Revenue Estimating Conference
Minutes
December 13, 2021

Members Present: Kraig Paulsen, Holly Lyons, David Underwood

Mr. Paulsen called the December meeting of the Revenue Estimating Conference to order at 11:00 a.m.

Approval of the December 13, 2021 agenda

Mr. Paulsen called for any objections to the agenda for the December 13, 2021 meeting. Hearing no objections, the agenda was approved unanimously.

Approval of the October 11, 2021 minutes

Mr. Paulsen called for any objections to the minutes for the October 11, 2021 meeting. Hearing no objections, the minutes were approved unanimously.

Opening Statements

<u>Ms. Lyons</u>: We are now a year and a half into an expansion phase following a very unusual two-month pandemic-induced recession that started in February 2020 and ended in April of that year. I'm not stating anything new here, but since the Spring of 2020, the U.S. economy collapsed as the nation experienced lockdowns, businesses closed, hours were cut, consumers stayed home, and companies cut investment and production. At the national level, there was massive government spending in the form of stimulus payments and extended unemployment benefits in addition to emergency moves by the Federal Reserve to stabilize the economy.

In Iowa, tax revenue revenues continue to be remarkably resilient to the economic disruption caused by Covid-19. Since we met in October, revenues continue to grow at a relatively robust rate, currently exceeding the REC's October estimate. In the current Fiscal Year (FY 22), as of Friday, net receipts are up $212 million which is $82 million more than the growth estimated for the entire year at the October REC meeting. It should be noted that much of the growth in FY 21 was realized after the March REC, and was largely due to the impact of federal stimulus payments and consumer pent up demand. What that means though, is that as the current FY progresses, the comparison to abnormally high receipts last spring and early summer which were fueled by the stimulus payments and subsequent spending due to pent up demand will likely show unfavorable year-over-year growth rates beginning in the spring, and as pent up demand is met, and the impact of federal stimulus payments has ceased. While we do expect the end-of-year comparisons to be difficult, there are still a number of months to go where comparisons will be favorable for FY 2022 in terms of sales/use tax, corporate tax, and individual income tax withholding. We are expecting additional growth in December through February for this reason.

Despite the current robust growth, there are some headwinds facing the Iowa economy. These include uncertainty about inflation, the persistent Iowa labor shortage and slow employment growth that we mention each time we meet, and the unknown impact of the Omicron variant or future variants of Covid-19.

The surge in inflation, reported last week by the Bureau of Labor Statistics, at a rate of 6.8%, is the biggest 12-month jump since 1982. Caused partly by the supply chain bottleneck, and businesses unable to meet consumer demand, the increased inflation was once thought to be transitory and even necessary to fuel the struggling economy. While salaries and hourly pay have increased for many workers, it isn't accounting for such high inflation, and families are feeling the pinch in terms of higher retail prices.

Labor supply and employment growth continues to be a concern. U.S. and Iowa job numbers are still well below pre-pandemic levels, but employment continues to expand over last year's levels. That's a good sign.

Iowa added about 1,000 non-farm jobs in October and just over 27,000 compared to one year ago, but at that recent pace of job additions it will take the U.S. only about 7 more months to reach the former peak, but it could take Iowa longer than two years. We continue to have more jobs than workers, and this has been compounded by the pandemic with some workers choosing not to return to work for a variety of reasons, such as health, child care, job flexibility, or other reasons. Fortunately, while employment is still down, compared to 2020, wage and salary totals for Iowa do not seem to have been impacted to the same degree. Salaries are on the rise in many job sectors. That, combined with a strong stock market, should result in a strong tax return season come April of 2022.

Covid -19 and the impact of current and future variants is also a concern. After peaking in January 2021, the number of Iowa deaths has rebounded since June 2021 and while not near the pandemic highs of the Fall and Winter 2020, the statistic is disheartening. The number of deaths and significant illnesses must come down for the economic picture to finally stabilize.

Importantly for Iowa, the agricultural economy continues to benefit from high prices and good corn and soybean volumes. The drought worry for much of the state has subsided a bit after significant rainfall this past fall.

The LSA revenue estimate for FY 2022 is for 3.0% growth, slightly higher than the October REC estimate. As stated earlier, $212 million of this is already collected, reflecting a current, as of last week, 7.2% growth rate, and while we expect continued growth from December through February, we do expect a tapering in the later months of the fiscal year for reasons I mentioned earlier.

The LSA revenue estimate for FY 2023 reflects continued year-over-year gains in employment which should be good for income tax growth. Sales tax growth may be muted in the first third of the fiscal year because stimulus money was still providing a boost in the early months of FY 2022. Growth in FY 2023 will be further muted by a significant income tax decrease enacted this past Session and effective starting in January 2023. The continued 5-year phase-out of the inheritance tax elimination will also reduce revenues. The LSA projected 2.5% growth rate for FY 2023 reflects the issues mentioned above.

Mr. Underwood: The question becomes some of the major items that are more of a guess than anything else. The inflation rate would certainly seem, as Holly mentioned some higher inflation rates than we've been used to for quite a while. However, my recent reading is that most people are saying it isn't going to continue at such a high level. A year from now I doubt very much whether we are going to be seeing inflation rates approaching 7%. I think that's going to have a major impact and it seems to be between the two of your numbers as to what growth rates are going to be in such items as personal income tax rates. The other thing, of course, is we're still worried about variants on the COVID. A year ago we thought, "Oh boy, we're going to get the vaccine, that's going to take care of our problems; we're going to be at 70% and problems are gone." Now we're having higher rates than we had a year ago as far as people in the hospital. As we saw over the last variation that cropped up out of South Africa, huge reaction for a week then everyone decided okay maybe it's not as bad as we thought. But how many times can our economy take shocks like that without starting to impact our general fund revenue. Those are the two to me that are the biggest issues. When we get into discussion as to what's going to happen, it is more inflation rate related as far as I'm concerned. Other than that, everyone seems to be on the same page.

Mr. Paulsen: Thank you to the Governor for the opportunity to represent the executive branch on the Revenue Estimating Conference. The work we do is essential to ensuring the Governor and General Assembly have accurate revenue information to wisely and thoughtfully make decisions regarding necessary revenue and budgetary decisions. Of course, the decisions we make today will be the basis for the budget Governor Reynolds proposes to the upcoming General Assembly.

To that end, I extend a thank you to the committee members for their thoughtful participation and all the people who help the members prepare for these deliberations including the Legislative Services Agency, the Department of Management, and the Department of Revenue.

My remarks will be brief, but I have a few thoughts to share. It appears to me that the state of Iowa, the nation and beyond are experiencing an economy in transition. I suppose the state of the economy is always in some amount of transition, but it seems different somehow in current times. No doubt some of these transitions are caused by the pandemic. That said, I would suggest many, if not most of these transitions, especially those related to technology are more correctly identified as being accelerated by the pandemic.

The changes in employment expectations and decisions and the changes in purchasing expectations and decisions are two transitions that are being driven at the individual level and these changes in expectations are coming at a frenetic pace. The decision-making power of everyday citizens will be as high in 2022 as any other time that comes to mind. These expectations are driving economic changes in ways that were unimaginable just a short time ago and it appears they will continue.

There are three specific items that I want to address: labor, supply chain, and inflation. In particular the influence these have over revenues.

First, Iowa’s unemployment rate is at 3.9%. This is with a 66.8% labor participation rate that continues to lag previous highs. Additionally, there are roughly 64,000 plus Iowans in search of work with 110,000 available job openings. Meaningful wage growth is occurring, especially at the lower end of the wage spectrum but this growth appears to be broadening out as well. I believe this puts the state in a position of growth in Iowa’s economy and in-turn growth in Iowa’s revenues.

Second, supply chain issues are in the news non-stop. There are almost 100 ships sitting off California waiting to be unloaded, there is a truck driver shortage, inventories are low at manufacturing facilities and inventories are low on retailers’ shelves, the list goes on and on. Once again – I expect this puts us in a position of growth in Iowa’s economy and in-turn growth in Iowa’s revenues.

Lastly, we are seeing inflation numbers that we have not seen for decades. Early on there was some conversation about whether it was transitory or more permanent. I think that answer is now relatively clear. Inflation is not transitory, although maybe not at the numbers they are at the moment. While we could debate the cause and effect of this, how long it will last, or how the Fed may react; the truth is we don't know. What we do know is that product prices and state revenues traditionally move together. This would also indicate growth in state revenue.

Current revenues continue to be strong. Sales and use tax receipts continue to show strength at 11.9% growth year to date. Demand continues to be strong in both consumer and business spending – I see no indication of this slowing anytime soon. Withholding receipts show slim growth at 1.9% year to date, but we must remember this is without the preceding year's contributions driven by unemployment compensation and with a reduction in the withholding table schedules.

Real GDP growth continues at an annualized rate of 7.7%. This viewed with other available data indicate productivity gains.

I am again left to conclude that with a reasonable degree of confidence we should expect continued growth in both Iowa's economy and the state revenues that it drives.

A few specific comments about the Governor's recommendation. The FY22 2.4% net increase and FY23 1.6% increase should be a safe or conservative estimate. My confidence today is that these numbers will not go down when the Revenue Estimating Conference meets in March. What this means is the General Assembly should feel confident that they do not have to wait to begin their detailed budget work until we meet again in March.

The Governor's recommendation would leave nearly $1.3 billion as an ending balance. These are uncommitted dollars, or said another way this is the overcollection that is occurring beyond what the state has budgeted to meet the needs of Iowans. It does not include the dollars that have already been placed in Taxpayer Relief Fund.

The Legislative Services Agency is above these recommendations. Although slightly less conservative, I see these as realistic estimates as well. They do not make me uncomfortable.

Review Fiscal Year 2022 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers

Motion: Mr. Underwood made a motion to select the LSA numbers, as selected, for FY 2022.

Second: Ms. Lyons.

All voted in favor and the motion carried unanimously.

Review Fiscal Year 2023 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers

Motion: Mr. Underwood made a motion to reduce the LSA number on Personal Income Tax by $54 million, the Corporate Income Tax by $40 million, and increase the Sales and Use Tax numbers by $14 million, which is a net difference of $80 million. For FY 2023, this would be a 1.7% growth rate above the new estimate for FY 2022. (Net receipts plus transfers $9,210.6)

Second: Ms. Lyons.

All voted in favor and the motion carried unanimously.

Fiscal Years 2022 and 2023 Gambling Revenues Transferred to Other Funds and Interest Earned on Reserve Funds (transferred to Rebuild Iowa Infrastructure Fund)

Motion: Mr. Underwood made a motion to move the numbers presented from both LSA and the Governor's Designee, as they agreed.

Second: Ms. Lyons.

All voted in favor the motion carried unanimously.

Other Business

With no further business, Mr. Paulsen called the meeting adjourned at 11:22 a.m.

The December 13, 2021 minutes were unanimously approved at the March 10, 2022 meeting. tlw