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Is Iowa Moving In A Supply-Side Direction?

by John Hendrickson

The Tax Foundation noted that "states with the best tax systems will be the most competitive in attracting new businesses and most effective at generating economic and employment growth."[1] In *Rich States, Poor States*, a study by the American Legislative Exchange Council evaluating the economic conditions and outlooks of the states, Iowa was ranked as 28 out of 50 in economic outlook and 41 out of 50 in terms of economic performance.[2] Iowa, which tends to rank in the middle in regard to its tax rates in comparison to other states, needs to pursue further tax reform, which will lead to economic growth. The Legislature is currently considering a 20 percent across-the-board reduction in income taxes and Governor Terry Branstad is pushing for a reduction in the corporate tax to a flat 6 percent. Both of these tax reductions, along with spending reductions and budget reform, will result in economic growth for Iowa.

In a recent article in *The Washington Times*, Richard W. Rahn, a Senior Fellow at the Cato Institute, noted that states that have low tax rates and reasonable spending levels are growing economically.[3] Rahn noted that the "nine states without an income tax had much higher economic and personal income growth than those nine states with the highest marginal income tax rates."[4] Iowa's top personal income tax bracket is 8.98 percent and the top corporate income tax bracket is 12 percent. The various states are in competition with each other not only economically, but also in attracting people. For example, the state of Illinois recently raised their tax rates, which has made many businesses nervous. Caterpillar, one of the major employers and business leaders in the state of Illinois, is considering leaving because of the "anti-business climate."[5]

Historically, cutting marginal tax rates has been successful for economic growth. The last major across-the-board income tax cut in Iowa occurred in 1997 when the Legislature cut the rates by 10 percent.[6] In reviewing the impact of the tax cuts a decade later, "the amount of personal income tax collected by the state of Iowa, in constant dollars, the total amount collected in the ten years after the tax cut was higher than the total amount collected in the ten years prior to the tax cut."[7] The 10 percent tax cut resulted in more revenue for the state, because low tax rates not only provide a stimulus for business expansion, entrepreneurship, and employment, but also in the process create more taxpayers.

This approach, or the supply-side theory, has worked on a national level. The most recent example being the across-the-board tax cuts during President Ronald Reagan's administration and the tax reductions passed under President George W. Bush.[8] In fact, many economists have argued that the recent renewal of the Bush tax cuts led the way in the emerging economic recovery from the "Great Recession." The 20 percent across-the-board income tax reduction would not only provide tax relief for all Iowans, but also provide further economic incentive for continued investment, job growth, and a healthy business climate.

The proposal to cut the state corporate tax to a flat 6 percent rate would allow Iowa to be more competitive and business-friendly. The top rate of 12 percent is not only too high, but it is combined with a 35 percent top federal corporate tax rate. The United States has one of the highest corporate tax rates in the world. In an increasingly global economy with many nations competing for businesses by lowering their tax rates, the United States is at a disadvantage with such a high rate. Having a high state and federal corporate tax rate is a disadvantage to both the national economy and Iowa's economy.

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Another benefit from reducing Iowa's corporate tax is not only to provide a better business climate, but also to eliminate the many tax loopholes. Whether it be the state or federal tax code, it must be made more simple and business-friendly. "The ideal tax system — whether at the local, state, or federal level — is simple, transparent, stable, neutral to business activity, and pro-growth."[9]

Iowa needs to follow in a conservative supply-side direction. Governor Terry Branstad's efforts at reforming the budget to a two-year budget along with spending and tax reductions is moving Iowa in the right direction. Both the 20 percent across-the-board income and corporate tax reductions, if enacted by the Legislature, will result in a pro-growth policy for Iowa and make the state more economically competitive in attracting businesses. Many Governors, from Chris Christie in New Jersey, to Scott Walker in Wisconsin, to John Kasich in Ohio, are pursuing an economic agenda that centers on a pro-growth agenda of tax and spending reductions.

Although these policies will help Iowa's economy, uncertainty is still a factor with the policies emerging from Washington, D.C. Businesses are uncertain about the threat of the Patient Protection and Affordable Care Act (ObamaCare), the increase in regulatory activity by the federal government, and the spending and debt crisis, all of which are placing an albatross around the neck of the economy. Policymakers in Iowa as well as in Washington, D.C., would be wise to follow a policy of limited government by cutting tax rates, reducing spending, eliminating unnecessary regulations, and reforming entitlement programs.

If Iowa moves in a supply-side direction, it will alleviate some of the uncertainty. Charles Kadlec, a noted business and economics writer, recently wrote in *Forbes* that "the path to jobs and prosperity lies in increasing the liberty of the American people by reducing the burden of government spending, taxes, borrowing and regulations on individuals and businesses, big and small."[10]

Endnotes:

[1]Kail M. Padgitt, "2011 State Business Tax Climate Index," *Background Paper, No. 60*, Tax Foundation, Washington, D.C., October 2010, p. 1.
[2]Arthur B. Laffer, Stephen Moore, and Jonathan Williams, *Rich States, Poor States: ALEC-Laffer State Economic Competitive Index*, American Legislative Exchange Council, Washington, D.C., 2010, p. 86.
[3]Richard W. Rahn, "Lessons from the States," *Cato.org*, Cato Institute, Washington, D.C., March 29, 2011, <http://www.cato.org/pub_display.php?pub_id=12920> accessed on April 4, 2011.
[4]Ibid.
[5]Editorial, "Caterpillar's alarm bell for Illinois," *Investor's Business Daily*, March 29, 2011, <http://www.investors.com/NewsAndAnalysis/Article/567530/201103291852/Caterpillars-Alarm-Bell-For-Illinois.aspx> accessed on April 4, 2011.
[6]Public Interest Institute, "After the Income Tax Cut: Iowa Personal Income Tax Collections," *Fact Sheet*, No. 07-02, September 28, 2007, <http://www.limitedgovernment.org/publications/pubs/fact_sheet/fs07-02.pdf> accessed on April 4, 2011.
[7]Ibid.
[8]Historically tax reductions have proven to work and provide an incentive for private sector growth. Presidents Warren G. Harding, Calvin Coolidge, John F. Kennedy, and Ronald Reagan were examples of administrations that pursued tax reductions to stimulate the economy.
[9]Padgitt, p. 4.
[10]Charles Kadlec, "Job creation, economic growth, and social justice," *Forbes*, April 4, 2011, <http://blogs.forbes.com/charleskadlec/2011/04/04/job-creation-economic-growth-and-social-justice/> accessed on April 5, 2011.

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