Governor Jane Dee Hull delivered her last State of the State address to the Legislature on 14 January 2002. As in at least 40 other states, Arizona faced the prospect of not only redrafting the FY 2003 budget but also adjusting the FY 2002 budget.

The Governor’s first priority have always been children; improving the K-12 education system and health care coverage for children. She also warned that the economics of the time dictated no new programs and warned against eliminating programs, such as the state lottery, that contribute to the General fund. She urged the Legislature to put homeland security, the budget, and the economy “on the front burner” along with education (State of the State).


ECONOMY

Per capita income was $24,988 in 2000 (revised 30 June 2002) while median family income was $46,723. At the beginning of the 2002 session, non-farm employment had dropped by 12,700 persons (-0.57 percent) from January 2001. The unemployment rate was 5.4 percent (Department of Economic Security, Research Administration [DES]). Since November of 2000, the number of unemployed had risen by 43,000. Construction employment dropped in November 2001 by 3.2 percent. Approximately two-thirds of the economy rested with the consumer—and consumer confidence had dropped with layoffs announced or impending (DES).

The only positive forecast was by the Governor in her State of the State address when she predicted, “the economy will improve.”

DEMOGRAPHICS

Arizona’s population, 5,130,632, grew by 40 percent between 1990 and 2000. This growth ranked second behind Nevada’s 66.3 percent increase. Arizona ranks fifth in the under five-age group; 17th in the 5-17 age group (school age); ninth from the bottom in the 18-64 age group; and 21st in the 65 and over category. The median age is 34.2, the ninth youngest in the
nation. All of this results in a dependency ratio of 65.7 non-working age per 100 of working age—ninth highest in the U. S. (Economic Report to the Governor, 42, 47-48).

**POLITICAL COMPOSITION**

The Republican Governor enjoyed a 36 Republican to 24 Democrat House of Representatives, but faced a Senate that was evenly divided with 15 Republicans and 15 Democrats.

**BUDGET PROCESS**

Although Arizona is classified as a biennial budget state, recent budget reform law has identified 12 large agencies as “annual budget units” requiring them to submit annual budgets starting in FY 2004—the practice prior to FY 2000. These units are among the largest General Fund agencies (Office of Strategic Planning and Budgeting [OSPB]). Other agencies would continue to submit budgets biennially, however the Governor has the discretion to require biennial budget agencies to submit budget estimates more often than every two years.

The National Association of State Budget Officers (NASBO) periodically publishes *Budget Processes in the States* as a guide for students and practitioners of state budgeting. This publication is the source of a short summary of Arizona’s budget process.

The Office of Strategic Planning and Budgeting (OSPB) supports the governor in creating the Executive Budget. The Director, also a member of the cabinet, is appointed by the governor and serves at the governor’s pleasure. Functions include: revenue estimating, legislation review, management analysis, planning, program evaluation, preparation of the Tax Expenditure report, economic analysis, and demographic analysis. The director and deputy director supervise 24 personnel including a strategic planner, two economic positions, and budget analysts (NASBO).

Arizona’s budget calendar opens in June when budget guidelines are sent to the agencies. The agencies submit their requests to the governor on 1 September. The governor holds agency hearings during the November-December timeframe. The governor submits the Executive Budget to the legislature in January. At that point, the legislature adopts a budget from January through April (NASBO). That is the normal schedule, but it bore little resemblance to the 2002 session--Special Sessions were required.

**EXECUTIVE BUDGET**

**Revenue—General Fund**

One of the starting points for the Executive Budget is the revenue estimate. The responsible agencies are OSPB and the Department of Revenue. Both the governor and the legislature can adjust the estimate. Although a consensus forecast is not required, it became the practice in
recent years. The FY 2004 forecast involved a conference co-hosted by the Department of Revenue and the Federation of Tax Administrators. By state law, the estimate must be published.

Actual Tax Revenue for FY 2001 was $6.26 billion; the FY 2002 estimate was $5.92 billion, a 5.32 percent shortfall. The Tax Revenue estimate for FY 2003 was $6.18 billion, an increase of 4.22 percent.

Actual Other Revenues for FY 2001, $262.24 million; the FY 2003 estimate was $227.0 million, a 13.44 percent shortfall. The FY 2003 Other Revenues estimate was $210.0 million, a 7.49 percent shortfall.

Factoring in adjustments, such as Urban Revenue Sharing, the Grand Total of Revenues shows a 5.87 percent shortfall from actual FY 2001 to the FY 2002 estimate, to a 3.1 percent increase to the FY 2003 estimate.

The difficulty of the state budgeting formulation during adverse economic conditions was illustrated by the necessity of Governor Hull submitting her third Executive Budget in 15 months on 21 March 2002 for FY 2003. Her priorities and fiscal principles (Governor Hull)(OSP) included:

- No new taxes on the citizens of the state;
- minimize the impact on classroom funding for K-12;
- maintain important public safety programs;
- sustain important health service programs; and
- deliver important programs vital to economic health and growth.

The new Executive Budget called for a 2.5 percent reduction in most agencies. Some agencies should see some of these reductions offset by costs of servicing driven by caseloads. The Legislature voted to abolish the Governor’s Office of Equal Opportunity. The Governor saved the agency through a line-item veto, but recommended a 4.0 percent reduction in General Fund support. The Governor showed her support for the Arizona Lottery by recommending a $723,900 increase in the FY 2003 budget. Although she recommended a $2,101,100 General Fund reduction for the Arizona Health Care Cost Containment System (AHCCCS, Arizona’s Medicaid), this was more than offset by a $10,000,000 match funding infusion recommendation from the Alcohol Tax & Health Care Fund.

**FINAL BUDGET**

** Appropriations**

The Arizona Constitution limits appropriations to 7.41 percent of personal income. A two-thirds affirmative vote of the legislature is required to pass a revenue increase.
Total Operating Spending for FY 2003 is shown in Table 1 (Joint Legislative Budget Committee [JLBC]). The figures do not reflect direct state Capital expenditures. The General Fund was the largest funding source with $6,194.3 million (38 percent) while Federal funds provided $4,656.6 million (28 percent).

**TABLE 1**

**TOTAL OPERATING SPENDING**

<table>
<thead>
<tr>
<th>Budget Unit</th>
<th>Spending (Millions)</th>
<th>Percent of Total Spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>AHCCCS</td>
<td>$3,552.7</td>
<td>21%</td>
</tr>
<tr>
<td>Education (K-12)</td>
<td>3,433.7</td>
<td>21</td>
</tr>
<tr>
<td>Universities</td>
<td>2,143.2</td>
<td>13</td>
</tr>
<tr>
<td>Economic Security</td>
<td>1,775.2</td>
<td>11</td>
</tr>
<tr>
<td>Transportation</td>
<td>1,209.4</td>
<td>7</td>
</tr>
<tr>
<td>Health Services</td>
<td>738.6</td>
<td>5</td>
</tr>
<tr>
<td>Corrections</td>
<td>670.9</td>
<td>4</td>
</tr>
<tr>
<td>Administration</td>
<td>648.8</td>
<td>4</td>
</tr>
<tr>
<td>Other Agencies</td>
<td>2,265.6</td>
<td>14</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$16,458.1</strong></td>
<td><strong>100 %</strong></td>
</tr>
</tbody>
</table>

A comparison of General Fund FY 2003 increases above or funding below FY 2002 shows: Department of Education, $300,000 below FY 02; Universities, $23.4 million above FY 02; Community Colleges, $600,000 above FY 02; AHCCCS, $153.4 million above FY 02; Department of Health Services, $10.5 million above FY 02; and Department of Corrections $29.6 million above FY 02. As in other states, the Department of Corrections has received the greatest percentage of increase over time—131.1 percent increase from FY 1993 to FY 2003.

Capital outlays for FY 2003 were appropriated through the Arizona Department of Administration and the Arizona Department of Transportation. These departments would allocate funds to the projects. Table 2 depicts the results.

Examples of Building Renewal and Individual Projects under the Department of Administration include: Mental Health Center Building, Exposition and State fair Fund, State Lottery Fund, Pioneers’ Home, and State Hospital Construction Fund. Examples under the Department of Transportation include: Airport Planning and Development, De-Icer buildings, Highway Construction, and Asbestos and Lead Inspections.

Other Funds sources include derived funds from fees and other user sources. Examples of these funds are: State Aviation Fund, Game and Fish Fund, and Vehicle License Tax Special Account.
TABLE 2

CAPITAL OUTLAY

FY 2003

<table>
<thead>
<tr>
<th>Building System Summary</th>
<th>General Fund</th>
<th>Other Funds</th>
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</thead>
<tbody>
<tr>
<td>Department of Administration</td>
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</tr>
<tr>
<td>Building Renewal</td>
<td>$0</td>
<td>$4,726,200</td>
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<tr>
<td>Individual Projects</td>
<td>2,642,900</td>
<td>23,573,500</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>2,642,900</td>
<td>28,299,700</td>
</tr>
<tr>
<td>Department of Transportation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Building Renewal</td>
<td>$0</td>
<td>$1,634,000</td>
</tr>
<tr>
<td>Individual projects</td>
<td>0</td>
<td>252,406,000</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>0</td>
<td>254,040,000</td>
</tr>
<tr>
<td><strong>Total Appropriations</strong></td>
<td><strong>$2,642,900</strong></td>
<td><strong>$282,339,700</strong></td>
</tr>
</tbody>
</table>

SUMMARY/CONCLUSION

The burden of reduced revenue was a tremendous challenge for the Governor and the Legislature. At this writing, education was spared damaging cuts, although minor reductions were necessary. The rainy day fund was used for its intended purpose and the tobacco fund was diverted. The Governor made use of her veto power when it was obvious the first budgets were out of balance and the FY 2003 budget was almost recreated from scratch.

Governor Hull assumed the governorship under unfortunate circumstances after a trailblazing career in the legislature and state office. Her final year as Governor reflected great credit on herself and the office.

REFERENCES

Department of Economic Security, Research Administration. Arizona’s Workforce, (Phoenix, AZ), 20 December 2001
http://www.de.state.az.us/

Governor’s Office of Planning and Budgeting. Economic Report to the Governor2002 (Salt Lake City).


