Budgeting, Taxing, and Spending in Arizona

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Though it falls far short of accounting for what the state spends each year, the general fund budgeting process is a major focal point of Arizona state politics (Note 1). Each year making the general fund budget requires considerable wheeling and dealing between the governor and legislators and among partisan and other groups in both houses of the legislature. The type and level of stress in budgeting, however, varies with several factors such as the partisan composition of the legislature, which party controls the governorship, the amount of partisan cohesion among legislators, and the anticipated level of revenue available for distribution.

In 2008, revenue shortages largely drove events. Hard hit by an economic downturn budget-makers were able to hold on and avoid severe cuts in most state services. Legislators, however, will have to come back and make revisions in the 2009 budget if, as many anticipate, revenue projections do not pan out. Arizona has been hit by a national economic downturn but especially hard by the battered housing market. It may take several years for the state to recover from the economic slowdown.

This report examines the general characteristics of the general fund budget, with particular emphasis on how the process unrolled in 2008, and concludes with a critique of the process and financial issues facing the state.

OVERVIEW

Under the executive budgeting system adopted in 1966, the governor is the central budget-making authority in Arizona. Department heads submit their spending plans to staffers in the Governor’s Office of Strategic Planning and Budgeting (OSPB) who review and revise them in accordance with the governor's priorities and in light of anticipated revenues. The governor then sends his or her proposals to the legislature. Legislators, however, are not dependent on information supplied by the governor. Since 1966, they have effectively used the Joint Legislative Budget Committee (JLBC), which has its own permanent staff, to do independent research, analyze the governor's budget recommendations, and prepare alternative budgets for each agency. The committee consists of the appropriations committees in each house. The chairs of the House and Senate committees rotate heading the joint committee. The JLBC’s budget recommendations go to the appropriations committees in the House and Senate. These committees draft a general appropriations act for the entire body, usually after holding public hearings. The adoption of the general budget requires a majority vote of the entire membership, 31 house members, and 16 senators.

In Arizona, Republicans have controlled the state House since 1966—the year the one-person, one vote standard brought about the present structure of the legislature—and have lost
control of the Senate on only a few occasions since that time. For much of the last three decades, however, the state has had divided government with one party controlling the governor's office and the opposite party controlling one or both houses of the legislature. In 2006 Democrats in Arizona, as elsewhere, made considerable gains in the general election—the Democratic governor Janet Napolitano was easily re-elected and Democrats picked up six seats in the state legislature though they remained in the minority in both houses. In January 2007, the line-up in the new Senate was 17 Republicans, 13 Democrats. In the House, it was 32 Republicans and 28 Democrats.

In recent years, Democratic gains, together with divisions among Republican legislators, have helped push the legislature from the right and closer to the middle on budgetary issues. Political power has shifted to a coalition of Democrats and moderate Republicans generally aligned with a popular and politically skillful Democratic governor. The underlying political dynamics could change with, for example, the election of a new governor, Republican gains in the legislature, or a successful effort by conservative Republicans to weed out or somehow control moderate Republicans. For the time being though, Democrats and moderate Republicans are in control and the direction of the legislature is toward the middle.

Changing political dynamics, aided to a certain extent by the revenue shortfall, have also brought changes, at least in the short run, in the budget-making process. Aspects of the new approach surfaced in 2007 in the Senate controlled by Republicans. The usual route had been for the Senate and House to agree on a budget before negotiating with the governor. This time the governor came on board in the initial formulation of the budget in the Senate and stayed on to negotiate the final budget with Republican leaders in the Senate and Democratic leaders in both chambers. Republican leaders in the House, who represented the more conservative wing of the party, got to the bargaining table too late to have much of an impact on the document.

In 2008, the governor and legislative leaders, with the exception of the more conservative Republicans, once again did most of the heaving lifting. This small group and/or their staffs worked behind closed doors, keeping journalists and even most legislators in the dark as to what was happening until they were ready to present the budget plan to the legislature as a whole. They bypassed the regular processes. The once powerful appropriations committees controlled in both houses by conservatives played a diminished role, serving mostly as window dressing.

In addition to the political dynamics at work, the Arizona budget process, like that in other places, takes the form of a “succession of responses to revenue forecasts” (Moore, 2003). In Arizona dueling revenue projections come from the governor and the legislature, the OSPB and the JLBC. Much of the early negotiating between governors and legislators centers on trying to reach agreement on just how much money the state can expect to take in the next fiscal year and on just how much money they have to work with in putting the budget together. Revenue estimates, though, are not fixed and may change while negotiations are going on. At times, new revenue projections showing an increase in anticipated revenue have helped resolve impasses between the governor and legislative leaders. In 2005, for example, a new projection that the state was going to have several more million in revenues than previously expected made it possible for each side to get what they wanted and to wrap up their negotiations. In 2008, on the other hand, projections kept getting worse, causing a feeling of panic and despair.
The Arizona Constitution (Article 9, Section 3) requires a balanced state general fund budget. This task is complicated somewhat by various legal constraints when it comes to both raising revenues and controlling spending. On the revenue side, for example, Proposition 108 adopted in 1992 requires a two-thirds majority of the total membership in the House and Senate to increase any tax or revenue source or to make any “net increase in the state’s revenue collection”—a requirement that, under existing political conditions, makes even the smallest increase very unlikely. Previously, changes of this nature required only a majority vote. When it comes to spending, budget-makers have to live with the fact that over 60 percent of what goes in to the general fund budget qualifies as mandatory rather than discretionary spending. The mandatory spending is largely formula-driven, for example, determined by changes in the number of schoolchildren or in the number of people eligible for health care services. With continued growth, state spending increases are on automatic pilot of six to seven percent a year. A good portion of this mandated spending is the result of measures adopted by the voters on the ballot (Note 2). These mandates are difficult to change because of Proposition 105, adopted in 1988, which requires a three-fourths vote in both legislative chambers to make any changes in measures approved by the voters. In addition, any change must “further the purpose” of the ballot proposition.

Although state lawmakers have had only a limited range of discretion when it comes to spending cuts and raising revenues, they have shown a remarkable ability to adjust to revenue shortfalls and achieve this balance without doing severe damage to major programs. Legislators have accomplished this in various ways, other than or in lieu of making major program cuts. They have been quick to deplete the state’s rainy day fund (technically the Budget Stabilization Fund) and, striking a much larger vein, raided special “off budget” funds fed by earmarked state revenues and set aside for particular purposes such as highways, ground water clean up, and job training. At last count, there were 270 non-appropriated special and revolving accounts out of which legislators can draw funds if necessary (Note 3). The budget has also been "balanced" by moves such as counting revenues not yet received or postponing the payment of bills to the next fiscal year. An example of the latter is the education "rollover" through which the legislature postpones payments to schools.

Legislators further cope by imposing expensive mandates on local governments. County officials, for example, have been stuck with large fiscal burdens in the area of health care. Municipalities enjoy a more independent status vis-à-vis the state and are not as heavily impacted by mandates. They have, however, had to fear “takeaways,” that is, legislative decisions to redirect revenue streams away from cities and towns into the state budget. In 2003, for example, the legislature sliced the share of the state income tax earmarked for municipalities from 15 percent to 14.8 percent and diverted some of the funds going to localities out of the highway fund into the general fund.

The general fund budget draws largely on sales and income tax revenues and distributes funds among a wide range of activities. Over the past several decades, K-12 education has claimed the largest share, currently 46% of the spending, though, as Table 1 indicates, the rate of growth has been greater for health services and the AHCCCS program, the state’s version of Medicaid, in recent years.
BUDGET MAKING IN 2008

In the summer of 2007, the governor and legislative leaders hammered out a general fund budget for fiscal 2008 that called for an expenditure of $10.6 billion dollars, an increase of $600 million or 6 percent over the previous year’s budget. Shortly after adopting the budget, state lawmakers began receiving warnings that revenues were falling short of projections. The amount of the anticipated shortage grew with subsequent reports, moving from $970 million in January 2008 to 1.4 billion four months later.

Experts put much of the blame for the slower than anticipated flow of revenues from the sales and income taxes to a severe downturn in housing and its trickle down impact on construction, a mainstay of the economy. Anyone looking for disturbing evidence of the economic hardships faced by Arizonans in 2007-2008 could point to numbers relating to the growth of home foreclosures, food stamp usage, unemployment, bankruptcy, and related indicators of distress. In the midst of recession-like conditions, the general fund shortfall in Arizona was among the highest in the nation. In the spring, a national study by the Center on Budget and Policy Priorities had Arizona ranked first when they measured deficits as a percent of total state spending.

Although legislators sitting on the appropriations committees went to work in joint meetings early in January to address the budget deficit problem, its members were well aware that the budget fix, in fact, would probably be determined not by them but through direct negotiations between legislative leaders and the governor. After several weeks of behind the scenes bargaining, legislative leaders and the governor came up with a compromise package in April 2008 that received bipartisan support in the legislature. An unusual mix of Democrat and Republican legislators, five Senators and three House members, voted against the package, though they gave different reasons for doing so. The budget fix relied upon four moves: (1) taking $487 million from the state ‘rainy-day” fund; (2) cutting $311 million in spending for various state programs; (3) “sweeping” $300 million out of various special-purpose funds; and (4) “rolling over” the final K-12 schools monthly payment into the next fiscal year, thus taking $272,000 off this year’s budget.

Immediately after making the adjustments in the fiscal year 2008 budget, state budget makers faced an even a greater challenge of dealing with a projected deficit of nearly $2 billion for the fiscal 2009 budget, a task that had to be accomplished before July 1, 2008 to avoid at least a partial shut down of the state government.

When first considering the 2009 budget the governor vowed to protect signature investments in education, children’s programs, and services for the state’s most vulnerable citizens from cuts. Chief among her recommendations for coping with the shortage was borrowing for school construction rather than following a pay-as-you-go policy. The latter was costing the general fund over $500 million a year. Republican leaders had long opposed borrowing for this purpose. In 2007, they successfully scuttled the governor’s proposal to move in this direction. Borrowing, they argued, generated heavy debt-financing costs and unfairly shifted the burden to latter generations. The governor, on the other hand, contended that schools were long-term projects benefiting not only current taxpayers and students but taxpayers and
students yet to come and should be paid for over the long run by borrowing rather than out of current revenues, as where roads and other capital projects.

Faced with the huge shortfall in revenues, Republican leaders changed their position in 2008 and conceded that some borrowing for schools was in order but also insisted that more emphasis should be place on spending cuts. The ensuing negotiations with the governor on the fiscal 2009 budget centered largely on finding a satisfactory balance between borrowing and spending cuts. In the end, the governor and the Democrats conceded just enough to win over a handful of moderate Republicans in the House and Senate. This was all they needed to secure a narrow victory in both houses.

Legislative leaders and the governor and/or her staff worked several weeks behind closed doors to resolve the differences. Each played the game of chicken, waiting for the other side to blink, as July 1 neared. A survey taken in the middle of June indicated that the public was far more inclined to blame the legislature than the governor for the impasse – 52% said they would blame the legislature if the state government shut down, 19% said they would blame the governor, and 13 percent said they would blame both (Morlock, 2008). The governor let it be known that she was at work preparing for a shut down if matters could not be worked out. Legislative leaders, showing some nervousness, blinked a bit and reassured the public that a shut down would be avoided because a deal would be made.

While negotiations with the governor and the Democrats were on hold, a small group of Republicans from the House and Senate, including the party leaders in the two houses, met in several Republican-only meetings in an effort to arrive at a united party stand. They were, however, unable to come up with a consensus on spending and borrowing issues. With this, and continued pressure to come up with a budget agreement before the July 1 deadline, the Republican Senator Tim Bee, Democratic legislative leaders in both houses, and the Governor went to work on a compromise. Taking one last shot late in the session, House Republican leaders attempted to rally Republicans behind a budget that differed in several respects from the bipartisan budget being put together in the Senate, relying more heavily on spending cuts and less heavily on borrowing. The plan though failed to secure enough support in the Republican caucus to come to a floor for a vote. Reporters quoted a House Republican as saying: “It’s unfortunate that we continue to have traitors among us in the Republican caucus” (Small, 2008).

On June 27, 2008, the legislature adopted the plan worked out in the Senate for fiscal year 2009. It called for the expenditure of $9.9 billion, some $700 million less than legislators had budgeted last year. The seven bills that made up the budget package were passed by very narrow margins in both bodies. In the Senate, where 16 votes were needed, the vote on six of the bills was 16-10, four Republicans joining 12 Democrats to make up the majority. One budget bill passed the Senate by a vote of 17-9. In the House, four Republicans also broke rank and voted with the Democrats to produce a 31 to 29 vote on the budget bills. A similar coalition had produced the budget last year. One Democratic legislator noted: “for the second year in a row, a budget backed by the minority Democrats and Democrats Gov passed with the help of a handful of Republicans” (Pitzl and Benson, 2008).
The work was similar to that done to repair the FY 2008 budget by including spending cuts ($343 million), fund transfers ($359 million, including $20 million from the rainy day fund) and a rollover of education payments into the next fiscal year ($330 million). The budget added a significant new wrinkle in providing for borrowing monies for K-12 school construction, a move that saved the budget $527 million. Most Republican legislators were unhappy about the results of the budgeting exercise. Most voted against the spending plan. They wanted deeper and permanent spending cuts and much less borrowing for school construction, if any borrowing at all.

On the revenue side, the budget makers anticipated $11 million for the general fund through new or higher fines and new or higher fees for various permits and services. They also hoped to bring an unspecified amount of money (the governors’ office had predicted as much as $90 million) into the general fund in 2009 through an expanded photo radar system designed to catch speeders and red light runners on state highways. Governor Napolitano initially proposed this program and defended it largely as a safety measure. Given the deficit problem, though, she and many legislators also welcomed it as a means of generating revenue. Budgeters further looked to an upgraded state lottery as a way of generating revenues to support $1 billion in bonding for an ambitious construction program at the state’s three universities. Budget specialists saw planned changes in the lottery system; for example, adding more prizes and ticket-vending machines, and doing more advertising as bringing in some $1.2 billion over the next ten years.

Unlike most recent sessions, the legislative session in 2008 did not produce any tax cuts. Republican leaders, backed by the Arizona Chamber of Commerce, had succeeded in securing the passage of a measure that permanently repealed the state equalization property tax that funneled money to local schools. This had no meaning as far as the current budget deliberations were concerned — the legislature had suspended the tax in 2007 and it was not scheduled to go back into effect until 2010. At that time, analysts predicted that it would bring in $250 million a year. Opponents of the tax hoped to eliminate the possibility of its return. Opponents of a permanent repeal argued that the legislature did not have to act now to prevent the tax from coming back into effect and should wait a year to see if the revenue was going to be needed for the fiscal 2010 budget. The governor took this view and vetoed the measure.

Overall, the budget was something of a “cosmetic triumph” designed largely to buy time. Still, it is possible to talk about winners and losers. Some programs in the social-service area, such as Child Protective Services did relatively well and aid for schools increased two percent. On the other hand, a temporary health-insurance program for disabled Arizonans was swept away. For some, the news was both good and bad. Legislators, for example, launched a $1 billion building program for the universities but took $50 million away from university budgets, leaving the task of deciding how this will be done to the Arizona Board of Regents.

Business groups and a variety of tax watchdog groups were unhappy about what happened during the session. Following the adoption of the budget, five such organizations sent legislators the following e-mail: “We, the undersigned organizations, encourage you to sine die as soon as possible before any more damage is done” (Palmer, 2008). They were particularly unhappy about the legislature’s failure to eliminate or at least extend the suspension of the equalization property tax. It retrospect though, it seems rather politically unwise to have pushed
for a tax cut at a time when the economy had gone sour, when the end to the recession-like conditions was not in sight, and when lawmakers were already wondering where they were going to find revenues to deal with a $2 billion dollar deficit.

Spokespeople for the state’s counties and municipalities also were unhappy. State budget makers made several moves in an effort to make sure that localities would share the pain of adjusting to declining state revenues. The budget shifted the cost of financing the Highway Patrol from the general fund to the Highway User Revenue Fund and, in the process, reduced the amount of money being sent to counties and municipalities out of the HURF for road projects by $106 million. The budget also cut the allocation going to the Department of Public Safety crime lab by more than half and, to make up for this loss of $7.8 million, directed the agency to start billing municipal and county officials for lab work services they had been receiving without charge. County officials saw the new photo-radar program leading to additional court costs they would have to absorb for processing the increased number of appeals of ticket citations. The budget plan further required officials in the two largest counties, Maricopa and Pima, to pick up $17.8 million in health care costs that would otherwise state would have to pay (Note 4).

One provision of the budget package that caught local officials off guard was a rather audacious one demanding that they donate nearly $30 million out of their own budgets to the state general fund. Seventeen million of this was to come from municipalities and $13 million from the counties. One mayor, also president of the League of Arizona Cities and Towns declared: “I’ve never seen anything like this before . . . It’s unusual and confusing. We don’t know if it’s a tax, a fee or an assessment or what the money will be used for” (Jensen, 2008). A lobbyist for the city of Phoenix added: “It’s not so much about the dollars . . . It’s the principle that they can reach into our budget and take money” (Pitzl, 2008). Municipal officials had rejoiced when budget negotiators said they would not cut shared revenues going to them through the urban revenue sharing program. What they saved in shared revenues, however, was mostly taken away by the directive in the budget that they hand over $17 million to the state.

CRITIQUE

The state budgeting process in Arizona in recent sessions, reminds one a bit of the fabled “three people in a room” system in New York in which the governor, the Assembly speaker and the Senate majority leader work out crucial public policy questions behind locked doors. In 2008, Arizona’s process was a bit more inclusive than the New York “triumvirate.” More legislative leaders and leaders from both parties were involved. Still, even with five or six people in the room making the major decisions, whatever else is going on in the legislature became superfluous.

Although making the general fund budget is arguably the most important single thing the legislature does, rank-and-file members had a very limited role in the process. They had a limited opportunity to make an input, were generally kept in the dark about what was going on during budget negotiations and were not in a position time-wise or information-wise to know much about what they were asked to vote on.

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Along with political dynamics, the budgeting process in Arizona is greatly impacted by revenue trends. In Arizona, as elsewhere, though, revenue forecasting is inherently difficult. Revenue projections, whether coming from the legislature or governor’s office, have often suffered in terms of accuracy (“Arizona, Grading the States, 2005). Inaccurate predictions have consequences. Overestimating revenues brings the risk that the legislature will commits itself to programs it finds it cannot afford and that they will have to make embarrassing mid-year corrections. Underestimating revenues, on the other hand, may mean the rejection of worthwhile programs that legislators could have funded. In Arizona, moderates have long suspected that conservatives purposely underestimated revenues to avoid spending on social programs. Conservatives, on the other hand, feel moderates overestimate revenues so they can spend more on such programs.

The problem in Arizona is compounded by having dueling estimates from the governor and the legislature. Arizona might be better off with a consensus estimating approach to revenue forecasting where, as found in other states, projections come from a single, independent and unquestionably non-partisan source. Giving the inherent difficulties involved, accuracy might not be that much improved, but the consensus approach could at least help built confidence in the objectivity behind the effort and help speed the process. As it now stands, it takes a considerable amount of negotiating time between the governor and legislature simply to arrive at an agreement on how much revenue budgeters have to play with.

Recent events have made abundantly clear that the state has a roller-coaster economy and lawmakers need to think ahead. With the slow down, the Budget Stabilization (rainy day) Fund came in handy. The only regret is that legislators did not put more away when times were good. To be safe, one needs to anticipate revenue shortfalls covering several years. Arizona currently caps the fund at 7 percent of state revenues. The original cap was 15 percent. Some states have no caps at all on how much can go into their rainy day accounts.

Large rainy day funds are difficult to build, because, at heart, most of the active participants in the budgeting process are uncomfortable about putting a big pot of money aside. For some, pouring money into rainy day funds means walking away from immediate pressing needs. Those bent on downsizing government, on the other hand, see rainy day accounts as way of avoiding spending cuts. Far better, they argue, to have excess funds returned to the taxpayers in the first place. Last session, some conservatives looked at the rainy day fund essentially as obstacle to overcome in their effort to cut spending. They set out to deplete the fund as soon as possible, hoping to use most of it to fix the shortage in the current year revenues. This, they reasoned, would bring greater attention to spending cuts when the legislature got around to putting together the fiscal year 2009 budget (Fisher, 2008).

Still, overall, there seems to be an emerging consensus that legislators should not view the Budget Stabilization Fund simply as something to be drawn upon to handle one-time unexpected emergencies. It may serve that purpose but more centrally, its value is providing a way of mitigating the effects of a roller coater economy. The money is set aside with the certainty that it will be needed when the economy inevitably slows down in order to maintain a desired level of service or, at least, to help avoid drastic cuts in necessary services until the economy recovers.
Recent events also illustrate that when state revenues are in decline, local governments come in handy. Each year municipal and county officials have to be concerned with mandates shifting expenses their way (‘shift and shaft’ federalism’) and having revenues they have been drawing upon taken away from them for state use. They always have to worry about costly mandates and takeaways, but especially so when state lawmakers face budget deficits. Unfortunately, these are the very times when localities also face revenue shortfalls and the state action makes a bad local situation even worse. State officials think of this as “burden sharing;” local officials think of it as “burden shifting.”

Quite naturally, state officials give prime attention to state budgets and local officials give prime attention to local budgets. The state, though, has the upper hand. State budget makers look at their essential task at hand as somehow putting together a budget that balances spending and revenues of the state government. They are not apt to worry excessively about the budgetary problems of local government officials or the impact of their decisions on local entities. Local officials have little choice but to adjust as well as they can. The result of all this is that a state budget problem becomes a hundred or so local government budget problems. A highly touted “savings” at the state level may be offset by an increase in local taxes.

In past several years, Governor Napolitano and the legislative majority have worked through economic slumps by making temporary adjustments (fund sweeps, rollovers, shifting costs to local governments and the rest) to hold the basic package of state services together while waiting for an economic upturn. How long they can continue to do so, though, is uncertain.

Deep spending cuts and a reordering of priorities may be in order somewhere down the line. Still, just attempting to keep up with projected population growth is likely to sustain the search for more revenue. Arizona is the nation’s most rapidly growing state, passing Nevada for this distinction in 2006. That year, the state grew by 3.6 percent, adding 213,311 people, out of which 130,000 came from other states. The state now has 6.1 million people and is the 16th largest in the nation. U.S. Census Bureau projections have the population of Arizona more than doubling by the year 2030, rising to 10.7 million people, making it the tenth largest state (Billeaud, 2005). Population growth has already brought increased pressure for more spending on education, health care, transportation and other services and the financial problems seem likely to magnify in the future.

Compared to citizens in other states, Arizonans do not hand over much in terms of taxes, fees and other charges to their state and local governments (See Table 2). Arizona state and local governments, according to U.S. Bureau of the Census reports for 2006, ranked next to last among the states in own source revenues per capita. They collected $4,487 per person, while governments in the average state collected $5,803. In the same year, Arizona governments ranked 43rd among the states on the percent of personal income in the state taken by state and local governments through taxes and other means. Arizona’s percentage stood at 15.3, the average state at 16.9.

At one time Arizona governments imposed a relatively heavy revenue burden on its citizens. With increased wealth and a series of tax cuts, however, the burden has become one of the lightest in the nation (Note 5). At the same time, though, Arizona governments have collected relatively little money. As a consequence, as Table 2 indicates, they have been
considerably below average when it comes to total spending per capita (41st in the nation in 2006) and particularly low when it comes to spending money on K-12 education (48th among the states in 2006).

Arizona governments could do considerably more without imposing much of a burden. One study suggests that the wealth of the state (including capital gains) has increased over the past 15 years at a greater rate than state spending – had state spending grown at the same rate as the growth of taxable income, the state, in 2007, would have been spending an additional $1 billion. (Hoffman and Clark, 2007)

Where to look for more revenue? Arizona politicians seem to prefer raising revenues by encouraging people to do the wrong thing -- smoke, drink, and gamble and, now, with an expanded photo radar system, speed. They also prefer the sales tax to other sources of tax revenue (see Table 3). Governments in Arizona stand out as unusually reliant on sales taxes (Note 6). At last count, 2006, state and local governments were drawing upon general and selective sales taxes for around 26% of all their revenues, compared to a national average of around 19 percent. (Table 3) Continued reliance on the sales tax may reflect a widely held belief in the fairness of taxing consumption. On a more practical level, it also reflects a long-standing desire to shift or “export” as much as possible of the tax load to winter residents, conventioneers, and tourists. Sales tax rates, though, are high and seem destined to continue to grow. Rate increases have reflected both the increased use of the sales tax by state and local officials, often with public approval, and a shrinking sales tax base. The base has been shrinking because of the growth of internet sales, the practice of exempting various businesses from the tax, and the failure to stay up with changes in the economy from goods to services by extending the tax to more services. The sales tax has extended to the point where some experts have already expressed concern that a recent proposal to add a one-cent hike to pay for urgently needed transportation improvements may prompt a taxpayer’s rebellion. In some places, the combined state-local sales tax rate is close to 10 percent.

Continued reliance on the sales tax runs the risk of igniting a negative taxpayer response. Broadening the sales tax base could reduce the pressure (and make automobile dealers a bit happier). Still, over reliance on this particular tax is dangerous because it is highly volatile to changes in the economy, thus promising more periods of extreme feast or famine. Critics too point out that the sales tax tends to be regressive, disproportionately burdening low-income people. A more diversified and progressive revenue structure could be achieved through the use of a revitalized state income tax.

NOTES

1. The general fund budget for the state of Arizona usually accounts for around only a little more than a third of what the state government actually spends. For fiscal year 2009, budget experts project this will be 35 percent of a total expenditure of $28 billion. Other expenditures come from federal funds and state funds earmarked for specific programs. Historically, Arizona has been considerably below the national average in the percent of total spending through the general fund, considerably above average in the amount of spending
through earmarked funds, and about average in percent expenditures from federal aid in recent years. In fiscal year 2004, for example, the general fund portion of total Arizona state expenditure was 31 percent, the federal funds percent was also around 31 percent, and the state earmarked funds some 37%. Comparable estimates for all states in fiscal year 2004 show general funds accounting for 43%, federal funds for 30% and earmarked state funds for 26% of total state spending (National Association of State Budget Officers, 2004).

2. Two voter-approved measures that have made a large impact on the general fund came in 2000. One of these, known as Proposition 204, expanded AHCCCS (the state’s Medicaid alternative) eligibility to all residents at or below the poverty level. Before passage of 204, eligibility was at about 35 percent of the poverty level. The proposition added hundreds of thousands of people to the program but provided only some $80 million per year in annual funding from the state’s share of the nationwide tobacco lawsuit settlement. This, as it turned out, was not enough money and the legislature had to come up with additional millions of dollars in the general fund to finance the program’s growth. The second measure, Proposition 301, was a revenue raising measure put on the ballot by the legislature after it was unable to come up with the two-thirds vote required by Proposition 108. The measure increased the sales tax to 5.6 percent from 5 per cent for twenty years to fund public education. Much of the revenue stream it created is earmarked for teacher pay raises. The measure also required the legislature to increase the base level of state aid to K-12 education by $94.5 million in 2002 and to annually adjust it by 2% or an inflation rate, whichever was less. These expenses are to come out of general revenues. In 2004, voters helped avoid such future situations by approving a measure that requires all initiatives and referendums that mandate expenditures to specify a source other than the General Fund.

3. Legislators have looked at special “off budget” funds as of value in providing a relatively secure and stable source of funding for a favored program or activity. They are protected in that they do not go through the periodic review that occurs during the general fund budgeting process or compete directly with other special fund programs. Still, when economic conditions are tight, the special funds come into play and the legislature may sacrifice them to help keep programs funded out of the general fund alive. In the broad perspective, fund sweeps are actually spending cuts.

4. Counties, however, dodged a bullet when the Governor’s proposals to shift the cost of housing some prisoners from the state to the counties went down during the negotiations. Napolitano’s proposal to send felons convicted of nonviolent crimes and sentenced to a year or less from state prisons to county jails would have saved the state some $60 million. While county officials had reason to complain about the added expenses to them, total costs to the taxpayers would have been reduced because county jails are a lower cost type of facility.

5. Per capita personal income (PCPI) in Arizona increased by 4.4 percent from $20,823 in 1996 to $31,936 in 2006, slightly above the average growth rate for the nation of 4.3 percent. In both years, however, the PCPI ranked below the national average. In 1996, Arizona placed 38th among the states and in 2006 ranked 39th (USDOC, 2008).
6. The state sales tax, technically the Transaction Privilege Tax (TPT), consists of several tax categories, the most lucrative of which is the retail sales tax. Others include sales taxes on contracting, amusements, utilities, restaurants and bars, and hotels or motels. Municipal governments in Arizona also levy sales taxes and are heavily dependent on this source.

**TABLES**

**Table 1 Comparison of 6 Largest General Fund Operating Budgets, 1997 vs. 2007**

($ in Millions)

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<td>Corrections</td>
<td>409.3</td>
<td>817.2</td>
<td>99.7</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>Economic Security</td>
<td>352.1</td>
<td>719.0</td>
<td>104.2</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>Health Services</td>
<td>206.3</td>
<td>549.2</td>
<td>166.2</td>
<td>4</td>
<td>6</td>
</tr>
<tr>
<td>Total</td>
<td>4,894.3</td>
<td>9,686.9</td>
<td>97.9</td>
<td>--</td>
<td>--</td>
</tr>
</tbody>
</table>

Source: Arizona Joint Legislative Budget Committee, 2007.

**Table 2 State and Local Revenues and Spending 2006**

<table>
<thead>
<tr>
<th>Item</th>
<th>Arizona</th>
<th>USA</th>
<th>Arizona Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total own source revenues, millions of dollars</td>
<td>27,665</td>
<td>1,733,785</td>
<td></td>
</tr>
<tr>
<td>Per capita burden imposed by own source revenues</td>
<td>4,487</td>
<td>5,803</td>
<td>49</td>
</tr>
<tr>
<td>Percent of personal income taken by own source revenues</td>
<td>15.3</td>
<td>16.9</td>
<td>43</td>
</tr>
<tr>
<td>Total Spending per capita</td>
<td>6,935</td>
<td>8,375</td>
<td>41</td>
</tr>
<tr>
<td>Spending per capita on K-12 education</td>
<td>1,255</td>
<td>1,672</td>
<td>48</td>
</tr>
</tbody>
</table>

Sources: U.S. Bureau of the Census, Federation of Tax Administrators, The Public Policy Institute of New York State
Table 3 Breakdown of State and Local Revenues, 2006

<table>
<thead>
<tr>
<th>Item</th>
<th>Arizona</th>
<th>USA</th>
</tr>
</thead>
<tbody>
<tr>
<td>General revenue, thousands of dollars</td>
<td>36,482,885</td>
<td>2,186,018,089</td>
</tr>
<tr>
<td>Percent from Federal Government</td>
<td>24.1</td>
<td>20.7</td>
</tr>
<tr>
<td>Percent from own sources</td>
<td>75.9</td>
<td>79.3</td>
</tr>
<tr>
<td>Percent from taxes</td>
<td>54.7</td>
<td>54.6</td>
</tr>
<tr>
<td>Percent from property tax,</td>
<td>15.1</td>
<td>16.4</td>
</tr>
<tr>
<td>Percent from sales and gross receipts</td>
<td>25.7</td>
<td>18.9</td>
</tr>
<tr>
<td>Percent from individual income tax</td>
<td>8.9</td>
<td>12.3</td>
</tr>
<tr>
<td>Percent from charges and miscellaneous general revenue</td>
<td>21.1</td>
<td>24.6</td>
</tr>
</tbody>
</table>

Data Source: U.S. Census Bureau of Census

REFERENCES


**About the Author:** David R. Berman is a Senior Research Fellow, Morrison Institute for Public Policy at Arizona State University (david.berman@aus.edu).