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Dealing with a Surplus: Budgeting, Taxing, and Spending in Arizona

Abstract: Arizona's 50th regular legislative session ended in May, 2012, after 116 days. It will be remembered for headlines, sometimes national ones, involving the ethical behavior of lawmakers (or the lack thereof), an attempt to remove the chair of the independent redistricting commission and various eye-catching legislative proposals or laws. This report examines the broader context in which decisions were made, the nature of the budgeting system, the making of the budget, and concludes with an overview of financial issues facing budget makers.

Keywords: Arizona; budget; FY 2012–13; governor; legislature.

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1 Introduction

Arizona's 50th regular legislative session ended in May, 2012, after 116 days. It will be remembered for headlines, sometimes national ones, involving the ethical behavior of lawmakers (or the lack thereof) an attempt to remove the chair of the independent redistricting commission and various eye-catching legislative proposals or laws.

Along the way, lawmakers came up with a General Fund budget for fiscal year 2013. The budget itself accounts for only 31% of what the state government spends. The remainder comes from federal funds (34%) and other state funds for specific programs, some of which are appropriated by the legislature and some of which are not (35%) (see Table 1).

Still, while the general fund budget does not tell us all we need to know about how the state raises and allocates funds, its making has long been a central focus of state politics. The year 2012 was no exception through the exercise was far less dramatic than in the previous 2 years.

In 2010 and 2011 budget making in Arizona – a place where the Great Recession had a particularly strong impact – was driven by revenue shortages. Governor and legislative leaders of a conservative bent dealt with the situation through spending cuts, fund transfers, borrowing, and accounting

Table 1: Arizona State Government Total Spending by Fund Source, FY 2013.

Fund source	Spending (Millions)	Percentage of Total
General fund	$8608.9	31
Other appropriated funds	3330.1	12
Non-appropriated funds	6440.6	23
Federal funds	9473.2	34
Total	$27,852.8	

Source: Arizona Joint State Legislative Budget Committee.

gimmicks. Voters helped out in 2010 by approving a temporary sales tax increase.

In 2012, the economy showed some improvement and state budgeting was largely driven by an anticipated growth in revenues. Ideological considerations, however, remained important in determining how the anticipated surplus funds should be distributed. Legislators also proved true to form in passing a tax-cutting package.

This report examines the broader context in which decisions were made, the nature of the budgeting system, the making of the budget, and concludes with an overview of financial issues facing budget makers.

2 Social, Economic, Political Context

As Table 2 indicates, Arizona's population in 2010 stood at 6.39 million, a 25% increase since 2000. The rate of growth between 2000 and 2010 was second in the nation to Nevada. Total growth gave Arizona an additional congressional seat – raising the total to nine.

Hispanics are by far the state's largest minority, comprising 30% of the population. Native Americans make up 5%, Blacks 4%, and Asians, 3%. The state has a comparatively large young population and old population. This results in a high dependency ratio – meaning that those in the labor force have a relatively heavy burden in paying for government programs for those not in the labor force.[1]

Arizona's economy appears to be improving though it may take 5 years or more for a full recovery. The recession brought a loss of over 300,000 jobs in the

1 According to the US Statistical Abstract 2012, Arizona's dependency ratio was 65.7 in 2000 and 64.7 in 2010. While it slightly declined over this period it remained considerably higher than the national average: in the US as a whole the dependency ratio was 61.6 in 2000 and 58.9 in 2010).

Table 2: Population Characteristics.

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%
Unemployment rate (March 2013)	7.9%	7.6%
Persons below poverty level, %, 2007–2011	16.2%	14.3%

Source: US Bureau of the Census, Arizona Joint Legislative Budget Committee.
*Census updates for 2011 have Arizona at 6,482,505 and the US at 311,591,917.

state. Thus far, some 78,000 have been regained – another 48,000 are expected by economists by the end of 2012. There has also been a dip in the mortgage delinquency rate and a rise in housing prices (del Puerto 2012b). Over the past several decades, though, the poverty rate in Arizona has generally ranged from 1 to 2% higher than the national average (Rex 2012).

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 3).

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 faced a Democratic governor (Table 4).

Table 3: Party Registration.

Party	2002	2004	2006	2008	2010	2012[a]
Republican	925,485	1,055,252	1,014,690	1,118,587	1,131,802	1,134,094
Democrat	799,653	914,264	854,228	1,022,252	1,002,937	952,907
Libertarian	14,259	18,261	17,446	18,153	24,382	22,530
Green				4009	4820	4929
Other/independent	489,783	655,554	682,037	828,450	982,477	1,037,155

Sources: Arizona Capitol Times, *Political Almanac 2011*, Arizona Secretary of State count for July 1, 2011. [a]As of March 1, 2012.

3 Budgeting Law and Process

Since 2004 Arizona has been one of two states – Kansas is the other – in which large state agencies, bring especially volatile to periodic and unforeseen expenditure changes, are budgeted on an annual basis while small agencies are budgeted biennially. This bifurcated approach, however, has been suspended since 2010 when revenue shortfalls forced lawmakers to evaluate every agency on an annual basis.

Under the executive budgeting system adopted in 1966, department heads are required by law to submit their spending plans for the following fiscal year to staffers in the Governor's Office of Strategic Planning and Budgeting (OSPB) by September 1 each year. The governor's staff reviews and revises these plans in accordance with the governor's priorities and in light of anticipated revenues. The governor then sends his or her proposals to the legislature, by law, within 5 days after the start of the regular session.

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 do independent research, analyze the departmental requests, and prepare alternative budgets for each agency. The

Table 4: Party Control of Legislature, Office of Governor.

Year	House R	House D	Senate R	Senate D	Governor
2001 and 2002	36	24	15	15	R
2003 and 2004	39	21	17	13	D
2005 and 2006	38	22	18	12	D
2007 and 2008	33	27	17	13	D
2009 and 2010	35	25	18	12	D
2011 and 2012	40	20	21	9	R

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

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 time, 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 General Appropriation Act (the "feed bill") which includes General Fund appropriations to various state agencies is the primary budget bill. A Capital Outlay bill providing funds for capital projects may also be passed along with several Budget Reconciliation Bills (BRBs) making statutory changes necessary to enact specific appropriations in various subject areas such as criminal justice or health care. The governor may sign the bills, permit them to go into effect without his or her signature, or veto the bills. Arizona governors also have a line item veto when it comes to appropriations in the feed bill.

Normally, the governor and a few legislative leaders do most of the heavy lifting in budget-making. Rank and file members of the majority party are briefed and brought in as needed. Members of the minority party in the legislature are largely ignored – what leverage they have comes if there are divisions among those in the majority party or when the governor belongs to their party and is willing and able to work with them.

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 often 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 during negotiations. At times, new revenue projections showing an increase in anticipated revenue have helped resolve impasses between the governor and legislative leaders. In 2005, for example, a new projection that the state was going to have several more million in revenues than previously expected made it possible for each side to get what they wanted and to wrap up their negotiations. In 2008, on the other hand, projections kept getting worse, causing a feeling of panic and despair.

The Arizona Constitution, 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. In 2011 legislators did not even go through the motions of balancing the budget for FY 2011 by July 1. Rather than do this "on paper" they simply folded the shortfall into the budget for FY 2012.

The state also has a spending limitation approved by the voters in 1980 following the adoption of Proposition 13 in California which imposed a severe restriction on spending in that state. The Arizona law restricts total state and local government spending to a percent of the combined personal income of everyone in the state. The percent has been adjusted over the years from the original 7.00% to the current level of 7.41%. The increase was done to accommodate new obligations, a leading example being the expansion of the Arizona Health Care Cost Containment (AHCCCS) program, the state's version of Medicaid. Total spending by Arizona governments, however, has never exceeded the spending cap – the closest it came to this was in 2007 when it hit 6.9% of total personal income.

Various other legal constraints, however, have complicated 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 close to 70% of what goes into the general fund budget qualifies as mandatory rather than discretionary spending.[2] 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 of 6–7% a year.

Some of the formula spending is self-imposed by the legislature and can be changed by altering a statute or gotten around simply 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. Estimates of how much vary widely, because of difficult legal questions over what should be included. A "low-end estimate" by JLBC staff in 2010 indicated voter- protected measures accounted for $800 million of the $8.3 billion in general fund spending, under

2 The percentage was 68 for FY2012 and 67 for FY 20111. (See: Arizona Joint Legislative Budget Committee 2011.)

10% of the total. Their "high end estimate" was $ 3.9 billion, around 47% of the total (Galeener 2010).

Voter-approved spending has been 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, a measure 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.

State lawmakers, in short, 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.

One has been to draw on the state's rainy day fund – technically the Budget Stabilization Fund which was established in 1990. Striking a much larger vein, they have 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 some 270 non-appropriated special and revolving accounts out of which legislators can draw funds if necessary. In some cases, however, sweeps have been successfully challenged in court.

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. 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 often 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 – in part, because conservative Republicans ousted targeted moderate Republican incumbents in several primaries and went on to win their seats. In 2008 Republicans took a lead of 35 to 25 in the House, a gain of 2, and 18 to 12 in the Senate, a gain of one seat. 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.

Shortly 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 1-cent-per-dollar sales tax increase to voters. Several Republican legislators had taken a pledge not to raise taxes and were unwilling to even ask the voters if they were willing to do so. It took nearly a year to get the sales tax proposal through the legislature. In the end, the support of Democrats in the legislature played a crucial role in getting the question sent on to the voters. 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 that 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 6 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 represented 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.

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. Most of this came out of health care for the poor and education.

Another highly significant piece of revenue legislation that passed prior to the adoption of the budget was a 214 paged "jobs creation" bill the governor and legislative leaders crafted and rapidly shuttled though 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 and 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 made 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 fiscal years 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. There was some dispute, however, over whether the tax cuts and incentives included in the bill would actually generate the desired new business development. The cuts were 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.

5 Budgeting in 2012

In January 2012 Governor Brewer, seeing increased revenues, called on the legislature to approve a budget for the upcoming fiscal year calling for the expenditure of $8.9 billion. This included increased spending for education, health services and public services. She also called upon lawmakers to buy back the mortgaged Capitol building – a move taken in 2010 which, as one observer noted, made Arizona "the poster child for extreme budget solutions" (Ingley 2010). The governor based her recommendations on a revenue projection of $9.2 billion. Legislators disagreed with her basic plan and unveiled one of their own that called for an expenditure of $ 8.6 billion, based on a revenue estimate of $ 8.8 billion.

On the legislative side, Brewer dealt with Republican Andy Tobin who, in late April, 2011, had replaced Kirk Adams as Speaker of the House. The later had given up his seat in the legislature to run for Congress. On the Senate side, Republican Steve Pierce a Prescott rancher became Senate president following the ouster of Republican Russell Pearce in a special recall election November 1911. Pearce became the first sitting state legislator in the state's history to be ousted from office by the voters as the result of a recall drive. He was a Tea Party favorite who had gained fame as the leader of the state's campaign against illegal immigration. Steve Pierce later described his job as "herding cats" and one where he strove to quiet things down "to keep us out of the news" (del Puerto 2012d).

Still, Pierce and Tobin were willing slug it out with the governor. Brewer contended that with an improvement in revenues, the state could afford some modest spending increases to meet immediate needs. Legislators, on the other hand, argued that the state needed to hold the line on spending and that the primary goal should be replenishing the state rainy day fund which had been quickly depleted during the recession. This, they said, was necessary to cushion against a loss of close to a billion a year when the one-cent temporary sales tax expires in May 2013. They added that ample reserve funds were needed to help offset the costs to be incurred should the federal Affordable Care Act survive a challenge in the US Supreme Court and go into effect in 2015, to cover expected losses due to federal budget cuts, and cope with other contingencies.

In addition to revenue estimates and priorities, the governor and legislative leaders differed on using fund sweeps – the governor wanted to continue the drawing money from other funds into the general fund to the tune of around $185 million, legislators opposed doing this, though, as noted below, they wound up pushing for one in regard to mortgage settlement funds (Pitzl 2012b).

At one point the governor threatened to veto all bills sent on to her until the legislature came up with a budget she could live with – legislative leaders, held back on giving new legislation a final vote. For a time, Republican leaders gave serious consideration to joining forces with Democratic legislators in putting together a bipartisan budget proposal. Reports surfaced that Democrats were willing to accept the lower revenue projects that the Republican budget makers were working with (a 5% increase) and less spending than the Governor, in exchange for more spending on various social programs.

The bipartisan budget deal fell through, however, after Republican legislative leaders were advised by the governor that she too was willing to accept the more cautious revenue projection and agree to a much smaller spending increase. The governor dismissed that idea that her change had anything to do with the talks going on between Republicans and Democrats in the legislature – she did not expect them to actually reach a deal. Some observers speculated that the governor was more influenced by a report of a group of economists that the revenue growth rate was going to be far less than she had originally anticipated (del Puerto 2012a).

Late in April Brewer and Republican legislative leaders finally agreed on a ten-bill compromise spending package of close to $8.6 billion for Fiscal year 2013. The plan called for a spending increase of $217 million over FY 2012. This was less than sought by the Governor but more than legislative leaders had proposed.

The Governor lost on her plan to repurchase the Capitol and saw some $200 million cut from her request for K-12 funding, but did receive money for a variety of spending proposals she had made. These included $40 million to improve reading skills of elementary school children, $50 million for a new maximum-security prison, and $39 million for programs for the chronically mentally ill. Also included among the Governor's requests was $42 million to the Department of Economic Security to make up for the loss of welfare dollars due to federal budget cuts. Legislative leaders, in turn, got a plan putting $450 million to the rainy day fund as a way of protecting against shortfalls in revenue over the next 3 years.

Only Republican legislators voted for the spending plan. They rejected proposals by Democrats to restore funding for various programs that had been cut in previous years. To Democratic leaders, it was already raining in Arizona and the money heading for the rainy day fund should be directed toward immediate needs in education and for priorities such as the Kids Care Program, providing health care coverage for children of the working poor, enrollment in which was frozen 2 years earlier. The Republicans, they charged, were simply using the rainy day fund to avoid spending on programs they did not like – they later, charged the rainy day funding was also intended by Republicans to help cover tax breaks they were giving to corporations.

Among the programs Republicans decided to fund, Democrats were especially critical of the $50 million for a new maximum security prison. Senate Minority Leader Democrat David Schapira contended: "In a year with a surplus, we have decided to make funding prisons a higher priority than funding health care for kids who, by no choice of their own, do not have access to health insurance" (Fischer 2012a). House Minority Leader Chad Campbell added: "The fact that this budget spends more money incarcerating adults than in educating them says a lot about this state" (Small and del Puerto 2012).

Democrats and housing advocacy groups were upset about the plan's diversion of $50 million out of the Attorney General's Mortgage Settlement Fund into the general fund. They argued that the money – allocated to the state as part of a foreclosure fraud settlement with mortgage-lending firms – was intended to be used to help those directly affected by the foreclosure crisis or to help head off future poor lending practices. Defenders argued that Arizona was correct in following the lead of some other states in using the funds to help balance the general fund budget.

Overall, public input into the process was minimal – public testimony was allowed only in February at appropriation committee hearings on a somewhat different budget plan (Pitzl 2012c).

As they did in 2011, legislators wound up the session by approving a business-friendly tax-cut and credit package designed to encourage investment. Staffers from the governor's office, legislative leaders, and business lobbyists negotiated the package. It called for a 25% reduction in the capital gains tax to be phased in over 3 years, starting in fiscal 2015. Also in the package were provisions increasing property tax deductions on business equipment and a generous tax credit for investments in commercial headquarters, manufacturing plants, or research facilities. Budget analysts estimated that by 2019 the package would be reducing state revenues by $108 million a year. A recent decision the Apple corporation to located a new operations center bringing with it 3600 high-paying jobs in Texas rather than Arizona provided an impetus for the legislation (Duda 2012).

The tax package passed largely along party lines, with Republicans in favor, Democrats opposed.

Some in the majority party though complained that they had little time to consider the proposal, parts of which had been thrown together just hours before the vote took place. One Republican Senator declared: "How on earth am I expected to read a bill on the final day of the legislative session that is approximately 80 pages and understand it in the amount of time I have been allotted to do this?" he complained. "This is ridiculous," he continued. "This is how bad things happen" (Davenport 2012; Fischer 2012b; Pitzl and Rau 2012).

The legislature also voted to put a constitutional amendment on the November 2012 ballot that would give business people a larger brake on the property tax they pay on new business equipment – increasing the current property tax exemption from $68,000 to around $2.4 million.

If approved, this was expected to cost the state some 8.2 million in revenue staring in 2013 (Arizona Joint Legislative Budget Committee 2012a).

6 Winners and Losers

Business groups were happy as they had been the previous year with economic development and tax policies. Their spokespeople were full of praise for the legislature and what it had accomplished (Hamer 2012).

Groups favoring education and various social programs joined in criticism of the priorities reflected in the spending plan, but, at the same time looked at the results as a decided improvement over the last 2 years. Advocates for housing were hostile to the raid on the settlement funds and children's programs advocates were not altogether pleased with the spending plan, while realizing things could have been worse.

Municipal officials were successful in getting legislators to reverse their 2011 decision to make local governments pick up over half of the cost of the state Department of Water Resources. This wound up costing cities and towns $6.3 million and generating many complaints from them. The negative feedback and an improved revenue picture prompted legislators to put the costs they had shifted to local governments back into the General Fund budget.

City and town officials though were less than enthused about that part of the tax package bill adopted at the last moment that changed the formula for distributing shared revenues to their disadvantage and with a measure that requires them to hold their elections at the same time congressional, legislative and statewide elections are held. The latter, they argued, violates the principle of local control and would politicize local non-partisan elections and increase election costs that municipalities have to bear.

Counties got some relief when the legislature repealed legislation shifting responsibility for housing prisoners to them, eliminated a mandate that counties contribute funds to the state's general fund, and did away with a shift of highway funds from the counties for road building to support the state Department of Public Safety and Motor Vehicle Department. Still, county officials could complain that since 2008, counties had been forced by the legislature to absorb $280 in costs, because of program shifts and the diversion of revenues (Knaub 2012).

Arizona legislators also voted to reverse a cost-cutting decision made in 2011 that required some 220,000 state employees up their contribution to the state retirement fund from 50% to 53%. Lawmakers hoped to save $41.3 a year. A judge ruled however that the change violated the state constitution. Lawmakers in 2012 returned to the old 50-50 formula and appropriated $40 million to reimburse employees.

7 Concluding Observations

General fund spending in Arizona has been on a roller coaster ride over the past several years. In 1994 general fund spending as a percentage of personal income stood at 5.0%. It generally declined for several years but began to rise again from fiscal years 2004 to 2007 (from 4.0% to 4.8%) and then to steadily decreased from 2007 to 2012 (4.0% to 3.5%) (See Table 5).

Table 5: General Fund Spending as a Percent of Arizona Personal Income.

Fiscal year	Arizona personal income ($ in billions)	General fund expenditures ($ in millions)	Expenditures % of Personal Income
1994	78.1	3930.1	5.0
1995	86.2	4425.1	5.1
1996	93.1	4532.6	4.9
1997	101.0	4894.3	4.8
1998	110.4	5232.0	4.7
1999	119.8	5893.3	4.9
2000	129.7	6012.3	4.6
2001	140.0	6367.7	4.5
2002	145.2	6338.6	4.4
2003	151.1	6040.6	4.0
2004	162.1	6515.8	4.0
2005	178.8	7545.1	4.2
2006	198.2	8768.4	4.4
2007	213.3	10,200.5	4.8
2008	222.3	10,037.2	4.5
2009	220.4	8754.4	4.0
2010	216.1	7851.5	3.6
2011	222.1	8334.3	3.8
2012	237.5	8317.6	3.5

Sources: Arizona Joint Legislative Budget Committee; University of Arizona Economic and Business Research Center Forecast.

Overall, the budgetary decisions made in Arizona in 2012 reflected the viewpoints of the most conservative ideological-minded Republicans. The general fund budget for FY 2013 of $8.57 billion represents an increase of over some $234 million over the previous year, but the total spending is still considerably lower than the over $10 billion reached in 2007–2008 (Arizona Joint Legislative Budget Committee 2012b).

Even with a budget surplus, Republican lawmakers in 2012 showed little desire to restore previous funding cuts, and proceeded to enact or recommend further cut taxes. In FY 2013, education remains fairly stable, following years of severe cuts, but funding is more than 1.5 billion below what it was 4 years earlier (Fischer 2012a).

The state has suffered 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, Borns, Clark-Johnson, Muro and Vey). The cumulative impact of tax cuts made in the last two sessions alone, most of which go to corporations, could reduce revenues as they are phased in over the next 8 years by $2.5 billion or more (del Puerto 2012c).

Many observers see a challenging revenue problem. 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. The state currently gets about $1 billion a year from temporary sales tax but this is set to expire in June 2013. In November 2012 voters turned down a proposition to make the temporary sales tax a permanent. Recent tax cuts have, in the eyes of many only contributed to the problem though defenders argue they are vital to renewed economic development.

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. The Tax Foundation estimates for 2009 (the most recent year available) has Arizona ranked 38th nationally in combined state and local tax burden (Tax Foundation 2011a). Arizona's state and local tax burden that year was 8.7% of income. This was below the national average of 9.8%. In 1977, the tax burden in Arizona was 10.3% and ranked 18th nationally (Tax Foundation 2012).

Where to look for more revenue? State governments around the country rely to two major tax sources: the sales tax and the individual income tax. In 2011 these two accounted for 83.5% of the taxes collected by the state government in Arizona – comparable to the 82.5% of the taxes collected by state government nationally. Arizona though differed greatly from other states in the extent to which they drew upon these taxes. Arizona state government drew 57.2% of its tax revenue from sales and 26.3% from the income tax. For all states 48.3% of the tax revenue came from sales, and 34.2% came from individual income taxes (United States Bureau of Census 2011).

Arizona politicians have generally preferred the sales tax to other sources of tax revenue and are unusually reliant on this source of revenue. According to the Joint Legislative Budget Committee, over 53% of the state's General Fund in FY 2012 came from sales tax. With the expiration of the temporary tax the percent is expected to be just over 50% in FY 2013 (Table 6).

Continued reliance on the 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, conventioneers, and tourists. Still, over reliance on this particular tax

Table 6: General Fund Major Tax Sources as a Percent of Total Revenue.

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
2013	50.2	34.5	7.0	8.2

Source: Arizona Joint Legislative Budget Committee.

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.

The state could generate billions of dollars a year in tax revenue without hurting competitiveness or low-income families by taxing services and lowering the sales tax rate by several pennies (Murry et al. 2011; Pitzl 2012a) Why, indeed, should some businesses be taxed while others are not? A more diversified and progressive revenue structure could be reach 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).

Recently, two new state task forces were created to examine sales tax issues – one with the central aim of overhauling the code to make it easier for business owners to comply with, and another with the mission, among others, of examining sales tax loopholes.

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