INSTITUTE BRIEF

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How to Avoid Future Budget Crises (And Give Iowa Taxpayers a Break!)

by David Hogberg and Amy K. Frantz

Public Interest Institute recently released a policy study entitled, "Iowa's State Budget: Fiscal Year 2004 Update." In addition to examining recent budget history and spending trends, the study also explored two methods for controlling state spending.

The first is limiting increases in spending for each fiscal year to growth in inflation and state population. The state of Colorado has had these limits in its State Constitution since the early 1990s. It was one of the few states that did not continuously sweat out its state budget during the recent crisis. In addition to keeping spending at manageable levels, such limits have the added benefits of returning surpluses to the taxpayers in the form of rebate checks. Our analysis demonstrates that if limits for inflation and population growth had been in place since Fiscal Year (FY) 1994, Iowa would have spent over $131 million less than it did this year on its total budget. It also showed that the largest portion of the state budget, the General Fund, would have been in much better shape. In FY 2001, when the budget crisis began, spending on the General Fund was $4.88 billion; this year, FY 2004, it will be $4.47 billion, a spending cut of about $410 million in the last three years. Now consider that if spending limits had been in place, the state only would have spent about $4.3 billion on the General Fund in FY 2001. What this means is that instead of cutting spending, our state could have still increased spending by $170 million in the last three years. In short, our budget crisis would have been virtually non-existent if such spending limits had been in place.[1]

The one drawback to spending limits based on inflation and population growth is that to be effective they need to be inserted into the State Constitution. Such limits are too easy for Legislators to evade if they are simply made part of the state budget statutes. However, amending the State Constitution requires that a proposed amendment be approved twice by both Houses of the State Legislature and then approved by the voters. Those are some big hurdles to overcome.

An easier, yet also effective, change to make is altering the part of the Iowa Code that deals with the state budget. Currently, the Iowa Code mandates a 99% spending limit on the General Fund portion of the state budget. In theory, the Revenue Estimating Conference (REC) meets at the end of each calendar year and estimates how much revenue the state government is likely to collect in the next fiscal year. Once it has estimated the amount, the Iowa Legislature and Governor are required by Chapter 8.54 of the Iowa Code to spend no more than 99% of the estimated amount.

As Table 1 (below) demonstrates, in the good years that limit is exceeded with abandon. In the past eight fiscal years, the 99% limit was exceeded four times. The total amount for those four years is more than $644 million: that's $644 million that should have been sent back to the Iowa taxpayer in the form of rebate checks but was not. The reason the limit is exceeded can be found in the Iowa Code. When

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Iowa runs a surplus — that is, when the state collects more tax revenue than the REC predicted it would — the surplus must be put in the economic emergency fund. Yet, the economic emergency fund may not exceed 10% of the amount spent in the General Fund. The Code reads, "If the amount of moneys in the Iowa economic emergency fund is equal to the maximum balance, moneys in excess of this amount shall be transferred to the general fund."[2] In practice, when the General Fund runs a surplus in one fiscal year, the surplus is then spent the following fiscal year. Thus, the Governor and Legislature for, say, FY 2000 were able to spend the amount of the 99% limit plus whatever surplus was left over from FY 1999.

Table 1: Difference Between General Fund Expenditure and 99% Limit

Fiscal Year	General Fund	99% Limit	Difference
1997	$4,138,941,803	$4,086,423,000.00	$52,518,803.00
1998	$4,359,215,808	$4,375,305,000.00	-$16,089,192.00
1999	$4,529,868,343	$4,374,414,000.00	$155,454,343.00
2000	$4,763,573,422	$4,539,744,000.00	$223,829,422.00
2001	$4,886,870,809	$4,673,740,500.00	$213,130,309.00
2002	$4,607,516,344	$4,938,325,611.12	-$330,809,267.12
2003	$4,530,817,513	$4,697,154,000.00	-$166,336,487.00
2004	$4,479,872,174	$4,480,542,000.00	-$669,826.00

A reform that could remedy this would be to return any surplus to Iowa taxpayers in the form of rebate checks. It would only require that State Legislators change the second clause in the sentence quoted above to "moneys in excess of this amount shall be returned to state income-tax payers." It is a simple change, and one that would hold down spending. If this law had been in place in FY 2001, the state government would have only had to make about $190 million in spending cuts in the last three years, not the $410 million that it ultimately did.

Since this is just a statutory change, and not a Constitutional Amendment, it would not be difficult for politicians to find ways around it. Yet it seems unlikely that they would do so. The popularity of rebate checks would pressure State Legislators and the Governor to send the surplus back to the taxpayers. After all, which Iowa politician would want to face voters after having spent their rebate checks on government programs?

A surplus is what the government overcharges the taxpayer, so changing the statute would be *morally correct* as well. Fiscally responsible and moral: two solid reasons why future surpluses should be sent back to Iowa taxpayers.

ENDNOTES:

[1]To read the full analysis of this, see pages 10-11 of "Iowa's State Budget: Fiscal Year 2004 Update," *Policy Study* No. 03-5. <http://www.limitedgovernment.org/publications/pubs/studies/ps-03-5.pdf>
[2]State Code of Iowa 2001, Chapter 8.55, p.102.

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