

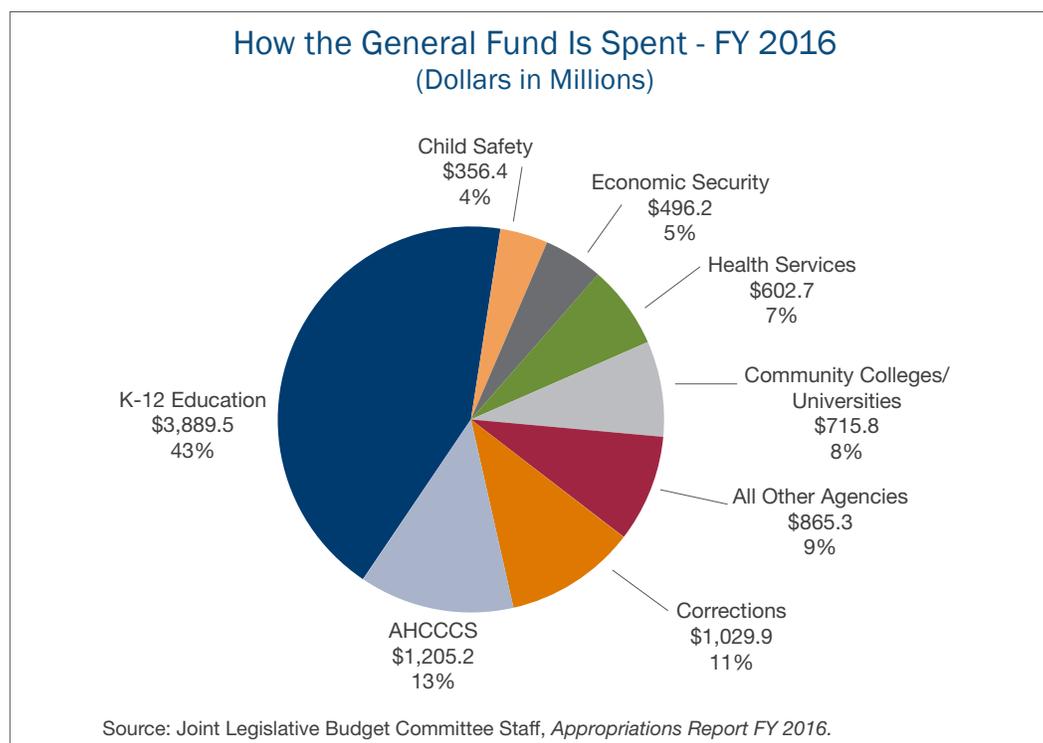


# BUDGET AND TAXES

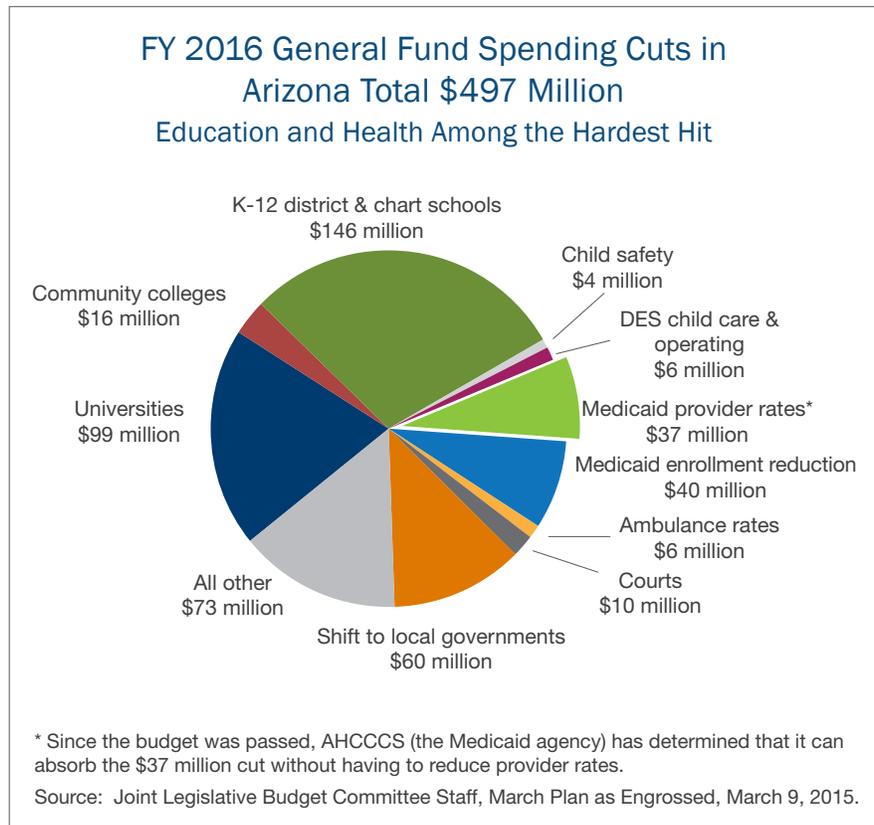
## What does the state budget look like this fiscal year?

Each year the state legislature and governor adopt spending and revenue policies that balance the budget with general fund expenditures below available revenues. To close a projected \$1 billion gap between revenues and expenditures, this year's budget includes \$500 million in cost shifts to local governments and spending cuts to education, health care, and families. Additional tax cuts were passed that will shrink available revenues for the coming years.

The Arizona budget reflects the state priorities of education, health care, and public safety. K-12 education, AHCCCS (Arizona's Medicaid program), and the Department of Corrections make up two-thirds of the \$9.2 billion appropriated from the state general fund for this fiscal year. The Departments of Health Services, Child Safety, and Economic Security along with the community colleges and universities make up another 24 percent. The last 9 percent of the budget goes to more than 50 agencies that receive some or all of their funding from the general fund. Most of these services involve consumer protection, including the Department of Financial Institutions and the Department of Veterans' Services. The Department of Transportation and all spending for state highways comes from the state gas tax and is not part of the general fund budget.



At the time the budget was passed on March 7, 2015, Governor Ducey proclaimed that it put “Arizona on a path toward structural balance for the first time since 2007.” But projections showed that ongoing revenues would not exceed ongoing expenditures until FY 2018. Less than a month after he signed the budget, Governor Ducey signed legislation that cut state revenues by \$31 million annually—effective immediately—with other tax cuts to phase in over the next few years, unbalancing the budget that had been so precariously balanced.



Since the legislature adjourned in April, state revenues have picked up, with general fund collections through May being \$257 million higher than had been forecast. This means that the planned withdrawal from the Rainy Day Fund will not be needed to finish fiscal year 2015 with a positive ending balance. The state begins the new fiscal year with a much larger beginning balance than had been expected, and the Rainy Day Fund balance remains at about \$460 million.

If revenues continue to come in above forecast, our elected leaders will be debating how to best allocate the unexpected funds and whether to consider them a one-time windfall or an ongoing boost. While they debate saving larger amounts in the rainy day fund, paying off debt, enacting additional permanent tax cuts, or investing in state needs, increased revenues may be needed to offset budget shortfalls in other areas. New fraud detection and tax amnesty efforts, for example, may not produce the \$57 million in revenues that was assumed in the budget. And spending amounts may be higher than budgeted in certain areas, like foster care, where growing needs were not factored into the budget. In addition, the adopted budget fails to fully address the lawsuit regarding K-12 education funding, providing \$74 million for this year’s inflation factor instead of the \$337 million ordered by the court.

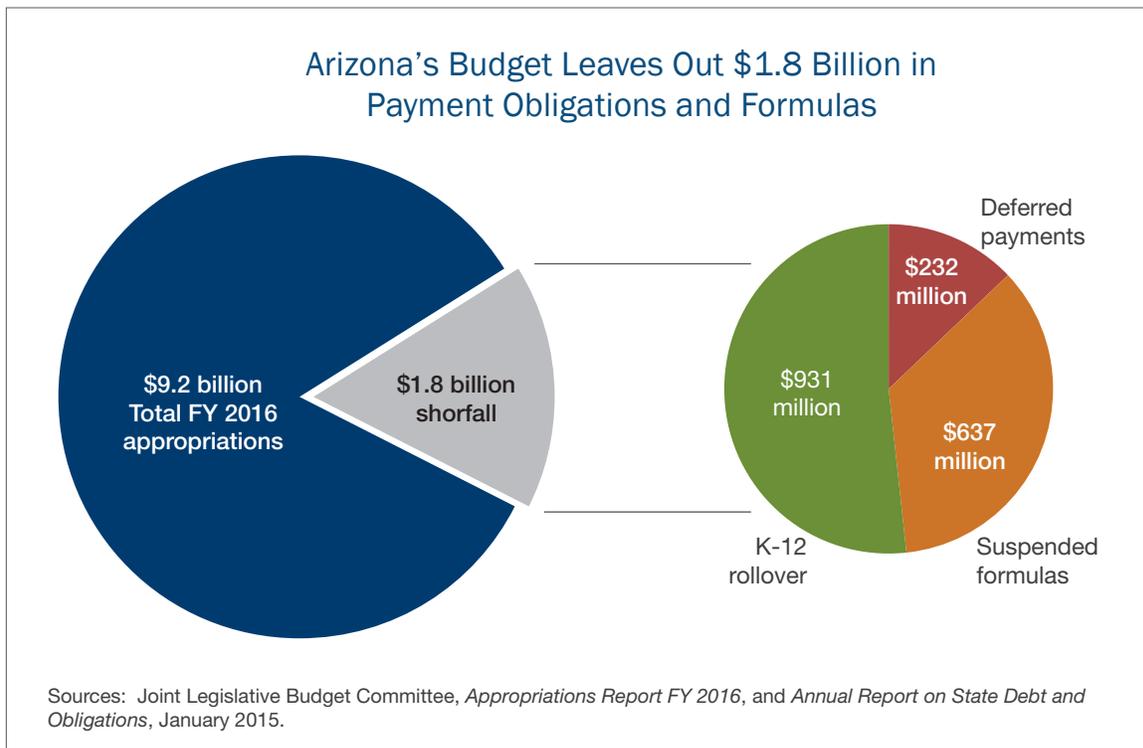
In addition to the potential gap between projected revenues and spending this year, Arizona has other debt and unfunded obligations. The state has built up \$3 billion in general fund debt with annual payments of principal and interest that must be funded every year—like paying a mortgage. The annual debt payments combined are \$366 million—just larger than the \$356 million general fund appropriated to the new Department of Child Safety.

Arizona also has \$1.8 billion in unfunded obligations, equal to 20 percent of total general fund appropriations. These include delayed payments, an accounting gimmick, known as “rollovers,” that push the payment of certain bills into the following fiscal year. They can continue year after year until enough funds are available to reverse them. In addition, a number of budget formulas in state law are unfunded. These formulas are put into state law to automatically adjust specific types of spending for certain factors every year, such as inflation or growth in people needing the service. The legislature has eliminated some of these formulas from state law (and they are not included in the \$1.8 billion unfunded obligations). Others remain in state law but go without funding in the budget.

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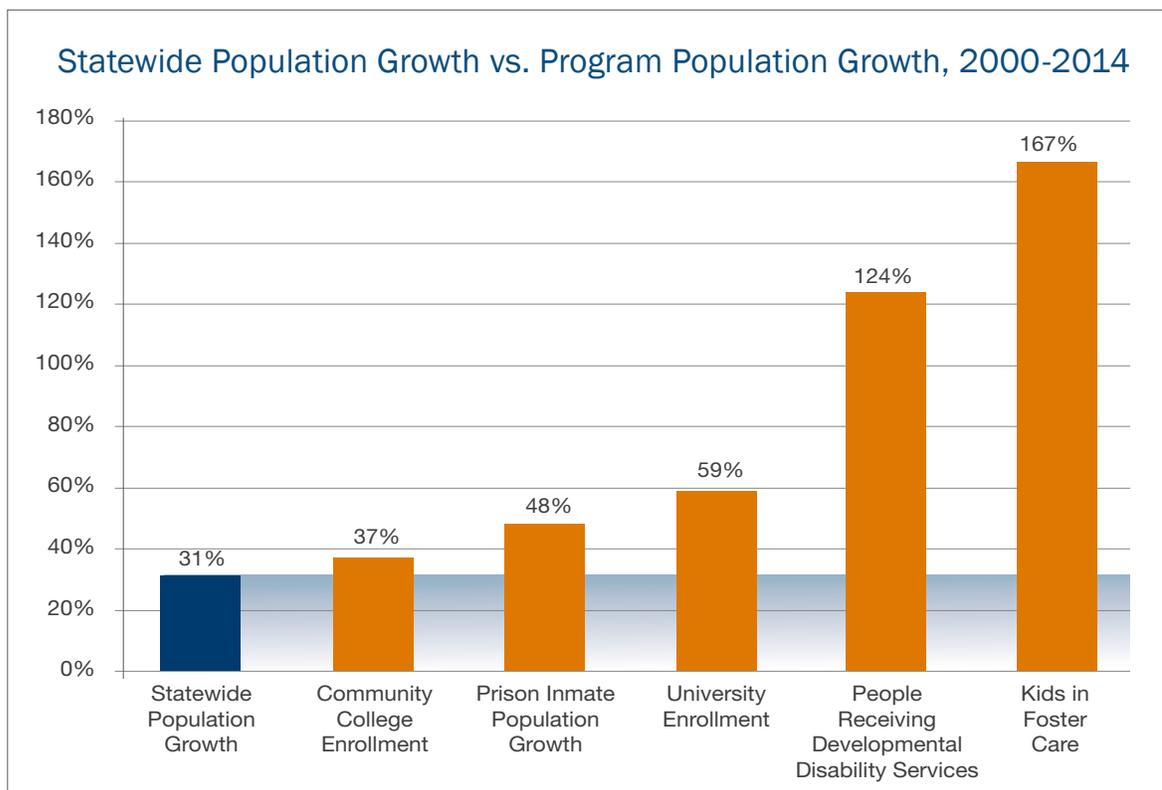
# BUDGET AND TAXES

## Why does state spending grow faster than the general population and inflation?

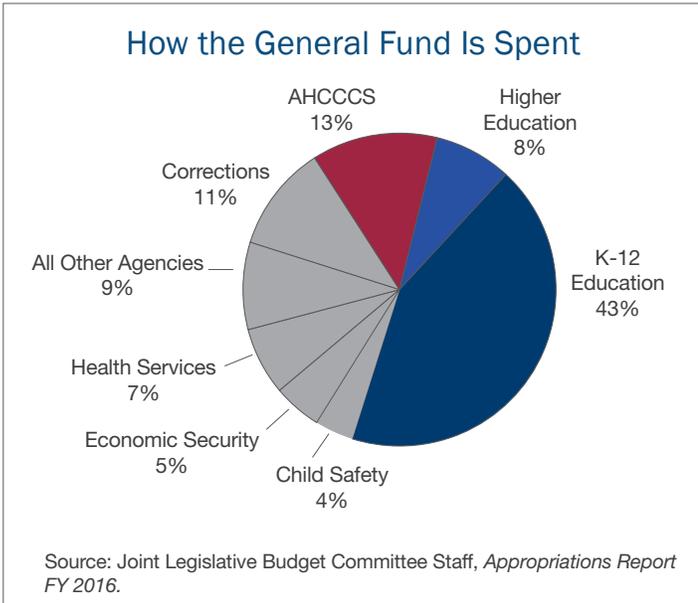
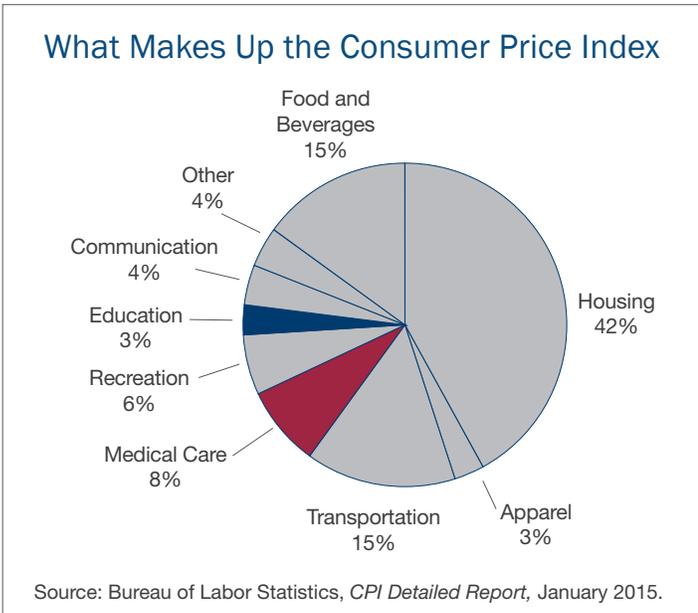
The populations and costs that shape state priorities are significantly different from the general population or general inflation. Any law or constitutional amendment that ties the complex state budget to a mathematical formula based on general population and inflation is like ordering pizza for five teenage boys based on the appetite of a senior citizen couple living in Sun City.

Over 20 states, including Arizona, have considered and rejected putting these TABOR formulas into their budget process. Only Colorado has adopted this so-called “taxpayer bill of rights.” It was such a disaster for the economy, schools, roads, healthcare, and public safety that Colorado voted to suspend it. State business leaders agree that TABOR led to slower job growth and delayed recovery from recessions.

**Population:** Many of the groups that drive the state budget grow far faster than the statewide population, including prison inmates, community college and university students, children in foster care, and children and adults participating in services for developmental disabilities.



**Inflation:** The mix of costs that go into measuring inflation is far different from the mix of costs that affect state spending. For instance, education—from kindergarten through post-secondary education—makes up 51 percent of Arizona’s budget, while education is only 3 percent of the cost that goes into determining the Consumer Price Index (CPI). Medical costs make up only 8 percent of the CPI, while AHCCCS/Medicaid health care costs make up 13 percent of state spending. On the other hand, food and beverages make up 15 percent of the CPI, while only a handful of state agencies, such as the prisons and the Arizona Pioneers Home, have food costs in their budget.



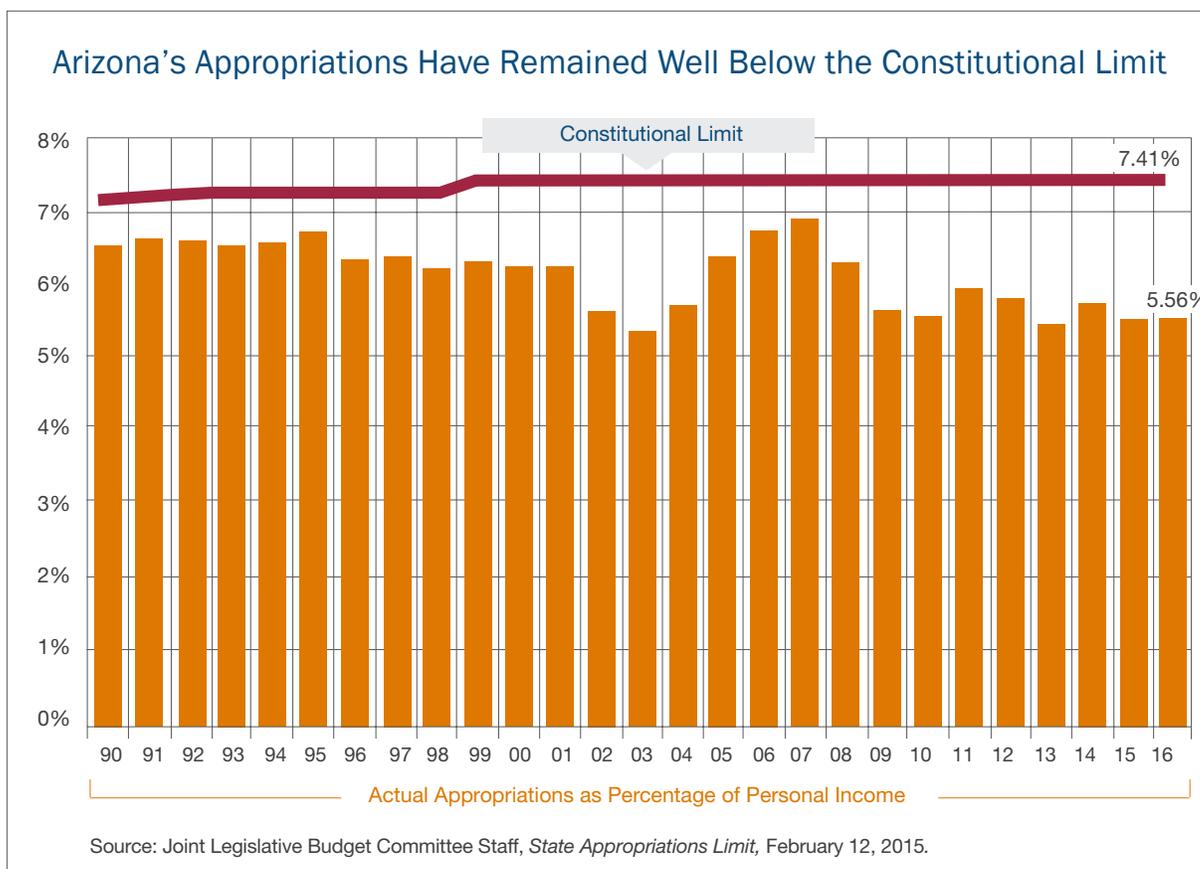


# BUDGET AND TAXES

## Does Arizona have limits on taxes and spending?

Yes. Arizona has a number of constitutional provisions that limit spending and revenue increases.

The Arizona constitution contains a limit on state spending that applies to all appropriated funds, not just the state's general fund. This limit is based on the size of the overall state economy. Currently the limit is 7.41 percent of total state personal income.



NOTE: The statutory limit is adjusted whenever government functions or funding responsibilities transfer between levels of government.

The Arizona constitution also requires that any legislation that would increase net state revenues must be approved by a two-thirds majority in the state House and Senate. This encompasses adopting new taxes or increasing rates on existing taxes. It also includes any reduction or elimination of tax deductions, credits, exemptions or exclusions. (Fees and assessments that are authorized by statute and are set by a state officer or agency do not require a two-thirds vote.) Unlike revenue increases, passing tax cuts, adopting or expanding new credits, or any other action that *reduces* state revenues requires only a simple majority vote.

Article 9, Section 3 of the Arizona constitution requires the legislature to provide sufficient sources of revenues to defray the ordinary expenses of the state for each fiscal year. In other words, the state budget must be balanced every year.

The state constitution also includes limits on expenditures from school districts and community college districts and limits on property taxes levied by counties, cities, towns, and community college districts.

