

Staff Paper 297

**A Preliminary Analysis of the
Proposed 1998 Taxpayers' Rights Amendments
to the Iowa Constitution and Fiscal Consequences
Assuming Implementation from FY1984 to Present ***

**By Mark A. Edelman, Ph.D. **
Department of Economics
Iowa State University
March 3, 1998**

* This report is designed to foster discussion among citizens, leaders and policy makers regarding a public issue of concern to Iowans. Iowa State University seeks to provide accurate research-based information on relevant issues and does not necessarily endorse or oppose any proposals that may be analyzed. The analysis provided herein was initiated after requests for information on the impacts of the proposals were expressed by leaders of several statewide interests. No external support was received for conducting this analysis. This analysis is based on methods and data that are judged to be valid by the author, given his training and expertise in the area, given the assumptions outlined in the report, and given the historical period analyzed. The goal of the project was to develop objective information sources to assist leaders and citizens in making reasonable judgements regarding the impacts of the proposals.

** Dr. Mark A. Edelman is a Professor of Economics and Public Policy, Department of Economics, Iowa State University. He has established a 16-year track record of professional accomplishments in the area of policy analysis on a variety of federal, state and local public issues.

Copyright © 1998 by Mark A. Edelman. All rights reserved. Readers may make verbatim copies of this document for non-commercial purposes by any means, provided this copyright notice appears on all such copies.

IOWA STATE IS AN EQUAL OPPORTUNITY EMPLOYER.

A Preliminary Analysis of the Proposed 1998 Taxpayers' Rights Amendments to the Iowa Constitution and Fiscal Consequences Assuming Implementation from FY1984 to Present

Abstract:

This staff paper reviews the Senate (SSB2072) and House (HSB688) versions of a proposed 1998 Amendment to the Iowa Constitution and provides a preliminary analysis of the fiscal impacts on the state general fund receipts, general fund appropriations, and local property taxes assuming each proposal was implemented in FY1984. While the year-to-year reductions in spending are relatively small, the cumulative fiscal impact of the SSB2072 would likely have resulted in (1) a FY1997 state general fund limit that allows 32 percent less spending than actual FY1997, (2) a \$710 million reduction in the growth of state aid to local government, and (3) a 29.7 percent increase in property taxes, if property taxes were used to fully replace the reduction in growth of state aid to local governments.

HSB688 excludes some measure of state aid applied to property tax relief from the TRA limit. However, the proposed Constitutional language for this exclusion appears to potentially contain ambiguous wording. One interpretation of HSB688 excludes only new state aid for property tax credits that "ensure" reduction in property taxes. Applying this definition to TRA implementation in FY1984 resulted in a FY1997 state general fund limit that allows 30.7 percent less spending than actual FY1997 and a \$639 million reduction in the growth of state aid to local governments. In turn, this would have required a 26.7 percent increase in property taxes to hold local government spending harmless from the reduction in growth of state aid to local governments.

Alternatively, a second interpretation of HSB688 may provide a broader exclusion of state aid to local governments. If all new state aid to local government is excluded, the TRA would have resulted in a FY1997 state general fund limit that allows 15.7 percent less spending than actual FY1997. No reduction in the growth of state aid to local governments means no increase in local property taxes. However, the Constitutional tax and spending limitation effectively only covers half of the state general fund revenues.

KEY WORDS: State tax limitations, tax limitations, revenue limitations, spending limitations.

A Preliminary Analysis of the Proposed 1998 Taxpayers' Rights Amendments to the Iowa Constitution and Fiscal Consequences Assuming Implementation from FY1984 to Present

What is the proposed Taxpayers' Rights Amendment (TRA) and how would it work?

The proposed constitutional amendment (SSB2072, HSB688) imposes a limit on state government revenues. The annual revenue limit equals the revenue for a base year annually adjusted by inflation or deflation and cumulative population change. If revenues exceed the TRA limit, the limit for next fiscal year is reduced by an equivalent amount.

The measure of inflation or deflation used for the annual adjustments is the federal implicit price deflator for state and local government purchases. The measure of cumulative population change is the most recent federal census or federal census estimate. The annual adjustment for population cannot go below the base year population.

How can modifications to the TRA limits be made?

A statewide voter referendum with a majority approval by voters may temporarily increase the TRA limit for up to 5 years. A separate ballot is required and the vote can only be conducted on election day in June and November.

Legislative action may temporarily increase the TRA limit for one year by a two-thirds majority vote in both houses of the General Assembly plus the signature of the Governor.

What is covered by the 1998 TRA?

A major difference in 1998 TRA proposals compared to previous proposals is that local government is excluded. The revenue limits include all amounts received from all state sources, including but not limited to all taxes, fees, charges, assessments, amounts borrowed and other receipts, unless specifically excluded. All state agencies, enterprises and operations are included.

Revenues excluded from the limits are: refunds to taxpayers, gifts and contracts from non-governmental sources, federal government receipts, fees to cover costs paid to state university hospitals, revenues required for meeting new federal mandates, road use tax funds, amounts borrowed after approval by voters, revenue bonds paid by non-tax sources, and receipts to debt service. Also included under the revenue limits are state trust fund receipts for retirement, medical or other benefits, but trust fund earnings are excluded from both revenue and spending limits.

A major difference between the two 1998 TRA proposals HSB688 and SSB2072 is that HSB688 excludes state receipts applied to new state aid "payments to local government and for tax credits against local property taxes, to the extent state law ensures a reduction in property taxes..."

The spending limit is defined as the sum of (1) the revenue limit with adjustments or actual revenue whichever is less, (2) actual receipts excluded from revenue, and (3) net unspent funds from the preceding year. Spending includes all payments and transfers into trust funds, but excludes payments out of trust funds for intended benefits. Payments for administration expenses are included under the spending limit. Certain elements of state unemployment trust funds are included and excluded from the revenue and spending limits. However, unemployment benefits paid are excluded from the limits.

What other provisions are in the TRA?

The amendment guarantees that state spending on transfers and tax credits to local government must be equal to or greater than the percentage of state government spending that was allocated for those purposes in the base year before the amendment was implemented.

State government must fully fund mandates that are passed after the amendment is implemented. If they are not fully funded, local governments are not required to comply with the mandate. All state government retirement plans and benefits must be fully funded within 10 years. GAAP accounting is required for all state government purposes.

What are the probable consequences of the TRA on state and local government?

Numerous versions of the TRA have been proposed since 1980. As the 1998 legislative session progressed, modifications with potentially significant impacts were still being proposed. SSB2072 published on February 4, 1998 included growth in state aid to local governments and property tax credits under the proposed revenue limit. However, HSB688 published on February 26, 1998 excluded a measure of state aid to local government and property tax credits from the limitations. In general, as the number of modifications increase, the coverage of the specific revenue and spending limitations is reduced and the complexity for estimating the potential impacts on controlled and uncontrolled revenues and spending increases. Therefore, the approach used in this report is to estimate the general fund impacts of the SSB2072 and then to examine the impacts of the state aid/property tax credit modifications included in HSB688.

Previous estimates of the TRA fiscal consequences for a historic set of general fund data were calculated by Levin and Driscoll (1993). The Levin and Driscoll data and methods have been updated in this current study under the assumption that SSB2072 was passed and implemented in FY1984. Table 1 shows inflation and population data used for updating the SSB2072 impact estimates. Table 2 updates Levin and Driscoll calculations for the state general fund revenue limits through actual FY1997 and estimated for FY1998 and FY1999. Note that estimates of impact on trust funds, taxes, fees and other receipts which are not included in general fund appropriable receipts as reported by the Department of Management are beyond the scope of this study, but they may be significantly impacted by the TRA. Table 3 shows comparisons for actual FY1997 and estimated FY1998 assuming across-the-board cuts for selected General Fund Appropriations. Table 4 provides comparisons for state assistance to local governments as reported by the Department of Management. Estimates in Table 4 are calculated under the assumption that state general funds are the primary source of state

aid to local government, except for road use tax funds which are excluded from the revenue limits. Table 5 shows estimates for the property tax impacts to fully replace the estimated reduction in the growth of state aid to local governments.

Below is a summary of preliminary findings for SSB2072 impacts on the state general fund, local government and property taxes.

1. In FY1997, Iowa's state general fund would have been \$1.380 billion smaller than it actually was had SSB2072 been implemented in FY1984. SSB2072 would have required 32 percent less state general fund revenues in FY1997 compared to actual revenues. The magnitude of the TRA impacts increase over time.

2. SSB2072 implementation in FY1984 and across-the-board cuts using FY1997 spending patterns would have resulted in \$569 million less in FY1997 state general fund revenues for elementary and secondary education, \$195 million less for regents' universities, \$264 million less for human services, \$54 million less for corrections, \$31 million less for the judicial system, \$15 million less for college student aid, \$13 million less for veterans affairs, and approximately \$8 million less each for natural resources, agriculture and land stewardship, and economic development.

3. Impacts on local government fiscal capacity are estimated under the assumption that Constitutional revenue and spending limits take priority over statutory limits that may exist on local sources of revenue. SSB2072 implementation in FY1984 and across-the-board spending cuts would have resulted in \$82 million less for FY1997 state assistance targeted for property tax credits and replacement. If this targeted state spending were to be fully replaced by property taxes, this would have represented a 3.4 percent increase in property taxes statewide. However, the total impact of the TRA on all state aid to local governments would have resulted in a much larger reduction in the growth of state aid--\$710 million. If the total decline in the growth of state aid would have been fully replaced by property taxes, a 29.7 percent statewide property tax increase would have been required to maintain actual FY1997 local government spending levels.

Tables 6 and 7 summarize impacts of two different interpretations of HSB688. The proposed language regarding how the Constitution would exclude the state receipts applied to new local government assistance and/or property tax credits appears to be ambiguous (Art. XIII, Section 2, Number (10)). Note the existing level of state aid to local government is guaranteed in Section 9 of all 1998 TRA proposals. The major difference in interpretation of HSB688 relates to the exclusion of state receipts applied to new state aid "payments to local government and for tax credits against local property taxes, to the extent state law ensures a reduction in property taxes..." Under the first interpretation (Table 6), only property tax credits are presumed to be excluded from the revenue limits because of the phrase "to the extent that state law ensures a reduction of local property taxes by an amount at least equal to the excluded amount."

Alternatively, a second interpretation of HSB688 may provide a much broader exclusion. Under the second interpretation (Table 7) all new state aid to local governments and for tax credits against local property taxes is assumed to be excluded from the TRA limits. In this case, there are no TRA impacts on state aid to local government and no TRA impacts on local property taxes. However under this approach, a smaller proportion of state general fund revenues are covered under the Constitutional tax limitation measure.

Below is a summary of preliminary findings for HSB688 fiscal impacts on state general funds, local government and property taxes for the different interpretations.

4. Under HSB688 implemented in FY1984 assuming only property tax credits excluded from the TRA limit, the state general fund revenue limit for FY1997 would have allowed 30.7 percent less spending than actual FY1997. There would have been a reduction of \$639 million in the growth of state aid to local units of government and property taxes would have increased 26.7 percent if property taxes were used to fully fund the total reduction in growth of state aid to local government.

5. Under HSB688 assuming all state aid is excluded from the TRA limit, the state general fund revenue limit for FY1997 would have allowed 15.7 percent less spending than actual FY 1997. There would have been no reduction in state aid to local governments or no increase in property taxes because these amounts are excluded from the revenue limit. However, the Constitutional tax limitation measure would effectively cover 49.1 percent of the state general fund revenues.

In summary, the purpose of this preliminary analysis was to develop reasonable judgements regarding fiscal impacts of the 1998 TRA proposals had they been in effect since FY1984. The apparent ambiguous nature of Art. XIII, Section 2, Number (10) prevents a narrowing of the fiscal impact estimates. However, the variation between Tables 6 and 7 interpretations illustrates an important fiscal impact principle: In order to develop some confidence that local property taxes would not assume an increasing share of the tax burden by passage of the TRA, about half of the state general fund budget must be excluded from the TRA limits. Alternatively, if a narrower TRA property tax credit exclusion had been implemented since FY1984, the impact of the property tax credit exclusions would likely have been overwhelmed by reductions in the growth of other forms of state aid to local governments. Increases in local property taxes would likely have resulted as the growth in state aid to local government became more constrained. This is a fundamental fiscal policy tradeoff embodied in the analysis of the 1998 TRA proposals.

Table 1. Update from Levin and Driscoll Study Table 4-1. Inflation and Population Data Used to Compute Tax Limitation, If SSB2072 Effective from FY1984 to Present

State Budget Fiscal Year	Calendar Year for Federal Price Deflator	Implicit Price Deflator for State and Local Government	Cumulative Inflation if Base Year was 1983 (percent)	Iowa Population Estimate for Calendar Year	Cumulative Population if Base Year was 1983
1983	1981	65.2	--	2,908,000	
1984	1982	69.2	6.1	2,888,000	-
1985	1983	71.9	10.3	2,871,000	-
1986	1984	75.2	15.3	2,859,000	-
1987	1985	78.6	20.6	2,830,000	-
1988	1986	81.1	24.4	2,792,000	-
1989	1987	84.1	29.0	2,767,000	-
1990	1988	87.7	34.5	2,769,000	-
1991	1989	90.5	38.8	2,771,000	-
1992	1990	94.9	45.6	2,777,000	-
1993	1991	97.9	50.2	2,792,000	-
1994	1992	100.0	53.4	2,808,000	-
1995	1993	102.5	57.2	2,822,000	-
1996	1994	104.9	60.9	2,832,000	-
1997	1995	108.2	66.0	2,843,000	-
1998	1996	111.7	71.3	2,852,000	-
1999	1997	114.3*	75.3	-	-

* Preliminary

Sources:

1. Levin, Richard A. and William P. Driscoll. "Taxes and Spending in Iowa: A Defense of Iowa's Constitution," Nov. 1993.
2. U.S. Department of Commerce, Bureau of Economic Analysis, "Implicit Price Deflators for Gross Domestic Product: State and Local Government Purchases," Jan. 30, 1998.
3. U.S. Department of Commerce, Bureau of the Census, Statistical Abstract of the United States, Oct. 1997.

Table 2. Update from Levin and Driscoll Study Table 4-2. Reduction in Iowa State General Fund Receipts Required If SSB2972 Effective From FY1984 to Present

Fiscal Year	Actual State Tax Receipts \$ millions	Cumulative Inflation Since 1983 Base Year percent	Receipts Allowed by the Proposed Amendment \$ millions	Reductions Required By the Proposed Amendment \$ mil. (percent)
1983	1739	--	1739	0
1984	1947	6.1	1845	102 (5%)
1985	2041	10.3	1918	123 (6%)
1986	2093	15.3	2005	88 (4%)
1987	2295	20.6	2097	198 (9%)
1988	2437	24.4	2163	274 (11%)
1989	2689	29.0	2243	446 (17%)
1990	2795	34.5	2339	456 (16%)
1991	2937	38.8	2414	523 (18%)
1992	3061	45.6	2531	530 (17%)
1993	3400	50.2	2612	788 (23%)
1994	3626	53.4	2668	958 (26%)
1995	3819	57.2	2734	1085 (28%)
1996	4039	60.9	2798	1241 (31%)
1997	4267	66.0	2887	1380 (32%)
1998	4437*	71.3	2979	1458 (33%)
1999	4513*	75.3**	3048	1465 (32%)

*Revenue Estimating Conference Estimates. **Preliminary.

Sources:

1. Levin, Richard A. and William P. Driscoll. "Taxes and Spending in Iowa: A Defense of Iowa's Constitution," Nov. 1993.
2. U.S. Department of Commerce, Bureau of Economic Analysis, "Implicit Price Deflators for Gross Domestic Product: State and Local Government Purchases," Jan. 30, 1998.
3. Iowa Department of Management, "State of Iowa, History of Appropriable Receipts," 1983-1999.

Table 3. Actual Appropriations for FY1997 and FY1998 and Estimated TRA Fiscal Consequences for Selected General Fund Items, If SSB2072 Effective from FY1984 to Present

	FY1997 Actual \$ million	FY1997 TRA Impact: 32 % Reduction \$ million	FY1998 Estimate \$ million	FY1998 TRA Impact: 33 % Reduction \$ million
Elementary and Secondary Education	1778	-569	1873	-618
Higher Education	610	-195	641	-212
Human Services	826	-264	837	-276
Corrections	168	-54	198	-65
Judicial System	96	-31	101	-33
College Student Aid Commission	46	-15	50	-17
Veterans Affairs	40	-13	42	-14
Natural Resources	25	-8	26	-9
Agriculture/ Land Stewardship	24	-8	24	-8
Economic Development	22	-7	24	-8

Note: The above estimates of impact do not include spending from funds other than General Fund Appropriations as reported by the Department of Management. Therefore, these estimates underestimate the total impact of the TRA. As a result, these figures are reported only to represent preliminary indicators of the potential TRA impacts under the assumed FY1984 implementation scenario.

Sources:

1. Department of Management, “State of Iowa, General Fund Appropriations, FY1997 and estimated FY1998.”

Table 4. Actual Financial Assistance to Local Governments for FY1997 and FY1998 and Estimated Fiscal Consequences, If SSB2072 Effective from FY1984 to Present.

	FY1997 State Aid to Local Governments \$ million	FY1997 Maximum TRA Impact \$ million	FY1998 Estimated State Aid to Local Governments \$ million	FY1998 Estimated Maximum TRA Impact \$ million
K-12 District School Aid	1621	- 519	1691	-558
Property Tax Replacements and Credits	221	- 71	247	-82
Other Local Assistance	674	- 81 *	739	-101
Total Assistance to Local Governments	2,641	- 710 *	2808	-784

*** Impact Excludes Road Use Tax Funds.**

Note: The above estimates of impact are reported only to represent preliminary indicators of the potential TRA impacts under the assumed FY1984 implementation scenario.

Sources:

1. Department of Management, "State of Iowa, Financial Assistance to Local Governments, FY1997 and Estimated FY1998"

Table 5. FY1997 Property Tax Collections and Property Tax Equivalent Impacts of TRA on State Assistance to Local Units of Government, If SSB2072 Effective from FY1984 to Present

	FY 1997 Actual Property Tax Collections \$ million	Maximum FY 1997 Property Taxes Under TRA \$ million	Maximum Property Tax Increase \$ million	Maximum Property Tax Increase Percent
TRA Property Tax Impact of Replacing Lost Local Revenue	2,389	3,099	710	29.7%

Note: The above estimates of impact are reported only to represent preliminary indicators of the potential TRA impacts under the assumed FY1984 implementation scenario. The above estimates presume that Constitutional revenue and spending limitations supersede statutory property tax limitations and would lead to revision of the latter.

Sources:

- 1. Department of Management, "Property Taxes by Type of Taxing Authority, FY1997"**

Table 6. Reduction in State General Fund Receipts FY1997 and Proportion of General Fund Covered by TRA Limit with State Funded Property Tax Credits Excluded from the TRA Limit, If HSB688 Effective FY1984 to Present

	Actual General Fund Receipts \$million	Initial TRA Limit \$ million	State Aid for Property Tax Credits	Adjusted TRA Reduction in General Fund Receipts \$ mil (%)	Estimated Percent of General Fund Excluded from TRA Limit	Property Tax Increase to Hold Local Spending Constant \$ mil (%)
FY1997	4,267	2,887	71	1,309 (30.7%)	5.2 %	639 (26.7 %)
FY1998	4,437	2,979	82	1,376 (31.0%)	5.6 %	NA

Note: The above estimates of impact are reported only to represent preliminary indicators of the potential TRA impacts under the assumed FY1984 implementation scenario. The above estimates presume that Constitutional limitations supersede statutory property tax limitations.

Sources:

- 1. Department of Management, "State of Iowa, Financial Assistance to Local Governments, FY1997 and Estimated FY1998"**
- 2. Department of Management, "State of Iowa, History of Appropriable Receipts," 1983-99"**

Table 7. Reduction in State General Fund Receipts FY1997 and Proportion of General Fund Covered by TRA Limit with all State Aid to Local Government Excluded from the TRA Limit, If HSB688 Effective FY1984 to Present

	Actual General Fund Receipts \$million	Initial TRA Limit \$ million	State Aid for Property Tax Credits	Adjusted TRA Reduction in General Fund Receipts \$ mil (%)	Estimated Percent of General Fund Excluded from TRA Limit	Property Tax Increase to Hold Local Spending Constant \$ mil (%)
FY1997	4,267	2,887	710	670 (15.7 %)	49.1 %	0 (0 %)
FY1998	4,437	2,979	784	674 (15.2 %)	50.5 %	0 (0 %)

Note: The above estimates of impact are reported only to represent preliminary indicators of the potential TRA impacts under the assumed FY1984 implementation scenario. The above estimates presume that Constitutional limitations supersede statutory property tax limitations.

Sources:

- 1. Iowa Department of Management, "State of Iowa, Financial Assistance to Local Governments, FY1997 and Estimated FY1998"**
- 2. Department of Management, "State of Iowa, History of Appropriable Receipts," 1983-99"**