Here a tax break, there a tax break, everywhere a tax break
Iowa’s revenue shortfall largely self-inflicted — education, other priorities suffer

By Peter Fisher

Iowa legislators facing projections of scant revenue growth for next fiscal year will have a difficult time adequately funding education and other priorities, but their dilemma is largely self-inflicted. A penchant for tax cuts over the past 20 years has left the state with a long-term revenue shortfall.

As lawmakers anticipate meager revenue growth for a budget exceeding $7 billion, they face built-in and anticipated spending increases for existing programs, projected to total $269.5 million. Furthermore, these increases assume no boost in per pupil state school aid because the 2015 Legislature failed to set that figure for FY2017 as required by law. The governor has proposed 2.45 percent growth in school aid, which would add another $100 million to the budget. Clearly that cannot be funded without large cuts elsewhere in the budget — or addressing the elephant in the room: rampant spending on business subsidies.

**Business tax credits create part of the problem**

Why is revenue growth a problem in a state that has done better than most in recovering from the Great Recession? The answers can be found in the growth in business tax breaks. Business tax credits already on the books drained $178 million from the state treasury in fiscal year 2015, then grew by $94 million to $272 million in FY16, and are expected to remain at about that level next year. The six largest credits (or groups of credits) account for 84 percent of the total (Table 1).

Spending on business tax credits has grown 263 percent since 2007. Caps on individual credits and groups of credits have done little to slow growth. The cost of credits has far outstripped growth in general fund spending overall.

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**Table 1. Iowa spends millions through the tax code**

<table>
<thead>
<tr>
<th>Business Tax Credits</th>
<th>Projected for FY17 ($Millions)</th>
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<tbody>
<tr>
<td>Research Activities Credits</td>
<td>$65.1</td>
</tr>
<tr>
<td>Industrial New Jobs Training Program</td>
<td>43.6</td>
</tr>
<tr>
<td>Historic Preservation Credit</td>
<td>49.0</td>
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<tr>
<td>High Quality Jobs Program</td>
<td>28.5</td>
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<tr>
<td>Ethanol and Biodiesel Credits</td>
<td>22.1</td>
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<tr>
<td>Enterprise Zone Programs</td>
<td>19.9</td>
</tr>
<tr>
<td>All other business credits</td>
<td>44.4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$272.6</strong></td>
</tr>
</tbody>
</table>

**Figure 1. Business tax breaks expected to reach $295 million**

Figures for 2016-2018 are projections. Source: Iowa Department of Revenue, Table 9, Contingent Liabilities Report, December 2015.
New tax breaks have worsened the problem

Recent measures have added greatly to the problem. The massive commercial and industrial property tax bill passed in 2013 is responsible for a $268 million cut in funds that otherwise would have been available to adequately fund education, natural resource programs, and other priorities in the current fiscal year, FY16. Next year that figure is expected to grow to $304 million. The property tax breaks are larger than the sum of all business tax credits.

To make matters worse, the administration has enacted a rule, without legislative approval, that greatly expands a sales tax exemption for manufacturing. That will cost the general fund another $35 million next year, while depriving schools and local governments of another $13 million.

Altogether business tax breaks will drain $611 million in revenue from the state general fund next fiscal year. At a time when the state is struggling to fund education at all levels, those business tax breaks take on added importance. And they tell us something about the state’s priorities.

Iowa business taxes are already quite competitive

Iowa did not need these tax breaks, and certainly does not need to add to the damage to state services by enacting more. Iowa has been right in the middle of the pack in how it taxes business for a long time. The most recent study of state and local taxes on business as a percent of state GDP by Ernst and Young and the Council on State Taxation shows that Iowa taxes business at 4.5 percent of GDP, just below the national average. A study by Anderson Economic Group in 2015 found Iowa’s effective tax rate on businesses to be 8.7 percent of profits, which placed it 32nd among the states, and again below the national average.

State and local taxes have little effect on business location decisions

State and local taxes are less than 2 percent of total costs for the average corporation. As a result, even large cuts in state taxes are unlikely to have an effect on the investment and location decisions of businesses, which are driven by more significant factors such as labor, transportation, and energy costs, and access to markets and suppliers.

Tax breaks erode support for public investments in our future

The proliferation of tax incentives and business tax cuts over the past two decades has resulted in several hundred million dollars each year cut from the state budget. This has undermined the state’s ability to support quality education, from preschool through public colleges and universities, which in the long run will have serious consequences for state economic growth and prosperity.
Fixing Iowa’s problem with unsustainable revenues

Long-term sustainability for Iowa revenues should begin with a recognition that business tax breaks have grown to unsustainable proportions. At the very least, the Legislature should reject any proposals for new tax breaks. Any bill to couple with the recently enacted federal tax changes should exclude coupling with the new depreciation rules. There is no justification for piling on additional business tax breaks at a time when basic state services cannot be adequately funded, breaks that will continue to erode revenues on into the future.

In the 10 years from FY2005 to FY2015 state tax revenue actually declined as a share of the Iowa economy. State taxes represented 5.8 percent of state personal income in 2005, 5.6 percent in 2015. If taxes had grown along with the economy over this period we would have had an additional $279 million in revenue in FY2015. A real long-term solution to sustain Iowa’s critical public services, including education, will require that the state rejuvenate state tax revenues by reducing or eliminating unnecessary and ineffective tax breaks and seeking new sources of revenue. To do otherwise is to shortchange our future.

1 Figures are based on Legislative Services Agency, Fiscal Services Division. Summary of FY2017 Budget and Department Requests. December 2015, pp. 12-13, with some adjustments for the Revenue Estimating Council report of December 10, 2015 which was released after the LSA report.

2 Legislative Services Agency, Fiscal Services Division. Summary of FY2017 Budget and Department Requests. December 2015, pp. 17 and 55. Includes the effect of SF 295 on state school aid as originally estimated.


Peter S. Fisher is research director of the Iowa Policy Project, which together with the Child & Family Policy Center formed the Iowa Fiscal Partnership, a nonpartisan initiative focused on helping Iowans to understand the impacts of budget choices and other public policy issues on Iowa families and services. IFP reports are at www.iowafiscal.org.