

Watch the burden of funding Iowa services

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By Peter Fisher

A slowdown in the economy and concern about state revenues have Iowa legislators pondering the possibility of raising the state sales tax. As this is in keeping with recent actions in Iowa and other states, it should not be surprising. But like those actions, it would represent yet another move to shift the financial burdens of public services away from wealthy Iowans and toward those of lesser or little means.

In “The Rising Regressivity of State Taxes,” from the Center on Budget and Policy Priorities (www.cbpp.org <<http://www.cbpp.org/>>), Nicholas Johnson and Daniel Tenny show how many states over the last business cycle made their tax systems less progressive. When taxes rose to meet budget shortfalls in the economic slump of the early 1990s, low- and moderate-income families bore much of the added burden. Later, when a stronger economy led to tax reductions, states did not reverse the increases of the early 1990s. Instead, states frequently targeted tax cuts to higher-income families.

We have seen this trend as well in the state of Iowa. In the 1990s, Iowa’s economy and personal income grew by more than 50 percent, while the inflation rate was 29 percent. Despite this substantial real growth in the Iowa economy, the state’s population did not share equally. Most of the gains went to the highest income families. In fact, the top 40 percent of income-earners accounted for 80 percent of the gains in income. Lower-income Iowans also benefited from the growth, but not in similar proportions. Average income for the lowest one-fifth grew 12.6 percent, but that represented only 3.2 percent of the total change in Iowa.

During this period of growth, there were two major changes to the Iowa tax structure – an increase in the sales tax in 1992, and a 10-percent income tax cut in 1997. The net effect of these two changes, on average, actually cut taxes only for the top one-fifth of the population. For the rest of the families, the average increase in sales taxes more than offset the average decrease in income taxes paid.

There can be no doubt that the state’s current budget woes are attributable to more than the recession. Tax cuts of the 1990s have left the state with insufficient revenue to meet increasing service needs. Without them, annual deposits to the rainy day fund would have been larger. While some contend it is fiscally irresponsible to use the rainy day fund for ongoing expenditures, recession-induced cost increases are precisely why such funds were created.

As lawmakers strive to make sure the state generates enough to meet its obligations, they could do more to recognize who is able to pay taxes. Iowa could:

- Expand the state earned income tax credit (EITC) and make it refundable. This would help working families with dependents who struggle most to raise their children.
- Pass measures to reduce the regressivity of the sales tax, such as a refundable income-tax credit for sales taxes paid for lower- and middle-income households.
- Provide expanded and refundable personal and dependent credits to better recognize the cost of raising children or caring for dependents.

Before new burdens are added to the backs of Iowa taxpayers, a concerted effort to ensure the progressivity and productivity of the state’s tax system is needed.

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