What's Eating Utah's General Fund?

How Tax Expenditures and Earmarks Undermine the Budget Process

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Executive Summary

The annual balance of Utah's General Fund (GF) fell further during the Great Recession than either state revenue in general or the Education Fund—and it continues to lag even as economic growth returns. This is a serious concern, since both the state's population and its economy continued to grow during this period. The GF's decline, in both relative and absolute terms, suggests that its traditional revenue base has been undermined, jeopardizing the stability and flexibility with which policymakers can address future budget challenges. This paper documents the erosion of the GF's base as the result of the proliferation of tax expenditures (exceptions written into the tax code). It also traces the growing restrictions on the use of GF revenue through earmarks.

The paper recommends that policymakers return to more sustainable budget practices by taking three crucial steps:

1. The legislature should direct the state to improve its measurement of the fiscal impact of tax expenditures.

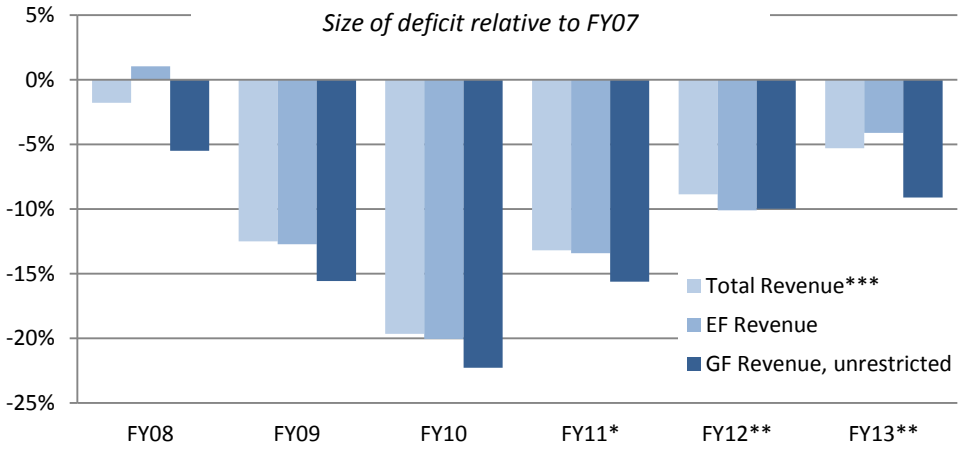
2. Lawmakers should schedule a comprehensive review of each of tax expenditure and each earmark, identifying and repealing those that are not priorities in the context of the state's annual budget.

3. Lawmakers should commit to inserting "sunset" provisions in all tax legislation and budget earmarks, to ensure that the GF's revenue remains able to meet the challenges of Utah's future.

Introduction

Utah's General Fund (GF) is in trouble. This fund, which pays for virtually all public services aside from education, declined faster than total state revenue during the recession, and it has not recovered at the same pace. Indeed, from FY07 to FY10, GF revenue declined by more than 22 percent (Figure 1). In FY13, well after the official end of the recession, **General Fund revenue remains stalled at 9 percent below its FY07 level**. Total Revenue and the Education Fund have not completely recovered either, but their revenue is expected to reach 6 percent and 4 percent below their FY07 levels, respectively.

Figure 1. General Fund Recovery Lags Both Total Revenue and the Education Fund



* In FY11 a temporary reduction in the Critical Highway Needs earmark added $113 million to General Fund revenue. This chart omits that supplement to focus on the size of the GF base.
** FY12 and FY13 figures are estimated by GOPB.
*** Total revenue is the sum of the General Fund, Education Fund, Transportation Fund, and Mineral Lease Fund.
Source: derived by Voices for Utah Children from GOPB *Budget Summary*, various years.

These data make clear that something has gone wrong with Utah's General Fund. Major categories of state revenue are designed to keep pace with demographic and economic change, both of which continued to grow in the state during this period, aside from a brief drop in 2009. State population grew by 7 percent and economic activity increased 17 percent from 2007 to 2012, in contrast to unrestricted General Fund revenue which remained 10 percent below its FY07 level in 2012. This pattern is simply unsustainable, and an indication of deeper problems in Utah's tax system.

This paper focuses on identifying the causes of decline in the General Fund. It documents a variety of changes since 2007 (the peak of the last business cycle), which has had the cumulative effect of undermining the GF. Because these changes coincided first with the economic boom and then with the Great Recession, the extent of the problems for the GF has been masked until now.

In the following pages, a careful review of the most recent revenue data reveals the impacts of two types of legislation. On the one hand are the growing number laws that reduce or narrow the GF tax base, referred to as tax expenditures. On the other hand are proliferating restrictions, or earmarks, on the use of GF monies.

The accumulation of both these types of legislation undermines the exercise of fiscal responsibility by elected officials, since their budget choices are constrained by declining levels of unrestricted GF revenue. The paper concludes with three recommendations that the legislature should adopt to reverse the decline in the GF and restore flexibility to the annual legislative appropriations process.

What does Utah's General Fund Do?

All Utahns benefit from an adequate General Fund. The state programs it pays for provide functional and efficient courts, highways, a statewide system of colleges and universities, and the enforcement of rules regarding commercial transactions, environmental protection, water safety, control of contagious diseases, and much more. The GF also provides a minimal safety net for families, especially in times of recession.

1. **Direct the Utah State Tax Commission to provide more accurate and thorough annual measurement of the amount of tax expenditures;**

2. **Commit to a process of comprehensive evaluation of the necessity and effectiveness of each existing tax expenditure and earmark in the state tax code;**

3. **Adopt mandatory expiration dates (sunset provisions), for each existing and new tax expenditure and earmark.**

Utah is justifiably proud of its record of fiscal sustainability. Taking these steps will help ensure that tax expenditures and earmarks to GF revenue are periodically evaluated on their merits, with an eye to their efficacy and their importance relative to other state priorities. These measures will also ensure that the General Fund has the capacity to support Utah's population and economic growth well into the future.

Decoupling Utah's GF Revenue from Population and Economic Growth

Utah's traditional "three-legged stool" approach to revenue has served the state well during decades of rapid change. Taxes on consumption, income, and wealth keep pace with the needs of the growing population and economy by tapping into different kinds of economic activity throughout the ups and downs of each business cycle.

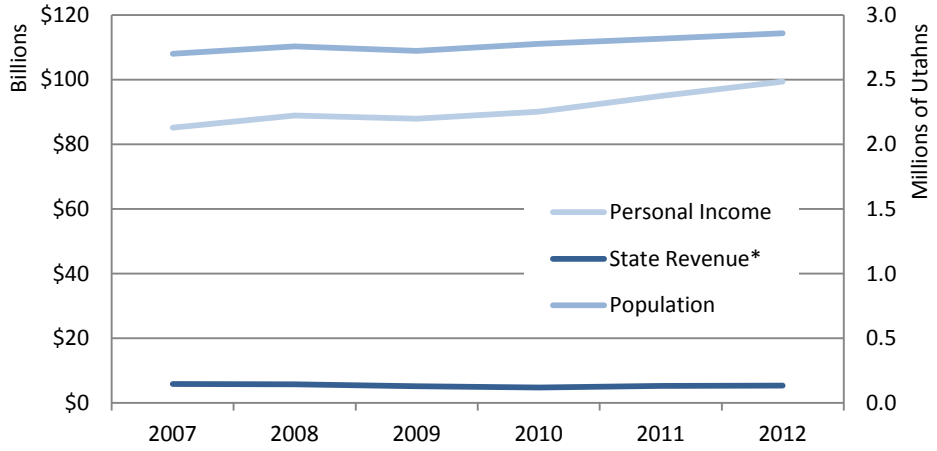
Utah lawmakers establish priorities and create a budget each year to reflect those priorities through the funding of state programs and functions. The state Constitution determines broadly how monies collected may be spent, according to their sources.[1] Specifically, all state individual and corporate income taxes must be used to support public (K-12) schools and higher education. Revenues generated through the operation of motor vehicles must be used on transportation-related expenses such as road repair, driver's education programs, and payment of debt for road construction. This leaves revenue from most other sources for the General Fund, which pays for virtually all other functions of state government.

The pressure of revenue shortfalls from 2008 to 2011 resulted in profound changes to the programs offered by the state. Utah's elected officials were forced to make difficult choices to balance the state budget. Ultimately, each of these years, they used a mix of reserve funds, bonding, federal American Recovery and Reinvestment Act of 2009 (ARRA) dollars, and cuts in state agencies.

At the same time, policymakers deliberately avoided any action that would have substantially increased available revenue. This means that since the onset of the recession, most state agencies have had to do more with less, even while the impact of the recession lingered for many Utah families. New efficiencies were found in some cases to help stretch state revenue further, but these actions simply could not keep up with growth in Utah's population and in the overall size of the economy.[2]

Indeed, the most recent data suggests that Utah's tax system has become "decoupled" from growth. Both population and personal income (a measure of the size of the state economy) rose steadily since 2007, apart from a brief dip in 2009. State revenue, in contrast, has fallen behind by an increasing margin (Figure 2).

Figure 2. Utah's Revenue has Stalled, but Growth Continues in Economy and Population



* Revenue data refer to fiscal years; other data are from calendar years.
Source: derived by Voices for Utah Children from GOPB, *2012 Utah Economic Outlook*. and GOPB *Budget Summary*, various years .

The "decoupling" of demographic and economic change from state revenue was obscured to some extent by the Great Recession. When Utah's total non-federal revenue dropped by 20 percent from FY07 to FY10 it was widely considered a temporary setback, one that would resolve itself once the economy began to recover. With the benefit of hindsight however, it is evident that despite the return to economic growth in 2010, state revenue remains stagnant.

Utah grew by 200,000 people (7 percent) and its economy expanded by $14.3 billion (17 percent) since 2007. In contrast, unrestricted General Fund revenue shrank by $209 million (9 percent) during this period. This pattern is simply unsustainable, and an indication of deeper problems in Utah's tax system.

Indeed, Utah's tradition of sustainable state budgeting appears to be at risk. Over the long-term, government expenditure must increase to support growth in population and the economy. For example, when the number of families in a state rises, so does the need for space in public schools, colleges, and universities. This is not optional: well-being and economic growth depend on a workforce with access to the benefits of public and higher education.

In states that grow successfully over the long term, ever-wealthier residents and growing businesses demand additional investment not only in schools, but also in highways, public safety, courts, public health, and regulatory agencies. This is why a state tax system must be linked to changes in population and the economy. Such a system provides a broad revenue base that is both flexible and stable, allowing lawmakers to meet changing needs and to plan for the future. It also permits tax rates to be set low enough to avoid distorting the decisions of households and businesses.

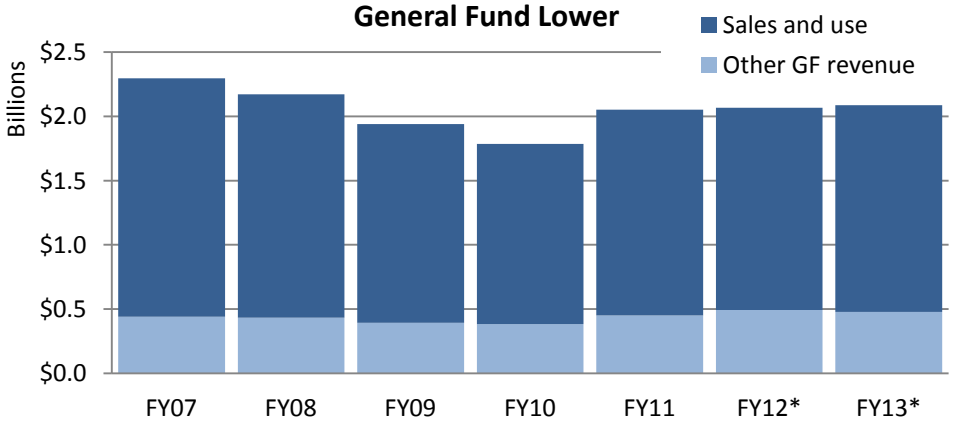
When a tax system becomes "decoupled" from population and economic growth, revenue does not grow fast enough to keep pace with the need for public services. Gains in the efficiency of public service provision may help temporarily, but ultimately, policymakers face the need either to drastically cut services, or to raise tax rates to generate new revenue.

How did Utah get to this point? Answers can be found on both sides of the balance sheet. As the next sections document, the tax base of the GF has been eroded, while at the same time, the use of GF revenue has been increasingly restricted. This adds up to fewer options for policymakers as they seek an appropriate balance between competing state needs.

The Erosion of the General Fund Tax Base

The largest single source of General Fund revenue is the sales and use tax, commonly referred to simply as the sales tax. Amid the overall decline in GF revenue from FY07 to FY13, sales tax revenue dropped by 13 percent (Figure 3). Meanwhile, the dollar amount collected from the other sources of GF revenue (primarily taxes on beer, cigarettes, tobacco, and liquor; severance taxes on natural resources; and taxes on insurance premiums) increased by 9 percent. Still, their growth was not sufficient to maintain the level of unrestricted GF revenue because sales tax revenue declined so steeply.

Figure 3. Declining Sales Tax Revenue Dragged the General Fund Lower



* FY12 and FY13 data are estimated by GOPB.
Source: derived by Voices for Utah Children from GOPB, *Budget Summary*, various years.

The failure of Utah's General Fund to recuperate after the recession is not simply a matter of broad macroeconomic changes outside the control of state policymakers. It is true that the Great Recession and the long-term shift toward a service-based economy contributed to the decline in state sales tax revenue. These macroeconomic issues fall outside the realm of direct legislative action.

Nevertheless, a good deal of the erosion of the sales tax base can be tied to the accumulation of legislation designed to reduce the amount of taxes imposed on certain economic activities, or even specific companies. These tax expenditures include the reduction of sales tax on groceries, a growing list of sales tax exemptions, and a variety of additional exceptions for certain economic activities that have been written into the tax code. Regardless of the potential merits of any one policy, their cumulative effect is the erosion of the tax base of the General Fund.

Only eight years ago, the experts convened by Governor Olene S. Walker's *Recommendations on a Tax Structure for Utah's Future* wrote that the sales tax "tracks the economy quite well and is more stable than the income tax."[3] As the data here show, this no longer appears to be the case.

Economic Trends

The Great Recession caused a dramatic drop in sales tax revenue. As families curtailed spending, businesses suffered and began to reduce their own expenditures on purchases and payroll. Growing uncertainty in the labor market induced families to cut back still more, resulting in a vicious circle that still has not been definitively broken.

Even before the recession, however, other macroeconomic factors combined to keep sales tax revenue from growing at the same pace as population and the economy as a whole. Most importantly, an increasing portion of economic activity is not taxed under Utah's current statute. In particular, sectors related to the fast-growing service and knowledge economy (finance, health care, real estate, law, communications, and more) are almost entirely absent from the sales tax base. This means that sales tax revenue is drawn primarily from the purchase of consumer goods. The value of these purchases is shrinking compared to the economy as a whole over the long run. In addition, consumers often fail to pay taxes owed on the growing share of internet purchases.

Changing Sales Tax Rates

Not only the sales tax base but also its rate was adjusted several times during the economic cycle that peaked in 2007.

That year the sales tax rate for food and food ingredients was reduced from 4.75% to 2.75%. In 2008, the general sales tax rate was reduced to 4.65% and the food and food ingredient rate to 1.75%. In 2009, the general sales tax rate was increased to 4.70% for all non-food and food ingredient items.

Amid so much change, it is difficult to attribute falling in sales tax revenue to a single cause. However, rates have remained unchanged since 2009, which provides a baseline of five years of rate stability.

As a result of these trends, Utah's gross taxable sales as a share of personal income plummeted from 70 percent in 1979 to 50 percent in 2009, according to a study by the Office of Legislative Research and General Counsel.[4]

The impact of macroeconomic trends on sales tax revenue has been intensified by the policy choices of Utah lawmakers. Some, like the reduction of the sales tax rate on groceries, decouple the General Fund from population growth. Others narrow its tax base by allowing certain businesses to exempt specific economic activities. Still others divert GF revenue to cover income tax credits or simply allow outdated tax policies to remain in place. Each of these types of policies is discussed in turn below.

Sales Tax Reduction on Groceries

The decision to reduce state sales tax on groceries, first to 2.75 percent in 2007 and a year later to 1.75 percent, unequivocally reduced sales tax collections. There is some merit to the argument that the sales tax on groceries places an unfair burden on low-income families, but the revenue impact of reducing the sales tax rate on all grocery purchases is substantial. The Legislative Fiscal Analyst estimated that if the full sales tax rate had been restored in FY10, it would have generated an additional $167 million in new GF revenue.[5]

Sales Tax Exemptions

Utah's sales tax base has been narrowed by an expanding list of exemptions offered for particular economic activities. However, the precise impact of these sales tax exemptions is unknown. Data from the Utah State Tax Commission's *Annual Report* suggest that the value of these exemptions was $538 million in FY07 and dropped to $428 million in FY11 (Appendix A).

Unfortunately, there is reason for skepticism about these numbers. Of particular concern is the removal of reporting requirements for sales tax exemptions on the purchase of manufacturing machinery and equipment. These requirements were whittled away beginning in 1995, when legislation dramatically lowered the penalty for inaccurate reporting of this information. Then, in 1999, the Tax Commission was given discretion on whether or not to impose penalties for non-compliance, paving the way for a new law in 2009 that dropped the reporting requirement entirely.[6]

Regardless of any potential merits of this policy, one key result is that the Tax Commission no longer receives even a rough indication of the amount of exemptions that businesses claim on their tax returns. Instead, state analysts are expected to estimate the amount of these exemptions by extrapolating from original fiscal notes (which date back years, or even decades), adjusting

based on changes in refunds and taxable sales, and using other general indicators of sector growth for companies that do business in Utah.[7]

Given these and other constraints, the Tax Commission *Annual Report* data are of questionable value. However, it is interesting to note that even if the manufacturing exemption is taken at face value, the combined impact of sales tax exemptions on the General Fund amounts to more than 2.6 times the size of the sales tax reduction on groceries in FY11. Yet these exemption policies have been much less controversial.

Sales Tax Diversions

A number of other kinds of problematic tax legislation have been written into the tax code in recent years, further undermining the base of the General Fund. These include legislation which diverts the value of certain income tax credits from the GF to the Education Fund. For example, the total value of income tax credits for "At-Home Parents" and for "Hand Tools Used in Farming" must be reimbursed from the GF, even though income tax credits typically would be deducted from the Education Fund.

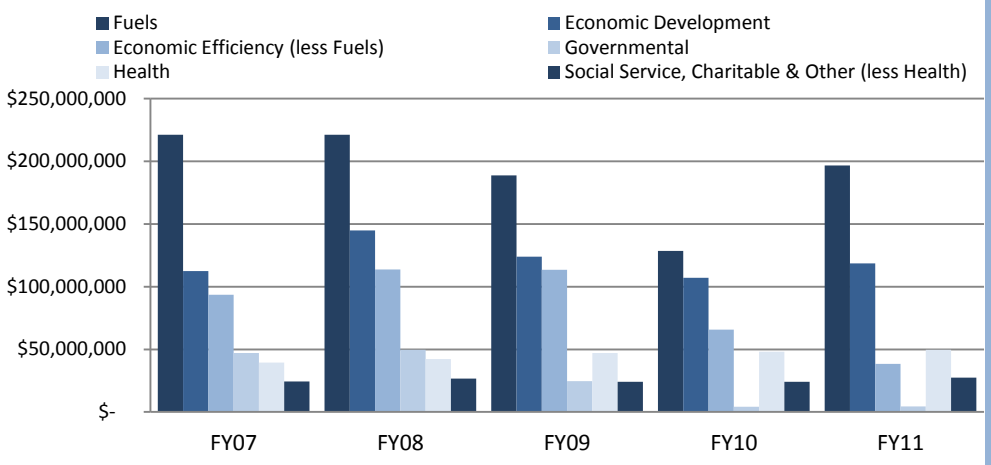
In addition, a number of complex credits tailor-made for the benefit of specific industries have appeared in recent years. For example, legislation from 2008 requires the state to pay 50 percent of local franchise fees for multi-channel cable television providers. A fiscal note prepared for related legislation in the 2012 legislative session suggested that this measure will cost the GF $6.6 million in FY13, 27 percent higher than the estimate in the original fiscal note.[8]

This glimpse of the fiscal impact of GF diversions, however, is unusual. The state does not publish an annual estimate for diversions that are written into the tax code. Only in rare cases, such as efforts to renew an expiring statute or expand an existing one, do policymakers (and the public) become aware of their impact on state revenue.

Are Sales Tax Exemptions for Economic Development Worth Their Cost?

The Utah State Tax Commission's *Annual Report* categorizes each sales tax exemption by purpose: Economic Development; Economic Efficiency; Governmental; or Social Service, Health, Charitable & Other. For this analysis, two of these categories are further broken out into Fuels and Health (prices in these two sectors are known to have increased during this period, which may largely explain the changes in their totals). The resulting patterns are striking: in spite of the Great Recession, the share of sales tax exemptions in the Economic Development category remained second in size after Fuels. In addition, growth in these two categories accelerated relative to all other exemptions (Figure 4).

Figure 4. Economic Development is Utah's Second Largest Sales Tax Exemption



Note: Two clear typographical errors were corrected in FY07 data for Economic Efficiency.
Source: derived by Voices for Utah Children from Utah State Tax Commission *Annual Reports*, 2007 - 2011.

Indeed, during this period, the Economic Development category rose to account for 27 percent of Utah's exemptions from sales tax. Businesses which benefit from these exemptions are estimated to have slightly increased the pace of their tax exempt expenditures throughout the recession, with the value rising to $119 million in FY11.

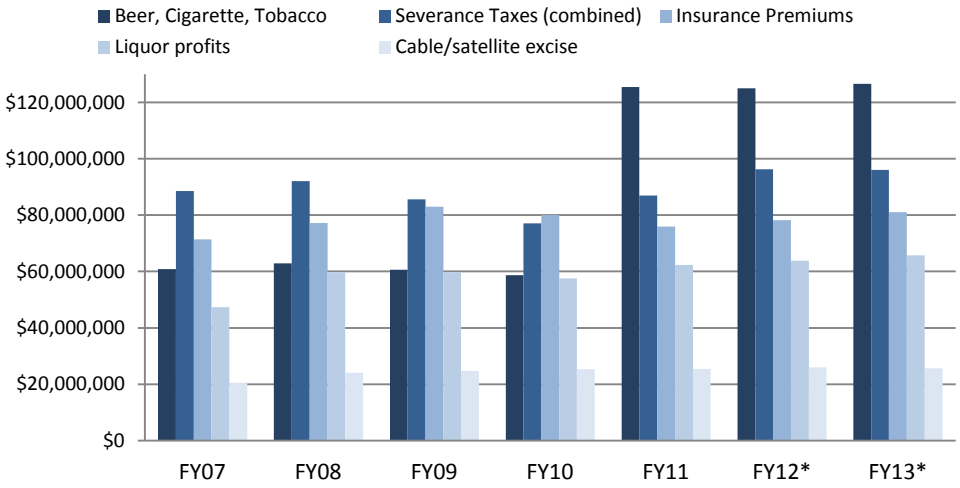
Thus, without explicit discussion by policymakers, Utah's sales tax exemption policy has shifted from primarily to accounting for economic efficiency and equity considerations toward promoting economic development through a discount of 4.7 percent on purchases by certain businesses. Whether or not this change is a positive outcome may be a matter of debate, but even the Tax Commission's estimate of the impact on GF revenue—which, as discussed in the text, must be considered very conservative—estimates a substantial amount of foregone revenue.

To make matters worse, no evaluation exists of the degree to which "Economic Development" sales tax exemptions meet their goal. While some of these businesses certainly grew during the recession, no evidence shows that any businesses altered their strategic or financial decisions because of Utah's sales tax exemptions. In fact, the Tax Commission's 2011 *Review of the Sales and Use Tax Exemption for Manufacturing Machinery and Equipment* acknowledges that it cannot "explicitly establish a cause and effect relationship" between this exemption and growth in Utah's manufacturing sector (page 21). Remarkably, however, the report goes on to recommend *against* removing the exemption. Without far more extensive and higher-quality data, that recommendation should be characterized as, at best, generous.

Other Taxes in GF Revenue

As sales tax revenue fell after the peak of the last business cycle, other GF revenue sources grew in importance. The five largest sources contributed over $400 million to the GF in FY13, up from $140 million in FY07 (Figure 5). Together, they buoyed GF revenue through the recession, growing from 16 percent to 24 percent of the balance in FY13.

Figure 5. Other GF Revenue Sources Grew, But Could They Do More?



* FY12 and FY13 data is estimated by GOPB.
Source: derived by Voices for Utah Children from GOPB, *Budget Summary*, various years.

The increasing importance of these revenue sources for the GF suggests that like sales tax revenue, they merit closer attention from policymakers. However, comprehensive evaluation of the policies that guide their collection is rarely undertaken from the standpoint of optimizing state revenue.

The importance of this type of evaluation can be illustrated with the example of the severance tax charged on the extraction of Utah's oil and natural gas. A variety of exemptions and exceptions were written into severance tax legislation in the 1980s, when oil prices hovered around $10 per barrel, compared to around $85 today. In addition, a two-tiered tax rate of 3 percent and 5 percent was adopted to promote continued extraction of oil and natural gas from existing wells.

This industry has fought hard to maintain this favorable treatment during the intervening decades. As a result, today's effective rates for severance tax on oil and gas are around 1.75 percent—far lower than the statutory rates.[9] If outdated exemptions and exceptions to severance tax laws were removed, the

effective rates would approach the statutory 5 percent, providing the state with an additional $198 million at today's resource prices.

While the potential revenue gains from improved tax policy for severance tax on oil and gas may be greater than those of other components of GF revenue, this example emphasizes the importance of careful evaluation of all aspects of the tax code. As another example, no severance taxes are currently charged on a variety of other valuable Utah resources, including coal. A comprehensive analysis of these implicit exemptions would help policymakers determine whether or not these exemptions meet their objectives.

The severance tax discussion also brings up a pending issue for voters. During the 2012 General Session, the legislature passed a resolution (HJR6) that will ask whether to amend the state constitution to shift an increasing share of severance tax revenue from the General Fund to a permanent state trust fund. The problem with this proposal is that it would introduce another permanent earmark into Utah's budget process. Such constitutional measures are ill-advised, since they further reduce flexibility for meeting future budget challenges.

Money for Nothing? The Cost of Earmarks

A shrinking base is not the only threat to the programs that depend on the General Fund. In addition, lawmakers have approved a growing number of restrictions, or earmarks. Earmarks affect the "other side" of the balance sheet by permanently diverting a share of sales tax collections from the unrestricted portion of the General Fund. These monies automatically bypass the annual appropriations process and are directed to specific projects without systematic review.

In recent years, the division of the General Fund into restricted and unrestricted portions has become increasingly important. But as is the case with tax expenditures, the total amount of earmarked revenue is difficult to quantify. The state does not tally and report on a regular basis all of the wide variety of provisions in law that earmark GF revenue. The Governor's Office provides a page of information on earmarks in the annual *Budget Summary* (see Appendix B), but it is not exhaustive.

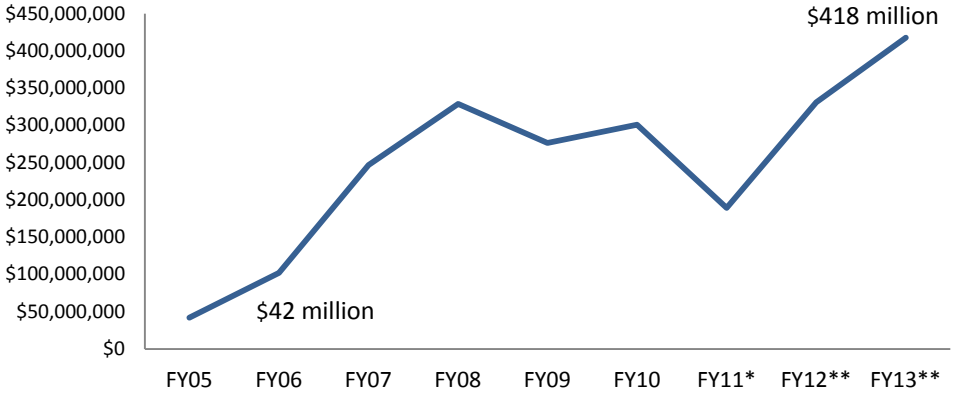
For example, the Industrial Assistance Fund receives income from so-called General Fund surpluses through a complex series of statutes that also direct revenue to a number of other funds, like the Medicaid Growth Reduction Fund

and the Budget Stabilization Fund.[10] There is no regularly published report of how much GF revenue is earmarked for such funds each year.

Even in the absence of comprehensive data, however, it is obvious that earmarks of GF revenue have ballooned since at least FY05. That year, less than three percent of total sales and use tax revenue was earmarked. By FY13, the amount soared to 26 percent of the total, removing $418 million from unrestricted GF revenue. In just eight years, the amount of sales tax revenue diverted to earmarks that are traced by the Governor's Office grew by 900 percent (Figure 6).

Figure 6. From Molehill to Mountain

Earmarks to the General Fund since 2005

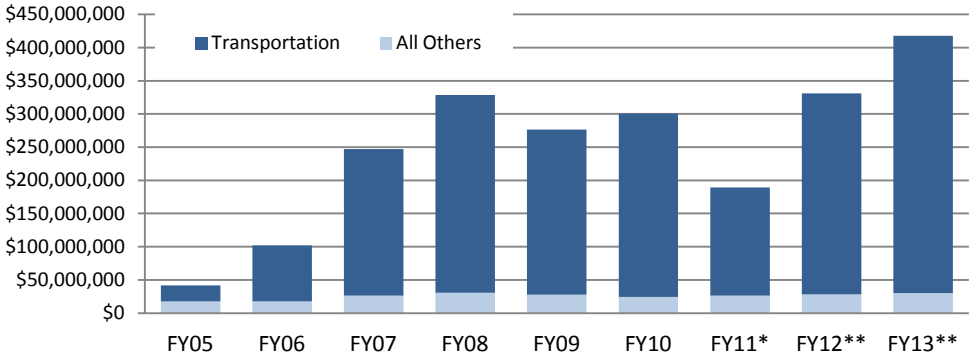


* For FY11 only, there was a reduction in the Critical Highway Needs earmark, which resulted in temporarily higher General Fund revenue.
** FY12 and FY13 figures are estimated by GOPB.
Source: derived by Voices for Utah Children from GOPB *Budget Summary*, various years.

During the height of the recession-induced state revenue crisis, Utah's legislature did go so far as to suspend one large earmark, Critical Highway Needs, to help balance the budget. An additional $113 million was made available for FY11 by directing 1.93 percent of sales tax collections to Critical Highway Needs, rather than the statutory level of 8.30 percent.[11] Otherwise, the Legislature likely would have made additional cuts to already-stressed state programs.

The primary beneficiary of the growth in earmarks has been transportation. In FY05, state transportation projects received 58 percent of all earmarked sales tax revenue, equivalent to $24 million. That amount will increase in FY13 to 93 percent—$388 million (Figure 7). These transportation earmarks provide revenue beyond the funds that already are directed by constitutional mandate to the Transportation Fund, and beyond additional annual appropriations that the legislature may approve.

Figure 7. Transportation Earmarks Dominate GF Restricted Revenue



* For FY11 only, there was a reduction in the Critical Highway Needs earmark, which resulted in temporarily higher General Fund revenue.
** FY12 and FY13 figures are estimated by GOPB.
Source: derived by Voices for Utah Children from GOPB *Budget Summary*, various years.

Surprisingly, in spite of only modest growth in state revenue, the General Fund confronted pressure from new proposals for additional earmarks during the 2012 General Legislative Session. The reason is two-fold. First, Utah has nearly reached its constitutional debt limit thanks to record-setting use of bonds to finance highway projects in recent years. As a result, any additional large expenditure must be funded through some other mechanism.

Second, since most lawmakers have vowed to reject any measures that would raise additional revenue, there are few options for funding new projects. The General Fund may appear to be a viable source for the revenue they seek. A precedent of sorts was set during the 2011 session, when the Legislature approved Senate Bill 229, over Governor Gary Herbert's veto, to divert 30 percent of future growth in state sales tax revenue to transportation projects. This new earmark is estimated to amount to $71 million in FY13. Like others, it will grow as economic recovery continues.

Several new projects proposed during the 2012 General Session would have used a similar funding mechanism. While the specific rationale for these new earmarks varied, they all sought to tap future growth in sales tax collections to fund a new, on-going expenditure without raising new revenue.

For example, HB 174, *Sales and Use Tax Allocations for Water Resources Construction Fund* would have funded new water pipeline projects. Another bill, SB 54, *Amendments Related to Education Funding*, sought to increase funding for public schools. The legislature ultimately rejected most of these attempts to earmark additional GF revenue.[12]

To some lawmakers, an earmark may appear to be "money for nothing" since it can allow them to claim credit for new projects without the practical and political difficulty of raising new revenue. But this is an illusion. After four years of budget-cutting, in a state already known for its frugality, there is no such thing as money for nothing. Any new expenditure diverts funds from existing programs that depend on the General Fund. This leaves less money for these programs even while Utah's increased population and economic activity means that demand for them grows.

The Annual Appropriations Process as a Tool for Prudent Budgeting

Although Utah is experiencing a modest economic recovery, the state's budget continues to suffer the impacts of the recession. Policy changes during the past decade have made matters worse, leaving the General Fund nine percent below its pre-recession level for FY13. Increasingly, the General Fund's base has been undermined by expenditures written into the tax code, while earmarks dictate spending on specific projects, regardless of other critical issues facing the state.

Whatever the merits of specific tax policies or projects, their accumulation during the past decade has placed the General Fund—and all state programs that depend on it—in a precarious position. These measures have decoupled the GF from population and economic growth by constraining its ability to return to growth after the recession.

Even in good times, the combination of an eroding tax base and proliferating earmarks is troubling. By removing substantial amounts of revenue from the scrutiny of the annual appropriations process, Utah lawmakers have lost flexibility to meet the evolving needs of the state and its residents. Unlike budget items approved through the annual appropriations process, most tax expenditures and earmarks remain in force until legislation removes them—a very rare occurrence.

Nevertheless, Utah's lawmakers can take the initiative to correct course. **A first step is to accurately measure the extent of the problem**. This paper identifies nearly $600 million dollars worth of tax expenditures for FY13 using only published estimates: $167 million from the reduced sales tax on food and $428 million in sales tax exemptions. The true figure is likely to be higher, since it would include better accounting of sales tax exemptions for economic development and the variety of outdated or implicit expenditures written into other taxes that support the GF.

This estimate could be refined with information that only state agencies can supply, but these agencies must be directed by policymakers to embark on this research. They also need the tools and staff necessary to do the job right. At least 33 other states require their tax authorities to make systematic annual efforts to identify all tax expenditures, and to quantify their fiscal impact.[13] By adopting a tax expenditure report, Utah would join the growing number of states that track all exceptions to state tax policy written into the tax code through legislation.

A second step toward restoring the flexibility and authority of Utah's annual appropriations process is to schedule a comprehensive review of each tax expenditure and each earmark. This process is already integrated into some sections of the tax code, but it is important to extend it to all of them. The large number of items adopted in recent years may mean that this review process must be spread over many years.

Of particular importance in this review would be the generation and analysis of reliable indicators that can demonstrate the effectiveness (or not) of each policy in meeting its stated goal. There are a variety of reasons for adopting tax policies, including concepts like fairness, equity, economic efficiency, and economic development. A careful evaluation of whether each policy meets its stated goals is a starting point for the next chapter in Utah's fiscal management.

Third, new legislation should ensure that both current and future tax expenditures and earmarks include a "sunset," or expiration date. Sunset provisions already exist in many areas of state law. Explicitly adopting a policy that would incorporate sunsets into all tax expenditure and earmark legislation would guarantee that Utah does not once again find itself laboring under the accumulation of these measures.

By taking these three steps, Utah lawmakers can reassert control over the process of setting budget priorities. Rather than facing a General Fund which is increasingly unable to keep pace with growth in population and the economy, elected officials would maintain flexibility for balancing policy priorities each year.

In spite of Utah's relatively prompt recovery from the Great Recession, the future is likely to hold increased economic volatility because of globalization and accelerated technological change. Policymakers and Utahns would be best served by strengthening the traditional budget-making processes so that Utah can adapt to changing conditions, whether good times or bad.

Appendices

Appendix A. Sales Tax Exemptions

	FY07	FY08	FY09	FY10	FY11
TOTAL	**$537,560,421**	**$598,420,480**	**$521,842,890**	**$377,722,550**	**$435,213,354**
A. ECONOMIC DEVELOPMENT	**$112,354,421**	**$144,858,100**	**$123,887,100**	**$107,101,000**	**$118,581,970**
1. Manufacturing machinery and equipment 3 year life, including replacements	84,679,200	105,180,000	91,290,000	86,805,000	91,145,250
2. Airline food	287,221	162,000	104,000	112,000	90,720
3. Airline equipment	175,000	400,000	290,000	313,000	336,000
4. Aerospace tools	406,000	1,750,000	1,170,000	570,000	612,000
5. Motion picture rentals & radio broadcast tapes	50,000	65,000	43,000	52,000	43,000
6. Machinery and equipment purchases used by non live motion picture and television programs, music videos, commercials or documentaries	250,000	341,000	259,000	274,000	224,000
7. Intrastate movement of freight by common carrier or people by taxicabs	2,825,000	3,910,000	2,010,000	3,707,000	3,890,000
8. Farm machinery and irrigation equipment	16,107,000	17,878,800	13,920,700	6,428,000	6,299,000
9. Commercial sprays & insecticides	625,000	641,000	551,000	890,000	904,000
10. Sales of hay	2,750,000	3,243,300	2,991,400	1,980,000	2,010,000
11. Sales of aircraft manufactured in Utah	0	n/a	n/a	n/a	n/a
12. Electricity sales to ski resorts for all lifts	94,000	74,000	76,000	75,000	113,000
13. Ski resort equipment	637,000	502,000	580,000	408,000	550,000
14. Steel mill non durable equipment	100,000	711,000	602,000	487,000	523,000
15. Semiconductor manufacturing (each figure is reported by state as "less than")	1,738,000	10,000,000	10,000,000	5,000,000	5,000,000
16. Renewable energy production facilities	n/a	n/a	n/a	n/a	n/a
17. Waste energy production facilities	n/a	n/a	n/a	n/a	n/a

18. Biomass energy production facilities	n/a	n/a	n/a	n/a	n/a
19. Media machinery and equipment	1,631,000	n/a	n/a	n/a	n/a
20. Purchases of tangible personal property use in coal-to-liquids, oil shale, and tar sands R&D	n/a	n/a	n/a	n/a	235,000
21. Telecom equipment, machinery or software with a useful economic life of > 1 year	n/a	n/a	n/a	n/a	6,600,000
22. In-flight sales of tangible personal property or product transferred electronically*	n/a	n/a	n/a	n/a	7,000
B. ECONOMIC EFFICIENCY	**$314,540,000**	**$334,893,800**	**$302,204,800**	**$194,287,000**	**$235,064,250**
1. Motor & special fuels	169,590,000	167,620,000	143,840,000	87,220,000	152,100,000
2. Aviation fuel	21,212,000	23,991,000	22,000,000	24,850,000	26,100,000
3. Vending machine sales < $1 of food or beverages	1,083,000	1,700,000	1,800,000	1,711,000	1,777,000
4. Coin operated Laundromats	263,000	571,000	602,000	592,000	619,000
5. Coin operated car washing	584,000	713,000	877,000	664,000	683,000
6. Nonresident vehicles	5,865,000	6,050,000	4,123,000	1,264,000	758,000
7. Nonresident boats	161,000	184,000	98,000	17,000	4,250
8. Occasional sales	2,732,000	2,980,000	1,440,000	3,180,000	2,303,000
9. Tangible personal property trades	n/a	n/a	n/a	n/a	n/a
10. Exclusive sales of locally grown farm produce	1,425,000	2,100,000	3,300,000	1,090,000	1,120,000
11. Containers, labels, casings	30,224,000	3,200,000	2,600,000	892,000	569,000
12. Property stored in the state for resale	n/a	n/a	n/a	n/a	n/a
13. Property brought in by a non resident for use	3,135,000	3,890,000	1,770,000	732,000	305,000
14. Property purchased for resale or as an ingredient or component part of manufactured products	30,357,000	69,750,000	71,850,000	37,600,000	18,780,000
15. Property upon which sales tax was paid to another state	n/a	n/a	n/a	n/a	n/a

16. Sales of transportation, interstate telephone, telegraph, or fuel for use in compounding a taxable service	15,393,000	19,113,000	22,804,000	16,450,000	10,030,000
17. Personal property shipped out of state & incorporated into real property	149,000	84,000	61,000	18,000	4,000
18. Coin operated amusement devices	694,000	830,000	950,000	810,000	750,000
19. 45% of new and 100% of used manufactured homes	1,000,000	2,397,800	1,101,800	691,000	350,000
20. Intrastate transportation to an employer s employee	25,000	32,000	14,000	7,000	4,000
21. Sales of natural gas, electricity, coal, fuel, oil for industrial use	30,313,000	29,688,000	22,974,000	16,499,000	18,561,000
xx. Telephone service from prepaid calling card	27,000	n/a	n/a	n/a	n/a
22. Tangible personal property shipped out of the state which becomes part of real property in another state	308,000	n/a	n/a	n/a	n/a
23. Pawnbroker repurchases or redemptions	n/a	n/a	n/a	n/a	n/a
24. Sales of property used in conducting business, if that property was purchased outside of the state, first used outside the state and brought into state	n/a	n/a	n/a	n/a	n/a
25. Sales of tangible personal property for maintenance, repair or overhauls of aircraft not registered in Utah	n/a	n/a	n/a	n/a	247,000
C. GOVERNMENTAL	**$47,026,000**	**$49,598,480**	**$24,586,000**	**$4,174,900**	**$4,427,749**
1. State government purchases	20,876,000	22,546,080	7,220,000	1,299,000	1,004,249
2. Local government purchases	24,431,000	25,530,400	14,850,000	1,248,400	1,370,000
3. Fares charged to persons transported by public transit	1,172,000	922,000	1,877,000	986,500	1,100,500
4. Admissions to college athletic events	527,000	575,000	620,000	625,000	950,000

5. Sales by state & local photocopies or copies of records	10,000	13,000	11,000	9,000	n/a
6. Sales by the Heber Creeper Railroad	10,000	12,000	8,000	7,000	3,000
7. Sales of construction material for SL International Airport	n/a	n/a	n/a	n/a	n/a
8. Sales to a public transit district	n/a	n/a	n/a	n/a	n/a
D. SOCIAL SERVICE, HEALTH, CHARITABLE & OTHER	**$63,640,000**	**$69,070,100**	**$71,164,990**	**$72,159,650**	**$77,139,385**
1. Food stamps	6,859,000	6,860,000	8,990,000	12,373,000	16,428,810
2. WIC program food purchases	1,617,000	1,089,000	1,952,000	1,276,000	$1,532,445
3. Meals served by schools, churches	536,000	536,000	600,000	658,000	546,140
4. Meals served by nursing homes & hospitals	523,000	523,000	600,000	673,000	585,510
4. Pollution control	218,000	199,000	201,000	228,000	216,000
5. Prescription drugs	35,707,000	38,421,000	43,750,000	43,518,000	45,533,000
6. Oxygen & stoma supplies	51,000	68,000	72,000	92,000	94,110
7. Religious or charitable sales > $1,000	5,323,000	6,388,000	4,120,000	3,551,000	4,083,650
& purchases < $1,000	4,435,000	5,322,000	3,400,000	3,012,000	2,007,000
8. Newspaper sales or subscriptions	2,386,000	2,687,000	1,890,000	1,001,000	794,000
9. Leases to authorized carriers	1,500,000	2,205,000	1,755,000	924,000	906,000
10. School & fund raising sales	50,000	54,000	23,000	29,000	21,000
11. Home medical equipment and prosthetic	525,000	559,000	610,000	779,000	537,000
12. Hearing aids	332,000	354,000	420,000	554,000	580,000
13. Sales by area aging services	1,000	1,100	1,990	650	720
14. Wind, geothermal, solar energy sales	n/a	n/a	n/a	n/a	n/a
15. Water in a pipe, conduit, ditch or reservoir	n/a	n/a	n/a	n/a	n/a
16. Currency or coinage which is legal tender	n/a	n/a	n/a	n/a	n/a
17. Gold, silver, platinum ingots, bars medallions	n/a	n/a	n/a	n/a	n/a

18. Prescribed prosthetic devices	2,200,000	2,360,000	1,720,000	2,555,000	2,312,000
19 Manufacturers rebates for new vehicles	500,000	525,000	440,000	602,000	641,000
20. Direct mail electronic databases	877,000	919,000	620,000	334,000	321,000

* Denotes Tax Commission estimate that is expressed as "<" the dollar amount noted.

Source: derived by Voices for Utah Children from Utah State Tax Commission *Annual Reports,* Fiscal Years 2007 to 2011.

Appendix B. Earmarks, Fiscal Year 2013

Earmark	Amount
Centennial Hwy Fund Restricted Acct.	168,345,600
Critical Hwy Needs Fund	100,524,500
Centennial Hwy Fund Restricted Acct., SB229	71,308,100
Transportation Fund (1/16%)	29,531,800
Transportation Fund Chokepoints .025%	10,524,500
Water Resources Conservation & Dev.	10,698,900
Centennial Hwy Fund (1/64% tax rate)	7,383,000
Water Development Loan Funds	7,175,000
Drinking Water Loan Fund	3,587,500
Water quality Loan Fund	3,587,500
Endangered Species	2,450,000
Water Rights	857,900
Qualif. Emergency Food Agencies Fund	533,800
Agriculture Resource Development	525,000
Watershed Rehabilitation	500,000
Water Resources-Cloud Seeding	150,000
EARMARK TOTAL	**417,683,100**

*This list is drawn from the GOPB's tally of earmarks. The budget impact of additional earmarks is unknown.

Source: derived by Voices for Utah Children from GOPB, *2013 Budget Summary.*

[1] *Utah Constitution*, Article XIII, Sect. 5.

[2] In 2010, the Utah Advisory Commission to Optimize State Government found remarkably little room for improvement in administration. As Chair Norman H. Bangerter observed in its Final Report, "After careful review, the Commission has discovered that State government is already operating efficiently." See http://performance.utah.gov

[3] *Governor Olene S. Walker's Recommendations on a Tax Structure for Utah's Future*. November, 2004.

[4] Office of Legislative Research and General Counsel, *Utah's Sales & Use Tax: Issues and Options*. Bagels & Briefings series, February 16, 2010.

[5] Fiscal note for HB403, *Sales and Use and Income Tax Amendments*, 2009 General Session of the Utah State Legislature.

[6] The 1995 legislation was SB89, *Sales Tax Exemption – Manufacturing*. The 1999 legislation was SB61, *Sales and Use Tax Exemptions – Penalty and Interest*. In the 2009 legislative session, the bill was HB65, *Reporting of Certain Transactions Exempt from Sales and Use Taxes.*

[7] An additional result is that state tax auditors are deprived of a convenient verification of the accuracy of business tax returns. For example, a company with $1 million in sales is unlikely to have made purchases resulting in a $100 million exemption, and tax auditors followed up on this type of information when it appeared.

[8] SB 112, *Multi-channel Video or Audio Service Tax Amendments*, 2012 General Session of the Utah State Legislature. Although the legislation was passed in 2008 as part of a far-reaching and complex bill, SB223, *Tax Amendments*, the original fiscal note for this measure was generated for SB96, *Multi-channel Video or Audio Service Tax Act Amendments*.

[9] The Governor's Office of Planning and Budget estimated the value of Utah crude oil sales at $2.2 billion in 2012, and the value of natural gas at the wellhead at $1.8 billion. Severance tax collected on oil and gas was $69 million in 2012, so the effective tax rate is 1.74%. Since FY07, the effective rate has not surpassed 2.68%, and in most years it actually was lower than 1.74%. See GOPB, *2012 Economic Outlook* and *FY13 Budget Summary*.

[10] See Utah Code 63M-1-905 and 63J-1-312.

[11] SB 282, *Capital Facilities Appropriations*, 2010 General Session of the Utah State Legislature.

[12] The exception, as mentioned previously, is HJR6. If approved by voters, it would place a new earmark in the state constitution, but on severance tax revenue rather than sales tax collections.

[13] Center on Budget and Policy Priorities, *Promoting State Budget Accountability Through Tax Expenditure Reporting*, 2009.