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Arizona: Structurally Balanced Only If You Omit Funding Shortfalls

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Abstract

The FY2018 Arizona budget had the most discretionary dollars in years with the bulk of it directed toward K-12 education. “Structural balance” was maintained, demonstrating a new normal in Arizona budgeting. Expenditure growth was less than inflation and population growth. Another lawsuit was filed with respect to inadequate state investment in school facilities. A more careful analysis finds the state will expend only \$3 for every \$4 it spent in FY2007 adjusted for population growth and inflation. Rollovers continue to take 10 percent of the budget, even though the expansion is in its eighth year. Consequently, structural balance hides a great many fundamental weaknesses.

Introduction

Arizona continues a path of fiscal austerity despite relatively robust economic times nationally. The FY2018 budget saw more discretionary dollars in the budget than in prior years, yet the state still increased expenditures by less than inflation plus population growth and continued a 27-year stretch of reducing taxes—though that effort is now largely done for ideological symbolism since no real excess revenues exist to cut, even from a conservative perspective. Meanwhile, the costs of fiscal austerity mount as a second long-awaited school funding lawsuit was filed over the state’s failure to follow past court rulings on funding school construction and maintenance. In addition, it appears the Arizona Board of Regents (ABOR) has set the state up for another future lawsuit over its state constitutional obligations to fund universities, whose funding has been dramatically cut back. The state’s Republican attorney general beat them to the punch by suing ABOR for high tuition instead of the legislature. To find additional resources, the Arizona Chamber of Commerce and Republican leaders tried to undercut a new minimum wage law put in place by voters that modestly impacted the General Fund but were cut down by the state Supreme Court. The supposedly balanced budget still uses accounting rollovers that are nearly 10 percent of expenditures—far higher than during the last expansion, but since additional revenues are needed to pay for or forestall lawsuits, Arizona will likely continue these rollovers for the foreseeable future. Finally, as the six-tenths of a cent sales tax for education expires on December 31, 2020, lawmakers and education advocates have begun public discussions on what funding should look like from 2021 onward with the status quo being the baseline. Some business leaders are now calling for higher taxes to fund K-12 education, and many advocates would like to see an initiative that could impact the 2018 election for governor.

Arizona Economically Lags Relative to the Nation

For decades Arizona's growth has been built off population increase from people from other states moving to Arizona as well as immigrants, legal and unauthorized, coming across the Mexican border. The Pew Hispanic Center estimates that the number of unauthorized immigrants has gone down by more than one-third from its peak in 2007 due both to lessened economic opportunities and a number of anti-authorized immigrant bills passed by the legislature over the last dozen years beyond SB1070, which was signed on April 25, 2010 and subsequently mostly struck down by the U.S. Supreme Court (Pew Hispanic Center 2016). Nonetheless, population growth in Arizona continues to surpass the United States, especially in the most recent years of the economic expansion as shown in Figure 1.

However, the state's economic performance seems to lag behind the United States as a whole. The U-3 unemployment rate, the version normally cited in press reports, has remained about half a point higher than the national average over the last few years. Additionally, a higher population and growing job market should lead to growth in the labor force further exceeded by growth in employment, yet Arizona has struggled to reach this as noted in Figure 2 below.

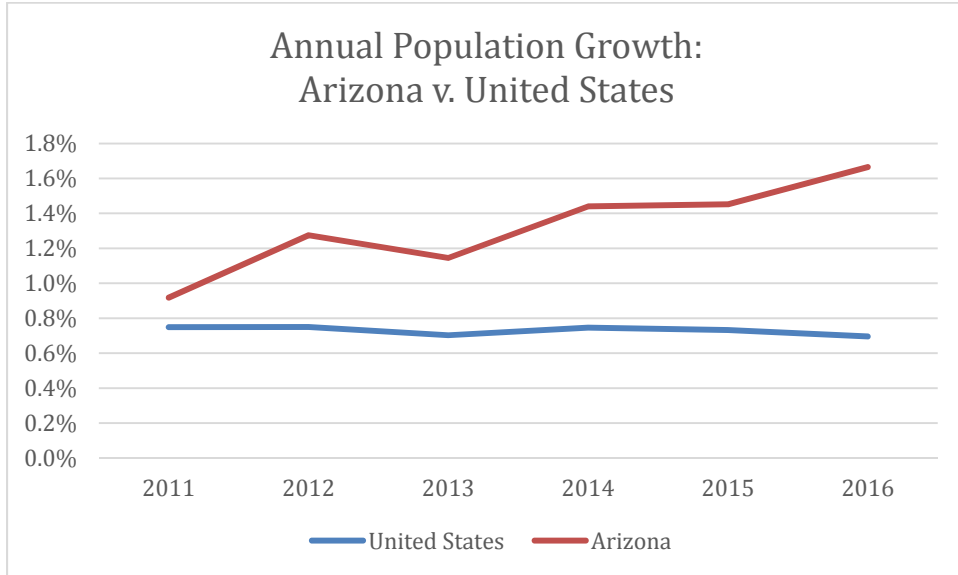
Consequently, Arizona's real GDP growth, which should be larger than that of the United States due to more robust population growth, actually trails the national numbers from 2011–2016 and regionally is far surpassed by California, Colorado, and Utah (Figure 3). Only New Mexico fares substantially worse than Arizona over this time period. Nevada also has less growth from 2011–2014, but from 2014–2016 surpasses Arizona substantially.

The Political Landscape

Arizona became a competitive state at the presidential level, joining California and Texas as the only two states where the Democratic voter share increased relative to 2012. Consequently, Democrats were hopeful that they might be able to pick up the four seats necessary to get the majority in the 30-member state senate or at least gain three to create a 15–15 tie. Democrats picked up two seats but failed to hold one, ending up with a 17–13 Republican majority, same as the last election (Table 1). One Democrat, Carlyle Begay, changed parties after the prior election in what had historically been a Democratic district. Democrats picked up that seat and also won a competitive seat in the Phoenix metro area when the incumbent Jeff Dial lost in the primary. However, that district also voted fairly strongly for Hillary Clinton, so Republicans may have lost that seat regardless. To the opposite effect, in Pinal County, south of the metro Phoenix area, Republican Frank Pratt defeated the incumbent Democrat Barbara McGuire. In the 60-member House, Democrats gained one seat defeating an incumbent in the same metro Phoenix district where they picked up the Senate seat. Meanwhile, two Tucson area districts exchanged one Republican and one Democratic pickup (Arizona Secretary of State 2016).

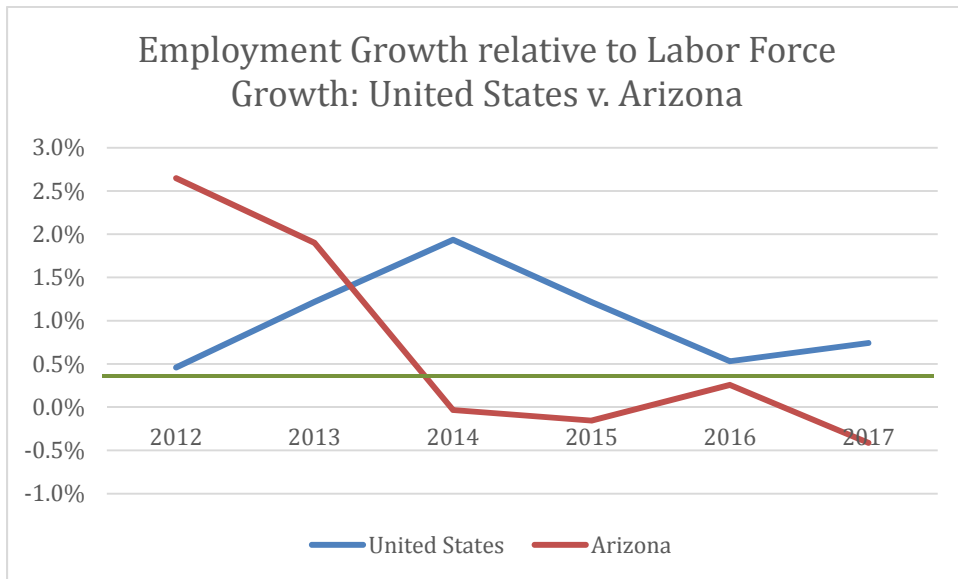
With both the House Speaker and Senate President seeing congressional offices, leadership changed. New House Speaker J. D. Mesnard made some efforts to make the budget process more open as Appropriations broke into numerous subcommittees when dealing with the budget. However, budget negotiation continued, as is standard practice, between the governor and Republican legislative leadership behind closed doors.

Figure 1.



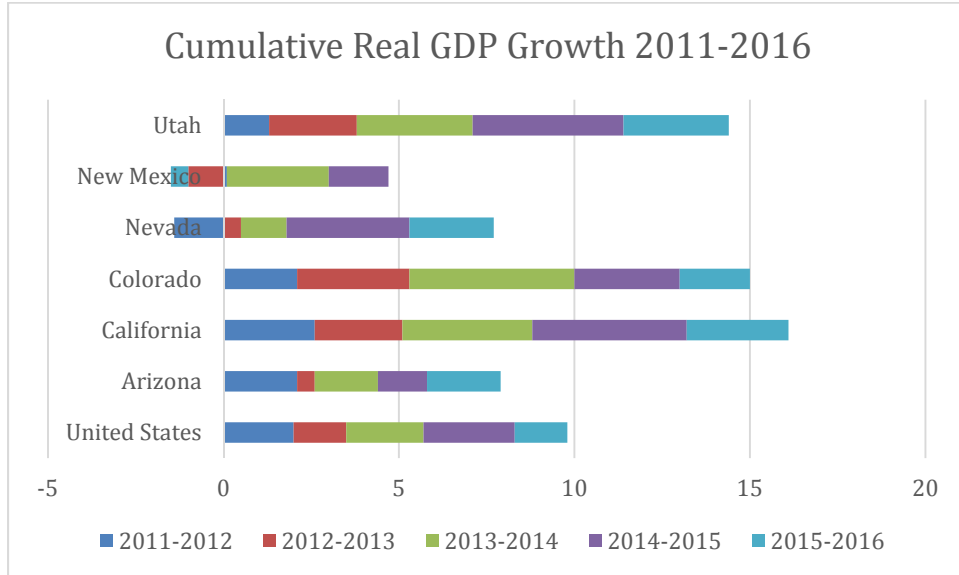
Source: U.S. Bureau of the Census

Figure 2.



Source: U.S. Dept. of Labor

Figure 3.



Source: Bureau of Economic Analysis

Table 1. Party Control of Legislature, Office of Governor

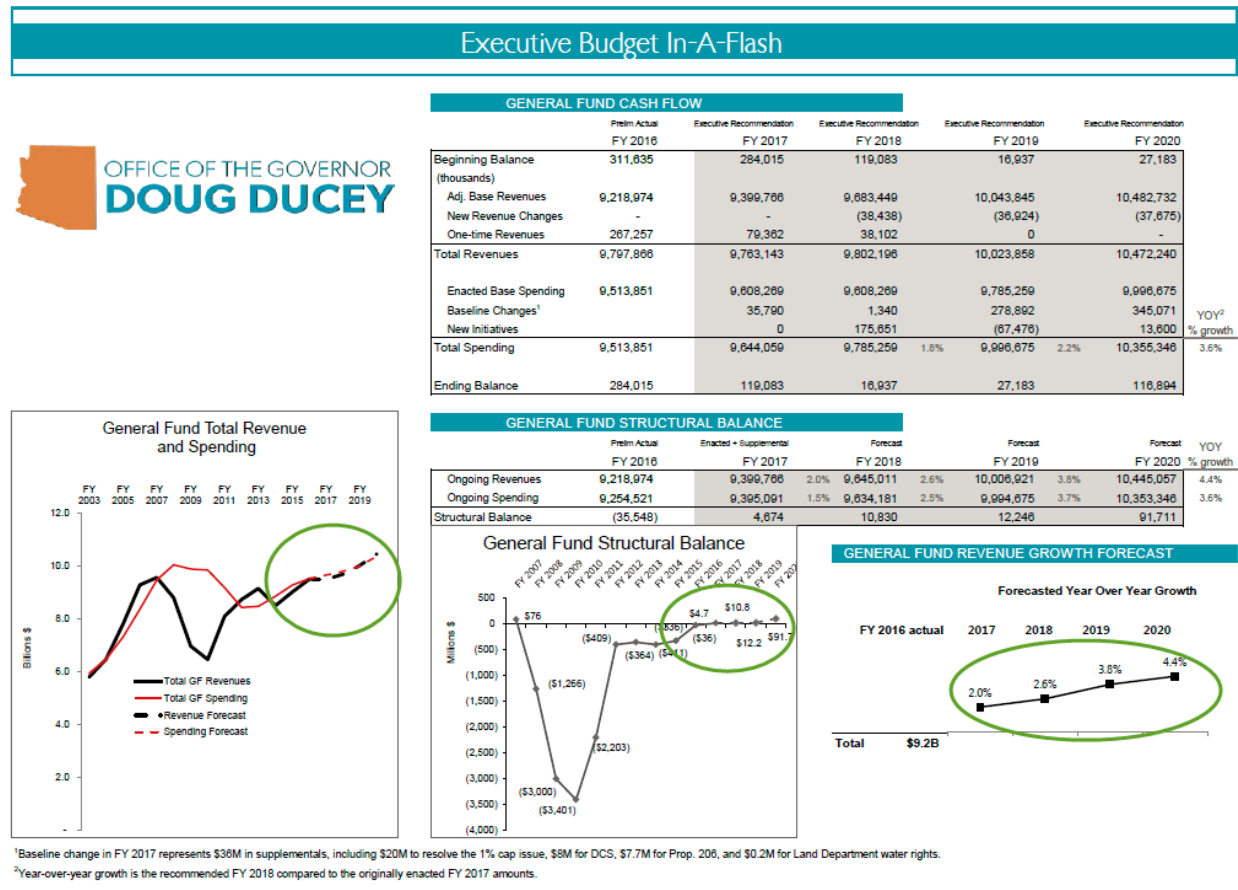
Year	House R	House D	Senate R	Senate D	Governor
2001-02	36	24	15	15	R
2003-04	39	21	17	13	D
2005-06	38	22	18	12	D
2007-08	33	27	17	13	D
2009-10	35	25	18	12	R
2011-12	40	20	21	9	R
2013-14	36	24	17	13	R
2015-16	36	24	17	13	R
2017-2018	35	25	17	13	R

Source: Arizona Capitol Times, Political Almanac 2017.

\$3 for Every \$4 in FY2007 for FY2018 as the “Best of All Possible Worlds”

The governor’s executive budget proposal included numerous graphs designed to illustrate the commitment and progress toward a balanced budget (see Figure 4 taken from the FY2018 Executive Budget Summary (Ducey 2017b)).

Figure 4.



Source: Office of the Governor

As Dr. Pangloss in Voltaire’s *Candide* would say, due to the work of the governor, Arizona is living in the “best of all possible worlds” (see three areas noted and circled in green (circles are overlaid on the original) in Figure 4). Seen on the left of Figure 4, a massive deficit has been turned into a balanced budget. In the middle, a deep structural deficit has been correct. On the right, revenues on a percentage base are projected to double in their growth rate. On the subsequent page of the summary, a text box highlights just how tremendous the governor’s work is, explaining, “The FY2018 Executive Budget Recommendation allows for General Fund spending to grow by 1.8 percent (compared to the enacted FY17), which is less than the 3.7 percent forecasted inflation (2.1 percent) plus population growth (1.6 percent) in 2018.”

Conservatives have long argued that the measuring rod of fiscal discipline is inflation plus population growth, while critics contend the appropriate measure is government spending as a portion of economic activity (personal income).

The most recent high point in government expenditure would be FY2007 when state spending was 4.7 percent of state personal income, the highest in that decade but not unusual for the period before that. Spending restraint in Arizona when adjusted for population and inflation, the

conservative yardstick, indicates that the state would have to increase spending by 40 percent in FY2018 to reach the population plus inflation yardstick—and this decline has happened all within the span of a decade. In fact, due to the significant economic downturn and state’s modest economic recovery, the more conservative yardstick is actually higher than the 4.7 percent of personal income measure during most of the last decade (see Figure 5).

Interestingly, this gap roughly equals the amount that taxes have been reduced since 1994 (Rau 2016). State employees have not been receiving raises. The use of budget rollovers—an accounting maneuver that transfers spending that should be in one fiscal year to the next one and a way in which deficits are hidden—has become a much more permanent part of the budget as shown in Figure 6. Even though they’ve been reduced, as a portion of all expenditures rollovers remains at a historic high for this point in a growth cycle compared to their use in the prior growth cycle.

When Figures 5 and 6 are analyzed together, rather than running a balanced budget, Arizona, relative to its performance in FY2007, is running a deficit of approaching \$5 billion—half of the entire General Fund. The text box emphasizing that the governor’s budget comes in at less than population growth plus inflation, effectively means that, measured by past state expenditure patterns, a significant gap exists.

Consequently, pressures to increase expenditures are growing, and even ideological Arizonans dedicated to cutting taxes now do so largely more symbolically so they can, as the governor ran on, say they reduced taxes every year.

FY2018 Budget

Due to higher projected economic growth, Governor Doug Ducey’s executive budget saw about \$125 million in discretionary dollars, whereas the House legislative leadership, following the more stringent view of the Joint Legislative Budget Committee’s analysis, finds only about \$30 million (Rau 2017b). Also, a voter approved initiative to raise the state’s minimum wage to \$10 in 2017 and eventually \$12 in 2020 created some turmoil as it has pushed up costs for those who care for the elderly and disabled. Negotiations on a final budget led to a resolution in early May 2017 for FY2018. The legislature accepted the higher revenue projections of the governor’s office, though the actual spending allocations were slightly modified from what the governor had proposed.

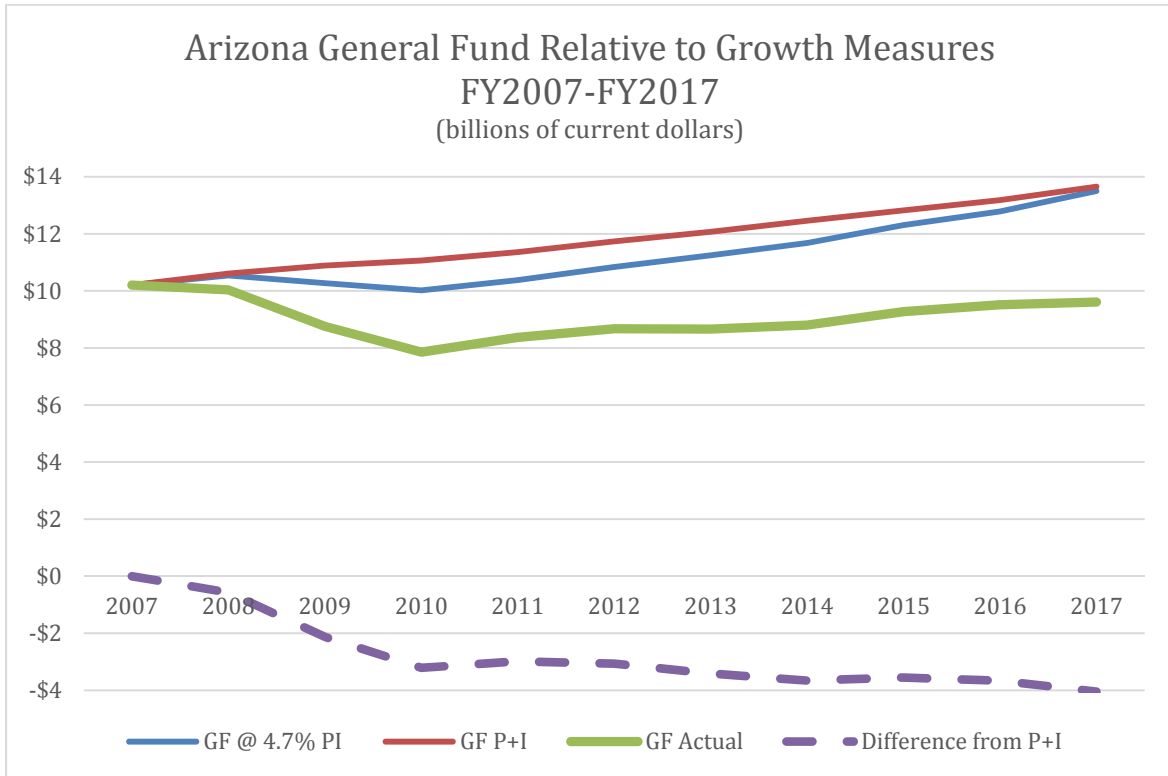
Teacher Salaries

In Governor Ducey’s January State of the State Address, he proposed giving teachers “a permanent, lasting salary increase” (Ducey 2017a). When the budget was unveiled at the end of that week, that statement translated into a 0.4 percent raise per year over five years and was widely panned as hypocritical. The House budget put the raise at one percent instead, and the final budget was for a 1.06 percent raise for each of the next two fiscal years—modest, but more meaningful with a cost of \$34 million versus \$14 million (Rau 2017b).

Other Education Initiatives

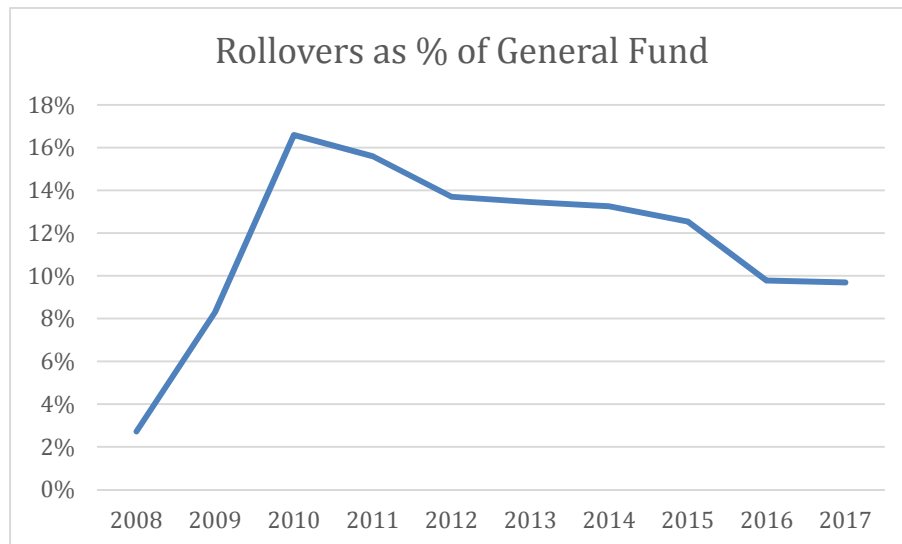
Governor Ducey proposed small amounts of initial funding for a large number of education initiatives as he faces re-election in 2018 and would like to run on education. His record on this subject includes the success of Proposition 123 that ended a school minimum funding lawsuit

Figure 5.



Source: Joint Legislative Budget Committee and author's calculations.

Figure 6.



Source: Joint Legislative Budget Committee

that he continually touts as new money as opposed to money that was legally owed. However, it didn't address the deeper issues with inadequate K-12 funding, leaving many education advocates wanting more. Proposals from the governor's State of the State address included funding full-day kindergarten at a few select low-income schools and literacy funding (\$10 million—of a cost of about \$250 million to fund all-day kindergarten statewide), \$6.4 million to provide a \$1,000 one-time bonus to attract teachers to high-need schools (something closer to \$10,000 would be impactful), and \$5 million to help with broadband for rural schools, although they argue that this amount is insufficient. He also had a \$37.6 million results-based funding initiative that would reward schools based on standardized test results in FY2018 and subsequently school letter grades assigned by the Arizona Dept. of Education (Ducey 2017b).

Ultimately, Ducey was successful in gaining these funding amounts except for the teacher bonuses, which did not get into the budget. Additionally, the rural broadband was cut to \$3 million and his all-day kindergarten and literacy funding was limited to \$8 million (Joint Legislative Budget Committee 2017).

Proposition 301, an education sales tax of 0.6 percent that passed by voters upon legislative referral in 2000, will expire in 2021. Gov. Ducey has already come out in support of continuing the sales tax, arguing it is not a tax increase as he maintains a vow to not increase taxes. Meanwhile, Jim Swanson, the business leader chair of the governor's Classrooms First Council, has joined some other prominent business leaders in advocating for a 1.5 cent sales tax alternative that would essentially backfill state spending on education to its FY2007 levels (Rau 2017c). Education leaders are considering their own alternatives as well. The key issue is whether the proposal gets presented for the 2018 ballot before the legislature weighs in with its choice in 2020. Democrat David Garcia, a well-regarded education professor at Arizona State University and veteran who narrowly lost the election for Superintendent of Public Instruction in 2014, has declared his run for governor in 2018. In addition, Democratic State Senator Steve Farley is also running for governor. Teacher shortages have become large news, so education could be at the forefront of that race, especially if a tax to fund education that the incumbent opposes makes it to the ballot.

On the flip side, a massive expansion of “empowerment scholarship accounts,” i.e., private school vouchers, which had been stalled with a holdout state senator who demanded changes, suddenly moved. On April 6, a 27-page amendment was filed at 9:02 a.m. (two minutes after the deadline) with debate and then voting ensuing within an hour. It passed 16–13. By the afternoon, it had also passed the House with a bare 31 votes (out of 60) and was signed by the governor. The amendment capped growth at 5,000 students per year up to 30,000 in six years, and finances were slightly restructured so that instead of receiving 90 percent of the funding of charters, recipients would receive 90 percent of the funding of the public school the recipient left (district schools receiving less from the General Fund). That turned the bill from a net fiscal cost to a very small fiscal savings (Sanchez, O'Dell and Rau 2017). The rapid vote on SB 1431 seemed like a classic strategy of getting it to the governor before the opposition could organize.

However, a grassroots movement of public school supporters, Save Our Schools, organized a referendum effort and successfully got enough signatures in the heat of the Arizona summer, most by volunteers with some by paid signature gatherers, to place that law on hold until voters can determine its fate on the ballot for 2018. Republican leaders including the bill's sponsor State Senator Debbie Lesko are exploring whether to pursue a repeal and pass a different version of the law next session or simply let the referendum proceed. In the meantime, a lawsuit is still pending challenging the signature gathering process.

School Construction

Another school funding lawsuit is looming as the state is currently shortchanging school districts for building construction and maintenance by about \$400 million a year relative to FY2007. These areas include money for computers and textbooks formerly known as soft capital and now called district additional assistance. Following the *Roosevelt v. Bishop* case, the state also took on more responsibility for school repairs and construction. The state has been violating the order in that case in which the court found that Arizona was failing to provide a “general and uniform public school system,” largely because low-income districts are not able to bond and pay for these costs through capital overrides the way wealthier districts can. Glendale recently had to temporarily close two elementary schools due to deferred maintenance issues. They are already a plaintiff in the lawsuit (Rau 2017a). Below are the required elements if they were fully funded, not including failures to fund them over the past decade (Wells 2016).

- Building Renewal Funds: \$93 million (based on actual 2007 allocation)
- New School Construction: \$288 million

In FY2017 the budget provided \$15 million. For FY2018, the legislature moved to increase it, but the amount, \$64 million, was far below what had previously been allocated (Joint Legislative Budget Committee 2017).

Tax Cuts

Governor Ducey has promised to reduce taxes every year. However, new tax cuts have become largely symbolic due to the lack of revenue. This year’s version adjusts the personal exemption by \$50 for each of the next two years from \$2,000 to \$2,100 at a cost of \$6.8 million (Joint Legislative Budget Committee 2017). After that, the exemption will be adjusted by inflation (Fischer 2017a).

University Funding

Universities have seen their per pupil funding cut in half over the last decade. The regents have proposed the state fund half the cost of resident students, but even that would require the state to increase funding by about 50 percent over current allocations. Only a token step was taken in FY2017. The FY2018 budget replaced a one-time expenditure from FY2017 with a similar amount for FY2018, meaning universities still are short about \$250 million from what’s needed to reach the regent’s goal. The governor proposed that universities retain their locally generated sales tax dollars and use it for bonding for capital construction. The state’s portion of that cost would be \$30 million as those funds currently go to the General Fund. Universities would match the funds, enabling bonding for up to \$1 billion in capital construction. Cities and towns would also lose revenue of about \$7 million, not the locations where the universities are located, as part of sales taxes goes back to localities based on their relative population. Resistance by many Republicans to providing this control to universities led to this proposal’s reformulation as a straight appropriation by the legislature of \$27 million annually to begin in FY2019 to fund bonding with universities matching it (Joint Legislative Budget Committee 2017).

In September Republican Attorney General Mark Brnovich sued the regents for making tuition too high, arguing the growth was higher than state budget cuts. The basis for the argument comes from Article 11, Section 6 of the Arizona Constitution:

The university and all other state educational institutions shall be open to students of both sexes, and the instruction furnished shall be as nearly free as possible. The legislature shall provide for a system of common schools by which a free school shall be established and maintained in every school district for at least six months in each year, which school shall be open to all pupils between the ages of six and twenty-one years.

However, few people expect the lawsuit to be successful, and the governor opposes it (Fischer 2017b). In practice the universities have moved to a higher discount rate, providing much stronger rates of need-based aid to in-state students, so middle- and lower-income students are paying less, while wealthier students are paying more. However, many observers also expressed surprise that the legislature was not sued by the attorney general, since it has cut per student funding by more than half in the last decade. Since the regents have formally embraced the state funding half of in-state student education costs, the repeated failure of the legislature to fund universities may well lead to future lawsuit aimed at the legislature (Arizona Board of Regents 2015).

Minimum Wage

The Chamber of Commerce with the support of Republican legislative leaders and the governor attempted to overturn a citizen's initiative, Proposition 206, which raised the minimum wage to \$12 an hour by 2020. They cited a provision that initiatives needed a funding source if they had a direct cost on the General Fund. However, crafters of the initiative exempted state employees, and the costs to the General Fund were indirect effects of higher wages for caregivers to persons with developmental and physical disabilities as well as the elderly under Medicaid. In March, the Arizona Supreme Court unanimously ruled against the chamber. The first increase in the minimum wage occurred on Jan. 1, 2017 going from \$8.05 to \$10 an hour, and on Jan. 1, 2018, it will rise to \$10.50 an hour. A supplemental appropriation covered an estimated \$8 million in costs for the remainder of the FY2017. Disability providers have also seen their rates cut significantly since FY2007, so that they, too, were already working on bare margins—the added costs of the minimum wage, they argued, would put them out of business. The budget included \$33 million to cover added costs for care of the disabled elderly and developmentally disabled due to the higher minimum wage (Rau 2017b).

Conclusion

Despite claims that Arizona had extra money this year, discretionary funds are far less than the number of rollovers, and the state only has \$3 for every \$4 it had in FY2007 when adjusted for population growth and inflation. Plus, another K-12 lawsuit looms. Thus, while Governor Ducey can point to a technically balanced budget and growing revenues, Arizona's budget remains in a far more precarious condition than many realize, and pressure to invest in areas like K-12 education continue to grow.

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