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Utah: Scrabbling for Innovation absent a Crisis

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Abstract

The 2017 Utah legislative session, an intensely busy 45 days, focused heavily on tax reform, funding of public schools, and addressing the state’s homeless crisis. At the conclusion of the session, the FY18 budget totaled \$16.2 billion, a seven percent increase over the FY17 budget. Public schools received a large increasing in funding—in total a seven percent increase to address student growth and other programs. The discussions about tax reform failed to produce any agreements and will likely be addressed in the 2018 session. Although homelessness was addressed with more than \$12 million in funding for new homeless shelters, low-income housing, and expanding a 10-year tax credit, the crisis in the state continues to grow and a special session is likely to be held in fall 2017. This report provides the details about the 2017 legislative session, the FY18 budget, and the factors—such as demographics and economics—that impacted the budget.

Introduction

Citizen engagement, uneven revenue growth, and booming demand from a burgeoning and diverse population placed Utah budgeteers in an unfamiliar territory for a second time in 2017. Having taken a year off for elections, the governor, and legislators were once again talking about revenue increases in an expanding economy. In the end, they kept pace on school spending and made progress on homelessness and infrastructure, but did not enact tax reform or large increases in public education spending as demanded by certain business leaders.

Overview of Utah

Demographics of the State

Utah’s consistent population increases since 2010 are a result of in-migration due to a healthy economy and Utah’s large family sizes, which rank first in the nation with 3.65 people per

Table 1. Utah Population

Population estimates, July 1, 2016	3,051,217
Population estimates, July 1, 2015	2,995,919
Population estimates base, April 1, 2010	2,763,888
Population, percent change – April 1, 2010 (estimates base) to July 1, 2016	10.4%

Source: U.S. Census Bureau

household.¹ Utah’s population continues last year’s growth rate of 1.9 percent. The population increased by an estimated 57,402 persons from 2015 to 2016; 24,274 persons were accounted for in net migration, constituting 42 percent of the overall growth.² Due to this extended period of growth, Utah surpassed the milestone of three million people, making it the 31st most populated state in America.³ Davis, Salt Lake, and Utah Counties, three populous counties often referred to as the “Wasatch Front,” added 38,446 new persons to the state in 2016, constituting two-thirds of the state’s overall increase. These three counties are the most populous in Utah, being home to about two-thirds of the population, or 2,054,879 persons.

Utah’s population forecast shows that Utah’s population is going to continue to grow and experience a much older median age. Total population is to surpass four million persons in 2034 and 5.5 million in 2065. By 2065, the percentage of persons 65 and older will have doubled to 21.3 percent, raising the median age by over 9 years.⁴

Utah’s population of minorities reached 21 percent in 2015, an increase from 19.4 percent in the 2010 census. Nationally, 38.4 percent of the population are minorities. Although this percent is lower than the national average, the percentage of minorities continues to rise in the state. The state’s largest minority remained Hispanic or Latino, with this group constituting 13.7 percent (411,143) of the population. Asians were the second largest group, making up 2.4 percent (70,971). Multiple ethnicities made up 1.9 percent of the population. Black and AIAN (American Indian and Alaska Native) groups each contributed one percent to the population.⁵

Political Context

As an election year, 2016 was an interesting year for Utah politics. The Republican Party continued its reign over the state in both national and state elections. In the presidential election, Donald Trump won the state with 45.1 percent of the vote, a significant drop from the 73 percent

¹ Robert Chase, “What State Has the Largest Families?” Overflow data, June 2016. <http://overflow.solutions/demographic-data/what-state-has-the-largest-families/>

² “Race and Ethnicity in Utah: 2015,” June 2016. <http://gardner.utah.edu/wp-content/uploads/2016/06/Race-and-Ethnicity-in-Utah-2015-Fact-Sheet.pdf>

³ “State Populations 2016,” *World Population Review*. <http://worldpopulationreview.com/states/>

⁴ Mike Hollingshaus, Emily Harris, Catherine Jeppsen, Pamela Perlich, “The Beehive Shape: Provisional 50-Year Demographic and Economic Projections for the State of Utah, 2015–2065,” Kem C. Gardner Policy Institute, October 2016. http://gardner.utah.edu/wp-content/uploads/2016/11/2016_10_07_StateProjections-Final-Nov-3.pdf

⁵ “Race and Ethnicity in Utah: 2015,” June 2016. <http://gardner.utah.edu/wp-content/uploads/2016/06/Race-and-Ethnicity-in-Utah-2015-Fact-Sheet.pdf>

of the votes former Republican candidate Mitt Romney won in the 2012 election.⁶ A major reason for this 30-point fall was the emergence of Evan McMullin, a Mormon ex-CIA agent. He appealed to the morals of Utahns and to the “Never Trump Republicans,” garnering 21.3 percent of the vote. Hillary Clinton, the Democratic nominee, mildly benefited from Trump’s relative unpopularity. She received three more percentage points than Barack Obama had, capturing 27.1 percent of the vote;⁷ however, Utah held true to its red color in the federal elections. The Senate seat and all four congressional districts remained firmly in Republican control.

Governor Gary Herbert, the Republican incumbent, won re-election by a substantial margin with 66.8 percent of the votes; his Democratic challenger, Mike Weinholtz, captured 28.7 percent. The state legislature followed suit as the GOP maintained its supermajority in both the House and the Senate, proving the continued dominance of Republicans statewide. In the Senate there were 24 Republican senators and five Democratic senators. In the House the count was 61 to 14, with Republicans holding the majority. The state treasurer, attorney general, and state auditor were also all Republican.⁸ Salt Lake City is the only true Democrat stronghold in the state, with the city’s Democrats holding their ground in this election cycle as Ben McAdams won his re-election for Salt Lake County mayor.

The Utah Economy

Leading up to the 2017 legislative session, Utah’s economy continued to expand in 2016. Every major industrial sector expanded in 2016, contributing a total of 49,500 new jobs over the year. An annual employment growth rate of 3.6 percent, down from 3.8 percent the previous year, was above the state’s long-term average and among the strongest in the nation (see Figure 1).

Utah’s construction sector posted the highest job growth in 2016, 6.8 percent, fueled by both robust residential and commercial activity. The value of commercial construction reached a record \$2.5 billion in 2016, with major projects across the state like the expansion of the Dixie Regional Medical Center in St. George, the expansion of the Utah Valley Hospital in Provo, and a 1,700-acre solar plant in Delta. Low unemployment and rising wages for Utahns, along with growth in travel and tourism activity—Utah’s ski resorts and national parks hosted a record number of visitors in 2016—contributed to exceptionally strong job growth of 6.1 percent in the state’s leisure and hospitality sector over the past year.⁹

The consensus forecast predicts moderate—but still healthy—job and wage growth, low unemployment, and increased net in-migration in 2017. Internal risks to the Utah economy this year and beyond include the supply of workers, education warning signs, and air quality. Potential

⁶ “2012 Utah Election Results,” *New York Times* November 2012.

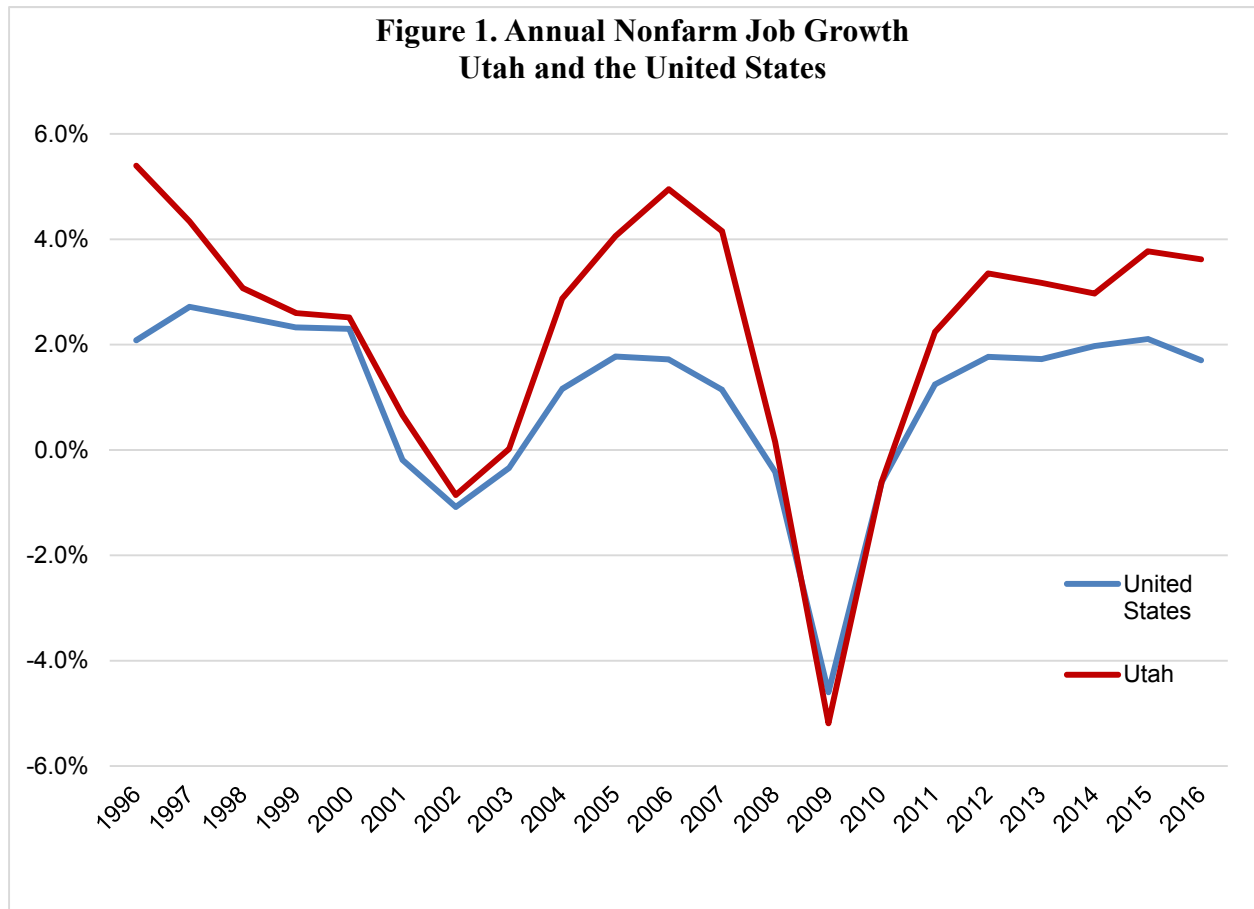
<http://elections.nytimes.com/2012/results/states/utah>

⁷ “Utah Election Results,” Lieutenant Governor’s Office, November 2016.

<https://electionresults.utah.gov/elections/federal>

⁸ “Utah State Senate Elections, 2016,” Ballotpedia, November 2016. https://ballotpedia.org/Utah_State_Senate_elections_2016

⁹ 2017 Economic Report to the Governor Highlights. Available at: <http://gardner.utah.edu/wp-content/uploads/2017/03/ERGFourPager-Singles.pdf>



Source: Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

Demographic advantages, an appealing business climate, and increasing labor force participation will continue to be an advantage for the Utah economy. Potential expansionary federal fiscal policy changes, including tax cuts and infrastructure spending, also present an upside risk. All going well, Utah’s economy will once again be one of the top performing economies in the nation in 2017.¹⁰

Budget and Tax Policy Challenges

Prior to the 2017 General Session, a group of influential business leaders in Utah, called “Our Schools Now,” proposed a ballot initiative to increase income taxes by 17.5 percent. They would move Utah’s modified flat tax from 5 percent to 5.875 percent. The group did so to inspire historic increases in Utah’s education spending. Many of the group’s members hoped the threat of a tax increase alone would spur budget writers to action. No such monumental spending increase happened in the 2017 General Session, thus the ballot initiative moves forward.

¹⁰ 2017 Economic Report to the Governor Highlights. Available at: <http://gardner.utah.edu/wp-content/uploads/2017/03/ERGFourPager-Singles.pdf>

The initiative, however, sparked other discussions surrounding tax reform. As is the case in many states, Utah’s demographic changes have led to shifting consumption patterns. Traditional predictors of sales tax revenue are no longer reliable. Sales tax collections as a proportion of both personal income and state specific gross domestic product are declining. At the same time, changes in technology and commuting patterns have led to stagnation in motor fuel taxes.

To address these and other structural inefficiencies, Utah legislators attempted tax reform in the 2017 General Session. Their proposals included raising taxes on groceries from 2 percent to 4.35 percent, reducing the overall sales tax rate from 4.7 percent to 4.35 percent, offering an earned income tax credit or refundable grocery tax credit, and moving to single factor apportionment on corporate income taxes. Legislators wanted these changes to be revenue neutral, but tax changes are rarely neutral for all. Ultimately, legislators could not agree on which sector of the population should bear the burden of tax reform.

The Utah Budget Process

Utah’s legislative session is an intensely busy 45 days commencing in late January and culminating in early March, and the budget is always a focus and a major point of debate for the legislature and population during this time. Utah, like other states, consistently faces the problem of holding true to its fiscally conservative dogma while still funding solutions for major public problems in the state (e.g., air quality, public and higher education, and public safety). Special interest groups, state agencies, the business community, and political parties all try to have a major impact on this crucial issue. The governor also takes part in the budgeting process by strongly advocating an adoption of his formal budget proposal each year. With all these factors considered, the final product reflects the direction of Utah’s economy.

Utah’s FY17–18 Budget

Like many states, Utah tracks its budget in two buckets—“state only” revenue, and “all sources”—which includes federal funds. In Utah’s case, “state only” means spending from the sales tax-backed General Fund (GF) and income tax-supported Education Fund (EF). For fiscal year (FY) 2018, Utah’s all source budget totals \$16.2 billion, a seven percent increase over the budget passed by legislators for FY 2017. Legislators increased current year FY 2017 appropriations by only a small amount in the 2017 General Session to reflect better estimates of federal funds collections.

General and Education fund budgets for FY 2017 declined slightly in the 2017 General Session by about \$7 million. Appropriators had the pleasant surprise of lower than anticipated cost growth for Medicaid this year. The 2016 Third and Fourth Special Sessions added to FY 2017 \$10 million GF for a new rodeo stadium and \$3 million GF for local roads. For next fiscal year—FY 2018—GF/EF budgets total about \$6.7 billion, an increase of 4.2 percent over FY 2017 after the 2017 General Session and two special sessions.

General Tax Revenue

The Utah Constitution establishes three main revenue sources for government spending. Taxes on income and property must be spent on education. Motor fuel taxes go to roads. Other general taxes—sales, severance, alcohol, tobacco, etc., can be spent on anything. The growth rates of

these three sources have diverged over the course of their histories. Income taxes are among the state's most volatile sources but have the highest growth rates. Gas taxes are set per gallon and do not grow with gas price inflation. As consumption patterns change from goods to services, sales tax growth rates have not kept pace with GDP or personal income. As a result, the three legs of Utah's general tax stool are not even.

Legislators examined rebalancing these big three sources in the 2017 General Session. They considered lowering income tax rates and eliminating credits for exemptions and deductions. They toyed with restoring the sales tax rate on food and reducing the overall sales tax rate. They debated several bills proposing changes to taxation on out-of-state sales. They discussed freezing certain property tax rates so that they won't "float down" as values increase. In the end, the distributional effects of these changes—combined with an expiring time clock—led legislators to defer such changes.

Two significant changes were made in this regard, however. In late December, the governor and Utah State Tax Commission announced that Amazon.com—the world's largest online retailer—would voluntarily collect and remit taxes on sales in Utah. While the agreement does not apply to Amazon Marketplace sales, the agreement could increase sales tax collections by between \$10 million and \$40 million per year. Second, when legislators indexed gas taxes to inflation two years ago, they set a retail price floor at which indexing would begin. Historically low gas prices have delayed indexing, so legislators modified the indexing methodology in Senate Bill 276, Transportation Funding Modifications. The bill starts indexing earlier and is expected to generate between \$5 million and \$10 million per year in new motor fuel taxes beginning in FY 2019—returning about \$5 million per year to the General Fund through reduced sales tax earmarks.

FY 2018 Budget Highlights

Education

Utah historically ranks last or second to last in per-pupil public education spending (a measure of input). Part of this can be attributed to the large family sizes and high proportion of children in the state; more than one in five Utah residents is enrolled in the public school system. Other nonmonetary inputs partially make up for the relatively low per pupil spending, keeping Utah in the middle of the pack with regard to student achievement. However, those nonmonetary inputs are changing. As a result, a group of influential Utah business leaders in proposing a ballot initiative—called "Our Schools Now"—to raise Utah's income tax rate from 5 percent to 5.875 percent. They are proposing that the increased funding go directly to public schools and institutions of higher education.

As noted in the revenue section above, the threatened initiative was not enough to inspire legislative action on income taxes and school spending. However, the governor proposed, and legislators appropriated, a four percent increase in the state's basic school formula. This increase was in addition to new funding for student growth as well as several other categorical programs. In total, public education spending increased by more than seven percent. Public and higher education combined received more than two-thirds of new and reallocated revenue in the 2017 General Session.

Homelessness

Several initiatives in 2017 and the previous general session aimed to address Utah's homelessness. This year legislators passed House Bill 441, Housing and Homeless Reform Initiative, providing more than \$10 million for new homeless shelters outside Utah's urban core. They also approved House Bill 36, Affordable Housing Amendments, appropriating \$2.5 million for low-income housing and expanding a 10-year tax credit for those who offer low-income housing. To address the drug addiction and mental health issues that sometimes correlate with homelessness, legislators provided more than \$10 million for addiction and mental health services.

Federal Land Issues

After finding extra money in the Constitutional Defense Fund, Representative Michael Noel requested \$379,400 to be moved from the Defense Fund to the Public Lands Policy Coordinating Office. This request was approved.

Transportation

While gas tax increases that were passed in previous sessions and modified in 2017 will address maintenance needs, demand for new transportation capacity in Utah still outstrips revenue. This is evidenced by the passage of S.B. 277 Highway General Obligation Bonds Authorization. S.B. 277 authorizes \$1 billion in new debt for highways over the next five years. The bill establishes certain controls on debt. New bonds must not push outstanding general obligation debt above 50 percent of the state's constitutional debt limit and the state treasurer must report to legislative committees before issuing debt. This "budgeting" of debt is a departure from Utah's historic propensity to pay cash for infrastructures while the economy is expanding.

Compensation Increases

State agency and higher education employees will receive a two percent labor market increase in FY 2018, which is twice what the state's chief executive recommended in his budget proposal. Additionally, certain high turn-over positions will receive targeted increases that sum to the equivalent of another one percent statewide. Legislators also provided funding for a seven percent to eight percent increase in the cost of employee health insurance benefits. Under House Concurrent Resolution 13, participants in the Public Employees Health Plan traditional pool will receive a rebate of between \$75 and \$205 in 2017, totaling \$3.75 million.

Conclusion

In the end, Governor Herbert and legislators felt that the budget process in the 2017 legislative session went smoothly. The governor stated, "This has probably been the most collegial, collaborative legislative [session] I can recall in the last seven years I have been governor."¹¹ Policymakers wound-up fully funding education growth, increasing per-pupil spending by almost twice the rate of inflation; providing significant funding for homelessness; accelerating gas tax indexing and borrowing \$1 billion for roads; and providing compensation increases equal to be-

¹¹ <http://www.deseretnews.com/article/865675383/Utah-budget-boils-down-to-people-services.html>

tween three percent and four percent for state agencies and higher education employees. Lawmakers and the governor did not, however, reform taxes or enact the 24 percent increase in education revenue proposed by certain business people.