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Utah: Economic Tailwinds Continue

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Abstract

The Utah Legislature faced two major budget and tax policy challenges leading into the 2018 General Legislative Session: federal tax reform and a citizen’s initiative to increase public school funding. Together, the two created a unique opportunity for legislators to re-balance the state tax system and generate additional revenue for public education. During the session, Legislators addressed these issues as well as homelessness, Medicaid expansion, transportation investments, and others. By the end of the 45-day session, the state had a \$16.8 billion budget for FY19, which was a 3.8 percent increase over the budget passed by legislators for FY18. This report provides details about the FY19 budget, examines the budgeting process, provides highlights on key budgetary items, and discusses the economic and demographic factors that impacted the budget.

Introduction

The state of Utah has benefited from a strong economy, including low unemployment, healthy job and wage growth, net in-migration, and a strong construction industry. The economic performance in 2017 resulted in more revenue for the state, leaving Legislators with \$581 million in revenue growth to spend during the 2018 legislative session. Record funding was provided to public education, Medicaid was expanded, additional funding was provided for homeless services, compensation was increased for state and higher education employees, and investments were made in transportation.

Although the state has benefited from the strong tailwinds, there are some economic headwinds as well. “Rising business costs, a tight labor supply, and a shortage of housing are creating growth challenges” (Gochnour 2018). Prior to the session, the consensus forecast of state economists predicted a moderating economy in 2018; however, the state’s economy continues to grow. In early December 2018, the Executive Appropriations Committee adopted revised revenue estimates for FY19 and new estimates for FY20. The legislature expects to have \$646 million in one-time money and \$675 million ongoing funding available in the 2019 session.

Overview of Utah

Demographics of the State

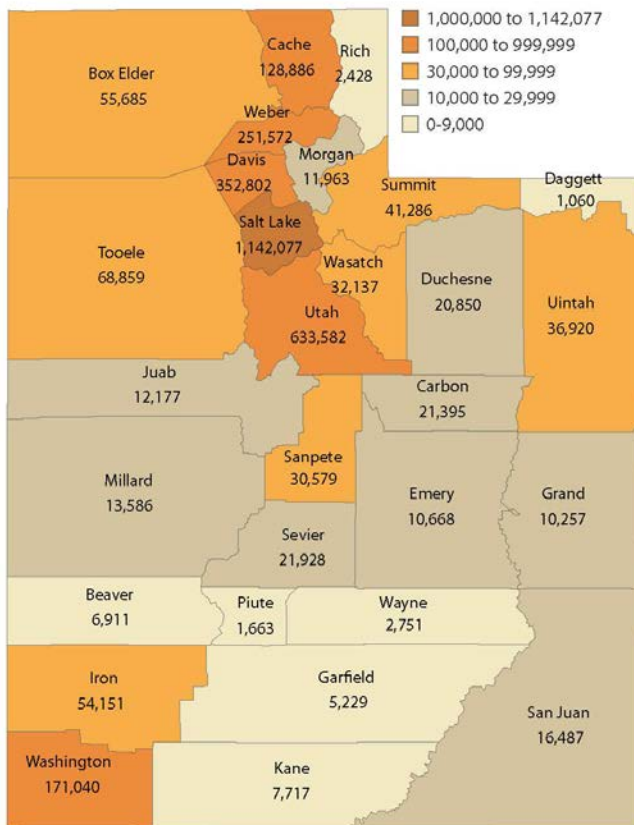
The state of Utah continues to experience population growth fueled by natural increase and net-migration. The population reached an estimated 3,166,647 people in 2018. This is a growth rate of 1.7% from 2017 to 2018. However, the state’s reputation for large families may be in jeopardy. The fertility rate (2.12) is at the lowest level since (year), ranking second behind North Dakota’s rate of 2.23. In fact, the fertility rate is now near replacement level. This decline matches a national trend downward – the national fertility rate is now at (xx). Net-migration contributed to 44 percent of the state’s population growth between 2017 and 2018 (Harris 2018). The total number of net migrants was 23,248. This is an indicator of positive economic conditions.

The state’s population is concentrated along the Wasatch Front in Davis, Salt Lake, Utah, and Weber counties. The four counties are home to about three-quarters of the population (Gardner Policy Institute 2018a). Utah and Salt Lake counties added the most people to their populations between 2017 and 2018. Utah County added 15,847 people, ending with a total estimated population of 633,583 people in 2018. Salt Lake County, the largest county in the state, added 13,806 people, ending with a total estimated population of 1,142,077. Several counties off the Wasatch Front experienced higher population percentage increases: Iron County (3.58%), Piute County (3.45%), Washington County (3.29%), and Juab County (3.21%). Two rural counties lost population: Emery County (-0.04%) and Garfield (-0.19%) (see Figure 1).

There are two additional aspects to note relating to the state’s population that will impact the state’s budget in the future: the population is aging and diversifying. The population forecast indicates that Utah’s population will continue to grow and experience a much older median age. Total population is projected to surpass 4 million persons in 2034 and 5.8 million in 2065 (see

Figure 2). By 2065, the percentage of persons 65 and older will have doubled to 21.3 percent, raising the median age by over 9 years (Hollingshaus, et al., 2016). The population will also become more diverse. Currently, the majority of the state’s population identifies as white or non-Hispanic (78.8 percent) but, the share of residents that identify as other races or ethnicities has increased. The state’s largest minority remained Hispanic or Latino, with this group constituting 13.8 percent (420,440) of the population. Asians were the second largest group, making up 2.4 percent (73,240). The remaining population was made up of people identifying as two or more races, 2.0 percent, Black or African American, 1.1 percent, American Indian and Alaska Native, 1.0 percent, or Other Pacific Islander, 1.0 percent (Gardner Policy Institute, 2017).

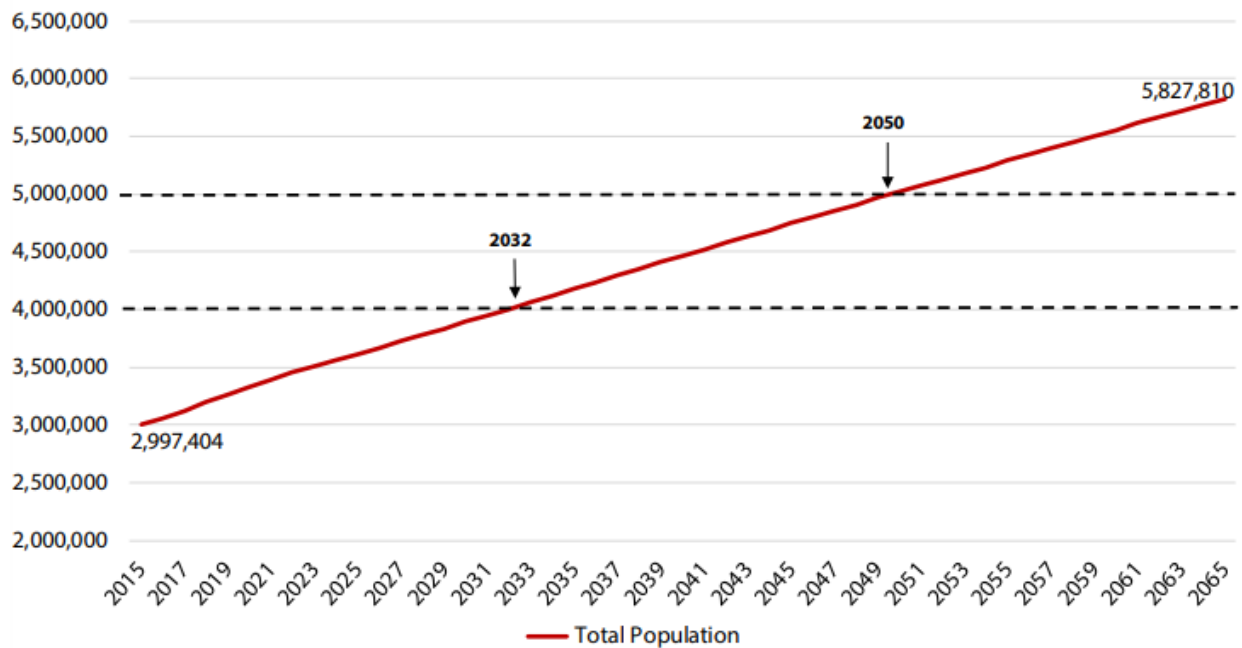
Figure 1. Utah County Population Estimates, 2018



Source: State and County Population Estimates for Utah: 2018, Kem C. Gardner Policy Institute.

Population growth, the aging population, and more diverse population have immediate impacts on the state’s budget. These trends are expected to continue. Projections indicate the population will increase to 5.8 million in 2065. This represents an increase of 2.7 million people in the next 47 years. These demographic changes will create new budgetary challenges for future policy makers.

Figure 2. Utah Total Population, 2015-2065



Source: Utah's Long Term Demography and Economic Projections Summary, Kem C. Gardner Policy Institute.

The Utah Economy

The state's economic performance was strong in 2017. Every major industrial sector expanded, contributing a total of 43,500 new jobs over the year. An annual employment growth rate of 3.0 percent, down from 3.5 percent the previous year, was in line with the state's long-term average and among the strongest in the nation (see Figure 3). That equates to 42,800 new jobs in the state.

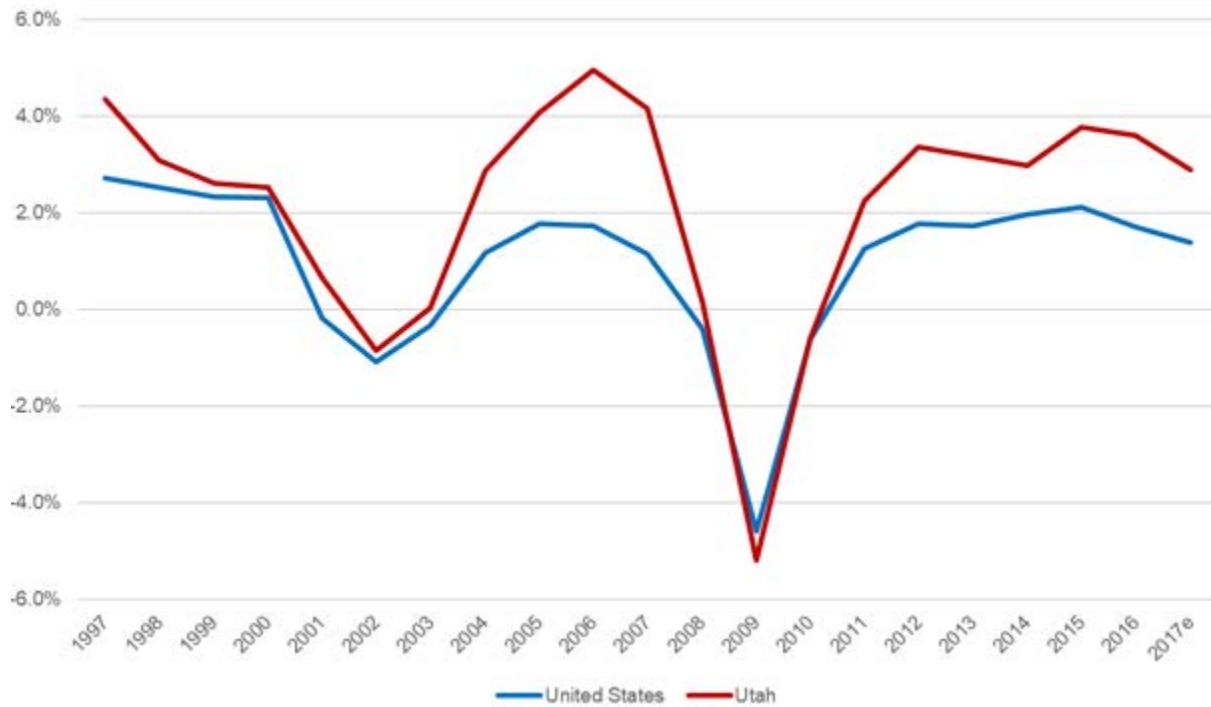
Utah's construction sector posted the highest job growth in 2017, 6.5 percent, fueled by robust residential and non-residential activity. The value of non-residential construction reached a near-record of \$2.4 billion in 2017.

The consensus forecast predicts moderate—but still healthy—job and wage growth, low unemployment, and increased net in-migration in 2018. Internal risks to the Utah economy this year and beyond include the supply of workers, increasing costs, increasing interest rates, air quality, housing affordability, and a late business cycle (Economic Report to the Governor, 2018).

Demographic advantages, low cost of living, a business-friendly economic climate, and transportation networks will continue to be an advantage for the Utah economy. Additionally, wage growth, improving labor force participation, and expansionary fiscal policy may also be

contributing factors to the state’s economy. Expansion in Utah continues, but is expected to moderate in 2018 (Economic Report to the Governor, 2018).

Figure 3. Annual Nonfarm Job Growth, 1997-2017



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

Budget and Tax Policy Opportunities

Utah faced two major budget and tax policy challenges leading into the 2018 General Legislative Session: federal tax reform and a citizen’s initiative called “Our Schools Now.” Together, the two created a unique opportunity for legislators to re-balance the state tax system and generate additional revenue for public education. Similar solutions had been debated in the 2017 General Session, but did not produce results. Federal tax reform pushed these concepts over the top in 2018.

Business leaders in Utah launched the Our Schools Now citizen’s initiative to raise \$715 million in revenue for public and higher education. They proposed raising the state’s personal income tax rate from 5.0 percent to 5.45 percent and the sales tax rate from 4.7 percent to 5.15 percent. Just before the 2018 General Session, opinion polls from the Salt Lake Tribune and Hinckley Institute of Politics showed that 55 percent of registered voters favored the measure and 41 percent opposed it (Wood, 2018).

However, the initiative met resistance on Utah’s Capitol Hill from budget hawks, as one might expect, and also from moderates who felt it exacerbated some of Utah’s structural tax problems. Because the initiative proposed raising income taxes, it increased Utah’s reliance on its most volatile revenue source. Republican leadership in the Legislature preferred tax re-balancing that broadened sales and income tax bases, lowered those rates, then froze and equalized property taxes for education and augmented user fees for transportation.

At the same time, just before the 2018 General Session, the U.S. Congress passed—and President Trump signed—the Tax Cuts and Jobs Act of 2017. While the bill reduced federal tax liability for most Utahns, it increased their state liability and therefore represented a revenue windfall to state government. While Utah boasts a “flat tax” on income, the state also offers a credit for certain federal exemptions and deductions. By eliminating federal exemptions and capping certain itemized deductions, federal tax reform narrowed Utah’s “taxpayer tax credit”—something legislators had attempted but failed to do in the 2017 General Session. The result was about \$80 million in unexpected state revenue associated with federal tax reform.

In the final days of the Session, legislative leaders and Our Schools Now backers agreed upon a compromise. Legislators would rebalance certain income and property taxes, then ask the voters whether they should increase gas taxes. Combined, these initiatives could result in as much as \$225 million per year in new revenue for education by FY 2023.

House Bill 293, “Tax Rebalancing Revisions” used the \$80 million federal windfall to reduce income tax rates from 5.0 percent to 4.95 percent and allow certain multi-state corporations to apportion their income to Utah based only on in-state sales. It then set a floor on the state’s largest education property tax—known as the “Basic School Levy”—allowing revenue to rise as property values increase. HB 293 also maintains property tax participation in overall school funding by indexing future rates to student enrollment growth and inflation. Additionally, the bill increased “circuit breaker” property tax credits for low-income homeowners. While HB 293 was nearly revenue neutral in year 1, it will generate \$125 million in new revenue by year 5 (Utah Legislature, 2018a).

House Joint Resolution 20, “Joint Resolution Submitting a Question to Voters,” asked whether Utah should increase its motor fuel taxes by ten cents per gallon to provide additional funding for education and local roads. Utah currently subsidizes highway costs from sales taxes by about \$600 million per year. By FY 2023, raising the gas tax ten cents per gallon could result in an additional \$80 million per year in local road funding under current formulas, but would also free-up as much as \$100 million in sales tax for education (Utah Legislature, 2018b). However, Utah voters defeated the question – 65 percent against the tax increase, 35 percent in favor (Utah Lt. Governor’s Office, 2018).

The Utah Budget Process

Utah's legislative session generally has a strong focus on the budget. 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 (including 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.

Over the past several years, Utah legislators have broadened their budgeting focus from short-term budget balancing to long-term fiscal sustainability. That trend continued this year with passage of House Bill 452, "Legislative Fiscal Analyst Amendments." The bill requires legislative staffers to establish a three-year cycle for examining and reporting on longer-term revenue and budget conditions. In year one, the Legislature will consider revenue volatility and its impact on reserve requirements. In year two, budgeteers will project a multi-year state budget considering anticipated demographic and economic trends. In year three, Legislators will put parts one and two together and subject them to alternative economic scenarios in a "budget stress test". These changes are intended to highlight and inform structural decisions like revenue and spending sustainability as well as contingency planning (Utah Legislature, 2018c).

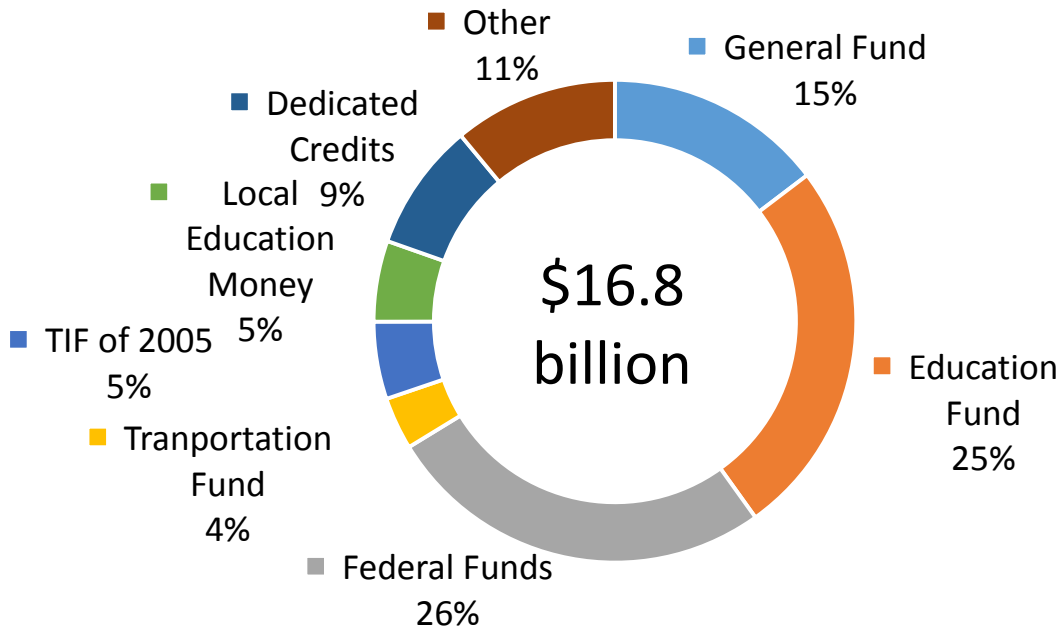
Utah's FY19 Budget

Like many states, Utah tracks its budget in two buckets: "state only" revenue and "all sources" revenue, 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) 2019, Utah's all source budget totals \$16.8 billion, a 3.8 percent increase over the budget passed by Legislators for FY 2018 (Utah Legislature, 2018d; Utah Legislature, 2017)¹. Legislators increased current year FY 2018 appropriations by nearly \$225 million in the 2018 General Session, largely to reflect better estimates of beginning balances, dedicated credits, and federal funds collections.

General and Education Fund budgets for FY 2018 total \$7.3 billion—up more than \$645 million (9.6 percent) over the previous budget for FY 2017. A growing economy, tax changes passed in House Bill 293, and federal tax reform afforded legislators more than \$800 million in new revenue to spend during the 2018 General Session. The last time Utah saw such increases was just prior to the Great Recession. Recognizing that not all of this new revenue is likely sustainable, Legislators deposited \$85 million of it into rainy day funds, put another \$10 million

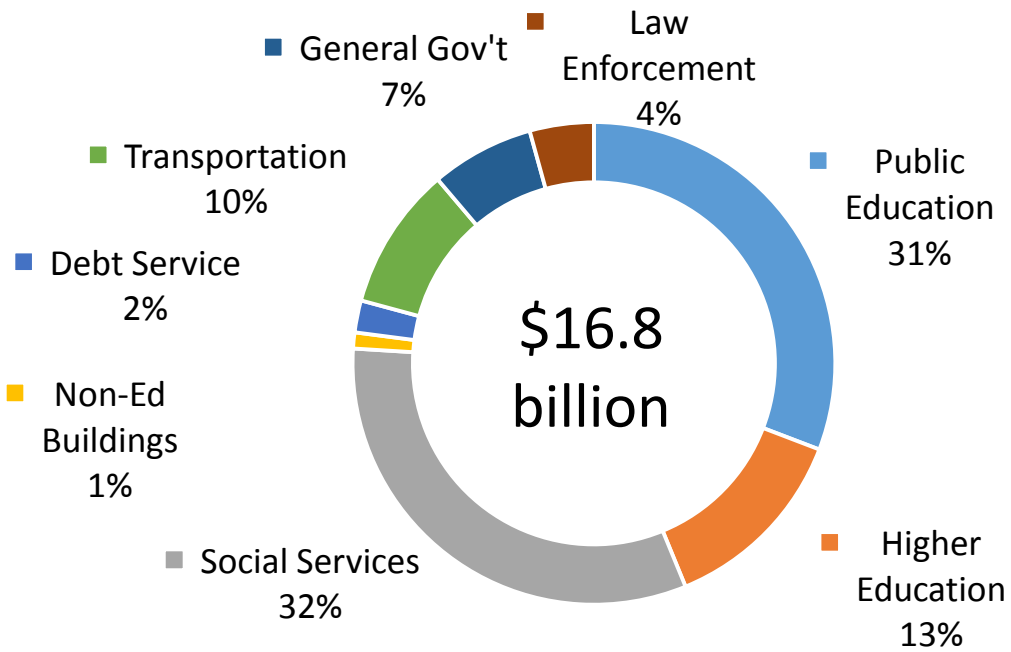
in a fund for future student growth, and used \$67 million in above-trend ongoing revenue to pay cash for previously approved building projects, bolstering the state's "working rainy day fund". Legislators used 54 percent of the remaining available sources for higher and public education.

Figure 4. Utah Budget by Source, FY19



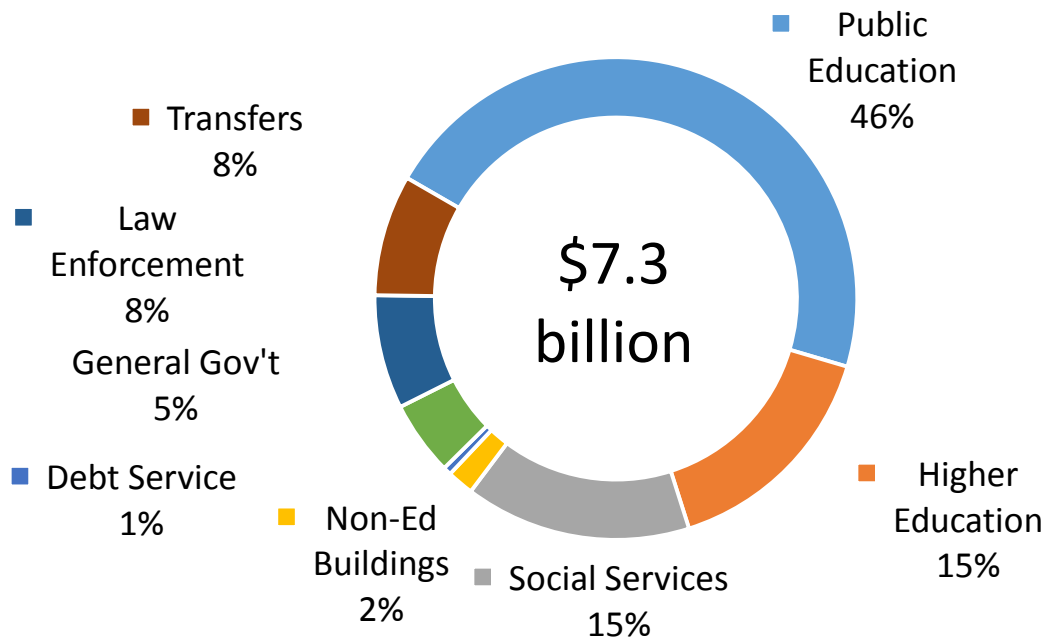
Source: Utah Legislature, 2018F

Figure 5. Utah Budget by Use, FY19



Source: Utah Legislature, 2018F

Figure 6. Uses of General Fund and Education Fund, FY19



Source: Utah Legislature, 2018F

FY 2019 Budget Highlights

Education

With the education-related tax changes shown above, appropriators allocated \$459 million to support public and higher education. They appropriated \$36 million for public education enrollment growth, \$77 million for a 2.5 percent increase in the state’s public education funding formula, an additional \$65 million (about 2 percent) for a new teacher and student success program, and \$36 million to further equalize local property taxes, among other initiatives. Higher education funding included \$40 million for operations and \$90 million for new campus buildings. That’s in addition to \$78 million for buildings approved—but only partially funded—in the 2017 General Session.

Homelessness

During the 2017 to 2018 interim period, the state of Utah partnered with Salt Lake City and Salt Lake County in a cross-jurisdictional effort to protect homeless individuals from criminal drug cartels and provide them access to services and housing. The program—dubbed Operation Rio Grande for the area in Salt Lake City most plagued by homelessness—will cost an estimated \$67 million over two years. State, county, and city officials identified about two-thirds of those resources within existing budgets—including a \$5 million state reallocation done in a September 2017 Special Session. The remaining \$21 million gap was split three ways—50 percent to the state, 25 percent to counties, and 25 percent to cities. To fulfill the state’s commitment to Operation Rio Grande, legislators appropriated \$10.5 million in the 2018 General Session. Legislators also provided \$6.6 million for the operation of new homeless shelters slated to come online next year (HB 462) and established a \$5.4 million local sales tax redistribution formula to

fund public safety and infrastructure costs associated with hosting a homeless shelter in a community (SB 235).

Medicaid

Providing traditional Medicaid to qualified Utah residents will cost state taxpayers an additional \$22 million in FY 2019. Through the passage of House Bill 472, “Medicaid Expansion Provisions,” policy makers also extended limited health care coverage to additional Utahns. Anticipating the eventual end of increased federal subsidy for the Children’s Health Insurance Program (CHIP), legislators also forward-funded \$13 million to pay the state’s increased share beginning in FY 2020.

HB 472 would provide Medicaid benefits to eligible individuals who are below 95 percent of the federal poverty level. Estimates provided during the 2018 General Session indicate the bill has the potential to expand Medicaid coverage to about 60,000 Utahns. The bill also creates a new Medicaid expansion hospital assessment.

Transportation

During the 2017 interim, the Legislature’s Transportation and Governance and Fund Tasking Force met several times to study transportation and transit in the state. One key transportation bill that was passed by the 2018 Legislature was SB 136, Transportation Governance Amendments. While this bill has many moving pieces, a few key effects stand out from the rest of the bill: it modified the makeup and responsibilities for a large transit district; reduced General Fund allocations into the Transportation Investment Fund of 2005 to the newly created Transit Transportation Investment Fund; authorized new local option sales and use taxes; modified the responsibilities and governance of Utah Department of Transportation; renamed the Utah Transit Authority to the Transit District of Utah; and modified vehicle registration fees.

Compensation Increases

Appropriators provided funding for a 2.5 percent general salary increase to state agency and higher education employees. Legislators also funded a 4.1 percent increase in the cost of state workers’ health insurance. Legislators do not directly control public education compensation. As mentioned above, policymakers provided funding capacity to local districts of up to 4.5 percent. Actual compensation in schools will depend upon the outcome of collective bargaining.

Conclusion

The FY 2019 budget totals \$16.8 billion, a 3.8 percent increase over the budget passed by Legislators for FY 2018 (Utah Legislature 2018d). Legislators increased FY 2018 appropriations by nearly \$225 million in the 2018 General Session largely to reflect better estimates of beginning balances, dedicated credits, and federal funds collections. Major legislation signed by the governor in late March increases the public education budget and continues to address the growing homeless problem in the state.

The Utah economy remains strong as the state nears the half-way mark for the fiscal year. In December 2018, the Executive Appropriations Committee adopted revised revenue estimates for

the fiscal year and new estimates for FY20. Available revenue is expected to be \$646 million in one-time money and \$675 million ongoing funding. The General Fund and the Education Fund show strong growth largely due to income tax and retail sales tax collections. General Fund growth is at 7.1 percent and Education Fund is growing at 12.9 percent. Wage growth is estimated at 5.6 percent and taxable sales are estimated at 6.0 percent growth. The state rate collections have not been this high since FY07 (Utah Legislature, 2018e). Although the economy remains strong, researchers and policy makers are concerned that the current business cycle may be coming to an end and caution is encouraged.

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