What’s Still Eating Utah’s General Fund?

Unfunded Earmarks are Undermining the Budget Process and Affecting Utah Families and Children

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Voices for Utah Children is the Utah affiliate of the State Priorities Partnership, a consortium of independent nonprofit research and policy organizations in 40 states that use evidence and analysis to advance public policies and investments that reduce poverty and give all people the opportunity to achieve the American dream.
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Executive Summary

Utah’s unrestricted General Fund continues to decline as a stable and reliable revenue source due to a nearly 1200% increase in earmarks from FY 2005 to FY 2015, from $42 million to over half a billion dollars, from 2% to over 18% of the overall General Fund and still rising. This practice of earmarking, which means a multi-year diversion of funds (and none of the major General Fund earmarks has a sunset provision), runs contrary to best practices in public budgeting because it ties the hands of policymakers and undermines their ability to use the annual budgeting process to meet the evolving needs of the state’s ever-growing and ever-changing economy and population.

This explosion of earmarks has been primarily for the purpose of meeting the state’s transportation needs. The earmarks in question are all “unfunded” earmarks, meaning that none of them was created with a new revenue source to finance them, even though they address newly identified investments required to keep up with the state’s growing economy and population.

This enormous diversion of resources has meant that everything else financed by the General Fund, including education, public safety, drug treatment, aid for the disabled, support for vulnerable families, and many more, has been given short shrift, leaving critical needs unmet and allowing the state to fall behind in a number of important areas, threatening to undermine progress toward the state’s most important goals.

The rise of unfunded earmarks bears considerable resemblance to the decision made by an earlier generation of policy makers in 1996 to divert Education Fund revenues to fund higher education as well as K-12 education.

The report concludes with a call for a return to best practices in the annual budgeting process so as to allow policymakers to adapt to changing circumstances in good times and bad.

Utah’s General Fund Is in Trouble

“Utah’s General Fund is in trouble” — those were the words that opened the original version of this report in 2012. Unfortunately, since that time, the trouble has only deepened. Indeed, the decline in the unrestricted General Fund has only accelerated. To understand how this came about, it is necessary to begin with an understanding of the role of the General Fund in the Utah state budget.
Background: The Role of the General Fund in the State Budget

Utah’s traditional conservative approach to public finance has served the state well during decades of rapid growth and change. A well-balanced variety of taxes on consumption and income generates revenue to enable state government to keep pace with the needs of the growing population and economy by tapping into different kinds of economic activity through the ups and downs of each successive business cycle.

Utah lawmakers establish priorities and create a budget each year to reflect those priorities through the funding of state investments, functions, and programs. The state Constitution determines broadly how monies collected may be spent, according to their sources. For example, all state individual and corporate income taxes are assigned to the Education Fund and dedicated toward supporting public education, both K-12 and higher education. Revenues generated through the operation of motor vehicles such as the gas tax go to the Transportation Fund and must be used on transportation-related expenditures such as road repair, driver education programs, and payment of debt for road construction. Revenue from most other sources goes to the General Fund (or GF), which pays for virtually all other functions of state government. About 80% of General Fund revenues are from the sales tax, with most of the rest coming from tobacco and alcohol revenues, insurance premiums, and oil, gas, and mining severance taxes.

The General Fund accounts for about one-third of Utah’s state-collected revenues each year, $2.5 billion of about $7.8 billion in FY 2013, and approximately one-fifth of the state’s entire annual budget. The entire annual budget comprises the state-collected revenues plus about $4.5 billion from federal funds, mineral leases, local property taxes, and higher education tuition and totaled $12.3 billion in FY 2013.1
The Decline of the General Fund

To understand the recent decline of the General Fund, it is important to distinguish first between the restricted and unrestricted segments of the General Fund.

The restricted portion of the General Fund is the part that has already been set aside by statute for some specific purpose and is therefore off-limits to the annual appropriations process. The remainder constitutes the unrestricted portion of the General Fund. In recent years the restricted portion of the General Fund has grown rapidly, as illustrated in the chart below.
As illustrated in the charts on page 6, both overall and unrestricted General Fund revenues peaked in 2007/2008 before the Great Recession and then fell sharply. Since then, total state revenues and overall General Fund revenues (including the earmarked revenues) have grown at a healthy pace (before accounting for inflation). The Utah State Tax Commission reported earlier this year that FY 2013 total state revenue collections exceeded their nominal FY 2007 level by 6.5%. Similarly, overall General Fund revenues for FY 2015 are projected to surpass their nominal 2007 levels by 7%. But unrestricted General Fund revenues have still not even accomplished that modest feat. Unrestricted General Fund revenues projected for FY2015 remain 4% below the FY2007 peak (in nominal dollars, not even accounting for the expected 16-17% inflation rate from 2007 to 2015).

The chart below presents this same information by comparing each year’s revenues to a base year, 2007, the last year before the Great Recession. The chart compares each year after 2007 in percentage terms to 2007 for overall revenue, total General Fund revenue, and unrestricted General Fund revenue.

As the chart above illustrates, total state revenues recovered to 2007 levels in 2013, and overall General Fund revenues did so in 2014. But unrestricted General Fund revenues have yet to recover to their pre-recession levels.
These data make clear that Utah faces a fundamental problem with its General Fund. Major categories of state revenue are designed to keep pace with population and economic growth. Utah’s population has grown by 12% since 2007 and the state’s economy has grown by 10.5% over the same time period in real, inflation-adjusted terms. Yet unrestricted General Fund revenue remained 9% percent below its FY07 peak in FY13, and is projected for FY15 to remain 4% below the FY07 level, not even accounting for inflation.

The Diversion of General Fund Revenues into Unfunded Earmarks

The main source of the weakness of the General Fund in recent years is the increasing share of its revenues diverted by unfunded earmarks, leaving it depleted at a time of elevated poverty rates and a still uncertain economy facing Utah’s children and families.

As the chart above illustrates, the annual level of General Fund earmarks has expanded by almost 1200% from $42 million annually in FY 2005 to a projected $531 million in the FY 2015 budget approved by the 2014 session of the Utah legislature.

This rapid but little-discussed growth of earmarked General Fund revenues undermines the exercise of fiscal authority by elected officials, since their budget choices are constrained by declining levels of unrestricted General Fund revenue.
Most General Fund Earmarks Are for Transportation Spending

The overwhelming share of the new earmarks that have diverted so much General Fund revenue in recent years are for new transportation investments.

The most recent and fastest growing of the transportation earmarks is SB229, enacted in 2011 over Governor Herbert’s veto to divert additional sales tax to the Centennial Highway Fund/Transportation Investment Fund of 2005. Starting in FY 2013, 30% of sales tax growth above the FY2011 baseline, up to a cap of 17% of total sales tax collections, is earmarked for transportation. This earmark is expected to reach $126 million in FY 2015 and eventually max out at more than double that amount in current terms.

Why Do We Call These “Unfunded” Earmarks?

In this report, these diversions of General Fund revenue have been referred to as “unfunded earmarks.” Why “unfunded?”

When policymakers identify a new area where state investment is needed, such as the transportation needs addressed by the new earmarks of General Fund revenue, they have two choices about how to finance the new investments.
1) Policymakers can identify a new funding source to pay for the new investments. This has the advantage of holding harmless the rest of the state budget and the priorities it reflects, but it may be controversial because it generally requires someone to pay higher taxes.

2) Policymakers can divert existing revenues from current state programs. This option avoids potential controversy over new taxes but places other areas of the state budget at risk for loss of funds.

In the case of the new transportation investments being financed through General Fund earmarks, no new revenue source was created to fund the new investments. Thus, these earmarks were “unfunded” and have created a situation where the state is “robbing Peter to pay Paul” – diverting existing revenue streams that the state is already counting on to continue to meet the needs of Utah’s growing economy and population.

The Impact of Unfunded Earmarks on Other State Priorities

Diverting half a billion dollars annually from the General Fund has meant that areas traditionally receiving General Fund dollars have been given short shrift. Nearly everything traditionally funded by the General Fund has suffered as a result. Several examples are illustrated below.

**Disabilities**

The critical needs wait list for disabilities services grew from 1,825 in FY 2011 to 1,892 in FY 2013, and the time spent on the wait list grew as well, from 5.3 to 6.5 years. It took until FY 2013 for the state-funded portion of the budget of the Department of Human Services’ Division of Services for People with Disabilities to recover (after inflation) to its prerecession level. The Division estimates that the cost to the state to eliminate the wait list would be $12,677,507. Moreover, the Utah Association of Community Services reports that the state’s low reimbursement rates paid to service providers is having an impact on the state’s ability to deliver high quality services because Utah’s lowest-in-the-nation $8/hour starting wage has made it difficult to attract and retain direct service staff, as illustrated by the annual turnover rate, which has reached an astonishing 86%.
**Mental Health and Substance Abuse**

The Utah Department of Human Services Division of Substance Abuse and Mental Health estimates that its current level of funding allows it to meet just 15% of the state’s need for substance abuse treatment and 17% of the need for mental health services. Illustrating the link between this kind of chronic underfunding of vital public services and other state problems that end up costing the taxpayers more in the long run, the Pew Charitable Trusts’ Public Safety Performance Project has cited these shortfalls in its recent research about why Utah is spending more money but getting worse results in certain aspects of our criminal justice system.

**Public Safety**

Recent presentations by the Pew Charitable Trusts’ Public Safety Performance Project to the Prison Relocation Commission and Commission on Criminal and Juvenile Justice have reported that funding for Adult Probation & Parole has not kept pace with the growth in overall Utah’s Department of Corrections funding and that there exist “significant shortfalls in treatment and reentry resources.” These shortfalls are a factor in the Pew Charitable Trusts’ finding that Utah Probation & Parole system is not doing enough to reduce rising reincarceration rates, as well as in some of the deficiencies uncovered in a 2013 AP&P performance audit by the Legislative Auditor General.
Higher Education
The depletion of the General Fund, which finances about half of state higher education spending (with the other half coming from the Education Fund) appears to have had a very serious impact on public college tuition in Utah. The average tuition at Utah System of Higher Education institutions rose by nearly 200% since 2000, and by even more at the University of Utah (not accounting for inflation). Such rapid increases make higher education less affordable and make it more difficult to achieve the state’s goal of seeing 66% of adults with a post-secondary certification or college degree by 2020.

K-12 Education
As the General Fund has been depleted by the growth of unfunded earmarks, higher education has tended to take more of its budget from the Education Fund in the last few years, leaving less for K-12. This has made it impossible for Utah to get out of the national basement in terms of per-pupil education spending. According to the most recent data released by the US Census Bureau in May 2014, Utah ranked 50th in per-pupil
education investment in FY 2012, spending $6,206 per pupil, $4,402 behind the national average of $10,608 per pupil and $453 behind 49th place Idaho. Multiplying that $453 gap by the 2012 public elementary and secondary enrollment of 553,873 reveals that Utah would have had to invest an additional $250,904,469 in public education that year to avoid being ranked 50th in the nation for per-pupil spending. That amount is almost exactly equal to the $252 million appropriated to higher education from the Education Fund that year.14

Pre-K Education
Evidence is mounting that preventing poverty and reducing education gaps for minority and low-income children require greater attention in the earliest years of life, including expanded access to high-quality preschool. In 2014, the Utah Legislature for the first time allocated state funding for preschool for approximately 600 at-risk children. But this progress is dwarfed by the size of the need: 32,000 lower-income children age 3 and 4 were not attending preschool of any kind in Utah in 2010-2012, the most recent years for which figures are available.15

Other Factors Undermining Utah’s General Fund
This pattern of depletion of an essential public revenue source is an indication of a structural problem in Utah’s system of public finance. This trend raises the concern that the General Fund may become increasingly decoupled from population and economic growth, leaving policymakers with fewer options as they seek an appropriate balance among competing state needs.

As previously discussed, diversion of General Fund revenues through earmarks, mostly for transportation investments, has been primarily responsible. However, there have also been other factors that have played a role in the unreliability of the General Fund and its increasing inability to grow at the same pace as the population and the economy.

One important factor is that nearly 80% of the General Fund comes from the sales and use tax, which generally applies to goods and not services. Over time, the economy has shifted from goods to services, meaning that the sales tax applies to a shrinking share of the economy.16 Moreover, an increasing share of goods are not subject to sales tax collection as internet purchases continue to rise and out-of-state internet sellers generally do not collect sales tax.
Passage of Constitutional Amendment A in 2012 will cause additional diversion of revenue from the General Fund. Beginning in FY 2017 and continuing for decades to come, tens of millions of dollars of severance tax revenue will be diverted each year from the General Fund into the permanent state trust fund. (The severance tax is paid on mining of natural resources like coal, gas, oil, and precious metals.)

To lawmakers, earmarking existing General Fund revenues may feel like free money, since it can allow them to claim credit for funding newly identified priorities without the practical and political difficulty of raising new revenue. However, any new expenditure diverts funds from existing initiatives that meet other urgent needs, even though they may be less visible or less politically popular or serve constituencies that are less politically influential.

**Conclusion: The Annual Appropriations Process as a Tool for Balancing Utah’s Priorities**

Utah is experiencing an economic recovery, and the state’s official unemployment rate has fallen faster than the nation’s. The labor force participation rate, however, remains well below pre-recession levels, down from a peak of 72.6% in July 2007 to 69.2% this July. Utah’s total employment now exceeds the 2007 pre-recession level by about 4%, but our population has grown by about 13% since then. In addition, Utah lags behind the national recovery in terms of restoration of real (inflation-adjusted) per capita economic output. Perhaps most distressing, Utah’s poverty rate remains much higher than before the Great Recession at 12.7% in 2013, a third higher than the pre-recession low of 9.6% and considerably higher than the previous decade’s peak of 10.9% that Utah reached in 2004. Nearly one-in-six Utah children live in poverty.17

Likewise, the state budget continues to suffer the effects of the recession. Policy changes during the past decade have made matters worse, leaving the unrestricted share of the General Fund 4% below its pre-recession level for FY2015 (before adjusting for inflation). Increasingly, the General Fund’s base has been undermined by unfunded, multi-year earmarks diverting revenues away from previous priorities into new ones.

These measures have decoupled the General Fund from population and economic growth. Whatever the merits of specific tax policies or projects, the accumulation of unfunded earmarks during the past decade has placed the General Fund—and all state programs that depend on it—in a precarious position.

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 and given up a substantial portion of their ability to meet the evolving needs of the state and its residents. Unlike budget items approved through the annual appropriations process, earmarks remain in force until legislation removes them—a rare occurrence.
Moreover, the decision to divert existing revenue streams to new priorities rather than identifying a new revenue source is strikingly similar to what happened in 1996 with regard to education funding. In 1996, Utah passed Proposition 6, a state constitutional amendment that for the first time permitted diversion of Education Fund revenues to pay for higher education as well as K-12 education. The Utah Foundation has published numerous reports in recent years documenting how, prior to that decision, Utah ranked in the top 10 states nationally for K-12 education funding effort. Since the passage of that constitutional amendment, Utah’s K-12 education funding effort has fallen to below the national average.\(^{19}\)

There are two major steps that Utah’s lawmakers could take to reverse course and place the state and its priorities on firmer fiscal ground:

- First, they could revisit their recent decisions regarding the use of earmarks of existing revenue sources and instead identify new revenue sources to finance newly identified public investment needs.

- Additionally, any new earmarks that are established should include provisions for “sunset” review. Sunset provisions already exist in many areas of state law. Explicitly adopting a policy that would incorporate sunsets into all earmark legislation would guarantee that Utah does not once again find itself laboring under the accumulation of these measures.

By taking these steps, Utah lawmakers could 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.

Utah is justifiably proud of its historically strong record of fiscal management. Taking these steps would help ensure that the General Fund has the capacity to support Utah’s population and economic growth well into the future.
Endnotes


7 Source: Office of Legislative Fiscal Analyst’s Compendium of Budget Information at LE.utah.gov/LFA/reports/COBI2014/LJ_KFA.htm and Utah Association for Community Services

8 Email from Division of Services for People with Disabilities Director Paul T. Smith, September 15, 2014. The $12,677,507 in state funds would be matched by an additional $30,304,378 in federal funds.

9 DSAMH Annual Report 2013 page 51


11 Ibid.


13 Tuition inflation data and chart from “Higher Education Tuition and State Tax Funding” by Office of Legislative Fiscal Analyst, September 10, 2014.

14 Source: http://www.census.gov/govs/school/. Utah began diverting education fund dollars from K-12 to higher education following a 1996 Constitutional amendment.

15 Source: Kids Count Data Center at datacenter.kidscount.org, which uses data from the three-year American Community Survey of the U.S. Census Bureau. Note: While pre-K funding was expected to come from the Education Fund, it is also affected by the growing inadequacy of the General Fund, for the same reason that K-12 funding is affected, as described above.

16 For example, see http://www.washingtonpost.com/blogs/govbeat/wp/2014/09/03/watch-the-u-s-transition-from-a-manufacturing-economy-to-a-service-economy-in-one-gif


18 Ibid.

19 Several Utah Foundation reports are available on this topic at utahfoundation.org/report_category/education and the most recent one was an October 2012 Issue Brief that included funding data through 2010.