

**Revenue Estimating Conference
Minutes
October 15, 2021**

Members Present: Kraig Paulsen, Holly Lyons, David Underwood

Mr. Paulsen called the October meeting of the Revenue Estimating Conference to order at 10:00 a.m.

Approval of the October 15, 2021 agenda

Mr. Paulsen called for a motion to approve the agenda for the October 15, 2021 meeting by unanimous consent.

No objections and the motion was carried unanimously.

Approval of the March 19, 2021 minutes

Mr. Paulsen called for a motion to approve the minutes for the March 19, 2021 meeting

Mr. Paulsen removed himself from this vote as he was not present at the March 2021 meeting. The motion carried 2-0.

Opening Statements

Ms. Lyons Let me open by stating that as of 2 weeks ago the FY 2021 books are closed and revenue came in MUCH higher than the March REC estimate. Like most states, we missed it big, but of course it's better to be on the high side than the low side. In both dollar and percentage terms, fiscal year 21 growth exceeded any year since at least fiscal year 2001. After FY 20's low rate of growth — which was a direct result of COVID-19 economic and social ramifications, FY 21 provided a very strong rebound **that was concentrated in the final three months of the fiscal year**. General Fund net revenue for the year increased \$870 million and 11 percent compared to the fiscal year 2020 level and exceeded the REC estimate by \$737.1 million or 9%.

Iowa's large revenue growth experience was similar to many states late last spring. The Urban Institute and the National Association of Budget Officers both indicate that despite the global health crisis and pandemic induced recession, most states saw double digit growth in revenues, and most of that growth was in the third and fourth quarters of the fiscal year. This growth reflected positive consumer confidence in the form of pent-up demand for goods and services, an improving economy, and massive federal assistance in the form of stimulus payments, child tax credits, extended unemployment benefits, and the paycheck protection program. In Iowa, according to the Federal Funds Information for the State (FFIS), just two of the federal stimulus programs, the federally funded extra unemployment and the Economic Impact Programs pumped nearly \$11 billion dollars into the Iowa economy since the start of the recession in 2020. This likely provided a huge boost to personal income and sales tax revenue. The

question is what happens as the impact of that stimulus money fades? Wage and salary income looks fine now, despite the reduction in employment, but come late spring and summer next year, Iowans as a whole may not have as much money to spend as they did the previous year.

We continue to be in strange times with an unbelievable level of uncertainty.

The COVID Delta variant continues to disrupt the US economy. Rapid spread of the Delta strain of the coronavirus in recent months has slowed third quarter calendar year growth in consumer spending on services and is expected to continue to inhibit growth through the end of the calendar year. Economic forecasters now expect the U.S. economy to expand at a slightly slower pace as measured by GDP compared to last Spring's estimates. It's still very uncertain how much of the shifts in consumer, business and worker behavior will persist, and whether short-term disruptions such as future case surges caused by variant strains will have long-lasting ripple effects. There are other headwind factors to consider as well and these include more jobs than people, supply chain disruptions, and rising interest rates. On the positive side, according to the Bureau of Economic Analysis, Iowa's GDP expanded 7.7 percent in the second quarter of 2021, growing faster than most states, with the agriculture and hotel accommodation sectors accounting for most of the positive change in that quarter.

Employment: US and Iowa job numbers are still below pre-pandemic levels. At the recent pace of job additions, it will take the U.S. about 8 months to reach the former peak, but it could take Iowa longer than two years. A continuous challenge for Iowa employers has been finding qualified workers and this has only been exacerbated by the pandemic.

While Iowa unemployment reaches a high of 11% in 2020, it's currently at 4.1%, much improved but still a ways from 2.9% before the pandemic. Like many other states, Iowa is not seeing a surge in hiring after the end of the federal extended unemployment benefits. On the positive side, while employment numbers are down, wage and salary totals for Iowa do not seem to have been impacted to nearly the same degree, possibly indicating that the jobs that are missing may be low on the pay scale. The dynamic of the U.S. workforce is shifting a bit as well as we've recently heard about the Great Resignation, more jobs than employees, increased demand for higher wages, or more job flexibility.

On a national level, supply chain disruptions are expected to continue to impede production, delivery, and investment, at least through the calendar year. The news is full of stories about all the ships stranded off the coast of California as there aren't enough workers to unload the cargo, or enough trucks or drivers to get the goods to the consumers. Factories in Southeast Asia and China have been periodically shut down as the virus sickens workers, further disrupting supply.

Interest rates. There is much economic talk about inflation and recent market activity indicates that longer-term interest rates continue to rise. While this can be a sign of an overheating economy, sometimes it's a necessary sign of future long-term economic growth. It's too early to tell. The Federal Reserve continues to indicate that it will act to ensure borrowing costs do not climb too quickly. The pent-up demand for goods, the labor shortage, and supply chain issues also play into price increases and could fuel price inflation.

Turning to some positive news, the increasing commodity prices are good for those who produce the commodities and bad for those who consume them. Iowa's increasing corn and bean prices are good for the Iowa ag economy.

Iowa's budget reserves are full and the last fiscal year ended with a large surplus as well. This gives Iowa better options for dealing with the pandemic and economic issues that remain compared to some other states.

In summary, while there are some headwinds facing the global economy and to some extent the Iowa economy, Iowa remains in a strong financial position.

Through last Monday, FY 22 General Fund revenue is up \$80 million or 5.0%, but that 5.0% growth is concentrated in sales/use tax and corporate income tax. Individual income tax is down.

Turning to the numbers, the LSA is cautiously optimistic in our FY 22 and FY 23 estimates. While the first three months of revenue data shows good growth, we believe the rate is likely to slow as the fiscal year progresses and the enacted corporate and individual income tax reductions, and the inheritance tax phase-out begin to be realized during FY 22 and FY 23.

The LSA estimates reflect a 1.5% revenue growth rate for both FY 22 and FY 23.

Mr. Underwood: Inflation is one thing we have to look forward to, at least from a revenue standpoint, in the state of Iowa. Over the years we always used to count on a certain level of increase in withholding and sales tax just because of inflation. It's been years now since I've been able to say that, but it's probably going to happen again. This morning on the radio, again they reminded us that inflation numbers are about 5.2%. That doesn't necessarily equate to a 5.2% increase in sales tax revenues but it certainly does give us some cushion there that off-sets increases and decreases in consumer spending. It kind of helps level that out a little bit. But it also has the same kind of impact on wages. When John Deere and their employees figure out what is going to happen to wage increases, that is certainly going to set a standard once that gets settled. But we have seen wage inflation throughout this pandemic and that is probably going to continue, so we will see growth. Last year tax returns came in and we saw much more of an increase than I thought we would see in reported wages by our employees throughout

the state. That is going to continue, we aren't going to see that decline. Every employer I'm talking to is, fortunately, profitable enough to be able to give their employees increases; never as much as the employee wants, that hasn't changed over the years. But definitely is going to be some increases going out throughout the year and is very competitive. As I watch people change jobs, particularly my grandchildren that are in that 20s age. They kind of set their own wages and working conditions more than anybody I've ever seen, somebody coming right out of college.

Interest rates. It seems like the feds are continuing to talk about letting interest rates increase. That will be good for Iowa because a lot of Iowans do have cash investments where they get interest. It's not much, but if that doubles it's going to help quite a bit. And it's very easy to say interest rates could double when they're from .01 to .02. It's not a lot of money but it does help the revenue for the state of Iowa.

Recession. We haven't really talked about recession very much. We weren't sure what to call it when COVID happened, and a lot of people did call that a recession. But that was kind of an artificial one because of COVID. But now we're talking about the real recession, when is it going to come. Of course, economists always say there is going to be a recession, we just don't know when. But the only talk I hear on a national basis about a U.S. recession is they talk about what is going to cause that and that's either action or inaction in Washington, D.C. If they can't get the debt limits raised, it will cause a recession and that's all they talked about. Of course, it got taken care of, at least for a while. Those are the kinds of things that there is no way we can predict what they are going to do or not do in D.C.

Here in Iowa, the farm economy is good. Crops are coming in much better than expected. Farmers I've talked to were surprised they got the yields that they did. Some of them have a docking problem on their soybeans because they are way too dry. But everyone seems to be pretty happy this year.

The employment numbers; it's not only Iowa it's everywhere. I just got back from New Mexico. They are having a really hard time finding anybody to work. You don't know if a restaurant is going to be open this afternoon. It just depends if they get enough people to show up whether they're going to open their doors. It made travel a little difficult. Same thing in the hotels, you may or may not get your room cleaned. Everyone is struggling with it. I felt good getting back to Iowa. Their COVID situation is so much worse than what we've got here. They're really scared about their situation and it's their indigenous population that has not gotten vaccinations and the impact of that has really spread throughout the whole state.

Mr. Paulsen: First of all, 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 the resulting budgetary decisions.

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.

Conclusions regarding Iowa's economic future are challenging to arrive at. The data is often conflicting and noisy. And because of the unique pandemic driven circumstances it compounds the complexity of interpreting available information. That said, available information looked at in its totality appear to me to point to a brighter and a very strong future for Iowa.

Unquestionably current revenues are strong, there is a strong base or foundation to build from and data would indicate continued growth into the future.

Speaking to a few specific receipts – sales and use tax receipts are showing remarkable growth at roughly 18%.

Withholding receipts show slim growth at roughly 1%, but we must remember this is without the preceding year's contributions driven by unemployment compensation and with a reduction to the withholding table schedules.

Of the various tax types – these two would be the more leading indicators.

A few other noteworthy items from my perspective:

Workforce participation rates are below pre-pandemic levels and it is not clear how soon they will return to pre-pandemic levels – but clearly there is room for growth. In Iowa there continues to be more job openings than there are persons seeking employment.

Real GDP has now surpassed pre-pandemic levels in the state and nationally. Combined, these two indicate meaningful productivity gains that could and probably should be expected to continue into the future. And over time, as the labor participation grows, this should only compound these positive facts.

Supply chains are currently very stressed. Once again, there is only room to grow and I am inclined to believe the creative supply chain operators will come up with solutions that get this critical piece of our economy moving as it should again. Hopefully in early 2022, but that is a very hard thing to predict.

Personal saving rates, while they have receded from the highs early in the pandemic, they are still slightly higher than pre-pandemic levels. This combined with the supply chain issues leave me to conclude there is significant pent up demand for consumer and business spending.

Although not necessarily equal through all strata, wage growth is occurring and appears it will continue to grow into the foreseeable future.

Inventories are unsustainably low. Another precursor to growth.

Iowa's ag sector shows strength and is contributing positively to Iowa economy. 2021 began with near record commodity prices, and while they have decreased somewhat since the beginning of the year, they are nowhere near the lows we saw in 2019 or 2020 and exports remain strong. Additionally, Iowa will have a near record soybean and corn crop in 2021. Farmland prices are near record highs and remaining steady, as demand remains strong.

Fuel costs are a concern and rising energy costs could be a drag on growth if not addressed in a meaningful manner.

We need to watch inflation closely and in fact we are watching to see how long elevated inflation persists and how this affects spending behavior in the state. Given current economic conditions it is hard to predict what inflation will do and its effect on state revenues. However, as some of the other previously-mentioned matters normalize, inflationary pressures should decrease.

I say again from my opening, there is much conflicting information to review at the macro level, but I am 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.

Review Fiscal Year 2021 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers

Motion: Ms. Lyons made a motion to move the LSA numbers for Fiscal Year 2021.

Second: Mr. Underwood seconded the motion.

All voted in favor and the motion carried unanimously.

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

Motion: Mr. Underwood made a motion to move the LSA numbers for Fiscal Year 2022.

Second: Ms. Lyons seconded the motion.

All voted in favor and the motion carried unanimously.

Fiscal Years 2021 and 2022 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 for both years.

Second: Ms. Lyons seconded the motion.

All voted in favor the motion carried unanimously.

Other Business

With no further business, Mr. Paulsen called the meeting adjourned at 10:23 a.m.

*The October 15, 2021 minutes were unanimously approved
at the December 13, 2021 meeting. ttw*