FIVE-YEAR LONG-TERM BUDGET ANALYSIS

EXECUTIVE APPROPRIATIONS COMMITTEE
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ISSUE BRIEF

OVERVIEW

Across the nation states face long-term financial and demographic pressures like an aging population, student enrollment growth, and rising health care costs, all of which will increase their budget demands going forward. Because of these pressures, lawmakers need quality information about the impact of their budget decisions. By considering the long-term implications of budget decisions, states can improve their business climate, cope with economic volatility, and make government more efficient.

Utah is in better fiscal shape than many states. The state budget has recovered from the downturn experienced during the Great Recession. However, lawmakers face many of the same challenges as other states. Of particular concern are rising construction costs, population growth, a changing and aging workforce, and increased health costs for both state employees and Medicaid populations. Fortunately, Utah policymakers have always been forward-thinking when considering the state budget. To prepare for the future, legislators have implemented a three-year comprehensive budget evaluation process.

1. The first year involves an evaluation of revenue volatility for the sources of revenue that fund the state budget. These sources are evaluated against the adequacy of state rainy day funds and, when necessary, recommendations are made to adjust the capped percentages diverted into state rainy day funds.
2. In the second year, the analyst develops a five-year long-term budget for programs appropriated from major funds and tax types. This report meets that requirement.
3. In the third year, a budget stress test compares estimated future revenue to and expenditure from major funds and tax types under various potential economic conditions.

LONG TERM BUDGET PROJECTIONS

Long-term budgets are useful for aligning budget capacity with budget needs. The Government Finance Officers Association recommends that governments regularly engage in long-term planning that includes the following elements:

1. A five to ten-year time horizon;
2. A scope that include the most important funds to state budgets;
3. A regularly scheduled review of long-term trends;
4. A report that includes the key indicators of economic health; and
5. A transparent communication of the results.

UCA 36-12-13(e)(iii) requires the Office of Legislative Fiscal Analyst to prepare a report on the long-term budget for programs with funding appropriated from major funds and tax types. To facilitate the analysis, the analyst created an interactive Excel-based calculator, where individuals can enter their own assumptions about revenue indicators and spending growth to see how various policy changes can impact the state budget. The calculator is available here. By creating a state long-term projection, legislators can demonstrate the impact of the aging of the population, rising health care costs, and economic trends on state spending, revenues, deficits, and debt.

When considering a long-term budget, legislators could evaluate the following: Is the state's future workforce well-suited for the jobs of tomorrow? Will the state's infrastructure meet emerging needs? Can the state afford to maintain an aging infrastructure? Is the state tax system sufficiently up-to-date for the modern economy? Will expenditure growth outpace revenue growth when economic trends are considered? Can the state maintain services for disadvantaged populations, particularly if the federal government reduces its assistance? Can the state sustain public education enrollment growth?

SUMMARY

Demographic changes such as the aging population are putting increasing pressure on Utah's budget, while the future course of health care costs, one of the largest parts of Utah's budgets, continues an upward trajectory. Also, the federal government, which provides over one-quarter of Utah's state revenues, is a risk to the state budget; if federal funding levels were to change, the state could face difficult decisions about funding programs to maintain the current level of services. The state is also faced with an aging infrastructure and rising construction costs. Additionally, State revenues are under pressure as a result of the changing sales tax base.

The analyst tested two potential baseline scenarios: a scenario, that predicts moderate growth, and a scenario that predicts a moderate recession. Under each scenario, we present the estimated expenditures, estimated revenues, and the net impact of the two. We then provided the same analysis with known policy changes that address some of the state pressure points included.

The moderate growth scenario assumes that wage growth averages 6.0% annually and taxable sales growth averages 5.3% annually from 2020 to 2024. This is reminiscent of current growth rates.

Under the moderate recession scenario, we presume a moderate recession in 2021 and 2022, followed by a strong recovery. The assumptions for the recession scenario mirror the recession in the early 2000s. In this scenario, wage growth averages 4.4% annually from 2020 to 2024 and taxable sales grow by an average of 3.4% annually.

The following sections detail the results of the two scenarios. Under both scenarios, the most important variables for both revenues and expenditures in the analysis are the unemployment rate, personal income, and demographic shifts.

SCENARIO 1: CONTINUED MODERATE ECONOMIC GROWTH FROM 2020 THROUGH 2024

Under Scenario 1, we assume the economy continues to expand at a moderately healthy pace in 2020 through 2024. In revenue terms, a moderately healthy pace is taxable sales growth around 5.3% annually and total wages growth of approximately 6.0% annually. Inflation is estimated to be approximately 2.0% annually over the same period, and population is expected to grow between 1.7% and 2.0% annually over the coming five years. Budget pressures in this scenario stem from increasing costs related to healthcare and infrastructure; however, slowing growth rates in public education enrollment reduce some fiscal strain.

Analysts used the calculator to link the assumptions to revenues and expenditures. Scenario 1 produces positive budget positions of $20 million in FY 2022 and $450 million in FY 2024, prior to any adjustments for policy impacts. After the analyst made adjustments for known policy issues including Medicaid expansion, redistricting, new prison construction, tax reform, and inflation indexing of gasoline taxes, the net budget position was $128 million in FY 2021, dropping to $8 million in FY 2022, and then expanding again to $47 million in FY 2024. Barring an external shock or a significant change in policy direction, under a moderate growth scenario, state budget growth is sustainable.

Detailed information for this scenario is shown in the spreadsheet tab labeled "Baseline, Scenario 1" linked here. Figures 1 and 2 are graphical representations of the impacts of Scenario 1 for the General and Education Funds and the Transportation Fund.

Figure 1: Revenue and Spending from General/Education Funds

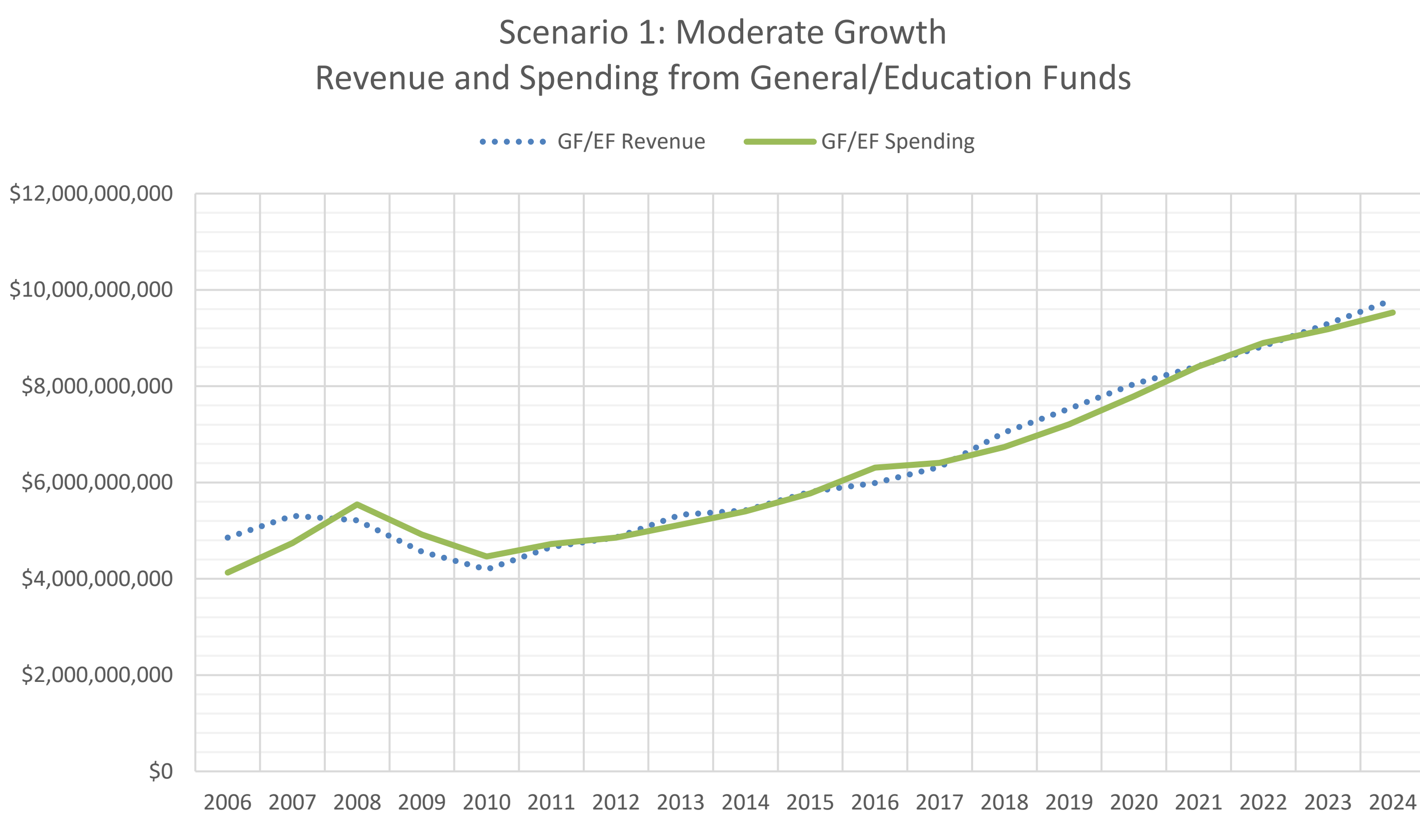
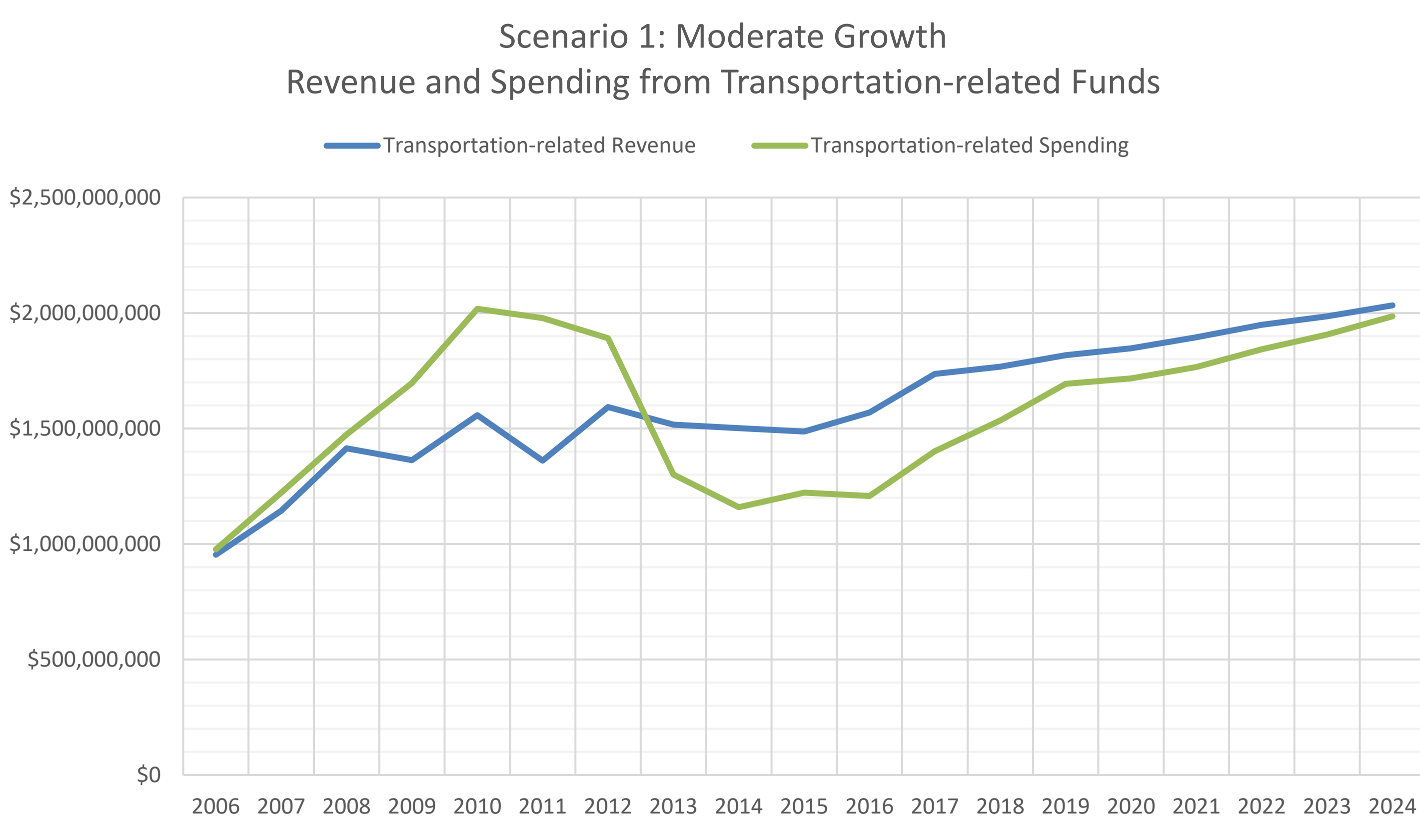


Figure 2: Revenue and Spending from Transportation-Related Funds



SCENARIO 2: A RECESSION IN 2021 THROUGH 2022 AND THEN A RECOVERY

Scenario 2 assumes a recession in 2021 and 2022 followed by a recovery in 2023 to 2024. Scenario 2 produces a net budget deficit of -$275 million in FY 2022 and a return to a positive budget position of $95 million by FY 2024 prior to known policy adjustments. The same known policy adjustments described in Scenario 1 were made to the recession scenario.

The detail for this scenario is provided under the "Recession, Scenario 2" tab found here.

Figures 3 and 4 are graphical representations of the impacts of Scenario 2 for the General and Education Funds and the Transportation Fund. Overall, instead of a healthy budget picture as presented in Scenario 1, the recession/recovery scenario produces, unsurprisingly, a weaker balance sheet.

Instead of a GF/EF net budget position of +$87 million in FY 2021, the net position switches to -$110 million. The net budget position declines further to -$275 million in FY 2022 and recovers to $95 million by FY 2024. Under this scenario legislators would likely need to utilize the list of tools they identified during the stress test evaluation including, budget cuts, utilizing working or statutory rainy-day funds, revenue enhancements, sweeping restricted account and non-lapsing balances etc.

The transportation-related picture also deteriorates, going from +$128 million in FY 2021 for Scenario 1 to a budget deficit of -$115 million in this scenario. The budget deficit accelerates further in FY 2022 to -$402 million, after which the net position brightens to +$162 million by FY 2024. In this instance, legislators could consider borrowing rather than paying cash for roads. If legislators decide to borrow in the downturn, they will need to account for debt service of the bonds in the out years.

Figure 3: Revenue and Spending from GF/EF in the Boom/Bust/Recovery Scenario

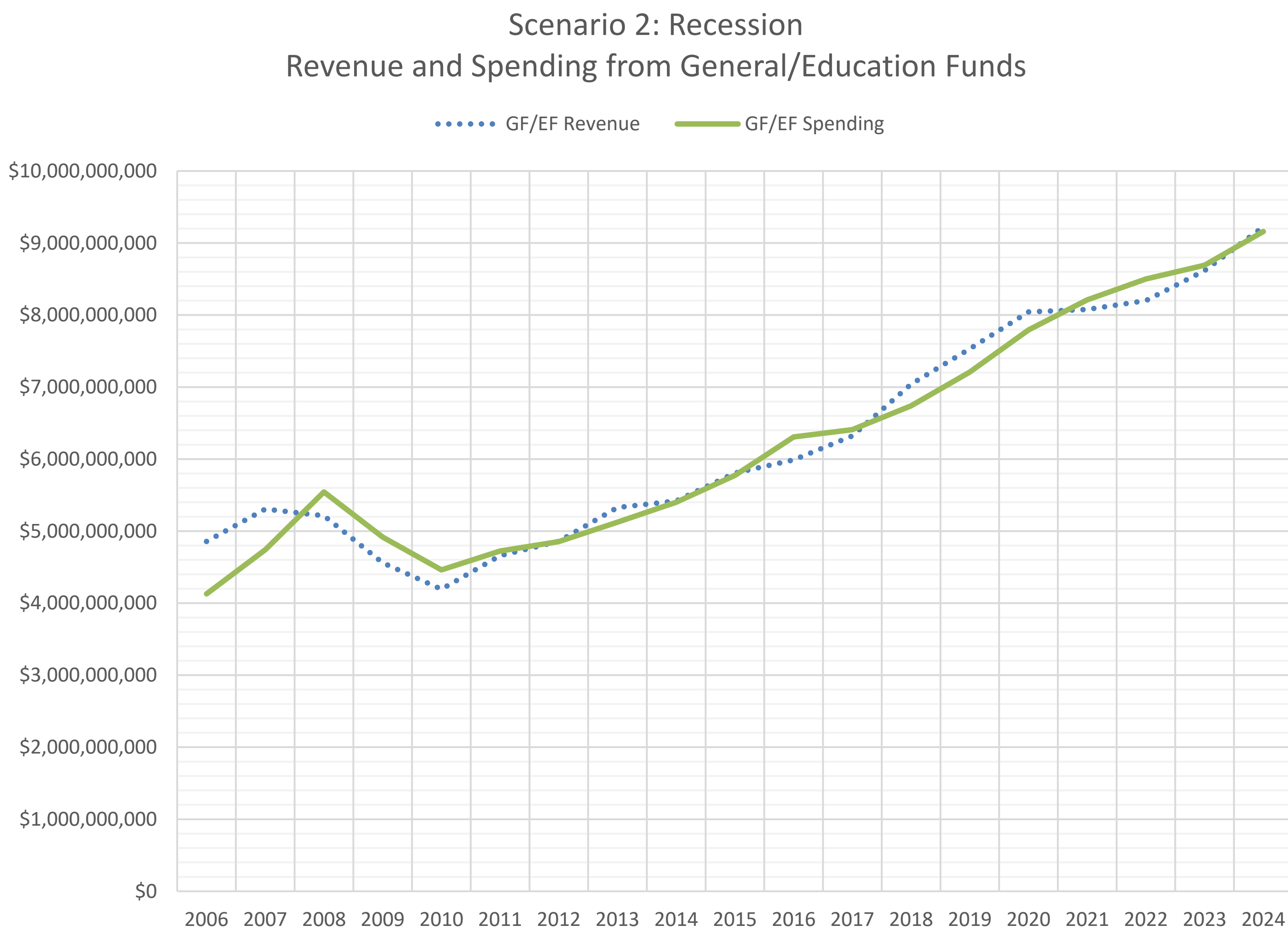
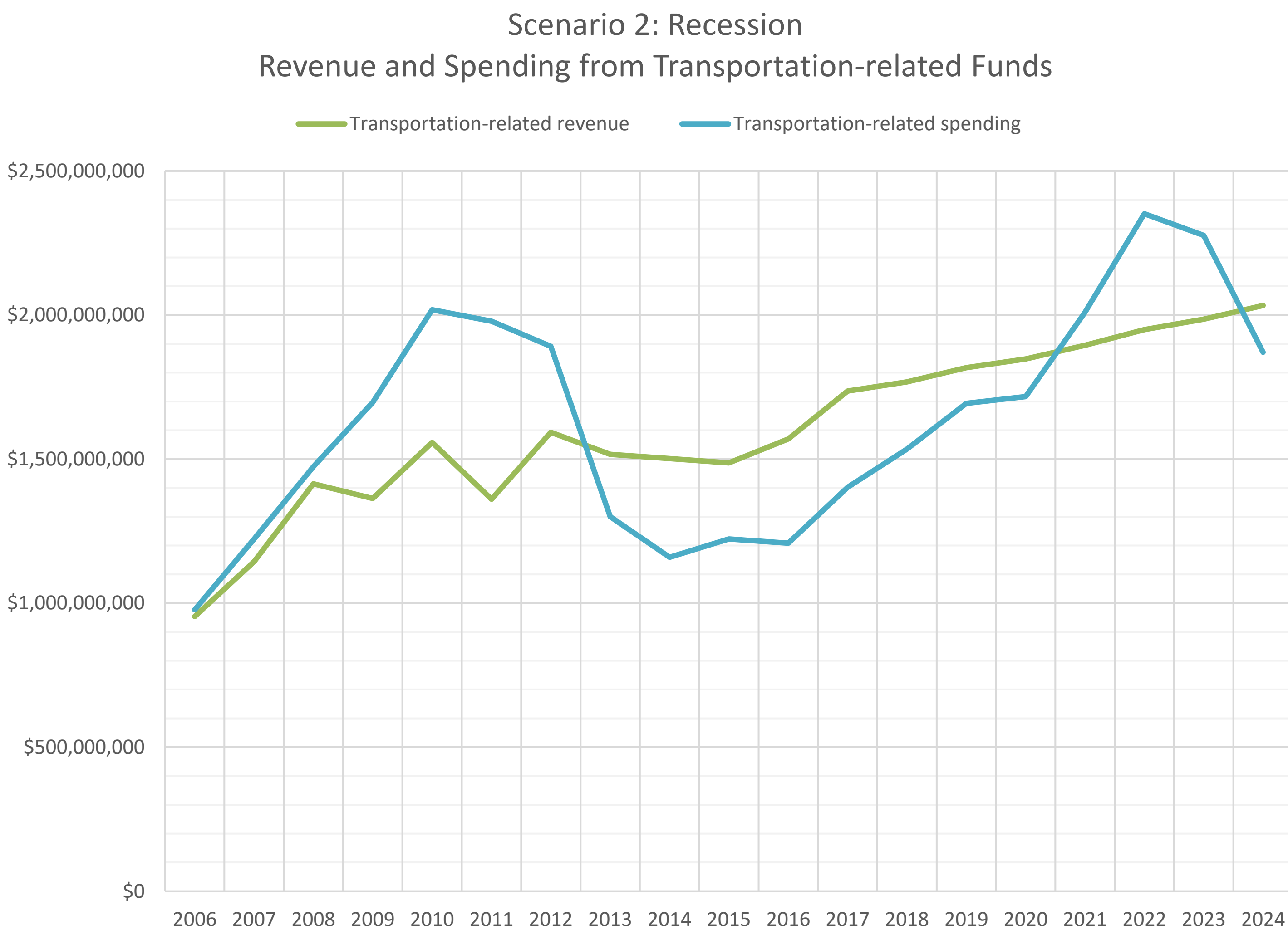


Figure 4: Revenue and Spending for Transportation-related in the Boom/Bust/Recovery Scenario



DETAILS

A detailed list of assumptions used are contained in Column C of the "Baseline, Scenario 1" or "Recession, Scenario 2" tabs of the calculator. The calculator provides all the historical information, assumption on indicators, and the adjustments for various known policy issues.

Projected revenue and significant expenditures based on known policy issues are presented in Rows 33-39, with notes defining the policy issues in Column AC. These projections are the same across all scenarios.

In the "Moderate Growth Scenario," the basic assumptions are as follows:

- Moderate rates of growth for taxable sales (Row 9), total wages (Row 10), corporate profits (Row 13), and personal income (row 17);
- Moderate decrease in unemployment rate (Row 16); and
- Basic projections for oil price (Row 11), population (Row 12), births (Row 14), and net migration (Row 15) (same across all scenarios).

In the "Moderate Recession Scenario," the basic assumptions are as follows:

- Declines in taxable sales (Row 9) and corporate profits (Row 13);

- Slower rate of growth in total wages (Row 10) and personal income (row 17);
- Increase in unemployment rate (Row 16); and
- Basic projections for oil price (Row 11), population (Row 12), births (Row 14), and net migration (Row 15) (same across all scenarios).

HOW TO GUIDE

A user of the calculator may change the assumptions to simulate different budget scenarios. For example, a stronger recession may be simulated by decreasing taxable sales, slowing the rates of growth of total wages, corporate profits, and personal income further than in the listed values, and/or increasing the unemployment rate. Other policy variables may be modeled either by adding percentage values to the highlighted cells (Rows 25-31 and Columns W-AB) or manually adjusting spending and revenue in different budget areas (Rows 33-39 and Columns W-AB). Changes to the State's net position will be reflected at the top of the sheet (Rows 3-5, Columns W-AB).