



**AN OPEN LETTER
TO IOWA POLICY MAKERS**

FOR RELEASE FRIDAY, JAN. 2, 2009

January 2, 2009

Governor Chet Culver
Lieutenant Governor Patty Judge
Speaker of the House Pat Murphy
House Majority Leader Kevin McCarthy
House Minority Leader Kraig Paulsen
President of the Senate Jack Kibbie
Senate Majority Leader Michael Gronstal
Senate Minority Leader Paul McKinley
Members of the Iowa General Assembly

Dear Iowa Lawmakers:

When the Iowa General Assembly convenes this month, it will face major fiscal challenges. National reports indicate the fiscal deficits facing states in 2009 and 2010 are even larger than the deficits of the 2001-03 state fiscal crisis.

Iowa is one of 44 states facing deficits that will require a careful and considered response. We agree with Governor Culver that the state must act in ways that minimize any potential for prolonging or deepening the recession in Iowa. We also believe that Iowa must take actions that help to mitigate the effects of the recession on those most affected by it and that avoid pushing more children and families into poverty.

We believe that a responsible approach to the state fiscal crisis requires that decision makers:

- factor in the impact of federal stimulus and recovery measures;
- recognize the cyclical nature of the economy;
- avoid actions that compound recessionary impacts;
- examine tax expenditures as well as direct appropriations; and
- understand Iowans' support for services to vulnerable children and families and the need for a differentiated response to addressing budget issues.

Each of these points is discussed separately below.

The Iowa Policy Project

20 E. Market Street
Iowa City, IA 52245
(319) 338-0773 • www.iowapolicyproject.org

CHILD & FAMILY POLICY CENTER

1021 Fleming Building • 218 Sixth Ave.
Des Moines, IA 50309
(515) 280-9027 • www.cfpciowa.org

1. Iowa must build its strategy for addressing the fiscal crisis in recognition of likely federal responses. The federal economic recovery package will have a dramatic impact on Iowa's state budget situation — state actions to cut some services may be premature and self-defeating.

President-Elect Obama and the 111th Congress have committed to enacting an economic recovery package early in the year. This economic recovery package is expected to include substantial fiscal relief to the states, including a temporary increase in the federal matching rate (FMAP – federal medical assistance percentage) under Medicaid to the states that will provide relief during both the 2009 and 2010 state fiscal years. The economic recovery package also may include substantial federal funds for infrastructure development and construction.

U.S. Senate leaders have indicated they are considering an 8 percent increase to FMAP that would provide \$37 billion in additional support to states over the 15-month period from October 2008 through December 2009. Iowa's share of such an FMAP increase would be \$302 million, more than enough to cover current projected increases in Iowa Medicaid expenditures over funds appropriated in 2009 and used as a base by the Revenue Estimating Conference for 2010 projections. President-Elect Obama has indicated he may recommend an FMAP increase more than double that amount, which could address a large share of Iowa's projected deficit in both 2009 and 2010. Subjecting Medicaid to an across-the-board cut at this time does not make sense, especially since the federal government is expected to require some "maintenance of effort" in Medicaid as a requirement for securing this funding.

In addition, the economic stimulus package may provide substantial additional support to states for rebuilding infrastructure. Any expansion of Iowa's bonding for such construction should be evaluated in the context of federal actions.

2. Iowa must determine the appropriate role for using "rainy day" funds to address budget deficits that are cyclical in nature.

Some, although not necessarily all, of the current Iowa budget crisis is the result of the recession. There is an appropriate role for using "rainy day" funds to provide fiscal support for weathering temporary downturns in revenue, particular to address state programs that are designed to provide relief to those affected by economic difficulties. Demand for some state services is counter-cyclical and "rainy day" funds are particularly appropriate to be employed to support these services, as the demand for them will decline as the economy improves.

3. Iowa must avoid budget actions that risk prolonging or deepening the recession.

Federal economic stimulus packages include fiscal relief to states out of recognition that states must balance their budgets, and that state spending reductions are likely to prolong or deepen the recession.

Economists agree that when states choose ways to balance the budget, cutting government spending and laying off employees have serious negative impacts upon

economic recovery. Peter Orszag, recently named by President-Elect Obama to head the Office of Management and Budget, and Nobel Laureate Economist Joseph Stiglitz have written:

Basic economic theory suggests that direct spending reductions will generate more adverse consequences for the economy in the short run than either a tax increase or a transfer program reduction. ... Tax increases on higher-income families are the least damaging mechanism for closing state fiscal deficits in the short run. Reductions in government spending on goods and services, or reductions in transfer payments to lower-income families, are likely to be more damaging to the economy.

Economists also know that federal stimulus funding generates the most impact on the economy when it is directed towards maintaining essential services. Mark Zandi from Moody's Economy.com, a firm providing consulting services to both business and government, has estimated that federal investments in direct transfers to low-income individuals and relief to enable states to maintain services and invest in infrastructure have the highest positive economic impact (\$1.36 to \$1.73 for every dollar invested), while tax incentives to wealthy individuals and corporations produce the lowest impact (\$.27 to \$.37 for every dollar invested).

The same logic applies to state budget choices, but here the importance of continuing services such as Medicaid and IV-E (child welfare) that are jointly funded by the federal government is even more pronounced. For these services, every state dollar cut from the budget means the loss of two matching federal dollars. On the other hand, the impact of tax increases at the state level is less pronounced than it would be federally, both because much of the impact would be outside Iowa and because higher state taxes would be offset by lower federal tax liabilities.

In short, across-the-board cuts in state appropriations will have a significant adverse impact on Iowa's economy, producing negative effects that are likely many times more severe than the consequences of any tax changes affecting higher income Iowans and multistate corporations.

4. Tax policies must be part of any state fiscal "belt tightening." While tax credits have grown much faster than general fund expenditures as a whole, they are much less subject to review or evaluation for their effectiveness or public benefit.

Since 1990, Iowa has enacted a wide range of tax incentives and benefits promoted to attract businesses or expand business activity. The cost of these business tax incentives to the state treasury has grown at many times the rate of growth of state revenues or state appropriations. Business tax incentives are projected to exceed \$405 million in SFY2010, a 350 percent increase since SFY2005.

These tax incentives are not subject to the annual review or reauthorization required of general fund appropriations. Names of corporate beneficiaries and the amounts of their benefits largely are not disclosed, making accountability for such expenditures impossible. Much economic research suggests the actual benefits of such incentives to state economic activity are very small in relation to their costs, if they exist at all.

As Iowa looks to tighten its fiscal belt, tax expenditures as well as appropriations need to be subject to review. As these are reviewed, it also is important to look seriously at the fairness of Iowa's overall tax system and how Iowa's tax system can better reflect tax principles.

5. Iowa must respond in ways that are consistent with the public's views regarding essential services. Voters have definite views of where services should and should not be cut. These views deserve consideration as lawmakers take action.

Iowans expect efficient and effective state government that produces a high-quality educational system, ensures that seniors can live in dignity, meets health needs for vulnerable Iowans, and provides for public safety. Iowans recognize that some services provide a safety net that must not be reduced in times of economic stress.

In a poll commissioned by the Child and Family Policy Center, Selzer and Associates surveyed 513 Iowa voters on a number of issues. One question directly asked voters their views regarding different state government programs and is shown below:

Iowa lawmakers will be thinking about whether and how to make cuts in some government services next year. For each of the following areas of government spending, please tell me if you think it should be protected from any cuts, should share in cuts equally with other programs, or should be among the first to be cut.

	Protected From cuts	Share equally In cuts	Be among First cuts	Not Sure
Sorted by Protected from cuts.				
C. Services for abused or neglected children	79	18	1	2
A. Health care for low-income children	77	19	2	2
H. Nursing home care for low-income seniors and persons with disabilities	67	30	2	1
D. Funding for public education for kindergarten through 12 th grade	66	30	2	2
F. Health care for low-income adults	50	43	6	1
I. Funding for energy conservation and alternative energy programs	41	46	12	1
G. Preschool education for 4-year-olds	40	38	19	3
J. Funding for higher education, including community colleges	36	51	10	3
E. Economic development grants to encourage businesses to build or expand in Iowa	27	53	17	3
K. Cash incentives to encourage businesses to invest in research for new products and services	15	46	35	4
B. Prison construction and expansion	11	48	36	5

As this poll shows, Iowa voters place services to vulnerable Iowans at the top of the list for protection from across-the-board spending cuts. Voters place cash incentives to businesses, such as those provided through the research activities credit, at the top of the list for receiving cuts.

When the Iowa General Assembly convenes January 12th, fiscal issues clearly will be at the top of the agenda. Iowans are looking to the Governor and the General Assembly for solutions that are practical and take into account the realities of their daily lives. While a budget crisis brings many challenges, it also provides an opportunity to position Iowa for the future and should prompt lawmakers to ask hard questions about tax policy as well as appropriations choices.

The Iowa Fiscal Partnership is committed to providing our insights and expertise to this discussion and can share more detailed information on all the points raised in this letter.

Respectfully submitted,

David Osterberg
Iowa Fiscal Partnership Co-Director
Iowa Policy Project

Charles Bruner
Iowa Fiscal Partnership Co-Director
Child and Family Policy Center