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The Teapublican Budget: Budgeting, Taxing, and Spending in Arizona

Abstract: In 2011, the revenue shortages of the past several years and Tea Party ideology largely drove the legislative session in Arizona. This budget report examines the broader context in which decisions were made and concludes with an overview of financial issues facing the state.

Keywords: Arizona; budgeting; governor; legislature; spending; taxing; Tea Party; western budget report

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1 Introduction

In 2011, the past several years' revenue shortages and ideological considerations largely drove budgetary decision making in Arizona. Conservative legislators with a Tea Party outlook took charge of the process. This report examines the broader context in which decisions were made, the budgeting system as well as the making of the budget. It concludes with an overview of the financial issues facing the state.

2 Social, Economic, and Political Context

As Table 1 indicates, Arizona's population stood at 6.4 million in 2010, a 25% increase since 2000. This growth rate was second in the nation to Nevada. Population growth gave Arizona an additional congressional seat – raising the total to nine. The rate of growth, however, was not as high as expected in large part because the Hispanic population did not increase as much as anticipated.

Measures	Arizona	USA
Population 2010	6,392,017	308,745,538
Population, % change, 2000–2010	24.6%	9.7%
Population 2000	5,130,607	281,424,602
Persons under 5 years old, % 2010	7.1%	6.5%
Persons under 18 years old, % 2010	25.5%	24.0%
Persons 65 years old and over, % 2010	13.8%	13.0%
Female persons, % 2010	50.3%	50.8%
White Persons, % 2010	73.0%	72.4%
Black Persons, % 2010	4.1%	12.6%
American Indian, % 2010	4.6%	0.9%
Asian persons, % 2010	2.8%	4.8%
Persons of Hispanic or Latino origin, % 2010	29.6%	16.3%
White persons not Hispanic persons, % 2010	57.8%	63.7%
Per capita money income (2009 dollars)	\$25,203	\$27,041
Median household income, 2009	\$48,711	\$50,112
Unemployment Rate (June, 2011)	9.3%	9.2%
Persons below poverty level, % 2009	21.2%	14.3%

Table 1: Population characteristics.

Source: U.S. Bureau of the Census, Arizona Joint Legislative Budget Committee.

Declining birth rates among Hispanics help account for this (Arizona Department of Health Services 2009). To some extent, the decline may also reflect the effects of the recession on the availability of jobs and of the anti-legal immigrant campaign in the state (Pew Hispanic Research Center).

Nevertheless, the Hispanic percent of the population soared over the decade, from 25 to 30 from 2000 to 2010. By far, Hispanics are the state's largest minority – Native Americans comprise 5% of the population, Blacks 4%, and Asians 3%. The state also has a comparatively large young population (percent 18 and under 5) and old population (percent over 65). As a result, there is a high dependency ratio, which means that those in the labor force have a relatively heavy burden in paying for government programs for those who not in the labor force¹.

In late 2010 and early 2011 – a time when budgeting matters were being considered – economic indicators for Arizona were not encouraging. In 2010,

¹ According to the U.S. Statistical Abstract 2011, Arizona's dependency ratio was 65.7 in 2000 and 65.0 in 2009. While it slightly declined over this period, it remained considerably higher than the national average: in the U.S., as a whole, the dependency ratio was 61.6 in 2000 and 59.2 in 2009).

the state stood 10th from the bottom in per capita income, and only had a 2.1% growth rate compared with the national average of 3% (only Nevada and South Dakota had a worse rate). Government figures in September 2010 found Arizona the second poorest state in the nation, such that more than one in five Arizonans (21.2%) lived in poverty. Only Mississippi was worse by this measurement (U.S. Census Bureau). In March 2011, the seasonally adjusted jobless rate slipped to 9.5%. It would have been worse but for the spending of winter visitors. In April 2011, over 16% of the housing stock in the state (464,000 units) was vacant.

Politically, Republicans have long outnumbered Democrats in the state, though the most noticeable trend in recent years has been the rapid growth in the number of independent voters. The number of voters registered as “independents or other” has grown to the extent that it currently exceeds the number of registered Democrats and is close to the number of registered Republicans (Table 2). Republicans have enjoyed an edge in legislative elections over the past several decades. They 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. At various times, though, they have had to contend with a Democratic governor (Table 3).

Party	2002	2004	2006	2008	2010	2011
Republican	925,485	1,055,252	1,014,690	1,118,587	1,131,802	1,138,802
Democrat	799,653	914,264	854,228	1,022,252	1,002,937	999,232
Libertarian	14,259	18,261	17,446	18,153	24,382	24,854
Green				4,009	4,820	5,174
Other/independent	489,783	655,554	682,037	828,450	982,477	1,043,649

Table 2: Party registration.

Sources: Arizona Capitol Times, *Political Almanac 2011*, Arizona Secretary of State count for July 1, 2011.

Year	House R	House D	Senate R	Senate D	Governor
2001–2002	36	24	15	15	R
2003–2004	39	21	17	13	D
2005–2006	38	22	18	12	D
2007–2008	33	27	17	13	D
2009–2010	35	25	18	12	D
2010–2011	40	20	21	9	R

Table 3: Party control of legislature, Office of the Governor.

Source: Arizona Capitol Times, *Political Almanac 2011*.

3 Budgeting Law and Process

Under the executive budgeting system adopted in 1966, the governor is the central general fund 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 employed a Joint Legislative Budget Committee (JLBC), which has its own permanent staff to conduct 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 (though, at times, including last year, appropriations bills have been drafted hastily with little to no public input permitted). The adoption of the general budget requires a majority vote of the entire membership in each legislative body – 31 house members, 16 senators.

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. Arizona legislators missed a July 1 deadline for coming up with a balanced general fund budget for fiscal year 2010 without any penalty. As noted below, in 2011 legislators did not even go through the motions of balancing the budget for FY 2011 by July 1. Rather than attempt to balance expenditures and revenues in the budget for FY 2011, they decided to regard the debt incurred that year as something to be dealt with in making the FY 2012 budget.

Various other legal constraints, however, do 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". Under existing political conditions, this requirement 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% of what constitutes the general fund budget qualifies as mandatory rather

than discretionary spending. 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 begin to search for ways to trimming expenditures.

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 for 6–7% a year.

Some of the formula spending is self-imposed by the legislature and can be changed by altering a statute or being side stepped by legislation diverting the flow of revenue to other purposes. A good portion of the mandated formula spending, however, is the result of voter-approved measures. These are difficult to change because of Proposition 105 (i.e., 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. In 2004, voters approved a proposition that required that any new program adopted by 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, as evidenced in the discussion of health care.

State lawmakers only have 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 cleanup, and job training. There are approximately 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 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. Both municipalities and counties, however, have reason to fear “takeaways”, that is, legislative decisions to redirect revenue streams away from cities and towns into the state budget.

4 Recent History

The election of Janet Napolitano as governor 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 Napolitano, however, was frequently able to forge a winning coalition of Democrats and moderate Republicans.

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

Not long after taking office, Governor Brewer kicked up a storm in her own party by vetoing key parts of the legislature's budget and suggesting the referral of a temporary sales tax increase to voters. Several Republican legislators had taken a pledge not to raise taxes and were unwilling to even refer the question to the voters. After close to a year of fighting she got the sales tax proposal through the legislature as a way of protecting core services, especially education, until the economy improved. Voter approval of the temporary sales tax in May 2010 by nearly a two-to-one margin came as somewhat of a surprise in a state where anti-tax, anti-government politicians are prominent.

Brewer and the legislature worked out a “balanced budget” in 2010, which was contingent not only on voter approval of the sales tax hike but on voter approval of proposed spending cuts worth about \$450 million in the November 2010 election. Voters, however, rejected the spending cuts. This, along with revenue shortfalls and increased costs, left the state with a projected deficit of \$763 million six months into the FY 2011 budget.

In 2010, Brewer was re-elected, benefiting – like other Republicans – from popular support for an illegal immigration bill (Senate Bill 1070) she signed into law. The 2010 election catapulted a record number of Republicans to the Legislature, giving the party a supermajority control of the two chambers – a lead over the Democrats of 40-20 in the House and 21-9 in the Senate. An unusually large number of the Republicans members were from the far right wing of the party and were endorsed by Tea Party groups devoted to down-sizing government by reeling in government spending. The result was what some observers called a “Teapublican” budget.

5 Budgeting in 2011

Arizona, like most other states, faced daunting fiscal challenges in 2010–2011, including a recession, a decline in revenues, and a continuing need for services; meanwhile, options for addressing shortfalls and the general fiscal problem dwindled. The state was suffering from both a serious cyclical budget shortfall due to a temporary collapse of revenue because of the recession – and a chronic, longer-term, structural imbalance largely due to policy choices, especially a number of tax cuts, made when the economy was stronger. Starting in 1993 the state made tax cuts each year through FY 2000 and, again, from FY 2005 through FY 2100. When adjusted for population growth, inflation, and real per capita economic growth, this cumulative impact of the cuts amounted to \$2.9 billion. A majority of the cuts came from the personal income tax (Murray et al. 2011).

Over the past several years, the state has used a combination of reserve funds and federal stimulus funds, along with budget cuts and tax increases, to close these recession-induced deficits. This year the legislature simplified matters by placing a strong emphasis on spending cuts.

As in the past, the budgeting process in 2011–2012 was one in which only a few people – the governor, President of the Senate, and Speaker of the House – did the heavy lifting behind closed doors, and members of the minority party played little or no role. There were differences among those most involved. In particular, Brewer was more inclined than legislature leaders to use accounting maneuvers (i.e., new debt or rollovers) and to spare cuts in K-12 education spending. Throughout the process, though, the governor and Republican leaders in both houses stuck to the budget strategy of scaling back the state’s Medicaid program known as the Arizona Health Care Cost Containment (AHCCCS) program.

Year	Enrollees
2002	787,573
2003	952,682
2004	954,626
2005	1,047,982
2006	1,035,407
2007	1,053,943
2008	1,114,548
2009	1,275,109

Table 4: AHCCCS annual historical enrollment figures.

Source: Morrison Institute for Public Policy, Arizona State University, Arizona Indicators, <http://arizonaindicators.org/>.

At the time the budget was being considered, one out of every five Arizonans, or some 1.3 million people, were in the AHCCCS program (see Table 4). Cost and enrollment increases in the program skyrocketed because of the job losses and reduced incomes brought about by the recession. In Arizona, the financial problem for the state was particularly severe, because the voters adopted a measure in 2000 that extended coverage to all Arizonans living below the federal poverty line. Prior to this, the law set eligibility at around 33% of the poverty level. The proposition raised the coverage level to the most generous in the nation.

In February 2011 the governor proposed an \$8.9 billion spending plan, to erase what she saw as a FY 2011 deficit of approximately \$764 million and \$1.2 billion for FY 2012. She targeted higher education for \$170 million, community colleges for \$89 million, and AHCCCS for some \$542 million by dropping 280,000 Arizonans from coverage. She also asked for a “rollover” of \$245 million in funding for public education. Additionally, she proposed the use of an accounting gimmick to balance the budget in which the state would borrow \$300 million on June 30 and pay it back the following day, July 1, the beginning of the next fiscal year.

No sooner had the governor and legislative leaders begun negotiations when, in March, Senate leaders – apparently unhappy with what they saw as gimmicks and lack of real cuts in the governor’s budget – decided to act unilaterally and adopt their own version of the budget. The Senate budget called for spending \$700 million less than the governor proposed. The plan took an extra \$60 million from the universities and some \$250 million out of K-12 funding. In effect, the Senate’s budget proposals, rather than that of governors, became the baseline for further negotiations (Coakley and del Puerto 2011).

The final budget, adopted mostly along party lines (Republicans for, Democrats against), called for \$8.3 billion in spending for fiscal year beginning July 1, some \$400 million less than the governor’s original proposal. It relied heavily on spending cuts. There were no new taxes or borrowing or rollovers. Spending cuts totaled \$1.1 billion, and most of these came out from funds for education and health care for the poor. Rather than deal with unanticipated deficits in the FY 2011 budget by making last minute maneuvers, the legislature took the route of simply allowing the budget for FY 2011 to end in the red to the tune of \$332 million, and then folding this shortfall into the budget for FY 2012.

The budget plan directed the governor to find ways of taking over \$500 million from AHCCCS, close to half of the projected deficit. She moved to do this by phasing out coverage for childless adults and imposing co-pays and various penalties and charges for people who abuse the system (e.g., by making unnecessary use of hospital emergency rooms, or have unhealthy life styles such as smoking, among others).

By going this route, the state sacrificed \$1 billion in federal matching funds. The restriction on eligibility also meant the loss of medical coverage for up to 160,000 Arizonians and the loss of an estimated 14,000 private health care jobs. Dropping thousands from the program was also expected to undo hospital service, especially in rural areas, and to bring larger crowds and costs to emergency rooms.

Lawmakers rejected an alternative put forth by a coalition of health care institutions that would have avoided the loss in federal dollars, medical coverage, and employment through a special assessment tax on their operations (which would be reimbursed). The taxes on health care institutions of this nature are used by several other states.

Federal rules did not require that childless adults be covered, but federal permission was sought and given to make other changes in the program. The changes in AHCCCS were challenged by lawyers for a trio of public interest law firms in state court as in violation of the mandates in the 2000 initiative extending coverage – the cuts, though, have been upheld thus far.

Backtracking a bit, budget deliberations led to a reversal of a decision that took effect in October, 2010 to no longer fund several types of medical transplants. At that time, lawmakers concluded that these transplants, costing about \$1.2 million, were not proven effective in extending the life of patients and were an unnecessary expense especially at a time when the state was facing a large deficit. Advocates of transplants disputed the lawmakers' claims concerning their effectiveness.

The decision left a hundred AHCCCS patients, who had been on the waiting list for transplants, without coverage. Two of these people died following the defunding of the program. The state received widespread negative publicity for cutting the program, and Democrats in the legislature kept the issue alive by constantly contending that the \$1.1 million could be easily found in the budget in spite of the shortfalls. Commenting on the restoration of funds, an editorial in the *Arizona Republic* noted: "Arizona made headlines around the world when it cut off funding for certain types of transplants. Ninety-eight people on the waiting list were suddenly denied hope. None on this ever made any sense. Cutting off transplants was cold-hearted and dumb" (Editorial 2011).

In addition to health care cuts, major spending cuts in the budget included \$198 million from universities, \$183 million from K-12 schools, \$73 million from community colleges, \$50 million from the Department of Economic Security, which provides the state's safety-net programs, and \$53 million from the Department of Health Services. The budget plan took away a subsidy for child-care fees for working poor families. This bought a savings close to \$14 million but a loss of \$40 million in federal matching funds. The cut ended

support for over 13,000 children and threatened the jobs of some 1,600 child-care workers.

Brewer conceded to legislative leaders in agreeing to cut \$50 million more than she had proposed for K-12 funding. Educators accused Brewer of going back on her promise to protect state aid to public schools when she campaigned for the temporary sales tax hike in 2010. They expected education to be protected as a result of sales tax increases. Brewer claimed, however, that she never said the sales tax would be enough to avoid cuts in education.

Another highly significant piece of revenue legislation that was passed prior to the adoption of the budget was a 214-page “jobs creation” bill the governor and legislative leaders crafted and rapidly shuttled through the legislature in February. One part of the bill created the Arizona Commerce Authority. This semi-independent public-private authority headed by business leaders was slated to replace the Department of Commerce to focus on bringing new businesses to the state. It was given discretion in spending over \$30 million a year in doing so.

The measure also created a series of tax breaks to stimulate the economy. Included among these was a cut in the corporate income tax rate from close to 7% to 4.9% between FYs 2014 and 2018. This came in answer to a long-standing complaint that the tax system favored homeowners at the expense of business and put Arizona at a competitive disadvantage when it comes to attracting and retaining businesses. While it is unclear whether or not the tax cuts and incentives included in the bill will actually generate the desired new business development, the cuts are estimated to result in \$38.2 million in reduced revenue for FY 2012 and over half a billion dollars by FY 2018 when all the elements of the bill are implemented.

By the end of the session, relations between the governor and the legislature were strained. The governor did not do well in budget negotiations – the budget cuts were more severe than she had proposed. By May, on the other hand, she had reasserted her strength by vetoing 29 bills, more than twice as many as she vetoed the previous year. These included a “birther bill” that would have required presidential candidates to prove their natural born citizenship to get on the Arizona ballot – something that legislative conservatives believed would disqualify President Obama. Brewer branded the bill a “bridge too far” that “creates significant new problems while failing to do anything constructive for Arizona” (Governor Veto Letter, April 18). Another measure vetoed by the governor was a spending limitation along the lines adopted in Colorado – a measure she felt was too restrictive and had proven to have been a failure in that state (Governor Veto Letter, March 28).

The governor also vetoed a measure that allowed guns on campuses and other public facilities, saying that it was poorly drafted, as well as two tax-cut measures and a school choice bill that, she felt, would have an adverse effect

on the state's finances and undermine the just-approved budget. Some conservatives openly questioned if she was still one of them (Rough and Rau 2011).

The legislature struck back on an unemployment extension issue. Called into a special session in June by the governor, they refused to even consider her request to extend the period that Arizonans can collect unemployment benefits from 79 to 99 weeks, even though the federal government would pay the bill, effectively cutting off benefits to some 15,000 Arizona households. Some legislators were simply not supportive of unemployment aid, while some blamed the governor for poor communication with the legislature and suggested the rebuff came as payback for her vetoing various bills.

6 Winners and Losers

Overall, the budgetary decisions reflected the viewpoints of the most conservative ideological-minded Republicans. Democrats, a minority in both houses, spent much of their time attempting to protect funding for a variety of programs, keeping issues such as the restoration of transplant services on the agenda, and pointing out ways through which the state could gather in more revenues (e.g., by closing loopholes exempting various transactions from the sales tax). They and other critics characterized the budget package as a declaration of war on the poor, and condemned cutting an already under performing educational system².

Local officials, as they have in recent years, wound up on the losing side – as many of the savings were achieved by shifting costs to them or by taking away revenue sources they were using and diverting them to the general fund. Localities were required to pick up costs for services, such as housing mentally ill patients in state hospitals and maintaining Motor Vehicle Division offices. They also lost a sizeable portion of the revenues they had been receiving from the Highway User Revenue Fund. In addition, the five largest counties were ordered to contribute a combined total of \$38 million to the state general fund. Total costs to municipalities and counties in the 2012 budget amounted to around \$138 million (Russo 2011).

² Arizona consistently ranks at or near the bottom in both educational funding and achievement. In the 2010 Annie E. Casey Foundations “KidsCount” data profiles of the 50 states, Arizona ranked 44th in the percent of 16–19 year olds not in school and not high school graduates (Annie E. Casey). The National Education Association, as part of its annual *Rankings and Estimates* report, also ranks public school revenue per student; for fall of the 2009–2010 school year, Arizona not only ranked 45th, it also ranked last in the nation for expenditures for public K-12 schools per student (National Education Association 2011).

Also coming out on the losing end were some 220,000 state employees required to increase their contribution to the state retirement fund from 50% to 53%. This move, designed to save \$41.3 million, prompted a court challenge.

Business groups generally had more of an impact in the legislature than in the last few years. This was especially true on economic development and tax policies as evidenced in the jobs bill. Hoping to avoid further damage to the state's reputation for extremism on immigration – an image they felt was interfering with the state's ability to compete on the economic field – they also helped scuttle several proposed anti-illegal immigration bills. In addition, business leaders and groups were also out against draconian cuts in education, though this, in the end, appeared to have had little effect.

7 Concluding Observations

The general fund budget adopted for Fiscal Year 2012 amounts to about 31% of the \$27 billion the state expects to spend over that period. The remainder will

Fund Source	Spending (Millions)	Percent of Total Spending
General Fund	\$8,355.4	31%
Other Appropriated Funds	\$3,097.4	12%
Non-Appropriated Funds	\$6,361.5	24%
Federal Funds	\$9,106.6	33%
Total	\$26,920.9	

Table 5: FY 2012 total spending by fund source.

Source: Arizona Joint Legislative Budget Committee.

Budget Unit	Spending (Millions)	Percent of Total Spending
AHCCCS	\$5,993.2	22%
Education (K-12)	\$4,923.4	18%
Universities	\$3,971.3	15%
Economic Security	\$2,710.3	10%
Health Services	\$1,780.0	7%
Corrections	\$1,062.2	3%
Other Agencies	\$5,286.1	20%
Capital	\$1,194.4	4%
Total	\$26,920.9	

Table 6: FY 2012 total spending – all sources.

Source: Arizona Joint Legislative Budget Committee.

Fiscal Year	Revenue	Expenditures
2002	\$6,339.6	\$6,339.6
2003	\$6,232.8	\$6,040.6
2004	\$6,876.2	\$6,515.8
2005	\$8,184.1	\$7,545.1
2006	\$9,814.9	\$8,768.4
2007	\$10,672.2	\$10,200.5
2008	\$10,038.2	\$10,037.2
2009	\$8,273.7	\$8,754.4
2010	\$7,851.5	\$7,857.2
2011	\$8,002.1	\$8,334.3
2012	\$8,331.3	\$8,317.6

Table 7: General fund revenues and expenditures (\$ in millions).

Source: Arizona Joint Legislative Budget Committee.

come from federal funds (some 33%) and other state funds for specific programs, some of which are appropriated by the legislature and some of which are not (Table 5). Looking at total spending from all sources we find AHCCCS leading K-12 and all other conventional categories of spending (Table 6).

The general fund expenditures for FY 2012 of about \$8.3 billion are about the same as last year, but considerably lower than the over \$10 billion reached in 2007–2008 (Table 7). K-12 education continues to be the largest single expenditure in the general fund budget. When we compare the budgets of FYs 2002 and

	FY 2002 Actual	FY 2012 Appropriated	\$ Change FY 2002–2012	% Change FY 2002–2012
Education (K-12)	\$2,601.9	\$3,436.5	\$834.6	32.1
AHCCCS	\$500.3	\$1,363.7	\$863.4	172.6
Corrections	\$541.1	\$948.2	\$407.1	75.2
Universities	\$765.8	\$682.5	\$(83.3)	(10.9)
Economic Security	\$434.6	\$602.6	\$168.0	38.7
Health Services	\$279.1	\$493.3	\$215.2	77.1
Community Colleges	\$137.2	\$71.1	\$(66.1)	(48.2)
School Facilities Board	\$383.6	\$164.1	\$(219.5)	NA
Public Safety	\$48.9	\$46.5	\$(2.4)	(4.9)
Other	\$578.8	\$545.9	\$(32.9)	(19.3)
Total	\$6,271.3	\$8,355.4	\$2,005.1	32.0

Table 8: Comparison of the nine largest general fund operating budgets FY 2002 vs. FY 2012 (\$ in millions).

Source: Arizona Joint Legislative Budget Committee.

2012, K-12 education shows some modest growth, but the real winners have been AHCCCS, health services, and corrections. The losers have been community colleges and universities (Table 8). Legislative leaders see no need to restore these cuts even if the revenue situation should improve, as some signs have indicated (del Puerto, June 20, 28, 2011a,b). Given the economic and political conditions, emphasis is likely to continue to be on spending cuts.

Thus far, the legislature has ignored studies on tax reform, including one by a blue ribbon panel of economists that the legislature commissioned. Study groups and community gatherings, such as Arizona Town Hall, have advocated reviewing Arizona's tax policy and, for example, exploring the feasibility of taxing services; however, there is no political will in the legislature and executive branch to do so. Meanwhile, it does appear that measures perceived as spending limits, such as a "Taxpayers Bill of Rights" (TABOR) will continue to find interest and life at the legislature though some studies have indicated that this would likely have a devastating effect on the ability of the state to fund basic services (Hoffman et al. 2011).

In 2011, the legislature did adopt a measure to encourage Arizonians to voluntarily pay state sales taxes on items they buy online. Legislators had hoped to raise \$1million even though compliance was left, in effect, on a voluntarily basis. Arizona legislators also signed on to a flat tax proposal that sailed through the House before any one even bothered to crunch the numbers. The Department of Revenue later informed them that the bill would raise the taxes of six out of seven households, such that only those making more than \$100,000 a year would pay less. The sponsor withdrew his bill. Conservatives, though, are ideologically committed to the flat tax idea and the idea is likely to surface again.

Though having little support in the legislature, many observers insist that the problem in Arizona is not too much spending but too little revenue, and that it is time for lawmakers to look for long-term revenue solutions to budgeting problems. The revenue problem is, indeed, a challenging one. Federal assistance for states has been helpful in avoiding further budget cuts but are now largely gone and seem unlikely to increase in the immediate future. The state, moreover, is likely to experience a severe revenue drop when the temporary sales tax expires and the tax cuts in the jobs bill set in.

Compared with citizens in other states, Arizonans do not hand over much in terms of taxes, fees, and other charges to their state and local governments. The Tax Foundation estimates for 2009 (the most recent year available) shows Arizona ranked 38th nationally in combined state and local tax burden (Tax Foundation 2011a).

Where to look for more revenue? Arizona politicians have generally preferred the sales tax to other sources of tax revenue and are unusually reliant on this

Fiscal Year	Sales	Individual Income	Corporate Income	Other
2002	48.1%	33.4%	5.5%	12.9%
2003	48.8%	33.7%	6.3%	11.2%
2004	49.2%	34.5%	7.4%	8.9%
2005	46.1%	36.4%	8.8%	8.7%
2006	46.0%	39.7%	9.4%	4.8%
2007	46.9%	38.9%	10.2%	3.9%
2008	45.5%	35.6%	8.5%	10.4%
2009	45.5%	31.1%	7.2%	16.1%
2010	41.1%	29.0%	5.0%	25.0%
2011	53.7%	32.0%	7.3%	7.0%
2012	52.7%	30.8%	7.9%	8.5%

Table 9: General fund major tax sources as percentages of total revenue.

Source: Arizona Joint Legislative Budget Committee.

source of revenue. According to the Joint Legislative Budget Committee, nearly 53% of the state's General Fund in FY 2012 will come from sales tax. This percent had increased in recent years, in part because of the temporary sales tax (Table 9).

Continued reliance on sales tax reflects 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, conventioners, 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 likewise point out that the sales tax tends to be regressive, disproportionately burdening low-income people.

Still, the state could generate some \$2 billion without hurting competitiveness or low-income families by taxing services and lowering the sales tax rate by several pennies (Morrison Institute 2010). A more diversified and progressive revenue structure could be reached through a revitalized state income tax. By the most recent measurement, Arizona is 41st in per capita income tax collections among the 43 states that have such taxes (Tax Foundation 2011b).

Along with tax restructuring, several reforms seem in order with regards improving legislative flexibility on budgeting matters and in improving the process itself. Legislative flexibility could be greatly improved by ballot measures, such as eliminating the requirement of a supermajority legislative vote for revenue increases (returning to a majority vote requirement), giving lawmakers the ability to waive voter-approved spending mandates during economic downturns, requiring voters to reauthorize voter-approved spending every 8 years, and replacing the existing cap on general obligation bonds of \$350,000 (set when

Arizona became a state) with one that raises the limit to no more than 5% of the state's assessed property value.

As for the process itself, 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% of state revenues. The original cap was 15%. In comparison, some states have no caps at all on how much can go into their rainy day accounts.

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