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IOWA'S "D.O.G.E."

HOW STATE GOVERNMENT ALIGNMENT IS RETURNING MONEY BACK TO IOWANS AND CONTRIBUTING TO THE STATE'S ECONOMY

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ABOUT THE AUTHOR

Ben Murrey is Iowa Director of Policy and Research with the Common Sense Institute (CSI) where he leads the research efforts of CSI Iowa to provide insightful, accurate and actionable information about the impact of public policy on families, businesses, and communities.

With over a decade of experience researching and advising lawmakers on tax and economic policy, Ben has contributed to key legislative and ballot issues at the state and federal level, including the 2017 Tax Cuts and Jobs Act and landmark state tax reforms. In addition to publishing regular research reports for CSI, Ben has been published in state and national outlets including the Wall Street Journal, Real Clear Policy, the Corridor Business Journal, the Colorado Springs Gazette, and others. Prior to joining CSI, Ben worked for a state-based think tank in Colorado and as a U.S. Senate aide for tax, budget, and economic policy.

ABOUT COMMON SENSE INSTITUTE

Common Sense Institute is a non-partisan research organization dedicated to the protection and promotion of Iowa's economy. CSI is at the forefront of important discussions concerning the future of free enterprise and aims to have an impact on the issues that matter most to Iowans. CSI's mission is to examine the fiscal impacts of policies, initiatives, and proposed laws so that Iowans are educated and informed on issues impacting their lives. CSI employs rigorous research techniques and dynamic modeling to evaluate the potential impact of these measures on the economy and individual opportunity.

TEAMS & FELLOWS STATEMENT

CSI is committed to independent, in-depth research that examines the impacts of policies, initiatives, and proposed laws so that Iowans are educated and informed on issues impacting their lives. CSI's commitment to institutional independence is rooted in the individual independence of our researchers, economists, and fellows. At the core of CSI's mission is a belief in the power of the free enterprise system. Our work explores ideas that protect and promote jobs and the economy, and the CSI team and fellows take part in this pursuit with academic freedom. Our team's work is informed by data-driven research and evidence. The views and opinions of fellows do not reflect the institutional views of CSI. CSI operates independently of any political party and does not take positions.

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INTRODUCTION

The state of Iowa does not have a Department of Government Efficiency, however, Iowa lawmakers began improving government efficiency through a state initiative known as "alignment" more than a year before the American public ever heard of a "DOGE" at the federal level.1 This report evaluates Iowa's 2023 government alignment.2 Specifically, it identifies the portion of the 2024 tax cuts attributable to the savings from alignment and uses dynamic modeling to forecast its economic impact on the state.

By controlling the rate of growth in government, Iowa lawmakers increased state surpluses over the last five years even while cutting taxes and expanding total state spending.3 During a period when individual income taxes fell from a top marginal rate of 8.98% to a flat rate of 3.8% and the top corporate rate fell from 12% to 7.1%, total state spending rose by nearly 23%.4 Education and healthcare saw the greatest increases in spending.5 When revenue growth outpaces the growth in government, the state can increase its revenue and spending even as tax rates fall. State government alignment helped moderate government growth over the last 18 months, resulting in significant savings for the state budget relative to the counterfactual.

Most recently, the legislature enacted additional reductions to the state's individual income tax rates during the 2024 legislative session. Reforms prior to 2024 gradually lowered individual income tax rates over time, condensing Iowa's nine tax brackets with a top rate of 8.98% in 2018 to a single rate of 3.9% in 2026.6 The 2024 reform moved the state to a single flat rate of 3.8% starting in tax year 2025. The change took the state to a single rate one year sooner and reduced the final rate by 0.1%. A June 2024 CSI report, Iowa's 2024 Income Tax Cuts: Dynamic Economic and State Revenue Impacts, goes into more detail on the most recent income tax reductions and their impact on Iowa's economy and the state government's revenue and spending.7 Using dynamic economic and revenue forecasting, it concludes the state can sustain its tax cuts to date without cutting government services. However, this achievement required deliberate policy choices, which last year's report did not evaluate. This report serves as an addendum to last year's report, investigating alignment's contribution to the state's ability to enact additional tax cuts in 2024. Readers who have not seen CSI's report on Iowa's 2024 income tax cuts may consider reviewing it for background and context for the following analysis.

KEY FINDINGS

CSI found Iowa's state government alignment—

- Allowed for an additional $217 million in income tax cuts.
- Enabled Iowa to lower its individual income tax rate from 3.9% to 3.8% two years sooner.
- Puts an additional $112 in the pocket of a median Iowa household.

CSI projects the portion of the 2024 tax cuts attributable to alignment will—

- Increase statewide after-tax income by $368 million over 5 years.
- Boost Iowa's GDP by $252 million over 5 years.
- Grow state tax revenue by $10.8 million over 5 years.

ALIGNMENT'S CONTRIBUTION TO INCOME TAX REFORM

In 2022, state lawmakers enacted HF 2317, which ended the nine-bracket individual income tax system in place since 1987 and initiated a schedule for gradually reducing Iowa's individual income tax rates. Starting in 2023, the bill moved the state to just four brackets with a top rate of 6%, down from 8.53%. It then put the state on track for three brackets and a top rate of 5.7% in 2024, two brackets and a top rate of 4.82% in 2025, and finally a flat rate of 3.9% starting in 2026. As explained in the section "Why It Matters" in CSI's report on the 2024 tax cuts, pandemic related stimulus precipitated a surge in state revenue at the existing tax rates.8 Rather than increasing state spending to their full allowance under the state statute, state budgeters chose to proceed conservatively, growing the state budget more slowly than revenues grew over the next two years. As higher revenues persisted, lawmakers continued to control the growth in state spending, instead choosing to reduce tax rates to bring revenues more in line with spending. In 2023, lawmakers enacted SF 514, directing state agencies to assess their structure and operations and identify opportunities to improve efficiencies.9 This reform helped control the growth in government spending and contributed to the state surpluses that allowed lawmakers to further reduce tax rates in 2024.10

FIGURE 1. PROJECTED COST SAVINGS OF ALIGNMENT

FOUR-YEAR COST SAVINGS OPPORTUNITIES

ALIGNMENT PROPOSALS	YEAR 1	YEAR 2	YEAR 3	YEAR 4	TOTAL SAVINGS
Strategic Personnel Alignment	$18.6 M	$19 M	$19.4 M	$19.8 M	**$76.8 M**
Reduce Office Space Footprint	$13 M	$3.5 M	$3.5 M	$3.5 M	**$23.5 M**
Consolidate Common Technology	$15.3 M	$15.3 M	$15.3 M	$15.3 M	**$61.2 M**
Recover Medicaid Matching Funds	$ 5.5 M	$0.3 M	$0.3 M	$0.3 M	**$6.4 M**
DOC Medical Cost Capture	$0.5 M	$0.5 M	$0.5 M	$0.5 M	**$2 M**
Community Based Corrections	$3 M	$3 M	$3 M	$3 M	**$12 M**
Land Sales	$17.6 M	—	$15.1 M	—	**$32.7 M**
TOTAL SAVINGS	**$73.5 M**	**$41.6 M**	**$57.1 M**	**$42.4 M**	**$214.6 M**

Source: Iowa Department of Management, Vision for Iowa State Budget: FY 2024, January 10, 2023, dom.iowa.gov/.

Figure 1 shows the cost savings the governor's office expected the state to experience over four years when proposing alignment in early 2023. The Department of Management prepared this projection six months before the state began implementation. In her 2025 Condition of the State Address, Iowa's governor announced alignment in fact saved the state $217 million in just 18 months.11 This new figure serves as the basis for CSI's analysis in this report.

In 2024, the year after the state implemented alignment and began seeing savings, the legislature enacted SF 2442. Presumably thanks in part to savings from alignment, the bill expedited and enhanced previously scheduled tax rate reductions. Rather than moving to two rates in 2025 and a flat rate of 3.9% in 2026, the bill took the state directly to a flat rate of 3.8% starting in tax year (TY) 2025. According to the bill's fiscal note, reducing the final permanent rate from 3.9% to 3.8% will reduce state revenue by $97 million relative to the prior law baseline in FY 2026-27. It will reduce FY 2028 and 2029 revenue by an estimated $96.8 million and $99.5 million, respectively. The cost of the rate reduction will increase each year thereafter in line with nominal statewide personal income growth. In effect, alignment allowed the state to move to a tax rate of 3.8% two years sooner and covered 23% of the cost of the 0.1% reduction in year three. Table 1 shows the rate reduction schedule prior to the 2024 income tax cuts, the actual new rates after the 2024 reforms, and the rates necessary to maintain the same state fiscal outcomes without alignment.

TABLE 1. STATE INDIVIDUAL INCOME TAX RATES UNDER THREE SCENARIOS

	Prior Law (HF 2317)	New Rates (SF 2442)	Rates without
2025	4.82%	3.80%	3.90%
2026	3.90%	3.80%	3.90%
2027	3.90%	3.80%	3.82%
2028	3.90%	3.80%	3.80%
2029	3.90%	3.80%	3.80%

Not considering secondary economic effects, the portion of tax reductions attributable to alignment amounts to an additional $112 in take-home pay for a median Iowa household earning $80,000 per year. In practice, the state could have promulgated the individual income tax reform found in SF 2442 even without alignment. State surpluses far exceed the amount necessary to offset the resulting change in revenue.12 However, state reforms under SF 514 follow the same formula by which the state has ratcheted down income taxes without cutting state government since 2018. Learn more about Iowa's approach to tax reform in the section of this report entitled "Background on State Budgeting and Tax Reform" and in CSI's previous report on Iowa's 2024 tax cuts under "Impact on the State Budget."13

ECONOMIC IMPACT OF ALIGNMENT

Common Sense Institute employs REMI to simulate the economic impact of Iowa's 2024 tax cuts. The following simulation applies only to the portion of the 2024 tax cuts paid for by savings from alignment and uses the following assumptions. First, it assumes the $217 million in savings from alignment contributed dollar-for-dollar to a reduction in the state individual income tax rate. Second, it makes the same assumptions as CSI's previous report on the 2024 income tax cuts about how the new capital enters the economy. It treats the share of the income tax reduction that will increase business income as a reduction in business production costs and the rest as an increase in personal consumption.14 Finally, the simulation does not change the model's baseline assumptions for state spending. Table 2 shows the macroeconomic impact on the state of Iowa of the portion of the 2024 tax cuts attributable alignment.

The simulation projects reducing taxes by $217 million in 2025 will increase after-tax personal income across the state by $368 million and expand Iowa's economy by $252 million over five years. It also estimates the increase in personal income and economic activity will result in a $10.8 million increase in state tax revenue over the 5-year period.

TABLE 2. 5-YEAR DYNAMIC ECONOMIC IMPACT OF ALIGNMENT

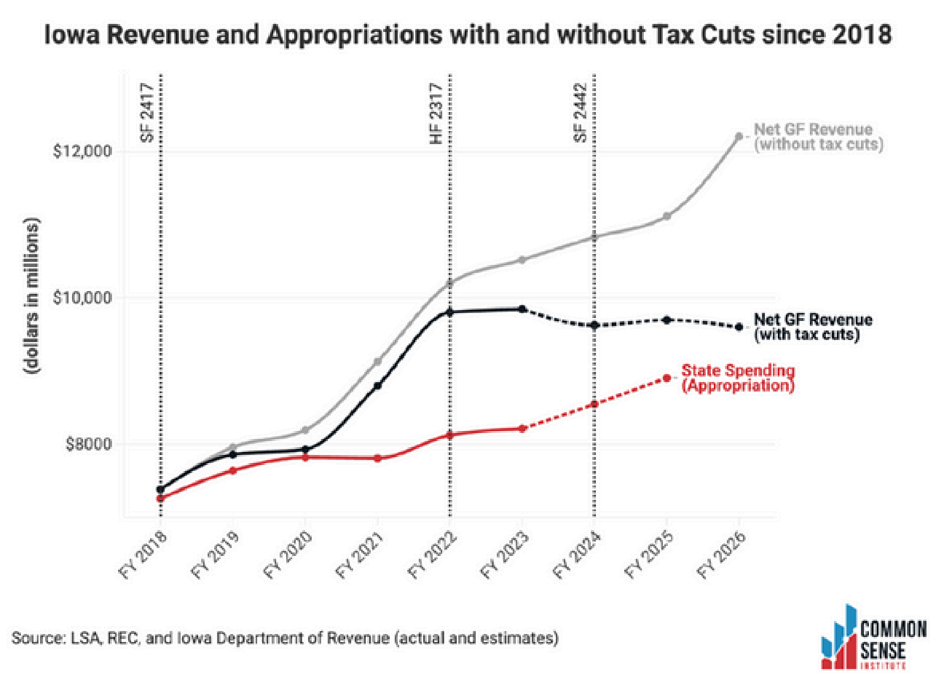
(dollars in millions)	5-year Impact
Direct Income Tax Savings	$217.0
Total Statewide Growth in After-tax Income	$368.4
Change in Gross Domestic Product	$251.9
Increase in State Revenue	$10.8

BACKGROUND ON STATE BUDGETING AND TAX REFORM

State lawmakers' approach to tax reform has a profound impact on how tax cuts impact a state and its economy. Generally, reducing the tax burden on income has stimulative effects for an economy and increases disposable income for individuals and businesses.15 However, if not done responsibly, reducing tax rates can lead to a state budget shortfall with deleterious effects on the state's ability to perform essential functions. In the so-called "Kansas Experiment," for example, lawmakers enacted tax cuts that brought revenues below the level needed to maintain state programs.16 Ultimately, Kansas's economy lagged the rest of the country and lawmakers were forced to roll back the cuts. Fortunately, Iowa lawmakers have taken an entirely different approach. They controlled the rate of growth in government and allowed a gap to open between revenue and spending before reducing revenues via tax cuts.17 This approach and its outcome are explained in more detail in the section "Impact on the State Budget" in CSI's report on Iowa's 2024 income tax cuts.18

Figure 2 demonstrates the result of Iowa's approach. Tax cuts reduced state revenue; however, the state budget and state spending has continued to grow. Since the first tax reform legislation passed in 2018, Iowa's general fund appropriations have grown by nearly 23%. Total spending has grown by more.19 Fearing revenue

FIGURE 2. IOWA REVENUE AND APPROPRIATIONS WITH AND WITHOUT TAX CUTS, FY2018-FY2026

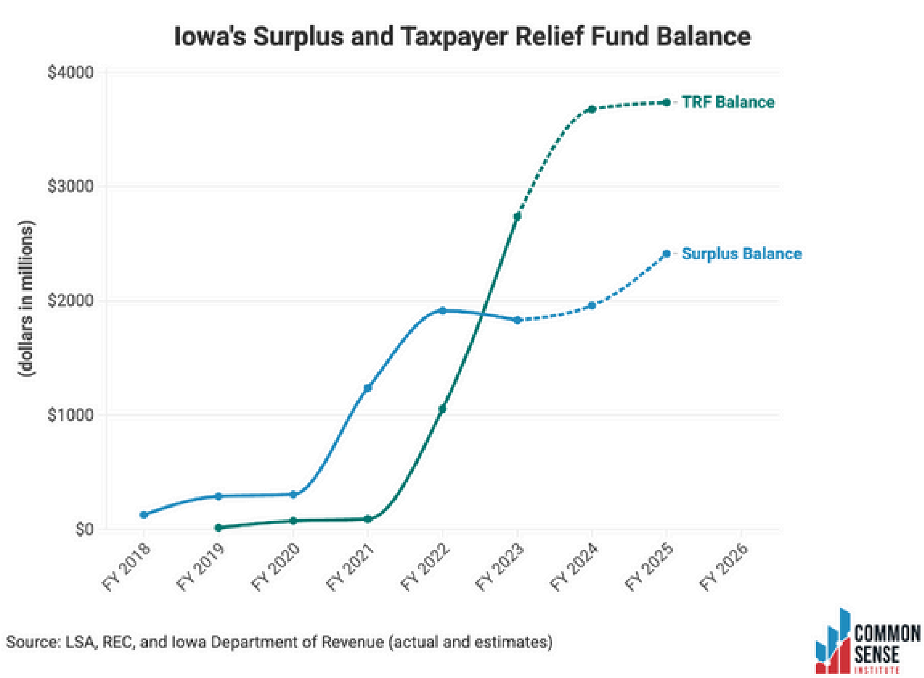


losses due to the pandemic, state budgeters reduced spending in 2020 only. This proved unnecessary, as revenues surged in FY 2021 and 2022. Iowa's statute allows the state to spend 99% of its forecasted revenue in the following year.[20] Had lawmakers spent the maximum allotment each year since FY 2018, the red line (state spending) would have run parallel 1% below the gray line (revenue before tax cuts) in figure 2 and prevented tax cuts. But because lawmakers restrained the growth in government spending when revenues surged, tax cuts only narrowed the gap between revenue and spending. This gap represents a state surplus. Each year a gap persists, the surplus grows, as seen in figure 3.

Because the approach lawmakers took allows for tax cuts without spending cuts, CSI's dynamic economic analysis of the 2024 income tax cuts assumes no reduction in state spending, as explained at the start of the section of the 2024 CSI report entitled "Dynamic Impacts" and in the section of this report entitled "Economic Impact of Alignment."[21] Figure 2 shows recent tax cuts have not impacted state spending to date. However, if net revenues fall below appropriations in a future year, statute allows the state to withdraw money from the Taxpayer Relief Fund to cover the shortfall and ensure no reduction in state spending.

Based on the size of the state surplus and revenue and spending projections under current law, CSI found in its previous research that the state can promulgate additional tax reductions without cutting state spending. Indeed, lawmakers could enact additional tax cuts without so much as reducing the historic rate of growth in state spending under all three scenarios forecasted by CSI. This may require running annual deficits for a few years and drawing funds from the TRF. In fact, under current law the state can only release TRF dollars into the economy if it runs a deficit.[22] Additional tax cuts that cause state revenues to drop temporarily below appropriations would unlock TRF dollars to enter the state's private sector economy and create additional economic stimulus. Likewise, increasing state spending could create a deficit that would unlock TRF dollars. Lawmakers must approach either course of action—additional tax cuts or spending increases—judiciously to avoid secular deficits.

FIGURE 3. IOWA'S STATE SURPLUS AND TAXPAYER RELIEF FUND BALANCE



BOTTOM LINE

An economy thrives when the state extracts from the private economy only what it needs to serve proper government functions. If the state can perform its proper functions well with less revenue than what the current tax code generates, that signals the need for tax reform that reduces the tax levy on the economy. Importantly, maintaining the current scope of state functions generally requires annual revenue growth to keep up with rising costs. Additionally, if lawmakers identify a proper function of government not filled by the state or that the state lacks the resources to perform well, that may also require additional revenue. Voters and their elected officials must sort out these matters through the political process. To promote a free economy and economic growth, lawmakers ought to ensure the state collects adequate revenue to perform its proper functions well while maximizing efficiency and allowing Iowans to retain as much of their hard-earned dollars as possible. Iowa's alignment initiative advances this ideal, resulting in economic growth for the state and higher levels of personal income for its residents and businesses.

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