0%	15.0	0.1%	No Change
ROCKY MOUNTAIN					
Colorado	0.0	0.0%	0.0	0.0%	No Change
Idaho	0.0	0.0%	174.5	7.7%	No Change
Montana	0.0	0.0%	43.1	3.0%	No Change
Utah	11.9	0.3%	19.2	0.5%	No Change
Wyoming	0.0	0.0%	20.0	1.8%	No Change
FAR WEST					
Alaska	2.7	0.2%	0.9	0.1%	No Change
California	1,995.0	2.2%	100.0	0.1%	Not Applicable
Hawaii	-65.1	-1.9%	-16.0	-0.5%	No Change
Nevada	0.0	0.0%	413.0	10.5%	No Change
Oregon	176.0	3.0%	37.0	0.7%	No Change
Washington	-15.9	-0.1%	145.1	1.1%	No Change
TOTAL	$9,097.7	1.6%	$8,762.8	1.6%	0.5%

Source: National Conference of State Legislatures

Reports from the Iowa Fiscal Partnership

The Iowa Fiscal Partnership produced several papers examining Iowa budget policy in recent months. They are available as free downloads from the IFP website, http://www.iowafiscal.org.

- ***Everything You Wanted to Know About Closing Tax Loopholes and Balancing Iowa's Budget … But Were Afraid to Ask.*** 40 pages.

- ***Iowa Voters and Taxes: Strong Public Support for Selective Taxes to Maintain Services.*** 6 pages.

- ***Property Tax Assessment in Iowa: Changes With HF692.*** By Thomas Pogue. 31 pages.

- ***Rethinking Iowa's Personal Income Tax: Tax Reform Based Upon Recognized Tax Principles.*** By Charles Bruner. 10 pages.

- ***Iowa Taxes on Social Security Benefits – The Facts.*** 2 pages.

- ***Whose Bonus? No Rationale for Iowa Adopting Federal Depreciation Options.*** By Charles Bruner and Peter S. Fisher. 2 pages.

- ***Average by Any Measure: State and Local Taxes in Iowa.*** By Peter S. Fisher. 6 pages.

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