Volume 33 December 2008 Number 12

The Utah Taxpayer

A Publication of the Utah Taxpayers Association
1578 West 1700 South♦Suite 201♦Salt Lake City, Utah 84104♦(801) 972-8814

December 2008 Articles

State Welfare Spending Exceeds $2.73 Billion in FY2008

State welfare spending, which includes Medicaid, CHIP, WIC, Food Stamps, and numerous other programs, reached $2.7 billion in FY2008, according a recently released report from the Office of the Legislative Fiscal Analyst. The annual report is required by legislation promoted by your Taxpayers Association. State expenditures for welfare programs account for nearly one-quarter of the entire state budget

The following table shows revenue sources for state welfare spending in FY2008.

State Welfare Expenditures, FY2008

State Agency	General Fund	Education Fund	Federal Funds	Other	Total	% of Total
Health	344,215,500	-	1,216,514,800	261,146,500	1,821,876,800	67%
Workforce Svcs	77,732,300	19,247,500	370,929,500	847,900	468,757,200	17%
Human Services	78,348,700	-	183,339,700	-	261,688,400	10%
Public Education		13,872,900	107,448,500	21,611,700	142,933,100	5%
Comm/Econ Dev	2,612,300	-	26,185,700	2,200,300	30,998,300	1%
Higher Education	1,889,700	112,100	-	34,500	2,036,300	<1%
Courts	238,080	-	-	-	238,080	<1%
Total	505,036,580	33,232,500	1,904,418,200	285,840,900	2,728,528,180	100%
Percent of total	19%	1%	70%	10%	100%	

Source: Legislative Fiscal Analyst; Workforce Services expenditures include Utah State Office of Rehabilitation

Welfare expenditures in the Department of Health, almost entirely Medicaid, were the largest single welfare expenditure at 67%, followed by Workforce Services at 17% and Human Services at 10%

Largest State Welfare Programs

Medicaid is by far the single largest welfare program in state government and accounts for nearly two-thirds of total state welfare expenditures.

Largest State Welfare Programs, FY2008

	General Fund	Education Fund	Federal Funds	Other	Total	% of Total
Medicaid (1)	332,158,500		1,165,591,800	243,282,300	1,741,032,600	64%
Disability Medicaid Eligible (DHS)	36,842,700		93,911,300		130,754,000	5%
WIC			37,256,000	12,132,400	49,388,400	2%
Foster/Adoption Care (DHS)	16,262,900		42,409,100		58,672,000	2%
Family Employment Program (DWS)	17,966,900		68,799,300		86,766,200	3%
Child Care (DWS)	7,674,900		58,831,400		66,506,300	2%
Food Stamps (DWS)	20,938,900		155,094,000		176,032,900	6%
Child Nutrition Programs (USOE)		168,100	107,448,500	21,611,700	129,228,300	5%
CHIP	20,281,000		26,604,900		46,885,900	2%
Vocational Rehabilitation (USOR)	265,100	15,621,600	24,272,500	784,000	40,943,200	2%
Other	52,645,680	17,442,800	124,199,400	8,030,500	202,318,380	7%
Total	505,036,580	33,232,500	1,904,418,200	285,840,900	2,728,528,180	100%

Source: Legislative Fiscal Analyst; (1) Includes administration, services, pharmacy, clinics

Federal funding is huge

About 70% of state welfare spending is funded by federal money. Two-thirds of Department of Health welfare expenditures are funded by the federal government, and about two-thirds of federal funds for state welfare programs were appropriated for Medicaid

In FY2008, Utah state government received about $2.5 billion in federal funds of which $1.9 billion was for state welfare programs. While 70% of state welfare expenditures is funded by the federal government, about 23% of total state government is funded by the federal government. Excluding welfare expenditures, federal funds account for 7% of total state expenditures.

But is this really a big deal since this is mostly federal money?

Too many state and local leaders look at federal money as "free" money, and argue that if Utah's state and local governments don't spend the money, other states will. There are at least two problems with this perspective. First, Utahns pay federal taxes just like other Americans, and therefore are interested in making sure federal taxes are spent efficiently. Second, one of the biggest threats to Utahns' prosperity is the massive federal deficit, which will probably get worse as baby boomers retire. Most likely, the federal government will have to slow the growth in funding for state programs in order to slow the growth in federal deficits, meaning that state taxpayers will have to make up the difference.

Most likely, the federal government will have to slow the growth in funding for state programs in order to slow the growth in federal deficits, meaning that state taxpayers will have to make up the difference.

Tax Expenditure Report?

Some legislators and organizations want to include a "tax expenditure report" as part of the state government welfare expenditure report. A tax expenditure report would list all tax deductions, exclusions, credits, and exemptions. Spending groups argue that tax exemptions, credits, deductions, and exclusions are really forms of government expenditures. In other words, if government lets taxpayers keep more of their own money by exempting 45% of a primary residence valuation from property tax, this is really no different than if government had written out a check to each homeowner.

While a summary of tax base reductions is not a bad idea (the Tax Commission already lists most exemptions in its various reports), and while some tax base reductions are not easily justified, equating tax exemptions with government expenditures is problematic. First, reductions in the tax base such as deductions, credits, exclusions, and exemptions are offset by increases in tax rates. What government gives with one hand, it takes away with the other hand. While tax rates may not immediately increase as exemptions are granted, in the long run government usually raises rates to offset the reduction in revenue. One of the biggest tax reform mantras is "expanding the base and lowering the rates."

Second, equating base reductions with government expenditures would allow politicians to incorrectly claim that they were not increasing taxes and the size of government by eliminating deductions and credits. For example, government revenues would increase by nearly $900 million per year if the primary residential property tax exemption were eliminated and property tax rates were not reduced. However, using the "tax expenditure" logic, the spending lobby would argue that eliminating the exemption would be revenue neutral since the increased revenue would be offset by eliminating the 45% exemption "tax expenditure".

We've generally supported broad tax bases (and lower tax rates), but we've never argued that reductions in tax bases are the same as if the state had actually spent these dollars directly in government programs.

Because the life span of road projects are so long, bonding over 15 or 20 years is wise policy, especially when compared with the alternative of raising taxes

My Corner - by Howard Stephenson

Road projects on the chopping block

Utah's sales tax revenues are falling for the first time in 20 years, as described elsewhere in this month's newsletter. In response, the Utah Department of Transportation (UDOT) has put on hold nearly 60 transportation projects totaling $3.9 billion. This temporary postponement gives flexibility for the Governor and the Legislature to decide how to proceed in the budget cutting process. However, if those projects remain on hold, Utah's economy will suffer even more. Businesses will not be able to efficiently get their products to market, jobs will be lost, and Utah's economic competitiveness will suffer. And sales, income and corporate income taxes will dip even further.

The Legislature has long used current transportation spending as a quasi-rainy day fund. When tax revenues fall, the Legislature often redirects current transportation spending to pay for other current programs. The transportation projects continue, but instead of using "pay as you go," long-term bonds spread the costs over the lifetime of the project.

I-15 in Utah County does not just serve Utah county; it is a critical artery in moving goods and services statewide.

Beginning work on the Mountain View Corridor is critical to the transportation infrastructure of Salt Lake County's booming west side. And if work does not begin on the Mountain View Corridor by 2015, the price of that road will increase significantly.

If these cuts remain in place, Utah's economy will suffer. We cannot allow gridlock to stymie Utah's economic growth, especially when the economy is already ailing.

Because the life span of road projects are so long, bonding over 15 or 20 years is wise policy, especially when compared with the alternative of raising taxes. Moving from pay-as-you-go to bonds, or from shorter to longer term bonds decreases the annual payment, thereby increasing the amount of money available for other programs.

For example, in 2002 the Legislature faced a nearly $400 million gap in balancing the budget. In addition to reducing spending, they issued $209 million in bonds to pay for various road projects that otherwise would have been paid for with on-going, General Fund dollars.

The recession continued in 2003, and the Legislature faced a $173 million shortfall. To balance the budget, the Legislature again tapped transportation projects, first by refinancing the bonds that were used to pay for the rebuild of I-15 in Salt Lake County. Instead of paying those bonds off in 10 years, the refinanced bonds extended their term to 30 years. Second, the Legislature redirected $66.4 million in revenues for the Centennial Highway Fund to the General Fund.

Table 1 describes the largest transportation projects postponed, and how they were to be paid for prior to this decision.

The economic consequences of this decision if made permanent will be terrible. Already Utah's construction industry is contracting, which will further dampen sales, corporate income and individual income tax revenues. More importantly, not moving forward with these projects will harm Utah's economic competitiveness.

List of projects paid for with the General Fund delayed by UDOT

Route	Description	Cost
I-15	Core in Utah County	$2,600,000,000
I-15	Southbound; 7200 S to 9000 S	$15,000,000
	800 North to I-15 AF Interchange (Vineyard Connector)	$200,000,000
MVC	E/W Connection in Utah County	$130,000,000
MVC	N/S Salt Lake County	$160,000,000
92	I-15 to Highland	$118,000,000
68	Redwood Road/Legacy Parkway to I-15	$12,000,000
189	Heber to Provo Canyon	$7,000,000
114	Geneva Rd: Provo Center St/I-15 to Orem 1600 North	$34,500,000
108	Northbound from Syracuse Road	$70,000,000
201	Bangerter Hwy to 5600 W	$25,000,000
	Other projects statewide	$537,585,000
Total		$3,909,085,000

Source: Utah Department of Transportation

The most glaring delay is the rebuild of I-15 in Utah County. Utah County is one of the state's economic engines; population is exploding, and businesses are popping up across that valley. However, that growth is quickly outpacing the road system's ability to efficiently move people and goods.

Moreover, I-15 in Utah County does not just serve Utah County; it is a critical artery in moving goods and services statewide. We must provide capacity necessary for Utah's economy to expand. Simply filling the potholes and sealing the cracks will not meet the economic demands of the state's 2nd largest county.

Several of the other projects noted in the accompanying chart are prerequisites to completing the I-15 rebuild in Utah County. Without the Vineyard Connector and the rebuild of Geneva Road from I-15 to Orem 1600 North, the I-15 work cannot even begin. Otherwise Utah County, and thus the state, would lose virtually all north-south mobility.

Beginning work on the Mountain View Corridor is critical to the transportation infrastructure of Salt Lake County's booming west side. And if work does not begin on the Mountain View Corridor by 2015, the price of that road will increase significantly.

Certainly there is room to question whether the projected $2.6 billion price tag to rebuild I-15 in Utah County is appropriate. The Utah Taxpayers Association will be working with the legislature, and the Transportation Committees to identify the most cost-effective ways of completing these projects. But we must continue those projects now. If these cuts remain in place, Utah's economy will suffer. We cannot allow gridlock to stymie Utah's economic growth, especially when the economy is already ailing.

Don't hitch education funding to sales taxes

Public outcry over property taxes has spurred a vigorous debate on Capitol Hill about how to improve Utah's property tax system. Recommendations have ranged from expanding the age limit on Utah's circuit breaker system, to enacting a property tax deferral system and beyond.

One of the more prominent proposals would cut school property taxes significantly, and replace that revenue by raising the statewide sales tax rate by 1.45%. The Association has serious concerns with a proposal that moves education funding off the most stable tax base available, property taxes. Utah simply cannot afford to place our children's education at risk because the economy happens to soften in some years. Even laying that overriding concern aside, the current economic environment argues strongly against a policy that shifts education funding from property to sales tax.

The stability of various taxes

Because the property tax base is so broad, and legislative changes to the property tax base are so rare, property taxes are the most stable tax.

The amount of tax revenue collected varies by what is taxed, and how the economy is doing. Corporate income taxes (CIT) are the most volatile; during economic good times, their profits rise rapidly, and so does CIT revenue. When the economy softens, however, corporate profits turn negative, and CIT revenue dries up.

Individual income taxes also fluctuate with economic performance, though the fluctuations aren't nearly as dramatic as CIT. When the economy is expanding, individuals are receiving pay raises, so they pay more in income tax. When the economy slows, unemployment increases, which depresses income tax revenues. Similarly, a slowing economy means fewer pay raises, which also depresses income tax revenue. Nevertheless, individual income tax revenue is quite stable, especially now that Utah has enacted a much flatter income tax structure.

Property taxes are the most stable tax. Because new land is pretty hard to come by, the base is quite stable. In rare instances, legislative changes alter the property tax base, like when the Legislature enacted a 45% exemption on property taxes for a primary residence in the mid 1990's. Other than that, however, the property tax base expands slightly year over year, as the value of property increases.

Despite the more or less annual increase in property value, Utah's Truth-in-Taxation process (TnT) keeps property taxes quite low. Under TnT, the property tax rate decreases every year, so that taxing entities receive the same amount of property tax revenue this year as they did last year, plus additional tax revenue associated with new growth. Because the property tax base is so broad, and legislative changes to the property tax base are so rare, property taxes are the most stable tax.

The Utah Legislature has authorized a variety of city-option and county-option sales taxes, so sales tax collections vary geographically, in addition to the economic fluctuations.

Like corporate income taxes, sales taxes are highly dependent on economic conditions. All else being equal, when the economy expands, people spend more, and thus pay more sales tax. And when the economy contracts, people spend less, and pay less sales tax.

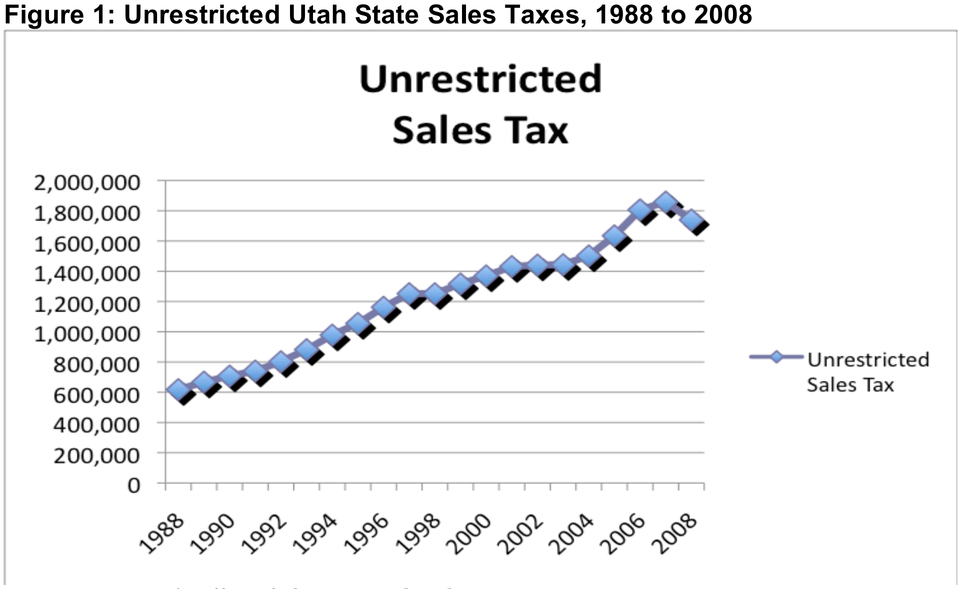
In addition, legislative changes to sales taxes are more frequent. The Utah Legislature has authorized a variety of city-option and county-option sales taxes, so sales tax collections vary geographically, in addition to the economic fluctuations.

Why are Utah sales taxes now dropping?

Utah's year over year sales tax revenues are dropping for the first time in at least 20 years.

The preceding analysis is based on a variety of studies in states across the country. In one instance, however, Utah has bucked the trends described above – for the past 20 years, Utah's sales tax collections have increased steadily year over year. However, Utah's year over year sales tax revenues are dropping for the first time in at least 20 years.

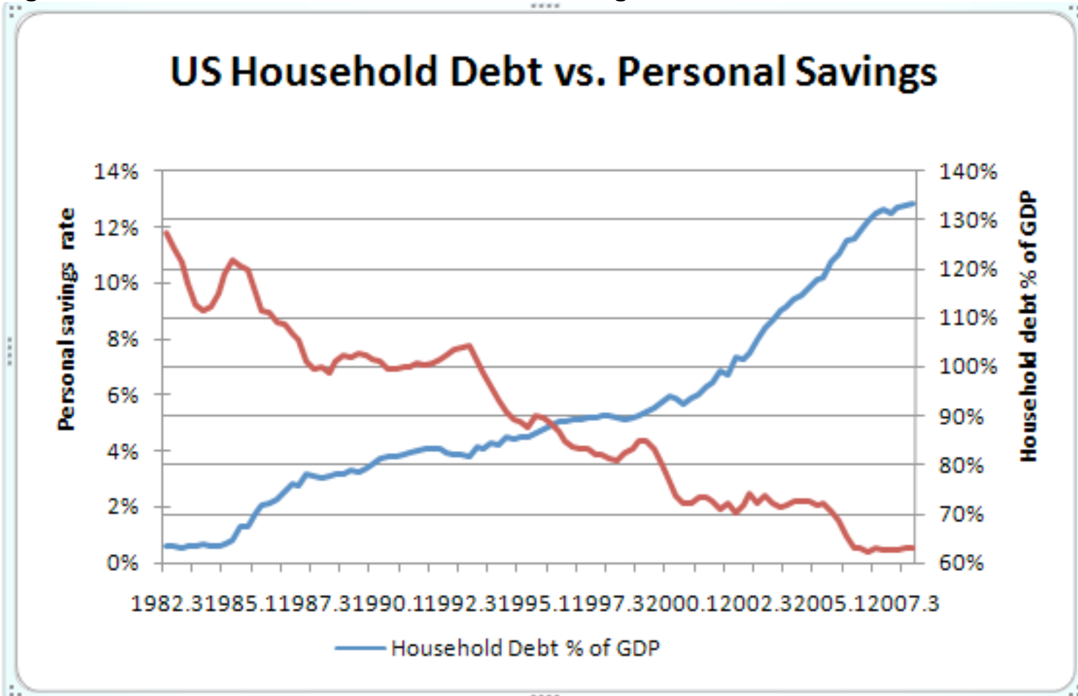
Figure 1: Unrestricted Utah State Sales Taxes, 1988 to 2008



Source: Governor's Office of Planning and Budget

So what makes this economic downturn different from the others over the past 20 years? Why are sales tax collections decreasing, instead of just flattening, as in past economic downturns? The answer lies in debt.

Figure 2: US Household Debt vs. Personal Savings



Source: U.S. Bureau of Economic Analysis

In Figure 2, the blue line represents household debt as a percentage of GDP, while the red line represents Americans' personal savings rate. Americans have been spending more than they earn since 2002 or so, when the debt ratio went above 100%. Over the same time period, the nation's savings rate has fallen to nearly zero.

Much of this increase in household debt comes from significant increases in home-equity associated debt. Americans have borrowed against the equity in their homes to pay for on-going expenditures. That model worked, as long as home values were increasing. They could still sell their house and pay their outstanding debts.

When home prices began to retreat, however, the model falls apart. Not only do homeowners cut back on the spending financed by the home equity loans, now they must use otherwise discretionary income to repay outstanding home equity debts. Not until consumers are again comfortable with their ability to pay their bills and businesses have adjusted their workforce and investments to the new spending levels, will consumer spending pick up again. The process of adjusting those investment priorities is painful, and may be prolonged.

Quote of the Month #1

"There is no equity [in California's acquisition date based property tax system], only different forms of inequity."

Peter Detwiler, Staff Directory, Local Government Committee, California State Senate, in testimony before the Utah Legislature's Revenue & Taxation Interim Committee, commenting on the problems with California's Prop #13.

Source: Revenue and taxation committee recording

This analysis suggests that the current drop in sales tax revenue is not temporary. Tying education to a funding source that will likely decrease for some time means one of three things. First, the Legislature can simply cut education spending as sales tax revenue continues to fall. Given the critical importance of education to the state's economic health, that option is untenable.

Second, the Legislature can maintain education spending by raising sales tax rates. Raising sales tax rates even further would raise additional dollars in the short run, but it would harm the state's economic competitiveness in the medium and long run. High sales tax rates would scare retail businesses into other states, which would lower in-migration and job creation. Third, the Legislature could raise income taxes to offset the drop in sales taxes. The effect of that option on business and the state's economic competitiveness would be similar to a further increase in sales tax.

Utah should not replace school property taxes with sales taxes. The economic downturn the state is entering will be prolonged, and sales tax revenues will be decreasing for some time to come. The consequences of that lost education spending or tax revenue are far worse and more substantial than the political problem that Utah's property taxes are perceived to be too high.

Too often education funding mechanisms make little or no connection between where a student attends school and who receives the funding to educate that child.

Transparency in government funding, version 2.0

Since Governor Huntsman signed SB 38, Transparency in Government Funding, Utah's Transparency Advisory Board has been meeting regularly to create a free, searchable, online database of state expenditures. Their progress has been impressive, and has shown that your Taxpayers Association's belief in transparency for all levels of government is both appropriate and feasible.

A new study from the University of Washington, "Funding Student Learning: How to Align Education Resources with Student Learning Goals," takes transparency to the next logical step. Following a five-year review of school finance across the country, the report notes that dollars need to follow student to their schools.

Too often education funding mechanisms make little or no connection between where a student attends school and who receives the funding to educate that child. Instead, arcane formulas govern education funding, and those formulas were designed with an eye to preserve existing school districts' distributions of funding. According to the University of Washington report, the value of this approach "lies in funding students and their educational needs directly in dollars, rather than indirectly via programs, grants, staffing ratios, and other allocation mechanisms, all of which muddy the connection between resources and the students they are intended to serve."

Your Taxpayers Association will continue to advocate for Utah to implement this kind of transparent education funding. In addition, we will continue to work with Senator Wayne Niederhauser, sponsor of Utah's original transparency legislation, and the rest of the Legislature to extend transparency requirements to cities, counties and school districts. Having these governments' budgets and expenditures available free, online and searchable will be particularly important as taxpayers prepare for truth-in-taxation hearings, bond elections, and other important financial decisions these taxing entities make.