

2010

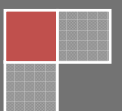
## School Funding and Tax Policy Series—Report I

Diverting Education Funds from K-12 Public Education

COST TO PUBLIC EDUCATION \$250 to \$761 MILLION PER  
YEAR

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## Diverting Education Funds from K-12 Public Schools

### COST TO PUBLIC EDUCATION—\$250 TO \$761 MILLION PER YEAR

*Abstract—A constitutional amendment passed in 1996 has precipitated significant changes in the way the state's three major funds are distributed. Instead of maintaining three separate revenue streams, each with a specific source and purpose, the current system allows lawmakers to divert public education funds to non-education projects. These changes have siphoned off between \$250 million and \$761 million per year from the Education Fund over the past 12 years. In fiscal year 2007-08, K-12 lost \$761 million through the higher education diversion.*

### Background

Taxation in the State of Utah has existed since Utah was a territory. Utah's authority to tax can be found in Article XIII of the Utah State Constitution adopted in 1895. The authority to tax became effective when Utah was admitted as a state a year later. From 1896 to 1931, Utah generated revenue by levying tax on real and personal property. Property tax revenues declined dramatically across the country, including in Utah, during the Great Depression.

With the reduction in state property tax revenues, states began to examine other revenue-generating alternatives. Individual and corporate income taxes were thought to more accurately measure a person's or entity's ability to pay taxes and helped distribute the tax burden between property owners and non-property-owners. Utah adopted corporate and individual income taxes in 1931. The State of Utah showed its commitment to K-12 public schools very early on with its dedication of the income tax revenue for school funding.<sup>i</sup>

### Until the Mid 1990's, the Utah State Budget Included Three Completely Separate Major Funds:

1. Money for the Education Fund (formerly known as the Uniform School Fund) came primarily from state income taxes, as well as corporate taxes and a small amount of property taxes. Prior to 1996, income tax revenue, by constitutional mandate, could only be used for public K-12 education.
2. State sales tax revenues flowed into the General Fund, which covered most state programs, including higher education, health and human services, corrections, and general government.
3. The third major fund, the Transportation Fund, came primarily from motor fuels and special fuels taxes, and provided for the Utah Department of Transportation and the Utah Highway Patrol.

Because these three funds represented completely separate revenue streams, the resources allotted to public education were protected and could not be used for other government services, such as higher education and roads.

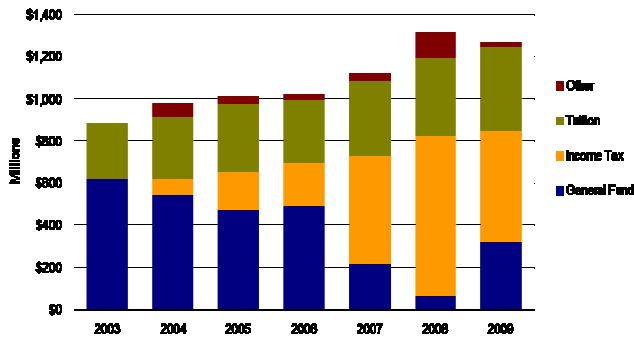
### Changes

#### Stage 1: Diverting Education Fund Revenues to General Fund Projects

The 1996 constitutional amendment, which allowed income tax revenues to be used for higher education as well as K-12 public schools, broke down the boundaries between protected funds. By using income tax revenues to fund higher education needs, legislative appropriators were then able to free up General Fund monies for other priorities. Thus, public education lost its revenue protection and had to vie for resources with many other state programs. Utah's funding effort for public education fell dramatically from 1996 to 2004 following the amendment.<sup>ii</sup>

**Chart 1. Higher Education Funding<sup>iii</sup> –**

As higher education received more dollars from income tax, general fund dollars were taken away from higher education, allowing growth in other areas of the budget.

**Stage 2: Diverting General Fund Revenues to Transportation Projects**

During the 2007 General Session, the Utah Legislature passed Second Substitute [House Bill 314](#) and Substitute [House Bill 383](#), which diverted a stream of sales tax revenues into the Transportation Fund. Money that would have gone into General Fund programs was transferred into the Centennial Highway Fund, the Critical Highway Needs Fund, and other special Transportation Fund projects. Like the constitutional change, nearly a decade earlier, these changes to state funding structure affected more than was immediately apparent. They eliminated the clear division of resources in the previous system.

**Effects**

Because of the bills discussed in the last section, in fiscal year 2007-08, \$426 million<sup>iv</sup> of sales tax was diverted into Centennial Highway Fund. At first glance, this diversion might not appear to affect public education. However, this change has hurt the General Fund's ability to provide for its critical needs, including higher education. If higher education

funding needs cannot be met with General Fund revenues, the Education Fund must make up the difference. Over the years since the constitutional amendment, an increasing percentage of higher education funding has come from money formerly dedicated to K-12 public schools, at a cost of \$250 million to \$761 million per year.<sup>v</sup>The fiscal year 2007-08 appropriation included an astounding one-year increase of \$250 million, resulting in a total \$761 million<sup>vi</sup> diversion from public schools to General Fund uses. This diversion of funds obviously leaves fewer resources available for public school needs, such as reducing class sizes, improving teacher salaries, and providing extra help for struggling students.

**Political Notes: Why Were General Fund Resources Diverted to Transportation Needs?**

The fuel taxes on gasoline and diesel are particularly well suited to funding both transportation construction and maintenance needs. They are well suited because they're based on the "benefits" principle of taxation—those that drive the roads pay for the roads. But because they're based on gallons consumed without a price component, the fuel taxes do not cover inflationary driven cost increases in materials (such as asphalt, concrete, and steel) or salaries. Periodic increases in the tax rate are necessary to cover these inflationary costs. When it became clear that the revenues from the fuel tax were not sufficient to cover growing transportation needs, lawmakers were faced with a choice: raise gas taxes or find the money somewhere else. Raiding the General Fund allowed them to avoid a rate increase, plus it gave them an excuse for limiting funds for public programs such as Medicaid and Health Services. In other words, they could fund their road projects while siphoning needed funds from other government programs.

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<sup>i</sup> Understanding Taxes – Income Tax, State & Local Taxes, [www.tax.utah.gov](http://www.tax.utah.gov)

<sup>ii</sup> Utah’s Education Funding Effort, Utah Foundation, Report Number 680, August 2007.

<sup>iii</sup> Utah Foundation, School funding vs. Tax Cuts: Utah’s political Choices

<sup>iv</sup> Governor Jon Huntsman, [Budget Recommendations, Fiscal Year 2010](#), p. 156

<sup>v</sup> Although the diversion to higher education dropped to \$256 million in fiscal year 2009-10, the current budget proposal recommends a \$185 million increase to \$441 million in the 2010-11 budget. Governor Gary Herbert, Budget Recommendations, Fiscal Year 2011, p. 93.

<sup>vi</sup> Governor Jon Huntsman, [Budget Recommendations, Fiscal year 2009](#), p. 96