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Sometimes it's Good to be "Average"

By Deborah D. Thornton

Though most Iowans, like the Minnesotans from Lake Wobegon, think they are all "above average" sometimes being average is good.[1] For example, in crafting a state budget.

The recent (December 2010) Mercatus Center-George Mason University working paper on Tax and Expenditure Limit (TEL) impacts on state budgets – "TEL It Like It Is: Do State Tax and Expenditure Limits Actually Limit Spending?" – offers an analysis of which TELs are most effective, or ineffective, in limiting state spending. Research Fellow Matthew Mitchell reports that based on historical state budget growth, many TELs haven't been that effective.

The more effective versions limit spending to a combination of "inflation plus population growth" and require either a supermajority legislative or a public override vote to raise taxes or increase spending, as in Colorado. Strict balanced-budget requirements are also important in responding to budget imbalances caused by recessions. Most importantly, TELs which are established by citizen initiative; i.e. passed and required by voters, not the Legislature, and which are attached to the state Constitution, are the most effective.[2]

Another suggestion is that a state budget be crafted using an "average" of the previous year's tax collections and spending provisions.[3] This proposal, by Emily Washington and Frederic Sautet, also from the Mercatus Center, could certainly be useful for groups such as the Iowa Revenue Estimating Conference (REC) in estimating what "normal" tax collections were and therefore what might be expected. This number could also be helpful in providing future estimates that take into consideration the effects of the recent recession.

For example, according to the December 2010 REC report tax collections projected for Fiscal Year 2012 are $6.03 billion.[4] This is the number the Legislature legally must use in determining the FY 2012 state budget. It is significantly higher, by 16 percent, than the original estimate for Fiscal Year 2011 – the current budget year – of $5.4 billion from December 2009.[5] It is also higher than the actual tax collections during the FY 2009 and 2010 recessions. These numbers were $5.7 and $5.5 billion respectively. If the REC and the Legislature used a different number, that generated by a rolling average of actual tax collections, you would see a much different picture.

The average of the FY 2006-2010 budgets – five years including the recession – is $5.7 billion. If the previous five years are also included, FY 2001 to FY 2005, the average is another 10 percent lower at $5.2 billion. This method might be helpful in holding down spending increases and assist in preventing overly optimistic projections and spending. While the 5-year average only results in a slight decrease ($330 million) from current proposals, the 10-year average is lower, by $830 million – a significant amount – than the $6.03 billion currently being allocated by the Legislature.

As a part of the background information for the FY 2012 budget, this is useful information. It would need to be broken down by specific agencies and programs and would need to consider any changes in accounting procedures or budget revenue assignment categories. However, rolling averages would be yet another tool for guiding officials in crafting the state budget.

Using rolling averages would help prevent the problems caused following an unusually "flush" year or series of flush years, such as FY 2008 when the economy was in good shape and total tax collections were over $6 billion. FY 2008 increases unduly influenced the FY 2009

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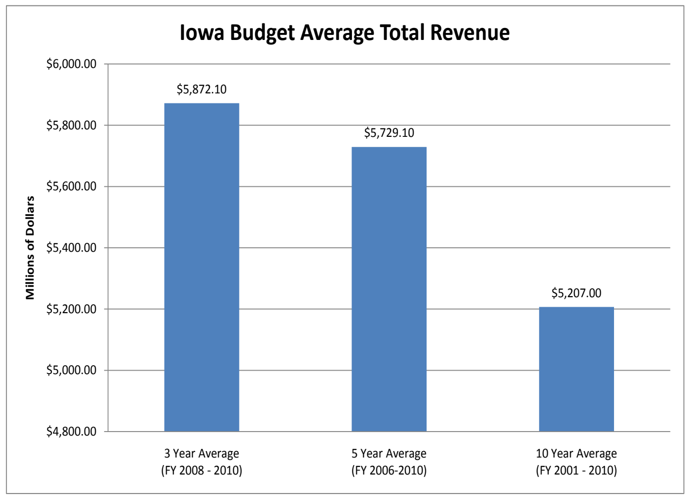
decisions. Rolling averages would also help prevent overly optimistic estimates by the REC. When reviewing the final budget numbers from the last 10 years, the drops in FY 2009 and 2010 caused by the recession, compared to FY 2008, are readily apparent.

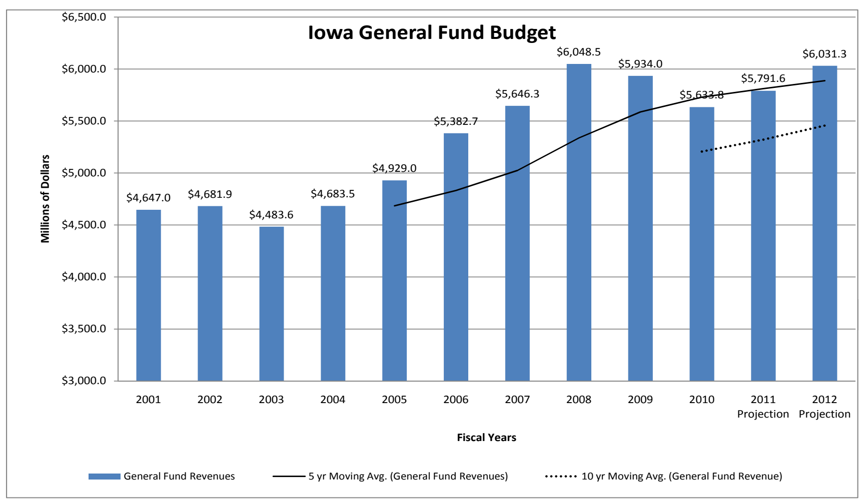
In order to be most effective in holding down budget increases, a rolling ten-year or five-year average should also have a percentage increase cap tied to the average to address tax revenue spikes such as 2008.

The graphs below show the actual ten-year budgets of the State of Iowa, along with projections based on the three-year, five-year and ten-year rolling averages. Recent budgets have been significantly higher, and the use of a rolling average would have helped to keep increases in check. By using a 10-year rolling average Fiscal Year 2011 and 2012 potential budgets would be almost $1 billion less going into the discussion, at about $5.2 billion.



The significant increases in the budgets of the last three years clearly show that the current weak TEL of holding spending to 99 percent of the REC projected tax-revenue estimates has not held budget growth in check.

Using rolling averages to control budget growth might have prevented the recent mid-year budget cuts caused by the recession, and improved the long-term structural deficit projections. This is much like a family who puts a short-term increase caused by overtime hours in the bank rather than rushing out to buy a new car which they cannot afford later, when the plant cuts the overtime.



(Endnotes)

[1] Prairie Home Companion, Lake Wobegon Factbook, <http://www.publicradio.org/columns/prairiehome/posthost/2009/07/13/lake_wobegon_factbook.php> accessed on April 11, 2010.

[2] Matthew Mitchell, "TEL It Like It Is: Do State Tax and Expenditure Limits Actually Limit Spending?," Working Paper #10-71, Mercatus Center, George Mason University, December 2010, p.3.

[3] Emily Washington and Frederic Sautet, "Tax and Expenditure Limits for Long-run Fiscal Stability," No 67, Mercatus Center, George Mason University, October 2009, p. 3.

[4] Iowa Department of Management, Revenue Estimating Conference Report December 6, 2010, <http://www.legis.state.ia.us/lsadocs/QRE/2011/QRJWR001.PDF> accessed on April 8, 2011.

[5] Iowa Department of Management, Quarterly Revenue Estimating Conference Reports, December 2010, 2009, and 2008, <http://www.dom.state.ia.us/state/REC/rec_quarterly.html> accessed on April 8, 2011.

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