

**Revenue Estimating Conference
Minutes
March 10, 2022**

Members Present: Kraig Paulsen, Holly Lyons, David Underwood

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

Approval of the March 10, 2022 agenda

Mr. Paulsen called for a motion to approve the agenda for the March 10, 2022 meeting

Motion: Mr. Underwood

Second: Ms. Lyons

All voted in favor and the motion was carried unanimously.

Approval of the December 13, 2021 minutes

Mr. Paulsen called for a motion to approve the minutes for the December 13, 2021 meeting

Motion: Ms. Lyons

Second: Mr. Underwood

All voted in favor and the motion was carried unanimously.

Remarks

Ms. Lyons: A lot has happened in the world, the country and in Iowa in the three months since we met in December, and much of what we're hearing in the headlines is likely to impact the global, U.S., state, and local economy one way or another. We've all seen the news; surging inflation, War, rising fuel and oil prices, volatile stock prices, potential stagflation. But let's start with some good news.

- While there was a significant downshift in U.S. economic growth during the 4th quarter of 2021, partly due to the Omicron variant of Covid-19, the economy still grew at a robust 5.7% for the year, the largest annual increase since the early 80's.

- The number of severe illnesses, hospitalizations and deaths due to the Covid-19 Omicron variant has slowed, and life seems to be returning to a new normal.
- Farm commodity prices are high and moving higher, which should be good for Iowa farm income. Recent rains should help relieve drought concerns as well.
- Iowa General Fund revenue growth on a fiscal year basis is up more than 7.8% so far this year and we're nearly $\frac{3}{4}$ of the way through the fiscal year. The current REC estimate is for 3.0% annual growth. Individual income tax and sales tax are both far exceeding projections. The rub is that most of our growth last year occurred after February, so the year over year comparisons from this point forward will likely decrease.
- National and Iowa employment numbers are still below the pre-pandemic peaks, but they're making steady monthly progress, slowing a bit in the last months of calendar 2021. Wage rates are higher as businesses are competing for labor. And getting back to basics, as long as employment numbers continue to improve, tax revenue growth should remain positive.

The headwinds facing the economy that I mentioned at the December meeting still exist. It just seems a little more turbulent now:

- Inflation is higher than it's been since the early 1980's and is showing signs of persistence. We have not had to project revenue during a time of inflation for a long time. It remains to be seen what the Federal Reserve will do about it when they meet next week.
- Supply chain issues still exist, but they are easing a bit.
- High commodity prices, while generally a good thing, may mean higher food prices.
- The persistent labor shortage and more jobs than workers that we mention at every conference meeting is a continued concern.
- War - the Ukraine/Russian conflict shows no signs of ending soon and there is potential for it to become a wider geopolitical conflict. The humanitarian losses are horrific, but there is also an economic cost associated with the uncertainty. Sanctions on Russia won't have a significant impact on Iowa trade

as Russia is Iowa's 31st largest export partner, but Iowans WILL feel the impact on fuel and food prices.

There is indeed more economic noise than the last time we met, but Iowa is certainly in a very solid revenue position. All indications point to solid tax year for 2021 tax receipts.

The LSA estimates before you reflect an optimistic projected growth of 4.4% in net receipts for FY 2022.

The FY 2023 LSA projection accounts for estimated revenue reductions for FY 2023 of \$236 million due to the recently passed and signed tax reduction legislation (HF 2317) and therefore reflects a growth rate of -0.8% for FY 2023.

Mr. Paulsen: I'll go ahead and make my remarks now. First of all, thank you to the Governor for the opportunity to represent the Executive Branch on this conference. The work we do is essential to ensuring the Governor and the General Assembly have accurate revenue information to wisely and thoughtfully make decisions regarding revenue and budgetary decisions. I also want to thank the committee members for their thoughtful participation and all the people who help prepare the members for these deliberations, including the Legislative Services Agency, Department of Management, and the Department of Revenue.

Conclusions regarding Iowa's economic future are challenging to arrive at. Conditions continue to be conflicting and noisy. Pandemic driven circumstances compound the complexity and the Russian invasion of Ukraine only exacerbates the challenge of drawing conclusions with certainty.

That said, a few thoughts:

- Iowa's economy continues to expand amidst inflationary pressures, although the pace of growth has modestly slowed.
- Demand continues to surge despite rising prices.
- The labor market remains tight and companies continue to hire.
- Possible Federal Reserve interest rate hikes will likely not derail growth; personal and employer balance sheets are strong enough to withstand modest rate hikes.

- Downturn risks appear minimal over the next year even after recognizing supply chain, labor, and inflation challenges.

In fact, Fiscal year 22 and 23 continue to show strong economic growth for Iowa. Pressures impacting fiscal year 24 are harder to predict. Although too far out to draw solid conclusions, there does appear to be a greater risk of a slower economy and in turn weakening state revenues in FY24. Although I see no reason to conclude this slowdown will cause an economic contraction.

The greatest uncertainty presented today is the war Russia has chosen to wage in Ukraine. The biggest worry for Iowa associated with this invasion and subsequent trade dislocations and sanctions is not trade exposure. As mentioned before, Russia is Iowa's 31st largest export partner and they're our 56th largest import partner.

The greater risk is up-chain issues that drive higher prices. In particular, agricultural input prices (energy and fertilizer), prices of natural gas and oil, and food prices. An already vulnerable supply chain is also at risk. Although, there may be some benefits for Iowa corn producers if Ukraine's corn production does not make it to market. There could also be upward pressure on ethanol prices.

One of the key features of the current economic environment is disequilibrium, meaning that supply and demand curves are dislocated. Early on, many thought a new equilibrium would be reached at this point. Now it appears likely we are one to two years before this new supply/demand equilibrium is achieved. Frequent shocks, the pandemic, supply chain challenges, and now the Russia-Ukraine conflict make it harder to reach the new normal. Additionally, inventory build is shifting the demand curve out further as inventory management models are moving from just-in-time to just-in-case.

A few specific comments about Iowa.

Iowa's economy continues to rebound from the COVID-induced recession, although there is some evidence of a slowdown in the pace of growth.

- Iowa real GDP contracted slightly quarter over quarter in the third quarter, however, GDP was still up. Real GDP is now 3.4 percent ahead of its pre-pandemic peak reached in the fourth quarter of 2019.

- The six-month annualized change of the Iowa Department of Revenue Leading Indicators Index is up over 2 percent.
- Iowa continues to have more job openings than unemployed, about 1.68 jobs per unemployed person.
- Iowa added 39,400 jobs in 2021 although Iowa jobs remain 2.3 percent below the February 2020 level. Most of the additions were in leisure and hospitality. However, manufacturing added 6,300 jobs with 4,000 added in durable goods manufacturing.
- Regarding agriculture - Commodity prices are up sharply and are expected to remain strong for the foreseeable future. Iowa land values increased 29 percent in 2021 and are 12 percent higher than their previous peak.

Specifically looking at Iowa Tax Revenues, sales tax revenue has seen some moderation from very strong numbers earlier in the year but that was expected and they continue to be very healthy at 11.6%. Withholding is quite strong, up 4.4%. Matched tax returns between tax year 2020 and tax year 2021 show adjusted gross income up 7.1% and wages up 6.8%.

This is all very positive news, especially viewed in the aggregate.

Lastly, FY23 will start to see the impact of recently enacted HF2317. The Legislative Service Agency's expected revenue impact of these tax cuts is \$236 million more will be left with Iowans in FY23 and \$561 million will be left with Iowans in FY24. This is accounted for in the Governor's proposal today. Neither the Governor's nor the Legislative Service Agency's proposals will cause a change to the Governor's proposed budget, nor does it independently drive a change to the publicly released legislative targets released earlier in the session.

In conclusion the State of Iowa continues to be on very solid financial footing and I see no reason to expect that to change for the foreseeable future.

Mr. Underwood: During the news report they were talking about inflation and the lady that was talking about it was talking in a very excited voice and she said "Everything's up and it's only going to get worse." And I just kind of like, uh-oh, we're not going to be able to buy toilet paper again, the last time that happened that everything was up. I guess that's the worst thing that could happen and that was only 2 years ago when that happened. And the other thing is the discussion

of the war. What's amazing to me is it's on the news all the time but it's not anywhere else that I go. People don't sit around and talk about Ukraine and the war and they aren't worried about it in their daily lives yet. But we're starting to see the impact as we start to notice what's going on with our dysfunctional energy policy on the national level; it was terrible before and it's much worse now. Trying to decide whether we're going to buy Russian gasoline or not. And it's just a situation where I don't think any of the forecasters that we used to build this model really had an opportunity to put in what the war potentially could do. And that's because who knows how long that's going to go on, but it was only three weeks ago it was just so unraveling and all of a sudden here we are three weeks later and they're in a serious war over there. I was just listening to somebody who is supposedly an expert on the nuclear power plants in Ukraine and somebody that doesn't know how to run them is taking them over. What impact that could have is another Chernobyl type of situation and now that's going to impact the entire world not just a little corner of the world. So, there is a lot of uncertainty put back in and it was feeling really good 4 weeks ago or 6 weeks ago that, oh boy, maybe this pandemic is kind of going away and we'll get back to a newer normal. So, there is some great uncertainty, I think you're right, Iowa has been very strong in it's recovery. In itself it's not a huge recovery but it is a very solid recovery. But then we talk about commodity prices going up and that's great for the farmer but then I also heard the price of nitrogen and it didn't go up a little bit, it went up a lot in the last year and a half. From \$400-\$500 per unit to \$1300 per unit, so that's a huge increase for the farmer and it requires a significant increase in corn prices to make up that kind of difference so it's good for the farmer that the crop prices are looking good and profitable for them. At least they can plan a little bit knowing they have an opportunity for profit but it's better than the Ukrainian farmer that doesn't know whether he's going to get a crop in the ground or not this year. So, I think there is room for optimism for Iowa, but I think it just has to be a measured approach so that's what I'm urging. And then I look at sales tax. That's been the one area that's been unbelievable in its growth; how much longer that's going to continue at that level, I don't know. With the inflationary pressures, what are people going to spend money on. Their food, but that's non-taxable. And with food prices rising that cuts into their discretionary spending. So, income tax looks pretty solid. Capitol Gains might be impacted a little bit. But that's for next April, not this April.

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

Mr. Underwood stated that recognizing that on the front page, under the REC FY22 estimate, the number is pretty close to what everybody else is estimating. Other than sales tax I'm pretty comfortable with the numbers. I would suggest we took LSA numbers and knocked about \$46.7 million off. I'd be real comfortable with LSA numbers. Lower the LSA by \$46.7, which would also be lower than the Governor's estimate.

Motion: Ms. Lyons made a motion to move the Governor's numbers and adjust \$30 million upwards on the Sales and Use Tax.

Second: Mr. Underwood seconded the motion.

Discussion:

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

Mr. Underwood suggested lowering the Governor's numbers, in the personal income tax line, by \$50 million.

Ms. Lyons feels confident in the Governor's numbers in both years, with no changes in the second year and Mr. Paulsen agrees. Mr. Underwood stated one of the issues is the growth in withholding and wages, etc. Everything he reads about says the wage inflation is really starting to level off. We've gone through a period of two years where we've had significant wage growth and that is not expected to continue at the kind of levels we've seen. So that would temper the withholding estimates that were used. In fiscal year '23, it was really just the withholding growth I thought was a little too aggressive. Again, it's only \$50 million one way or another, but I suggest we not be too optimistic given some of the current circumstances.

Ms. Lyons asked what percent increase the Governor's numbers would show over FY2022. LSA's Mr. Robinson responded it would be -0.2% growth.

Motion: Mr. Underwood made a motion to adopt the Governor's recommendation for the FY2023 estimates.

Second: Ms. Lyons seconded the motion.

All voted in favor and the motion carried unanimously.

Estimate Fiscal Year 2024 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers

Motion: Mr. Underwood made a motion to adopt the Governor's recommendation for FY2024.

Second: Ms. Lyons seconded the motion.

All voted in favor 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 LSA numbers.

Second: Ms. Lyons seconded the motion.

All voted in favor and the motion was carried unanimously.

Other Business

With no further business, Mr. Paulsen called the meeting adjourned at 11:27 a.m.

The March 10, 2022 minutes were unanimously approved at the October 13, 2022 meeting. *tlw*