

# IOWA ECONOMIC SCORECARD

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## A Prudent State Budget Requires Responsible Budgeting and No Gimmicks

By John Hendrickson

The state may contract debts to supply casual deficits or failures in revenues, or to meet expenses not otherwise provided for; but the aggregate amount of such debts, direct and contingent, whether contracted by virtue of one or more acts of the General Assembly, or at different periods of time, shall never exceed the sum of two hundred and fifty thousand dollars; and the money arising from the creation of such debts, shall be applied to the purpose for which it was obtained, or to repay the debts so contracted, and to no other purpose whatever.

Article VII, Sec. II., Iowa State Constitution

“What Iowa really needs is a constitutional limit on the state budget. Specifically, the State Constitution should be amended so that the State Legislature cannot spend more than what was spent in the previous year’s budget plus an increase for inflation and state population,” wrote former Public Interest Institute Research Analyst David Hogberg.<sup>1</sup> In addition, Iowa taxpayers would be better served with a more transparent budget process and a Taxpayer’s Bill of Rights measure. With that said, it is also important to remember the prudent idea of balancing the budget, which if neglected, leaves the state with a bad bond rating, and also trickles down to affect the state’s entire economy.

In order to improve the financial health of the State the debt needs to be controlled to its constitutional limits. Currently Iowa has a Double A bond rating (Triple A rating being the best). As of June 30, 2005, the state of Iowa has about \$719.6 million in debt.<sup>2</sup> The “total long-term debt increased by \$216.9 million to \$2,078.3 million” during Fiscal Year 2006.<sup>3</sup> As of June 30, 2006 the Treasurer of State reported a total of outstanding debt as \$9,511,449,398, which is a total of outstanding debt for Cities, Counties, Schools, Area Education

Agencies, Community Colleges, State Authorities, State Agencies, Board of Regents, and Others.<sup>4</sup>

The Iowa Constitution, as noted above, does not allow over \$250, 000 in general obligation debt without the approval of voters. State government debt includes “revenue bonds, certificates of participation (COP), and certain lease purchase agreements entered into by state agencies.”<sup>5</sup> Types of bonds that are issued and contribute to the debt include, but are not limited to, Vision Iowa Bonds, Prison Construction Bonds, and School Infrastructure Bonds, among others, which are used for capital projects.<sup>6</sup> Payment on the “revenue bonds is paid from dedicated revenue sources which would otherwise be available for appropriation by the General Assembly.”<sup>7</sup> In Fiscal Year 2007 the debt service is expected to be about \$76 million.<sup>8</sup>

Even though constitutional requirements exist for the state budget, loopholes can be found. Iowa “statute authorizes the issuance of Tax and Revenue Anticipation Notes (TRANS), provided the total issuance does not exceed the anticipated revenue receipts for the fiscal year and the total issuance mature during the fiscal year.”<sup>9</sup> TRANS allows the State to borrow more money to finance projects. In fiscal year 2006, \$450.0 million was reported in TRANS, while \$375.0 million was reported in fiscal year 2005.<sup>10</sup> During Fiscal Year 2006 the State repaid \$450 million in TRANS.<sup>11</sup>

At the end of the legislative session the Legislature approved a budget of about six billion, which is about a ten percent spending increase and will most likely increase to twelve percent with built-in spending within

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the budget. Recently, State Auditor David Vaudt completed a full analysis of the Fiscal Year 2008 budget which shows a \$300 million gap. Such a gap could turn Iowa's currently healthy budget into a budget crisis situation. If the economy slows, the extra spending will have to be accounted for by either cutting programs or increasing taxes.

To bring greater prudence back to the budget, Vaudt recommends several budget reform measures, suggesting the state "align revenues and expenditures in same fiscal year, eliminate reliance on one-time and limited-time resources for on-going expenditures, incorporate a longer-range focus into the budgeting process, and implement a real spending limitation — 99% or 98%."<sup>12</sup> In addition, revenue shifting should be avoided, and budgets should not depend on unpredictable tobacco taxes.

Chris Edwards, Director of Tax Policy Studies at the CATO institute, wrote that state and local debt has "soared from \$1.19 trillion in 2000 to \$1.85 trillion by 2005, an increase of 55 percent."<sup>13</sup> Overall, "2007 has been a year of stable financial conditions for the states."<sup>14</sup> The current outlook may be economically good, but a slowing economy or shorter than expected revenue growth can create some budget hardships. Currently, Iowa's revenue is increasing more slowly than expected, at about 5.4% instead of the predicted growth rate of 5.9%. In addition, the tobacco tax revenue has not been as strong as expected.

In his press release on the 2008 General Fund Budget, Vaudt stated, "The increased spending of more than \$550 million, or approximately 10% , in Fiscal Year 2008 compared to Fiscal Year 2007, substantially exceeds Iowa's most recent historical three-year average revenue growth of \$336 million. Even when the additional cigarette and tobacco tax revenues are included, spending growth significantly outpaces the anticipated revenue increase."<sup>15</sup> States, including Iowa, will have to make some difficult budget and policy decisions in the near future, especially in the field of healthcare and entitlement programs such as Medicaid.

State rainy-day funds may provide some short-term cushion, but as Vaudt stated, "longer-term planning and a longer-term mindset are critical to Iowa's sound financial future."<sup>16</sup> Reforming the State budget

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should consist of adapting the Auditor's budget recommendations and implementing a transparent budget process, which would represent prudent budgeting.<sup>17</sup>

(Endnotes)

<sup>1</sup>David Hogberg, "Iowa's Budget Needs Constitutional Spending Limits," INSTITUTE BRIEF, Volume 11, No. 32, November 2004.

<sup>2</sup>2006 Iowa FactBook, Legislative Services Agency: Fiscal Services Division, January 2007, p. 29.

<sup>3</sup>"Financial Section," Office of Auditor of State, December 20, 2006, p. 4.

<sup>4</sup>Treasurer of State, "Outstanding Obligation Disclosure Report," Treasurer of State, <<http://www.treasurer.state.ia.us/finance/outstanding.cfm>> (May 18, 2007).

<sup>5</sup>"State of Iowa Net-Tax-Supported Debt," Report to the Legislative Fiscal Committee, Legislative Services Agency, December 8, 2004, p. 2.

<sup>6</sup>Ibid., pp. 3-4.

<sup>7</sup>Iowa FactBook, p. 29.

<sup>8</sup>"State of Iowa Net-Tax-Supported Debt," p. 4.

<sup>9</sup>Fiscal Facts 2006, Legislative Services Agency: Fiscal Services Division, May 2006, p. 43.

<sup>10</sup>Ibid.

<sup>11</sup>"Financial Section."

<sup>12</sup>David A. Vaudt, "Budgeting—Iowa's Future," Office of Auditor of State, January 2007.

<sup>13</sup>Chris Edwards, State and Local Government Debt is Soaring, Tax & Budget Bulletin, No. 37, July 2006.

<sup>14</sup>The Fiscal Survey of States, National Governors Association and National Association of State Budget Officers, June 2007, p. vii.

<sup>15</sup>David Vaudt, "State Auditor Vaudt Reviews Fiscal Year 2008 General Fund Budget," Press Release, Office of Auditor of State, June 6, 2007.

<sup>16</sup>Ibid.

<sup>17</sup>For more information see "Transparency in State Spending Encourages Limited Government" in the July 2007 edition of Iowa Economic Scorecard.

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**Iowa's Monthly State Revenue:**

For the fiscal year to date "total gross cash receipts increased \$126.4 million. All major tax categories showed positive gains. Concern has risen over recent national economic problems and over the numerous budget commitments that may put pressure on the budget.

**Iowa's Estimated Net Yearly Revenue:**

The Revenue Estimating Conference, which met on October 9, 2007, revised the estimate for FY 08 to a total of \$5,934.8 million. This is "\$49.1 million higher than the April REC estimate." Growth is also expected for FY 09.

**Source: Legislative Fiscal Bureau, "Monthly Revenue Memo," Revenue Estimating Conference Report**

**Iowa's Unemployment:**

Iowa's unemployment rate has remained stable at 3.9% in September. Nationally the unemployment rate is 4.7% . In addition payroll jobs are up 110,000 and productivity for the 2nd Qtr remained in the positive at 2.6%. Overall job growth has been "mildly subdued across the economy." Iowa's Workforce Development reported that the local construction industry "added 600 jobs in August, bucking the national trend." In addition Workforce Development reported that "the total number of working Iowans fell to its lowest point for the year in August at 1,591,800."

**Source: Iowa Workforce Development, Labor Market Information Bureau, "Monthly Unemployment Rate"**

**Consumer Confidence Index:**

In the early Fall season the Consumer Confidence Index has declined to 99.8 in September, which is down from August's index rating of 105.6. The Conference Board reported that the "Index is now at its lowest level in nearly two years." Some of the reasons include "weaker business conditions combined with less favorable job market continue to cast a cloud over consumers and heighten their sense of uncertainty and concern." Regionally the Index rose slightly to 117.1.

**Source: Conference Board, "Consumer Confidence Survey."**

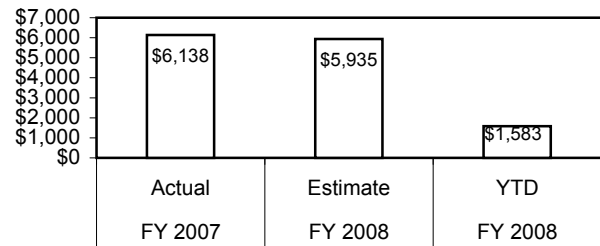
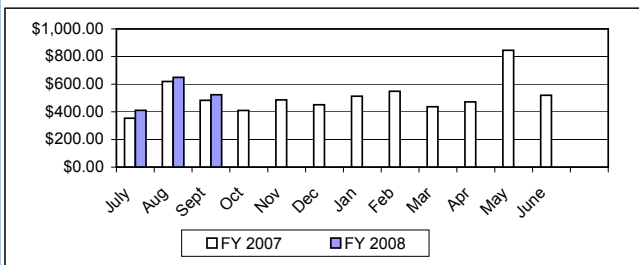
**Consumer Price Index, Monthly Change:**

The Consumer Price Index for urban consumers declined 0.2% in August, but the level was "2.0% higher in August 2006." The Indexes for recreation and transportation declined, while the housing index was unchanged. The Indexes for food and beverages, apparel, education and communication, and other goods and services, all increased. Medical care costs "rose 0.5% in August." In the Midwest the Price Index also decreased 0.2%. The "decline reflected lower energy prices led by falling prices for gasoline and utility gas service."

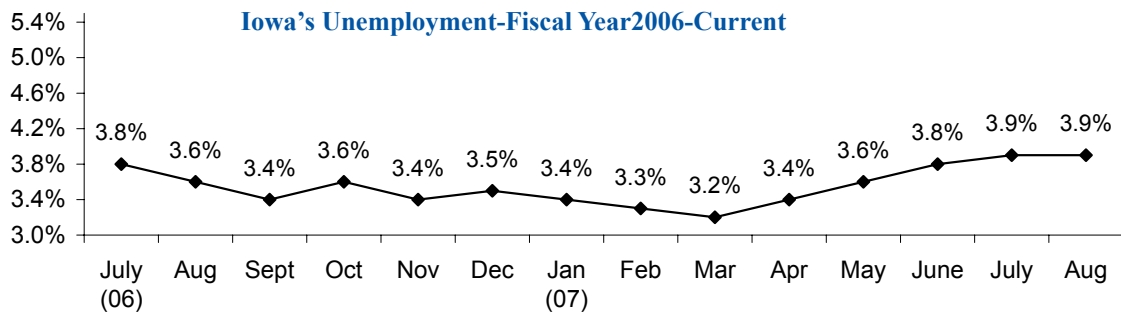
**Source: U.S. Department of Labor, Bureau of Labor Statistics**

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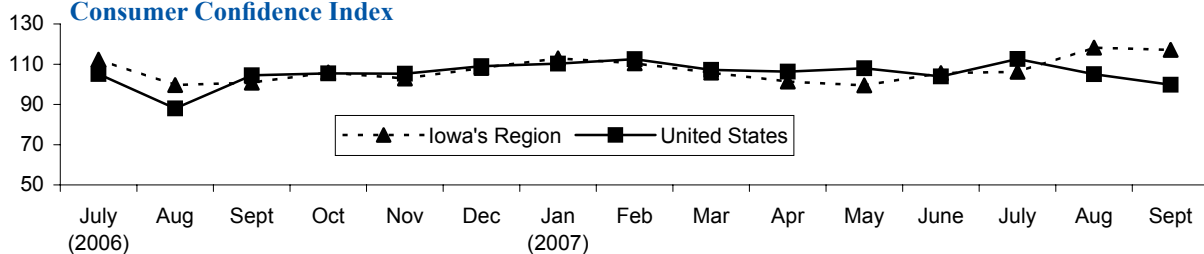
Iowa's Monthly State Revenue and Estimated Net Yearly Revenue



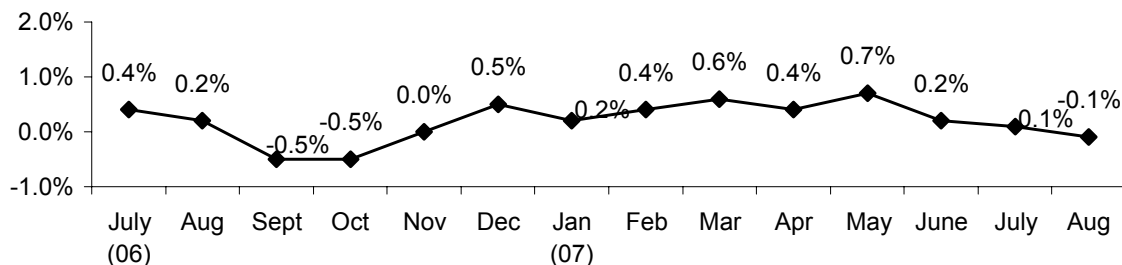
Iowa's Unemployment-Fiscal Year 2006-Current



Consumer Confidence Index



Consumer Price Index, Monthly Change



**REVENUE ESTIMATING CONFERENCE  
ESTIMATE OF GENERAL FUND RECEIPTS**

**Historical Figures**

<b>TAX RECEIPTS</b>	<u>FY 04</u>	<u>FY 05</u>	<u>FY 06</u>	<u>FY 07</u>	% Change FY 07 Act. Vs FY 06 Act.
Personal Inc. Tax	2,592.3	2,782.3	2,854.2	3,085.9	8.1%
Sales and Use Tax	1,465.6	1,812.3	1,881.1	1,910.1	1.5%
Corporate Income Tax	234.8	280.9	348.6	424.6	21.8%
Inheritance Tax	80.1	78.4	73.1	76.0	4.0%
Insurance Premium Tax	138.2	130.9	121.4	105.2	-13.3%
Cigarette Tax	87.1	87.4	89.5	122.0	36.3%
Tobacco Tax	8.1	8.7	9.2	12.1	31.5%
Beer Tax	14.0	14.0	14.2	14.3	0.7%
Franchise Tax	38.0	35.4	35.5	33.3	-6.2%
Miscellaneous Tax	1.0	0.6	0.6	1.0	66.7%
<b>Total Tax Receipts</b>	<b>4,925.9</b>	<b>5,230.9</b>	<b>5,427.4</b>	<b>5,784.5</b>	<b>6.6%</b>
<b>Other Tax Receipts</b>					
Institutional Payments	13.7	12.7	13.0	12.9	-0.8%
Liquor Profits	58.0	59.0	63.8	64.8	1.6%
Interest	7.6	9.7	17.5	28.7	64.0%
Fees	79.8	72.3	76.2	84.7	11.2%
Judicial Revenue	57.6	59.2	63.1	66.9	6.0%
Miscellaneous Receipts	55.3	65.1	49.7	35.7	-28.2%
Racing & Gaming	60.0	60.0	60.0	60.0	0.0%
<b>Total Other Receipts</b>	<b>332.0</b>	<b>338.0</b>	<b>343.3</b>	<b>353.7</b>	<b>3.0%</b>
<b>Total Tax &amp; Other Receipts</b>	<b>5,257.9</b>	<b>5,568.9</b>	<b>5,770.7</b>	<b>6,138.2</b>	<b>6.4%</b>
<b>Transfers</b>					
Lottery	43.9	49.3	79.6	59.3	-25.5%
Lottery-Touchplay					
DHS Intergovernmental Transfers					
Other Transfers*	13.6	39.1	64.4	9.3	-85.6%
<b>Total Transfers</b>	<b>57.5</b>	<b>88.4</b>	<b>144.0</b>	<b>68.6</b>	<b>-52.4%</b>
<b>Total Receipts &amp; Transfers</b>	<b>5,315.4</b>	<b>5,657.3</b>	<b>5,914.7</b>	<b>6,206.8</b>	<b>4.9%</b>
<b>Accruals (net)</b>	<b>83.6</b>	<b>(34.1)</b>	<b>54.0</b>	<b>37.4</b>	<b>-30.7%</b>
Refunds	(715.0)	(696.9)	(586.0)	(597.9)	2.0%
<b>Net Receipts</b>	<b>4,683.5</b>	<b>4,929.0</b>	<b>5,382.7</b>	<b>5,646.3</b>	<b>4.9%</b>

Source: Iowa Department of Management, Revenue Estimating Conference

**REVENUE ESTIMATING CONFERENCE  
ESTIMATE OF GENERAL FUND RECEIPTS**

Estimates of April 6, 2007

Estimates of October 9, 2007

04/07 FY 08 <u>ESTIMATE</u>	% Change FY 08 Est. vs. FY 07 Est.
3,175.4	2.9%
1,961.7	2.7%
428.6	0.9%
81.2	6.8%
124.0	17.9%
219.7	80.1%
15.4	27.3%
14.3	0.0%
38.7	16.2%
1.0	0.0%
<b>6,060.0</b>	<b>4.8%</b>
12.6	-2.3%
67.8	4.6%
29.0	1.0%
62.9	-25.7%
67.9	1.5%
38.3	7.3%
60.0	0.0%
338.5	-4.3%
<b>6,398.5</b>	<b>4.2%</b>
55.5	-6.4%
8.4	-9.7%
63.9	-6.9%
6,462.4	4.1%
25.6	-31.6%
(602.3)	0.7%
<b>5,885.7</b>	<b>4.2%</b>

10/07 REC FY 08 <u>ESTIMATE</u>	% Change FY 08 Est. vs. FY 07 Actual	10/07 REC FY 09 <u>ESTIMATE</u>	% Change FY 09 Est. vs. FY 08 Est.
3,262.2	5.7%	3,425.0	5.0%
1,966.7	3.0%	2,002.4	1.8%
436.0	2.7%	419.0	-3.9%
83.6	10.0%	90.3	8.0%
125.6	19.4%	129.7	3.3%
223.1	82.9%	223.7	0.0%
18.6	53.7%	18.6	0.0%
14.6	2.1%	14.7	0.7%
30.2	-9.3%	31.2	3.3%
1.0	0.0%	1.0	0.0%
<b>6,161.6</b>	<b>6.5%</b>	<b>6,355.0</b>	<b>3.1%</b>
12.6	-2.3%	12.6	0.0%
67.8	4.6%	70.4	3.8%
20.0	-30.3%	20.0	0.0%
73.7	-13.0%	72.5	-1.6%
89.6	33.9%	90.9	1.5%
40.0	12.0%	35.4	-11.5%
60.0	0.0%	60.0	0.0%
363.7	2.8%	361.8	-0.5%
<b>6,525.3</b>	<b>6.3%</b>	<b>6,716.8</b>	<b>2.9%</b>
56.3	-5.1%	58.6	4.1%
13.9	49.5%	1.9	
70.2	2.3%	60.5	
6,595.5	6.3%	6,777.3	2.8%
(18.9)	-150.5%	8.7	N/A
(641.8)	7.3%	(695.0)	8.3%
<b>5,934.8</b>	<b>5.1%</b>	<b>6,091.0</b>	<b>2.6%</b>

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## *IOWA ECONOMIC SCORECARD*

### **Question of the Quarter:**

Do you think the Federal Government should “bail out” subprime mortgage holders?

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We may publish some of your ideas in the January 2008 issue of  
*IOWA ECONOMIC SCORECARD*.

Keith Cook, a longtime supporter of PII from Dubuque, responded to our question of the quarter in the July 2007 edition of IES asking whether Iowa state government needs a more transparent budget.

Mr. Cook wrote: “Iowa is tough on investors. The national government has reduced the dividend tax rate to 15%. Iowa has done nothing. The Federal tax rate on capital gains is also 15% and Iowa continues to add such income at the top applicable rate. Thus, the combined capital gains rate in Iowa approaches 25%. It seems perfectly honest that Iowa’s capital gain tax treatment is really designed to alienate anyone who wants to start a business and see it grow and prosper.”