



THE ARIZONA CENTER

— FOR ECONOMIC PROGRESS —

The Arizona Center for Economic Progress engages a diverse group of partners in advancing thoughtful analysis and effective solutions to generate economic growth shared by all Arizonans. We work toward a long-term vision that builds economic opportunity and quality jobs through great education, balanced tax and budget policies, as well as robust infrastructure.

Our priorities:

- Quality jobs
- Economic growth
- A long-term vision for Arizona

TODAY'S AGENDA

- How state government is funded
- State revenues
 - Economy
 - Tax cuts
 - Tax credits
 - Who pays, who doesn't, and what happens when you change tax policy
- State spending
 - Where we are and how we got here
 - Budget balancing
 - Governor's budget proposal
- Potential landmines

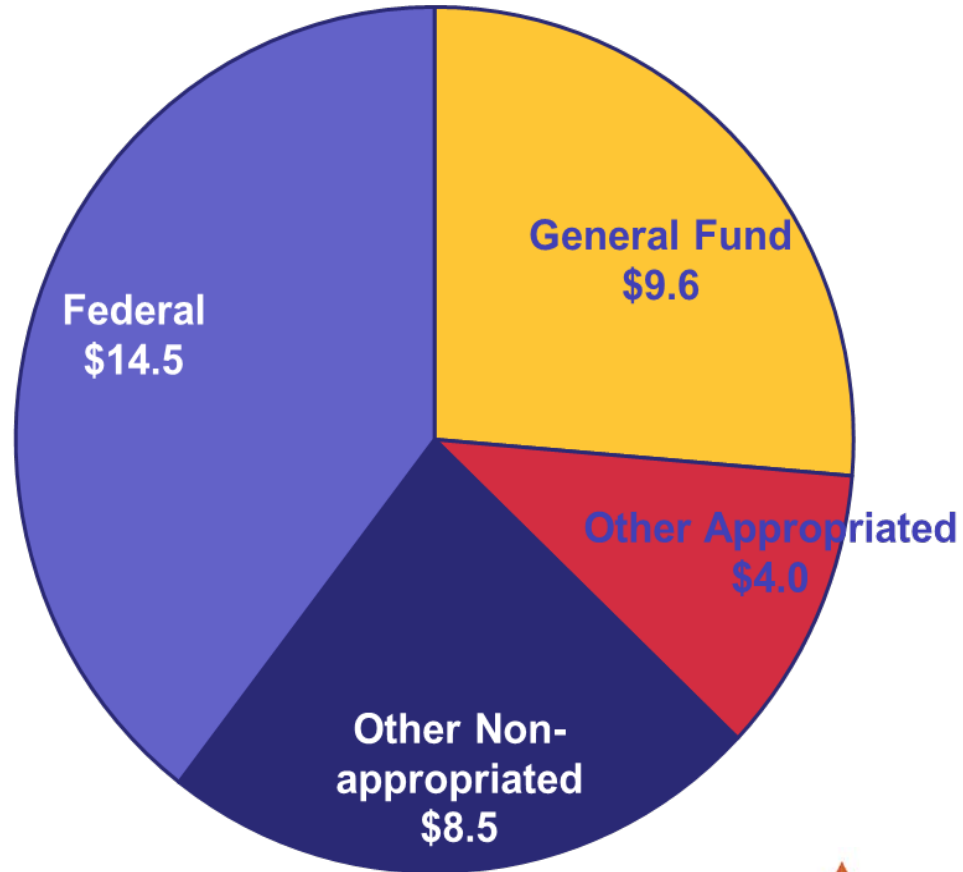
HOW ARIZONA STATE GOVERNMENT IS FUNDED



Where does the \$37 billion dollars state agencies spend come from?

Total spending by fund source
FY 2017

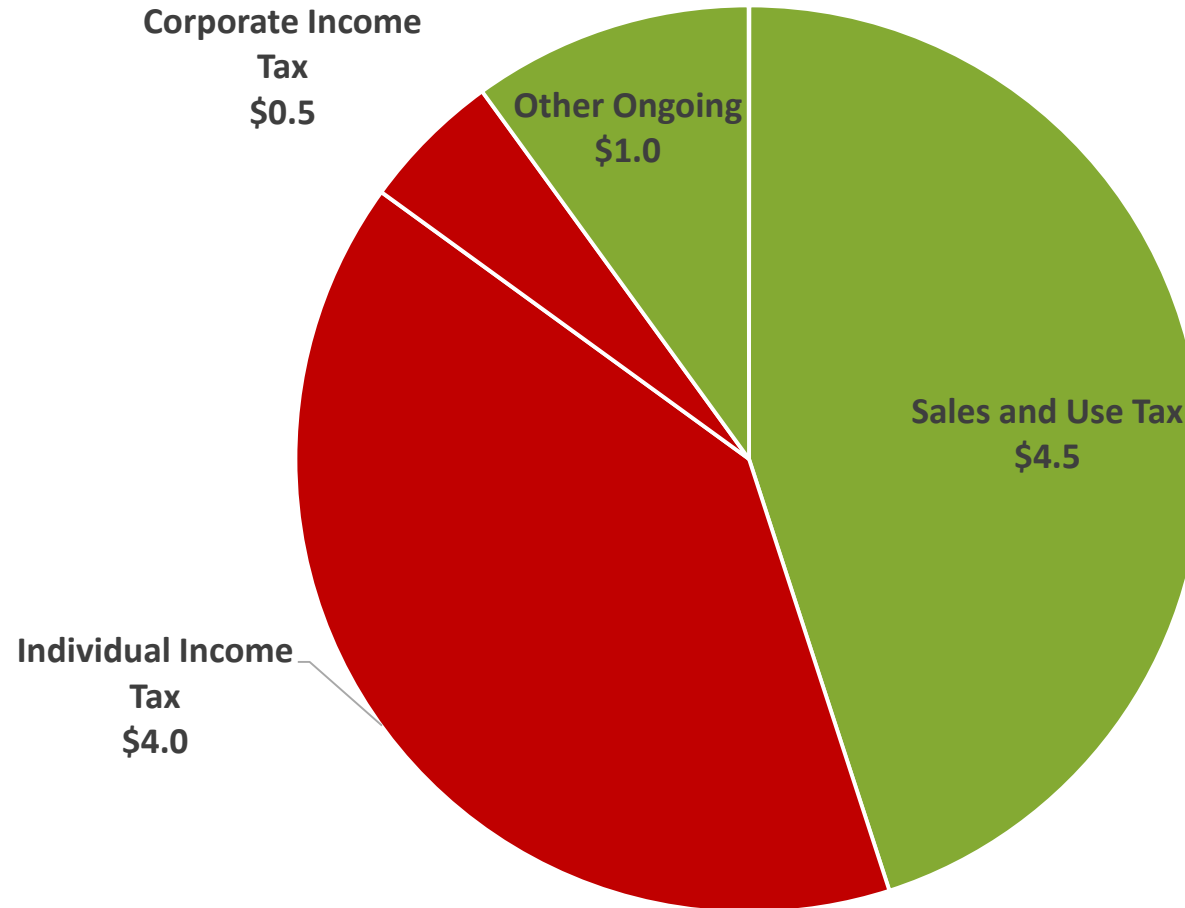
Dollars in Billions



Source: Joint Legislative Budget Committee staff, *Appropriations Report, FY 2017*

What are the sources for the state's general fund?

Dollars in Billions



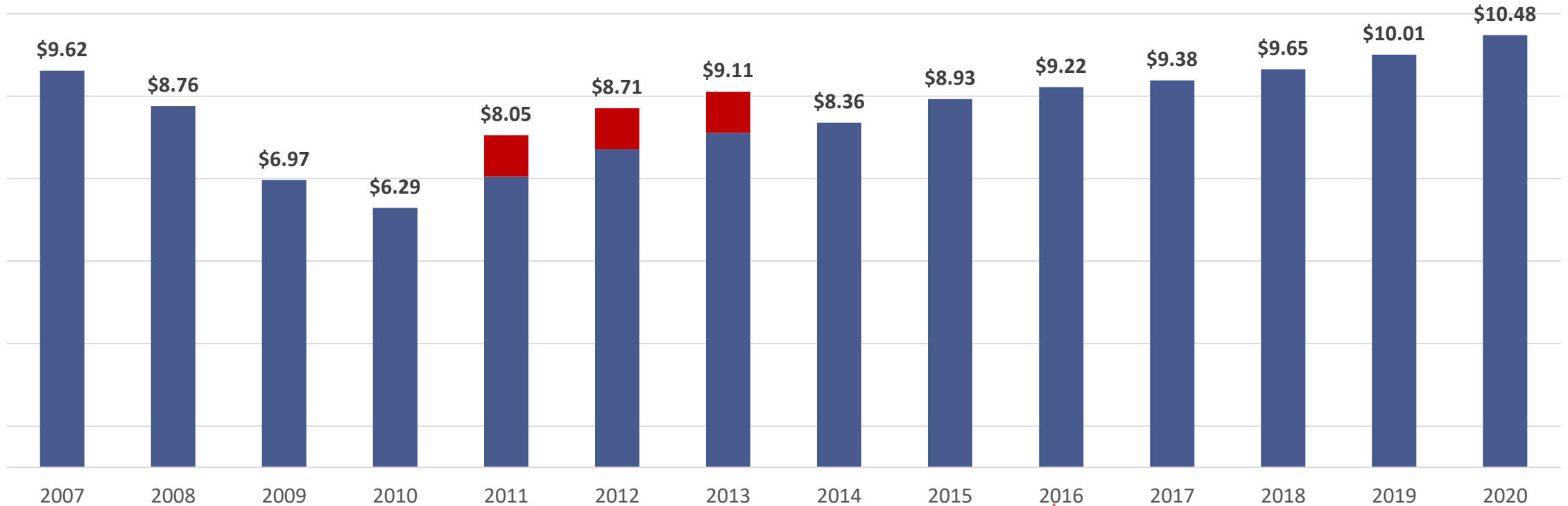
Source: Joint Legislative Budget Committee staff, *Appropriations Report, FY 2017*

State Revenues



Has Arizona recovered from the Great Recession?

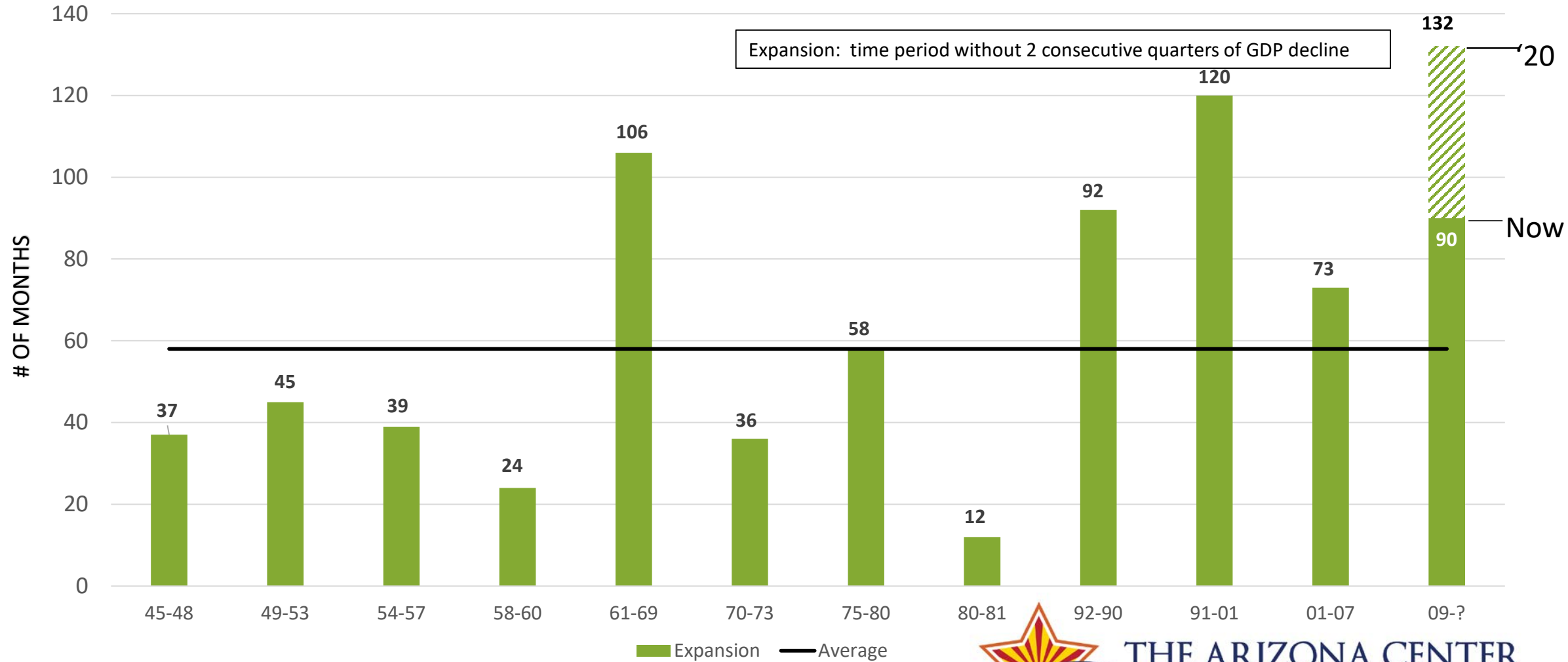
Dollars in Billions



Source: Joint Legislative Budget Committee Staff, Finance Advisory Committee presentation, 11-19-17

CURRENT EXPANSION EXCEEDS HISTORICAL AVERAGE

Length of US Economic Expansions

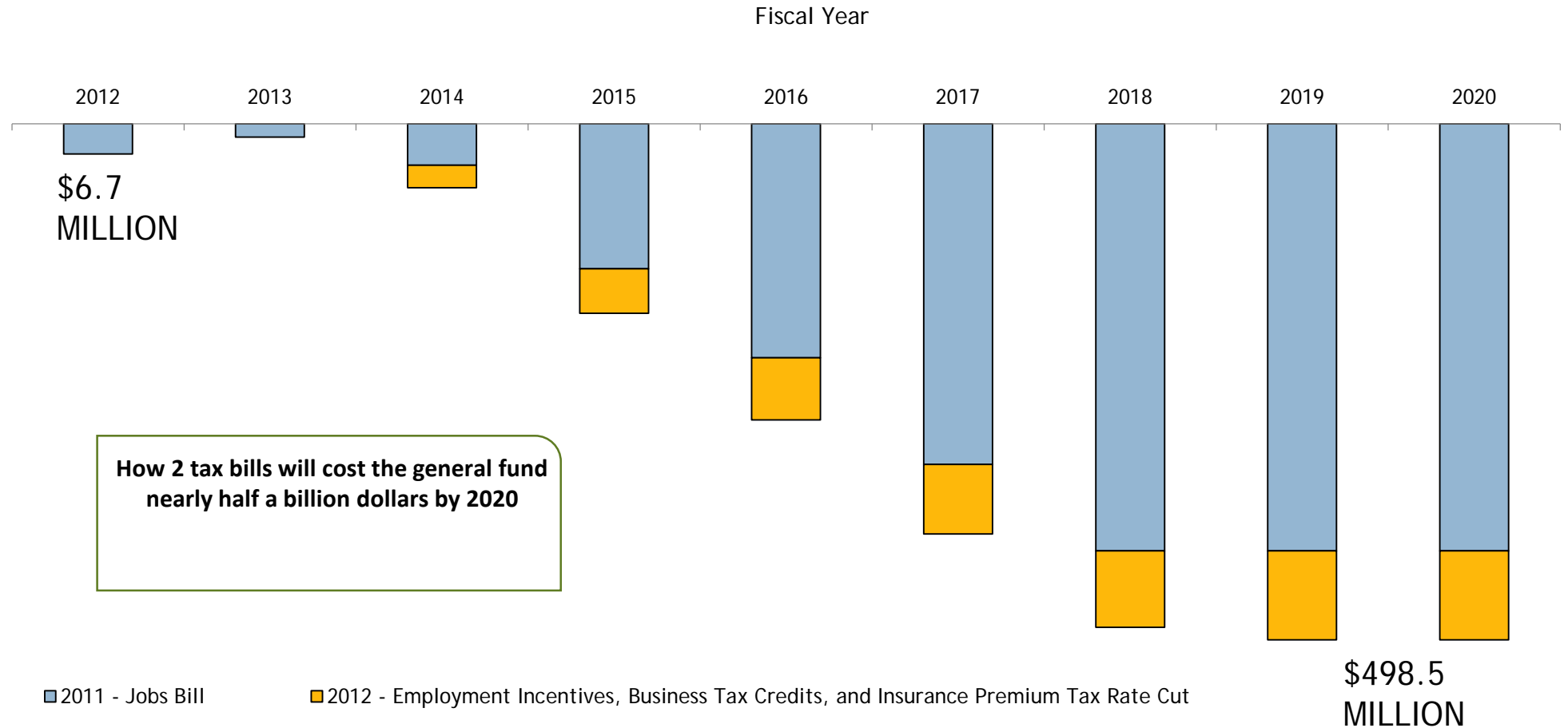


Source: Joint Legislative Budget Committee staff, *Budget Update- House Orientation*, 12/9/16



Tax Cuts in the Middle of the Great Recession?

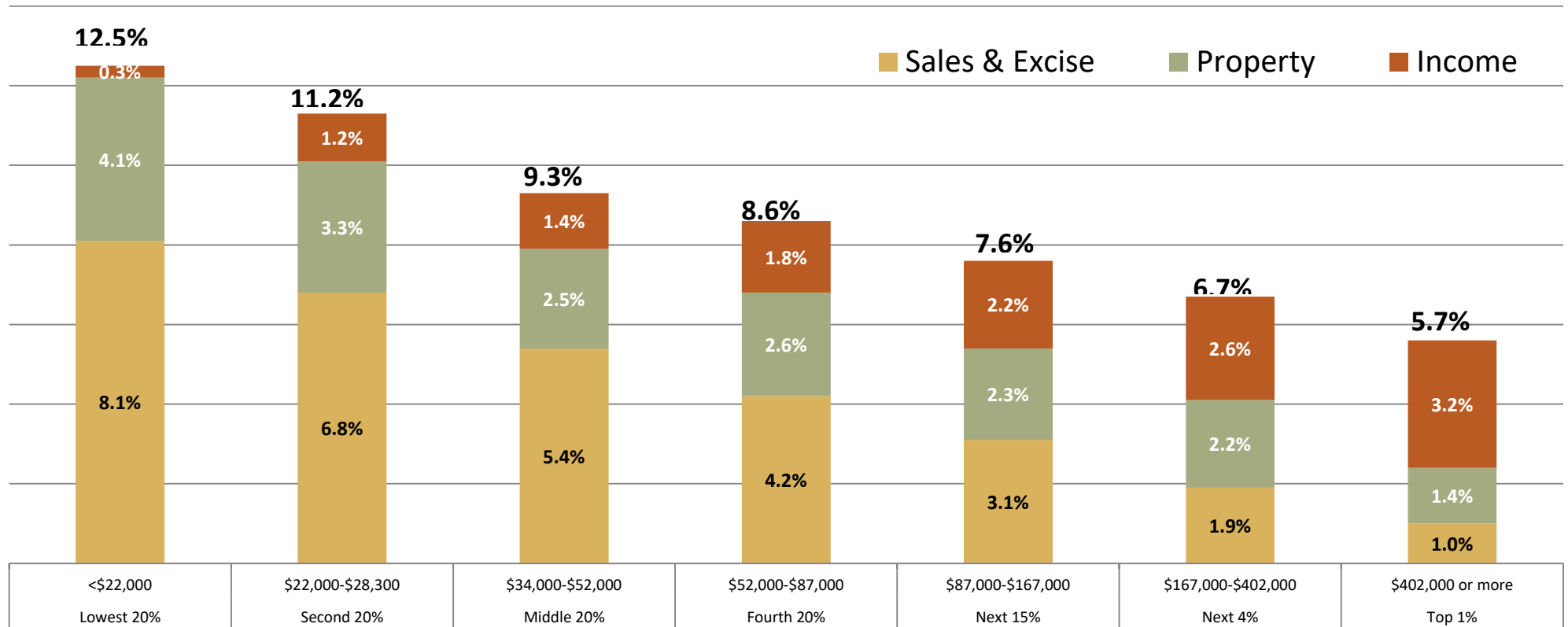
YES



Source: Joint Legislative Budget Committee staff, *Tax Handbook, 2015*

Arizona's Tiered Income Tax Only Partially Offsets Impact of Sales Tax

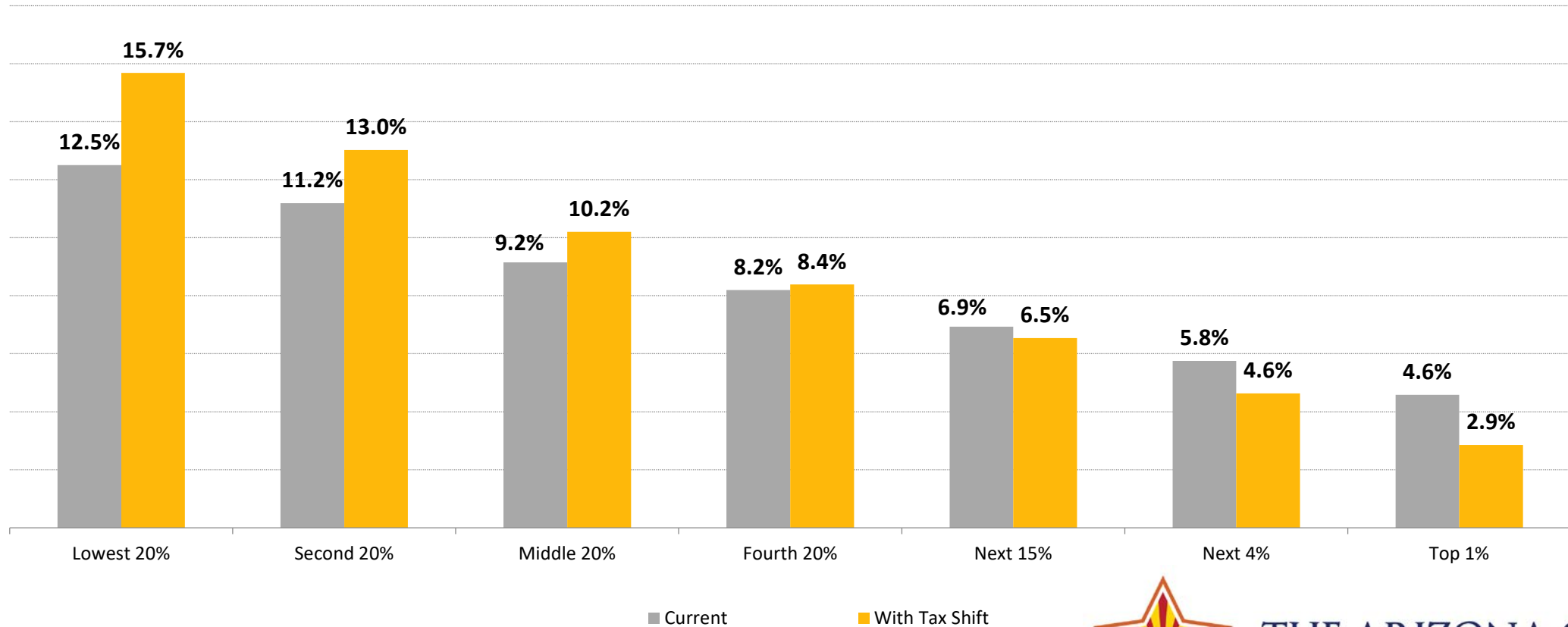
Portion of Income Paid on State and Local Taxes



Source, Institute on Taxation and Economic Policy, *Who Pays?*, January 2015. Share of family income for non-elderly taxpayers

What happens when if you reduce the income tax and increase the sales tax?

Low- and Middle-Income Arizonans Would Pay A Larger Share of Their Income in Taxes If the Income Tax was Eliminated and Sales Tax Increased



Source: Institute on Taxation and Economic Policy, microsimulation model



\$196 MILLION IN TAX CUTS ARE STILL PHASING IN

Incremental Change over Prior Year

	FY 18	FY 19	FY20
Corporate Rate Reduction/Sales Factor	-\$62 million	-\$43 million	--
Corporate Private School Tuition Indexing (increases by 20% each year – no end)	-\$12 million	-\$15 million	-\$18 million
Bonus Depreciation Full Conformity	-\$8 million	--	--
Expiring Research and Development Credit Enhancement	-	+\$3 million	+\$8 million
Manufacturing Electricity Exemption	-\$12 million	--	--
Other	-\$13 million	-\$11 million	-\$13 million
Total	-\$107 million	-\$66 million	-\$23 million

Source: Joint Legislative Budget Committee staff, Finance Advisory Committee, 1-19-17

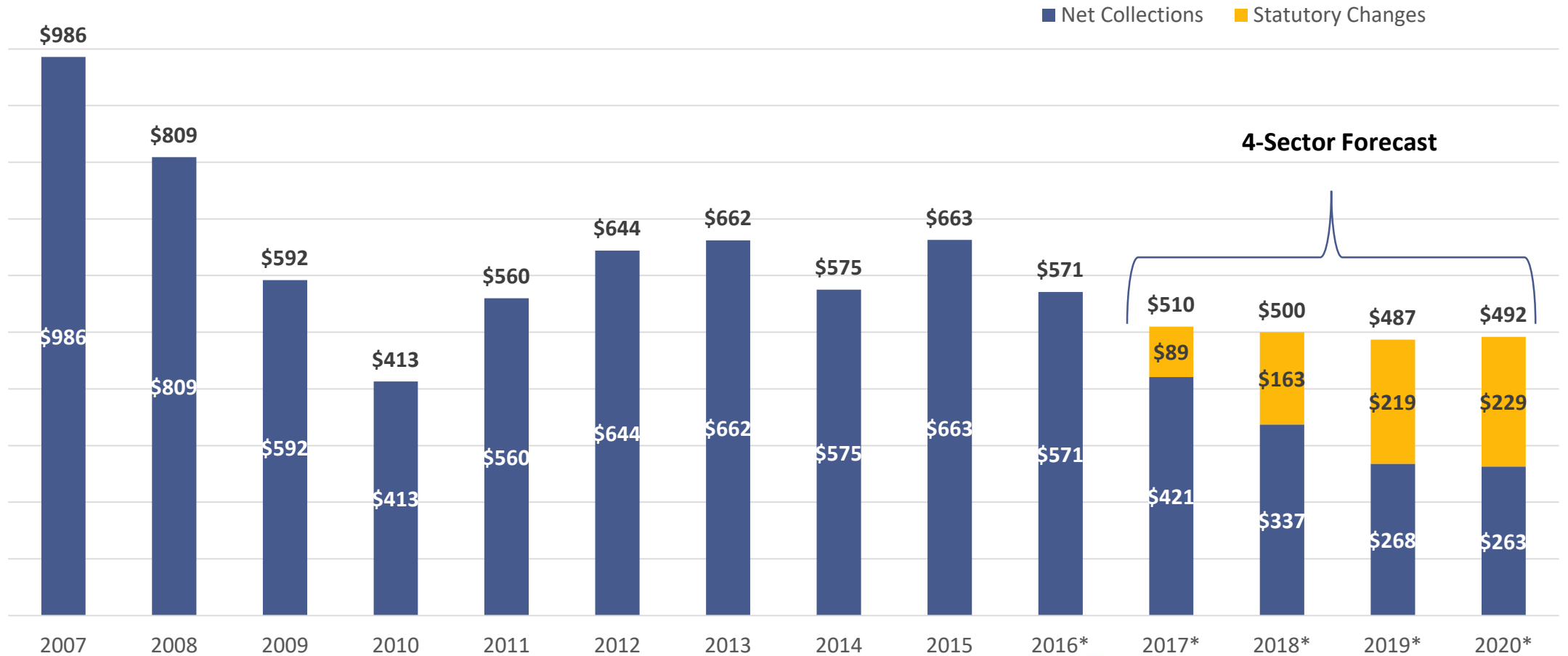


**The Great Recession isn't the only reason our
revenues are slow to recover**

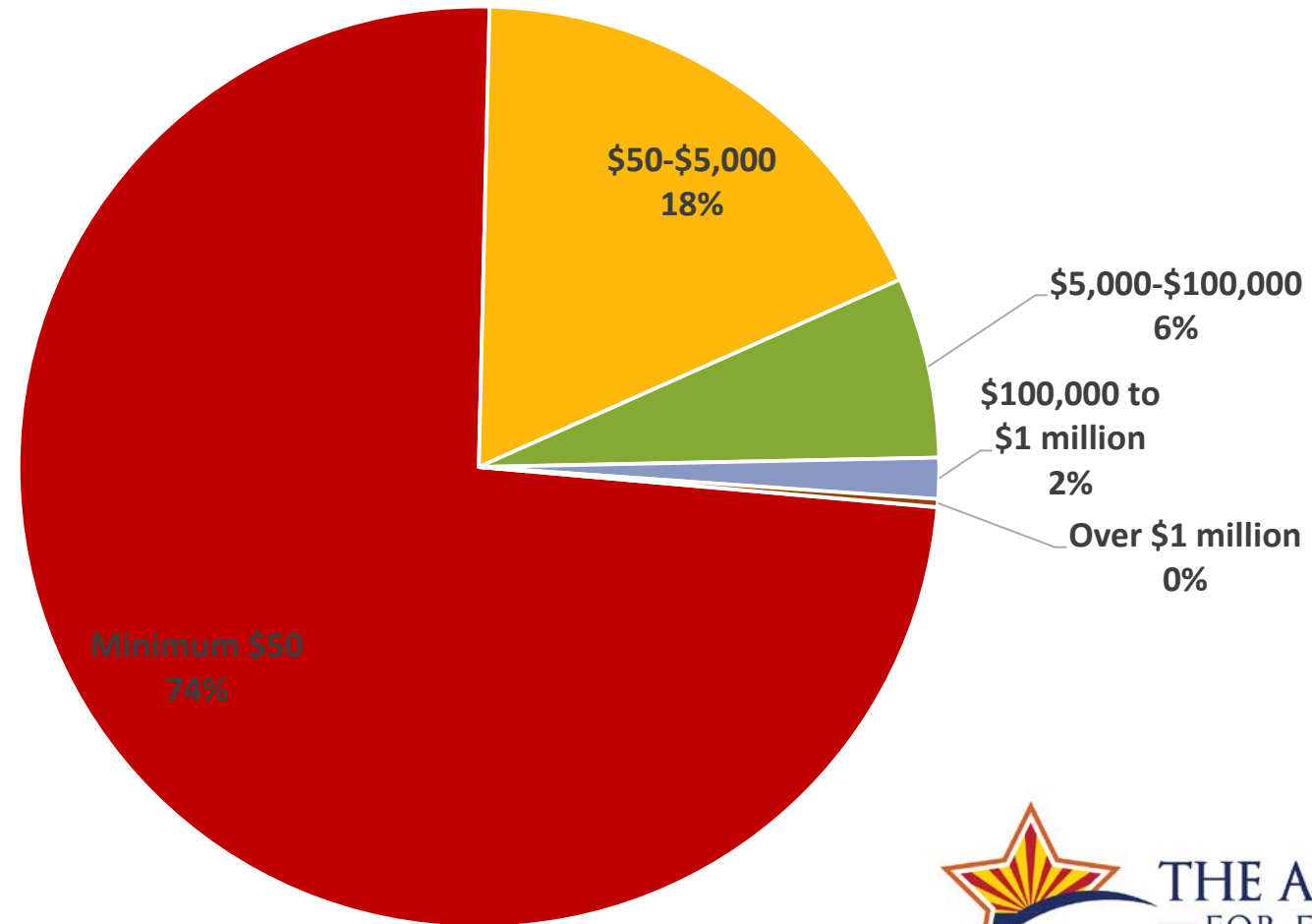


CORPORATE INCOME TAX COLLECTIONS ARE DECLINING DUE TO TAX CUTS

Primarily due to rate cut and 100% sales factor



Three Out of Four Corporations Pay \$50 Minimum Income Tax



Tax credits are a growing threat to the state's general fund


What is a tax credit?

Answer: A dollar-for-dollar reduction to an individual or corporation's tax liability

Example:

Tax liability	\$500
Tax credits	<u>- 400</u>
Net tax liability	\$100

A family with income in excess of \$150,000 can end up paying nothing in state income taxes by claiming 6 common tax credits



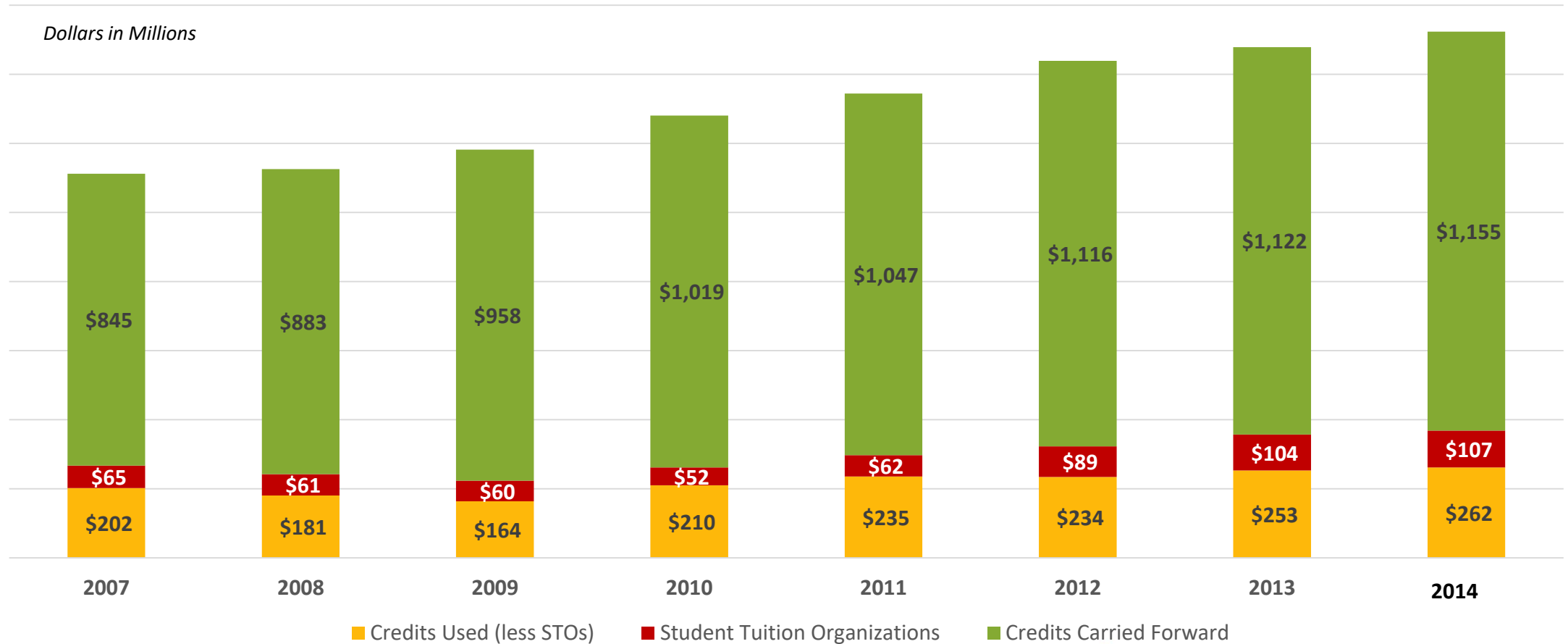
Arizona Income Tax Return for Family of Four

Federal adjusted gross income	\$161,880
Subtractions	
Standard deduction	-10,173
Personal exemptions	-6,300
Dependents (2)	-4,600
Taxable Income	140,807
Tax (Income x .0424 less \$1,178)	4,773
Credits	
Student Tuition Organization	-1,090
Student Tuition Organization – “switcher”	-1,083
Qualifying charitable organization	-800
Qualifying Foster Care Charitable	-1,000
Public schools extracurricular activities	-400
Military Family Relief fund	-400
Subtotal – Credits	-4,773
Taxes Owed	0

TAX CREDITS CLAIMED HAVE INCREASED 30% SINCE 2007

PRIVATE SCHOOL TUITION TAX CREDITS NOW TOTAL MORE THAN \$100 MILLION

\$1+ BILLION CARRY WILL AFFECT FUTURE REVENUES

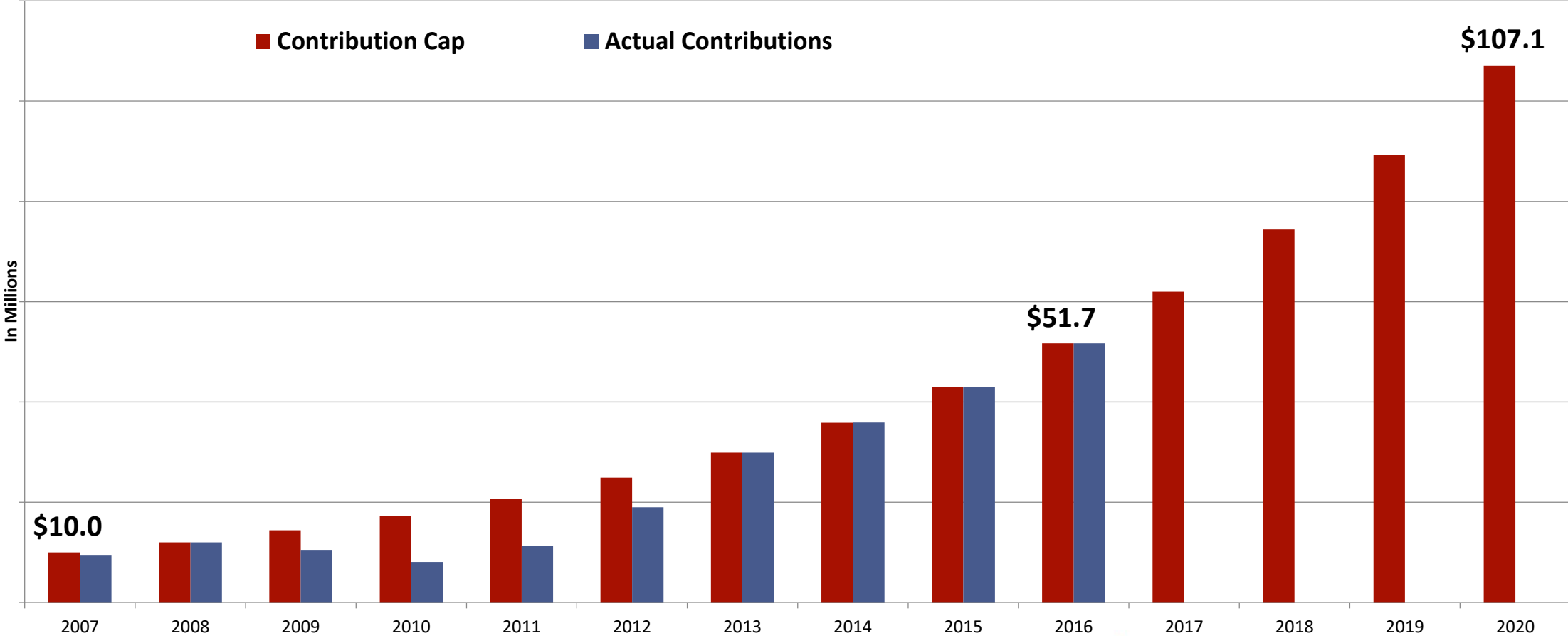


Source: Arizona Department of Revenue, *Arizona Income Tax Credits*, October 2016



THE CORPORATE PRIVATE SCHOOL TUITION TAX CREDIT CAP DOUBLES EVERY FOUR YEARS

Corporations Now Maxing Out Their Contributions Every Year

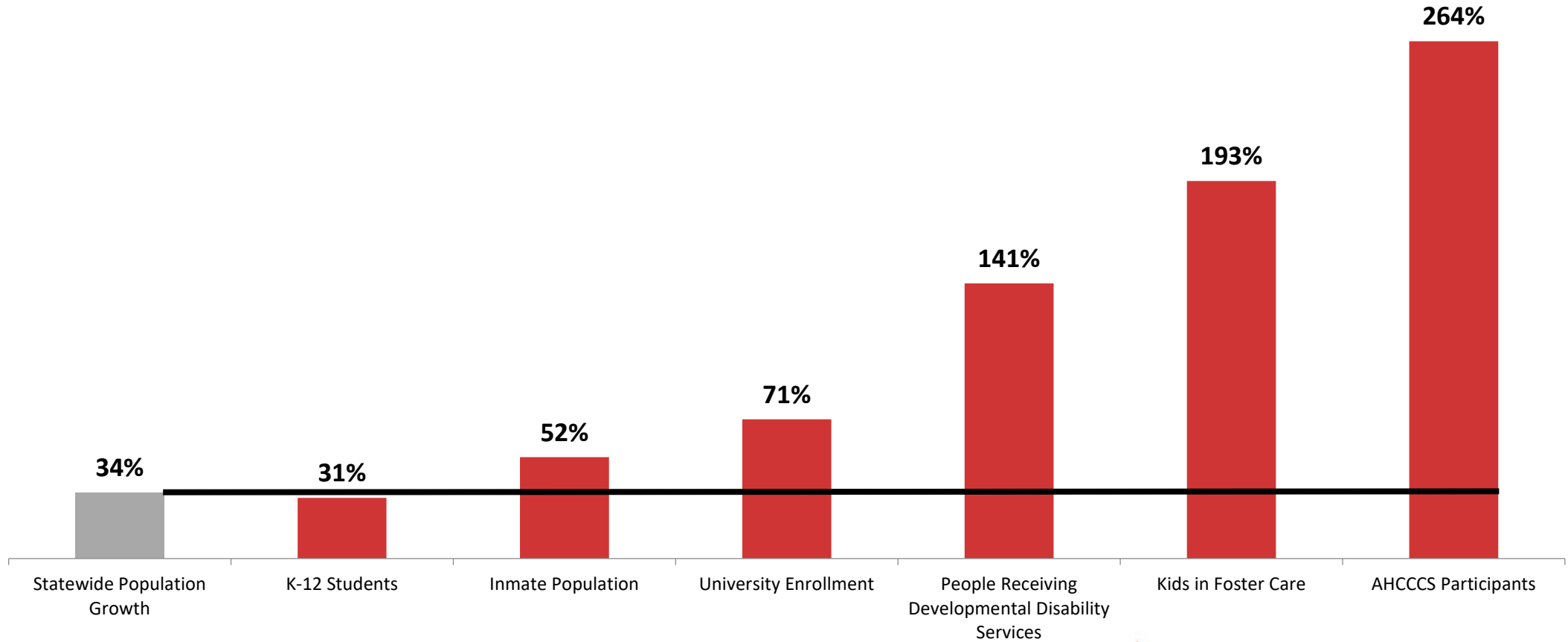


Source: Arizona Department of Revenue, *Arizona Income Tax Credits*, August 2016; calculation by Children's Action Alliance

State Spending



Populations That Drive State Spending Grow Faster than the General Population 2000 to 2016



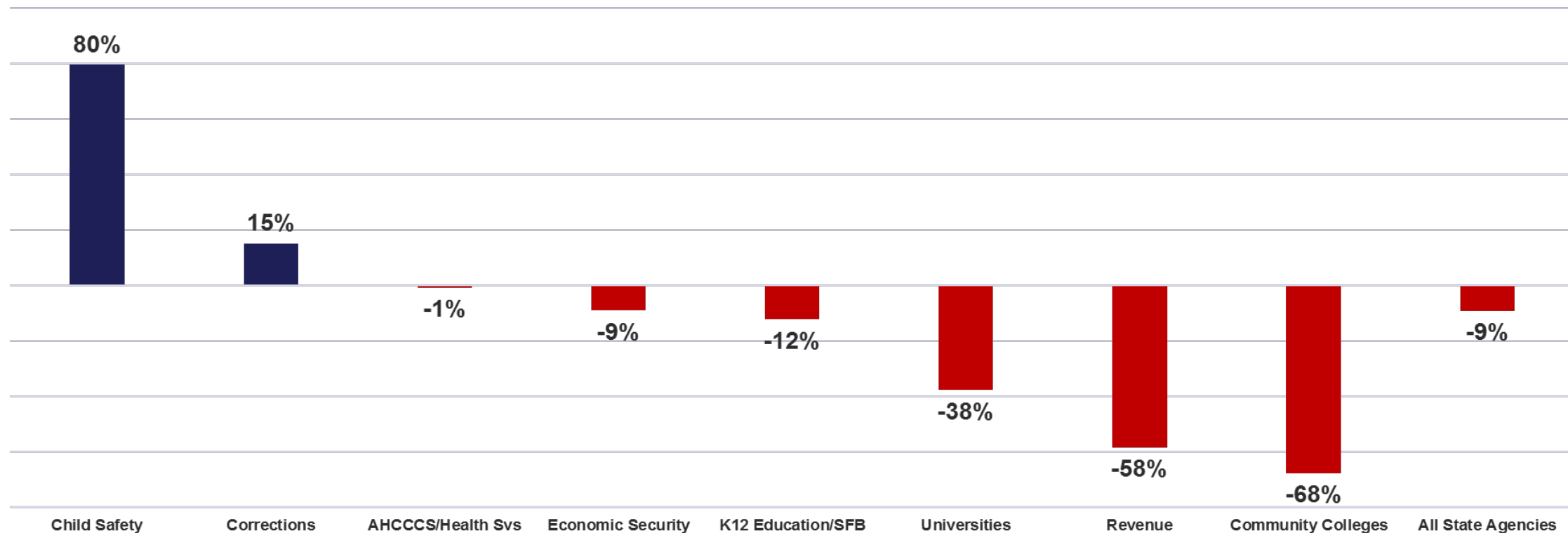
Sources: Joint Legislative Budget Committee, *Appropriations Report Fiscal Years 2000, 2001 Supplemental* and 2017; AHCCCS Population as of July 1st

Education and safety net appropriations are still \$970 MILLION lower than pre-recession

Changes in General Fund Appropriations

FY 2008 - FY 2017

Not Adjusted for Inflation

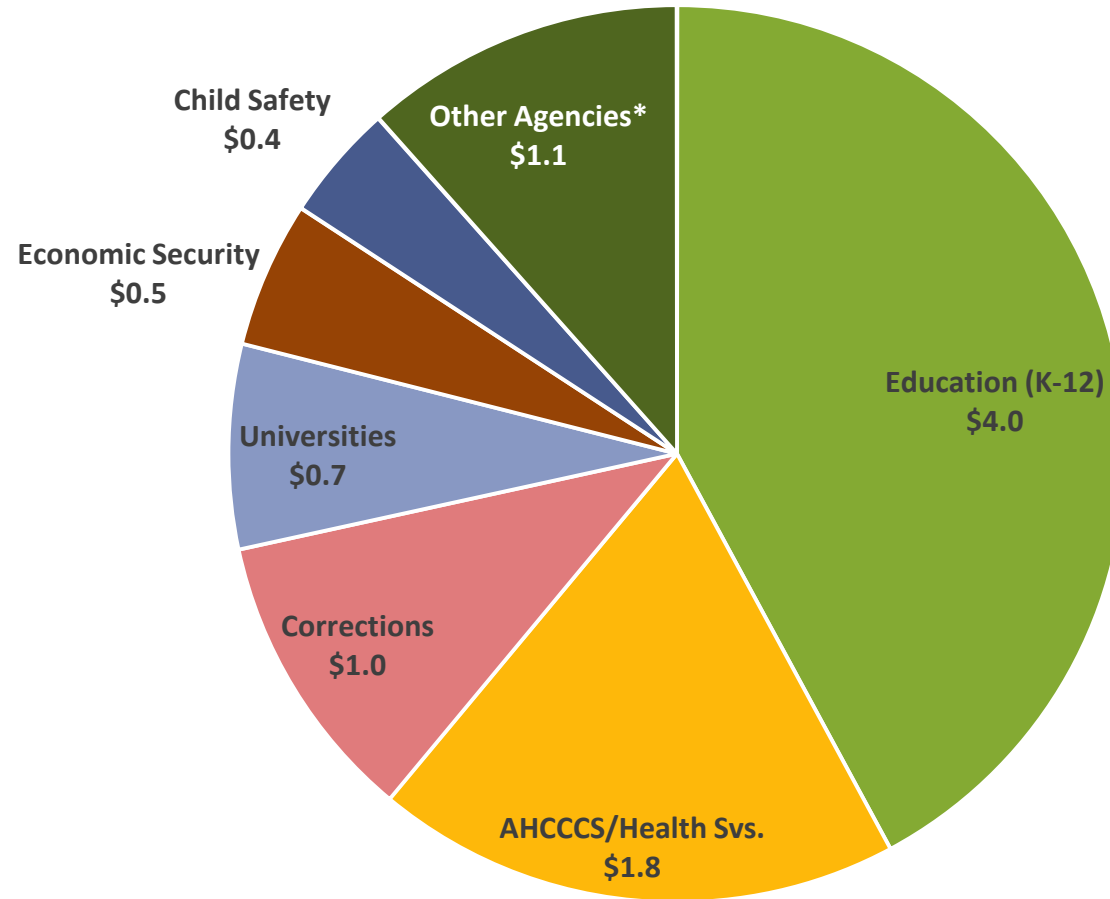


Source: Joint Legislative Budget Committee Staff, *Appropriations Reports FY 2008 and FY 2017*



HOW THE \$9.6 BILLION GENERAL FUND IS SPENT FY 2017

Dollars in Billions



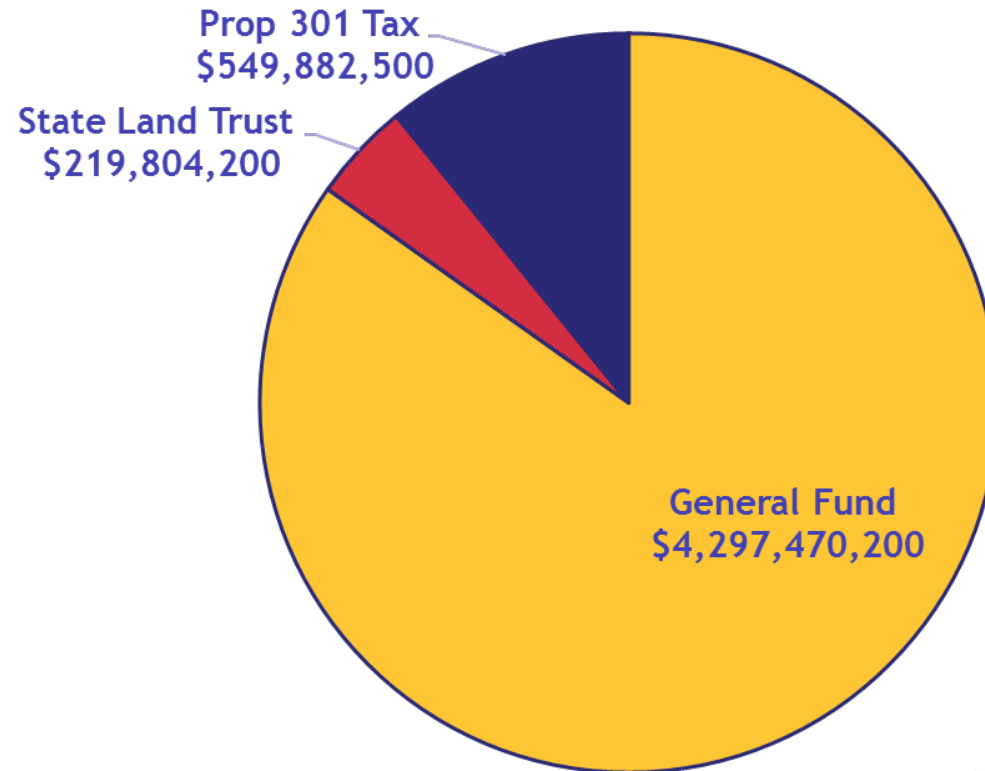
*Includes \$228 million for the School Facilities Board

Source: Joint Legislative Budget Committee Staff, *Appropriations Report FY 2017*.

\$4 OUT OF EVERY \$10 GOES TO K-12 EDUCATION

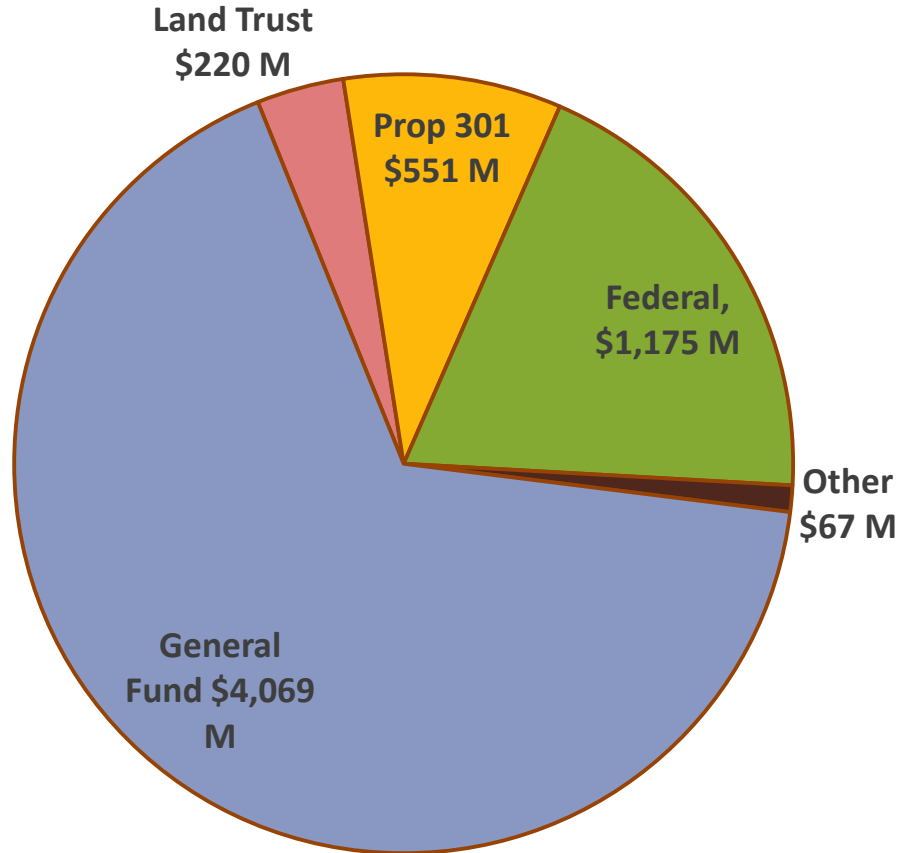


General Fund Dollars Provide 85% of State Funds for K-12 FY 2017

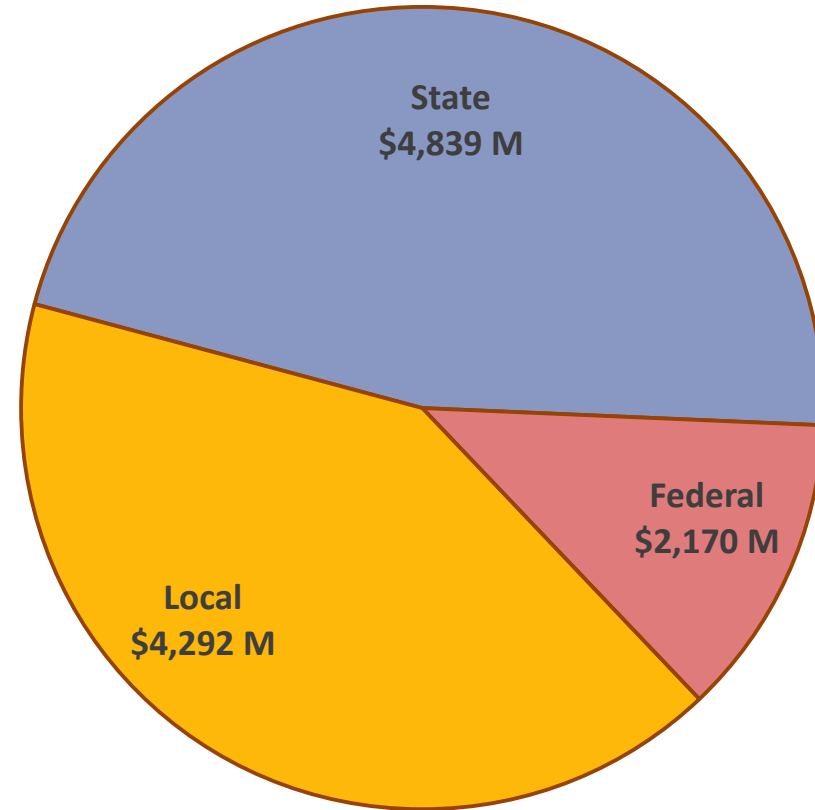


PUBLIC SCHOOL FUNDING OVERVIEW

Az Department of Education Only Versus Total K-12 Resources



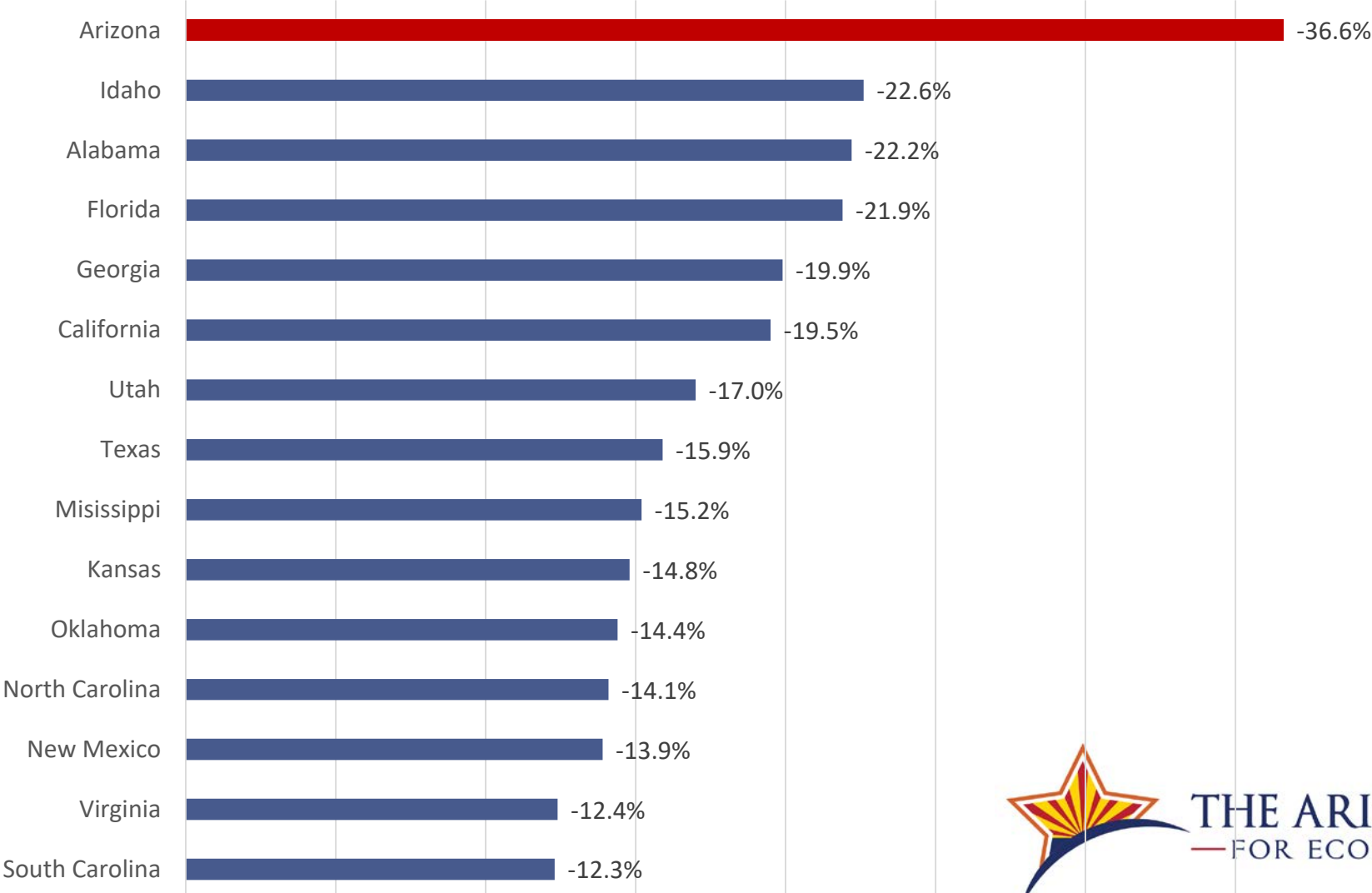
ADE Only - \$4.1 B GF/\$6.1 B Total ('17 Estimated)



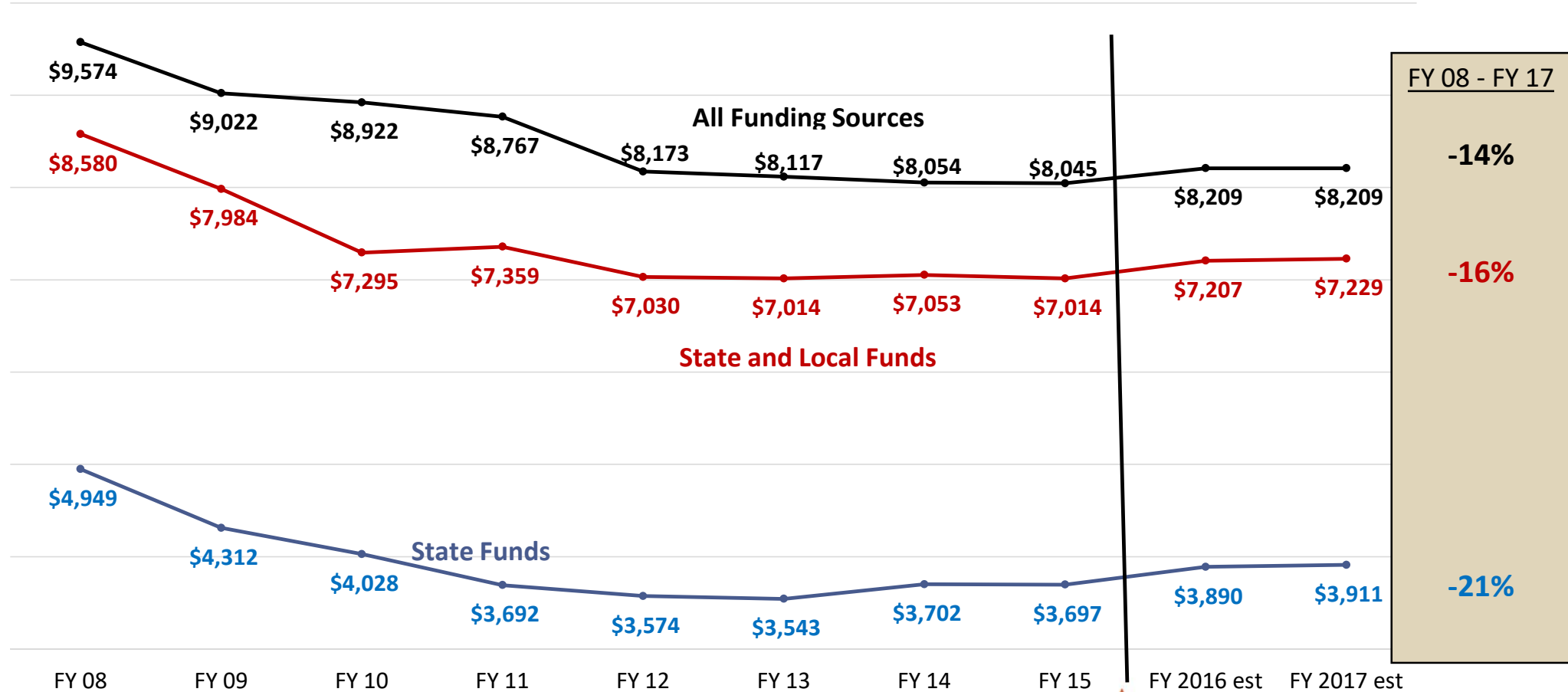
K-12 ADE & Local Resources - \$10.4 B (/17 Estimated)

ARIZONA LED THE NATION IN PER-STUDENT PERCENTAGE CUTS TO K-12 EDUCATION

Inflation Adjusted
Fiscal Years 2008-2014



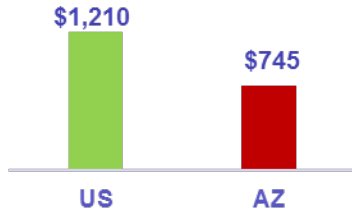
K-12 Funding Per Student Improves As a Result of Prop 123 But Still Leave Students Behind Where They Were 10 Years Ago Adjusted for Inflation



Note: State funding includes General Fund, Permanent State School Fund (land trust), and Proposition 301 sales tax
 Source: Joint Legislative Budget Committee staff, *K-12 Funding (M&O, Capital and Other)*, FY 2008 through FY 2017 est, 7/20/16

Education Spending Per Student 2014

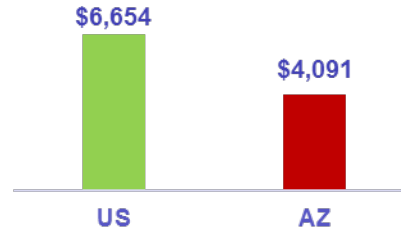
Administration



Percent of Total Spending

US 11% AZ 10%

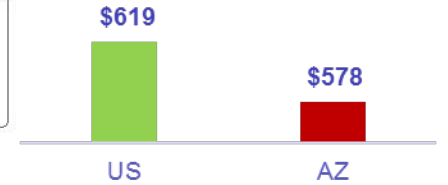
Instruction



Percent of Total Spending

US 60% AZ 54%

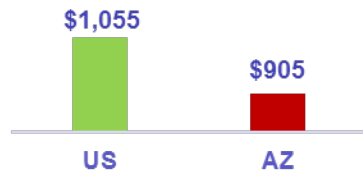
Student Support



Percent of Total Spending

US 6% AZ 8%

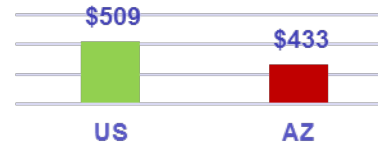
Operations and Maintenance of Plant



Percent of Total Spending

US 10% AZ 12%

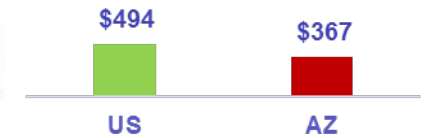
Instructional Staff Support



Percent of Total Spending

US 5% AZ 6%

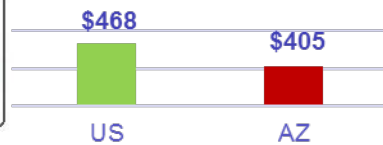
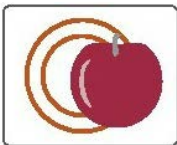
Student Transportation



Percent of Total Spending

US 4% AZ 5%

Other



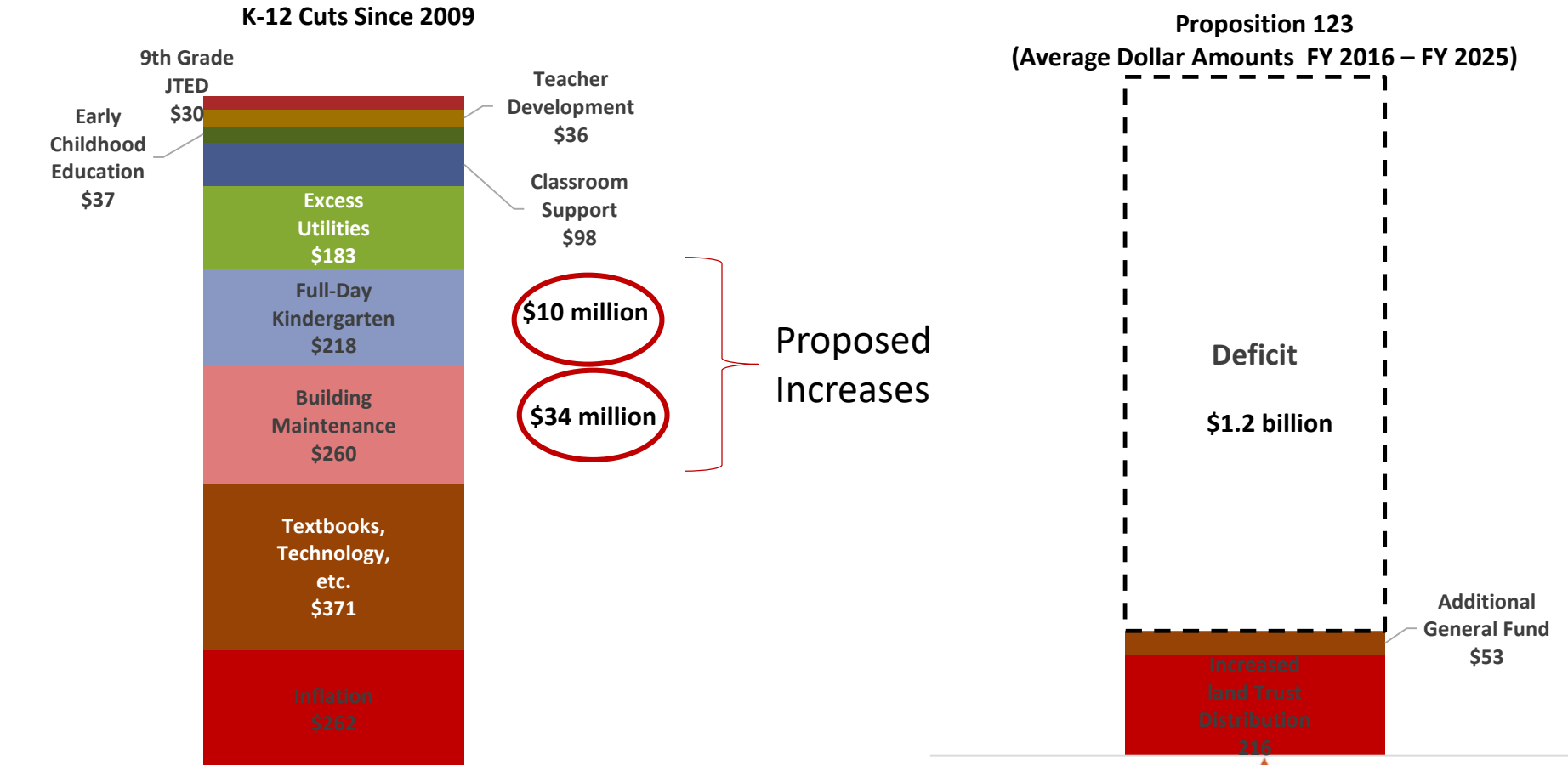
Percent of Total Spending

US 6% AZ 8%



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We still have a long way to go just to get back to 2008 levels



Our state universities have sustained significant cuts

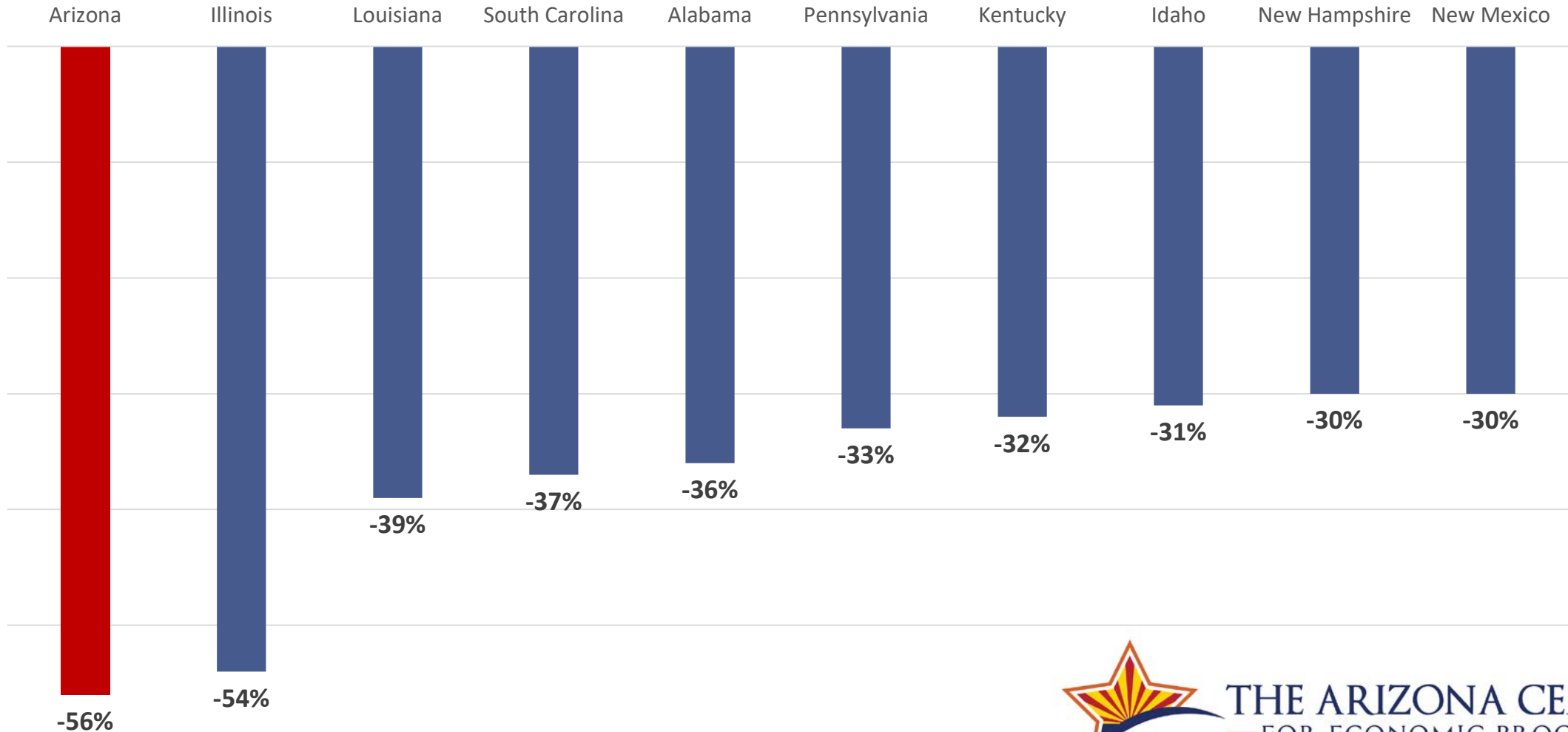
Both the Maricopa and Pima county community colleges have been removed from all state funding formulas



NO STATE HAS CUT FUNDING FOR HIGHER EDUCATION MORE THAN ARIZONA

Per Student Spending, Adjusted for Inflation

2008 - 2016

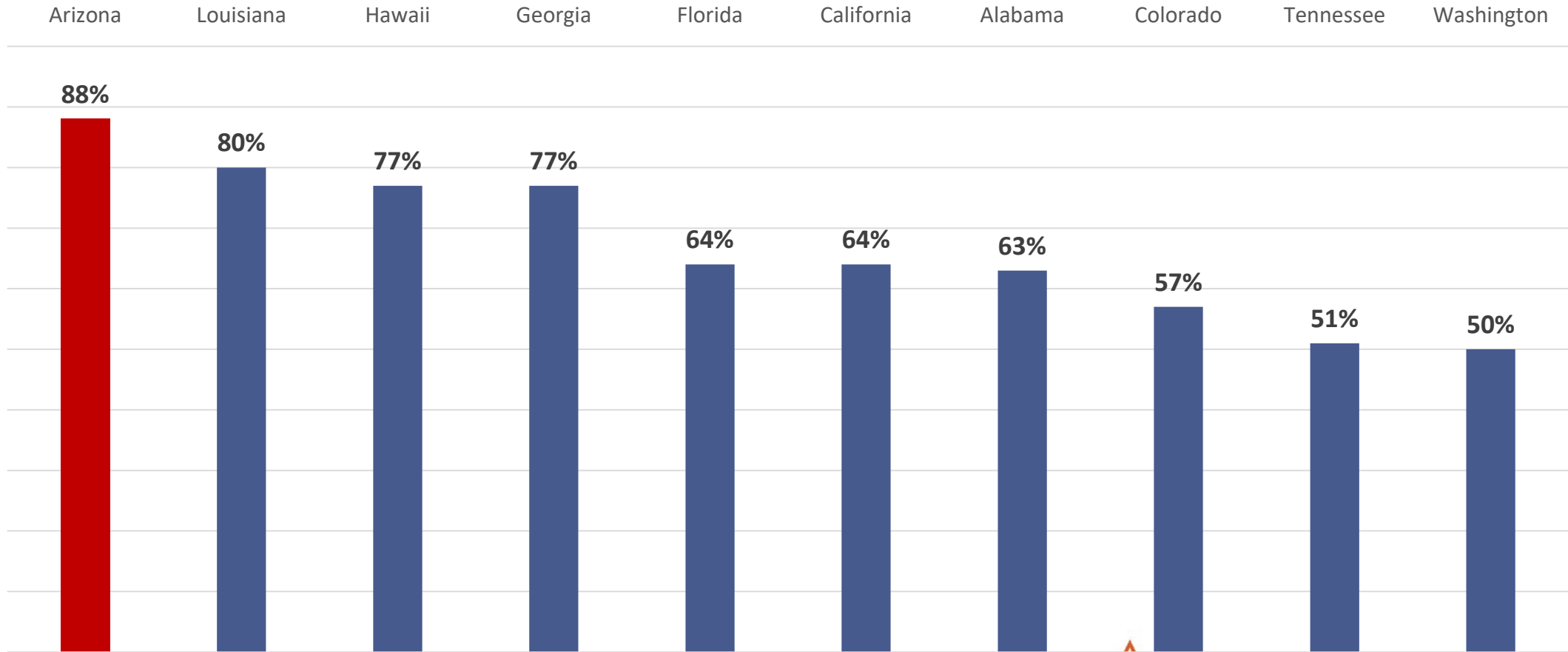


Source: Center on Budget and Policy Priorities



NO STATE HAS INCREASED TUITION MORE THAN ARIZONA

Per Student Spending, Adjusted for Inflation 2008 - 2016



Source: Center on Budget and Policy Priorities



**BUDGET BALANCING ISSUES AND TRICKS:
STRUCTURAL DEFICITS, ROLLOVERS AND
UNFUNDED FORMULAS**



WHAT IS A STRUCTURALLY BALANCED BUDGET?

	FY 16	FY 17	FY 18
Ongoing Revenues	\$9,219.0	\$9,399.8	\$9,645.0
Total Revenues	9,797.9	9,763.1	9,802.2
Ongoing Expenditures	9,254.5	9,395.1	9,634.2
Total Expenditures	9,513.9	9,644.1	9,785.7
Ending Balance	284.0	119.1	16.9
Structural Balance	-35.5	4.7	10.8

Dollars in Millions

Source: Governor Ducey's budget proposal



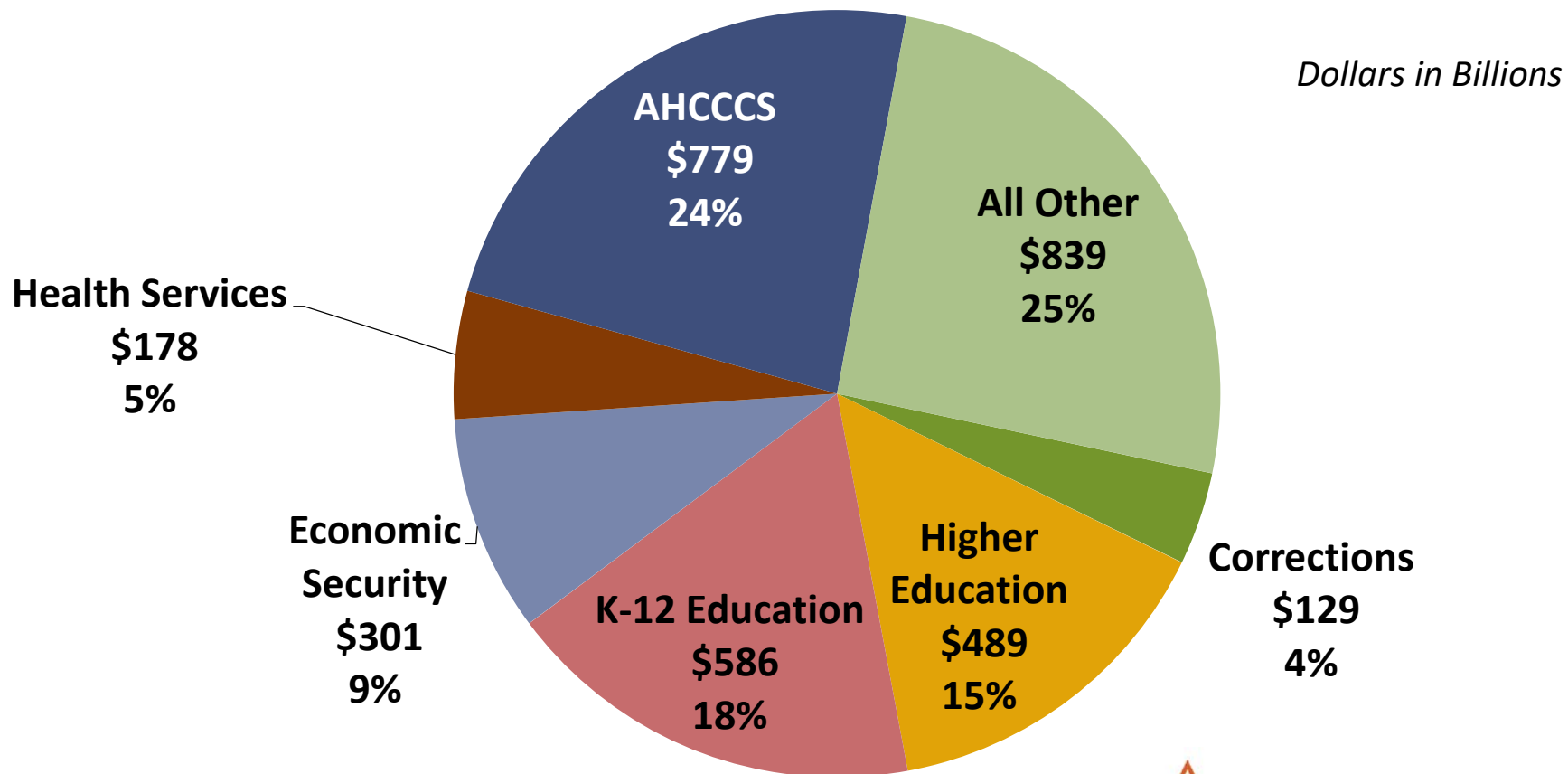
How the Budget Was Balanced

FY 08 – FY 12

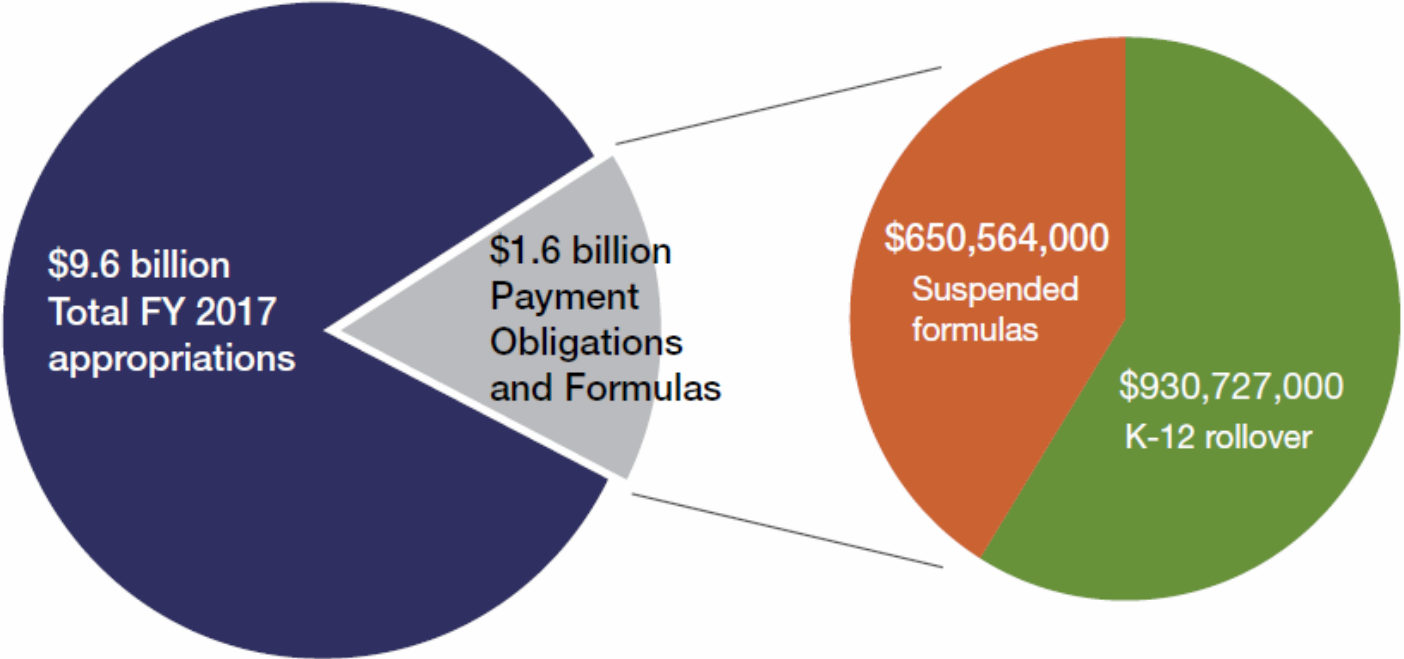
	Amount	Percent of Total
Permanent Spending Reductions	\$3.3 billion	25%
Additional Federal Assistance	\$2.7 billion	20%
New Debt	\$2.1 billion	16%
Fund Sweeps	\$1.9 billion	14%
Rollovers (payment delays)	\$1.4 billion	10%
Temporary Sales Tax	\$0.8 billion	6%
Rainy Day Fund Transfer	\$0.5 billion	4%
Permanent Revenue Increase (non-tax)	\$0.4 billion	3%
Other	<u>\$0.3 billion</u>	2%
Total	\$13.4 billion	

70% of Budget Cuts Between FY 09 and FY 12 were to Health, Education and Human Services

\$2.2 billion out of \$3.2 billion



Arizona Budget Is \$1.6 Billion Short in Payment Obligations and Formulas



Source: Joint Legislative Budget Committee, *Appropriations Report FY 2017*.

\$650 Million in Formula Suspensions

Revenue Estimates Assume the Suspensions Continue Indefinitely

Agency	Formula	Suspended
Community Colleges	STEM and Workforce Programs State Aid	\$ 751,000
K-12 Education	District Additional Assistance	352,442,700
K-12 Education	Charter School Additional Assistance	1,602,400
Dept. of Environmental Quality	Water Quality Assurance Revolving Fund	12,176,400
Dept. of Health Services (State Hospital)	Restoration to Competency	900,000
Dept. of Health Services (State Hospital)	Sexually Violent Persons	2,988,100
Dept. of Public Safety	Highway User Revenue Fund (HURF)	86,006,100
Universities	Financial Aid Trust	17,640,800
Building Renewal		
Dept. of Administration		12,848,500
Dept. of Corrections		14,652,600
Universities		129,900,000

IS ONE-TIME SPENDING REALLY ONE-TIME? Numerous Spending Items Expire in '17

	\$ in Millions
<input type="checkbox"/> Dept. of Education Formula Spending	43
<input type="checkbox"/> Local Assistance (HURF/Juvenile Corrections)	38
<input type="checkbox"/> Universities	19
<input type="checkbox"/> Dept. of Child Safety	23

Source: Joint Legislative Budget Committee staff, *Budget Update- House Orientation*, 12/9/16



**NEW FUNDING APPROVED IN LAST LEGISLATIVE SESSION
GOVERNOR DUCEY'S PROPOSAL FOR NEXT YEAR**



K-12 EDUCATION

FY 2017

- Formula changes (inflation, increased number of students, increased cost per student)
- New schools due to enrollment
- One-year reprieve from current year funding
- Removed funding for students attending a JTED who have already graduated from college

FY 2018

- Formula changes
- No new schools even though 3 districts are in the approval process
- Partially offsets current year funding for districts with drop of more than 2%
- Adds funding for students attending a JTED who have already graduated from college if they have completed at least 50% of their JTED work.



K-12 EDUCATION

FY 18 – continued

- Teacher pay raises – 2% over 4 years
- Teacher signing bonuses - \$1,000 for high-poverty districts
- High performing schools – top 10% of AzMerit
- Kindergarten/early literacy for high poverty schools
- Increased slots for Principals Academy
- Provides broadband internet for rural/remote areas
- Computer science initiative
- Jobs for Arizona’s Graduates (dropout prevention)

CHILD SAFETY

FY 17

- More funding for shelter and group home placements
- More funding for growth in foster care
- Support services increase including a mid-year supplemental
- Child care increase including a mid-year supplemental
- Discretionary funding for overtime/case aides/pay increases
- Funds to eliminate the backlog, including contracting with an outside provider
- Continued CHILDS replacement
- Additional Attorney General staff
- Increase adoption subsidy due to increased placements
- Prevention funding (\$5 million)

FY 18

- No new money for shelters, group homes, or foster care placements
- Mid-year supplemental for support services for children in foster care; doesn't carry forward
- Eliminates funding for addressing backlog
- Continued CHILDS replacement
- Increase adoption subsidy due to increased placements
- Expand Grandparent Subsidy



ECONOMIC SECURITY

FY 17

- Annual adjustment for caseload increases/increased costs in the Division of Developmental Disabilities
- 1% increase for DD providers
- Dental services for adults in the DD program
- One-time funds for staff and services to address increase in Adult Protective Services
- More state money to provide match for the vocational rehabilitation program

FY 18

- DDD caseload increases
- Dental services for adults in the DD program (emergency dental)
- Expansion of TANF cash assistance program up to 24 months under certain circumstances
- Arizona Early Intervention Program (AzEIP) increased referrals
- Eliminate finger imaging program
- Increase funding for DDD providers associated with the minimum wage, including a mid-year supplemental



AHCCCS

FY 17

- Annual adjustments for changes in caseloads/costs
- Dental services for long-term care program (preventive)
- Restoration of KidsCare (100% federal funding)

FY 18

- Annual adjustments for change in caseloads/costs
- Dental services for long-term care program (emergencies)
- Opioid prescription monitoring for AHCCCS clients
- Increase for minimum wage (FY 18 only – AHCCCS is covering this year's costs)

CORRECTIONS

FY 17

- Partial year funding for 1,000 new prison beds coming online during the year
- Increased inmate health care costs
- Add resources for monitoring of private prisons
- Create Maricopa County community corrections center
- Authorized the department to proceed with a Request for Proposal to add 1,000 new male beds if the male population grew by 1,000 by November 30, 2017

FY 18

- Annualizes cost for 1,000 prison beds brought on in FY 17
- Adds substance abuse counselors and placement specialists at Maricopa County community corrections center
- No authorization to proceed with adding new beds
- Creation of a post-release fire crew, funded in the Department of Forestry



UNIVERSITIES

FY 17

- Increased cost per resident student (\$8.2 million across all universities) plus \$19 million in one-time funding
- \$5 million for economic freedom schools at ASU and U of A

FY 18

- \$15 million for one-time capital operations
- Proposal to divert Transaction Privilege Taxes (TPT) paid by universities to a special fund to be matched with university funding, creating the funds needed to issue \$1 billion in bonds for research and development infrastructure and delayed maintenance. Includes a trigger that if revenues exceed a certain level, the additional funds may be used in support of resident students. Reduces general fund revenues by \$30 million and shared revenues for cities and towns by \$6.5 million.

HEALTH SERVICES

FY 17

- Increase resources and staff at State Hospital
- Increase funds for newborn screening program
- Move Behavioral Health Services to AHCCCS

FY 18

- Increased resources at State Hospital
- Add a new test to the newborn screening program
- Provide one-time funding for the public health emergency fund

COURTS

FY 17

- Added new judges/pay increases for judges
- Funds growth in adult probation program
- Pay increases for county probation officers
- Increased resources for dependency court

FY 18

- Additional training and education resources for the Court Appointed Special Advocates program
- Increased resources for dependency court



TRANSPORTATION

FY 17

- \$56.5 million for state capital projects/\$30 million for local capital projects

FY 18

- Equipment replacement funding
- Repair cattle guards

OTHER

FY 17

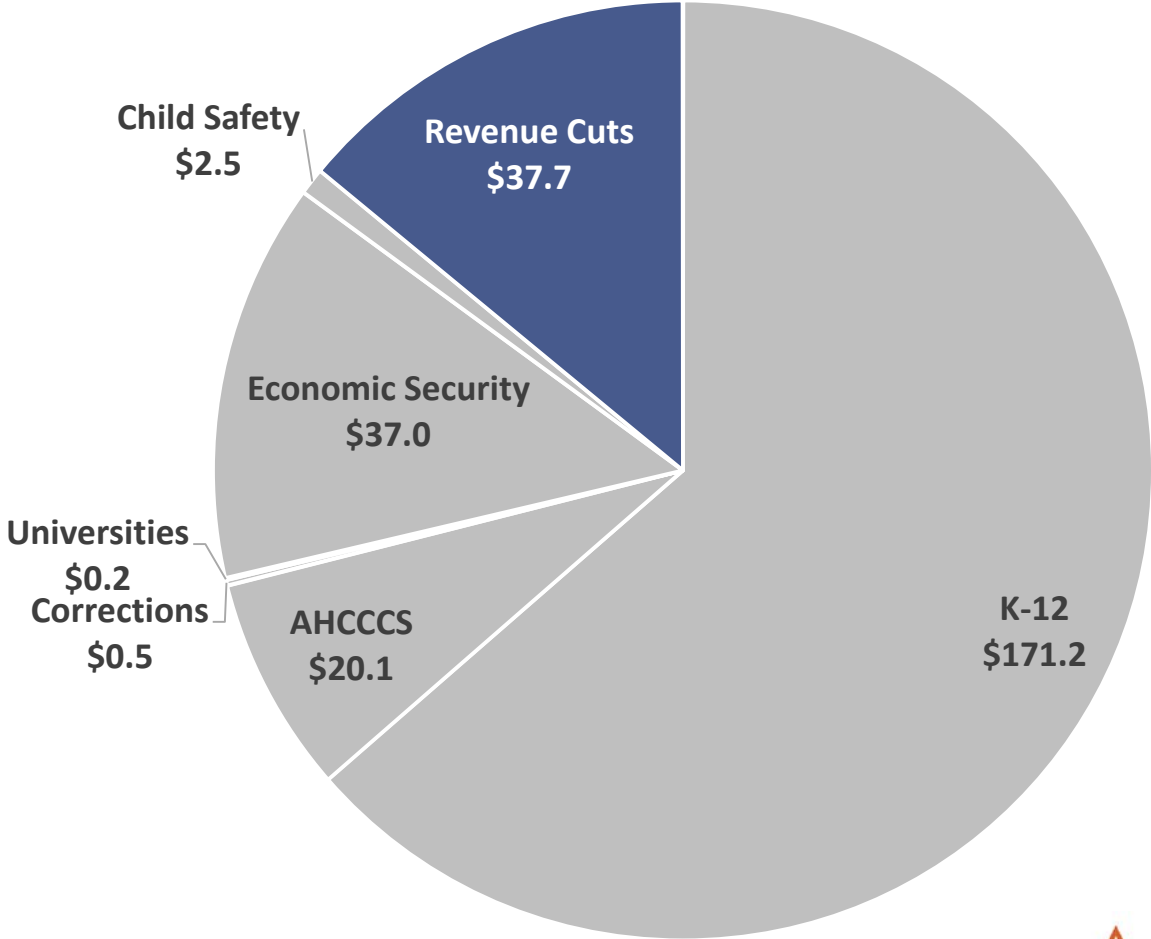
- One-time funding to backfill county support for Juvenile Corrections

FY 18

- Deposit \$30 million into State Employees Health Insurance Trust Fund which has had \$300 million swept into the general fund in recent years)

GOVERNOR'S MAJOR GENERAL FUND SPENDING PROPOSALS FOR FY 18

Increase over Current Year



Dollars in Millions

FY 17 Funding – \$9.6 billion
FY 18 Proposal - \$9.8 billion

Potential Landmines



The Affordable Care Act

It allowed Arizona to expand health care coverage for children and adults and yet save the state general fund money



... so repealing it without replacement could cost Arizona more in general fund spending depending on the scenario.

Scenario	General Fund Impact (Increased Spending)	Enrollment Reduction
1 - Eliminate all coverage expansions/retain drug rebates	\$96.9 million	(549,000)
2 - Eliminate adult expansion coverage only/retain drug rebates	\$154.5 million	(437,000)
3 - Eliminate adult expansion coverage only/lose drug rebates	\$265.0 million	(437,000)
4 - Retain all current populations/retain drug rebates	\$1.4 billion	0

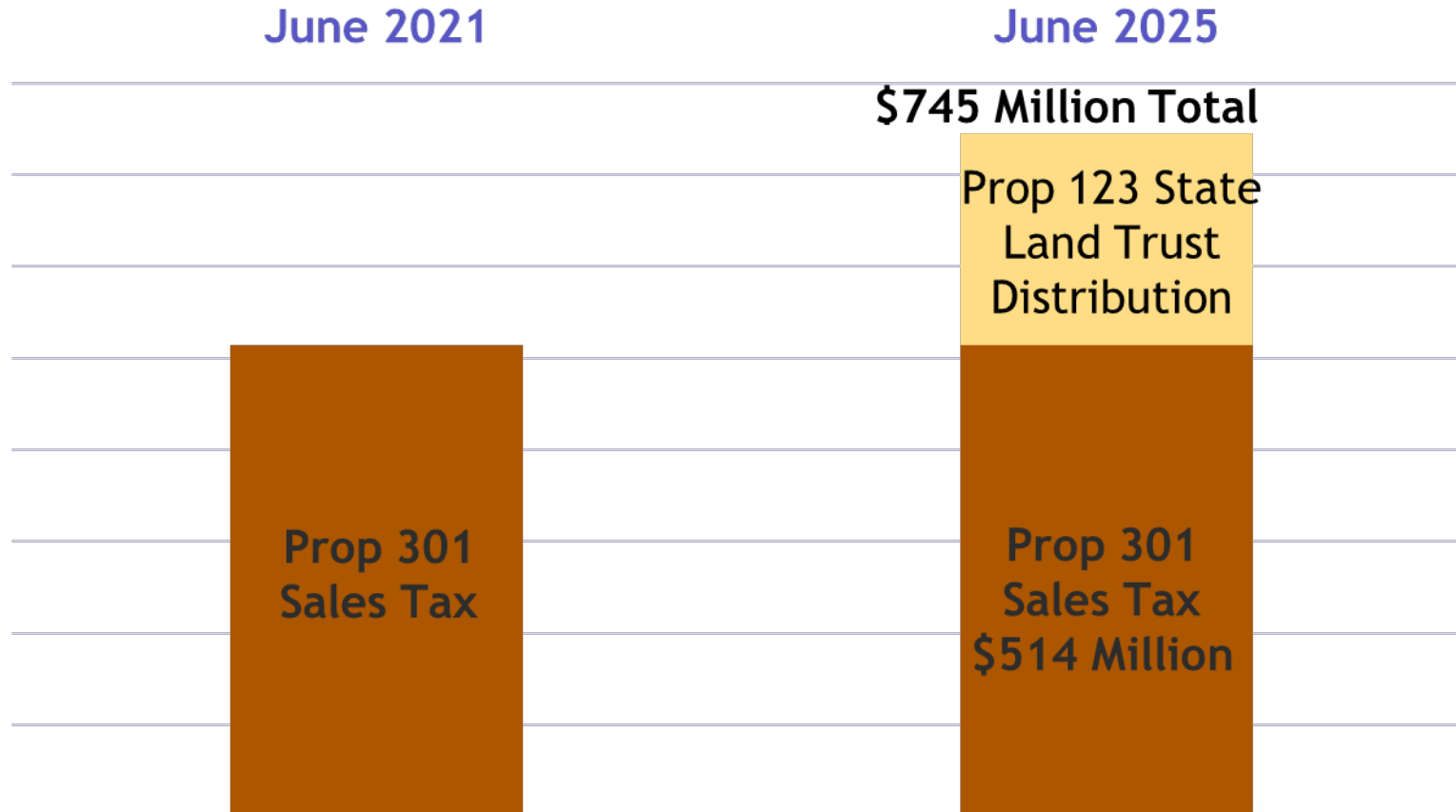
LAWSUITS THAT COULD COST MONEY

- Hospital assessment – Potential \$100 million - \$250 million cost if plaintiffs are successful
- Rental car surcharge – Potential cost of \$150 million
- Foster care services – Unknown cost
- Possible litigation – State funding of K-12 building costs

What if the Joint Legislative Budget Committee staff is correct about revenues and spending?

- JLBC projects lower ongoing revenues than Governor's budget
- Governor's budget assumes less caseload and formula growth than JLBC does (K-12 education, AHCCCS)
- Governor's budget uses a higher beginning balance than JLBC does (\$5 million difference)

K-12 FUNDING CLIFFS ON THE HORIZON



Other Potential Issues that Could Affect Revenues or Spending

- Recession
- The recent trend showing a reduction in the number of children in foster care reverses
- More tax cuts/tax credits



Contact information

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www.azchildren.org

www.azeconcenter.org under construction

In the meantime, AZ Center for Economic Progress can be found
on the azchildren.org website under “Issues”

