Arizona legislators went into September 2009 still struggling to meet a July 1 deadline for the adoption of a balanced general fund budget for fiscal year 2010. The governor finally picked through what the legislature had to offer and came up with a tentative budget plan intended to get the state through the balance of the year. The government had not shut down and legislators had not faced any official penalty for failing to prepare a budget plan in which revenues and expenditures were in balance. Still, as Labor Day sailed by, few had any kind words for the governor and the legislators responsible for the stalemate.

Though it falls far short of accounting for what the state spends, 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 between various groups in both houses of the legislature. The type and level of budgeting stress, however, varies with such factors 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.

As in 2008, revenue shortages drove events in 2009. Arizona has been hard hit by a national economic downturn but especially hard by the battered housing market. These have produced a revenue crisis through a precipitous drop in sales, income, and corporate tax receipts. A May 2009 report by the Washington, D.C.-based Center on Budget and Policy Priorities, found Arizona's 2009 shortfall to be the largest in the nation relative to the size of the budget (California had the largest hole in dollar terms). The group also had Arizona on track to have the second-biggest gap in 2010, trailing only California and Nevada (Center on Budget and Policy Priorities 2009). It may take several years for the state to recover from the economic downturn.

While economic conditions had much to do with the budgeting chaos in 2009, so too did a set of complex institutional and political factors.

This report examines the general characteristics of the general fund budget, with particular emphasis on how the process unrolled in 2009, and concludes with a critique of the financial issues facing the state.

BACKGROUND

The general fund budget draws largely on sales and income tax revenues and distributes funds among a wide range of activities. In fiscal year 2009 sales taxes contributed around 47% of the revenues and the individual income tax contributed 36 percent. Over the past several decades, K-12 education has claimed the largest share of funds, currently 43% of the spending,
though, as Table 1 indicates, the rate of growth in recent years has been especially high for health services and the AHCCCS program, the state’s version of Medicaid.

Table 1
Comparison of Nine Largest General Fund Operating Budgets
FY 1999 vs. FY 2009
($ in Millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
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<tbody>
<tr>
<td>Education (K-12)</td>
<td>$2,224.3</td>
<td>$4,141.2</td>
<td>$1,916.9</td>
<td>86.2</td>
</tr>
<tr>
<td>AHCCCS</td>
<td>476.5</td>
<td>1,425.3</td>
<td>948.8</td>
<td>199.1</td>
</tr>
<tr>
<td>Universities</td>
<td>728.9</td>
<td>1,080.4</td>
<td>351.5</td>
<td>48.2</td>
</tr>
<tr>
<td>Corrections</td>
<td>512.4</td>
<td>947.5</td>
<td>435.1</td>
<td>84.9</td>
</tr>
<tr>
<td>Economic Security</td>
<td>424.5</td>
<td>808.3</td>
<td>383.9</td>
<td>90.4</td>
</tr>
<tr>
<td>Health Services</td>
<td>253.9</td>
<td>611.5</td>
<td>357.6</td>
<td>140.8</td>
</tr>
<tr>
<td>School Facilities Board</td>
<td>310.9</td>
<td>101.2</td>
<td>(209.7)</td>
<td>NA</td>
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<tr>
<td>Public Safety</td>
<td>76.0</td>
<td>63.5</td>
<td>(12.5)</td>
<td>(16.4)</td>
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<tr>
<td>Community Colleges</td>
<td>124.1</td>
<td>147.7</td>
<td>23.6</td>
<td>19.0</td>
</tr>
<tr>
<td>Other</td>
<td>761.8</td>
<td>635.4</td>
<td>(126.4)</td>
<td>(16.6)</td>
</tr>
<tr>
<td>Total</td>
<td>5,893.3</td>
<td>9,962.0</td>
<td>4,068.7</td>
<td>69.0%</td>
</tr>
</tbody>
</table>

Source: Joint Legislative Budget Committee.

From 2000 to 2009, the budget generally grew, on average, a little over five percent a year (Table 2). For fiscal years 2005, 2006, and 2007, however, the increases were over 15 percent, considerably above the rate of inflation and population growth. The total amount of spending went from $6.5 billion in fiscal year 2004 to $10.2 billion in fiscal year 2007. Since 2007, however, total spending has been on the decline, and has been lagging behind inflation and population growth.

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 a 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 in each legislative body -- 31 house members, 16 senators.

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. The election of Janet Napolitano in 2002 and again in 2006 created a situation in which a Democrat held the office of governor while Republicans controlled both houses of the legislature. On budgeting matters the governor was often able to forge a winning coalition of Democrats and moderate Republicans.

Following the 2008 election, the legislature became increasingly Republican and increasingly conservative – partly because conservative Republicans ousted targeted moderate Republican incumbents in several primaries and went on to win their seats. In 2009 Republicans had a lead of 35 to 25 in the House and 18 to 12 in the Senate. More important, the underlying political dynamics changed after the 2008 election because of Napolitano’s decision to become
Secretary of Homeland Security in the Obama administration. Jan Brewer, generally known as a conservative Republican, moved up from the position of Secretary of State to become governor.

Regardless of partisan splits, the making of the general fund process has generally been one in which a few people do the heaving lifting and do so behind closed doors. A small group of legislative leaders and the governor and/or their staffs keep journalists and even most legislators in the dark as to what is happening until they are ready to present the budget plan to the legislature as a whole. Typically, members of the minority process have been excluded from playing a meaningful role in the process.

The Arizona general budgeting process, like that in other places, has also generally taken 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 budgets are being framed, thus prompting continuous adjustments.

The Arizona Constitution, in effect, requires a balanced state general fund budget. The constitutional requirement, however, is not self-enforcing and there is no implementing statute spelling out what happens if the budget is not balanced or giving a law enforcement officer, such as the state attorney general, the authority to take action in this situation.

Various legal constraints on both raising revenues and controlling spending complicate the task of balancing the budget. 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 into 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, the number of people eligible for health care services, or the number of people in prison. With continued growth, state spending increases are on automatic pilot of six to seven percent a year.

A good portion of the mandated spending is the result of voter-approved measures. These are difficult to change because of Proposition 105 (The Voter Protection Act), adopted in 1998 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. Since 2004, thanks to another popularly approved proposition, measures adopted through a public vote must have a devoted funding source other than the general fund. Voter-mandated programs adopted before that time, however, continue to draw on the general fund. One particularly expensive initiative approved by the voters in 2000 extends health care...
coverage to all Arizonans living under the federal poverty line. Before passage of the initiative, eligibility was at about 35 percent of the poverty level.

With so much of the budget essentially off-limits to cuts, relatively unprotected services such as universities receive a disproportionate share of attention when legislators began to search for ways to trim expenditures.

State lawmakers have only a limited range of discretion in raising revenues and cutting spending. Still, historically, they have shown a remarkable ability to adjust to revenue shortfalls and to achieve balance without doing severe damage to major programs. Legislators have accomplished this in various ways. They have drawn on 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. There are some 270 non-appropriated special and revolving accounts out of which legislators can draw funds if necessary. 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 have further coped 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 have not been 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.

Governor Napolitano and the legislative majority were able to work 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.

In 2009, however, things were different – the state was hard hit by a severe economic downturn. Tried and true gimmicks and relief provided by federal stimulus were not enough – lawmakers had to make some hard taxing and spending decisions (Note 2).

FROM FEAST TO FAMINE: BUDGETING IN 2009

Not long ago the central question facing Arizona budget-makers was what to do about surplus revenues. In 2006, a booming economy and record tax collections produced something in the range of $1.5 billion more than the state had been spending. Lots of ideas begin to surface about what to do with the extra money. Increased spending, cutting taxes, or simply using the extra funds to put the state’ fiscal house back in order were the major alternatives. Legislators and the governor decided to do all three things.

On June 21 2006, Governor Napolitano signed a state budget package totaling $10 billion, up about 20 percent over the previous year’s budget of $8.2 billion. Working out a
compromise with Republican legislative leaders she was able to secure $160 million over the next two years to expand the kindergarten program, $100 million for teacher salaries, and some $95 million for health care, social-services, an economic development program to promote science-based research, and other programs. In exchange, Republican legislative leaders secured income and property tax cuts worth some $545 million over two years, corporation tax cuts for private school scholarships, and a limited school voucher program. Both sides were happy with the addition of $345 million to accelerate highway construction. The budget agreement also had something for those who emphasized saving -- it put $485 million in the rainy day fund, bringing it up to the maximum allowed by law of $639 million.

In 2007, early meetings between the governor and legislative leaders revolved around the exchange of views on general priorities. In mid April the two sides passed a vital hurdle by reaching an agreement, actually a compromise, on the amount of current and projected revenues. Though they did not disclose the amounts, they declared that now that they knew how much money they had to work with, they were able to get down to business on the budget. (Note 3)

The outcome was a $10.6 billion bipartisan budget, an increase of $600 million, six percent, over the previous year’s budget. This included a tax reduction package of $11 million, $7 million of which went to businesses. The governor did not get her proposal to pay for school construction through borrowing but legislators provided $370 million in cash to pay for new schools and other projects. The governor’s proposal to free up $400 to $500 million for roads by refinancing highway bonds was approved. The budget also included $46 million to increase teachers pay, gave state employees a 3.25 percent pay raise, and expanded child-care subsidies.

Unlike most previous 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 a state property tax, technically known as a “county equalization 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. Analysts predicted that allowing the tax to go back into effect 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 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.

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. 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. 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 off $272,000 off the current budget.

Immediately after making the adjustments in the fiscal year 2008 budget, state budget makers faced an even greater challenge of dealing with a projected deficit of nearly $2 billion for the fiscal 2009 budget. The plan they came up with called for the expenditure of $9.9 billion, some $700 million less than legislators had budgeted last year. The work was similar to that done to repair the FY 2008 budget 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. 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.

As matters turned out, legislators had to make two adjustments in the budget for fiscal year 2009 because of a continued decline in revenues. Late in January 2009 the Republican-led legislature filled in a revenue shortfall of nearly $1.6 billion in the current budget by cutting spending some $580 million, sweeping special-purpose funds for approximately $585 million (including all that was left in the rainy day reserve), and throwing in $500 million in federal stimulus funds. In March the legislature restored funding to a variety of programs. Among these were health programs, the funding of which was necessary to qualify for federal stimulus aid. Continued revenue declines, however, forced legislators in May to make up for an additional $650 million shortfall in the operating fund. To meet this emergency, legislators relied on accounting maneuvers and more federal assistance. They pushed payments of $400 million to K-12 schools and public universities into the next fiscal year and stirred in $250 million in more federal stimulus dollars to bring about a balance.

With the final adjustment behind them, legislators turned to the task of making a budget for fiscal year 2010. The projected deficit by this time was $3 billion. As a reporter pointed out: “If you cut out all general-fund money sent to the state university system, essentially shutting it down; eliminate the state prison system; close the state parks; stop state funding to the arts and welfare services; and get rid of the Commerce Department, you still wouldn't close the gap” (Pitzl, 2009).

To the surprise of many, including several Republican legislators, Governor Brewer was among those who argued that the budget could not be balanced though spending cuts alone or by spending cuts accompanied by the tried and true budgeting maneuvers such as rollovers or help from Washington. The longtime fiscal conservative suggested that budget makers had little choice but to turn to a temporary tax increase. To put it mildly, Republican legislators were less than enthusiastic about taking this course of action – several (38 out of the 53) had formally pledged not to raise taxes. Indeed, many continued to think in terms of tax cuts – especially the permanent repeal of the state equalization property tax.
Republican leaders had initially looked forward to working with Brewer. But, as House Speaker Kirk Adams later remarked, her proposal for the sales tax increase “was a game-changer.” Trying to get this through the legislature was “a bit like carrying a piano up 10 flights of stairs” (Small, 2009b).

Brewer raised the possibility of raising taxes in a press conference held on December 6, 2008, after learning she was about to become governor. A month later revised revenue projections showed the budget shortfall was growing. Speaking to the legislature in her inaugural speech on January 20, 2009, Brewer said: "In some ways, this feels like you've just shown up for a party - but the guests have all gone. Only the caterer is left, and she immediately hands you the bill" (Scarpinato, 2009).

Early in March she called for a temporary tax increase that would bring in $1 billion a year in new revenue for the next three years. This later turned into a more specific recommendation of a 1 percentage point hike in the state sales tax, from 5.6 percent to 6.6 percent which would expire after three years. The prospect of this being adopted outright by the legislature was highly unlikely. Most Republicans opposed the idea. Raising taxes, moreover, would require a supermajority, a two-thirds vote in both chambers. In an effort to get around these obstacles, the governor suggested that the question of a temporary sales tax increase be referred to the voters by putting it on a special election ballot in November. A measure could be referred to the voters by a simple majority vote in the Senate and House.

Early in June the governor released her budget proposal and, at the same time, voiced her opposition to a Republican plan that awaited action in the House and Senate, principally because it failed to include the sales tax hike. Her office estimated that the deficit had now grown to $4 billion while the legislative budget analysts had used a $3 billion estimate. She called for the expenditure of $9.1 billion and proposed to spend close to $950 million more on health care and education than did the legislative plan. The legislature, however, largely ignored the governor and on June 4 went ahead and approved the plan they had been considering -- an $8.2 billion budget that included deep spending cuts of over $630 million and no tax increases. Republicans in the legislature had lined up solidly against the Republican governor.

Fearing a gubernatorial veto, however, GOP leaders decided not to send the budget on to Brewer’s desk until they had worked out their differences with her. Once this was done they would send her supplemental bills amending the original budget. When negotiations stalled, Brewer brought suit against the Senate President Bob Burns and House Speaker Kirk Adams, claiming that they violated the state constitution by not immediately sending her the set of budget bills approved by both legislative chambers on June 4. On June 23, 2009, the Arizona Supreme Court agreed with Brewer. The court, however, declined to force the legislative leaders to take action because the fiscal year was nearly over and leaders said they would send the bills by the end of the month anyway.

Negotiations continued, but publically the governor went on attack against the budget plan she had not yet officially received. In day long forum arranged by her office, some two dozen stakeholders -- educators, health care providers, law enforcement officers, and city officials -- spoke against the legislature’s plan. Many of those who testified spoke in favor of the
governor’s proposed sales tax increase. The governor made it clear she was unhappy with several provisions of the legislature’s budget and would use her veto power once it reached her desk.

One Republican Senator dismissed the forum as a “kangaroo court” packed with “people at the public trough” and Brewer supporters. In the same vein, another Republican legislator said the governor had set up “a panel of essentially tax-spenders to come in and whine and cry about how the legislative budget is going to cut their budget.” He questioned the governor’s credentials as a Republican and conservative. Democrats, while favoring increased spending in some areas were not about to go to the governor’s defense. They labeled the forum as a “clearly scripted parade of political allies” and media stunt (Duda, 2009).

Democrats had little to do but wait to see what was going to result from negotiations between the governor and Republican legislative leaders. On June 26 negotiators announced a compromise plan that included a sales-tax ballot referral. The deal fell apart, however, when many rank and file Republican legislators, in defiance of their legislative leaders, refused to go along with the referral. The governor’s efforts to restore the agreement with the help of Democrats did not pan out.

On July 1, legislative Republicans voted for a budget with no tax referral and $600 million in spending cuts. The later had been agreed to by the Governor as a sweetener to conservatives, but only in exchange for the sales tax referral. The governor responded by vetoing most of the package and calling legislators back into special session. She complained that the budget made devastating cuts to education, public safety and vital health services. She put considerable pressure on the legislature to come back soon with an improved budget by using her line-item veto to eliminate all state funding for education. Money for schools would start to run out unless legislators passed a new allocation before July 15. Especially troublesome to Republican leaders was that possibility that charter schools, something they had strongly supported, ran the risk of going out of business if the legislature did not act before that time (Arizona Daily Star Editorial, 2009b).

Senate President Bob Burns responded by issuing a statement saying Brewer’s vetoes and subsequent call for a special session appear to be "vindictive retaliation" for the legislature’s refusal to rubber-stamp her plan for a ballot referendum on a temporary one-cent sales tax increase. He also took aim at her conduct throughout the legislative session. "These past few months I have witnessed behavior that is incomprehensible to me. The governor has surrounded herself with a team of outstanding staff, most of whom I have known for years and respect very much. However, decisions and demands coming from her office have been unbelievable and in some cases unachievable," Burns wrote. "It appears the governor is having problems managing the level of responsibility to which she has been elevated" (Small, 2009a).

The special session that convened July 6 found Republicans leaders upset about their dysfunctional relationship with the governor, less willing to work with her, and more willing to work with Democrats on a compromise budget. Democrats were anxious to get more involved, having been marginalized for the past several months. In a rare spirit of cooperation, Republicans and Democrats got behind budget bills providing funds for public education $500
million beyond that in the budget vetoed by the governor and clearing the way for the state to receive more than $2 billion in federal stimulus funds. Brewer signed the education-funding bill on July 8, eight days into the new fiscal year.

Burns and Adams had initially hoped to arrive at a compromise budget with the governor that could also be passed in the legislature with only Republican votes. By working with the Democrats at the beginning of the special session, Republican leaders demonstrated to the governor that they had options – that they need not work with her and could, if necessary, produce super majorities necessary to override vetoes. Still, they had, in fact, not altogether given up on dealing with the governor and, despite whatever agreements had been made with Democratic leaders, soon reverted to the Republican-only strategy.

In the last week in July, the governor and Republican legislative leaders finally came up with a budget package that was similar in many respects to the one the governor had earlier vetoed. It had all the budget cuts to which the governor had objected and negated the supplemental spending increases for education. The package did include a provision for a public vote on a temporary sales tax hike. But along with this came a variety of offsetting provisions adopted, in part, in hope of winning over the support of fiscal conservatives in the legislature for the package. Among these were provisions calling for income tax cuts for businesses and individuals and the immediate repeal of the state property equalization tax. The effect of these cuts was expected to more than offset gains to be made through the sales tax increase, should it be approved by the voters (the cuts would go into effect no matter what happened to the sales tax). The package also called for a cap on state spending (at $10.2 billion for the next three years), a five percent reduction in the number of state and university employees, and a referendum asking voters to temporarily suspend the constitutional provision that prevents the legislature from tapping into funds for voter-approved programs.

Reports surfaced that adoption of the tax cutting provisions of the proposed budget reflected, at least in part, an effort on the part of Republican legislators to make sure that they would not encounter the wrath of a national organization, the Americans for Tax Reform, headed by Grover Norquist, for supporting the referral of the sales tax question. Norquist reportedly told legislators that voting for the referral would be ok if, at the same time, they also voted for the large corporate and individual tax reductions being considered and the permanent repeal of the state equalization property tax. Some Arizona papers were critical of “Governor” Norquist’s involvement (Arizona Daily Star Editorial, 2009a).

The House passed the ten budget bills, including the tax cuts, making up the package. The vote took place along party lines, Republicans generally in support, with Democrats generally in opposition. The proposed package, however, failed in the Senate, largely because of the sales tax provision. Three Republicans refused to go along with sales tax referral even when coupled with more than off-setting cuts in other taxes. The best Senate President Burns and the governor could do was to line up 15 Republicans to go along with referring the sales tax question, 16 were needed. The governor went to the Senate office building and spent an hour and a half in a face to face meeting with one holdout but to no avail. Last minute attempts to get the 16th vote from a Democrat failed. On August 12, Senate Republicans abandoned the sales
tax referral and decided to ask the governor to go along with essentially the same budget package they had sent her on July 1 and which she had condemned and vetoed.

Senate Majority Leader Chuck Gray declared that it was time for the governor to just sign the budget. "We bent over backwards to try to do what she wanted, and I think we did Herculean efforts to try to accommodate her, and in the end we did not have the votes for what she wants….I think it's time to get this budget and this state back on track" (Arizona Daily Star Editorial, 2009c). The governor, meanwhile, issued the following statement: “I trust the people of Arizona. But, I am deeply disappointed that some Members of the Arizona State Senate do not. They have so little trust in the voters, that they would once again delay the passage of a sound state budget, and deny the people an opportunity to protect critical funding for education, public safety, and care for our most vulnerable citizens. Their actions are irresponsible, create an increasing cost to state taxpayers and, if not resolved quickly, will do irreparable harm to our families and our economic future.” (Brewer, 2009)

Though the budget package sent to the governor was essentially the same as the one she had vetoed in July, public discontent over the prolonged struggle and continued deterioration in the state’s finances had increased the pressure for her to bend. In August, the State Treasurer, Dean Martin, warned that the state would run out of operating cash by October and that the banks were unwilling to give the state a line of credit without the adoption of a balanced budget. The Treasurer reported that the government was being kept afloat by loans to the general fund, payable with interest, from accounts belonging to specific state agencies. The state, he suggested, may be headed towards what had happened in California – sending out IOUs or imposing emergency furloughs.

On September 5, 2009, the governor announced that she was giving up on the sales tax increase measure at least for the time being and proceeded to approve most of the budget plan for fiscal 2010. She did, however, veto the bill calling for the repeal of the state equalization property tax, thus adding some $250 million a year in revenue and used her line-item veto to eliminate cuts to education and programs for Arizona’s poor, restoring some $300 million. The budget was still out of balance to the tune of $1 billion, including $500 million of deficit from fiscal 2009, but the governor felt that the state could continue to operate until early next year without having to borrow funds. The governor blamed a handful of Republican and Democratic extremists in the legislature for opposing the sales-tax increase and dragging on the debate for nearly nine months.

Republican legislators were unhappy about the restored spending for education and welfare and about their inability to repeal the state equalization tax -- they had made this a priority. Business groups also expressed their displeasure over the governor’s actions on these matters and predicted they would throttle economic recovery. Though the governor had few kind words for the Democrats (and vice versa), the budget plan she fashioned with her vetoes was along the lines of what the Democrats had been seeking. The Arizona Education and advocates of programs for the state’s children, elderly and poor applauded the governor’s actions. Still, many agencies suffered cuts. The overall plan called for an expenditure of $8.7 billion, compared to $9.9 billion budgeted for fiscal 2009.
CONCLUDING OBSERVATIONS

With the recession and conservative control in the legislature, spending cuts in the general fund budget have been difficult to avoid. Given the economic trends, even deeper cuts are likely in the immediate future. To improve flexibility in this regard there is considerable sentiment, shared by the governor and Republican legislative leaders, for a ballot measure giving lawmakers the ability to waive voter-approved spending mandates during economic downturns.

Still, many would insist that the problem in Arizona has not been too much spending but too little revenue. 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.

Arizona state and local governments, according to the most recent report of the U.S. Bureau of the Census in 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. At the same time, though, Arizona governments have collected relatively little money. As a consequence, as Table 3 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).

Table 3
State and Local Revenues and Spending 2006

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<th>Item</th>
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<th>Arizona Rank</th>
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<td>Total own source revenues, millions of dollars</td>
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<td>1,733,785</td>
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<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

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)

Just trying to keep up with projected population growth is likely to sustain the search for more revenue. 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. 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.

Where to look for more revenue? Arizona politicians seem to prefer raising revenues by having people do the wrong thing -- smoke, drink, and gamble and with a recently expanded photo radar system, speed. They also prefer the sales tax to other sources of tax revenue and are unusually reliant on this source of revenue. 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 4). 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.

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 reach through a revitalized state income tax.

Table 4
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
1. The general fund budget for the state of Arizona usually accounts for 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. The state was expected to receive more than $6 billion in federal stimulus dollars, much of which went to municipalities, counties and the state for “shovel-ready” infrastructure projects. Federal funds were also coming in for education, health care, and with few strings attached, as general-purpose stabilization funds. The funds were expected to ease the burden on the budget for a year or so.

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. Legislators have generally been able to make such moves with impunity. Various groups in recent years, however, have challenged the legality of fund sweeps and some have enjoyed court victories. Early in July of 2009, for example, a Superior Court judge rule that the legislature had acted illegally in 2008 when it took $160,000 from accounts for agricultural research and advertising campaigns that were built with voluntary private contributions. Later that month the Arizona Supreme Court held that the legislature had violated the Voter Protection Act by taking millions of dollars accumulated as interest from a fund for childhood development that had been approved by the voters. Earlier, the high court invalidated a provision of the budget package for fiscal 2009 demanding that city and county officials donate nearly $30 million out of their own budgets to the state general fund. This decision, though, rested on a technicality and left room for the state to divert local revenues to the state general fund.

4. 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.
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).