LFA
Legislative Fiscal Analyst

Utah Legislature

October 2017

Revenue Update

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Part A: Tax Collections

The State of Utah collected $6.32 billion in General and Education Fund revenue for FY 2017. That is $47.0 million more than expected by the Executive Appropriations Committee (EAC) in May. (See Figure 1.) After adjusting for expenditures, statutorily required reserve account deposits, and anticipated restorations, the available General Fund balance is $8.0 million and the available Education Fund balance is $18.0 million, with the combined total summing to $26.0 million.

For FY 2018, economists from the Governor's Office and the Fiscal Analyst's Office estimate that revenue collections to the General Fund will range from $10.0 million below to $50.0 million above the EAC's most recent target. Similarly, economists estimate that revenue collections to the Education Fund will range from $10.0 million below to $95.0 million above the target. We expect the Transportation Fund to end FY 2018 between $10.0 million below and $10.0 million above the target.

The economic outlook includes a number of upside benefits and downside risks. On the upside, the economy has yet to see a real strong boom in economic activity. Instead, it has shown a steady, healthy growth. Typically, business cycles experience some period of very strong economic growth, and given the strengthening labor market, stronger business investment, well-capitalized equity markets (S&P 500 Index in Figure 2), still historically low interest rates (Figure 3), and various other factors, the "boom" period of the current expansion could still occur.

On the flip side, the current expansion has already lasted longer than a typical expansion — suggesting that a downturn is a possibility in the near future.

Overall, analysts continue to watch for signs of cracks materializing in the economy. Outside of businesses or consumers losing confidence in the state of the economy, problems would likely begin to materialize in areas such as a weakening stock market, increasing interest rate spreads, or decelerating retail sales. None of these have yet signaled a problem.

Figure 1

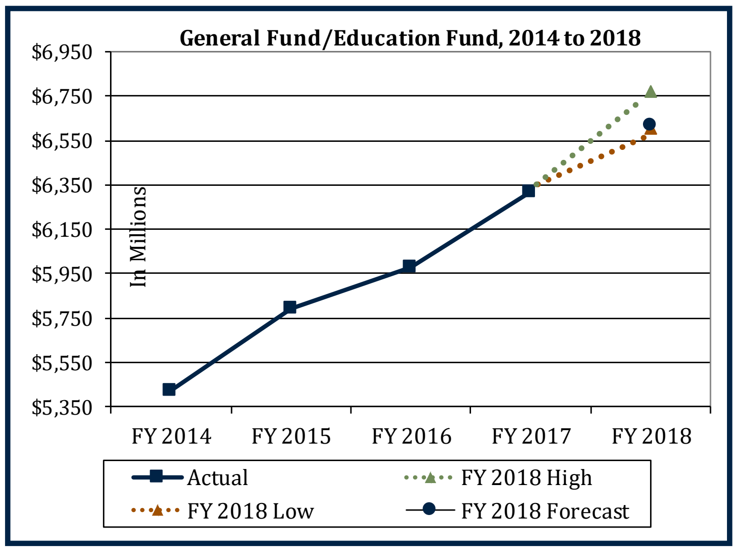


Figure 2

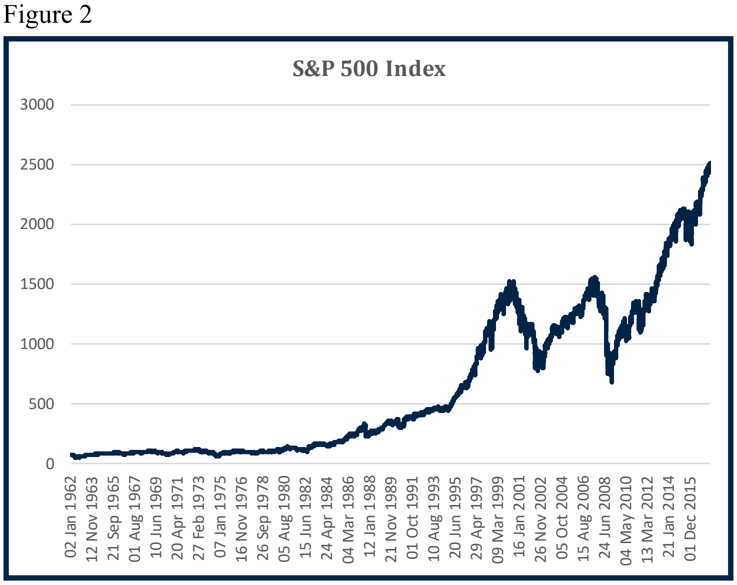
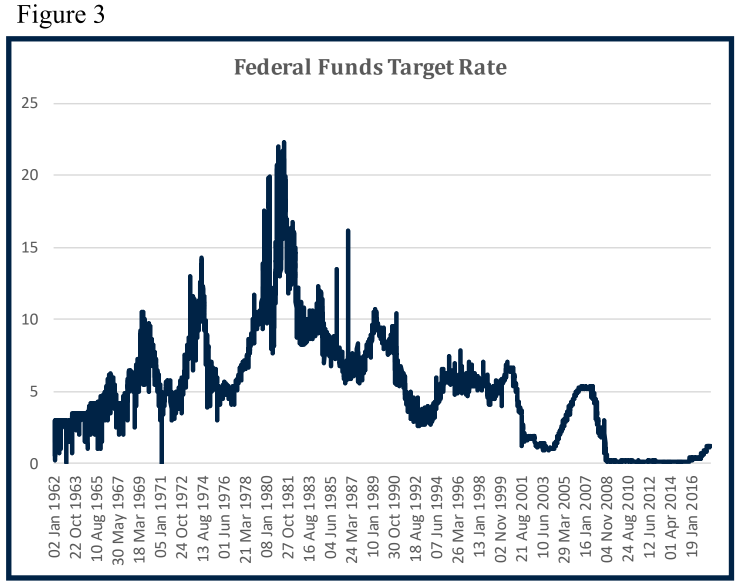


Figure 3



A1 General Fund

The State collected $2.34 billion in General Fund revenue for FY 2017. That is $22.6 million more than anticipated by the EAC in May. It collected $1.86 billion from sales tax, the largest revenue source to the General Fund, nearly reaching in nominal dollars the historic revenue high-point that occurred in FY 2007 (Figure 4).

After adjusting for expenditures, other statutorily required deposits, and anticipated restorations, the FY 2017 year-end balance is approximately $8.0 million. We expect FY 2018 revenue to be between $10.0 million below and $50.0 million above target.

Insurance premiums, the second largest revenue source to the General Fund are also performing well. Economists expect that revenue collections will reach $122.0 million in FY 2018, a growth of about $10.0 million over FY 2017 (Figure 5).

A2 Transportation Fund

The State collected $573.0 million in Transportation Fund revenue in FY 2017, almost in-line with the $573.2 million May EAC target. Looking forward, we anticipate FY 2018 revenue to be between $10.0 million below and $10.0 million above the May EAC target.

Motor and special fuel taxes make up the two largest sources of revenue to the Transportation Fund, both of which are at their all-time highs due to the recent gas tax acceleration. Overall, motor fuel tax increased by $39.0 million and special fuel tax increased by $14.0 million. (See Figures 5 and 6)

Overall, as with the General Fund, Transportation Fund revenue growth continues at a healthy pace.

Figure 4

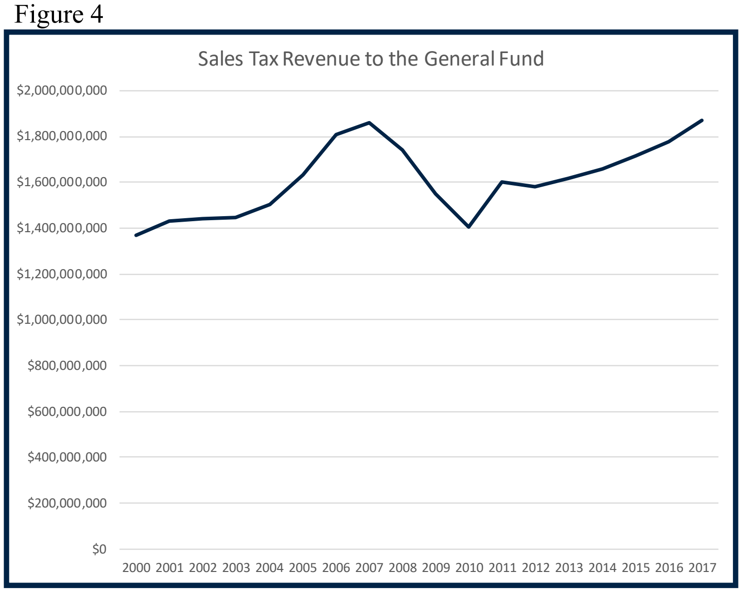


Figure 6

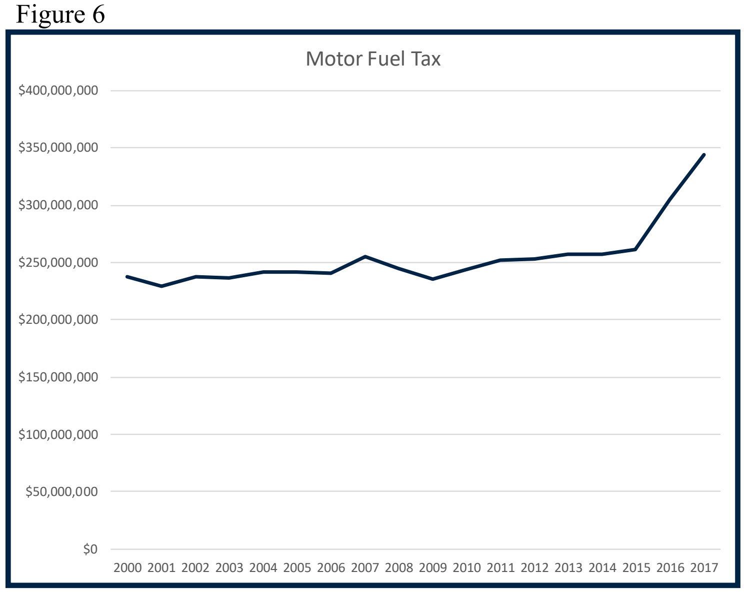


Figure 5

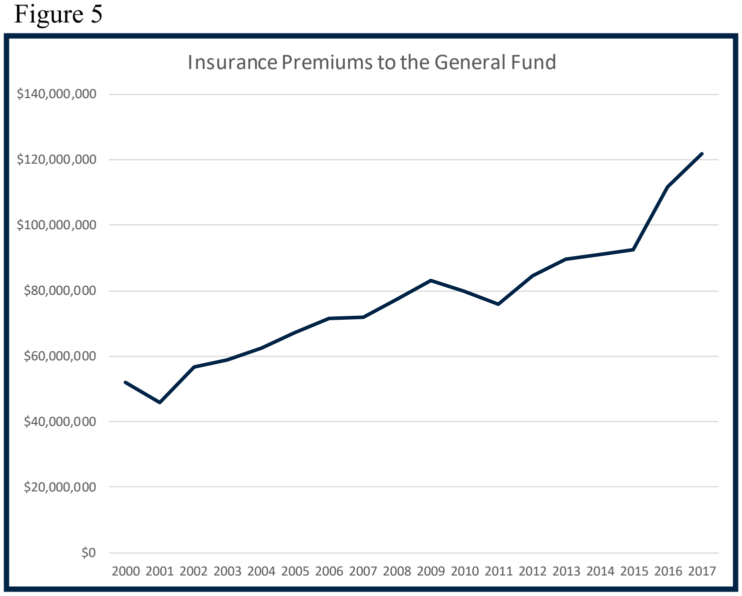
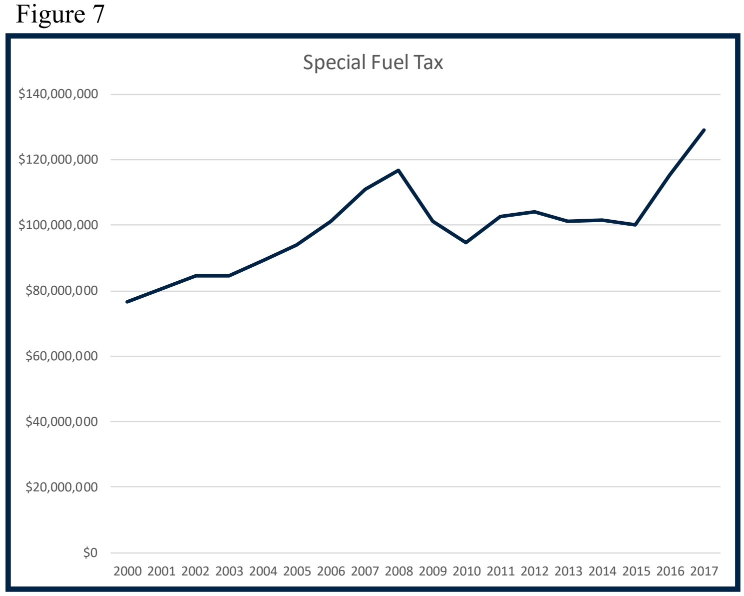


Figure 7



EDUCATION FUND

The State collected $3.98 billion Education Fund revenue for FY 2017. That is approximately $24.7 million more than expected by the EAC in May. After adjusting for expenditures, recapture and statutorily required deposits, the FY 2017 year-end balance is approximately $18.0 million. Looking forward, we anticipate FY 2018 revenue to be between $10.0 million below and $95.0 million above the EAC target.

Overall, Education Fund revenue continues on a healthy growth path. Personal income tax withholdings represent the largest component within the individual income tax, and as a result the largest revenue source to the Education Fund at about $3.0 billion. This is $208.0 million above the FY 2016 final amount. That is about a 7.5 percent year-over-year growth rate. (See Figure 8.)

Gross final payments for individual income tax filers are also coming in healthy, with a year-end value of $1.1 billion. This represents total growth of $63.0 million, a 6.1 percent year-over-year increase (Figure 9). Income tax refunds grew by $32.0 million to $468.0 million, a year-over-year growth rate of about 7.3 percent (Figure 11). On the whole, income tax revenue reached its all-time high for the fifth year in a row in FY 2017.

The State collected $328.0 million in corporate income tax revenue in FY 2017, a decline of about $10.0 million from the previous year, representing an overall decline of about 2.9 percent. In contrast to the income tax picture, corporate income tax is still about $86.0 million below its FY 2007 all-time high of $414.0 million (Figure 10). This might be due to loss carryforwards, a change in industry makeup, a shift in which industries are paying corporate income tax, difficulty in making taxable profits, and other factors.

Figure 8

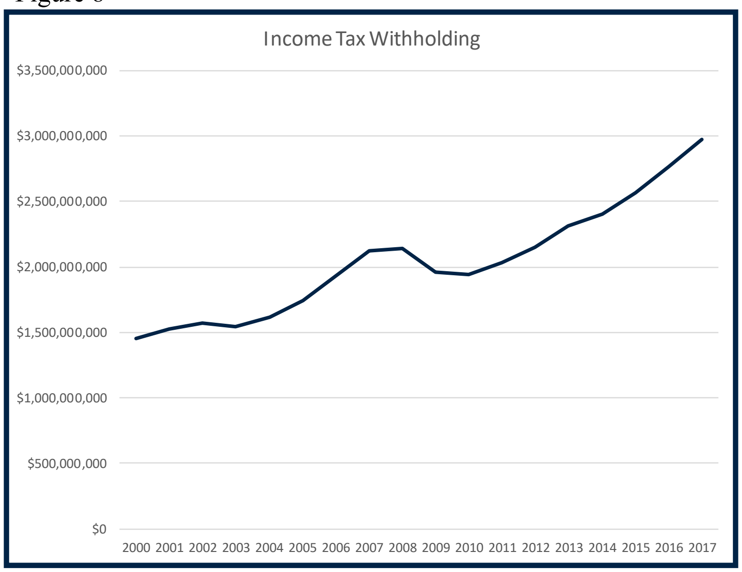


Figure 10

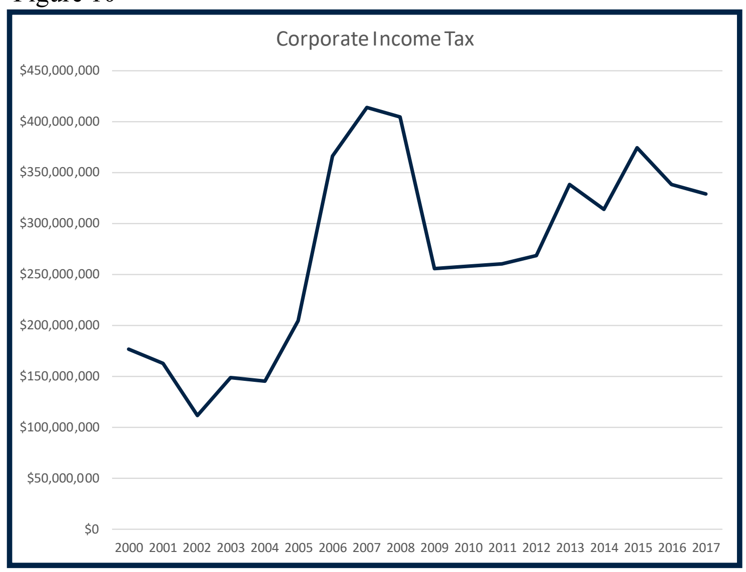


Figure 9

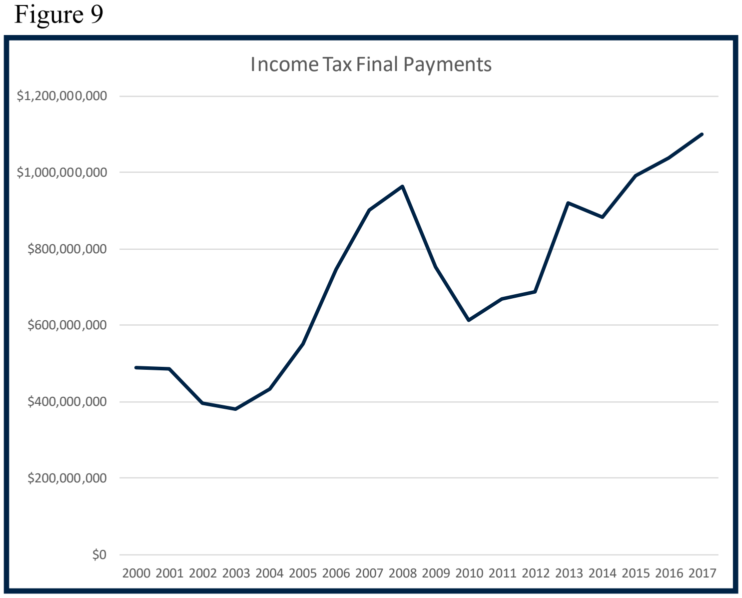
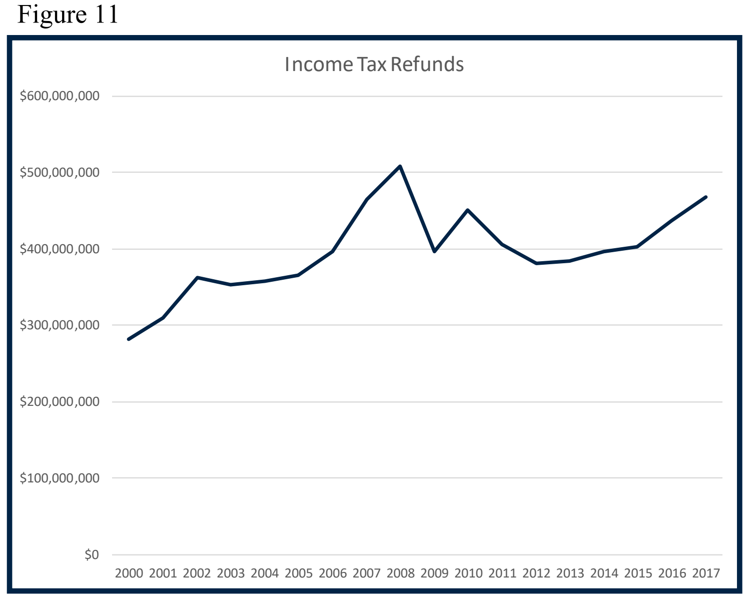


Figure 11



B1 DEMOGRAPHIC TRENDS AFFECTING REVENUE

Changing demographics of the U.S. and Utah populations affect state revenue and expenditures in a variety of ways.

Figure 12 shows the percentage of the Utah population aged 64 and under and the percentage of the population aged 65 and older. In 2010, the percentage of the population under 65 years old was about 91.0 percent. The percentage of the population 65 and over was 9.0 percent. In 2019, the percentage of the population under 65 may decline to about 88.6 percent, a decrease of about 2.4 percent. Simultaneously, the percentage of the population aged 65 and over may increase to about 11.4 percent of the population.

Although seemingly small, a 2.4 percent demographic shift can make a marginal difference on revenue growth, in that the spending and income-generating habits of the different demographics can influence sales tax and income tax. The growth in the population aged 65 and over is anticipated to continue over the coming years. The percentage of the population aged 65 and over may grow to 13.5 percent by 2025.

In addition to the aging demographics, certain population groups in Utah opt for a more urban living lifestyle without homeownership. This change may also affect revenue. Figure 13, plots the percentage change in the homeownership rate by age group from 2006 to 2016. The younger age groups, namely 25 to 39 years, represent the largest declines in home ownership rates. Individuals aged 25 to 29 saw their homeownership rate drop by 26.0 percent. Individuals aged 30 to 34 saw their homeownership rate drop by 18.8 percent. Individuals aged 35 to 39 saw their homeownership rate drop by 16.7 percent.

In contrast, older individuals have not seen such a dramatic drop in homeownership. Individuals aged 70 to 74, the oldest age group in the survey, saw the smallest decline, by only 1.6 percent. The next oldest age group, aged 65 to 69, saw the second smallest decline, by only 4.1 percent.

As mentioned, the demographic shift in homeownership matters because younger generations purchase homes at slower rates than a decade ago. Thus, they buy fewer durable goods like appliances, and pay less sales tax. The decline in home ownership rates may stem from the inability to purchase a home or a choice factor where younger generations want to be less committed to a geographic area.

Figure 12

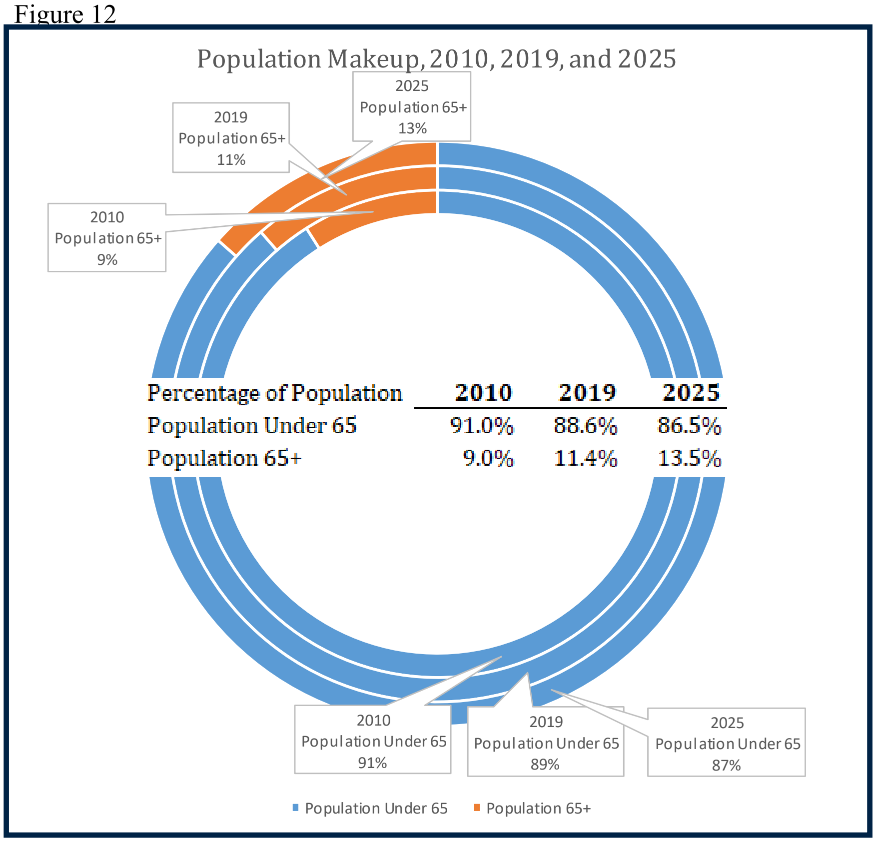
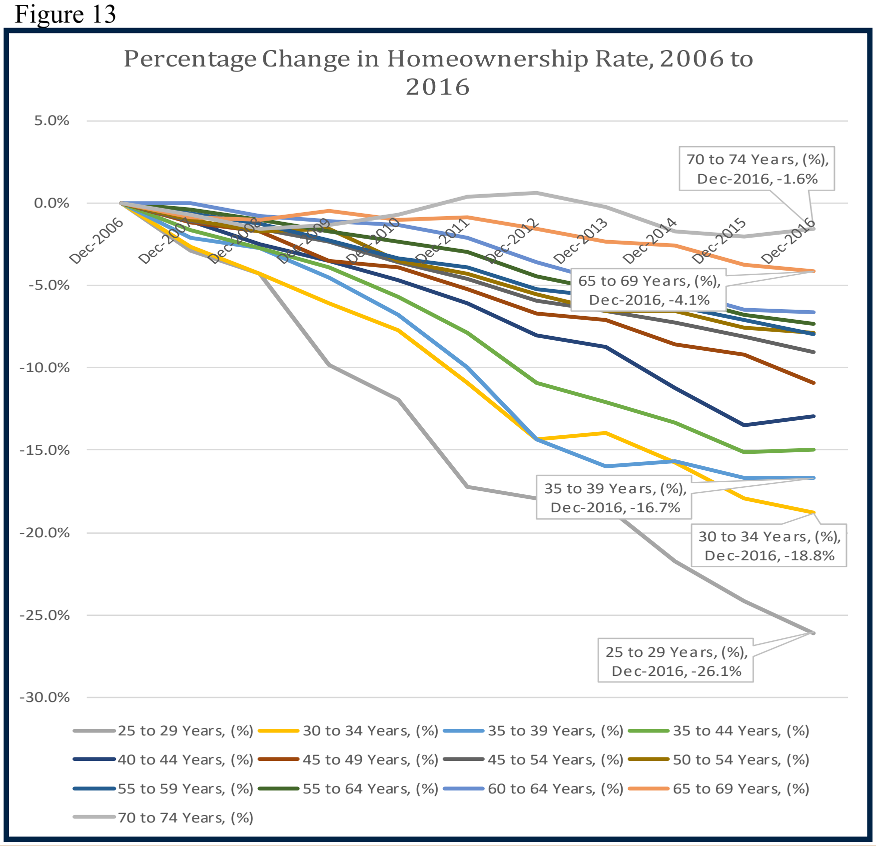


Figure 13



Household size also affects state revenue collections. Figure 14 shows a decline in household size from 2010 to 2025 (projected). Should these projections turn out to be accurate, household size will drop from 3.1 (average household size) in 2010 to about 2.8 in 2025, a decline of 8.4 percent. A number of factors contribute to this projected decline, including declining fertility and death rates, and an increased length of time before individuals marry.

Why does the household size matter for revenue? A declining average household size usually means fewer wage earners per household. As a result, net household income declines over time. The decrease in net income could have a direct negative impact on both income and sales tax collections. In the instances where declining household size is the result of fewer children there could be less demand for state resources such as public education.

The demographic shift also shows up in the makeup income. Of the top four growing income sources since 2000, three have a direct link to demographics, and the other is indirectly linked. Taxable Social Security represents the fastest growing source of income. Other taxable income sources include partnership income, taxable individual retirement account withdrawals, and taxable pensions. An aging population has a greater percentage of its income from these types of retirement accounts.

These income categories impact revenue, particularly income and sales tax, because when individuals gain more of their income from retirement-type of sources, they typically have a lower tax rate and spend income on items that may have lower sales tax incidence, such as out-of-state travel or medical care.

In broader terms, summing these four sources of income together produces a total well below the size of taxable wages ($15.6 billion vs. $57.3 billion in 2015). Because of the increase in these sources, income tax is growing at 6.0 percent instead of 7.0 percent. That one percent differential is approximately $32.0 million in revenue.

On the other end, the weakest performing sources of income includes interest income and capital gains. Interest income was about $1.1 billion in 2000. In 2015, interest income was $670.0 million, a decline of about $419.0 million over 15 years. The decline in interest income stems from interest rates, which are still near historical lows. The relatively subdued capital gains estimates may stem from individuals forgoing capital gains until Congress and the President address tax reform.

Figure 14

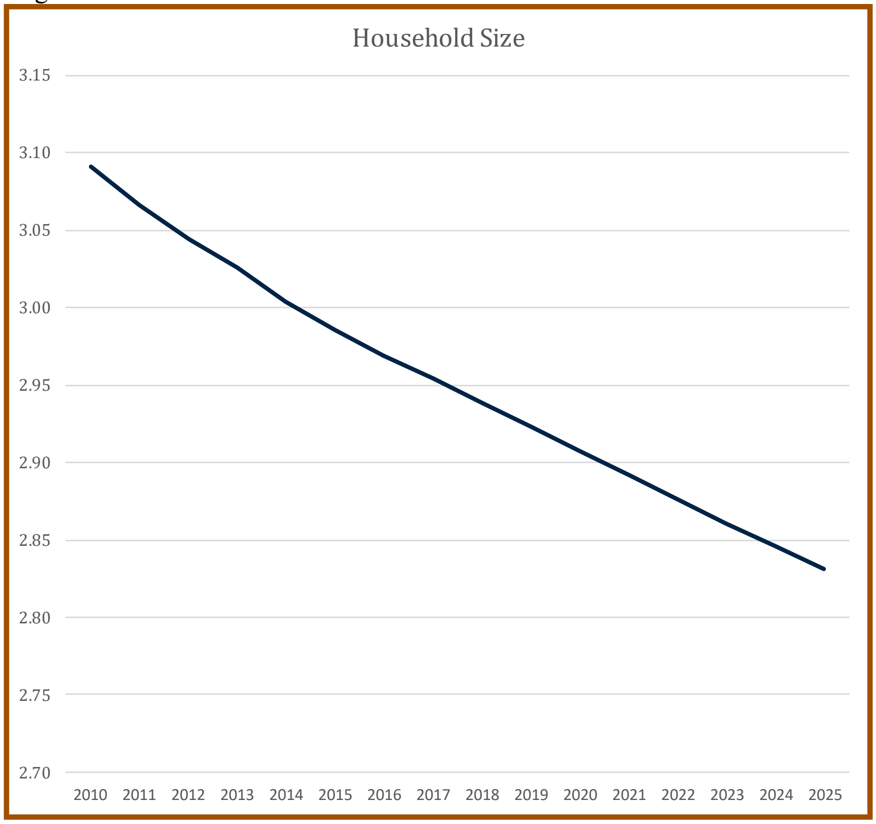
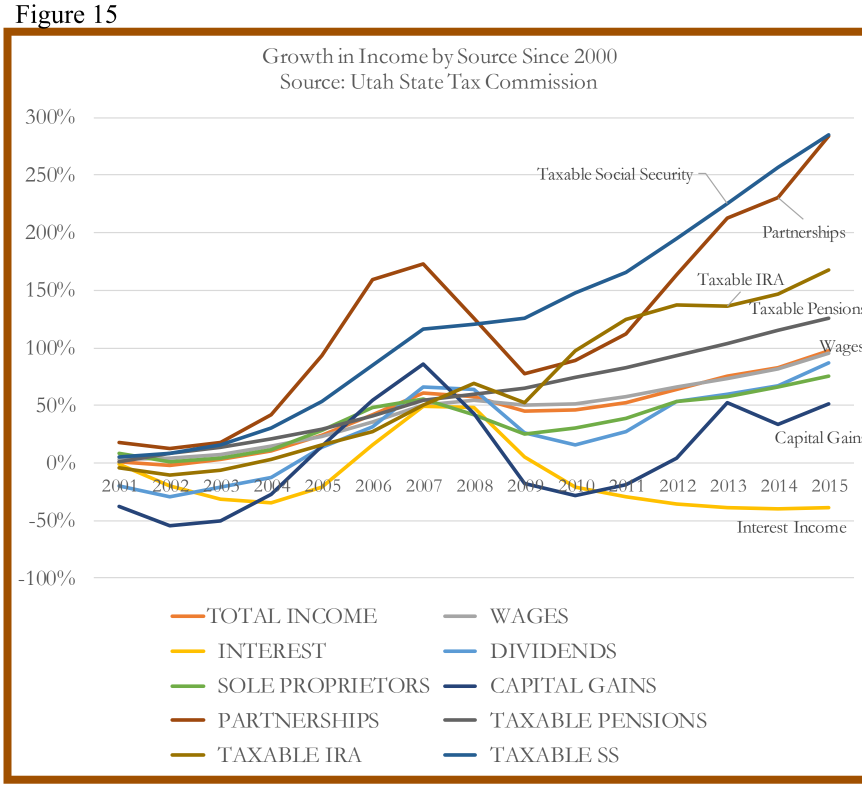


Figure 15



B3 W2 EARNERS VS. 1099 EARNERS/SHIFT TO THE SHARING BUSINESS

The Great Recession, which left 8.7 million American workers unemployed, also gave a boost to the freelance economy. Freelance workers are estimated to generate $1.2 trillion in revenue for the U.S. economy, which accounts for approximately 6.0 percent of national GDP. A Bureau of Labor Statistics study estimates that by 2020 more than 40.0 percent of the American workforce, or approximately 60 million people, will be independent workers—freelancers, contractors, and temporary employees.

There are several reasons why independent work is on the rise, from shifting economic conditions to corporate downsizing and employee dissatisfaction. Additionally, there are now more ways to work remotely than ever before, from devices, apps, and other personal technology that lets us communicate with one another from virtually everywhere.

Economists debate the effect the freelancing economy has on the broader economic picture. The freelance economy appears to be gaining steam, but quantifiable evidence is spotty and sometimes conflicting. Figure 16 shows the cumulative percentage growth in W-2 forms issued by the Internal Revenue Service (IRS) compared to the cumulative growth in 1099-Miscellaneous forms issued by the IRS since 2000. The growth in W-2 forms (i.e. withholding forms for employees) has declined slightly by 3.3 percent over the 16 years shown. By contrast, the growth in 1099-Miscellaneous forms, where freelancing work likely shows up, has expanded by about 29.0 percent over the same time frame.

Figure 17, shows the cumulative percentage growth in state tax revenue since 2005 across all states on the horizontal axis (x-axis). The vertical axis (y-axis) shows the cumulative percentage growth in professional and business services since 2005. The figure indicates a general upward correlation (not causation), which means that state taxes generally increase as growth in professional services increases.

How is this related to freelancing? When individuals opt for freelancing, they usually show up in the "Professional and Business Services" category. And, the chart shows that states' taxes generally grow faster in states with faster growing professional services. This implies that on an inter-state comparison basis, freelancing may increase a states' tax revenue relative to other states' tax revenue. It appears that states with more entrepreneurial workforces are more likely to win freelancing business at the expense of workers in other states.

Where does Utah fit in? Utah is closer to the top of the graph, at about 40.0 percent growth in professional services and about 30.0 percent growth in state tax revenue. This means that freelancing individuals in Utah likely increase revenue in Utah at the expense of states with less entrepreneurial workers.

Figure 16

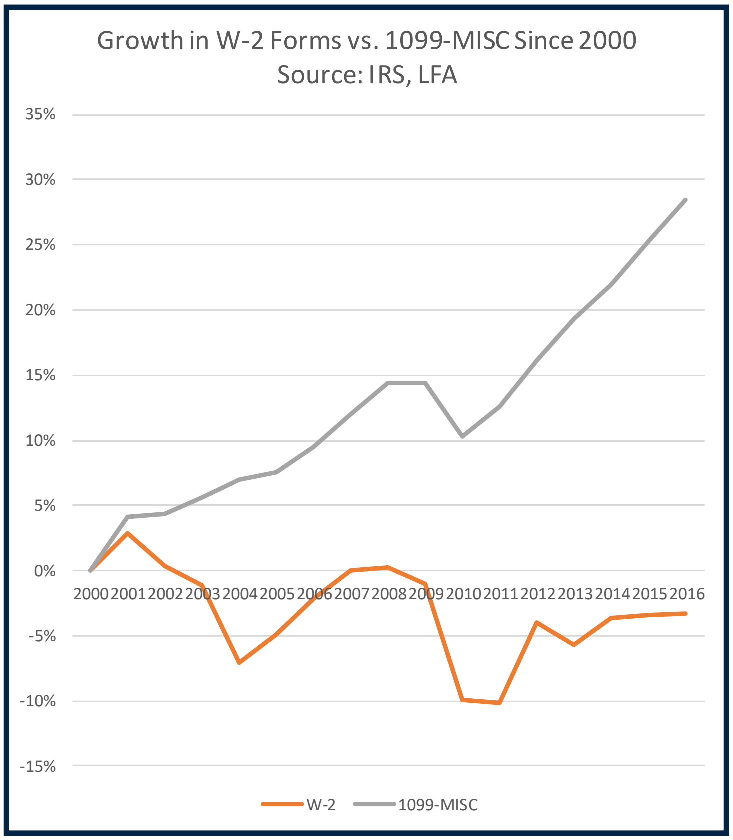
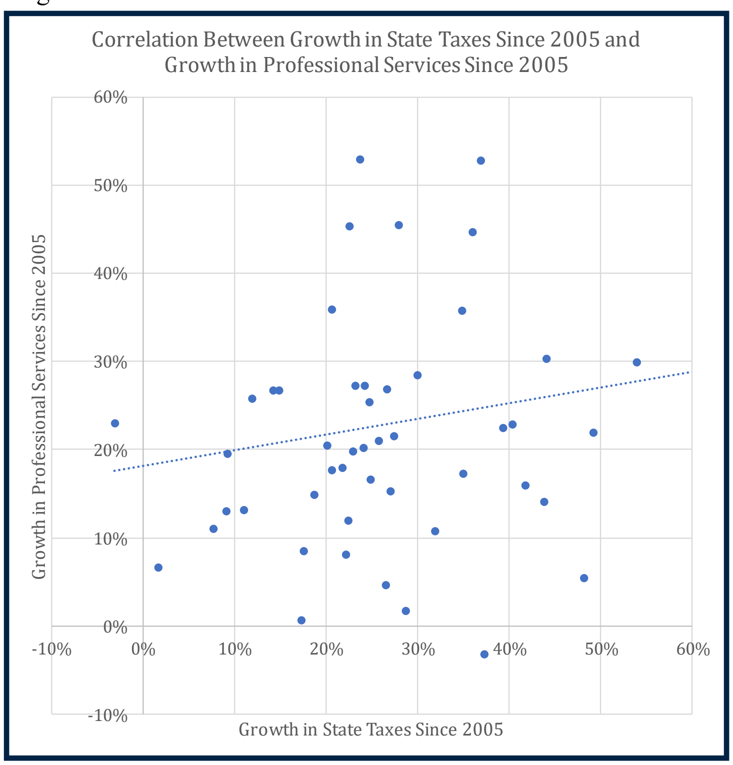


Figure 17



B4

INFLATION

Subdued inflation, which affects revenue in a number of ways, is one of the most surprising elements of the current business environment.

Figure 18 shows the growth in prices for the current business cycle compared to the prior business cycle. In 2003, prices slowly started to rise following the bursting of the technology bubble in the early 2000s. Prices started to rise quickly when the economy started booming in 2006. Over the course of the entire period, prices rose by 30.0 percent, on average. By contrast, the current business expansion has experienced subdued price growth (inflation). From early 2010 to the first quarter of 2017 prices have risen about 12.0 percent, a marked difference from the previous business cycle. And the current expansion has already lasted eight quarters longer. What's causing the subdued inflation? A number of factors play a role, including international competition for demand, shifts in consumption patterns, a strong dollar, and technological changes.

Workers complain that wages are not growing fast enough. That's true if you look at nominal wages (not adjusted for inflation). Figure 19 shows nominal wages growing slower this business cycle, but inflation-adjusted wages are growing much stronger than the prior expansion (see Figure 20).

Figure 18

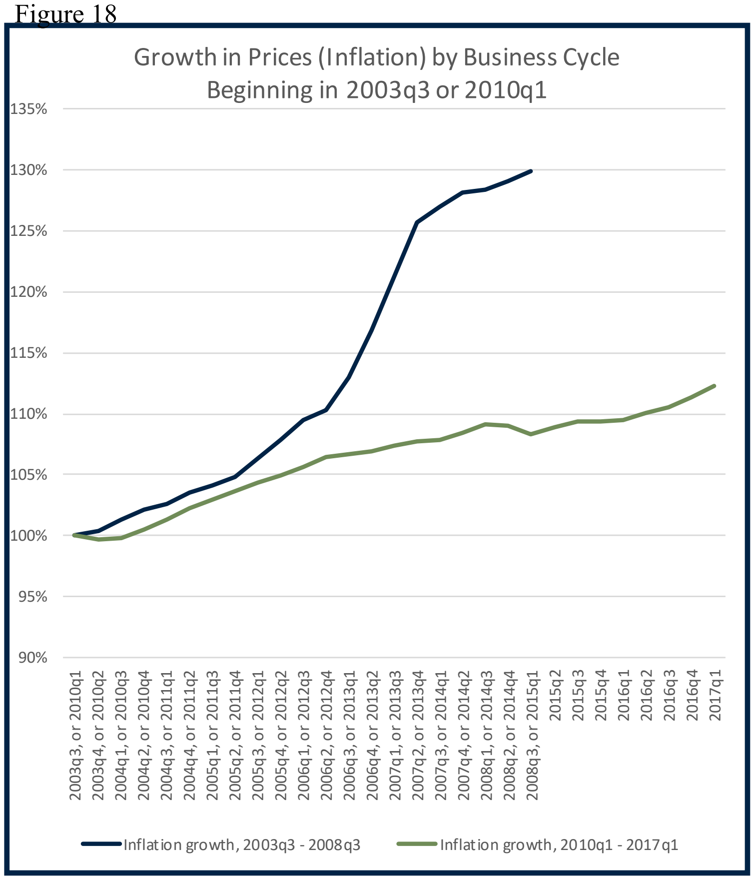


Figure 19

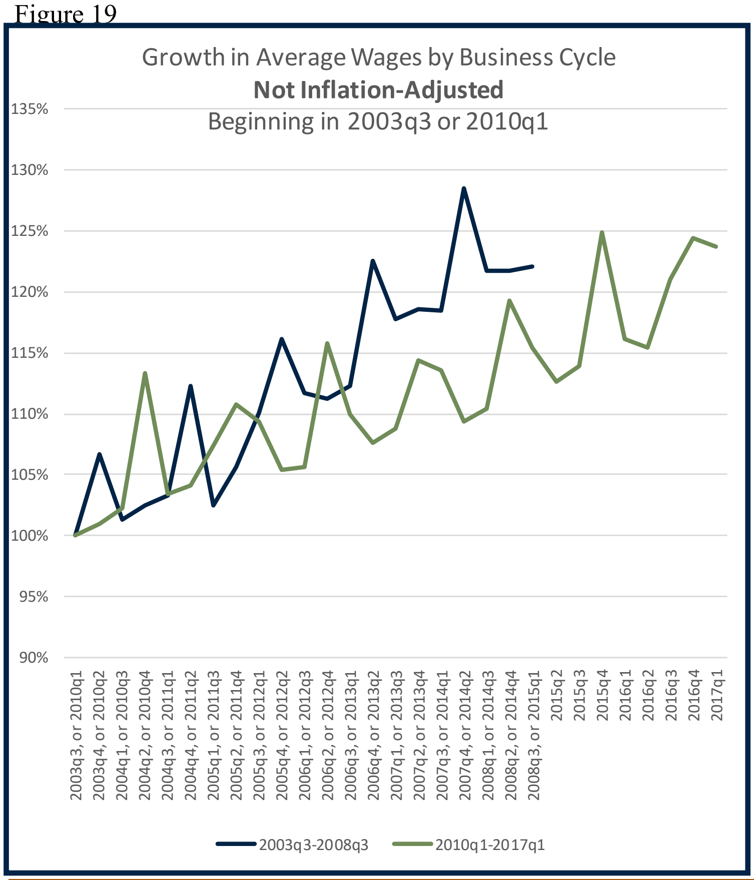
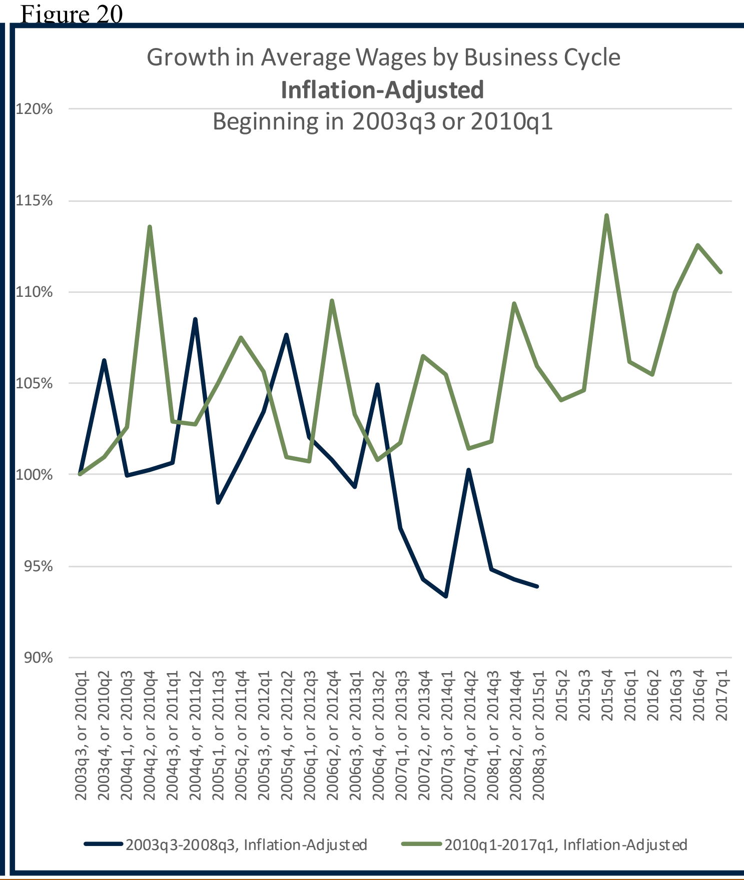


Figure 20



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Part C: Revenue Collections

Tax Revenue *(In Millions of Dollars)*	FY 2017 Final	FY 2018 Consensus	FY 2018 Consensus Growth Rate	FY 2017 Year-to-Date 10/9/2016	FY 2018 Year-to-Date 10/9/2017	FY 2018 Year-to-Date Growth Rate
Sales & Use Taxes	$1,856.75	$1,944.40	4.7%	$489.92	$533.02	8.8%
Individual Income Tax	3,609.45	3,804.75	5.4%	744.58	802.45	7.8%
Corporate Franchise Tax	323.50	343.85	6.3%	75.84	72.56	-4.3%
Beer, Cigarette & Tobacco	116.27	116.63	0.3%	25.68	24.50	-4.6%
Insurance Premium Taxes	122.02	116.21	-4.8%	26.79	29.26	9.2%
Severance Taxes	16.14	24.00	48.7%	3.30	4.78	44.7%
Other Sources	277.43	275.15	-0.8%	46.57	50.67	8.8%
Total - General & Education Funds	**$6,321.56**	**$6,624.99**	**4.8%**	**$1,412.68**	**$1,517.24**	**7.4%**
Motor Fuel Tax	$348.76	$360.00	3.2%	91.60	91.48	-0.1%
Special Fuel Taxes	134.91	131.00	-2.9%	31.15	32.40	4.0%
Other Transportation Fund	89.33	93.00	4.1%	20.75	20.30	-2.2%
Total - Transportation Fund	**$573.00**	**$584.00**	**1.9%**	**$143.50**	**$144.17**	**0.5%**

Source: LFA, USTC, DOF