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Tax Reform and Priority-Based Budgeting Can Solve Iowa's Economic Problems

By John Hendrickson

Iowa policymakers are facing a problem because revenues are not rising as predicted by the Revenue Estimating Conference (REC). If this continues, the Legislature must fill the budget from the reserves. "We are still a state that's seeing growth in revenue, although it's not as robust as we had projected…We have over $600 million in our economic cash reserves…," stated Governor Kim Reynolds in a press conference.[1] Iowa is in need of economic growth that will not only create more economic opportunities for Iowans, but also bring more stability to state finances. To achieve this goal, Iowa policymakers must enact tax reform and reform state spending by following priority-based budgeting.

Several states across the nation are struggling economically. States such as Illinois, Connecticut, and California are in fiscal turmoil. At this time, Iowa is more economically stable than our neighbors in Illinois, but we are starting to see some warning signs. Iowa's problem is that we are spending too much.

In order to address spending, the Legislature should consider priority-based budgeting. Priority-based budgeting forces Legislators to answer some difficult questions:

- What is the role of government?
- What are the essential services the government must provide to fulfill its purpose?
- How will we know if government is doing a good job?
- What should all of this cost?
- When cuts must be made, how will they be properly prioritized?[2]

The purpose of priority-based budgeting is to "increase efficiency through controlling costs, streamlining activities of agencies, and eliminating waste without tax increases."[3] This means state programs must be reviewed on a regular basis to determine if they are actually achieving results. This is a more responsible way to budget because it brings more accountability to the taxpayers who must finance state government.[4] Jonathan Williams, Chief Economist at American Legislative Exchange Council, wrote:

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> Policymakers should consider adopting the priority-based budgeting model to determine how to provide core government services while rooting out waste and protecting against overspending. This approach was successful on a bipartisan basis in Washington State, saving taxpayers more than $2 billion in the process.[5]

In addition to priority-based budgeting, Iowa policymakers must consider tax reform. The issue of tax reform was sidelined during the 2017 legislative session, but Legislators cannot delay tax reform any longer. Iowa policymakers should not be scared away from tax reform because of the lower than projected revenues. States such as North Carolina, Wisconsin, Florida, and Utah are seeing economic growth because of tax reform.

North Carolina is currently setting an example many state policymakers are following. Policymakers in North Carolina not only faced a budget crisis, they resolved the crisis and enacted major tax reform, as Jonathan Williams explained:

> North Carolina provides us a clear example of the constructive effects of pro-growth tax reform and budget prioritization. Despite being handed a $3 billion budget gap for the 2011-12 fiscal year, North Carolina's General Assembly took great strides in repairing the ailing budget and its structural problems, all while providing substantial tax relief.[6]

The North Carolina tax-reform measure reduced the state's corporate tax rate, abolished the estate tax (16 percent), and created a flat income tax.[7] The corporate tax rate in North Carolina went from 6.9 percent to 4 percent, and it will eventually fall to 3 percent in 2017.[8] In addition, the personal income tax rate was 7.75 percent and is scheduled to be lowered to 5.499 percent in 2017.[9]

Jonathan Williams described the economic impact of North Carolina's tax reform when he stated:

> The state led the nation with 13.4 percent growth in its GDP from 2013 to 2015, and preliminary numbers have it continuing this trend in subsequent quarters.

> Strong domestic in-migration and job growth put North Carolina ahead of every regional competitor and in the top 10 nationwide. Over the last 10 years, North Carolina has attracted more than 500,000 new residents, on net, from the other 49 states, earning economic vitality, social capital, and tax revenue from these new taxpayers. In spite of, or perhaps because of, all this tax relief and budget prioritization, the state has maintained its AAA bond rating, met every revenue requirement, balanced its budgets every year, and as of February 2017, the state reported a $552 million budget surplus. Opportunity thrives in North Carolina, and in no small part due to these reforms. What the future holds looks brighter still, with long-run effects of these reforms putting the state on track to provide nearly $6 billion in total tax relief by 2020. North Carolina serves as a textbook example of what pro-growth tax and budget reform can do for an economy.[10]

John Hood, Chairman of John Locke Foundation, argues that one of the reasons why North Carolina is successful is the fact that the Legislature utilized fiscal prudence in planning their tax reform. As Hood wrote:

> When lawmakers and former Governor Pat McCrory rewrote the state's tax code in 2013, they didn't project that the resulting tax cuts would pay for themselves, or anything close to that. And when they constructed state budgets, they used conservative revenue forecasts and largely eschewed fiscal gimmickry.[11]

Tax reform and fiscal prudence — controlling spending — result in the economic growth North Carolina is experiencing today. Policymakers must remember that tax cuts do not automatically pay for themselves and spending must be controlled in order to avoid budget deficits. Nevertheless, tax cuts do provide a fiscal stimulus and can create additional revenues.

The North Carolina Legislature's spending restraint is making the tax cuts more successful. "Annual growth in North Carolina's General Fund budget has never exceeded the combined rates of inflation and population growth during Republican rule in Raleigh," noted Hood.[12]

"So far this fiscal year, most states are reportedly experiencing some kind of revenue shortfall or budget gap. North Carolina is running a surplus and is currently projecting $2 billion in new General Fund revenue over the next two years," wrote Hood.[13]

Iowa policymakers can learn from North Carolina's example. Priority-based budgeting, along with prudent tax reform, will create an opportunity for Iowa's economy to grow and keep the vital functions of the state government funded. Certainly, policymakers will disagree on what constitutes a priority in state government, but Iowa can either follow in the direction of North Carolina or Illinois.

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Endnotes:

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[5]Jonathan Williams and John Hendrickson, “Make Iowa more competitive through tax reform,” *The Des Moines Register*, April 20, 2017, <http://www.desmoinesregister.com/story/opinion/columnists/2017/04/20/make-iowa-more-competitive-through-tax-reform/305700001/> accessed on June 22, 2017.
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[7]Elliot Young, “North Carolina bears standard for good tax policy,” *American Legislative Exchange Council*, August 4, 2016, <https://www.alec.org/article/north-carolina-bears-standard-for-good-tax-policy/> accessed on January 9, 2017.
[8]Ibid.
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[10]Williams, “United States House of Representatives Committee on Ways and Means Written Testimony.”
[11]John Hood, “Tax cuts are not self-financing,” *Carolina Journal*, May 30, 2017, <https://www.carolinajournal.com/opinion-article/tax-cuts-are-not-self-financing/> accessed on June 22, 2017.
[12]Ibid.
[13]Ibid.