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Governor’s budget sets tone for session of cuts

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Governor Doug Ducey released his inaugural budget on January 16. With it, the Governor noted, “As I promised in my State of the State, my budget offers the reality of spending discipline with decisions that are timely, real and permanent.” The budget proposal comes as the state continues to slowly recover from the Great Recession. The budget also attempts to tackle a deficit the Governor’s Office of Strategic Planning and Budgeting estimates at $159.6 million for the current fiscal year and potentially more than $533 million for FY2016.

The budget promises to lay “the final groundwork to close the structural imbalance and place the State in long-term fiscal stability” and touts education and classroom spending as key areas of focus. While the budget closes the fiscal gap as estimated by the Governor’s staff, there are policy choices – and ultimately that’s what all budget decisions are – that while providing short-term balance, could have long-term negative impact. Additionally, the budget relies on one serious gamble.

The Structural Deficit

Foundationally, the budget seeks to not only bring current spending in line but to attack and “close the structural imbalance and place the State in long-term fiscal stability.” The budget addresses the cyclical – short term – budget crisis through cuts. The plan to address the structural – chronic imbalance between revenues and expenditures – budget deficit relies heavily on making many of those reductions permanent.

In a brief published in 2011 by the Brookings Institution and Morrison Institute, the deep cyclical and structural deficits the state was facing at that time were examined in detail. That report found that Arizona’s structural deficit was largely attributed to policy choices that began eroding the state’s revenue base long before the economic crisis. Specifically, “Beginning in FY 1993, the state implemented tax cuts in every year through FY 2002, and again from FYs 2005 through 2010 (though in only about half of these years was the revenue reduction substantial). Nominally, the net changes during this 17-year period totaled some $1.7 billion. Adjusting for inflation, population growth, and real per capita economic growth, the cumulative impact climbs to $2.9 billion.”

Despite the substantial impact of revenue reductions, potential meaningful revenue options have not been considered part of the solutions mix for any state budget since 2011, with one exception: the 1-cent sales
tax passed by the electorate, not legislative leaders, that expired in 2013. Further, the Governor made it very clear that a package of business tax cuts – additional revenue reductions – are going forward this year despite the staggering FY2016 deficit.

Education

Governor Ducey has articulated that K-12 education and classroom spending are key drivers of his policy agenda. His budget proposal identifies an additional $134 million for classroom spending. However, it also includes a near $124 million reduction in what his budget labels “non-classroom spending” for district schools and “additional assistance” for charters. As a result, the net increase to schools is approximately $10 million.

Reduction of non-classroom spending can conjure images of cutting bloated bureaucratic leadership structures in school districts. However, those non-classroom dollars pay for much more than just administration. Items that are paid for out of that pot of money include transportation to ensure children arrive at school as well as student and instruction support such as librarians.

Additionally, the shift proposed by the Governor’s budget carries a huge logistical challenge. It is unclear how, and even if, the state can enforce the administrative cuts coming from non-classroom dollars. When John Arnold, the Governor’s Director of the Office of Strategic Planning and Budgeting, was asked if verifying administrative cuts came from administrative functions was legally enforceable, Arnold responded “Define ‘legally.’” He continued, “I think the harder question is, it is enforceable with some 220 some odd school districts?”

The K-12 budget is also where the Governor’s big gamble is found. The state’s top executive is wagering that the state will prevail in an on-going school funding lawsuit, resulting in the current budget projections remaining accurate. However, if the court rules against the state, it could result in hundreds of millions more each year needed from the General Fund to meet the legal K-12 funding obligation.

Finally, while the budget stresses quality education and a strong economy, there is a $75 million cut to the universities. Universities are not only key economic development engines for the state, high-paying jobs in growing sectors now almost always require some kind of post-secondary education. A quality K-12 experience alone will not prepare Arizona’s students for the high-skill jobs that propel a stable economy.

Healthcare

Another key economic sector is healthcare, and one of the drivers of healthcare consumption is Arizonans covered by AHCCCS, Arizona’s Medicaid program. Under Governor Jan Brewer, Medicaid coverage was expanded, resulting in more Arizonans covered by insurance, and as a likely result, more individuals seeking care. Ideally, covered Arizonans utilize insurance to seek preventative care as well as receive care for health issues long before they become costly emergencies.

However, this model only works if there are physicians available to provide that care. The Governor’s FY 2016 budget proposes cuts to reimbursement rates for hospitals, ambulances and potentially most impactful, providers. This cut to provider reimbursement is estimated to equal $40 million. AHCCCS provider rates have traditionally been low and it is likely this will further discourage doctors from treating
those covered by AHCCCS. Further, these reductions are not simply a matter of legislative and executive approval. The Federal Centers for Medicare and Medicaid Services must also approve any changes.

The Governor’s budget proposal contains a number of budget solutions, reductions and even a few agency increases, such as in Corrections. A statewide hiring freeze, sweeps from the Arizona Commerce Authority and cost-shifting to counties for juvenile corrections are just a handful of the myriad solutions included.

Additionally, the budget does include one revenue enhancement through increased vehicle licensing fees to fund the Department of Public Safety ($65 million) and no budget reductions or hiring freeze for the Department of Child Safety.

**Tough choices**

There is no question the Governor inherited a budget that required hard choices and clear vision for Arizona’s economic future. However, as with many fiscal decisions made throughout the state’s slow recovery from the recession, Governor Ducey’s budget contains both sustainable and forward-looking choices alongside policy choices that could serve to harm economic growth and long-term sustainability.

All options – including revenue beyond a single licensing fee – should be part of the debate. Bringing the balance sheet in check in the short-term is good public policy only if it sets Arizona on a sustainable economic path in the long-term.

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