

**Revenue Estimating Conference
Minutes
March 14, 2017**

Members Present: Dave Roederer, Holly Lyons, David Underwood.

Mr. Roederer called the Revenue Estimating Conference to order at 11:00 a.m.

Mr. Roederer reiterated that the Code of Iowa establishes a three member panel consisting of the Legislative Branch represented by Ms. Holly Lyons, the state represented by Mr. Underwood, and himself representing the Executive Branch. The Conference is required to meet at least three times per year, where it is required to reach a consensus. Projections are developed independent of each other, using a variety of sources. The Department of Revenue is relied upon heavily. The Governor is required to submit his budget recommendations based on the December estimate of the year. The Legislature is to use the lower of the two estimates – December or March. The Governor is also required, if the March estimate is lower, to submit modifications to his budget. Today the current fiscal year, fiscal year 2017, will be reviewed and fiscal year 2018 will be reviewed and fiscal year 2019 will be updated.

Approval of the December 12, 2016 minutes

Mr. Roederer called for a motion to approve the December 12, 2016 minutes. Mr. Underwood made the motion to approve the minutes and Ms. Lyons seconded the motion. All voted in favor and the motion was carried unanimously.

Approval of the March 14, 2017 agenda

Mr. Roederer called for a motion to approve the March 14, 2017 agenda. Mr. Underwood made the motion to approve the agenda and Ms. Lyons seconded the motion. All voted in favor and the motion was carried unanimously.

Ms. Lyons began by stating the Iowa economy is showing signs of weakness in some areas. There is no indication that we are headed into a recession in the near time, but we are facing a difficult time. State revenues are still experiencing growth, just slow growth and unfortunately at the present time, very very slow growth. Sales tax revenues, income tax estimated payments and potentially income tax final payments are all lower than anticipated.

At the national level, since the REC met three months ago, economic data has been mostly positive, showing improvements in nominal GDP, personal income, business spending on equipment and infrastructure, employment and consumer spending. GDP is forecasted to increase 4.3% in this calendar year, well above the average. U.S. nominal income is projected to increase by 2.5% and 4.9% over the next two years. National employment projections suggest a tight labor market, with the growth in employment slowing some but that should contribute to a stronger wage and salary income growth, the primary driver of Iowa's personal income tax. National growth projections for wage and salary income are 5.2% for the next two

years. Uncertainty remains concerning which proposed U.S. economic policy changes will be enacted and the impact of those policies on the economy. Until those changes become clear, they remain sources of forecast risk at both the national and state level. These changes include changes to foreign trade policy, health care policy, and tax and fiscal policy. Additional risks to the U.S. economy are geopolitical tensions and the strong U.S. dollar.

Turning to the Iowa economy, there continues to be an underlying strength in the economy. Iowa showed a strong gain in third quarter GDP data released in February and was one of 11 states that experienced a real gain of GDP of 4.5% or more. Commodity prices seem to have stabilized. Prospects for 2017 farm income improved slightly. The downward revision in employment benchmarking required by the Bureau of Statistics and announced yesterday is a little concerning. Not quite as many people were employed this past year as statistics originally indicated. But employment is still steady and unemployment remains very low. Initial unemployment insurance claims, an early signal of a recession, remain low. Housing, building permits and sales of existing homes are forward looking indicators and the number of permits in Iowa in a 12-month period reached its highest level since 2006 last month and is 25% higher than one year ago; sales of existing homes continues to be strong; energy prices remain relatively low. The Conference Board's National Leading Economic Index and the Iowa Leading Indicators Index have both increased in the last 90 days. The business conditions for Iowa Index experienced its largest month to month increase since 2013. On the negative side, rural Iowa is still struggling from the effects of the difficult farm economy, as indicated by the Creighton University Rural Main Street Index, generated from a survey of rural bank CEOs in a ten state region dependent on agriculture and energy. Their survey indicates that more than one-third of the CEOs believe their rural communities are still in an economic downturn. An early indication of farm tax revenue in terms of returns processed is that income is down again this year, but not nearly as much as last year. Iowa is close to full employment and it may be more of an issue of qualified employees than a lack of available jobs for the economy to grow at a healthy pace.

Going back to the three components of general fund revenue, three areas where Iowa is currently seeing very weak growth- sales tax revenue, income tax estimated payments and income tax final payments. Sales and use tax is perplexing. Economic indicators would suggest that with growing wage and salary income, and near full employment, sales tax revenue should be growing at the anticipated 1.9% forecast in December, which was adjusted down from the estimate of 3.3% in October, but it's not. Sales and use tax is currently flat at just less than zero. It is a definite drag in overall general fund receipts, given that sales tax revenue is approximately 35% of gross general fund revenue. Many states are experiencing sluggish or weak sales and use tax. According to a report by the Rockefeller Institute of Government, which states that there was a substantial weakness in the sales tax in many states, consistent with weak growth in taxable consumption, consumers have been reducing spending and this may be compounded by low inflation. As you remember, low inflation means that we are paying lower prices and we are paying lower prices for taxable items, we are paying less sales and use tax. Another contributing factor may be that consumers are spending more on services, which are not taxed, and less on taxable goods. It is also possible that an Iowa law

change in 2016 exempting consumables from sales and use tax may have a greater impact in reducing sales and use tax revenue than originally estimated. Consumables are things like drill bits, sandpaper, cutting blades, antifreeze, oil and other lubricants; items that are used in the manufacturing processes. Income tax estimate payments are down 5% for eight months in Fiscal Year 2017. Final payments with returns are down a light amount through last week. Last spring, Iowa experienced a drop in both estimated and final payments, partly attributed to the lower farm income and partly attributable to the poor performance of the financial markets and lower capital gains income. This year lower estimate payments may be attributable to changes in taxpayer behavior, such as deferring capital gains in anticipation of federal tax changes. Or in the case of final payments, a delay in filing due to a federal restriction that refunds could not be paid before February 15th. It is also still very early in the tax return season and the Department of Revenue indicates that processing of returns has been slow due to state and federal efforts to combat tax refund fraud. We are also hopeful that the estimate payments and final payments may still show some growth due to the strong returns in the stock market.

Turning to the LSA estimate for the current year, fiscal year 2017; for next year, fiscal year 2018; and for our new charge in statute, establishing an estimate at this meeting for fiscal year 2019. Estimate for fiscal year 2017 is reduced by \$82.4 million, to \$7.129 billion, a 3% growth rate compared to the December REC, and for fiscal year 2018 the LSA estimate is reduced by \$190.4 million, compared to the December REC estimate. This makes LSA's fiscal year 2018 revenue estimate \$7.36 billion, a growth rate increase of 3.3% or \$236.4 million. For our first look at 2019, the LSA applied an optimistic 4.5% growth rate to the estimate of fiscal year 2018 revenues, for an increase of \$331.5 million.

Mr. Underwood began by stating there is a fairly good example of Iowans tax returns that have been processed and the data the Department of Revenue has been able to show us, shows that Iowans did not have the income they did in the previous tax reporting year, which is kind of a surprise. Interest is down, capital gains are not doing well, and farm income which was down to just about nothing is falling below that level even. Some of that was in anticipation that our earlier numbers would be stabilized. Unfortunately, we don't know that until people file their tax returns. Unless something happens with the next big rush of tax returns, if this is a representative sample, these revised numbers are unfortunately what we will be stuck with. The sales tax continues to be perplexing in Iowa. Regardless of prior tax law changes, it does not make a lot of sense other than everything is getting discounted so often and we are seeing in a lot of the retail with the bankruptcies and the closing of stores that people just are not supporting retail throughout the Midwest.

Mr. Roederer stated that throughout the world we are seeing somewhat of a slowdown, primarily caused by China's continued growth, but not near the rate that they were for some time, starting to have a big impact on Asia and Latin America in particular. International exports from Iowa are \$12.5 billion, slightly less than what it was in the previous year. The other thing that is unique about China in the relationship with Iowa is that China is the largest

importer of soybeans – 83 million tons per year that they get from other countries, as well as the United States.

From the U.S., looking at the economy the manufacturing is still hampered somewhat by the strength of the U.S. dollar. It is not as competitive as some others and many national indicators are that it is improving somewhat, but it is not getting all the way through the system. We are finding that while wages are increasing nationally, the stock market is indicating positive territory. How long that is going to sustain itself is still a question mark.

Locally, Iowa is still growing, but it is not growing at the rate projected back in December. Part of the issues on the personal income is that we are seeing the results of the year when Iowa's unemployment was a little above 4%. When that is broken down even further, construction and manufacturing, of all the people that were unemployed, 50% was in those two sectors. Those two sectors represent 30% of the earnings that come from wages in the state, although they only represent 18% of the employment. The latest figures on unemployment are at 3.3%. That is the lowest unemployment Iowa has had in 16 years. That tells us that individuals are working, or starting to go back to work. One of the reasons that unemployment has continued to drop is because of the mild winter we had and the construction season went a lot longer than it has in other years.

The agriculture sector has some concerns. There is a net farm drop again this year, not nearly as much as the year before, and capital gains are down, as are withholding. Our major agricultural products – corn, soybeans, pork, beef and poultry – are being produced at a loss or close to breaking even, depending on the individual producer. We are also seeing a bumper crop, not only in Iowa but throughout the Midwest, as well as Brazil and South America. Much of the manufacturing is dependent upon agriculture and when you look at the significant wages that come in from that sector, we are obviously seeing somewhat of a reduction. The agriculture fundamentals are still very sound, it is the commodity prices.

We know there is more online purchasing taking place and it is more complex. Even though we have one of the big online companies that collect sales tax with their customers and remit it, we also know that in some cases they may be selling for other individuals or companies that don't necessarily have to remit that.

Global economy is something that we need to pay close attention to, which goes back to some of the issues mentioned by Ms. Lyons. The strength of the dollar and how that will affect us internationally, and obviously federal trade and agricultural policy going forward is going to have a big impact.

Review FY2017 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers

Motion: Made by Mr. Underwood to use the Governor's Appointee recommendation for Fiscal Year 2017

Second: Mr. Roederer

Discussion: Ms. Lyons stated she could agree to that. The Conference all agreed that this not the time for the estimates to be high.

All voted in favor and the motion was passed unanimously.

The new number for FY17 is \$7,106 billion, an increase of 2.7% from the previous fiscal year. The change from the December REC is \$105.9 million. However, since the December REC, there was a \$25.2 million transfer to general fund that was approved in legislation (SF130), so the actual impact on the balance sheet of the general assembly to the Governor is \$131.1 million reduction. The reduction in the balance sheet, the money available for fiscal year 2017 is \$131.1 million.

The difference between FY16 actual and the estimate is \$184.9 million.

Review FY2018 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers

Motion: Mr. Underwood made a motion that the Governor's Appointee Fiscal Year 2018 estimate be utilized for the new estimate.

Second: Ms. Lyons

All voted in favor and the motion was passed unanimously.

For Fiscal Year 2018, the action has removed \$191.8 million from both the REC estimate and general fund balance sheet. This is based on a percentage of 3.6.

The difference between the revised FY17 estimate and the FY18 estimate is \$258.5 million.

Estimate FY2019 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers

Motion: Ms. Lyons made a motion to use the Governor's Appointee numbers.

Second: Mr. Underwood.

All voted in favor and the motion was passed unanimously.

The difference between the FY18 estimate and the FY19 estimate is \$262.0 million.

Fiscal Years 2017 and 2018 Gambling Revenues Transferred to Other Funds and Interest Earned on Reserve Funds (transferred to Rebuild Iowa Infrastructure Fund)

Motion: Ms. Lyons made a motion to go with the estimates.

Second: Mr. Underwood.

All voted in favor and the motion was passed unanimously.

Other Business

With no further business, Mr. Roederer called the meeting adjourned at 11:30 a.m.

These minutes were approved at the October 19, 2017 meeting. David Underwood made a motion to approve the minutes of the March 14, 2017 meeting and the motion was seconded by Holly Lyons. All members voted in favor of the motion and it was carried unanimously.

Respectfully submitted,
Tammy Winters