Iowa Fiscal Partnership

BACKGROUNDER

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Undermining democracy: A straitjacket on local finance

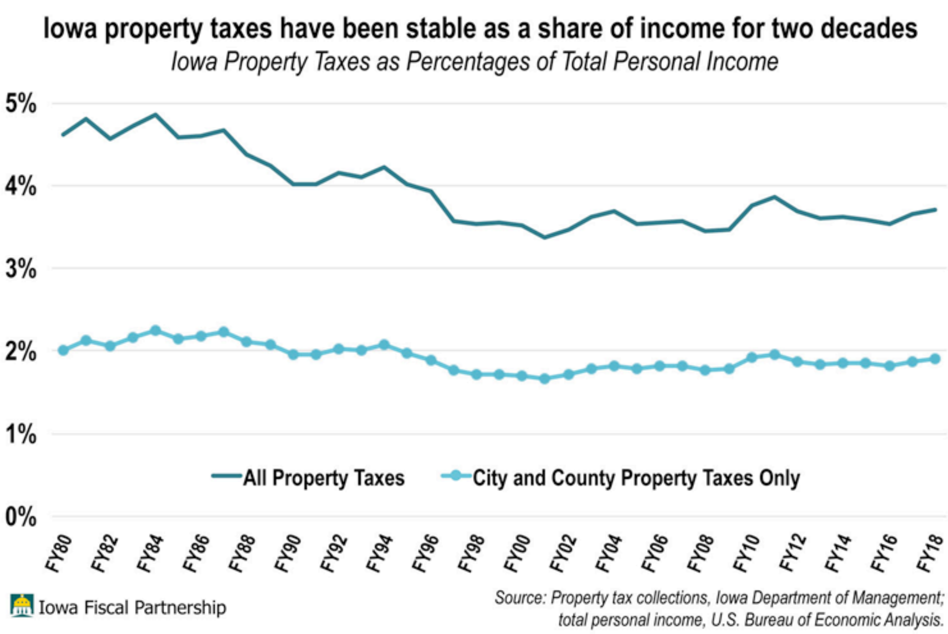
Despite reality of stable property taxes, new limits sought to stop local decisions

By Peter Fisher, Iowa Policy Project, and David Swenson, Iowa State University

A bill under serious consideration in the Iowa Legislature (HSB165) would impose unprecedented state control over budgeting decisions of local, democratically elected city councils and county boards. It would impose a 2 percent cap on the growth of property tax levies every year, regardless of the needs and desires of local residents or of rising costs.[1]

Why 2 percent? The number is completely arbitrary, rendered even more so by its application to counties and cities of all sizes, declining or growing, rural or urban, in periods of expansion or in recession, and with all the variations in voter preferences that exist across our state.

It is not as if Iowa's property taxes have been rising rapidly, despite the claims of some. In fact, they have been remarkably stable in recent decades. The best summary measure is the fraction of income that goes towards taxes each year. As the graph below illustrates, total property taxes in Iowa have remained at about 3.5 percent of personal income in the state for the past 20 years. And that level is *below* the 4.0 percent to 4.5 percent that prevailed for the previous two decades. Further, cities and counties specifically targeted by this legislation have even more stable property taxes: around 1.9 percent of personal income.



This bill is anti-growth. The amount of property taxes allowed for the upcoming fiscal year is the sum of two amounts: (1) taxes collected from existing properties in the current year plus 2 percent, and (2) this year's tax rate applied to new construction that will be on the tax rolls for next year. But one year's new construction is next year's existing tax base, subject to the 2 percent growth limit. A locality experiencing significant growth year after year is likely to face demands for additional services for the growing population that outstrip the growth in tax base. An arbitrary limit could make it difficult for a city or county to accommodate growth, particularly where more affordable workforce housing is needed.

Cities or counties that have recently faced the challenges of a natural disaster may find their abilities to respond severely limited by this bill. Rural areas that have lost a major employer or have simply not participated in the growth of urban centers may find themselves with a population with increasing needs for public services, but their voters' needs could fall victim to the Legislature's arbitrary cap. Cities whose citizens want a new recreation center or a new library may be quite happy to pay for it, but would find that there is no room for the new operating costs under the 2 percent cap.

Cities or counties with needs would have a few troublesome safety valves under this new law. First, they could borrow to the limit; general obligation bond debt payments do not fall under the 2 percent cap, giving localities a strong incentive to borrow to meet spending needs that previously would have been funded with current revenues. This is not a fiscally sound practice.

Cities also would have greater incentive to issue Tax Increment Financing debt. Some might designate the entire city as a TIF area to maximize the revenue from any growth. Unavoidably, this would shift a greater share of municipal costs onto the rural residents in the surrounding county.

The bill would also create an incentive to maximize the use of fees and of local option sales taxes. Both options fall disproportionately on lower income households.

At some point the Legislature will discontinue the backfill provided to local governments for the loss of commercial and industrial tax base under the property tax bill of 2013. Cities and counties would have little ability to respond if this bill were to pass. The loss of state aid could not be offset by an increase in local property taxes beyond the 2 percent allowed.

The bill would force cuts in public services. Employee benefits now financed by a "trust and agency" property tax levy will instead become part of a city's general fund subject to the 2 percent cap. Counties similarly would be forced to include employee benefits under the cap. But increases in pension contributions and health insurance premiums are outside the control of cities and counties, and have been growing faster than 2 percent.[2] Localities would be forced to cut other services in the face of continued inflation in health costs, and in pension contribution increases necessitated by recession and by failures of state policy.[3]

The bill does allow a county board or a city council to propose exceeding the 2 percent growth limit for up to two fiscal years. A petition signed by 2,000 voters or 20 percent of the persons who voted in the last presidential election, whichever is less, would force a special election to be held. The measure to exceed the limit would be approved by a simple majority vote.

This bill, in other words, substitutes a cumbersome and costly special election for the local democracy embodied in the election of public officials. As special elections are notorious for small turnouts, this plan would shift budget decisions to a small percentage of the voters, some with a special-interest axe to grind — whether or not they showed up to elect supervisors and councilors to make such decisions on our behalf, with our input, and with research and planning. The proposal markedly changes how democratic government works in Iowa.

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[1] The bill discussed here includes amendments proposed at a March 13 House subcommittee hearing where HSB165 was recommended for passage.
[2] Premiums for employer sponsored health insurance by government employers in the Midwest for family coverage rose 4.0 percent from 2017 to 2018, and averaged 3.9 percent annual growth for the past 10 years. https://bit.ly/2HAsFd5
[3] See Iowa Policy Project, "IPERS works to boost retirees, economy," October 2018. https://bit.ly/2WgLQfr

Peter Fisher is research director at the Iowa Policy Project, and David Swenson is an economic scientist at Iowa State University.