The taxpayer's watchdog for over 60 years

ARIZONA TAX RESEARCH ASSOCIATION

ATRA makes recommendations on budget deficit

With agreement reached on the size of the fiscal year (FY) 2002 budget deficit, now pegged at $675 million, the Legislature and Governor will begin work on November 13 to eliminate it.

The size of the budget in the second year of the biennium (FY 2003) will be contingent on the methods used to close the FY 2002 deficit.

The $675 million deficit is 9.5% of the $7.045 billion general fund budget and 4% of the total operating budget of the state which approaches $16.8 billion.

BUDGET REDUCTIONS

While there is general agreement that significant budget cuts have to be made to balance the budget, there is little agreement on the amount. To date, Governor Hull has called for a 1% ($102 million) decrease in general fund spending and a 0.6% cut in the total operating budget. The Governor's budget reduction effort was limited by a decision to insulate up to 60% of the general fund from the budget cutting exercise. After taking $3.8 billion "off the table" under the theory that it is all voter protected spending, the Governor recommended a 4% across the board reduction in the remaining 40% of the budget.

The Legislature's budget staffers, on the other hand, have developed a lengthy list of budget reduction options, many directed at specific programs and formulas that drive the state spending.

RAINY DAY FUND

When the budget stabilization fund (BSF), or so-called "rainy day fund," was established in the early 1990s, it was the subject of considerable debate. There is little debate now that the current balance of $326 million will come in handy to help close the FY 2002 deficit. However, the arguments used against its creation should be used as

Continued on next page.

1. *Balance FY 2002 and repeal FY 2003*

There has been considerable confusion and debate about the size of the deficit, some of which was caused by the fact that there are two budget years in question. When the FY 2003 budget is included in the estimates the size of the deficit skyrockets. The Governor has estimated the deficit for the biennium to be as high as $1.6 billion. One of the reasons the deficit jumps even higher in FY 2003 is that spending jumps significantly over the current FY 2002 budget. (See charts on following page.)

Knowing what we do now about the economy and slumping state revenues, most should agree that the FY 2003 spending plan is simply unrealistic and should be repealed. The special session in November should focus on balancing the current budget with an eye toward ensuring that those changes do not make building a new FY 2003 budget more difficult. After repealing the FY 2003 budget in November, the Legislature, with more up-to-date revenue information available, could develop a new spending plan for FY 2003 in the Spring.

2. *All budgets should be "on the table"*

Arizona's slumping economy and the dramatic downturn in state revenue argues for significant reductions in state spending. Further, meaningful reductions can only be accomplished by including all state programs and agencies. Taking 60% of the budget "off the table" will only result in deeper cuts than necessary into those programs "on the table" or fail to generate the necessary spending reductions to solve the problem.

The 1.5% reduction in the general fund budget that has been called for by Governor Hull only addresses 15% of the current $675 million deficit.

In addition to across the board reductions, the Legislature should focus reductions on programs and spending on a targeted basis. Not all state spending is created equal and budget-reducing exercises can be an effective way of re-prioritizing state spending. The potential savings through targeted reductions could and should exceed those done in an across the board fashion.

3. *Carefully tap the Rainy Day Fund*

The rainy day fund was established in order for the state to use it. However, as mentioned earlier, caution must be exercised not to use a one-time revenue source to fund ongoing expenditures that must be met again in FY 2003.

4. *Avoid shifting problems to the future*

Every effort should be made to match current spending with current revenue and avoid the use of budget gimmicks to resolve the problem. Specifically, selling revenue bonds to free up general fund spending capacity should be opposed. While providing short-term budget relief, this gimmick has tremendous long-term costs.

5. *No tax increases*

Following a huge tax increase in June, and the struggling economy, it should go without saying that the Legislature and Governor should avoid raising taxes. Taxes are generated by establishing a ***tax base*** and applying a ***tax rate*** to that base. Changes in either the base or the rate in an effort to generate more taxes is a ***tax increase.***

ATRA recommendations on budget *(continued)*

cautions in its use now. Specifically, the use of the BSF in a manner that simply masks the current deficit with the hope that revenues will rebound in FY 2003 is dangerous. For that reason, Governor Hull's argument that the FY 2002 cannot be addressed in isolation of the FY 2003 is correct. The size of the budget deficit in the second year is even greater and every effort needs to be made not to exacerbate that problem.

BUDGET GIMMICKS

State government was infamous for its use of gimmickry in addressing budget deficits in the late 1980s. Shifting expenditures into future budgets or pulling forward revenues avoids the need to address deficits through more straightforward means. Top on the list of budget gimmicks for this session will be proposals to sell revenue bonds to free up cash available for other general fund programs.

Punting this budget problem to the future is particularly problematic considering that the size of the estimated deficit in FY 2003 is higher than that for FY 2002.

TAX INCREASES

Despite the fact that the state just imposed a record voter-approved tax increase in June, there is some interest in looking for additional revenue to close the deficit. As was the case in the late 1980s, some are blaming this budget crisis on a "structural deficit." In an effort to shift focus away from spending reductions, some are pointing to problems with the State's tax structure.

Attempting to avoid talk of tax increases, some legislators have talked of "closing loopholes" or eliminating "special interest tax exemptions." Most of the interest centers on the state transaction privilege tax (sales) tax base, where the focus on the labels "exemptions" and "loopholes" grossly exaggerates the issue.

While there are some major activities that have been removed from the sales tax base (e.g. food & commercial leases), the majority of activities being looked at have ***never*** been subject to tax in Arizona.

It is safe to say that despite some efforts to define such expanding of the tax base as something other than a tax increase, the affected industries and citizens will not buy it. In addition, any effort to address the budget crisis through any measure that raises state revenues, regardless of the label, will require a two-thirds vote of the Legislature.