



The taxpayer's watchdog for over 60 years

ARIZONA TAX RESEARCH ASSOCIATION

ATRA urges legislators not to miss another opportunity to improve Arizona's financial management

The Legislature is in the process of tackling another very difficult budget. Projected general fund revenues in fiscal year (FY) 2005 will again fall far short of proposed expenditures and, again, the Legislature will be under tremendous pressure to consider closing the budget gap through debt financing, fund sweeps, and accounting gimmicks. The Arizona Tax Research Association (ATRA) remains concerned that “balancing” the budget with such short-term fixes has become the path of least resistance despite their long-term repercussions.

As every legislator knows, much of what drives the state government expenditures involves formulas. Some formulas are as simple as multiplying an established dollar amount by the number of people served, or eligible to be served, by a particular program. In most cases, however, spending formulas are considerably more arcane and complex. Undoubtedly, formulas can be useful tools in the budget-making process, providing benchmarks to determine annual funding levels. As with other tools, however, it is unwise to allow these state funding formulas to run on automatic, doing the appropriator's work unchecked. In too many cases, formulas contain hold harmless provisions, or merge with other formulas, or become obsolete altogether, resulting in spending that lacks accountability or that is replete with redundancies. These same flawed spending formulas are sometimes referred to as “statutory” or “non-discretionary” or are grouped unnecessarily with voter-mandated spending.

ATRA has pointed out that budget shortfalls of the type you have recently been dealing with provide a rare opportunity for those involved with the budget making process to simplify, repair, and regain control of these formulas and, to a considerable extent, the appropriations process. The following are several recommendations to reform such problematic formulas in K-12 and higher education. ATRA encourages the Legislature to apply similar scrutiny to other statutory formulas such as those in corrections, health care, and retirement funding.

Manage the general fund exposure to additional state aid costs: “Additional state aid” is money that the State pays to school districts in recognition of what residential property taxpayers would pay were it not for the 35% homeowner's rebate and the one-percent constitutional cap on primary taxes. Despite efforts to contain property tax growth through the state's adherence to the truth-in-taxation laws (TNT), growth in local school district property taxes for desegregation/OCR, excess utilities, career ladder, and transportation will result in increased exposure to the state general fund. JLBC's FY 2005 budget book estimates the cost of additional state aid at \$287,990,600. The State should minimize its exposure to homeowner rebate and one-percent cap costs by capping local school district levies that are outside the school district equalization system.

Don't exaggerate your obligation to adjust for inflation: Enacted by Prop. 301 in 2000, § 15-901.01 requires the Legislature to “increase the base level *or* other components of the revenue control limit by two per cent” [emphasis added]. Some have argued that (for the purposes of this statute only, apparently), *or* means *and*. Therefore, goes the argument, the Legislature is required to apply the 2% factor to both the base level *and* other components of the revenue control limit (RCL). During the 1990s, mandatory inflation adjustments we purposefully removed from statute because of the detrimental effect they can have on the appropriations process in lean years. If there are sufficient funds to adjust formulas for inflation, then there is no reason for the Legislature not to make such adjustments. Increases in funding to hold government harmless for the impact of inflation when the State is facing a deficit of this magnitude is a certain recipe for tax increases. Citizens and taxpayers are not held harmless for the impact of inflation. If the Legislature wants to adjust the base level by 2% it should make that decision because it desires to do so and it has the revenue to do so — not because it is a legal requirement. Further, if such an adjustment is made to the base level, no such adjustment should be made to “other components” such as the transportation support level (TSL).

Cap the transportation revenue control limit: State law provides two K-12 formulas for transportation — the transportation support level (TSL) and the transportation revenue control limit (TRCL). The TSL formula involves the average daily route miles per eligible student transported. Additional factors in the formula reflect academic, vocational, and athletic trips, as well as students with disabilities. The formula can result in changes as variables in the transportation calculation of the district change. Meanwhile, the TRCL calculation can change in only one direction — up. To calculate the TRCL, the previous year's TRCL is adjusted by growth, if any, in the TSL. In other words, if the TSL formula results in more funding, the TRCL grows by the same amount. If there was no growth in the TSL, or even if it declined, the TRCL is held harmless. In 1980, the year the current system was adopted, the TSL and the TRCL were approximately equal. Over the last two decades, as the actual transportation needs of districts have changed, this “hold harmless” funding mechanism has resulted in the TRCL outpacing the TSL by approximately \$49 million in FY 2004. That's \$49 million in transportation funding for students who are not there. The state's equalization formula (with only a handful of exceptions) recognizes only the TSL. School district budgets, however, use the TRCL. What this means is that the \$49 million to transport ghosts is falling to local property taxpayers. The cost to the state general fund is approximately \$13 million through additional state aid in recognition of the homeowner rebate and the one-percent cap.

Phase out career ladder: Despite the fact that Prop. 301 helped set a policy direction toward performance pay for all school districts in the state, 28 school districts currently have the legal authority to participate in a “career ladder” program. The number of participating districts was capped as of FY 1994 because of concerns raised about the cost and effectiveness of the program. According to JLBC, \$24,389,800 was levied in local property taxes for career ladder in FY 2004, while \$36,350,400 was appropriated from the general fund. Property tax levies on residential property for career ladder also exposes the state general fund to additional state aid costs. Because it is available to only 28 districts, career ladder contributes greatly to inequities in Arizona's school district spending and taxation.

Cap joint technological education districts (JTEDs) and avoid redundant student counts:

Student counts between school districts and JTEDs can, by law, add up to a total of 1.25 ADM if the JTED class is being conducted on the high school campus (the so-called satellite model). The blending of the centralized campus model and the satellite model, such as is occurring at the East Valley Institute for Technology (EVIT), raises concerns about how these student counts are conducted and monitored by the state. Add the fact that many of these courses also qualify for community college credit through dual enrollment, and you have the recipe for potential triple counting of students.

Move from the “prior year plus growth” to current year funding: School district funding is based on the prior-year’s 100th day student count plus current year growth. The system therefore holds districts harmless for reductions in enrollment from the prior year, even though state taxpayers may be funding those very same students at another district or charter school.

Ensure districts properly withdraw students: Numerous cases have emerged where students are being counted in two districts because one of the districts failed to complete withdrawal paperwork. The Legislature needs to continue to develop checks on student counts and ensure that state dollars in the system follow the child.

Eliminate or reduce rapid decline funding: School districts that experience declining enrollment for more than one year (they are held harmless automatically for the first year) may be eligible for additional “rapid decline” funding. ATRA supports the Legislature’s effort to fund rapid decline at 50%, which was included in the education budget for FY 2004 but vetoed by the Governor.

Eliminate student count adjustments for the “concerted refusal by students to attend classes”: Districts are allowed to adjust their student counts in certain circumstances, such as widespread illness or adverse weather conditions. Surprisingly, this list also allows an adjustment for “concerted refusal by students to attend classes for three consecutive days or more.” Again, sometimes these students are actually attending another district or charter school.

Revisit building renewal and new construction formulas: Several adjustments to Students FIRST formulas should be made. ATRA supports the Legislature’s effort to reform the building renewal formula. Similar scrutiny should be applied to the new construction formula, especially in regards to population growth estimates used to determine when districts qualify for new schools.

Eliminate automatic 5% additional funding for statutorily-defined “rural” districts: Students FIRST statutes require the School Facilities Board (SFB) to add 5% to new construction and building renewal formulas for “rural areas.” Rural is defined as a district outside a 35-mile radius from the boundary of a municipality with a population of more than 50,000. The formula generates some interesting results. Globe is rural; Miami is urban. Skull Valley is rural; Kirkland is urban.

Eliminate invisible square footage for new construction qualification calculations: School district square footage that is built with local option dollars (class B bonds or overrides) is invisible to the state while students within the walls of that square footage are not invisible in the “pupil per sq. foot” calculation to determine if a school qualifies for new construction.

Eliminate the community college hold harmless formula: Operating state aid for colleges increases through student growth, but never decreases for declining student counts. For example, say a hypothetical district started with 1,000 full time student equivalents (FTSE). In the following year, that district's student count declined resulting in 800 FTSE. The funding formula holds the district at the 1,000-FTSE funding level. If that district gains those 200 FTSE in the year after that, those FTSE are counted as growth and added to the base. In effect, then, the formula generates 1,200 FTSE worth of funding for only 1,000 FTSE. Community college funding should be reformed so that student-based funding follows the students.

Reduce redundant funding for dual enrollment: Community colleges award credit to high school students who receive that instruction on the high school campus, during regular high school hours, from high school salaried instructors.

Eliminate the community college "equalization assistance" formula: Four of Arizona's eight "rural" community college districts qualify for equalization assistance from the state general fund. The key driver in this formula is the average net assessed value (NAV) for the eight districts. The further a district is from the average, the more money it gets from the state. Valuation growth in Coconino and Yavapai counties has been driving a wedge into the formula resulting in greater exposure for the state general fund. The formula for FY 2004 resulted in an estimated \$13.6 million cost to the general fund. The equalization assistance formula was designed to provide money to Eastern Arizona College when the system was established. If the formula were eliminated, the State would support Eastern through direct appropriation.

Eliminate state aid to community colleges for recreational classes: The State's taxpayers have an interest in providing funding to community colleges for academic and technological training. However, taxpayers can and should question what it is the State is paying for when credit is awarded for a course and thus are funded at the state level. Courses like *Single Again*, *Coping with Stress*, *Humor and Play*, and *Creative Grandparenting* have appeared on community college catalogs. Other courses appear that have been offered in Arizona community colleges might lead one to question whether they are truly at a college level: *Approaching Math Positively*, *Notetaking*, *Testing Tips*, and *How to Study* are all offered for college credit and therefore generate state funding.

Stop adding to the problem: Every year, the Legislature is asked to codify in statute a host of formulas that further erode the Legislature's flexibility to deal with spending demands and priorities. For example, HB2047 would add to statute an enhanced version of the formula JLBC uses to calculate funding for student growth in the state universities. Similarly, community colleges are seeking legislation (SB1350 and HB2246) to entitle them to inflation adjustments to their growth formula.

The importance of the appropriations process would be difficult to overstate. The decisions you make can certainly impact citizens and taxpayers in very serious ways. Formulas can be of great value in determining the distribution of limited resources in government. But it is not the formulas making these decisions — it is you, the Legislature, that controls the state purse and you have the constitutional obligation to balance your spending decisions with what the State can afford. Wherever you set funding levels this year, do so because that is what you as a legislative body have decided to do, not because some formula tells you to do it.