GROWING IOWA'S ECONOMY

A BLUEPRINT FOR FREE-MARKET SOLUTIONS

ITR FOUNDATION

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ITR FOUNDATION

Introduction

Iowa's economy is growing, but it is important to ensure that this growth continues. While being tested over the past two years with the COVID-19 pandemic and storms that have left massive devastation, our economy has proven to be resilient. Even with the strength Iowa's economy has shown in the face of such tests, it is still confronted by major challenges such as rural economic headwinds and the need for workers to fill a plethora of jobs. One major reason Iowa's economy has remained on the right track is that the state has been following sound public policies that foster economic growth and opportunity.

For several years now, states across the nation have been demonstrating two remarkably different approaches to economic policy. One set of states seems to believe that high taxes, rapid spending growth, and lots of regulation are the key to prosperity. Each of those policy strategies point to a belief that government can and should be heavily involved in driving economic growth. States like Illinois, California, and New York have embraced that philosophy. Those three states have seen their population growth lag behind the rest of the country and they will lose Representatives in Congress because of it.

The opposite approach to growth embraces free-market principles. This strategy believes in less government involvement, and instead places faith in the ingenuity and determination of its citizens and businesses. Florida, North Carolina, and Texas, for instance, have grown faster than the rest of the country and will soon be sending more members to Congress because of it. Those three states have spent the past decade crafting policies that lower taxes, reduce the regulatory burden, and rely on the choices of their citizens instead of government mandates and control.

Governor Kim Reynolds has made growing Iowa's economy and creating opportunity a cornerstone of her policy agenda. The governor, along with the legislature, has enacted a series of tax reform measures that have begun the process of reducing the tax burden. Equally important, Iowa lawmakers have restrained the growth of spending.

2022 is an inflection point for Iowa. Elected officials who want people to move to our state, our jobs to be filled, and our economy to grow, have decisions to make. They can follow the lead of President Biden and the U.S. Congress and attempt to find a government solution for each of their goals. But they could also choose to build on the policy foundation they've laid over the past several years by removing barriers to work and allowing Iowans to hold onto more of their own money. The free-market solutions presented in this report are a blueprint for growth and a reliable roadmap for Iowa's future.

Income Tax Reform

"Today's legislation ushers in a new era of growth and opportunity in Iowa," said Governor Kim Reynolds when signing the 2021 tax reform bill into law. "But we are not done yet. Next year, I'll be proposing additional income tax cuts as we continue to make Iowa the most attractive place in America to open a business, raise a family, and start a career," stated Governor Reynolds. Iowa was one of 15 states that passed tax reform bills in 2021, continuing the work to improve Iowa's tax climate that began in 2018. As Governor Reynolds has said, however, that work will need to continue.

In 2022, policymakers will have an opportunity to enact historic tax relief. Iowa's budget

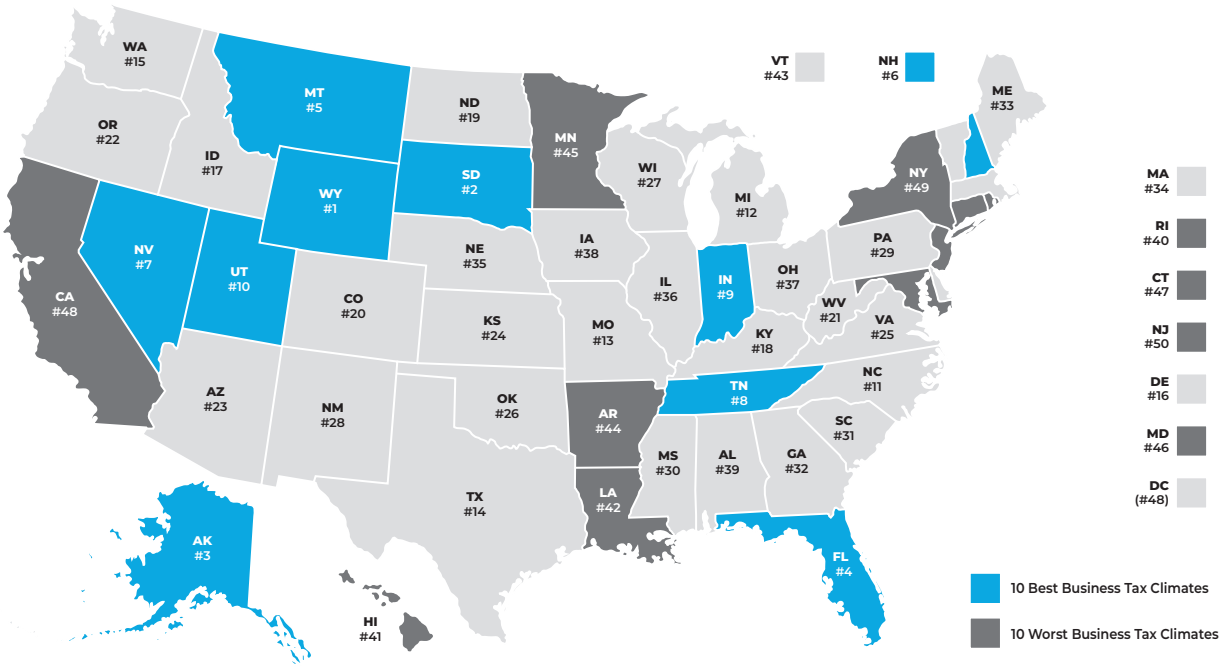
finished the 2021 fiscal year with a $1.24 billion surplus, which also means that over $1 billion is sitting in the state's Taxpayer Relief Fund. It is projected that by summer 2022 the balance of the Taxpayer Relief Fund could increase to $2 billion. Because of an economy that remained open and productive, as well as years of conservative budgeting, the legislature will have an opportunity to deliver large tax cuts.

Iowa's tax climate matters because it impacts not only the earnings of hard-working Iowans, but it also determines how competitive and attractive the economy will be in comparison to other states. The Tax Foundation, in their *2022 State Business Tax Climate Index*, ranks Iowa 38 out of 50 in terms of tax climate. Improving two spots from the previous year's ranking, Iowa is beginning to reap the rewards of earlier tax changes, especially the 2018 reforms. One reason Iowa hasn't climbed further in the rankings despite those many positive reforms is so many other states are working to reduce their tax rates, as well.

Iowa cannot become complacent as it is competing with 49 other states for both jobs and people. The recent census data demonstrates that states that have low income tax rates, or no income tax at all, are gaining population. Taxes act as incentives and they can encourage or discourage certain economic behaviors. As an example, Iowa has become a leader in the insurance industry. This is due in part to the poor tax and regulatory policies in the state of Connecticut, where many insurers were previously headquartered. Firms have left Connecticut, which used to be first in the nation as a home for insurance companies, and settled in Iowa.

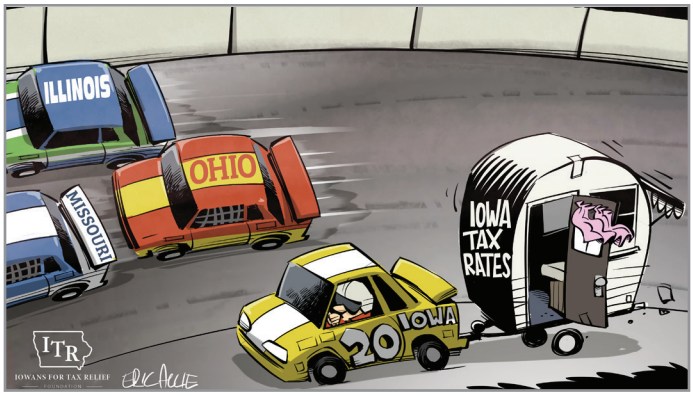
A crucial component of the 2021 tax reform law, besides phasing-out the inheritance tax, was ensuring lower income tax rates go into effect in 2023. The top individual rate will fall to 6.5 percent next year, and the number of individual income tax brackets will condense from nine to four with a bottom rate of 4.4 percent.

2022 State Business Tax Climate Index



Note: A rank of 1 is best, 50 is worst. D.C.'s rank does not affect other states. The report shows tax systems as of July 1, 2021 (the beginning of Fiscal Year 2022).
Source: Tax Foundation

In 2021 Iowa's corporate tax rate was lowered from 12 percent, the highest in the nation, to 9.8 percent, tying us with Minnesota. In comparison, Nebraska passed a corporate income tax cut this year which will gradually lower its rate to 6.84 percent. While corporate tax reform wrongly gets associated with "tax cuts for the rich," the reality is the cost of high corporate taxes are simply passed onto consumers. High corporate tax rates not only discourage businesses from operating in Iowa, but they also end up hurting productivity and employment.



As the Iowa legislature considers income tax changes in 2022, priority should be placed on further lowering our high rates for individuals and businesses.

Lowering income tax rates requires continued fiscal vigilance and following conservative spending practices. In addition to keeping the growth of spending in check, policymakers should also examine Iowa's numerous tax credits and incentives. Lower income tax rates for everyone are far better than relying on a tax code dominated by credits and incentives that benefit select special interests.

A number of elected officials in Iowa have stated that their ultimate goal is to eliminate Iowa's income tax. Eliminating the income tax is a worthy policy goal and one that ITR Foundation supports, but states such as Utah, North Carolina, and Indiana have enacted pro-growth tax reforms without completely eliminating their income tax. While Utah has been steadily chipping away at their tax burden, that state's gross domestic product has almost tripled since 1999. In North Carolina, the Tar Heel State's historic tax reforms have continued and in 2021 lawmakers there passed a plan to phase out the corporate income tax by 2030.

Lower tax rates may take time to fully implement, but policymakers have numerous policy tools they can choose to utilize. Revenue triggers, phased-in rate reductions, eliminating tax credits and incentives, and broadening the sales tax base, among other measures, can be used to help lower income tax rates. Legislators can also simply control the growth of spending and bring tax rates down accordingly. While elimination should be the long-term goal, Iowa's immediate focus should be continuously lowering tax rates.

One word of warning about the use of revenue triggers before tax rates can be cut: triggers are meant to be budget safeguards, not roadblocks to cuts.

It is likely that the most challenging barrier to tax reform will be the need for policymakers to say "no" to the numerous special interests arguing for new or additional spending. When every other argument is peeled away, spending demands are the leading driver of high tax rates.

Property Tax Reform

Income taxes aren't the only piece of Iowa's tax climate that impedes economic growth; our heavy property tax burden is harmful, too. Iowans are increasingly frustrated about their property taxes, likely because their local governments send them a bill that continues to grow each and every year. Thankfully, a solution exists that will benefit all property taxpayers in

Iowa. Utah's direct notification Truth-in-Taxation law has brought real property tax relief to Utah, and more states are starting to pass this pro-taxpayer reform.

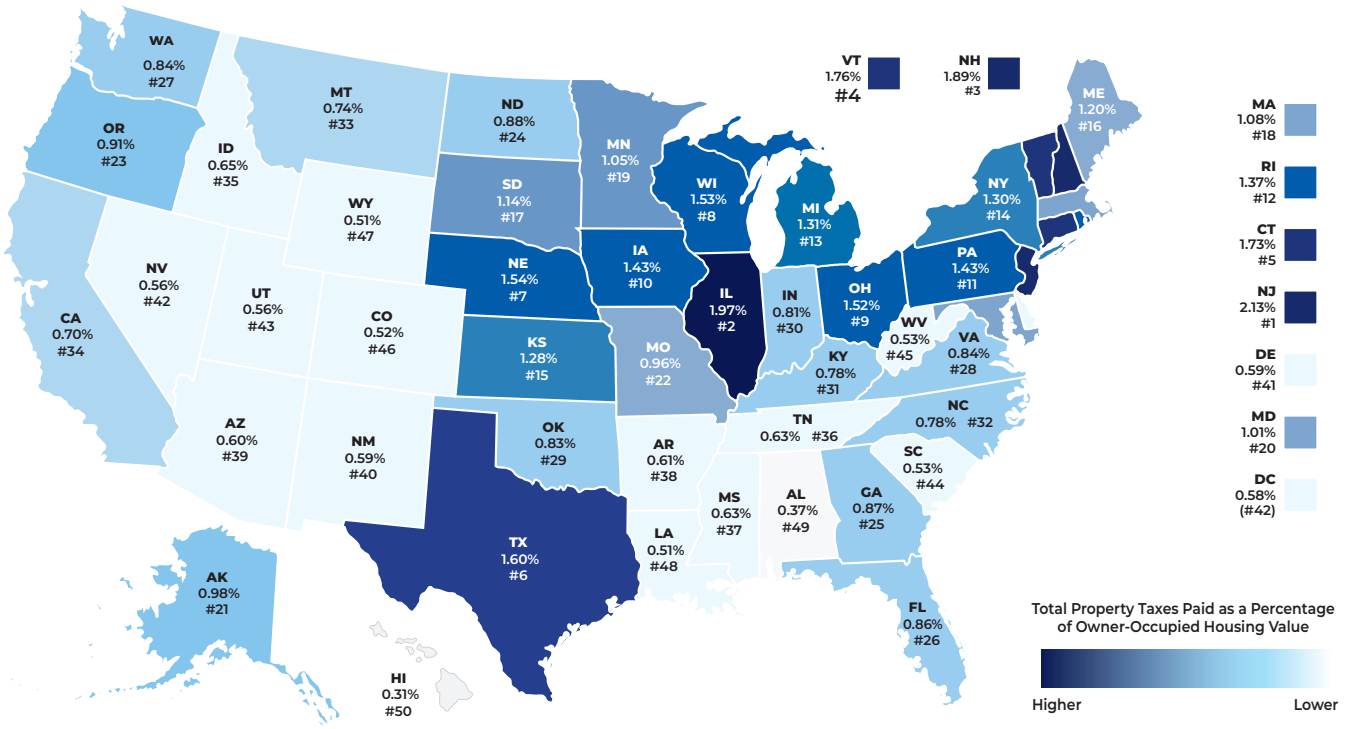
In 1985, Utah's legislature passed a Truth-in-Taxation law to address high property taxes. Prior to Truth-in-Taxation, Utah taxpayers were facing the same challenge Iowans face now: property taxes increasing faster than the combined rates of inflation and population growth. Since the passage of Truth-in-Taxation, though, property tax rates have fallen back in line with those broader measures of growth. Today the Tax Foundation ranks Utah as having the eighth lowest property tax burden in the country. By comparison, Iowa has the tenth highest. Utah's Truth-in-Taxation law is the gold standard for property tax reform and is considered one of the most taxpayer-friendly laws in the nation.

Truth-in-Taxation refers to strict transparency and accountability requirements that local governments must follow to raise property taxes. Sunlight is provided to the local government budgeting process by forcing local governments to tell taxpayers exactly what a proposed budget will do to tax bills, and then hold a forum for citizen input. No longer can a city council, for instance, hide behind a levy rate or blame the county's assessor for property tax increases.

Too often, local governments reap a windfall generated by increased assessments, and the taxpayer is left wondering why their tax bill is higher. If assessments increase by 10 percent, it does not mean that a taxpayer has 10 percent more in their bank account. When local government officials argue that they are not to blame for higher tax bills in these circumstances, an honesty gap is created.

How High Are Property Taxes in Your State?

Property Taxes Paid as a Percentage of Owner-Occupied Housing Value, 2019

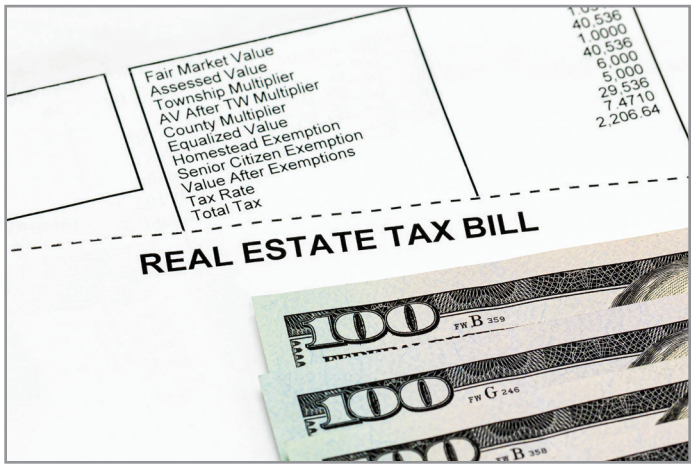


Note: The figures in this table are mean effective property tax rates on owner-occupied housing (total real taxes paid/total home value). As a result, the data excludes property taxes paid by businesses, renters, and others. D.C.'s rank does not affect states' ranks, but the figure in parentheses indicates where it would rank if included.

Source: U.S. Census Bureau, "2019 American Community Survey"; Tax Foundation Calculations

Kansas is one recent example of a state seizing Utah's property tax solution. In 2021 the Kansas legislature passed a Utah-style Truth-in-Taxation law. To date, more than half of all cities, counties, townships, school districts, and special tax districts in Kansas decided to not increase property tax this year.

One fundamental aspect of Truth-in-Taxation is direct notification. Under both the Utah and Kansas laws, local governments must send notices directly to taxpayers, providing information on the proposed tax increase and **how it will impact that particular property owner's tax bill**. The notices include the date, time, and location of the Truth-in-Taxation budget hearing. This extensive public notification and hearing process has been successful. It also forces local governments to take a recorded vote after the Truth-in-Taxation hearing, making politicians think twice and justify their spending increases before raising taxes.



Another aspect of Truth-in-Taxation is property tax rates automatically "ratcheting down". As assessments or valuations increase, tax rates are automatically decreased to provide local governments the same amount of property tax dollars they received the previous year. If local governments want to increase spending by increasing property taxes, it then triggers the Truth-in-Taxation hearing.

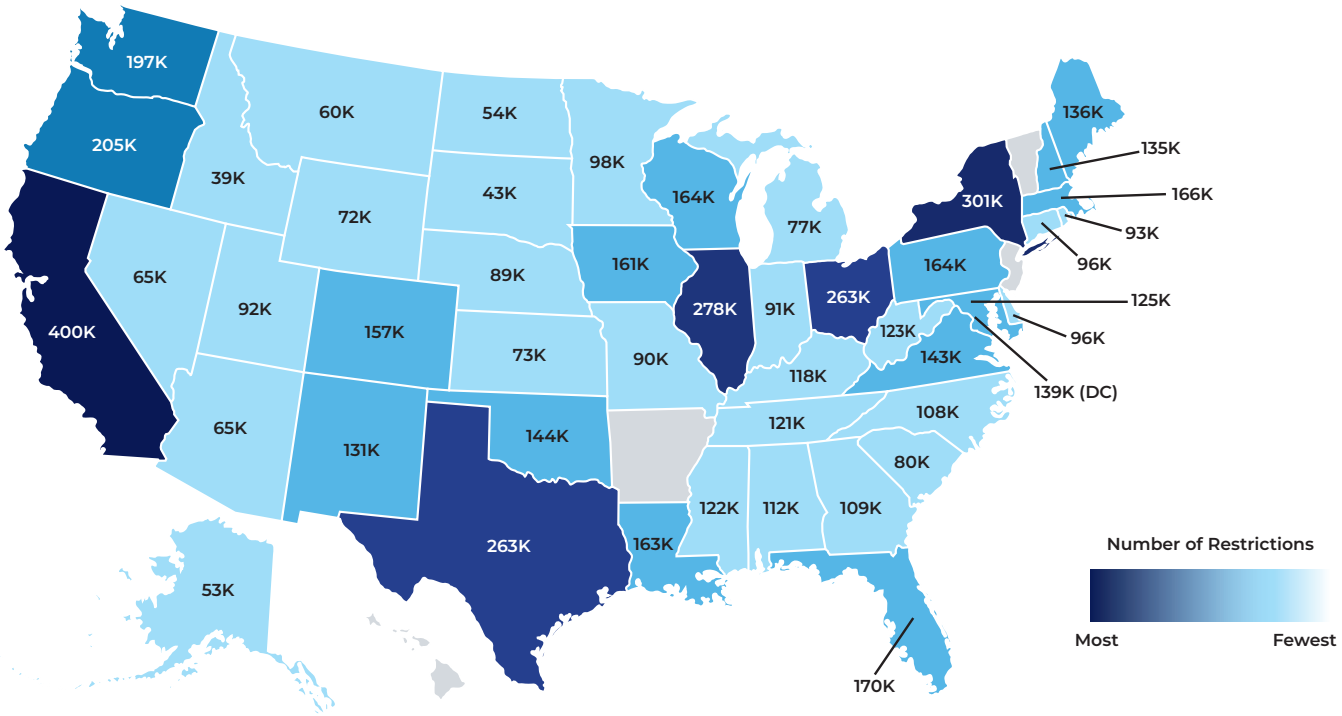
Spending is at the heart of high property taxes. The voice of the taxpayer is often drowned out by special interests who are demanding local governments spend more money on their respective cause. Some of these causes may be noble, but Truth-in-Taxation gives property owners a more complete picture of local finances, and a better opportunity to weigh in on the budgeting process.

Regulation

"Regulations influence behavior. When we want less of something, we regulate it. For the sake of our families, young people, and low-income workers, we must not regulate jobs out of existence," stated Rea Hederman, Executive Director of the Economic Research Center and Vice President of Policy at Ohio's Buckeye Institute for Public Policy. Reducing the regulatory burden on an economy will also spur economic growth, as President Trump demonstrated when his administration combined tax cuts with eliminating unnecessary regulation. That type of free market reform would be particularly powerful in Iowa, since we are home to some of the highest levels of state regulation in the Midwest and across the country.

James Broughel, a Senior Fellow at the Mercatus Center at George Mason University, argues that regulatory red tape is a "drag on economic growth." Regulations are not just rules printed in state code. They impact the cost of doing business, raising prices for consumers, and ultimately lowering the standard of living for Iowans. Broughel recommends strengthening Iowa's regulation review process, "Rules in Iowa are supposed to be reviewed every five years, but that process lacks teeth. Agencies just have to issue a report summarizing the results of their reviews—there's no requirement for rules to go away if they've outlived their usefulness."

State-Level Regulatory Restrictions, 2021



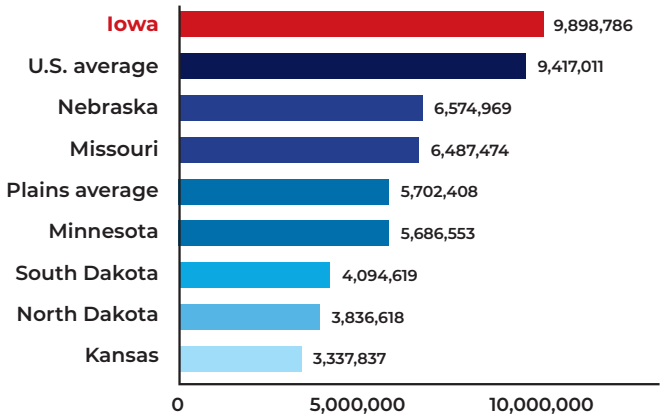
Note: Version 3.0 of State RegData includes data on 44 states and the District of Columbia that were gathered between May and September 2021. Uncolored state are those for which the number of regulatory restrictions has not been calculated. Data for Alaska, Connecticut, and Utah are from years earlier than 2021 owing to data availability issues.
Source: Patrick A. McLaughlin et al., State RegData 3.0 (dataset), QuantGov, Mercatus Center at George Mason University, Arlington, VA, accessed by Sept. 21, 2021

Regulatory reforms in North Carolina and Idaho can serve as examples for Iowa's regulatory reform. "North Carolina has a 10-year review process, but the state also sets a schedule of expiration dates for rules so that they cease to exist unless reauthorized. In Idaho, rules must be repealed on a five-year staggered basis. If the regulating agency wants to keep its rule, it must refile a new one," stated Broughel.

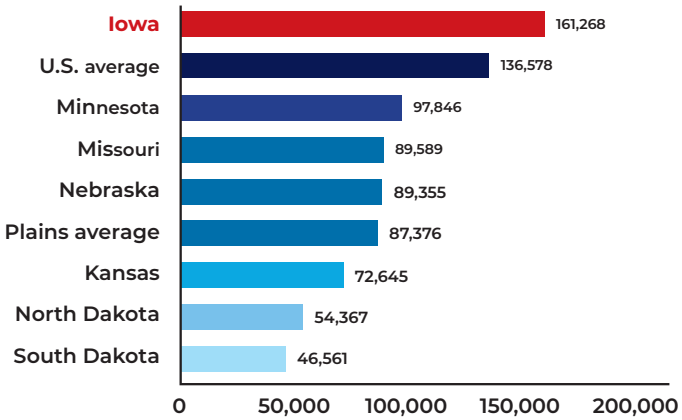
Iowa could also duplicate a regulatory reform measure President Trump instituted. Under the former President, agencies had to eliminate two regulations for every new one enacted. Oklahoma and Ohio are two states that are now following this approach.

Reviewing and eliminating excessive and unnecessary regulations will help Iowa businesses, and create a more supportive climate for economic growth.

Word Count in State Administrative Codes, Plains Region

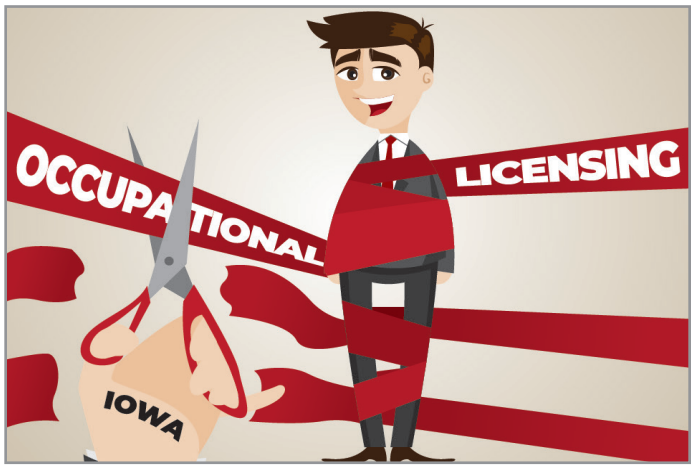


State Regulatory Restrictions in U.S. States, Plains Region



Occupational Licensing

The ability for Iowans, as well as those who relocate to Iowa, to earn a living will be greatly improved due to 2020's historic occupational licensing reforms passed by the legislature and signed into law by Governor Kim Reynolds. Those reforms allow for universal recognition of out-of-state licenses, waive licensing fees for low-income individuals, and establish a standard for a fairer review process if a license is denied based on past criminal convictions. Reforming occupational licensing expands liberty and makes Iowa a more competitive state.



Removing career barriers should not stop with 2020's improvements, but also include a regular review process for occupational licenses and licensing boards. While protecting the health and welfare of the public is important, these licenses and boards must not restrict the ability for an individual to earn a living.

In reviewing licenses and boards, policymakers should consider both sunrise and sunset measures. Existing licenses and boards should be subject to a sunset provision that would require the legislature to periodically review the need for a specific license or board, and the existing guidelines. Any new license or board should also be subject to a sunrise provision, which would require a review to make sure that the proposed license or board is needed and does not restrict occupational freedom.

Iowa's neighbors in Nebraska have developed a blueprint for these review processes. Nebraska's system does not imply that all licenses should be repealed, nor does it recommend a "free-for-all" economy. The Nebraska model simply requires that an occupational license is reviewed every five years by the appropriate legislative committee. The legislative committees are tasked with reviewing occupational regulations and issuing a report that recommends "ending, modifying, or maintain(ing) these regulations."

The review "must include information on the number of licenses issued or denied by the board being reviewed, an examination of the basic assumptions underlying the board's powers, and a comparison of what other states do in similar occupations."

The Nebraska legislation declares that an individual's right to pursue work is a "fundamental right" and that the "state should use the least restrictive means to protect the public when regulating an occupation."

Further reforming occupational licensing will create opportunities for Iowans and make our state more attractive for workers and employers.

Home-Based Businesses

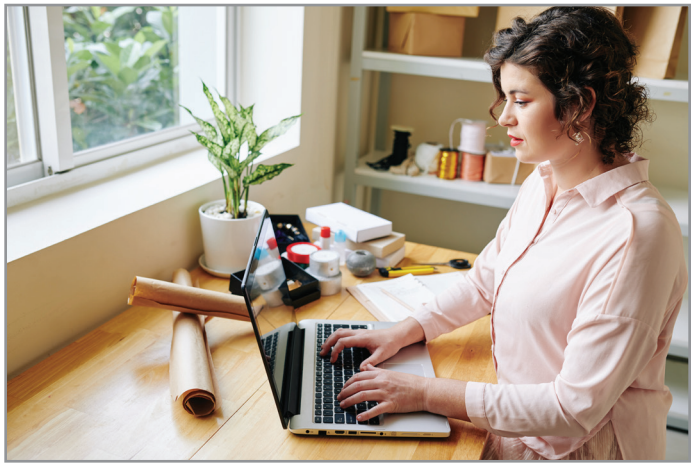
A *Des Moines Register* headline from September 2020 posed a question that is already being answered in the affirmative: *As working from home becomes routine, will others follow?* It's not just large corporations in Iowa's biggest city that have shifted where their employees work, but employers of all sizes in every corner of the state have developed flexible and remote work options. Just three years ago, 13 percent of Americans were working from home. At the height of the coronavirus

pandemic in 2020, that number had grown to nearly one third of Americans. It is natural to assume that out of necessity or opportunity, a similar trend has occurred among entrepreneurs.

While offices of all sizes sit empty across the country now, working from home is not a new phenomenon. It is a widely accepted fact that Apple Computers was a business that started in the garage of its founder, Steve Jobs, back in the 1970s. Not everyone working from home intends to launch the next tech giant, though. For years, Iowans have operated businesses that offer child care, or piano lessons, or haircuts out of their homes. While these smaller home-based businesses (HBBs) may never grow to rival Apple, collectively they make a big impact on their local economies and an equally large impact on the customers they serve.

There are different reasons for launching a HBB. For some entrepreneurs, these businesses begin as a way to pursue a passion or to generate a second income and that work is most easily done from home, allowing them to balance their existing personal and professional responsibilities. For others, they simply view their garage or spare bedroom as a more cost-effective, and often temporary, option than leasing commercial space. Others still may simply not have any other choice but to launch their business from home, as they are shut out from traditional sources of capital that would otherwise be available to a main street business. For those entrepreneurs, HBBs are the best route to pursue growth and financial freedom.

As Iowa's economy continues to grow past the impact of the pandemic, it is important for HBBs not to be left behind. In fact, precisely because of the flexibility working from home offers, HBBs could play an important part of getting more Iowans into the workforce. Unfortunately, most HBBs face a patchwork of local regulations and licensing requirements that can restrain their growth and put them under a continuous threat of fines or closures.



The focus of local government regulation on a community should center on public safety. To ensure that individuals can start a home-based business without battling regulatory roadblocks, state policymakers could establish guidelines that will encourage entrepreneurship, while protecting public safety. This would also create a uniform network of guidelines for home-based businesses.

Some of these guidelines would include exempting home-based businesses from regulations if they:

- Employ less than three nonresident individuals.
- The business does not cause parking or traffic issues within the neighborhood/community.
- The business is not the primary purpose of the home.
- The business cannot be visible from the street.
- The business must be compatible with residential uses.
- The business must comply with all city and county health and safety regulations.

Arizona refers to these as "no impact" home-

based businesses. Arizona has passed model legislation for other states that creates these uniform guidelines. The law exempts home-based businesses that are “no-impact” if they meet the above criteria. Under this reform, local governments would still be able to regulate public safety measures such as building codes, fire codes, and environmental concerns such as noise and pollution.

Removing regulatory roadblocks to home-based businesses will encourage greater entrepreneurship and create more opportunities for economic growth in communities across Iowa.

Reforming Unemployment

Iowa employers currently have numerous jobs available illustrating that a major problem confronting businesses is the need for workers. The COVID-19 pandemic has impacted Iowa’s labor force and as the economy works through that impact, it will be important to encourage people to move back into the workforce. An area of reform that should be considered is Iowa’s unemployment guidelines.

Recently, Governor Reynolds announced changes at Iowa Workforce Development that will attempt to transition unemployed Iowans back into the workforce as quickly as possible. The new plan calls for more case managers at Workforce Development to assist Iowans and help them find work. It also will increase the number of search requirements applicants must do each week.

Other reforms could also be considered to link-up out-of-work Iowans with the many employers who are in need of workers. Iowa’s unemployment system could index benefits to conditions of the economy. Indexing refers to establishing a sliding scale that determines how long a person can draw unemployment payments. When unemployment is low, the number of weeks one can draw benefits would be reduced, while higher unemployment would extend the allowable time for unemployment benefits. As an example, if a state’s unemployment rate is below 5.5 percent, then 12 weeks of unemployment compensation would be available. This would increase as the unemployment rate rises and a max of 26 weeks could be established if unemployment exceeds 9 percent.

Currently, Iowa allows a person to draw up to 26 weeks of unemployment benefits. Under certain circumstances, such as a factory closing, that period may be expanded to as much as 39 weeks of unemployment benefits.

“By indexing unemployment benefits to economic conditions, employers are able to hire more workers, individuals move back to work more quickly, and states are better prepared for economic downturns,” wrote Jonathan Ingram, Vice President of Policy and Research at the Foundation for Government Accountability.

Georgia, Florida, and North Carolina all indexed unemployment benefits to economic conditions. When the pandemic hit, the unemployment trust funds in these states were all in better financial condition than many funds in states without

indexing. Ingram noted these states "have moved people off unemployment insurance and back to work nearly twice as quickly as non-reform states."

Transitioning workers off unemployment not only places people back into the workforce but also creates savings for employers from paying more into the unemployment trust fund. "Florida, Georgia, and North Carolina show that indexing unemployment better positions states to handle these downturns, allows businesses to hire more workers, gets people back to work more quickly, and helps businesses reinvest in their companies," wrote Ingram and Josh Waters, a Senior Research Fellow with the Foundation for Government accountability.

Another reform that Iowa could consider is a waiting period for unemployment benefits. Most states have a one week waiting period before an individual becomes eligible for unemployment benefits, but Iowa does not. One benefit of the short waiting period is that fraudulent unemployment claims can be weeded out before a check is sent. Less fraud in the system means more people back to work.

Program Integrity and Work Requirements

In Iowa, Medicaid is not only one of the most significant drivers of the budget but also one of the fastest growing. Medicaid is a shared expense between states and the federal government, but recent policies on the national level, especially the Patient Protection and Affordable Care Act, have led to an expansion in recipients.

Iowa needs to audit its Medicaid program to ensure Iowans who truly need the services are protected and have access to funds, as well as confirm that taxpayer dollars are not needlessly spent on those who don't actually qualify. Several states have conducted audits of their respective Medicaid programs, and the results confirm that abuse is occurring within their systems. Some audit findings from those states include:

- Michigan identified more than 7,000 lottery winners who were still collecting welfare, some with jackpots as high as $4 million.
- Illinois uncovered more than 14,000 dead enrollees on Medicaid.
- Utah and Maine found that individuals were using their welfare benefits exclusively out-of-state.
- Arkansas discovered more than 20,000 individuals with high-risk identities, including people using stolen identities or even fake Social Security numbers, who were enrolled in its program.
- Louisiana's legislative auditor made a random selection of 100 Medicaid recipients and determined that 82 of those individuals were not qualified to receive the level of benefits they were being given.

Two additional states have found savings eclipsing $100 million in their Medicaid systems. In March of 2019, Oregon announced that a Medicaid audit would save the state over $100

million annually by ending improper payments to people who didn't qualify for the program. The North Carolina State Auditor reported that the Department of Health and Human Services improperly paid more than $100 million in Medicaid claims, which included overpayments to providers and benefits to ineligible recipients.

Other social support programs beyond Medicaid, including food stamps (SNAP), should receive greater scrutiny through verification requirements to ensure only the people who truly qualify for support are receiving government assistance.

Iowa should also consider work requirements. Those who are on Medicaid and who can work should be required to do so. Intelligently-crafted work requirements have led many people out of poverty and back into the workforce, breaking the cycle of government dependency.

Enhanced program integrity and work requirements for those who are able can combine to make a real difference in the financial futures of many, while also supplying Iowa with a larger labor force.

Conclusion

The tax and regulatory reforms outlined in this report offer a policy blueprint that will encourage economic growth and create new opportunities for Iowans. These reforms will also make Iowa more competitive when trying to attract new residents and employers. Governor Reynolds and the Republican-led legislature deserve credit for enacting policies that have created a stable fiscal foundation and a growing economy.

Iowa's emergence from the COVID-19 pandemic and devastating weather events demonstrates that our economy is resilient, in large part due to the hard work and ingenuity of Iowans. But conservative policies, prudent spending decisions, and an improving tax climate have been crucial, too.

Policymakers can keep the momentum going! The solutions offered here are not an exhaustive list but implementing tax and regulatory reforms like these will help make Iowa an economic leader in our region and across our nation.

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