

Iowa faces ‘perfect storm’ of budget challenges

Lawmakers must prioritize needs of Iowans amid another revenue drop stemming from state and federal tax cuts, pet-project spending and a slowing economy

The state Revenue Estimating Conference today projected that net revenue for the current fiscal year, FY 2026, will be \$804 million lower than FY 2025, which ended in July — a 9.1% drop.¹

This forecast reflects the impacts of state tax cuts passed over the last half-dozen years and new federal tax cuts passed in July, which matter because Iowa automatically adopts most federal tax provisions.

The REC also released estimates for FY 2027, which starts next July: modest growth of 3.2% from this year. Although that would be a welcome turn, it should be taken with great caution. At nine different points in REC forecasts since October 2023, revenue predictions were revised downward from the previous

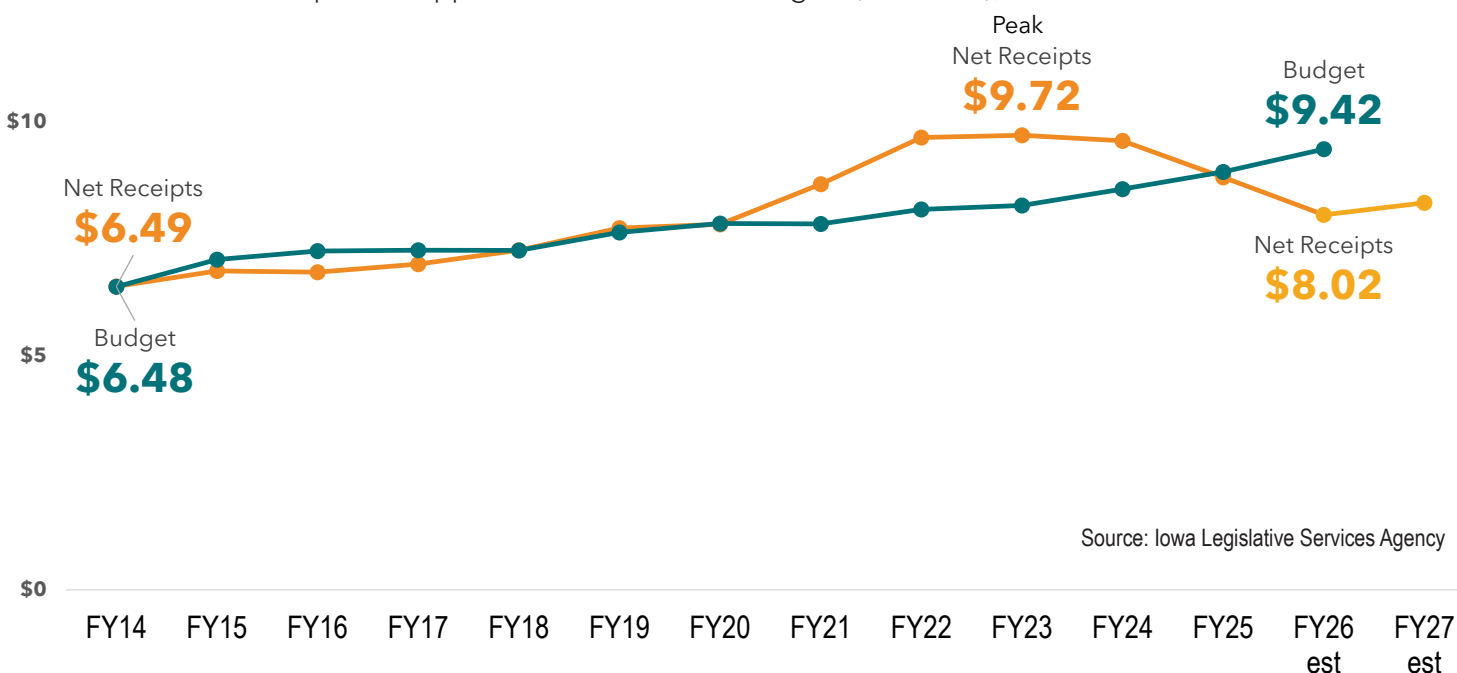
report. The overestimation is accelerating, too — final FY 2025 revenue was \$744 million under budget, and today’s estimate for FY 2026 is already \$1.47 billion under the estimate made in spring 2024.

All told, Iowa faces fiscal challenges not only from state tax cuts, but from other sources, including growing costs for pet projects like private-school vouchers, a new slew of tax cuts and Medicaid and SNAP responsibilities courtesy of this summer’s Republican reconciliation megabill and a slowing economy.

Read on for a refresher on how we got here, new threats ahead — and a plan for getting out.

Tax cuts have opened a structural deficit that imperils our ability to fund schools, health care and other services

Net General Fund receipts and approved General Fund budgets (in billions), FY 2014-2027



How we got here

► State tax cuts

The primary fiscal challenge we face is Republican lawmakers' tax-cutting spree that started in 2018. Since then, they have approved four sets of personal income tax cuts and three corporate income tax cuts, exempted all retirement income from personal income taxes and eliminated the inheritance tax. The deepest cuts have been to the personal income tax, and most have taken effect since 2023 (sidebar).

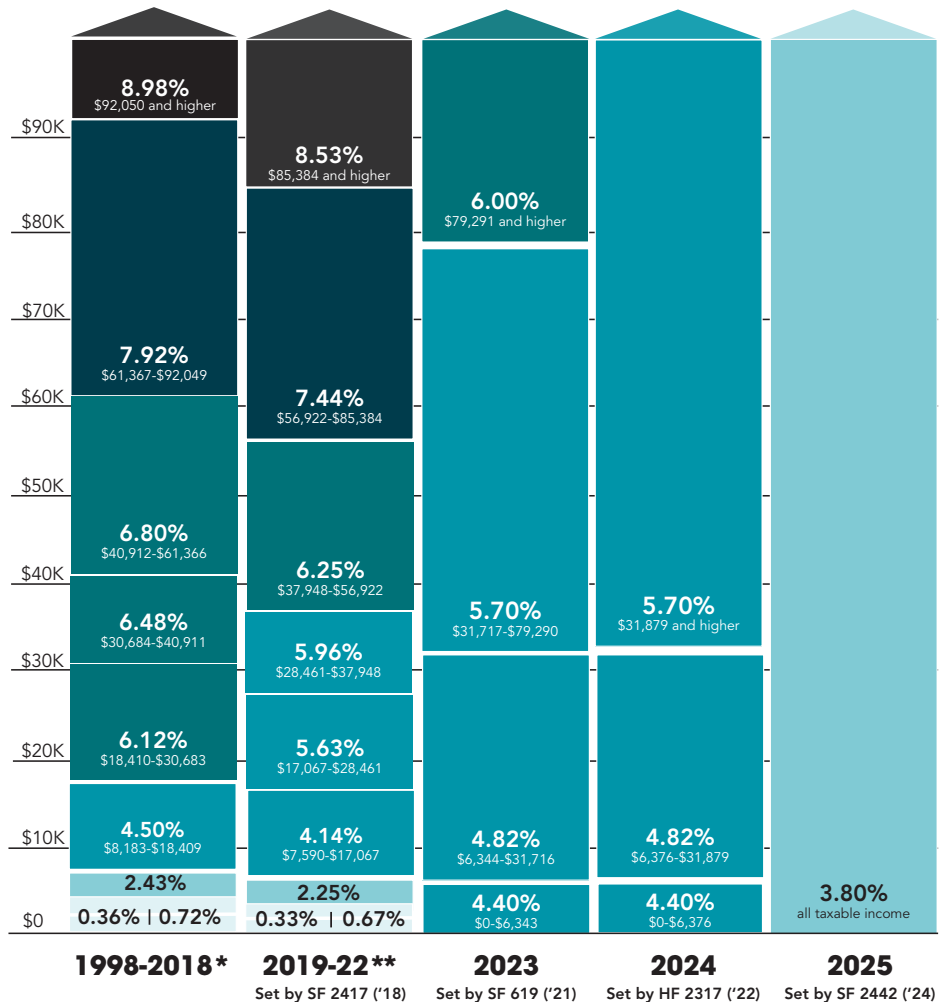
The scale of the cuts swamped modest revenue-raising steps — like extending the sales tax to digital services and online purchases and doing away with a state tax deduction for federal taxes paid.

Proponents justify these tax cuts, which overwhelmingly go to the highest earners, by claiming that low taxes attract new business and ultimately pay for themselves.² But decades worth of evidence shows that their trickle-down theory never works. The most recent example is the 2017 federal tax cuts: no matter how you measure it, federal revenues are lower today than were projected before the law was passed.³

Decades worth of evidence shows that tax cuts skewed to high earners do not pay for themselves.

Repeated cuts to our largest revenue source, the personal income tax, disproportionately benefit the wealthy

Iowa personal income tax rates and brackets by taxable income (single filer), tax years 1998-2025, in 2025 dollars



2018 | Lawmakers approved modest rate cuts starting in tax year (TY) 2019 as well as a more extreme set of rate cuts and bracket reductions to take effect when certain revenue targets were met, as soon as TY 2023.

2021 | Lawmakers put the tax cuts approved in 2018 into effect starting in TY 2023, even though the state had not met both required revenue targets.

2022 | Before revenue impacts of the 2021 tax bill were clear, lawmakers passed another drastic set of cuts to start in TY 2024. These lowered tax rates and eliminated brackets, setting a 3.9% flat rate to start in 2026.

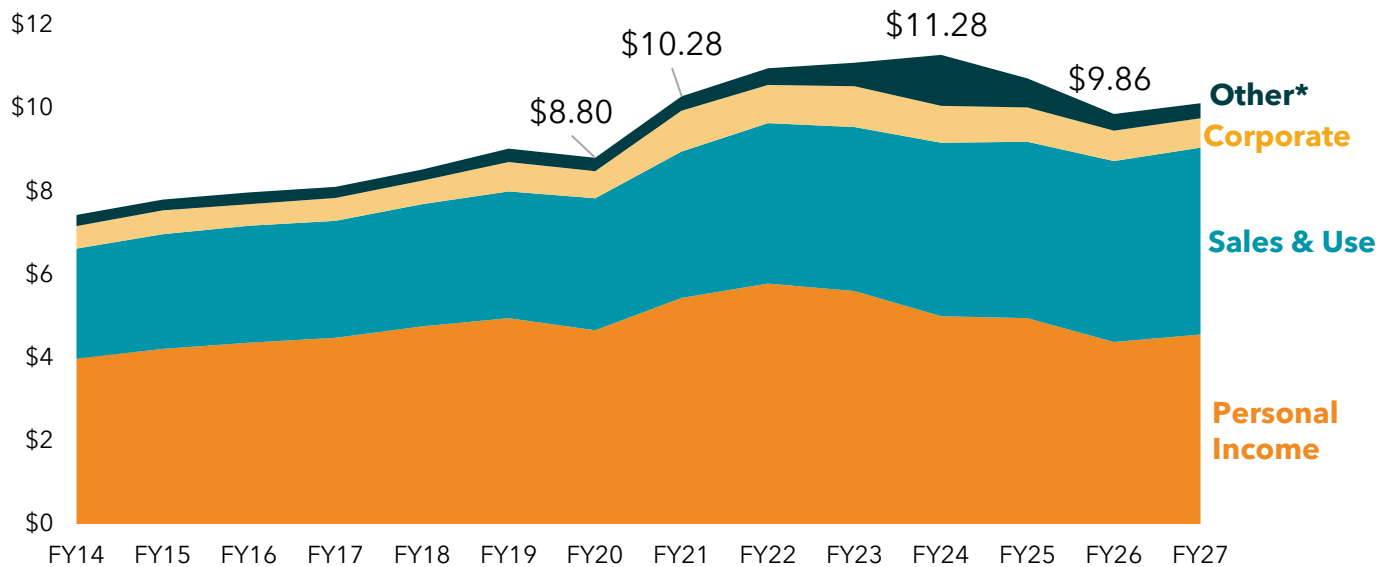
2024 | Majority lawmakers again short-circuited their own plans by accelerating the tax cuts laid out in 2022, moving the flat rate up a year, to TY 2025, and reducing the rate itself from 3.9% to 3.8%.

Sources: Iowa Department of Revenue, Iowa Legislative Services Agency, and the Tax Foundation, "Historical State Individual Income Tax Rates, 2015-2025"

* Shows 2018 taxable income (adjusted to 2025 dollars) ** Shows 2022 taxable income (adjusted to 2025 dollars)

Greatest revenue loss stems from drop in personal income tax receipts

Gross tax receipts by type (in billions), FY 2014-2027



Source: Iowa Legislative Services Agency

* Inheritance, insurance premium, beer, franchise and miscellaneous taxes

For a while, tax cutters were able to gloss over the revenue harms of their tax cuts. They phased them in over multiple years, mostly toward the end of an economic boom fueled by federal pandemic aid. From FY 2021 to FY 2024, the state saw unusually high receipts across tax types. Surpluses grew. Majority lawmakers helped pad them by holding down state investments in public schools, health care and other services.

Earlier this year, the Legislative Services Agency estimated that for FY 2026, Iowa would have \$849.2 million in its two “rainy day” funds, \$3.65 billion in the Taxpayer Relief Fund, and \$2.54 billion in General Fund surpluses.

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These one-time dollars can — and should — help us weather the storm in the short term, but they are not a long-term solution to a structural deficit. Faced with a shortfall when budgeting for FY 2026, the Legislature last

session approved using nearly \$1 billion in one-time surpluses, about half from the Taxpayer Relief Fund, to balance the budget.⁴ At that rate, our surpluses could be gone within just a handful of years, soon enough that some current legislators would have to deal with the consequences.

► New spending obligations

As lawmakers passed tax cuts, they added General Fund spending. For example, in 2021, they took responsibility for the state’s mental-health system from the counties in part to reduce local property taxes, at a cost of \$148 million by FY 2026. In 2023, they launched an expensive private-school voucher program, mostly serving children already enrolled in private schools, at an estimated cost of \$315 million by FY 2026.

► A slowing economy

If Iowa built up record surpluses thanks to an economic boom, it now faces economic headwinds that are likely to weaken state revenue receipts. In contrast to predictions of the tax-cut proponents, Iowa’s economy in 2025 ranks among the nation’s weakest. Rather than being supercharged by large tax cuts, real GDP has risen just an average of 1.5% per year since 2017 — well below the U.S. average. Real median household income grew just 1.5% over the last seven years, and the state has fewer jobs than it did last year. On the ag side, tariffs are weakening grain prices despite a potential record harvest, and growing input costs are contributing to a rise in farm bankruptcies.⁵

New challenges on the horizon

► Federal conformity

Iowa is one of just five states that automatically adopt provisions of the federal tax code, a policy known as “rolling conformity.” That policy means that Iowa will see a large revenue hit from federal OBBBA tax changes passed by Congress and the President in July. Unless Iowa lawmakers act, these provisions, which mostly benefit the wealthiest tax filers, are a permanent part of Iowa’s tax code. The Governor reported in September that the state anticipates losing an additional \$438 million from these provisions in FY 2026 and \$384 million in FY 2027.⁶ These losses are reflected in today’s REC report.

► OBBBA Medicaid and SNAP provisions

The federal reconciliation bill passed in July makes enormous cuts to food assistance and health care over the next few years in part by shifting substantial new

costs onto state governments. It makes states pick up more of the costs of SNAP administration and levies costly new SNAP and Medicaid penalties against states that can’t meet harsh benefit processing standards. It requires more red tape of enrollees that states will have to administer. It limits non-General Fund financing strategies almost all states, including Iowa, use to fund their Medicaid programs. Over time, these provisions will cost Iowa millions.⁷

► Possible property tax cuts

The House and Senate tax chairs spent the 2025 session championing a bill that would have forced local property tax cuts, in part by having the state General Fund pick up as much as \$400 million in school funding now covered by local property taxes.⁸ Their proposal did not advance, but given the state budget challenges we face, it merits serious pushback should it reemerge in January.

The path forward

We’re in a new era of budget shortfalls. But we can turn things around. Here’s what lawmakers should do when they return to Des Moines in January:

► 1. Stop cutting taxes

The days of magic math are over. The state cannot afford more income tax cuts — and certainly not extreme plans to eliminate the income tax floated by the Governor and legislative leaders — nor to buy down local property taxes using the General Fund.

► 2. Protect current services

We have options to weather the storm in the short term. We can avoid gutting services that protect the health, education and safety of Iowans by using surpluses to fill budget gaps. We have them. Use them.

► 3. Recapture revenue lost to federal cuts

By their very nature, one-time surpluses are only a short-term answer to deficits. Longer-term, we will need to raise more revenue. An obvious first step lawmakers should take this session is to uncouple the Iowa tax code from the federal megabill’s most expensive tax provisions. Those include the Qualified Small Business Stock deduction that will drain resources from Iowa’s coffers, and communities, to enrich coastal venture capitalists.⁹

► 4. Don’t tie the hands of future lawmakers

Legislators and the Governor will need the ability to address budget shortfalls over the coming years with a full set of policy tools. The 2026 Legislature should reject two proposed constitutional amendments. One would preclude the wealthy from doing their fair share by requiring a flat personal income tax, and the other would allow a legislative minority to overrule their colleagues and constituents by requiring two-thirds approval on income tax increases.

Notes

- ¹ Revenue Estimating Conference, Quarterly Revenue Estimate, October 2025. Accessed at: <https://www.legis.iowa.gov/docs/publications/QR/1544019.pdf>
 - ² For a recent example, see: Stephen Gruber-Miller, "Gov. Kim Reynolds peels back plans for DOGE, budget cuts, Medicaid in 1-on-1 interview," Des Moines Register, January 17, 2025. Accessed at <https://www.desmoinesregister.com/story/news/politics/2025/01/17/doge-medicaid-budget-what-kim-reynolds-said-in-a-register-interview/77719049007/>
 - ³ Madeline Shepherd, "The Trump Tax Cuts Led to Record-Low, Not High, Revenues Outside of a Recession," Center for American Progress, August 28, 2024. Accessed at: <https://www.americanprogress.org/article/the-trump-tax-cuts-led-to-record-low-not-high-revenues-outside-of-a-recession/>
 - ⁴ Legislative Services Agency. (July 2025). 2025 Session Fiscal Report. Accessed at <https://www.legis.iowa.gov/docs/publications/FR/1543046.pdf>
 - ⁵ Faith Parum. "Declining Farm Economy Continues to Pressure Profitability," Farm Bureau, October 6, 2025. Accessed at <https://www.fb.org/market-intel/declining-farm-economy-continues-to-pressure-profitability>
 - ⁷ Robin Opsahl, "Federal budget law, ag economy expected to deal blows to Iowa state budget," Iowa Capital Dispatch, September 25, 2025. Accessed at: <https://iowacapitaldispatch.com/2025/09/25/federal-budget-reconciliation-bill-ag-economy-expected-to-deal-blows-to-iowa-state-budget/>
 - ⁸ Center on Budget and Policy Priorities, "Harmful Republican Megabill Fails Iowa Families, Children, and Communities," May 29, 2025. Accessed at https://www.cbpp.org/research/state-budget-and-tax/harmful-republican-megabill-fails-families-children-and-communities#pick_state=1&state=IA
- Iowa Legislature, Senate Study Bill 1208, 2025. Accessed at <https://www.legis.iowa.gov/legislation/BillBook?ga=91&ba=ssb1208>
- Sarah Austin and Nick Johnson, "Quite Some BS: Expanded 'QSBS'