BUDGET RECOMMENDATIONS

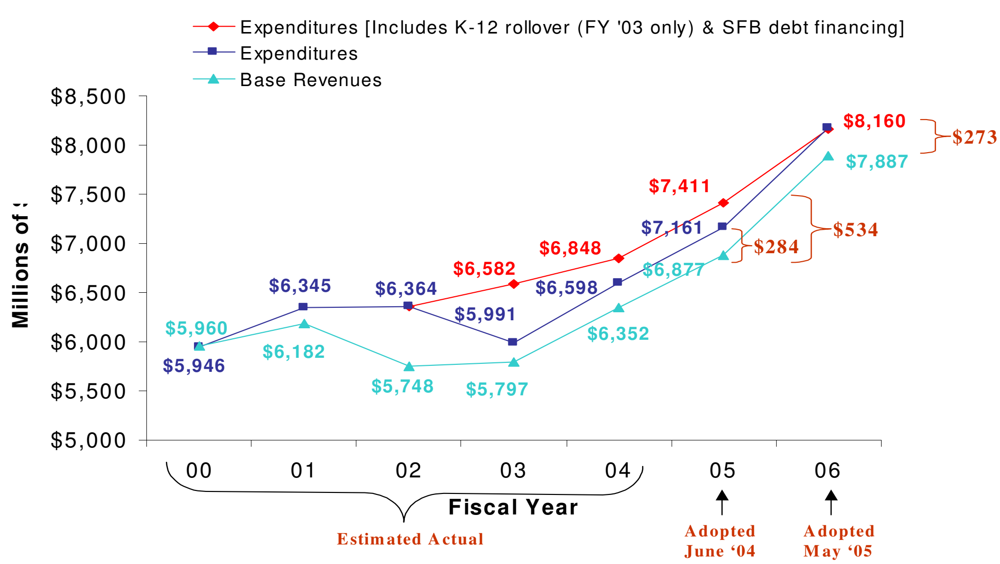
Improve Arizona's Financial Management

ATRA has aggressively monitored and publicized Arizona's on-going state general fund structural deficit. For the last six fiscal years the State Legislature and Governor have adopted spending plans that exceeded on-going revenue. The fiscal year (FY) 2006 budget reduced the overall deficit from $534 in the adopted FY 2005 budget to $273 million for FY 2006. Nevertheless, Arizona's state spending continues to climb at rapid clip with FY 06 spending up $1 billion (14%) over FY 05. (When the $250 million cash financing for SFB is excluded, state spending growth drops to 10.7%).

ARIZONA'S ONGOING STRUCTURAL DEFICIT

Comparison of General Fund Revenues & Expenditures

Excludes beginning balance, one-time revenues & expenditures, & Prop 301



Beg. Balance: (in millions)	255	203	13	1	18	243	329

Much of what drives 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, performing 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 provide a good opportunity for legislators to simplify, repair, and regain control of these formulas and, to a considerable extent, the appropriations process. The 47th Legislature should make every effort to avoid the kind of recent budget decisions that have relied on deficit financing and budget gimmickry.

The following are several specific recommendations to reform such problematic formulas in K-12 and higher education that are the result of either flawed policies or simply sloppy budgeting. ATRA encourages the Legislature to apply similar scrutiny to other statutory formulas such as those in corrections, health care, and retirement funding.

Reform agency authority to transfer line item funds between budgets: State agencies have the authority, subject to approval from the Department of Administration, to transfer funds between line items of their budgets in order to balance revenues with expenditures within a budget. A recent use of this transfer authority has exposed a lack of oversight and accountability by the Legislature in this policy. The Superintendent of Public Instruction used this authority last year to transfer $10 million in excess "additional state aid" revenue from the state general fund to fund a new tutoring program. The budget transfer authority was not intended to allow agency heads to circumvent the appropriations process to use "found money" to create new programs. The Legislature should reform this policy to maintain the integrity of the appropriations process.

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 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. For FY2006, the Legislature appropriated $297,213,200 in additional state aid. The state should minimize its exposure to homeowner rebate and one-percent cap costs by capping or phasing out local school district levies that are outside the public school equalization system.

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 FY1994 because of concerns raised about the cost and effectiveness of the program. According to the Joint Legislative Budget Committee (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.

Don't exaggerate your obligation to adjust for inflation: Since its enactment in 2000 by Prop. 301, the Legislature has exaggerated its requirement to increase school funding under §15-901.01. Through FY2006, this statute required the Legislature to "increase the base level ***or*** other components of the revenue control limit" [emphasis added] by 2%. 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). Despite serious budgetary problems, for the last six fiscal years the Legislature has chosen to adjust *both* the base level *and* the transportation support level by 2%. From and after FY2007, this statute requires the Legislature make such inflation adjustments by the GDP price deflator or 2%, whichever is lower. During the 1990s, mandatory inflation adjustments were purposefully removed from statute because of the detrimental impact 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. Simply put, increases in funding to hold government harmless for the impact of inflation should not be automatic. Citizens and taxpayers are not necessarily held harmless for the impact of inflation. If the Legislature wants to enact inflation adjustments, it should make that decision because it desires to do so and it has the revenue to do so — not because a statutory formula requires it. 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 $54 million in FY 2005. That's $54 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 $54 million to transport ghosts is falling mostly to local property taxpayers. The cost to the state general fund is approximately $12 million through additional state aid in recognition of the homeowner rebate and the one-percent cap.

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 vetoed by the Governor in FY2004 but survived in FY2005 and FY2006.

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.

Reform joint technological education districts (JTEDs) to increase efficiency and avoid redundancies: A recent report from the Arizona Auditor General confirms numerous concerns and observations that ATRA has communicated to the Legislature for years. JTEDs were originally conceived as opportunities to increase efficiency by centralizing the investment in vocational training facilities and technology. Growth in so called "satellite" JTED courses conducted in high schools and community colleges goes counter to the original purpose for JTEDs and has resulted in inefficient and redundant funding. Reforms should be targeted toward increasing efficiency and avoiding redundancy.

Revisit building renewal and new construction formulas: Several adjustments to Students FIRST formulas should be made. ATRA supports the Legislature's efforts 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 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 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.

Allocate university appropriations in accordance with enrollment growth: For primarily political reasons, general fund appropriations to the universities have strayed considerably over the years from the growth formula guidelines. The result is that there now exists a sizeable per-student funding inequity between Arizona's three public universities. The Legislature should begin immediately to close this funding gap by appropriating whatever dollars are available for the universities proportionate to where enrollment growth is occurring.

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. A district's operating state aid cannot be increased until the FTSE count exceeds the highest recorded FTSE since FY 2004. Community college funding should be reformed so that student-based funding follows the students without hold harmless mechanisms.

Reduce or eliminate redundant funding through dual and concurrent enrollment: Community colleges, high schools and joint technological education districts often enter into agreements that can result in two or more entities counting the same students for the same seat time for funding purposes. Funding should go only to the entity providing the services or should be distributed proportionately.