

ARIZONA STATE GOVERNMENT REVENUE

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PUBLIC FINANCE CONCEPTS

Fiscal System Guiding Principle

- Revenues and expenditures should be linked.
 - Changes to the revenue system (such as reductions in tax rates and elimination of revenue sources) should be matched by a commensurate change in expenditures.
 - Funding of new programs and changes in the funding level of existing programs should be matched by a change in revenues of a corresponding magnitude.
 - Capital expenditures generally should not be paid out of the operating (general) fund.

Revenue System Guiding Principles

- *Stability*: The revenue system should minimize year-to-year fluctuations in revenues over the economic cycle.
- *Responsiveness*: The revenue system should produce revenues that keep pace with long-term growth in the state's economy.
- *Predictability*: A stable and responsive revenue system produces a predictable stream of revenues, benefiting taxpayers and policymakers.
- *Efficiency*: Revenue policy should have minimal impacts on economic behavior.
- *Competitiveness*: Revenue policies should promote economic vitality and prosperity.

Guiding Principles (continued)

- *Exportability*: The revenue system should be designed to tax nonresidents as well as residents.
- *Neutrality*: Differential treatment of similar economic activities should be minimized.
- *Horizontal Equity*: Revenue policies should treat people of equal means similarly.
- *Vertical Equity*: The overall tax structure should minimize regressivity.
- *Simplicity*: The revenue system should be designed to minimize costs of compliance and administration.

A Qualitative Assessment of the Overall Revenue System

Guiding Principle	Evaluation	Comments
Stability and Predictability	Poor	Highly cyclical revenues, multiple changes to tax code, poor use of rainy day fund, overemphasis on sales tax, little use of more stable revenue sources
Responsiveness	Poor	Overemphasis on sales tax, whose collections lag behind economic growth due to out-of-date tax code
Efficiency	Poor	Heavy reliance on certain taxes, some with high tax rates
Competitiveness	OK	Heavy taxation of businesses has been reduced
Exportability	Good	Some of the tax burden is borne by nonresidents
Neutrality	Very Poor	Multiple tax credits and exemptions
Horizontal Equity	Poor	Credits and exemptions are a negative
Vertical Equity	Poor	Heavy and increasing reliance on regressive taxes
Simplicity	Very Poor	Considerable complexity in the tax code of each of the major taxes

Public-Sector Cyclicality

- Government revenues are pro-cyclical (rise during an economic expansion and fall during a recession).
 - Revenues in Arizona are unusually cyclical due to the state's highly cyclical economy.
 - General fund revenues have become more cyclical over time due to the narrowing of the tax base and the subsequent high dependence on two cyclical tax sources.
- Demand for most public services is not cyclical, but demand for public assistance is counter-cyclical (rises during an economic recession).
- As a result of the unmatched cycles in revenues and demand for public services, governments experience cyclical budget surpluses and cyclical budget deficits.

Two Types of Public Sector Deficits

- **Cyclical** deficit.
 - Temporary; largely unavoidable due to economic downturns.
 - The Budget Stabilization (rainy-day) Fund was designed to offset cyclical deficits, but has not been adequately funded.
 - Revenue cyclicalities can be reduced somewhat by broadening the tax base and relying more on nontax revenues.
- **Structural** deficit.
 - Ongoing; the result of policy decisions to reduce revenue without cutting spending, or to increase spending without raising revenue, commensurately.

ARIZONA STATE GOVERNMENT GENERAL FUND

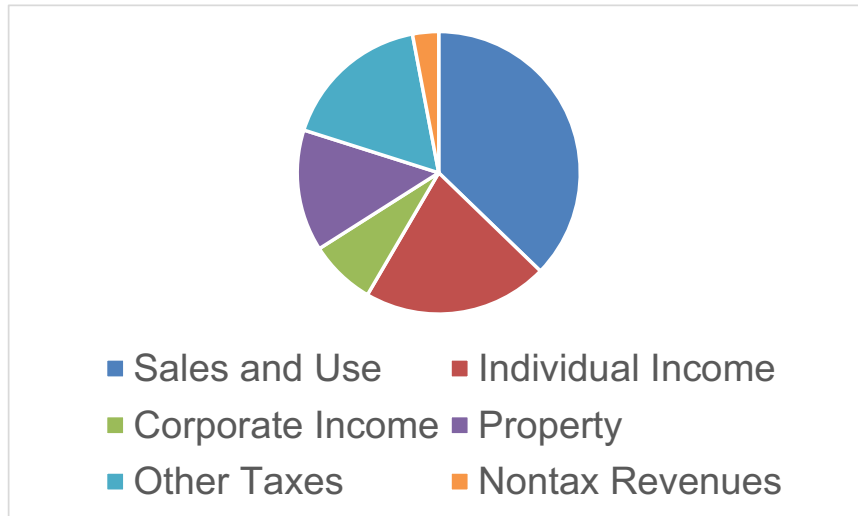
Fiscal Year (FY) 2017 runs from
July 1, 2016 through June 30, 2017

Arizona State Government Revenues

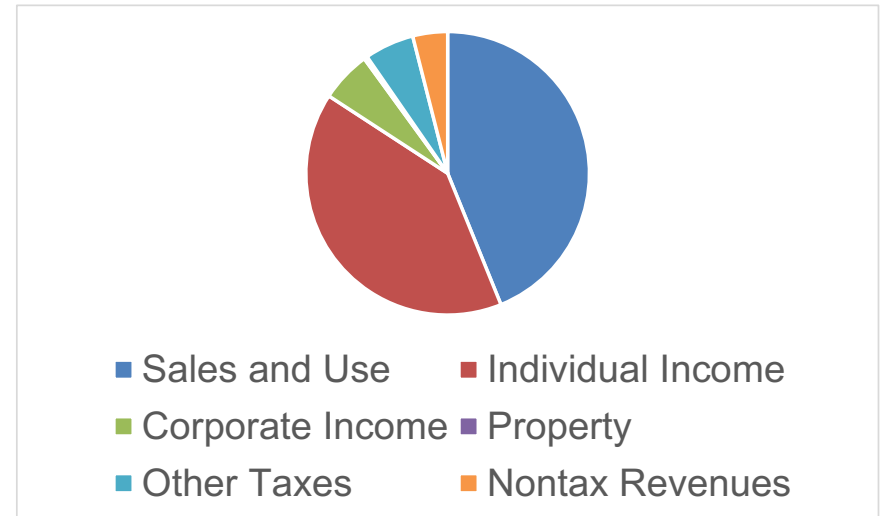
- Dollar figures are adjusted by personal income to account for inflation, population growth, and gains in prosperity.
- Primary source of data:
 - Arizona Joint Legislative Budget Committee. General fund revenues are available for fiscal years 1971 through 2016.

Ongoing Revenues by Source as a Share of the Total, Arizona State Government General Fund

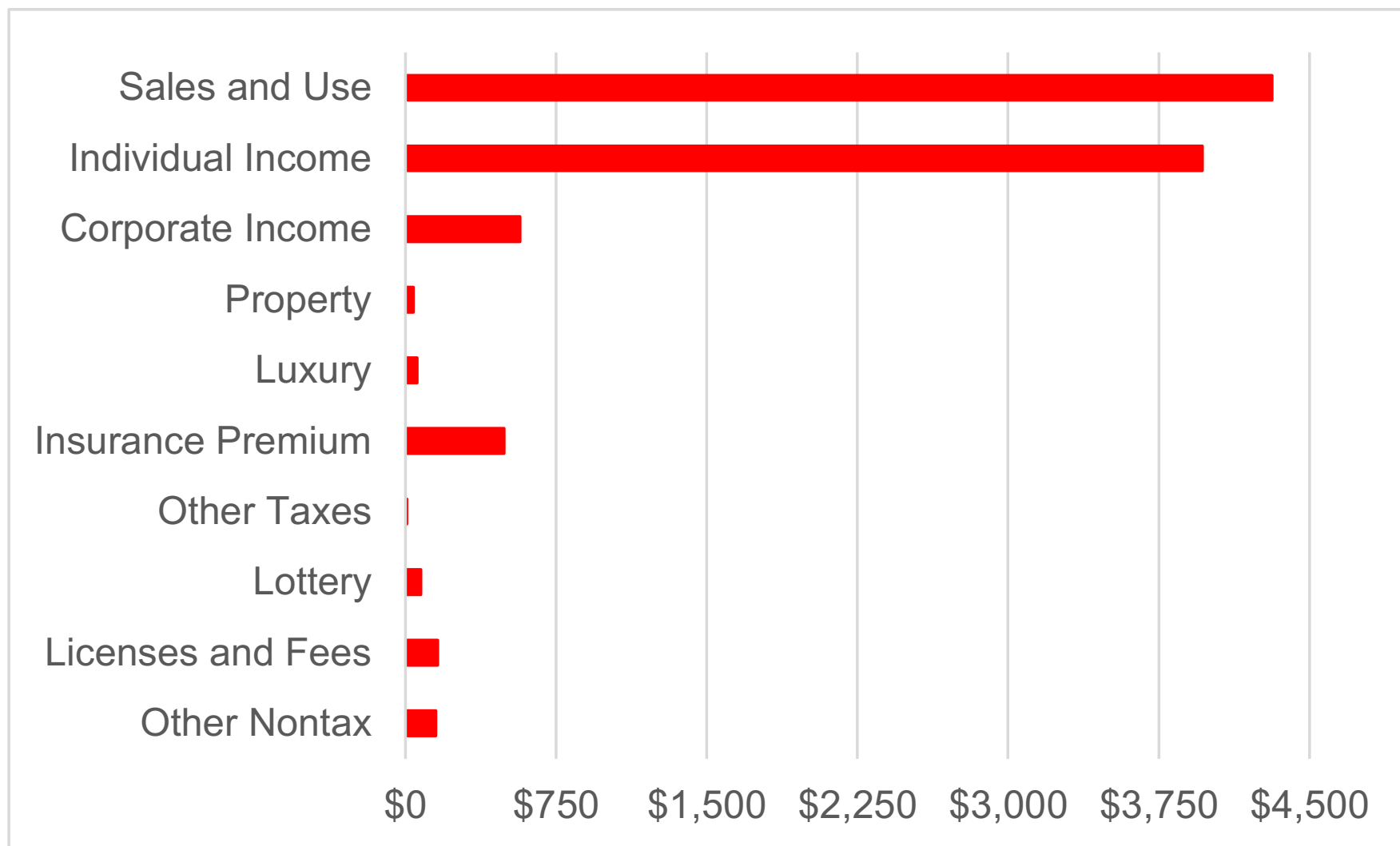
Fiscal Year 1971



Fiscal Year 2016



Fiscal Year 2016 Revenues in Millions, Arizona General Fund



General Fund History

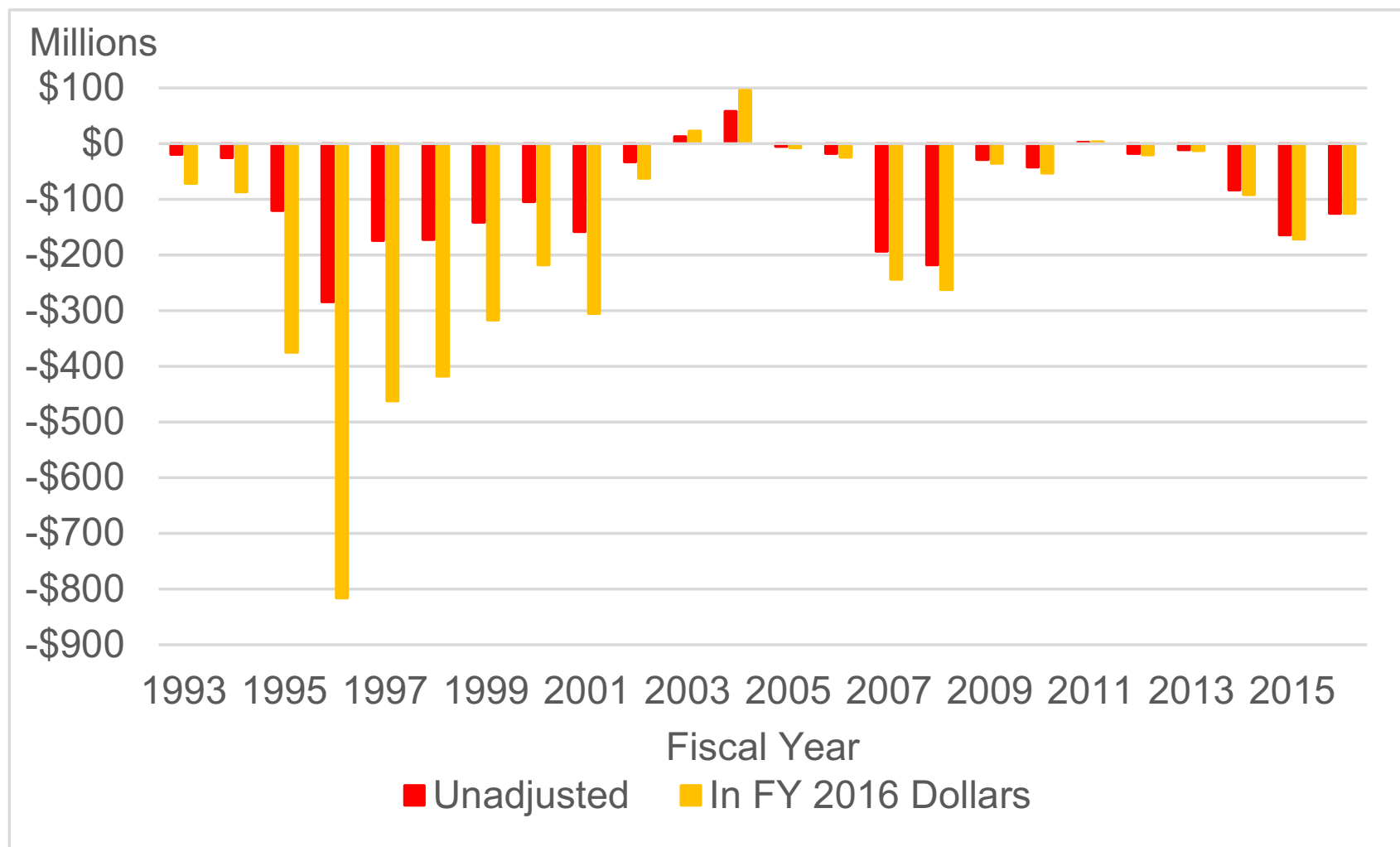
- Revenues

- Pro-cyclical, rising and falling with the economic cycle.
- Many statutory changes have been made that affect the amount of revenue collected.
- Net tax reductions since FY 1993 have amounted to \$2.2 billion per year in nominal terms. After considering inflation, population growth, and increases in prosperity, general fund revenues are \$4.4 billion per year lower.

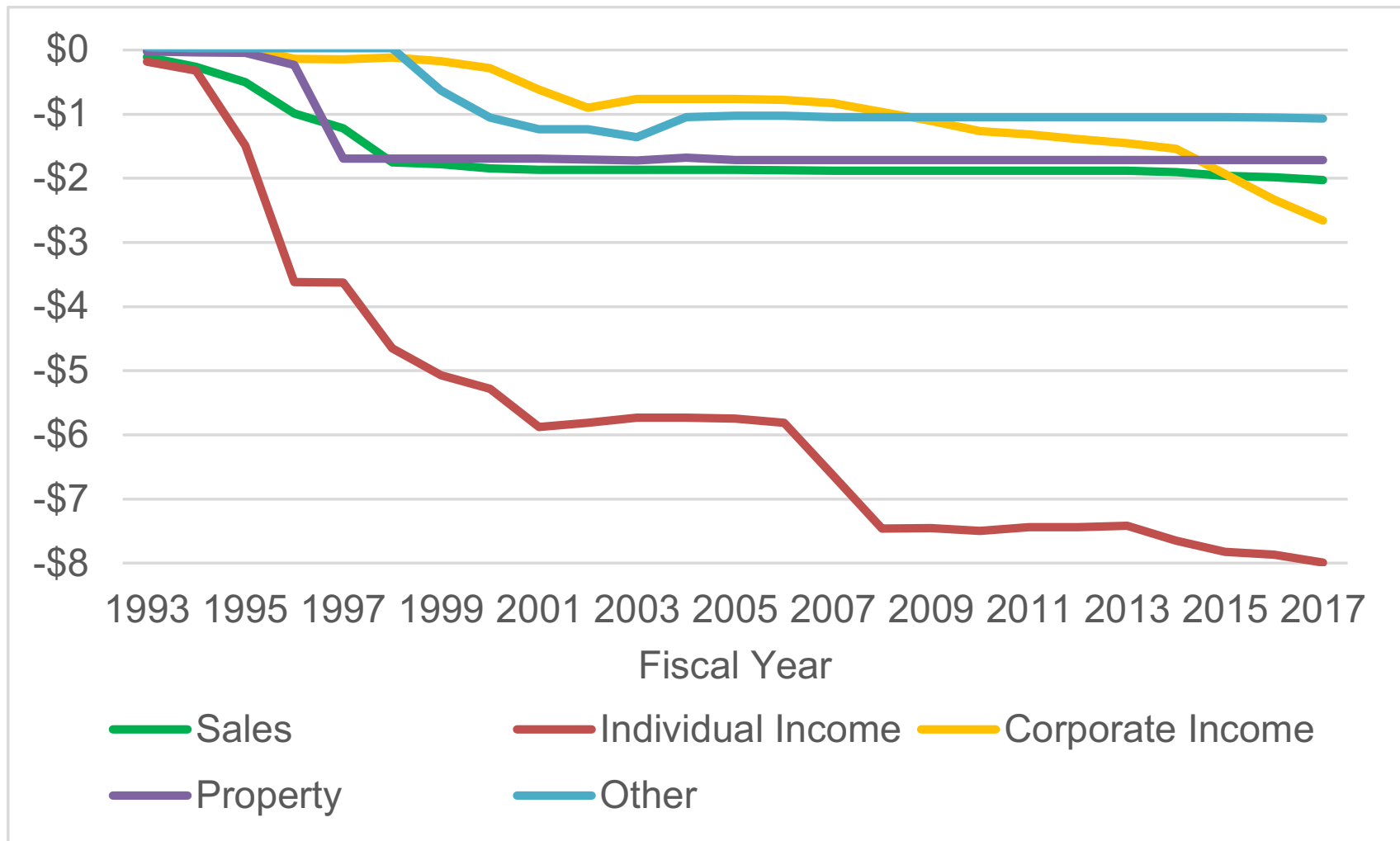
- Expenditures

- The demand for certain public-sector services are counter-cyclical, rising during recessions (due to job losses, etc.)
- Actual spending has been pro-cyclical, due to the pro-cyclicity of revenue collections.

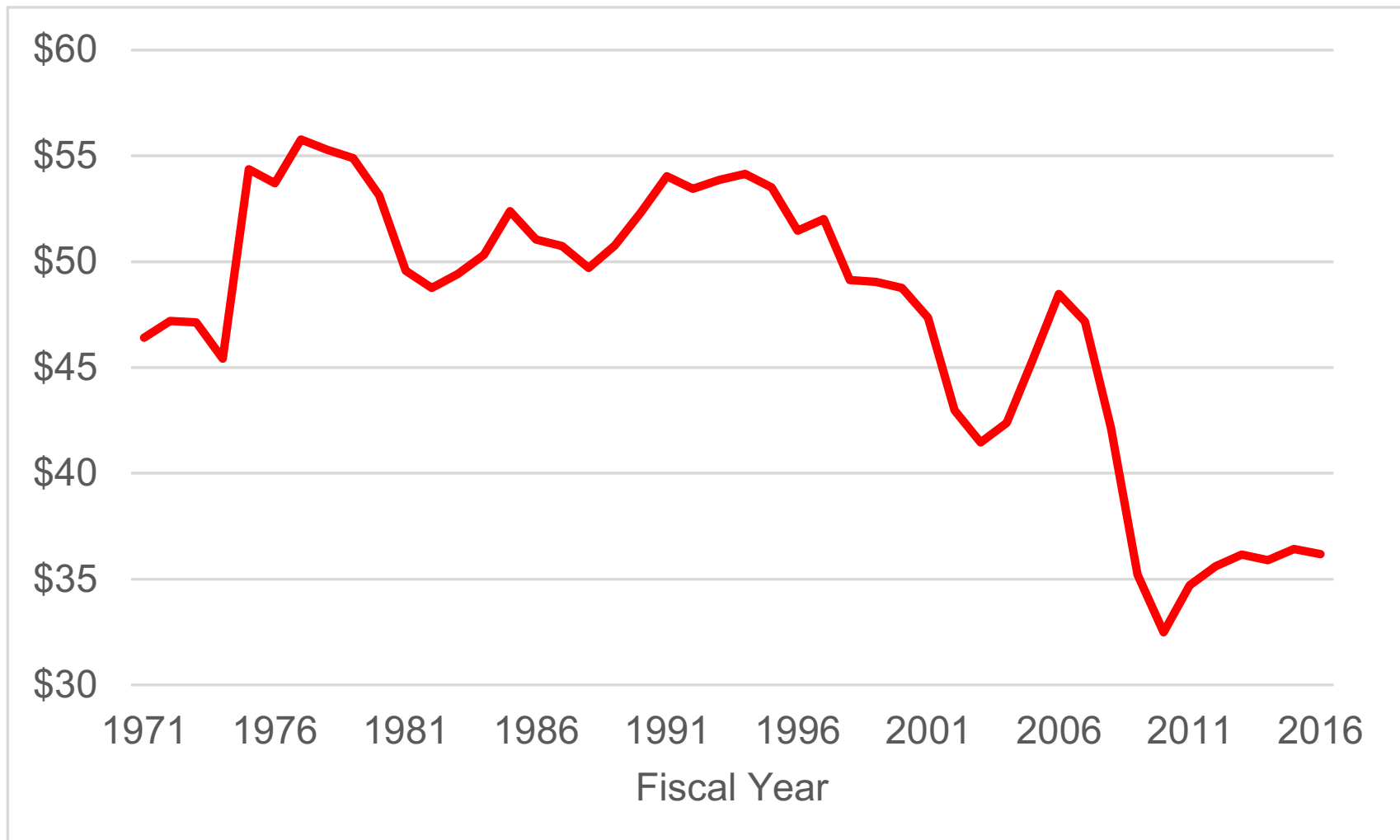
Change in Tax Revenue Due to Statutory Changes, Arizona General Fund



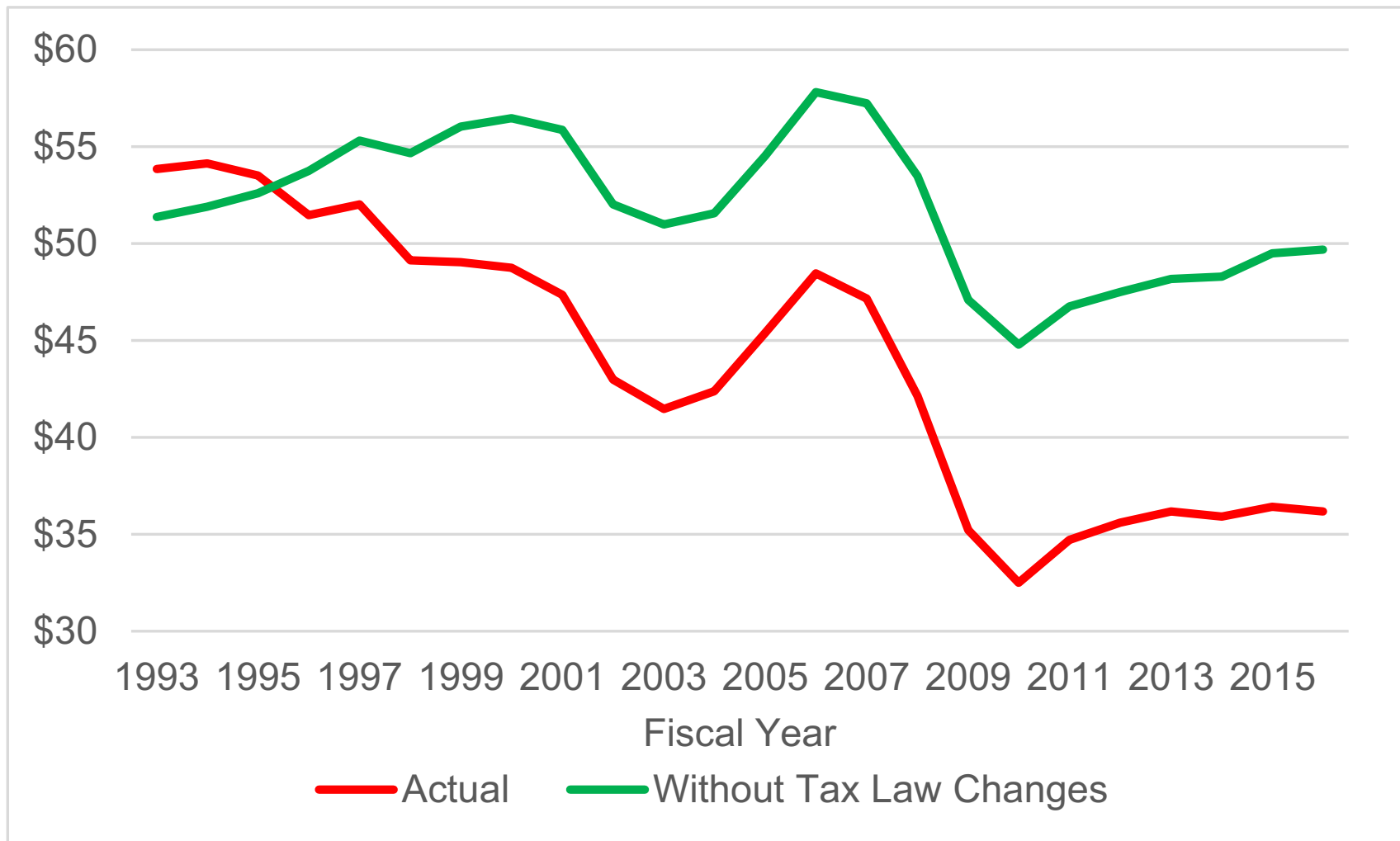
Cumulative Tax Change Per \$1,000 of Personal Income, Arizona General Fund



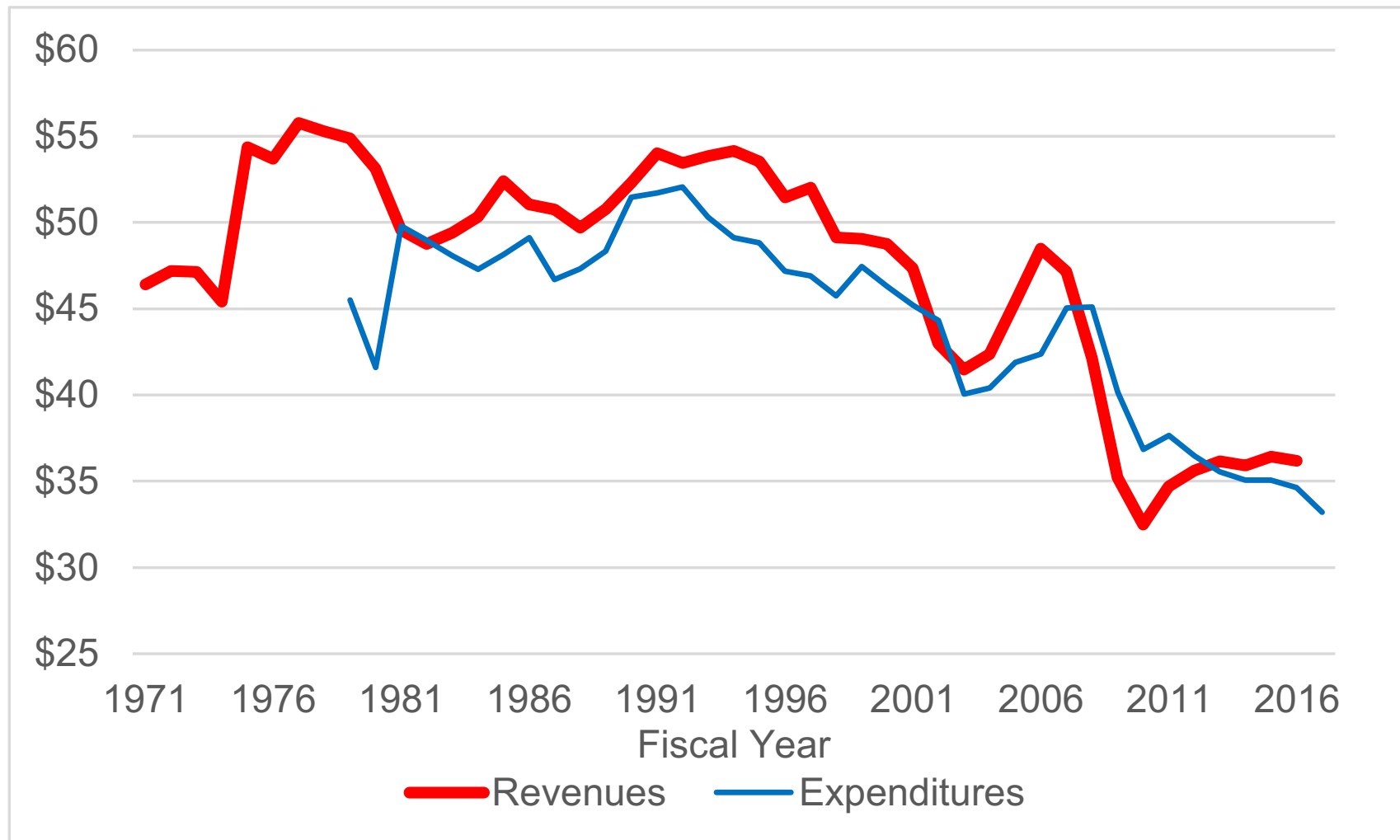
Ongoing Revenue Per \$1,000 of Personal Income, Arizona General Fund



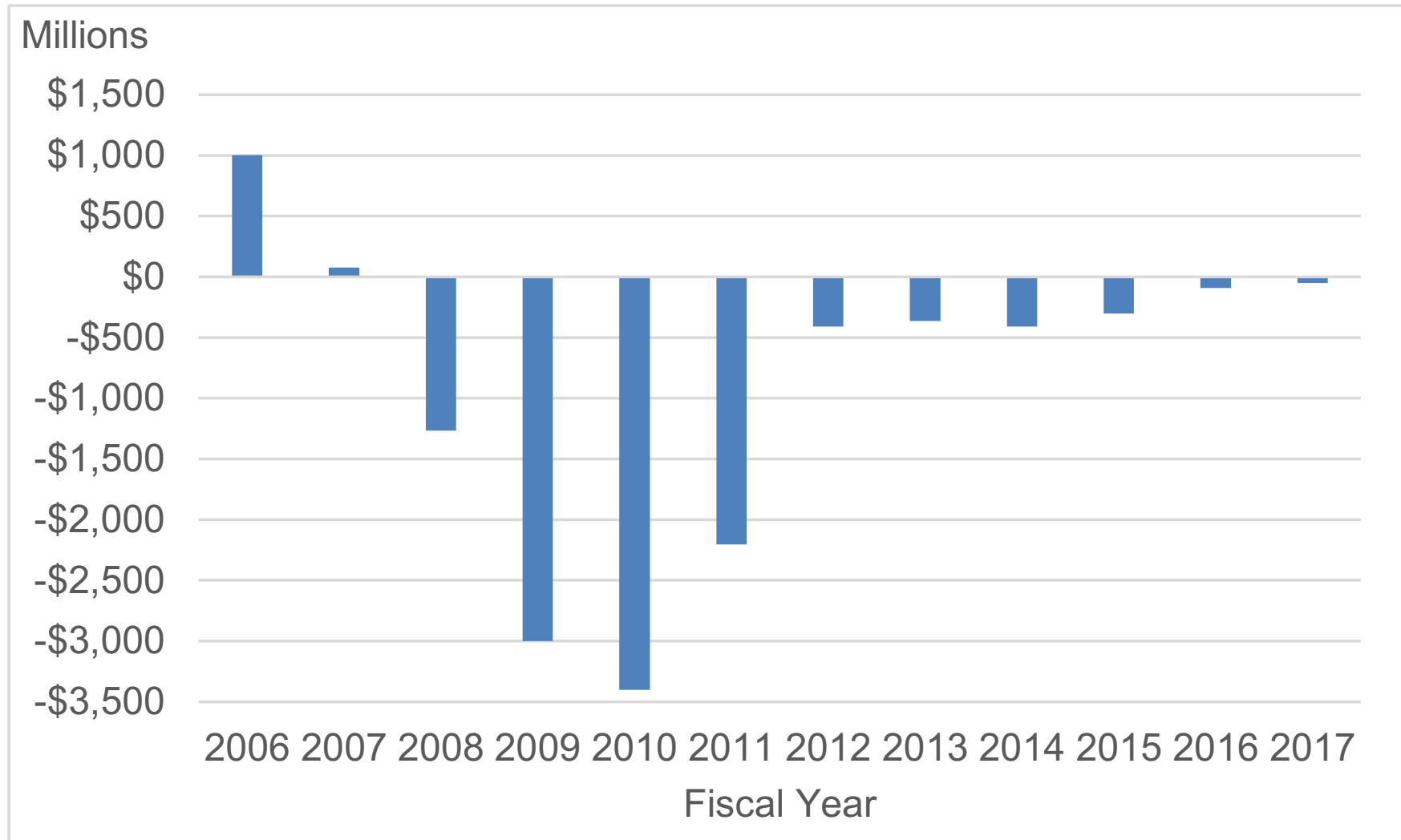
Ongoing Revenues and Effect on Revenues of Tax Law Changes, Arizona State Government General Fund



Ongoing Revenues and Expenditures Per \$1,000 of Personal Income, Arizona State Government General Fund



Difference Between Ongoing Revenues and Appropriations, Arizona General Fund



Budget Solutions Used in FYs 2008 Through 2012

- Payment deferrals (rollovers) of \$1.4 billion. \$931 million continues to be deferred, for K-12 education.
- Fund transfers of \$1.9 billion. Additional transfers have occurred since then. None have been reversed.
- Debt and lease-purchase financing of \$2.1 billion. The cost in the current FY is \$84 million.
- Statutory funding formula suspensions of \$493 million remain, plus another \$157 million in building renewal.
- \$3.3 billion in spending reductions.

JLBC General Fund Outlook

- The general fund currently is balanced and likely will remain balanced for the next few years assuming:
 - Discretionary spending increases or revenue reductions are less than \$100 million.
 - Economic growth, and therefore revenue growth, does not slow.
- This balance is narrowly defined. It is dependent on:
 - Very limited increases in expenditures – only for active statutory funding formulas.
 - No reversal of one-time budget solutions used since FY 2008.
 - No restoration of funding reductions.

Risks to the Balancing of the General Fund

- Economic cycle: at some time in the next several years, an economic downturn will occur, causing revenues to drop.
 - The balance in the budget stabilization fund (BSF) of \$460 million is unlikely to be adequate to cover the loss in revenue and increase in demand for public services.
 - Thus, another round of budget cuts and use of one-time budget balancing tools is likely.
 - The need to use such measures could be reduced if the BSF was fully funded – another \$200 million currently could be transferred to the BSF and remain within the 7 percent limit.

Risks to the General Fund (continued)

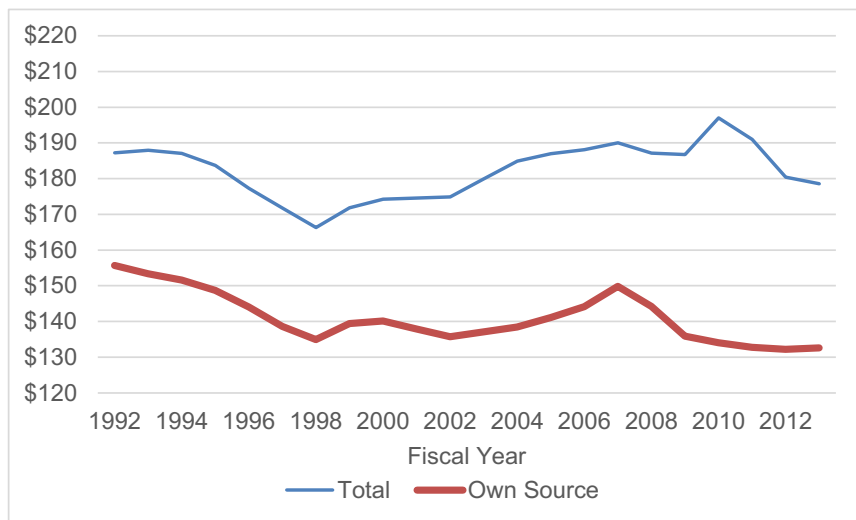
- Pending litigation: three lawsuits could cause a negative effect in the general fund:
 - Rental car tax: possible liability of about \$150 million.
 - Constitutionality of hospital assessment: revenue loss of about \$250 million per year.
 - Foster care litigation: possible liability unknown.

Comparison of Government Revenues Across States

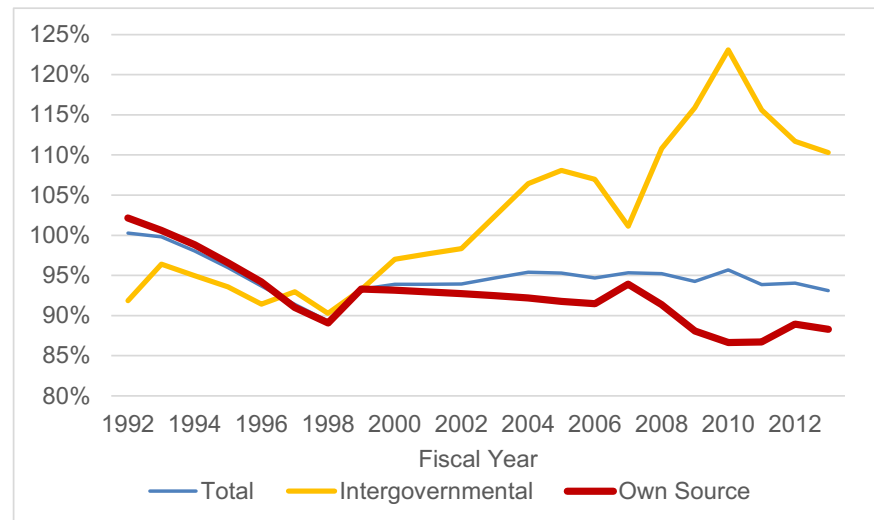
- To compare states, state and local government figures must be combined.
 - The level of government (state, county, local) that has revenue and expenditure authority varies by state.
- To compare states, an adjustment must be made for the size of the state. Figures usually are expressed per \$1,000 of personal income, but may also be on a per capita basis.

Revenues Per \$1,000 of Personal Income, Arizona State and Local Governments (Census Bureau Data)

Dollars

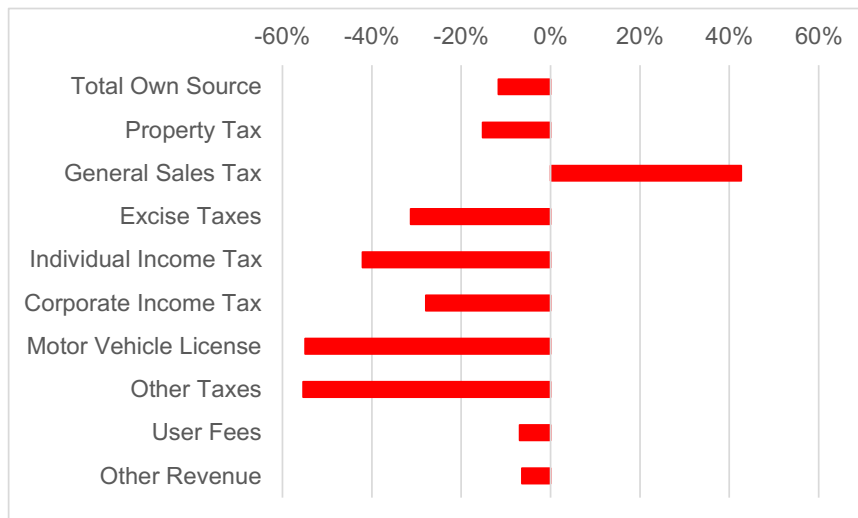


Percent of the U.S. Average

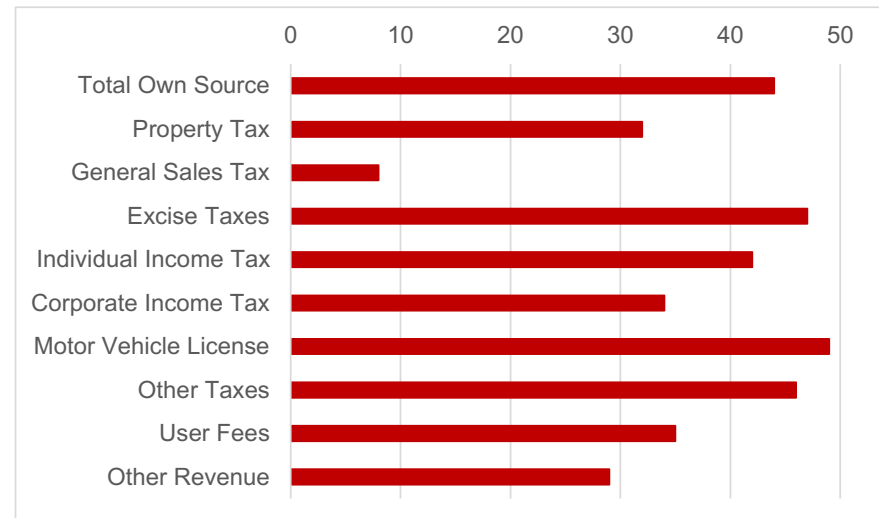


Arizona State and Local Government Revenues Per \$1,000 of Personal Income in Fiscal Year 2013 (Census Bureau Data)

**Percent Difference
From the U.S. Average**



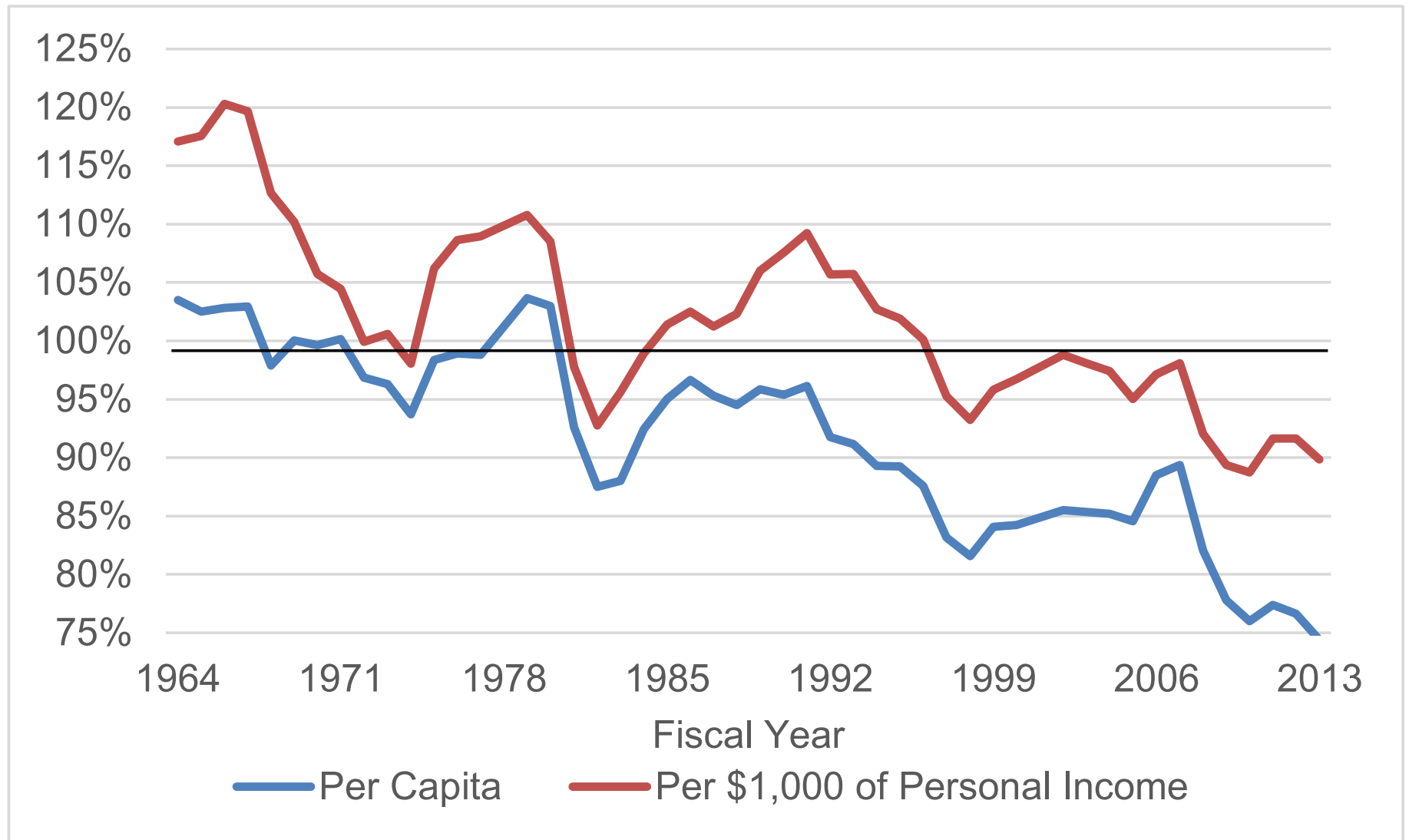
**Rank Among the 51 'States'
(1 = Highest Taxes)**



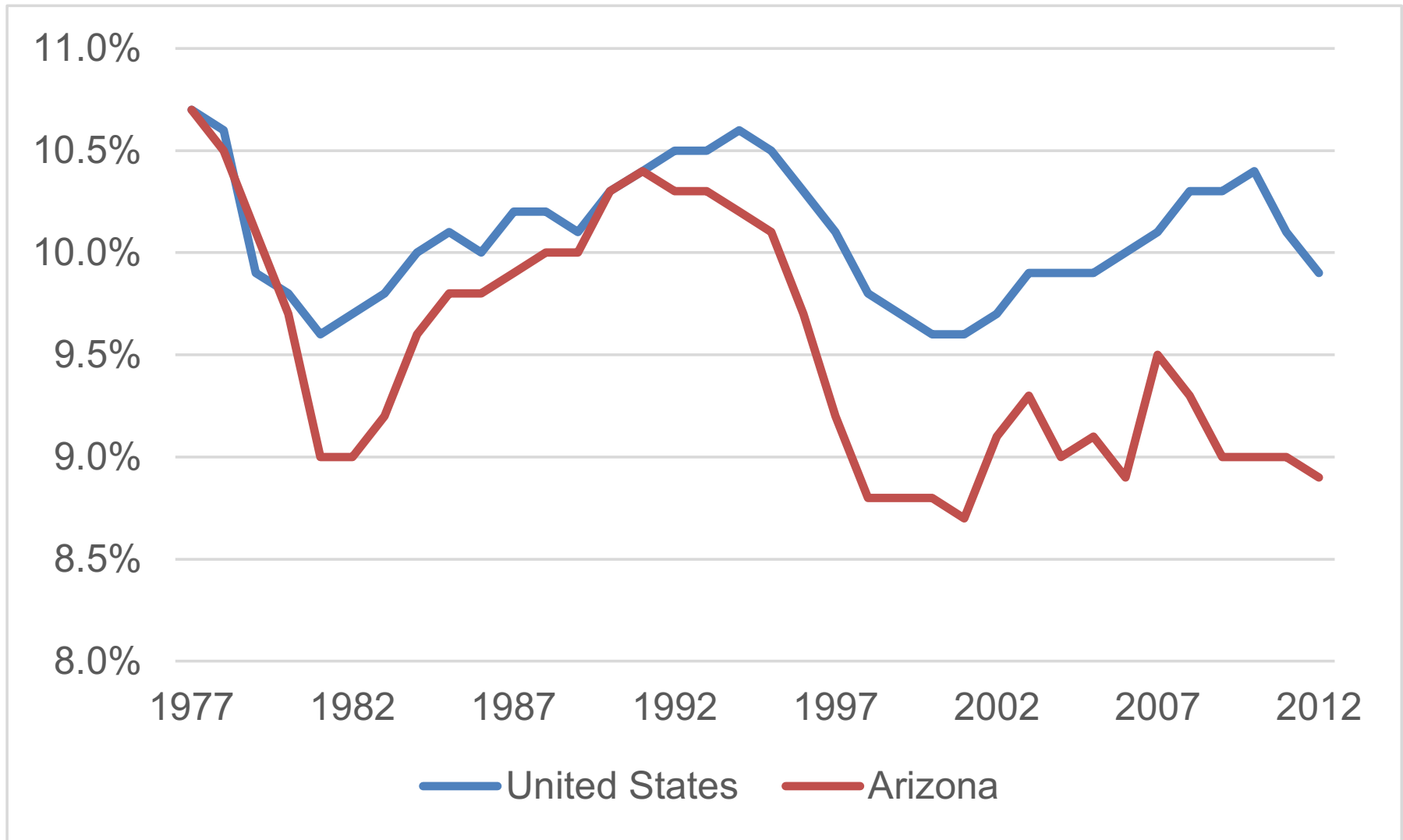
Tax Burden

- Most studies measure the overall tax burden – payments by businesses and individuals combined.
- A few studies allow the individual tax burden to be calculated separately from the business tax burden.

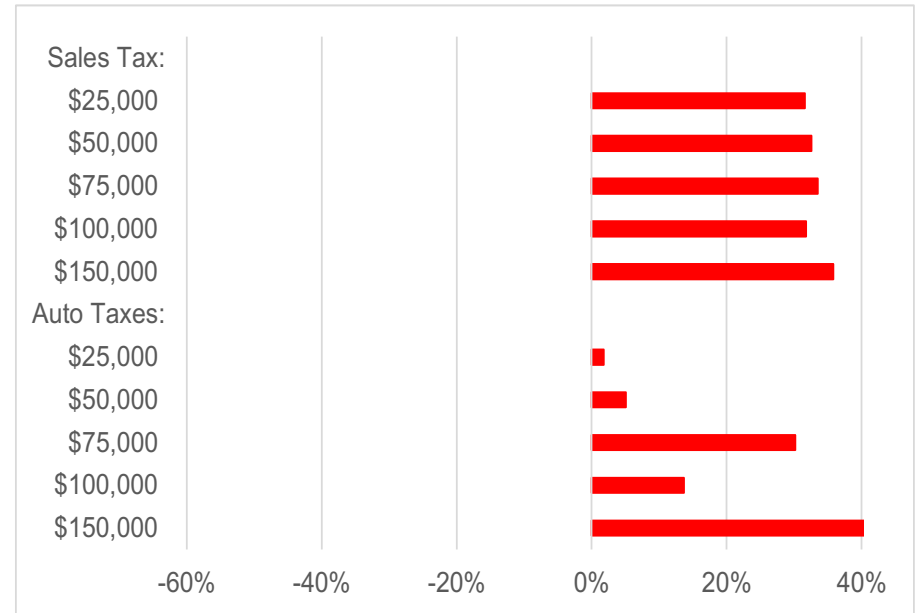
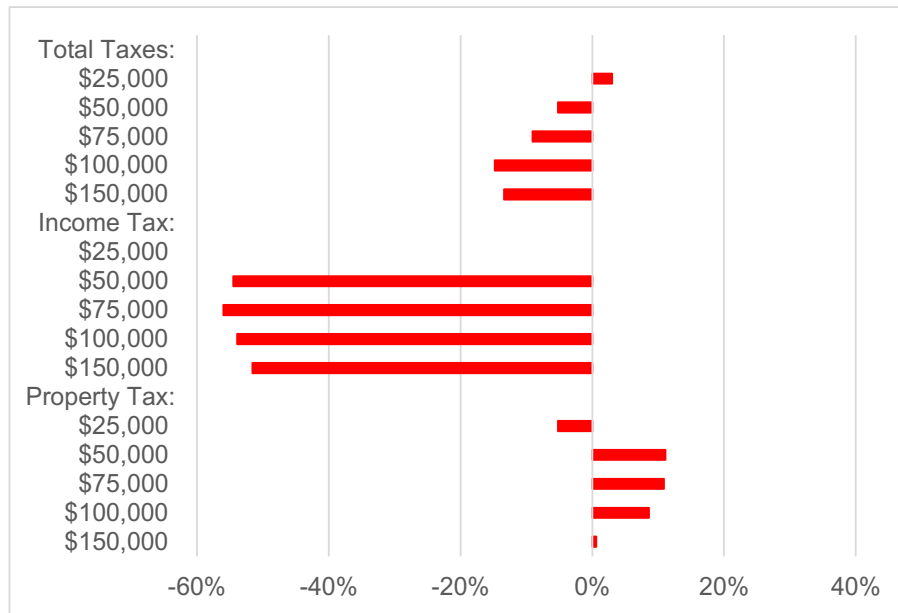
Total Tax Burden, Arizona as a Percentage of the National Average (Census Bureau)



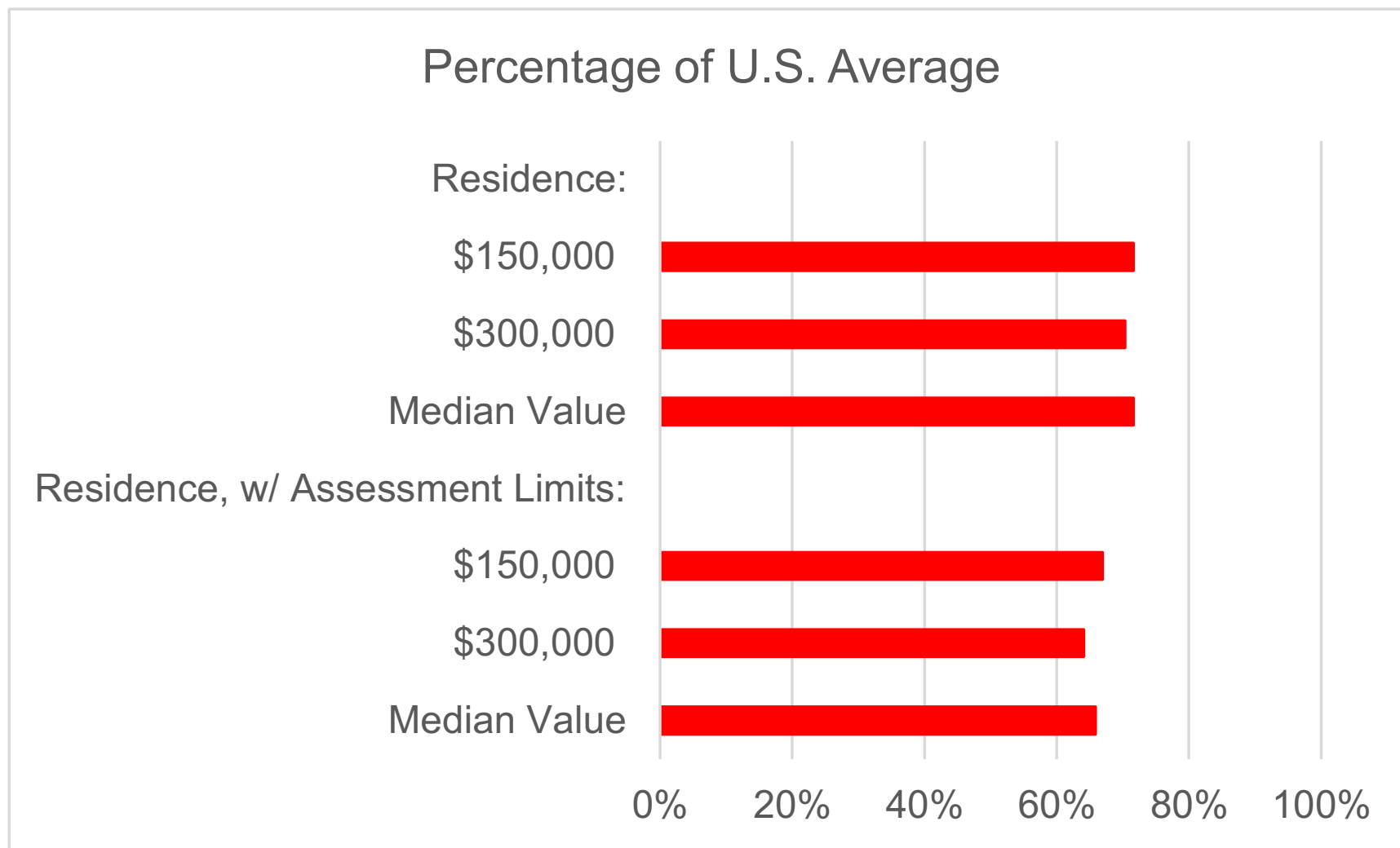
Total Tax Burden as a Percentage of Income (Tax Foundation)



Household Tax Burden in Phoenix, Percent Difference From the Average of 51 Cities, State and Local Government Taxes in 2014 (District of Columbia Study)



Property Tax Payments, Phoenix, 2014 (Minnesota Center for Fiscal Excellence)

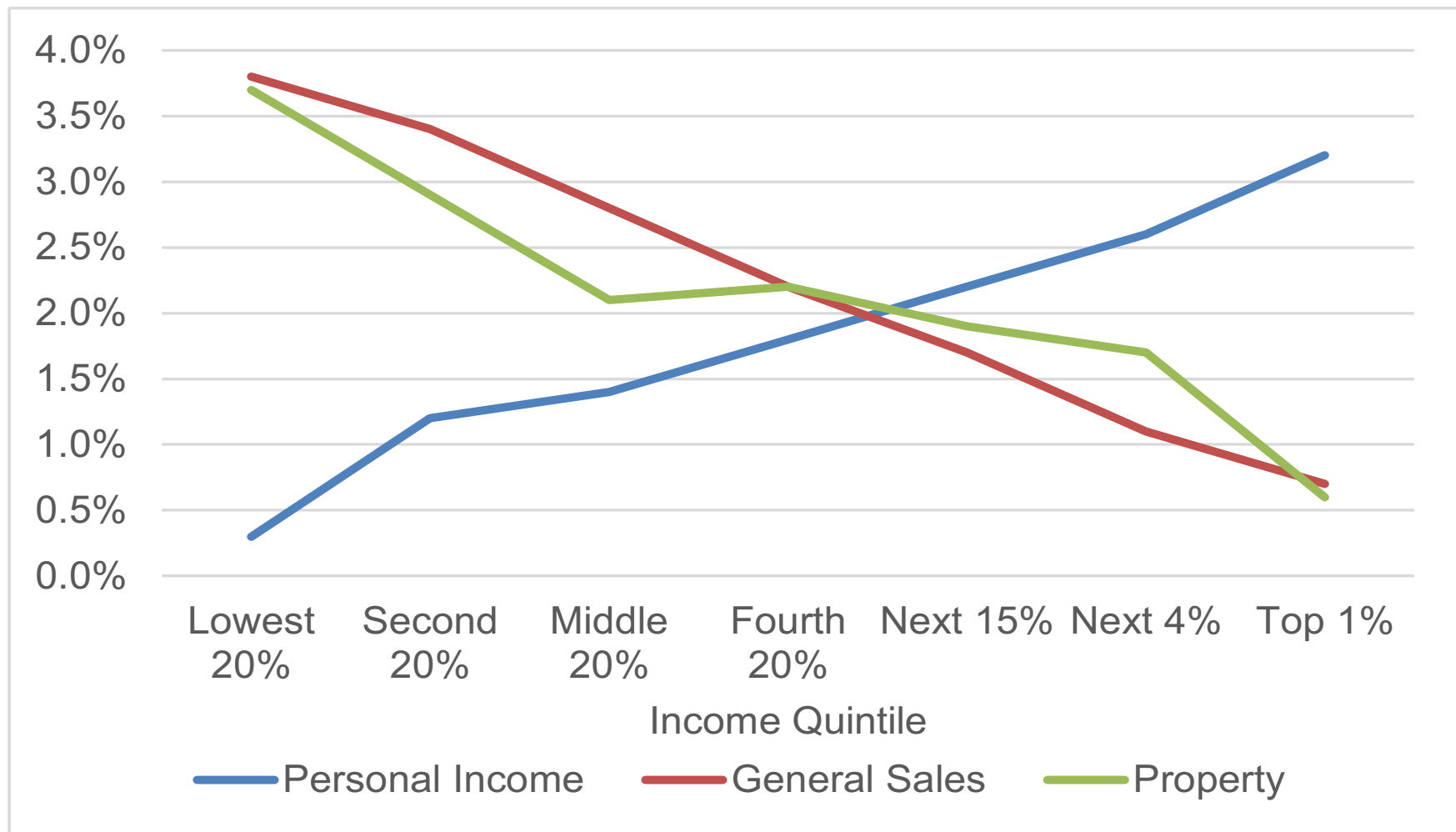


Individual Income Tax Payments, Arizona, 2013

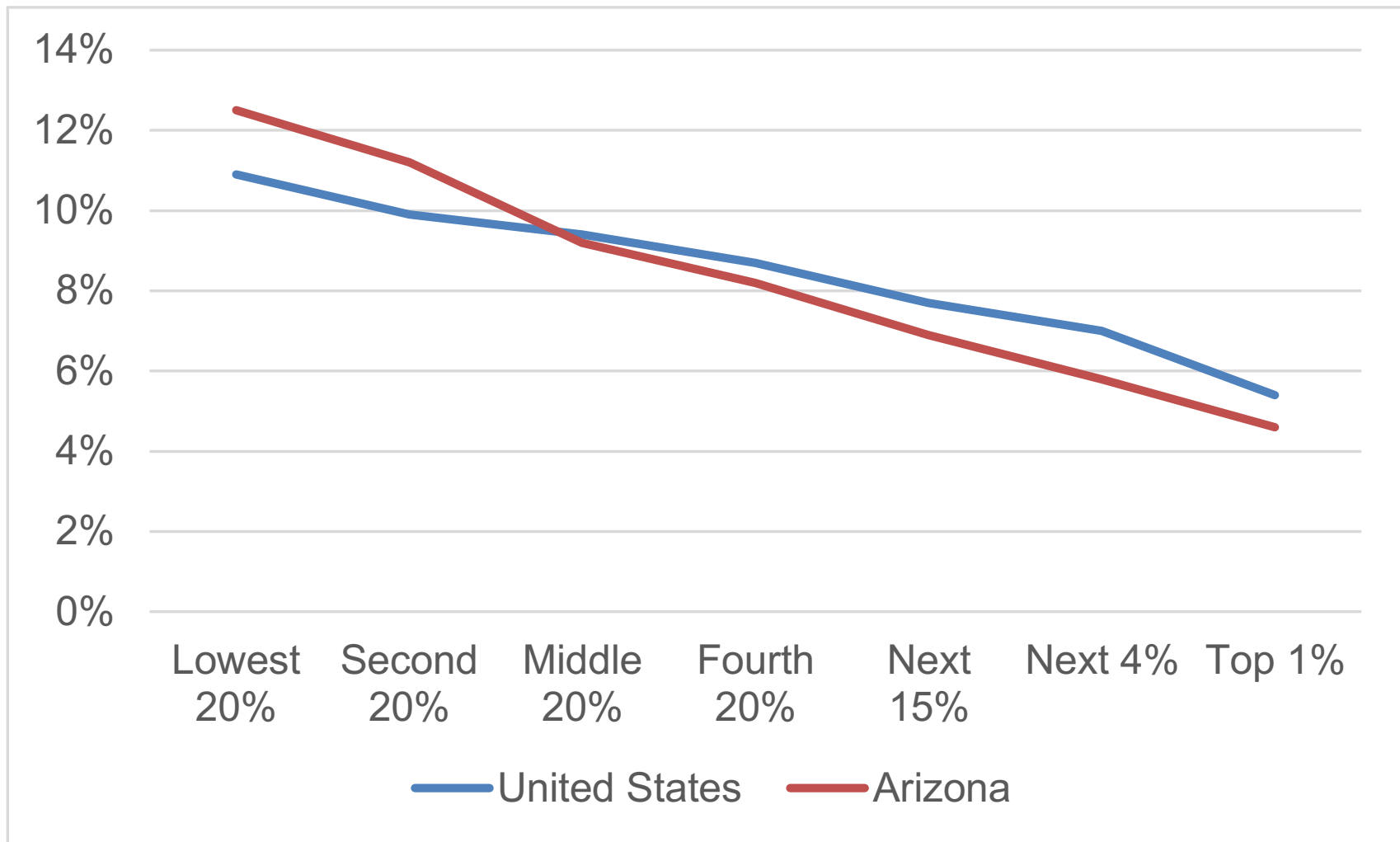
(Minnesota Center for Fiscal Excellence)



Major State and Local Taxes as a Share of Family Income in Arizona, 2015 (Institute on Taxation & Economic Policy)

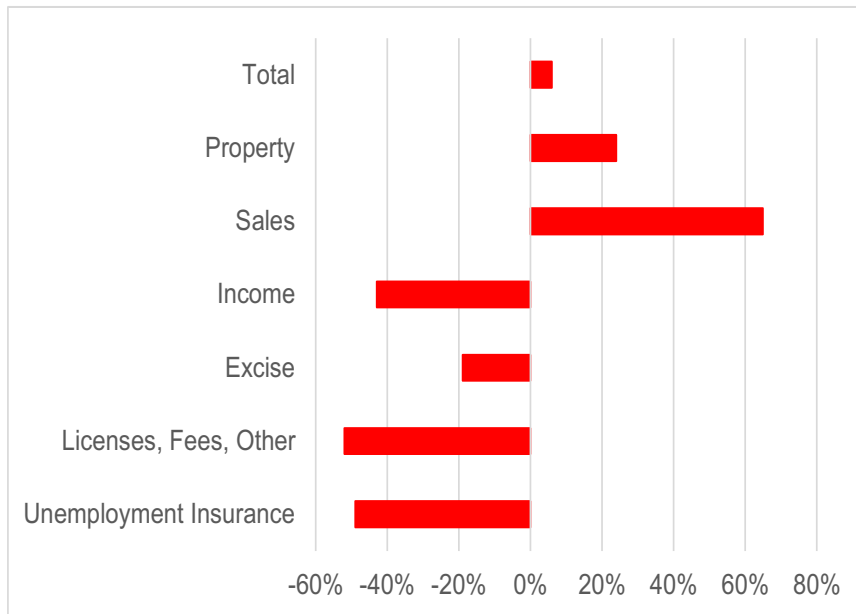


Total State and Local Taxes as a Share of Family Income, 2015 (Institute on Taxation & Economic Policy)

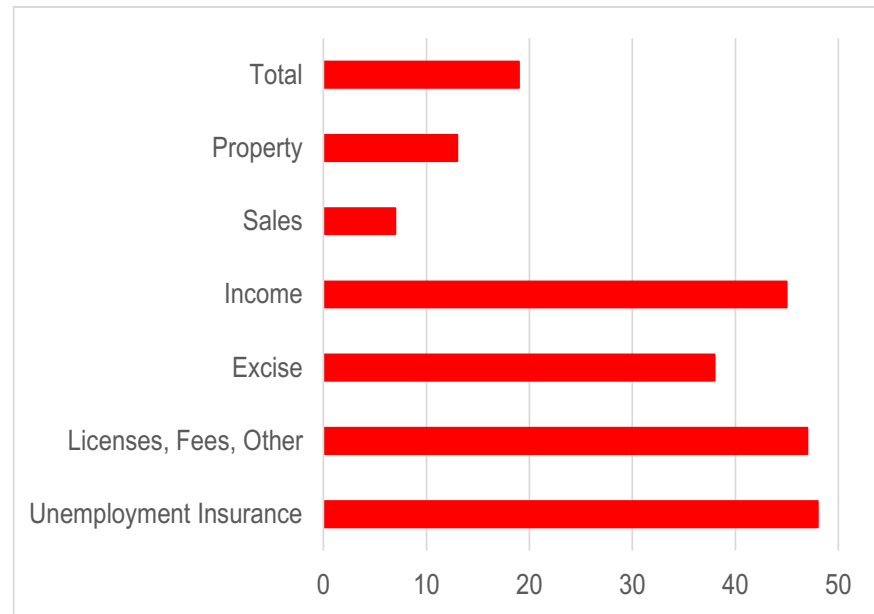


Business Tax Burden, Arizona State and Local Government Taxes in Fiscal Year 2014 (Ernst & Young Study)

**Percent Difference
From the National Average**



**Rank Among the 51 'States'
(1 = Highest Taxes)**



Property Tax Payments, Phoenix, 2014 (Minnesota Center for Fiscal Excellence)

