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Highlights

- Utah's 12-year construction boom is coming to an end, bringing slower overall economic growth.
- The Olympics have softened the impact of the national recession in Utah and will provide a temporary boost in the first quarter of 2002.
- After the Olympics, Utah's economy is likely to pause, then grow moderately toward the end of the year.
- Although growth is still barely positive, Utah is experiencing its worst slump since the 1980s.
- The defense and exports sectors are performing better than in most states, providing a boost to Utah.
- Agriculture, energy, and minerals sectors are holding steady with little, if any, growth.
- Construction, tourism, and high technology sectors are declining.
- Unemployment is expected to rise with slow job growth, but overall wages are expected to increase greater than inflation.

Utah Foundation is a nonprofit, non-advocacy research organization. Our mission is to encourage informed public policy making and to serve as Utah's trusted source for independent, objective research on crucial public policy issues.

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Economic Report to the Governor 2002: Executive Summary

Utah's economy slowed during 2001, especially after September 11th. Since 1994, the rate of job growth has fallen from 6.2% to 0.9% in 2001. Utah's slowdown is part of a global recession. Current expectations are that the recession in the U.S. will be relatively short and growth will resume at a moderate rate during the second half of 2002. In Utah's case, a short pause in growth should occur in the months after the 2002 Olympic Winter Games, followed by moderate growth as 2002 closes.

End of Construction Boom. For most of the 1990s, construction was a major driving force behind Utah's rapid economic growth. There are currently around 70,000 construction jobs in the state, nearly three times as many as existed in 1990. Construction employment began to decline during 2000 and will continue falling during 2001 and 2002 as many large projects are completed, some of which were accelerated to host the Olympics. Nonetheless, construction jobs in 2002 will still be 5.8% of total non-farm jobs, slightly above the 1978 to 2002 average of 5.5%.

Olympics. With well over \$1 billion spent in Utah to host the Games, the Olympics have been softening the impact of the national recession in Utah. The main sources of Olympic-related spending are:

- Salt Lake Olympic Organizing Committee (SLOC): \$1,240 million
- Infrastructure investment: \$435 million
- Visitor spending during the Olympic Games: \$348 million
- ISB's spending to broadcast the Games: \$99 million
- Direct federal funds to state government for Olympics operations: \$17 million

The total amount of spending directly related to the Olympics is estimated to be approximately \$2.1 billion. Only \$1.3 billion, however, actually impacts the Utah economy because some of the value of the goods or services used to host the Olympics is created out of state. Most of the airfare visitors will pay to fly to Salt Lake, for example, goes to support airline operations outside Utah.

The total employment impact is estimated to be over 35,000 job years. Employment grows steadily from about 1,100 in 1997 to over 25,000 during February 2002. Employment almost doubles from about 7,300 during 2000 to over 12,500 during 2001, and doubles again during the Games, before falling off to an average of 6,400 for 2002. The largest employment impacts are in the services sector, including SLOC employees, followed by trade and construction. Statewide employment growth rates in 2001 and 2002 would be much lower were it not for the Games.

While Utah and the mountain states experienced robust economic growth in the 1990s, that growth has been slowing for a few years.

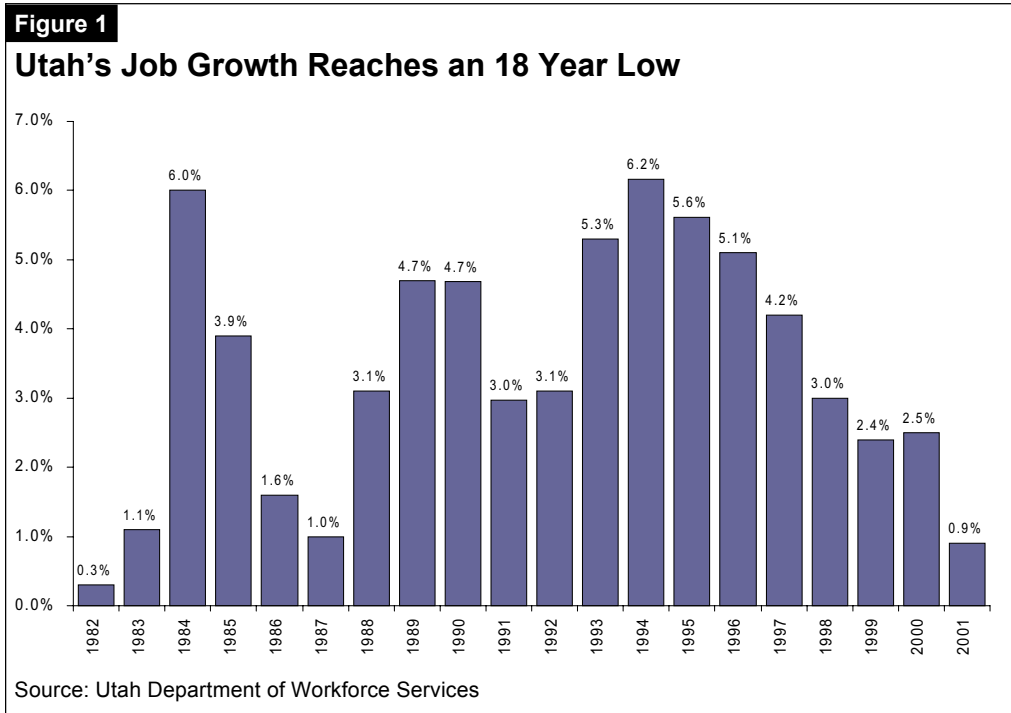
Outlook. The outlook calls for a brief pause after the Olympics before the economy returns to moderate growth as 2002 closes. Utah's unemployment rate in 2002 should be lower, and job growth higher than nationally, but the pace of activity will be slower than during the late 1990s. Population growth should slow in the months after the Olympics as the frenzy of preparations ends, and many of those helping to host the Games leave the state. Reflecting the Olympics build-up, net migration remained strong during 2001, with about 14,200 more people moving into the state than leaving. During 2002, however, net migration is expected to fall to 3,000. Still, with a record number of births, Utah's population will grow 1.7% in 2002, which is down significantly from the mid-1990s, but well above the nation.

International, National, and Regional Context

Global Recession. Utah's current slowdown occurs against the backdrop of a very weak international economy and a broadening U.S. slump. All the world's major industrial economies are in recession. Japan's economy grew at less than 1% per year during the 1990s; one-fourth the rate of the 1970s and 1980s. Though Europe's performance over the past decade was better than Japan's, its major economies are currently growing slowly if at all. The industrializing economies, which depend on the industrial world to purchase their exports, are slumping too; some mired in depression. As the U.S. recovers during 2002, the world economy should pick up as well. With the current slack in world demand, Utah's exports are about \$1 billion, or 25%, lower than would be the case with robust growth overseas.

National Recovery. For the U.S., 2002 will be a year of moderate recovery as the recession ends. Consumer spending will grow 1.3%, but GDP will grow just 0.4%, as investment falls 5.3%. However, growth will become stronger in the second half of 2002. Positives for both businesses and consumers include low interest rates and a stable inflation outlook.

Utah and the Mountain Region in Parallel. While Utah and the mountain states experienced robust economic growth in the 1990s, that growth has been slowing for a few years. Utah had been one of the top ten states in income growth and



has fallen to slightly below average growth in recent reports. Utah's latest employment growth is barely positive, but better than many states that are experiencing declines. Utah's performance is directly paralleling the performance of the mountain region, which has dramatically slowed in 2001.

Themes of the Past Year

The broad based and rapid growth of the 1990s reflected Utah's deepening integration with the national economy. The global contraction has dampened commerce between Utah businesses and their suppliers and customers in other states and countries. With in-state construction continuing to decline, a booming economy-wide recovery during 2002 is unlikely. Though the state's economy has slowed, Utah continues to out-perform the nation, and the current situation is really just a pause.

Sub-themes involve the performance of various sectors. Defense and merchandise exports are up; agriculture, energy and minerals are level; and construction, tourism and high technology are down.

A Pause in Growth

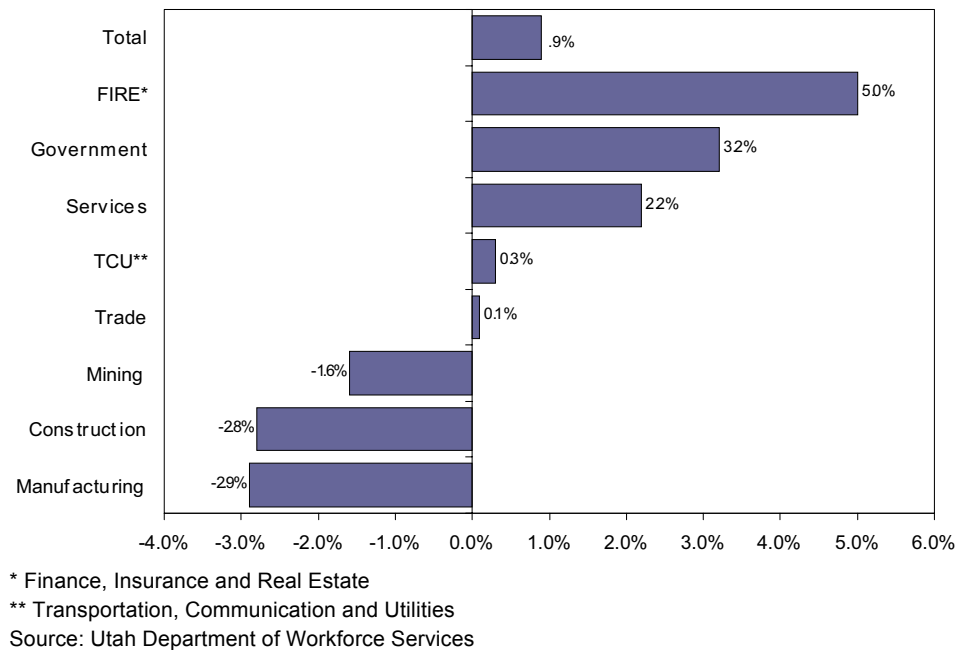
Population. Though Utah's population grew a robust 2.2% during 2001, with net in-migration of 14,200, much of this growth reflects the Olympics build-up. During 2002, population growth is expected to slow to 1.7%, with net in-migration of just 3,000. The 2002 pause marks the end of a decade of booming growth that saw several years in which 30,000 or more people moved into the state.

According to Census 2000, Utah's population increased 29.6% from 1990 to 2000, growing twice as fast as the U.S. over the decade. Utah ranked fourth among states in population growth from 1990 to 2000. Utah also continues to have a distinctive demographic profile. The state's population is younger, women tend to have more children, people on average live in larger households, and people tend to survive to older ages in comparison to other states.

Jobs and Wages. Near the end of 2001, Utah's economy was experiencing its worst slump since the 1980s. Nonfarm employers

Figure 2

All Large Industries Growing Slowly Employment 2000-2001

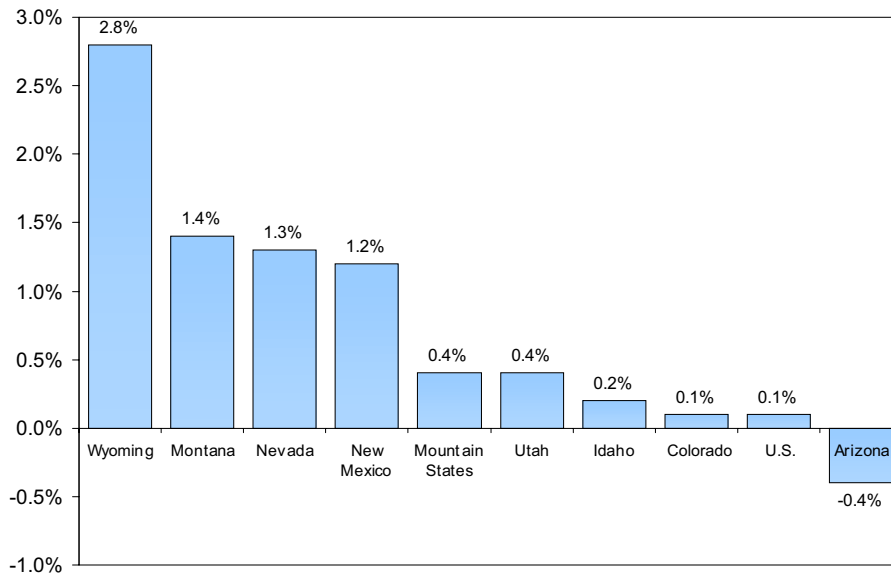


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Figure 3

Utah and the Mountain States Faring Better Than the Nation in Nonagricultural Employment Growth

October 2000-2001



Source: U.S. Bureau of Labor Statistics

Utah's defense industry continued to rebound in 2001, as base closures and realignments in other states shifted jobs and military spending to Utah.

added just 10,000 net new jobs in 2001, a growth rate of 0.9%. This is Utah's slowest job growth since 1983. It is only a fraction of the long-term average of 3.5%. Correspondingly, Utah's 4.4% unemployment rate for 2001 is a nine-year high. A monthly average of about 50,000 individuals were out of work in 2001.

The 2001 rate of job growth in Utah's major industrial divisions ranged from -3% in manufacturing and construction to 5% in finance, insurance, and real estate. The strong growth in finance results

from low interest rates sparking a jump in mortgage refinancing and other interest-sensitive transactions. In 2002, construction will drop even more, but most industries should see some minor improvements.

In 2001, Utah's average annual nonagricultural pay was \$29,700 – up 3.1% from the 2000 average, which increased by 4.8%. 2001 is the seventh year in a row that wages have grown faster than inflation.

Defense and Exports Up

Defense. Utah's defense industry continued to rebound in 2001, as base closures and realignments in other states shifted jobs and military spending to Utah. Hill Air Force Base has become the Air Force's new "center of excellence" for low-observable technology. This new classification, the result of a prime military contractor relocating to Hill, will help ensure the viability of this large Utah employer. Although the defense industry in Utah and in the US as a whole has decreased significantly since the end of the Cold War, in the past few years this trend has shown signs of reversing. Defense spending in Utah in 2000 totaled \$1.91 billion, up nearly 34% from 1999. Increased activity is expected to continue in 2002 as a result of September 11th.

Merchandise Exports. Utah's merchandise exports grew about 5% to an estimated \$3.4 billion during 2001. Although Utah's exports more than doubled during the 1990s, most of the growth occurred before 1997. Since then, exports have remained in the range of \$3 billion. If the Asian economies were as strong today as they were in the early 1990s, Utah's exports would likely be in the range of \$4.0 billion. Over the long term, economic globalization will spur both

trade and growth. In the short term, Utah's exports may not grow rapidly, but they appear to have held up well relative to other states and the nation. So exports may be softening the national recession's effects in Utah.

Agriculture, Energy and Minerals Level

Agriculture. Net farm income in Utah fell from 1994 to 1996 as livestock prices fell, and has yet to recover. Although the prices for livestock and other farm products have been increasing in recent years, and incomes have risen, at \$258 million in 1999, net farm income remains well below the \$321 million peak of 1993. The growth trend of recent years is likely to continue in 2001 and 2002, though at a slower rate.

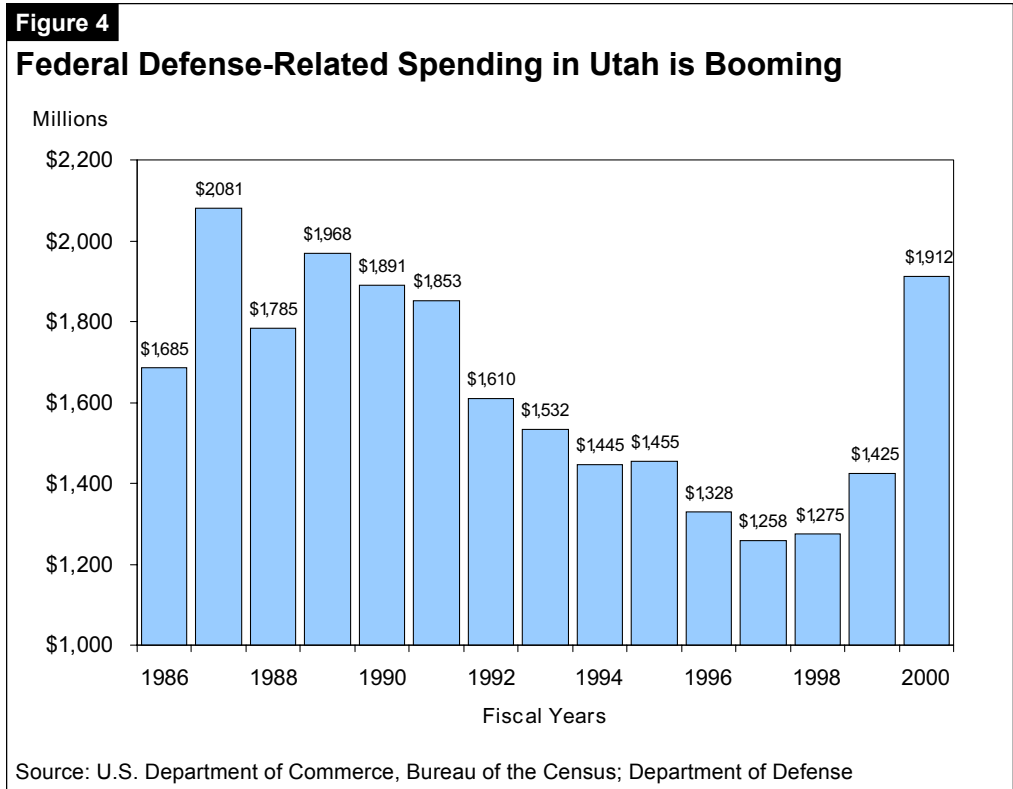
Energy. While crude oil production declined slightly in 2001, natural gas production continued to increase. Utah coal production has settled around 26.5 million tons per year for the past 5 years, as coal employment has fallen from 2,100 in 1997 to under 1,600 in 2001.

Minerals. The estimated value of mineral production in Utah was \$1.9 billion in 2001, marginally higher than the total for 2000, despite a year of continued low metal prices and a faltering national economy. The value of base metal production, which includes copper, magnesium, molybdenum, and the like, was \$703 million; industrial minerals production, which includes sand, gravel, crushed stone, potash, lime, gypsum, and others, was \$514 million; coal production was \$469 million; and precious metals production, gold and silver, was \$236 million. In 2002, the value of mineral production in Utah is expected to remain near the 2001 level of \$1.9 billion.

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Construction, Tourism, and High Tech Down

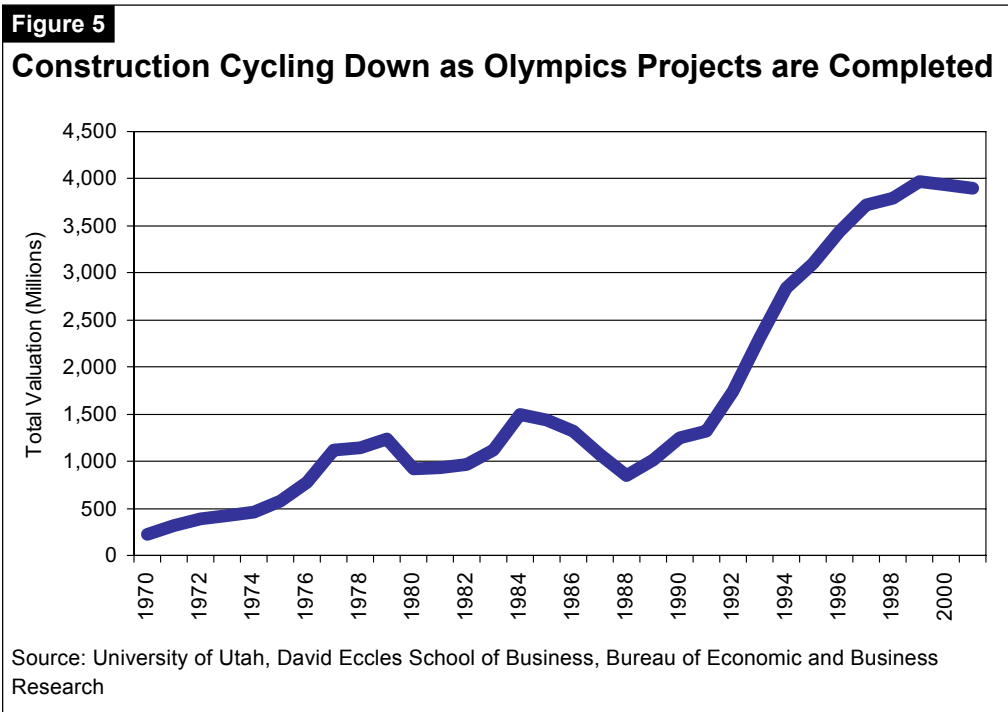
Construction. Construction employment fell 3%, from 71,500 to 69,500 during 2001. Despite the decline in employment, at \$3.9 billion, the value of construction was within 1% of the all-time high set in 1999. The near record valuation is due, in part, to the continued strength of the residential sector, which in 2001 produced nearly 19,000 new units valued at \$2.25 billion.



The surprising strength of the residential sector is due in large part to favorable mortgage rates – the 30-year conventional mortgage rate has been below 7% for most of the year. A notable feature of the residential sector in 2001 is the rebound in multifamily construction activity. Since 1998 there has been a steady decline in the number of new multifamily units, however, this year there has been an abrupt reversal. The number of new multifamily units is up over 30% in 2001, driven primarily by a surge in new condominium construction.

Nonresidential construction has not fared as well. Valuation dropped nearly 18% to about \$1 billion, which was the lowest level of nonresidential construction in five years. The sector began the year with exceptional first quarter strength but in subsequent quarters became weaker. The lack of any large multimillion dollar projects in 2000 has hurt nonresidential construction. The largest project statewide was the new Salt Lake City Public Library with a valuation of \$60 million.

Tourism. In contrast to 2000, when consumer optimism and robust spending helped offset several external shocks to the industry, the effects of an international, national, and regional economic slowdown, combined with the effects of September 11th, have negatively impacted the state’s tourism economy. Helping to mitigate the negative effects of the economic slowdown and the terrorist activity has been the increased media interest and improved visibility the state has enjoyed as the Olympics approach.



The addition of Olympic facilities, resort expansions, hotels, and infrastructure improvements have increased the state’s tourism capacity and improved its competitive positioning.

High Tech. Utah’s high tech sector peaked during 2000 with employment losses appearing to accelerate during 2001. In addition to the economic factors, there are other issues affecting the overall stability and vitality of high tech. For example, with very few exceptions, Utah has no large corporate headquarters conducting research and development activities in the technology industry. Rather than attracting technology companies, many of Utah’s premier high tech companies have been acquired, bought out, or moved beyond Utah’s borders. The companies that once formed Utah’s

high tech core are either gone or struggling. Identifying the reasons and implementing solutions may pose one of Utah's greatest challenges.

Significant Issue: State Budget Hold Backs

During March 2001, the Governor's Council of Economic Advisors realized state government revenue growth would slow faster than anticipated. So forecasted revenue growth was lowered for both FY 2001 and FY 2002.

To address decelerating tax collections, the state initiated budget hold backs. For FY 2001 \$51.6 million in new building projects and \$5 million in state park renovations, for a total of \$56.6 million, were held back. These hold backs included construction funding for four new higher education buildings plus the purchase of another. Since three-quarters of the fiscal year had already elapsed for ongoing state programs, these particular projects were chosen because the funds had only recently been appropriated and the projects had not yet started. Significant funding cuts to ongoing programs in FY 2001 would have been difficult.

A second round of hold backs was instituted following September 11th. Because of the pronounced slowdown in economic activity during October and November 2001, additional declines in revenue growth are expected, leading to an estimated budget shortfall of \$198 million for FY 2002. An additional \$24.6 million in budget cuts were instituted plus another \$18.6 million in savings that can be realized by replacing appropriated funds with bond proceeds for two new higher education facilities. Other sources of revenue have also been identified to fill the budget shortfall if necessary.

Looking Ahead

After pausing during the first half, Utah's economy should resume moderate growth during 2002. Job growth should pick up to 1.1% for the year. The unemployment rate is expected to increase to 5%, the highest since 1992. For the eighth year in a row, wages should increase faster than inflation in 2002.

For the first time in more than a decade, the revenue forecasts built into the state budget were higher than realized and corrective measures in the form of spending hold backs were required. The Governor's budget for FY 2003 addresses the tightened fiscal environment without economically harmful tax increases and without disrupting core responsibilities such as education, public health and safety, and transportation.

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