INTERIM JOINT COMMITTEE ON APPROPRIATIONS AND REVENUE

Minutes of the 3rd Meeting of the 2021 Interim

August 4, 2021

Call to Order and Roll Call

The 3rd meeting of the Interim Joint Committee on Appropriations and Revenue was held on Wednesday, August 4, 2021, at 1:00 PM, in Room 149 of the Capitol Annex. Representative Jason Petrie, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Christian McDaniel, Co-Chair; Representative Jason Petrie, Co-Chair; Senators Danny Carroll, David P. Givens, Alice Forgy Kerr, Morgan McGarvey, Stephen Meredith, Michael J. Nemes, Robin L. Webb, and Stephen West; Representatives Lynn Bechler, Danny Bentley, John Blanton, Randy Bridges, Myron Dossett, Joseph M. Fischer, Ken Fleming, Kelly Flood, Chris Fugate, Al Gentry, Robert Goforth, Mark Hart, Angie Hatton, Jason Nemes, Ruth Ann Palumbo, Melinda Gibbons Prunty, Brandon Reed, Steve Riley, Sal Santoro, James Tipton, and Lisa Willner.

Guests: Michael W. Clark, Director, Center for Business and Economic Research; John Hicks, State Budget Director, Office of State Budget Director; Sandy Williams, Deputy Executive Director, Kentucky Infrastructure Authority; and Jim Gray, Secretary, Kentucky Transportation Cabinet.

LRC Staff: Jennifer Hays, Grant Minix, Sarah Watts, and Chase O'Dell.

Approval of Minutes

A motion was made and seconded to approve the minutes of the July 7, 2021 meeting of the Interim Joint Committee on Appropriations and Revenue. The motion passed by voice vote.

Kentucky's Current Economy and Inflation Compared to the Nation

Michael W. Clark, Director, Center for Business and Economic Research, testified on Kentucky’s current economy and inflation compared to the nation.

Mr. Clark testified that in the United States and in Kentucky, economic output has continued to improve over the past year. Employment has rebounded substantially but still remains below pre-pandemic levels. Economic recovery has been uneven across sectors. Labor force participation rates remain low. Inflation has also increased during this time.

Gross domestic product (GDP) declined 10 percent from the first quarter of 2020 to the second quarter of 2020. Kentucky's GDP declined at an annual rate of 35 percent during this time. Each quarter since then, economic output has increased substantially. For the first quarter of this year, Kentucky GDP grew at an annual rate of 6.4 percent. National GDP has reached pre-pandemic levels.

Initial claims for unemployment insurance have dropped substantially since the height of the pandemic, but they still remain high compared to pre-pandemic levels.

The labor force participation rate in the U.S. has recovered more than in Kentucky. Some factors affecting the labor force participation rate include health concerns for workers, limited access to childcare, an increase in the number of people who have retired, skills and geographic mismatches, and enhanced unemployment benefits. It is unclear how much each individual factor is contributing to the overall lower labor force participation rate in the U.S. and Kentucky.

Of the jobs lost in Kentucky last year, roughly 69 percent have been recovered or replaced with other jobs. For several months in 2020, Kentucky was recovering lost jobs at a rate faster than the rest of the country, though the country has caught up in the last six months. As of June 2021, Kentucky employment was still down 4.6 percent relative to the level of employment in January 2020, which is very similar to the national situation. There were about 90,000 fewer jobs in Kentucky in June 2021 compared to January 2020.

While there has been a substantial increase in job openings, the labor force participation still remains low. With the high demand for workers, there are not enough workers to fill available positions. As a result, wages and salaries in the U.S. are continuing to increase.

Prices have significantly increased in the last three months. Inflation has jumped to levels not seen in a long time. There has been a substantial increase in the price of new cars. Used car prices accounted for a third of the increased inflation from May to June 2021. Much of the cause for inflation in certain categories of products has been due to supply chain issues and increased consumer demand. Most of these inflation pressures are likely to go away over time.

In response to a question from Senator Carroll, Mr. Clark testified that economists still see accurate data on employment, even with additional federal spending or reduced interest rates. Government agencies will have to figure out how to transition to consumer demand driving employment rather than stimulus. In response to another question, Mr. Clark stated that there is always a question of whether providing additional unemployment benefits provides a disincentive to work. In response to further questions, Mr. Clark testified that there are several contributing factors to why labor force participation rates remain lower than pre-pandemic levels, and that factors may vary between sectors, but that it is difficult to determine how much each factor contributes. It is likely that additional unemployment benefits and stimulus checks contribute to lower labor force participation, but it is difficult to determine how much they contribute.

In response to a question from Representative Petrie, Mr. Clark testified that there is always a concern that fiscal stimulus, in addition to higher consumer demand, may drive prices up. Economic output has recovered, but there is reason to believe that supply in the economy can be increased and thus mitigate the concern about inflation. In response to another question from Representative Petrie, Mr. Clark said that national studies show that retirements have increased during the pandemic. Most of these workers were going to retire in the next few years anyways, so eventually the labor force participation rate will catch back up.

In response to a question from Representative Fleming, Mr. Clark stated that he does not see a potential for a period of stagflation, because demand for goods and services remains high. In response to another question, Mr. Clark testified that compared to other states, Kentucky receives a relatively large portion of its total personal income from transfer payments from the federal government. These payments tend to be stable and are not tied to economic performance.

In response to a question from Representative Bridges, Mr. Clark testified that to the extent that enhanced unemployment benefits are having an effect on labor force participation, it would be expected that more people would return to work once those enhanced benefits end. Once workers return to the labor force, Mr. Clark anticipates that wage pressure will ease, causing wage increases to slow, which will ease inflation pressures. In response to another question, Mr. Clark stated that demand for workers and skilled workers is high.

In response to a question from Representative Petrie, Mr. Clark testified that the committee should keep an eye on the economic data measures presented during the meeting, particularly the employment numbers which come from the business survey.

In response to a question from Senator Carroll, Mr. Clark stated that he did not know how Kentucky ranked among other states in regards to the percentage of the population not seeking employment. In response to further questions, Mr. Clark testified that an individual is classified as not participating in the labor force if they are not actively searching for a job. Generally, the processes used to determine unemployment and labor force participation rates are accurate. There are, however, limitations and challenges to collecting data. Mr. Clark testified that he did not recall specific reports which focus on why individuals are not participating in the labor force.

In response to a question from Senator Meredith, Mr. Clark stated that there are a number of different measures of unemployment which look at the various situations workers find themselves in. He continued to say the he not only looks at the unemployment rate, but also at how many jobs are in the economy.

In response to a question from Representative Nemes, Mr. Clark testified that the labor force participation rate is calculated from the civilian non-institutional population, which excludes individuals institutionalized, in the military, or 15 years old or younger. The official labor force participation rate includes individuals 16 years old or older, so it includes senior citizens. Mr. Clark stated that he likes to look at the participation rate of prime-age workers, which includes individuals ranging from 25 to 55 years old.

Fiscal Year 2021 Year-End Closeout

John Hicks, State Budget Director, Office of State Budget Director, presented an overview of the fiscal year 2021 year-end closeout.

Mr. Hicks testified that fiscal year 2021 actual general fund receipts totaled $12.8 billion. Actual receipts for the year were $1.1 billion in surplus of the enacted estimate, more than triple the highest surplus ever recorded. Fiscal year 2021 receipts grew 10.9 percent from fiscal year 2020, representing the highest annual growth rate in 26 years. This growth in receipts was led by the sales and use taxes, the individual income tax, and the corporate income and Limited Liability Entity Tax (LLET) taxes. These taxes accounted for 87 percent of the revenue surplus.

Sales tax receipts grew 12 percent in fiscal year 2021, which was the highest growth since the sales tax rate was last increased in the 1990 regular session. Corporate income and LLET receipts grew 38.1 percent in fiscal year 2021, which was the highest growth since fiscal year 2006. Property tax receipts grew 9.2 percent in fiscal year 2021. Individual income withholding receipts grew by 5.9 percent in fiscal year 2021, the highest growth rate since fiscal year 2015.

The total general fund surplus for fiscal year 2021 totaled almost $1.2 billion. Of this surplus, $1.162 billion has been deposited into the budget reserve trust fund, which is the largest deposit ever. This brings the budget reserve trust fund balance up to $1.9 billion, which is equivalent to 16 percent of fiscal year 2022 general fund appropriations.

Fiscal year 2021 road fund receipts totaled $1.642 billion, with a surplus of $64.6 million over the enacted estimate. The bulk of this surplus consisted of an increase in motor vehicle usage tax receipts, which grew 24 percent over the prior year. Overall, road fund revenues in fiscal year 2021 increased 10 percent over the prior year.

The 10.1 percent growth rate in road fund collections was the highest growth rate since fiscal year 2011. Revenues from fiscal year 2021 were the highest in road fund history. The total road fund surplus for fiscal year 2021 totaled $97.3 million, with $29.7 million coming from spending less than budgeted.

The general fund enacted revenue estimate for fiscal year 2022 projects revenues of $11.850 billion, which is 7.6 percent less than actual revenues in fiscal year 2021. The Office of State Budget Director forecasts that general fund revenues will grow about 3.3 percent in the first three quarters of fiscal year 2022. The road fund is projected to grow by 4.6 percent in the same period.

In response to a question from Representative Prunty, Mr. Hicks testified that the economy adapted more quickly to the pandemic than anyone expected. The significant job loss which occurred at the beginning of the pandemic was highly concentrated among low wage workers, who do not pay a lot of income taxes. Middle income and high wage workers were able to maintain their income, thus income tax receipts grew. The sales tax receipts grew, largely because people spent more money on taxable tangible goods during the pandemic.

In response to a question from Senator McDaniel, Mr. Hicks stated that early in the pandemic, there were a substantial amount of income withholding receipts collected from individuals receiving unemployment insurance benefits who opted into withholding. In response to another question, Mr. Hicks confirmed that $600 million in COVID-19 funds was utilized for fiscal year 2020 and 2021 which would have otherwise been general fund revenue, which helped contribute to the surplus. Senator McDaniel spoke to the upcoming budget obligations and challenges.

In response to a question from Representative Tipton, Mr. Hicks testified that he was unsure of the amount of matching dollars that Kentucky would be required to put up once the federal infrastructure bill passes.

In response to a question from Representative Fleming, Mr. Hicks stated that wages and salaries have increased. The Office of State Budget Director projects that wages will continue to increase in the next three quarters.

Update on Broadband Initiative

John Hicks, State Budget Director, Office of State Budget Director; and Sandy Williams, Deputy Executive Director, Kentucky Infrastructure Authority, provided an update on the broadband initiative.

Mr. Hicks testified that the request for information for the broadband initiative was released in June, 2021. Twenty-six responses were received. Those responses were used to finalize the request for proposal (RFP) and application.

The RFP will be released in August. The map of unserved areas released with the RFP will be indicative of the information available. The RFP will be left open for 2.5 months. The challenge process will last for at least one month. The evaluation and award processes do not have a timeline yet.

In response to a question from Representative Petrie, Mr. Hicks stated that it is possible that the award process will be completed by the end of the calendar year, but that the process may go into the beginning of 2022.

Update on Water Projects

Jim Gray, Secretary, Kentucky Transportation Cabinet; and Sandy Williams, Deputy Executive Director, Kentucky Infrastructure Authority, presented an update on water projects.

The drinking water and wastewater grant program is responsible for water projects. The program is funded by the American Rescue Plan Act of 2021. These funds were appropriated by the General Assembly in Senate Bill 36 of the 2021 Regular Session. The program is part of the Better Kentucky Plan.

In the 2021 Regular Session, $250 million was appropriated for water and wastewater projects. Out of that total, a $150 million pool is allocated by county population. Another $50 million pool is dedicated for unserved drinking water customers in rural areas and federal consent decree projects. Finally, a pool of $49.9 million is dedicated to supplement a project grant where the cost is greater than the county's allocation, as well as for cost escalations and changed conditions.

The number of potential projects is greater than 350. There may be as many as 269 unserved drinking water projects. Four federal consent decree utilities will be eligible. Across the state, 713 utilities will be eligible for project funding. As of the end of July, 371 projects had been submitted for approval. These project submittals represent 91 counties and would total more than $612 million. The call for projects opened June 1, 2021, and the application deadline is November 19, 2021.

The obligation of funds must occur by December 31, 2024. Funds must be spent by December 31, 2026. Grant awards will be distributed June 20 through December 31, 2021. Project types determine the timeline for conditions compliance. The grant assistance agreement will be issued after conditions are satisfied.

With no further business before the committee, the meeting was adjourned at 2:59 p.m.