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ARIZONA TAX RESEARCH ASSOCIATION

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Legislature settles on reduced budget for 2002, repeals 2003

Baseline reductions, rainy day fund, one-time revenue, used to balance budget

The Arizona State Legislature's efforts to balance the budget were finalized this month, closing a \$673 million gap between revenue and planned spending for fiscal year (FY) 2002.

Though controversial, arguments ultimately prevailed to repeal the budget for FY 2003, which legislators had adopted as part of a biennial budget last spring.

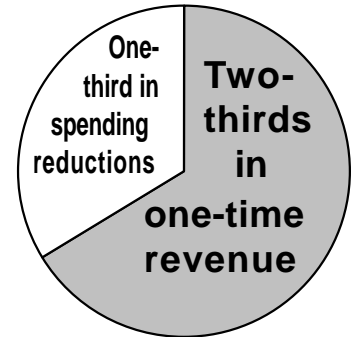
The bulk of the FY 2002 deficit was closed through a combination of spending reductions and one-time funding options (including use of the budget stabilization, or "rainy day" fund and various revenue changes).

Though a handful of tax increase proposals appeared, none were adopted, including a \$479 million sale tax hike. (See article on page 5.) Furthermore, a proposal

See **BUDGET FIXED**, page 2

How the \$673 million budget fix was accomplished:

Fund transfers:	\$218,911,200
Rainy Day Fund:	119,000,000
Other revenue changes	109,600,000
Spending reductions	225,667,500



Gov's K-12 task force recommendations on expenditures outside spending limits:

Addressing several long-standing issues in public school finance, the Governor's Task Force on Efficiency and Accountability in K-12 Education presented its final report this month. Among the task force's many recommendations, three deal directly with important school district property tax and spending issues: desegregation, excess utilities, and small school district taxes.

Conforming to the Governor's call, the 24-member Task Force, which began its work last Spring, divided into four subcommittees: 1) Accountability; 2) Teacher Pay-for-Performance Models; 3) Expenditures Outside the Revenue Control Limit; and 4) Consolidation/Unification of School Districts.

The Governor's call for a review of "expenditures outside the revenue control limit" was a direct result of ATRA's ongoing campaign to increase policy maker awareness of per-pupil spending and taxpayer inequities in Arizona's school finance system.

Dick Foreman, then ATRA chairman, was appointed by the Governor to the task force along with several business and school district representatives (see *ATRA Newsletter*, March 2001).

Specifically, the task force forwarded the following recommendations to the Governor:

Cap desegregation spending Address excess utilities now Consolidate small schools

- "The amount of desegregation expenditures outside the revenue control limit (RCL) must be held constant at the current fiscal year levels for the next two fiscal years while a statewide review of the expenditures is initiated."
- "Excess utilities must be eliminated as an item funded outside the RCL and supplanted with a system that places each district's total actual utility expenditures within the RCL."
- "No Arizona school district will be less than 100 students in size. This requirement must be mandatory within two years. . . . Legislation is needed requiring that all school districts that have more than 100 students be subject to the mandatory phase-out of the small school district adjustment when in excess of 10% of the [RCL]."

Bills reforming tax and spending policies for "desegregation," excess utilities, and small school districts are being prepared for the upcoming regular legislative session in January.

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Budget fixed for FY 2002

FY 2003 set to begin well into the red

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to debt finance ongoing spending commitments through the State School Facilities Board (SFB) was rejected.

According to the Joint Legislative Budget Committee (JLBC), spending reductions from the general fund totaled \$225.7 million. Much of the decreases in base spending took the form of 4.0 to 4.5% reductions in state funds to agencies.

One-time funding options totaled \$447.5 million. These included \$218.9 million in fund transfers, \$119 million from the rainy day fund, and \$109.6 in other revenue changes (tax amnesty, sale of the state plane, etc.)

Last October ATRA provided the Legislature with its recommendations for dealing with the budget deficit:

1. Balance FY 2002 and repeal FY 2003;
2. All budgets should be "on the table";
3. Carefully tap the Rainy Day Fund;
4. Avoid shifting problems to the future; and
5. No tax increases.

The fact that two-thirds of the FY 2002 deficit was closed with one-time revenue opportunities ensures future struggles in the development of a new FY 2003 budget. Recognizing that problem, House Republicans called for deeper spending reductions that would carry forward to FY 2003. In the final agreement with the Senate, however, the House was only able to extract another 0.5% reduction over Governor Hull's initial call for a 4% reduction.

Arguably, one of the wisest decisions made during this session was the avoidance of debt to finance the State's ongoing commitment for school construction.

Future legislators and taxpayers will no doubt appreciate the resolve of key members of this Legislature to not debt finance their way out of the current problem.

MARICOPA'S "GIFT" REFUSED

Special District Expansion Stopped

Historically, when the Legislature closes a state budget deficit local governments are asked to "participate" in the exercise. This participation generally comes in the form of cost shifts, budget reductions or revenue raids.

Mindful of the State's deep budget deficit, Maricopa County decided to add a new dynamic to state and local fiscal relations: a \$30 million gift to the state general fund in exchange for new and expanded taxing authority.

For Maricopa County taxpayers, the strings attached to the "gift" could have been costly. A surprise House floor amendment combined the \$30 million gift with significant changes to two special district statutes of interest to Maricopa County.

Most urgent for the county was an amendment to the existing *health service* district statute (which currently allows both

sales and property taxes to be levied without voter approval), giving the county authority to create a new *health care* district. The change would have allowed Maricopa County to shift the county hospital to a special taxing district without voter approval.

Also, Maricopa sought the approval to ask voters to extend the current voter approved jail tax when the current tax sunsets. That tax, approved by the voters in 1998, sunsets after nine years or when \$900 million has been raised through the 0.2% sales tax. The county sought a twenty-year extension to the tax.

ATRA expressed strong opposition to Maricopa County using its tax revenue in such a reckless fashion and urged the Legislature not to expand special district statutes without public hearings and further study.

In the end, the *quid pro quo* nature of the offer led the Legislature to reject it.

In memorium: Former ATRA Board Chairman Milt Whitley

D. Milton Whitley Sr., chairman of ATRA's Board of Directors between 1977 and 1979, died on December 27, 2001, at the age of 80. Milt was born in Phoenix on June 13, 1921.

Milt was a strong leader on ATRA's Board and had a lasting impact on the association's mission and financial stability.

He joined the Arizona Portland Cement Company in 1951 and retired as the head of their Arizona operations in 1983.



D. Milton Whitley Sr., 1921-2001

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Arizona's average instructional staff pay rank leads nation as a percentage of per capita personal income

Rank	State	1999-00 Amount (\$)	Rank	State	Avg. salaries as % of per capita pers. income
1	Massachusetts	59,906	1	Arizona	198.4%
2	New Jersey	55,513	2	Rhode Island	187.6%
3	Connecticut	53,753	3	Michigan	182.5%
4	Rhode Island	52,367	4	Pennsylvania	181.0%
5	New York	51,384	5	Massachusetts	180.3%
6	Pennsylvania	49,550	6	Utah	178.7%
7	Dist.of Columbia	49,153	7	West Virginia	178.6%
8	Michigan	48,695	8	Alaska	175.8%
9	Alaska	48,676	9	Alabama	174.0%
10	Illinois	48,390	10	Kentucky	172.2%
11	California	47,817	11	Indiana	172.0%
12	Arizona	46,771	12	California	171.5%
13	Delaware	46,662	13	Idaho	170.8%
14	New Hampshire	46,161	14	South Carolina	170.0%
15	Maryland	45,809	15	Wisconsin	168.9%
16	Wisconsin	44,105	16	Georgia	168.0%
17	Indiana	43,062	17	Mississippi	166.7%
18	Georgia	43,048	18	Oregon	166.5%
19	Washington	43,024	19	Arkansas	165.6%
20	Ohio	42,939	20	Maine	165.5%
21	Oregon	42,776	21	Ohio	164.4%
22	Hawaii	41,830	22	New Mexico	163.7%
23	Nevada	41,543	23	New Jersey	162.7%
24	Minnesota	41,044	24	North Carolina	162.7%
25	North Carolina	40,843	25	Illinois	162.2%
26	Kansas	40,670	26	Delaware	159.9%
27	Colorado	40,270	27	New York	159.7%
28	Texas	39,806	28	Montana	159.3%
29	Utah	39,280	29	Kansas	159.2%
30	Virginia	38,909	30	New Hampshire	157.5%
31	Maine	38,762	31	Texas	156.9%
32	Alabama	38,324	32	Louisiana	155.8%
33	Kentucky	38,239	33	Hawaii	155.8%
34	Florida	37,900	34	Tennessee	155.2%
35	Vermont	37,880	35	Vermont	153.6%
36	South Carolina	37,864	36	Washington	152.1%
37	Tennessee	37,790	37	Maryland	149.7%
38	Missouri	37,469	38	Oklahoma	149.7%
39	Nebraska	37,359	39	Iowa	149.3%
40	Iowa	36,980	40	Missouri	148.3%
41	Idaho	36,823	41	Nebraska	144.9%
42	West Virginia	36,250	42	Nevada	144.6%
43	Wyoming	35,341	43	Connecticut	143.9%
44	Arkansas	35,022	44	Florida	142.7%
45	Louisiana	34,759	45	Wyoming	141.8%
46	New Mexico	34,529	46	Minnesota	140.6%
47	Montana	33,827	47	Virginia	139.0%
48	Mississippi	33,147	48	Colorado	137.8%
49	Oklahoma	33,039	49	North Dakota	131.5%
50	South Dakota	30,256	50	Dist.of Columbia	129.7%
51	North Dakota	30,114	51	South Dakota	127.5%
	U.S. Average	43,768		U.S. Average	161.6%

Arizona's news media and some policy makers and analysts continue to characterize public school salaries as low, often lumping a variety of funding statistics to describe Arizona's public school system as "the worst in the nation" or "bottom of the heap."

One of the most egregious examples of this tendency was found in an *Arizona Republic* editorial in support of the sales tax increase in Proposition 301, stating that "this measure indisputably is anchored in a single fact: that until it is passed, Arizona teachers are paid worse than any other public school teachers in America" (September 26, 2000). The same editorial concluded that "raising [Arizona] from the bottom of the salary ladder is a vital first step."

While it is widely accepted and quoted that Arizona's per-pupil expenditures rank low nationally, it does not follow that instructional staff or teacher pay is last in the nation.

The National Education Association, (NEA), the largest teacher's union in the nation, ranks Arizona 12th for school year 1999-2000 in average salaries for "instructional staff."

The NEA defines instructional staff as including "consultants or supervisors of instruction, principles, teachers, guidance personnel, librarians, psychological personnel, and other instructional staff."

The instructional staff category does *not* include such positions such as administrative staff, attendance personnel, health service personnel, or clerical personnel."

Calculating these average salaries as a percentage of per capita personal income is a common method that accounts for differences in the underlying wealth between states.

Arizona's average instructional staff salary is found to be nearly double the per capita personal income figure, placing this state at the top of the national ranking.

See **AZ AVERAGE TEACHER PAY**, page 4

AZ average teacher pay ranks 28th as a percentage of per capita personal income

Continued from page 3

Much can probably be said of Arizona's public school teachers.

According to the American Federation of Teachers (AFT), Arizona teachers have, on average, less teaching experience than their counterparts in other states.

Arizona teachers also have full classrooms. With an estimated 18.1 students (in average daily attendance) to every teacher, the NEA ranks Arizona 4th compared to other states, putting us in the company of other fast-growing states, such as Utah, California, Washington, and Nevada.

One could also be inspired to inquire whether classroom teachers have been given low priority as school district administrators and governing boards allocate revenues to the multitude of objectives and initiatives districts undertake.

But what cannot be said (at least not accurately) is that Arizona teachers are at "the bottom of the salary ladder." With an average salary of \$35,650, according to the NEA, Arizona ranks 37th (just below Missouri but above Maine) for school year 1999-2000.

Adjusting for differences between states in per capita personal income, Arizona climbs to 28th in the national ranking.

The most important budgetary decisions school officials make are: 1) how many teachers are needed given the number of students? and 2) how much are they going to be paid?

What should not be part of the deliberations is where Arizona ranks in any given set of averages. A ranking of 37th should not translate into a conclusion that Arizona teachers are underpaid any more than a higher ranking should be an indication that teachers are overpaid.

National rankings do not show—nor should they be mistakenly or misleadingly used to claim—that "Arizona teachers are paid worse than any other public school teachers in America." Not unless you want to get calls from South Dakota.

Rank	State	1999-00 Amount (\$)	Rank	State	Avg. salaries as % of per capita pers. income
1	New Jersey	52,174	1	Michigan	182.5%
2	Connecticut	51,780	2	Pennsylvania	176.5%
3	New York	50,173	3	West Virginia	172.5%
4	Michigan	48,695	4	California	171.0%
5	Pennsylvania	48,321	5	Alaska	170.7%
6	California	47,680	6	Rhode Island	168.5%
7	Alaska	47,262	7	Indiana	167.2%
8	Dist. of Columbia	47,076	8	Alabama	166.6%
9	Rhode Island	47,041	9	Kentucky	163.9%
10	Illinois	46,486	10	Idaho	163.1%
11	Massachusetts	46,250	11	South Carolina	162.0%
12	Delaware	44,435	12	Mississippi	160.2%
13	Maryland	44,048	13	Georgia	160.1%
14	Indiana	41,850	14	Oregon	159.3%
15	Ohio	41,436	15	Utah	158.9%
16	Wisconsin	41,153	16	Ohio	158.6%
17	Georgia	41,023	17	Arkansas	157.8%
18	Washington	41,013	18	Wisconsin	157.6%
19	Oregon	40,919	19	North Carolina	157.0%
20	Hawaii	40,578	20	New York	156.0%
21	Minnesota	39,802	21	Illinois	155.8%
22	North Carolina	39,419	22	New Mexico	154.3%
23	Nevada	39,390	23	New Jersey	153.0%
24	Kansas	38,453	24	Vermont	152.9%
25	Colorado	38,163	25	Delaware	152.3%
26	Virginia	38,123	26	Maine	151.8%
27	New Hampshire	37,734	27	Montana	151.2%
28	Vermont	37,714	28	Arizona	151.2%
29	Texas	37,567	29	Hawaii	151.1%
30	Florida	36,722	30	Kansas	150.6%
31	Alabama	36,689	31	Tennessee	149.2%
32	Kentucky	36,380	32	Louisiana	148.4%
33	Tennessee	36,328	33	Texas	148.0%
34	South Carolina	36,081	34	Washington	145.0%
35	Iowa	35,678	35	Iowa	144.0%
36	Missouri	35,656	36	Maryland	143.9%
37	Arizona	35,650	37	Oklahoma	141.8%
38	Maine	35,561	38	Missouri	141.2%
39	Idaho	35,162	39	Massachusetts	139.2%
40	West Virginia	35,008	40	Connecticut	138.7%
41	Utah	34,946	41	Florida	138.2%
42	Wyoming	34,140	42	Nevada	137.1%
43	Arkansas	33,386	43	Wyoming	136.9%
44	Nebraska	33,284	44	Minnesota	136.3%
45	Louisiana	33,109	45	Virginia	136.2%
46	New Mexico	32,554	46	Colorado	130.6%
47	Montana	32,121	47	North Dakota	130.4%
48	Mississippi	31,857	48	Nebraska	129.1%
49	Oklahoma	31,298	49	New Hampshire	128.8%
50	North Dakota	29,863	50	Dist. of Columbia	124.2%
51	South Dakota	29,072	51	South Dakota	122.5%
	U.S. Average	41,724		U.S. Average	154.1%

Sales tax expansion debate heats up

\$479 million tax increase defeated during special session

Blaming the state's budget deficit on an inadequate tax system, some legislators found the recent special session a perfect opportunity to attempt to raise taxes. Most notable was a floor amendment offered by Representative Henry Camarot, which was backed by most House Democrats, to dramatically expand the transaction privilege tax (TPT) base. If successful, the amendment was estimated to raise taxes over \$479 million. The bill was introduced as a result of a report generated by a study group that was assembled by Representative Camarot during the fall.

Rep. Camarot's study group, which conducted five meetings to study the expansion of the TPT, claimed that "a review of the entire Arizona tax structure is past due but the sales tax exemption changes should not wait for this review to occur." The recommendations of the "study" to expand the TPT base were expected by those following the issue at the Capitol. Rep. John Laredo, a proponent of expanding the sales tax base said, "we've been trying to create this new revenue stream for the five years I've been in the Legislature."

To date, ATRA's efforts to educate policy makers on the state's TPT system have proved successful. At ATRA's recent 2001 Outlook Conference, Barb Dickerson, chair of ATRA's Tax Practitioners Committee and director of State and Local Taxes at *Anderson*, discussed a number of timely issues and controversies surrounding Arizona's TPT system.

Dickerson described ongoing efforts of the 38 states, including Arizona, in the Streamlined Sales Tax Project (SSTP) to create uniform definitions within tax bases, simplify tax rates and exemption administration, and establish uniform sourcing rules and audit procedures.

Arizona, Dickerson explained, would have to overcome several highly daunting obstacles before it could benefit from such an effort. Included in such challenges is a striking lack of uniformity between state and

local taxing authorities in Arizona and its definitions of taxable activity.

Contrary to the recommendation made by Camarot's group, Dickerson argued that Arizona's TPT system cannot be evaluated in a vacuum. Many TPT tax provisions are essential to attracting or retaining business to Arizona in the face of this state's high property tax burden. She pointed to a 1998 property tax study by the Minnesota Taxpayers Association that ranked Arizona 36th in residential property tax burdens while industrial burdens ranked as high as 4th. In contrast, Dickerson pointed out that Arizona's income tax burden compares favorably to other states. However, Dickerson emphasized that Arizona's TPT burden is already high, ranking 11th on a per capita basis from Census Bureau data prior to the tax increase enacted this year for education.

Camarot's floor amendment to HB 2014, which would have eliminated 113 exemptions and dropped the rate from 5.6% to 5.0% for most classifications, failed on a vote of 19 to 34. As reported by JLBC, the bill would have raised taxes \$479.9 million.

Vote on \$479 million sales tax increase

Member Name	Vote	Member Name	Vote	Member Name	Vote
Carolyn S. Allen	N	Mark Anderson	N	Carlos Avelar	Y
Linda Binder	N	Robert Blendu	N	Debra Brimhall	N
Bill Brotherton	Y	Meg Burton Cahill	Y	Henry J. Camarot	Y
Robert C. Cannell	Y	Carmine Cardamone	Y	Ted Carpenter	N
James R. Carruthers	N	Cheryl Chase	NV	Kenneth D. Chevront	NV
Mark Clark	NV	Dean Cooley	N	Eddie Farnsworth	N
Jake Flake	N	Kathi Foster	Y	Gabrielle Giffords	Y
Lowell S. Gleason	N	Randy Graf	N	Linda Gray	N
Deb Gullett	N	Philip J. Hanson	N	Jeff Hatch-Miller	N
J. Peter Hershberger	N	Steve Huffman	N	John Huppenthal	N
Gary Pierce	N	Karen S. Johnson	N	Laura Knaperek	N
James Kraft	N	Leah Landrum	Y	Sylvia Laughter	Y
Barbara Leff	N	Linda Lopez	Y	John A. Lored	Y
Bobby Lugo	Y	Mark Maiorana	Y	Wes Marsh	NV
Steve May	N	Marian McClure	N	Richard Miranda	Y
John B. Nelson	N	Debora Lynn Norris	NV	Tom O'Halleran	N
Russell Pearce	N	Marion Lee Pickens	Y	Edward Poelstra	N
Robert Robson	N	James J. Sedillo	Y	Victor Soltero	Y
Carol Somers	N	Albert Tom	NV	Steve Tully	N
Roberta L. Voss	NV	Christine Weason	Y	Jim Weiers	N

HB 2014, Committee of the Whole (COW), floor amendment by Rep. Camarot, December 4, 2001.

Y = Yes

N = No

NV = Not Voting



Legislature doubles funding weights for English learners

Starting July 1, 2002, the State of Arizona will double the current funding weights for districts and charter school students identified as "English language learners" (ELL).

The Governor signed the bill into law on December 27, 2001.

The legislation, HB 1010, was enacted in response to *Flores v. Arizona*, a lawsuit filed in Federal court in which the judge decided that Arizona's funding for ELL was "arbitrary and capricious."

The current ELL "Group B" weight of .060, which is added to the average daily membership (ADM) count, will be .115 for the next fiscal year. The weighted ADM student count is then multiplied by a base level set annually by the Legislature as part of school budget limit calculations.

For the current fiscal year, the ELL weight generated approximately \$23 million in revenue to public schools. The increased weight is expected to generate approximately \$30 million more next fiscal year for the over 150,000 students currently identified as ELL. The total ELL weight funding is expected to exceed \$60 million in the next few years through a combination of increases in the base level and a growing ELL population.

The bill requires Legislative Council to contract with a private entity to conduct a cost study of the increased ELL weight. A one-time appropriation of \$500,000 was made in FY 2003 for that purpose.

The bill also appropriated over \$14 million for each of FY 2003, FY 2004, and FY 2005 to implement a variety of programs including: teacher training, compensatory instruction, materials and supplies, monitoring, a personnel bonus program, and pilot programs.

ATRA had advised the Legislature to avoid overreliance on student count weights to distribute monies for certain types of funding requirements. Caution must be exercised to ensure that incentives are not created or enhanced to over-identify or misclassify students into specific placements that receive higher funding.

In recent years, considerable reform efforts have been underway in several states and at the federal level to maintain or create "placement neutral" systems for funding special education. In fact, the 1997 amendments to the Individuals with Disabilities Education Act (IDEA) included provisions requiring states to distribute funds in a placement neutral manner.

States have been debating the strengths and weaknesses of different funding mechanisms such as pupil weights, flat grants, resource-based funding, and percent reimbursement.

To some extent, Arizona's education finance system has maintained a high degree of placement neutrality by adopting a hybrid system that includes both pupil weights and a flat grant (or census-based) approach.

Since 1980, Arizona's school finance system has used "Group A" weights to fund a number of student categories including: specific learning disabilities, emotional disabilities, mild mental retardation, remedial education, and speech/language impairment.

Districts and charters receive this money based on the total number of students, irrespective of their placement or classification. The "Group A" weights are also intended, according to statute, to make increased funding available for "bilingual" education.

According to the Joint Legislative Budget Committee, an estimated \$355 million was distributed to public schools through the "Group A" weights.

Meanwhile, "Group B" weights increase funding in recognition of other costly categories, but ones that arguably would be less susceptible to over-identification. These include autism, hearing impairment, moderate mental to severe retardation, etc.

In addition to concerns about increasing incentives to misclassify students, several legislators appropriately argued that responding to the courts by increasing pupil weights encourages future litigation.

Meanwhile, the impact of the *Flores* case, not to mention other similar court cases on the horizon, may continue to reverberate through the three branches of government for some time.