

**REPORT OF THE**

**EIGHTY-THIRD ARIZONA TOWN HALL**

**“THE REALITIES OF ARIZONA’S  
FISCAL PLANNING PROCESSES”**

**Grand Canyon, Arizona  
October 26 – 29, 2003**

The fiscal planning process has been of special concern ever since humans first began to organize themselves under governments, becoming more complex along with each new layer of government and the increasing demands of society. The careful balance between the needs and wants of citizens and the taxes they are willing to bear requires almost constant attention. During its forty-two year history, Arizona Town Hall on ten separate occasions has addressed topics related to this subject.

Arizona Town Hall is not alone in its pursuit of answers to the questions plaguing the state’s tax structure and fiscal planning processes. At least four different groups currently are engaged in a similar examination. They include the Governor’s Citizens Finance Review Commission, the Arizona House of Representatives Ad Hoc Arizona Revenue Tax Review Committee, the Tax Reform for Arizona Citizens Committee, and the Superintendent of Public Instruction’s Committee on Capital Finance. Recognizing the focus of those entities was directed more closely at the tax structure, Arizona Town Hall saw a need to hold this 83rd session on how our state conducts its fiscal policy planning processes, what the interactions and influences are on those processes and what improvements are necessary.

With this background in mind, 139 participants in the Eighty-Third Arizona Town Hall gathered in the crisp air at the South Rim of the Grand Canyon on October 26-29, 2003 for three days of discussion and debate about the topic “The Realities of Arizona’s Fiscal Planning Processes.” The participants included not only recognized experts on taxation and fiscal planning, but interested citizens and community leaders from throughout the state, representing a diverse cross-section of Arizona, from a wide range of geographical locations, differing backgrounds, and business interests, all of whom shared a genuine interest in participating in the improvement of Arizona’s fiscal planning processes. The following conclusions and recommendations represent the consensus of the Town Hall. While not all of the Town Hall participants would agree with every one

of these conclusions and recommendations, this report does reflect the significant areas of consensus reached at the Eighty-Third Arizona Town Hall.

## **BASIC PREMISES RELATED TO BUILDING SUCCESSFUL FISCAL PLANNING PROCESSES FOR ARIZONA**

### **Responsibilities, Roles and Objectives**

The principal responsibilities of government in Arizona are derived from state and federal constitutional principles and further set forth in state statutes. Most felt that government responsibilities include public safety, health, welfare, education and the public infrastructure. Government is accountable to the citizens and responsible for carrying out their priorities. Some felt government responsibilities included other things, such as encouraging and enhancing economic prosperity, and these responsibilities should change in response to the collective desires of the people, while others believed government is playing too broad a role and its responsibilities should be limited to more directly reflect particular priorities.

Government policymaking and planning often is not driven by the state's best long-term interests, but instead has a short-term focus, driven by constituencies with narrowly defined concerns, by the initiative and referendum process, and by highly publicized issues that drive elections. As a result, policy sometimes is determined by policymakers driven by special interests or agendas, where public uproar determines governmental objectives. Some felt that current state policy is driven by court decisions and that state government is focused on existing mandates that frame the discussion and curtail government authority.

The role of government in establishing policy and planning for Arizona's future ideally should be one of addressing the needs and priorities of the citizens, which should be clearly defined and communicated. Government should help citizens understand government's fiscal planning functions, and help them organize and work together to establish the common good. Fiscal planning and control should occur closer to where tax revenues are generated and spent. Some felt that government and citizens are the same thing.

There currently is no long-term state level plan for identifying and prioritizing government objectives and services that is visible and understandable to the public. A long-term planning process should be established to give the state a framework for

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addressing various fiscal issues. Such a process should be established through a collaborative effort of the executive and legislative branches of state government. This fiscal planning process should result in a collective vision for Arizona. It should be an ongoing procedure rather than just a reaction to fiscal

problems as they arise, balancing the need for stability with the need for government to address changing concerns. While such a process must be given time to succeed, it also should include goals by which we can measure progress. Accountability is important. Finally, the process should be utilized, and not be ignored.

### **Cumulative Effects on Arizona's Budget Process**

Town Hall identified and discussed a number of factors that affect fiscal planning in Arizona. Many of these factors are endemic to the fiscal environment and therefore define the planning context.

Economic cycles are a reality and an uncertainty that we always will have to address. A current example of this reality and uncertainty is the profound impact of the economic downturn experienced in the state since 2000, which was exacerbated by fallout from the events of September 11, 2001 and the war on terrorism. Revenues have declined as a result of lost jobs and businesses, yet the demand for government services has remained the same or escalated, aggravated by the increasing level of unemployment. Some felt state government consistently fails to appreciate the impact of economic cycles: the state tends to reduce taxes and increase spending in good economic times and then is forced to deal with reduced revenues in bad times. The effect of a bad economic cycle may be heightened by unstable federal funding and initiatives that mandate spending regardless of available revenues.

The operating budget process allows the state to change its priorities depending on the economy and other factors. Some felt this should be described as reactive budgeting. They felt the operating budget process negatively affects fiscal planning because of a failure to account for federal funds and the will of the legislative majority. Others felt budgets fail to take into account state agency priorities, are created in piecemeal uncoordinated fashion and do not consider the effect of revenue constraints. The budget stabilization fund is one example of a valuable planning tool. However, Arizona has treated its budget stabilization fund in a short-sighted manner. A balance of revenue sources should be available to state and local governmental entities in order to provide a base level of essential services. The current system, in which the state is heavily reliant on income and sales taxes, cities are more dependent on sales taxes and counties rely mostly on property taxes, should be considered for reform.

Term limits and high staff turnover have significantly affected long-term fiscal planning. Over time, elected officials develop a knowledge base, which furthers their ability to participate in fiscal planning and educate the voters on complex issues. They are able to develop areas of specialty, contributing their knowledge to the debate. This "institutional memory" or "knowledge base" is weakened by term limits. There was concern that term limits give too much power to special interests and legislative staff who can unduly influence newly elected officials. Town Hall recommends that the solution is to repeal term limits and that it is the responsibility of voters to vote elected leaders out of office when they are not doing their jobs.

The two-year legislative election cycle also may obstruct the long-term planning process because legislators spend much of their time concerned with re-election. They may be hesitant to deal with “tough” fiscal issues during election years. Town Hall recommends extending the terms of state senators to four years.

Initiatives, citizen referenda and court decisions all occur outside the budget process and place constraints on the state’s ability to create a fiscal plan that meets our needs. Each limits the ability of the representative system of government to plan due to spending mandates that often are issued without accompanying revenue sources. Town Hall recommends the initiative/referenda process be revised to require that ballot propositions that mandate spending also identify sources of adequate increased funding for the General Fund. In addition, a better educated electorate, committed to civic understanding and involvement, would lead to better planning. Constant appeals to the electorate lead to voter apathy and give too much power to special interests who can influence election outcomes.

Other factors affecting long-term planning include state mandates, such as mandatory sentencing, AHCCCS and education; federal mandates; voter apathy; debt limits; revenue allocation and spending restrictions; changing population demographics; and the effect of sometimes excluding operating and maintenance costs from the capital budgeting process.

The cumulative effects of several individual factors impacting Arizona’s fiscal planning processes have contributed to the state’s difficulty in responding flexibly to challenging economic times. These cumulative effects generally create constraints within which the government is forced to operate. While some viewed these limitations as positive, and others viewed them as negative, all agreed the impact has been unquestionably significant.

### **Applying Business Practices to Government**

Businesses have the advantage of immediate feedback. Government should improve its ability to obtain such immediate feedback. Acknowledging that government is not a business, and there are different roles to be played by each, Town Hall identified several key business practices that should be adopted in government.

For long-term results, there should be more long-term strategic planning. Governments need to be able to identify clear goals, report on the results of meeting those goals, and be held accountable for success or failure. The goals of government are more difficult to define than in business, where the bottom line determines success or failure. Unlike business, the nature of our governmental system is that various branches are not always aligned toward a common goal. However, the information flow in government should be similar to that in business. In business, information flows not just to management but also to the stockholders. In Arizona government, information should flow not just to government officials, but also to the taxpayers.

Government budgeting processes should clearly reflect spending priorities but also should include a requirement to establish expected outcomes in order to evaluate program

effectiveness. Government agencies, including programs, managers and employees should be held accountable. Citizens must know what the priorities are for the expenditure of taxpayer funds to ensure that government regulations and regulators are working efficiently. Some felt the indicators used to measure accountability may be difficult to identify given the varied nature of services and programs provided by government. While it is important to recognize that government serves different needs and is evaluated on different standards than business, accountability should include an explanation of what is and is not working and why.

Government personnel management at all levels should include performance appraisals and reviews and other practices that maximize employee effectiveness. Managers should have to set minimum standards for their departments and the business principle of goal setting should apply throughout all levels of government. Such goals can be standards against which to measure progress and establish parameters of future vision. Implementing key measurements for each agency may provide consistency and a starting point for accountability, not only at the agency level, but also at the individual employee level. Some felt that public employees already devote a significant amount of their time to performance evaluation and accountability.

An important business practice not being fully funded or utilized by government is the use of performance and productivity incentives. For example, agencies and their employees should be rewarded appropriately for efficiency and productivity. Although the government has put some employee incentive programs into place, some feel that such incentive programs are not being adequately funded, such as the Department of Revenue, and are not appropriate in their current form.

Government's need and ability to incorporate business practices depends to some extent on the level of government. Problems of reporting and accountability are complicated by the fact that government operates on several levels. The ability of a state legislator to directly impact state administrative offices is more limited than that of a county or city official to cause local change.

Elected officials need to be encouraged to become more committed to long-term goals, rather than just those goals that can be accomplished before the next election. Businesses also experience change, but the goals transcend short-term personnel changes. Increasing the awareness of the mission statements of agencies and government programs will limit the amount of change that takes place due to election cycles and agency or legislative staffing turnover.

### **Arizona's Fiscal Planning Processes**

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fiscal planning process cannot succeed without such a plan even though the complexity of government makes development of long-term goals challenging. Some felt that at the state level our fiscal planning processes have failed to adequately address fundamental government responsibilities of health, welfare and security.

Many identified the initiative and referendum processes, important tools for the people to express their will, as impediments to effective planning. A drawback of legislating through initiative is that such enactments may limit flexibility in meeting future needs. Some suggested that initiatives and referenda be subject to sunset provisions, legislative revision, re-submission to the voters, or requirements of economic impact statements identifying sources of funding.

Certain aspects of fiscal planning are working, particularly at the local level. At the state level, some noted the legislature, in grappling with the deficit in the budget, has weathered the current issues while keeping basic services in place. Others identified as a positive aspect of the process the responsiveness of the Arizona Board of Regents to the individual vision of each of the state universities. All agreed that, as evidenced by the current fiscal crisis, which results in the government constantly “putting out economic fires,” improvements in long-term fiscal planning are necessary.

When election and economic cycles are combined, fiscal planning is a challenge. In addition to these recurring challenges, initiatives and referenda, the relatively small percentage of revenue sources in the legislature’s control, inaccurate and unrealistic projections of revenue sources, and delays in setting the state budget make it difficult for government, particularly at the local level, to engage in long-range planning. State agencies have difficulty knowing what revenue they will have at their disposal. Some suggested periodic review and revision of the state’s tax exemptions and analysis of both revenue and spending trends. Others felt the state tax code needs to be completely re-engineered, with attention to its underlying philosophy, not merely “re-cobbled” together.

The need for forecasting is critical. Effective planning should address long-term economic trends, such as changing demographics, capital budget needs and economic cycles over time. The planning process should identify a baseline, draw our attention to problems within inflexible mandates, and focus us on our priorities.

Forecasts must allow for change, however, and may not be as effective if government has difficulty responding to change. Government should strive for long-term goals at all levels by which to measure progress.

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## Balancing Government Spending and Revenues

Economic vitality and public fiscal policy decisions are inextricably linked. One has a direct effect on the other and vice versa. When the economy is good, government can reduce or rebate taxes, contribute to the “rainy day” fund and/or support new or expanded programs with identified revenue streams. Although public fiscal policies are only one of many factors affecting economic vitality, government can have an effect on Arizona’s ability to compete with other state economies. Good fiscal planning leads to a good infrastructure for businesses, including the provision of high quality services and an educated work force – human capital. The soundness of fiscal policy of state government plays a role in creating or reducing economic interest in the state. Retaining businesses is as important as attracting them. Both require a certain amount of predictability built into our fiscal planning and both require an examination of the relationship between fiscal policy and economic development incentives.

Economic vitality encompasses more than economic development and includes other factors, such as tax policy. Tax policy should be consistent with a long-term plan. Most thought we need to consider financial resources and expenditures as a balanced equation, adjusted over the long-term. Taxes can be too high, reducing Arizona’s ability to compete with neighboring states. Taxes can be too low, causing Arizona not to invest enough in vital functions, such as education and public infrastructure. While many had differing opinions on what level of taxes is too high or too low, all agreed that encouraging business through sound tax policy and investments in education, human capital and the state’s infrastructure is critically important.

Current fiscal spending decisions are important to Arizona’s future vitality. As a beginning, we need to identify and acknowledge our base level of services. Working from this guideline, we can begin to balance the budget and develop a strategy for the future. Providing a balanced tax structure by maintaining the three-legged stool of

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property, income and sales taxes is essential for the long-term financial health of Arizona. While not all agreed on which changes in tax policy are required, many suggested varying changes in personal and business property taxes, while recognizing a need to engage the electorate in making and understanding the necessary changes.

Some suggested that changes in tax policy favoring businesses are necessary to attract and retain them, and to increase economic vitality. They suggested decreasing the business property tax. However, individuals, many of them homeowners, vote in elections. Businesses do not. Consequently, this issue has yet to be addressed effectively. Others noted that the focus on reducing business taxes should be based on economic impacts related to attracting or retaining industry. They suggested that many businesses have no incentive to leave Arizona or may not provide the desired contribution to the state infrastructure. Others suggested a reduction in the property tax paid by businesses or a rebate paid from the General Fund in good economic times. Some also

suggested alternative sources of revenue, including the selling of assets, evaluating the necessity of existing programs and agencies, and promoting a view of government spending as an investment.

Where changes in fiscal policy are being considered, care is needed to avoid regressive effects on revenue. Critical fiscal decisions must be made to balance the burdens among sales taxes, income taxes and property taxes. Fiscal planning should include stabilizing aspects wherever possible, for example by extending the horizons on tax planning.

### **Examination of Arizona's Tax Structure and Spending Practices**

Arizona's tax structure was more or less designed in the 1950's and 60's for a very different economy. The current economy is much more service oriented and focused on e-commerce. Dramatic shifts in population have brought about new areas of change. Undocumented workers and employed persons not covered by health insurance, while making valuable contributions to the economy, also have created new burdens on the economy in the areas of health, education and public safety. The tax code should be reevaluated in light of these and other recent changes to reflect the current service economy, Internet sales, catalog sales, and the need to attract new business to Arizona.

Some elements of the economy were identified as areas for reduction or elimination of taxes. Most felt that business property tax burdens should be considered for reduction, although they urged that before such taxes are reduced, the public needs to be well educated as to the underlying rationale and local taxing jurisdictions should be protected from unintended fiscal consequences of tax shifts.

A few elements of the economy were identified as potential sources of new or higher taxes, although not all agreed with every proposal. Arizona leaders should support changes at the federal level to enable Internet sales to be considered for transaction privilege taxation in all states. This is one area where Arizona's tax structure has not kept pace with changes in the economy and corporate structure.

The sales tax contributes heavily to state revenues. The sales tax code contains many large exemptions, which have decreased the tax base. Many suggested an evaluation and elimination of some exemptions, as warranted. However, the sales tax is a regressive tax. Any increases or elimination of exemptions must be made with a view toward maintaining equity. Some suggested our decisions on sales tax exemptions, or any decision on new taxes, should be made based on solid public policy reasons, and there should be a review process open to the public. Others suggested that sales tax exemptions be examined for "sunsetting."

Some proposed increases in the fuel and alcohol taxes. They suggested these tax increases would be targeted to link to the public expenditure of funds in areas such as the environment and health care. Others suggested indexing the gasoline tax to inflation. New ideas about addressing the health care burden should be considered with an eye toward reducing costs. This is an area of particular importance to counties, which must pick up the tab if the state falls short.

Other proposed tax increases included implementation of a real estate transfer tax, re-instituting the state property tax, evaluation and adjustment of state user fees and “sin” taxes and the exemption of certain services from sales or transaction privilege taxes. Some suggested consideration be given to increasing personal income taxes. Also proposed was an evaluation of existing tax credits for the purpose of eliminating some or all of them. Any enactment or implementation of any of the aforementioned tax adjustments should be made only after careful evaluation of what effects each adjustment would have on the economy, taxpayers and tax collecting authorities.

Mandatory sentencing, probation and truth-in-sentencing policies were identified by many as areas of government that drive spending and require consideration after more fully studying and understanding their effects. This entails evaluation of the link between education and crime, focusing on the structure of programs, rather than uncritical funding of corrections and judicial policies and programs. Outsourcing was offered as a suggestion for reducing funding of certain government activities. If the same or better services can be obtained from private entities for lower cost, it’s worth it. A few suggested we re-evaluate our spending on the educational system. Others noted that spending on state employees is critical. Some were concerned by the high number of individuals on AHCCCS, but noted that increased funding in this area is to some extent matched by increased federal funding.

### **Arizona’s Budget Stabilization (Rainy Day) Fund**

The Budget Stabilization Fund (BSF) is a fundamental tool for managing and planning the state’s resources. When used as originally planned, with safeguards in place to avoid its misuse, the BSF should be continued. The BSF has not served the state’s needs well because it has been greatly abused.

**When used as originally planned, with safeguards in place to avoid its misuse, the Budget Stabilization Fund should be continued. There must be adequate limitations on the BSF so that it is available for use in difficult economic times only and is not raided when the economy is doing well.**

If the BSF is continued, it should be modified. Questions to be answered include the size of the fund, how it is funded, and what triggers its use for spending. Funding and withdrawals should be tied to economic cycles. When there are adequate surpluses, the BSF should be funded. Town Hall recommends that the BSF be fully

funded at an appropriate level based on objective criteria. Some suggested that once the BSF is funded, the excess should be refunded to the taxpayers. Others were concerned that as funds are deposited in the BSF, they will not be available for new programs, tax rebates and tax cuts that the public may desire. Arizona’s citizens will have to choose between competing priorities – fund either the BSF or new programs – and the legislature will have to resist the temptation to change those priorities. Town Hall believes the long-term benefits of a properly funded and managed BSF outweigh the short-term detriment to any new spending programs, tax rebates or tax cuts.

There must be adequate limitations on the BSF so that it is available for use in difficult economic times only and is not raided when the economy is doing well. Some suggested strict enforcement of spending formulas, perhaps even by constitutional amendment, preventing any use of the BSF other than as predetermined and in periods of economic downturn. Others were concerned that strict triggers on the use of BSF may unduly limit the ability of the legislature to deal with unforeseen developments, maintain services and balance the budget in tough economic times, all of which may be valid uses of the fund. All agreed, however, that there should be safeguards adequate to protect the fund from unnecessary raids occasioned by the wants of special interests.

### **Borrowing by Arizona Governments to Finance Their Needs**

Arizona state government currently is limited by the state constitution and state statutes in its ability to borrow money. Nevertheless, state government has utilized lease purchasing to access the capital markets and has resorted to deferrals, fiscal adjustments and other mechanisms to “borrow” money. Borrowing is not inherently bad. It is commonplace outside of state government for many needs. For example, individuals and businesses regularly borrow for homes, cars, buildings and other capital costs. With adequate risk management, borrowing makes sense, and risk management principles could be used by government. Prudent borrowing for state long-term capital expenditures, tied to the useful life of the asset being financed, should be encouraged rather than discouraged.

On other levels, Town Hall felt that bonding was an acceptable form of borrowing for capital purposes, but should not be allowed for operational expenses. Good borrowing should be allowed where it results in improved capital facilities that reduce the draw on the General Fund. Other factors that must be considered in the borrowing decision include timing – when is a good time to borrow, the effect of debt incurred today on future generations, and safeguards necessary to ensure that debts incurred are paid when due, without unnecessarily extending the debt term.

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## **COLLABORATION, COOPERATION AND LOCAL CONTROL AMONG THE VARIOUS LEVELS OF GOVERNMENT**

### **Financial Resources and Duplication of Services**

There is extensive reliance on and competition for the same financial resources among all levels of government: federal, state, county and local. By relying on the same revenue sources, governments compete for the same taxpayer dollars. For example, there is heavy competition between cities for sales taxes and among cities, counties and the state for resources including fuel and property taxes. Local governments rely on state shared revenues, which can make up a significant percentage of a local government's

budget. All levels of government “drink from the same trough,” as do other consumers of public resources. Therefore, competition between them is unavoidable, as is tension over their “fair share.” Coordination among all levels of government that compete for resources is important.

Many believe there is significant duplication of services between governments, especially during strong economic times. Some believe there is not significant duplication of services, while others felt that not all duplication is bad. Multiple districts may exist in the same area to provide fire, water or sanitation services. Local governments often prefer to self-provide services. Although some cities and counties are actively pursuing opportunities for collaboration, this can be a complicated and time-consuming process. Cities may compete with special taxing districts. County islands may be surrounded by municipalities providing the same services. Administrative overhead often is duplicated in the areas of city and county judiciaries, tax collection and audits, and education.

Some identified the multiplicity of Arizona school districts as an area of duplication representing an inefficient use of financial resources. They recognized that school expenditures need to be evaluated, but there is an interest in keeping schools small and under local control. Consolidating school districts may not be the only or best answer. They also noted that because of the nature of school funding in Arizona, this issue has statewide implications and a statewide study to examine potential cost savings in this area is essential.

Arizona should encourage all levels of government to communicate, collaborate, cooperate, and reduce unnecessary duplication. Each level of government can more effectively address different kinds of problems, and each has a role to play. Each level should operate with a view toward efficiency, economies of scale, cooperation and good business practices. In some areas, such as air quality and regional transportation, various levels of government have successfully cooperated in allocating and using resources. Some local governmental entities have cooperated to compete for more resources as regional entities to develop public safety, fire, environmental and other services.

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Fiscal planning should be coordinated and integrated among the various levels of government. Shared revenues should be more predictable and reliable to local governments including a consistently available percentage of funding. Significant savings can be realized through collaboration if elected officials set aside turf issues, abandon egos and come together to work for the common good. The extent of coordination and integration, however, must be reasonable. If too much local authority is

usurped, citizens lose some of their ability to influence government. Some felt that the state should provide incentives for cooperation and collaboration among the levels of

government to reduce duplication and increase efficiency. Others felt this is not a state government role, and there currently are sufficient incentive mechanisms in place. State laws should authorize the formation of collaborative arrangements between and among local, county and other relevant entities, where such arrangements provide effective solutions to important issues. Regional authorities are an example of such collaborative arrangements.

### **Pursuit of Federal Funds by Other Levels of Government**

The pursuit of federal funds should be a priority. Federal funds are crucial to Arizona in many areas such as our military bases, Indian governments, transportation, education and international border issues. Where there are federal mandates, Arizona should receive adequate federal funds. Competing effectively for federal funds is no small task. All levels of Arizona government should aggressively pursue and acquire federal funding to maximize the return on our tax dollars where they can be constructively used. Elected and agency leaders should be encouraged to demonstrate attempts to acquire federal grants.

Arizona's congressional delegation should work hard to assist us in obtaining federal funds. We have a right to expect our federal officials to treat our money with the same stewardship and attention to our needs that we demand of state and local officials. Some felt that Arizona needs to hold state government responsible for aggressively planning for, seeking, maximizing and managing federal block grants, including the determination of whether governmental or non-governmental entities are the best providers of such services, especially those that address Arizona's specific needs. Town Hall recommends that a state funded office be established in Washington, D.C. to work with Arizona's congressional delegation and federal agencies on this and other state issues.

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We should not seek federal funds for the sake of the money alone because federal funds also may come with "hidden" costs. There must be a critical analysis of whether federal programs meet our goals because federal funds come with strings. The federal government dictates accountability and compliance requirements that are attached to federal funds, such as with matching funds. Federally funded programs are specific, require audits, accountability and performance standards, and regular monitoring. These requirements begin at the application process, are extensive, and are meant to limit state discretion. Sometimes they are too burdensome to make obtaining federal funds cost effective. Some small communities find that the cost of applying for federal funds is prohibitively high and therefore rely on state agencies to pass along the federal monies within their budgets.

Taking federal funds may create immediate personnel problems. For example, federal money granted for one limited purpose, such as to fund a drug prosecutor, may require additional unfunded expenditures for which there is no identified source of revenue, such as to pay for public defenders, court costs and support staff. In addition, state and local governments may be forced to surrender control over their programs by accepting federal funds. These problems increase when new requirements are imposed by the federal government or the funds are depleted. Some federal funding is provided for a period of limited duration. When the funding ceases, the governmental entity receiving the funds has to either foot the bill or face the painful process of discontinuing a program.

Currently, the executive branch controls the distribution of most federal funds. Although the legislature has tried to exert influence over these funds, such attempts have been without success. Some felt that executive control over federal funds is preferred to legislative control. Others felt that increased legislative oversight or access to information regarding federal funds may be required.

Some felt that to eliminate inefficiency and unnecessary expense, federal funds should be disbursed directly to the appropriate government entity, not funneled through the state. Accountability for the use of federal funds should occur at each level of government to avoid infringing on local control. Currently, local governments do account for grants and other federal funds in their budgets. Some felt this does not always, but should, occur at the state level.

### **Shared Tax Revenue Collection and Distribution**

The advantages of the state collecting and sharing tax revenues with local governments include the following: minimizing compliance burdens on taxpayers; reducing duplication of efforts; increasing efficient collection; and providing funds to small communities that rely on shared revenue for basic services. These advantages allow local governments to benefit from the broader tax base of the state. Tax revenue sharing is a reality of the state's current fiscal planning processes. Some believe it is necessary to redistribute revenues from communities with large tax bases to communities with smaller tax bases. Shared revenue allows for a more even balance in funding.

The system is not without its disadvantages. Local governments are concerned that they receive their fair share of revenues they send to the state. Arizona's experience with federal funds is that state tax revenues do not always return to their source. The shared revenue pot should not be "raided" for other uses. When the state takes back some of this revenue, local governments can be left without a way to fill the void. The state should be accountable to each locality for how it distributes the money it collects. Some felt that rural governments have less influence at the state level and, as a result, the revenue-sharing process needs to be improved to deal with inequities and unpredictability. Many supported restoring shared revenue percentages to past levels, citing inadequacy of current funding levels as a key disadvantage.

Accountability for use of state shared funds is a local issue. Local governments should be accountable to their citizens for using shared revenues subject to state auditing

and compliance statutes. Nevertheless, a public that demands accountability of government must shoulder their responsibility to participate. Accountability in revenue-sharing both allows and demands citizen involvement in local government. The bottom line is that Arizona governments at every level must be accountable to their citizens, who are entitled to adequate information to make the process transparent and assure accountability. If the public does not believe it is adequately and regularly informed, it has an obligation to insist on change. Attaching too many controls on how the money is used defeats the benefits derived from the state collecting and distributing revenue.

Local governments, by local vote, should be empowered to levy new taxes without state control. Local governments, by local vote, should be empowered to levy new taxes without state control.

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Local governments already enjoy significant authority to levy taxes subject to constitutional and statutory limits. Some described the process as an antiquated system that needs to be overhauled to the extent it is no longer realistic. Local government levy and

expenditure limitations have not been comprehensively reviewed since 1980. Town Hall recommends a comprehensive review and revision of local government levy and expenditure limitations. Certain local government authority and flexibility to raise revenues should be expanded and state restraints on sales, property and fuel taxes should be limited. Local authorities should be permitted to raise revenues to meet mandates imposed on them.

### **Urban/Rural Relationships**

Arizona is a diverse state – urban areas and rural areas, different levels of government, and citizens with different desires and needs. This diversity should be viewed as a benefit, rather than a detriment. We are one state, but we have many faces.

It is the state's responsibility to provide a basic level of services for all Arizona residents. While defining the upper limits of that level is a matter of debate, the state should ensure that rural Arizona has the tools, authority and capacity to control its economic fate. Rural areas, particularly those with small populations and small property tax bases, generally cannot sustain themselves without additional state revenues. In order to keep property tax rates at reasonable levels and provide basic services, the state must commit additional financial resources to rural areas. Also, to the extent applicable, local governments should be empowered to establish their own budget stabilization funds.

The state functions better when we support both rural and urban areas. Some felt that the current fiscal planning processes treat rural and urban areas disproportionately, unintentionally disfavoring rural areas. The state needs to better balance state and local views of fiscal policy. We have a financial responsibility to rural Arizona to ensure that the citizens of those areas have sufficient resources. Urban dwellers and tourists also benefit from services provided by rural governments.

While the state has tried to manage resources effectively, rural areas are faced with special concerns that must be addressed. Those along the international border are faced with the increase in illegal border crossings and the additional services required thereby. Others have experienced the continuing shift in agriculture, cessation of logging and mining, the construction of new plants and industries and the effects of federal legislation and border policies. Still others are not getting the help they need in healthcare funding, public safety, protecting resource allocation and in dealing with water issues. We should continue to pressure the federal government for increased funding in areas of federal responsibility, such as the international border, forests and other public lands issues. In the meantime, until the federal government assumes its share of this responsibility, the state should increase its level of support to both urban and rural areas.

Many believe the legislature can and has provided various mechanisms, such as the Transportation Board, which recognize and accommodate the special needs of rural areas. Some recommend a re-examination of the current revenue distribution formula, which they felt places unincorporated areas at a relative disadvantage. Others recommend a shift to a simple population-based formula of revenue distribution for the provision of basic services.

## **MEASURING AND IMPLEMENTING EFFECTIVE FISCAL PLANNING PROCESSES FOR ARIZONA'S FUTURE**

### **Measuring the Success or Failure of Government Programs**

Measurement is neither a new idea, nor an unachievable one. State government should be required to report on the success of its programs. Yet, most existing measures focus on the process, rather than on results. Measuring the success or failure of state government programs by the outcomes achieved helps identify progress.

Appropriate measurements serve multiple purposes. They are important in communicating priorities to the individuals within the organization. They should add clarity to organizational goals and not be overly burdensome. Measurements are important as a tool to recognize and reward employees for high performance. Finally, measurements provide operational transparency to the public and are critical for ultimate accountability.

Currently, most state agencies are good at compiling information but do not go much further than compiling and reporting performance measures to the legislature. The state can learn from business in this area. Where government already measures outcomes, we applaud its efforts; where it does not, we encourage it to do more.

State agencies should use needs assessments to ascertain a baseline from which to determine program objectives and priorities, which must be communicated to the public. Such analysis should not be limited to the fiscal planning process, but should include annual agency reports with financial information comparing the proposed objectives and budget with actual results. With more communication, the public can better appreciate our progress as a state. Some felt the goals and objectives should be generated within the agencies that will administer the program, while others felt the major goals should be generated by the governor and the legislature. They felt that input from elected officials is important because determining what objectives are worth setting and which goals are worth pursuing at the expense of others often is a political matter.

After the program goals and objectives are ascertained, success or failure is measured in part by quantitative data analysis, and in part by qualitative means, such as measures of taxpayer satisfaction, evaluation of cost effectiveness, and comparisons with historical results and the

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performance of peer agencies. Suggested tools for measuring and reporting the outcomes of state programs include using private companies to analyze data and generate reports; using current measurements, such as per capita spending for education; using technology to measure outcomes; using services that rank states in relevant areas; reviewing and evaluating successes by certain agencies, and how they can be copied by other agencies; setting targets and monitoring whether they are met; using the budget process to affect programs; and best practices and benchmarking.

To be effective, the technique used to measure the success of programs must be tailored to the specific type of government program. Preventive programs are difficult to measure, requiring new ways to quantify success or failure. Measurements must be based on realistic expectations and take timing into account. Some programs may require more time to measure success or failure. It was thought that government performance in the corrections system can be measured by outcome-based goals such as reducing recidivism and injuries among inmates and employees and the long-term success of restorative justice programming.

One example of effective program review is that used by the Department of Education. It reviews school districts' successes and failures and shares the results with the public, thereby increasing public awareness and encouraging change and self-correction. Other examples include Maricopa County's Managing for Results program and the Department of Transportation Motor Vehicle Division review processes.

Another measurement tool that must not be overlooked is monitoring how well the state is serving its consumers, the people receiving government services. Those who are receiving government services should be asked for their input, and government should be sensitive to their concerns and the value of their feedback. Measurements of state government success and failures must be meaningful and communicated to the citizens in a simple and succinct format that is easy to understand and accessible to all. The media is a key partner in this process.

### **Measuring the Efficiency and Cost Effectiveness of Government Programs**

There really is no “best” way to measure efficiency and cost effectiveness of government programs. Needs for measurement and the tools to meet those needs change over time because our expectations of government, and the functions government performs, change over time. For example, government could measure its performance against its prior performance, but to do so, a certain level of consistency is needed. This may interfere with the need for government to be flexible. Any measure, however, depends on a baseline to determine success or failure.

Certain programs are easier to measure than others. Measurement is important, but we must ensure our tools recognize individual differences and truly provide an accurate picture of which programs are succeeding and which ones are not. There must be flexibility in setting measures of efficiency in order not to sacrifice the larger purpose of any program or agency. We should not expect the wrong measure to provide the right information. Thus, government should select the measurement tool based on the intended purpose.

Any measurement should include looking to comparable programs in other states. The efficient use of taxpayer dollars also may require comparison with the private sector to determine whether programs may be run in a better way. While some programs are essential to the role of government, in some cases the private sector can be an effective alternate provider. Outsourcing should be considered as an efficiency tool. Before outsourcing is conducted, however, criteria need to be developed and analyzed, and a determination made that it will be more cost effective. Any use of the private sector to deliver conventional government services must require that all private providers be held to public performance standards.

The state has some tools that could be used effectively. For example, the auditor general is available to review programs when requested. Care is needed, however, to use the audits as a program measurement and improvement tool, not merely to find fault. Some felt the state should implement a cost accounting system to be used to better evaluate efficiency and cost effectiveness, but were concerned this option may be too expensive. They suggested the next best, and more affordable, option for measuring cost effectiveness is to set benchmarks, collect data, and measure performance. Consideration should be given to tools adapted for public use, such as opinion polls. Whatever tools are selected, government should keep in mind that it is ultimately accountable to the public.

## **Adapting the State’s Fiscal Planning Processes to Changing Economic, Demographic, Social and Political Circumstances**

State government must establish and maintain long-term policy objectives. Without such objectives, there can be no meaningful measure of policy success or failure. These policy objectives must be publicized to ensure accountability. One way to increase the commitment to a long-term plan is to educate the public and involve them in the process. Planning must be flexible enough to respond to the will of the people. There should be a mechanism to allow for a joint revenue forecast not subject to political influences.

Most felt that given the structure of state government and the nature of political turnover, a fixed long-term fiscal plan may not be feasible. Those who support a plan believe no plan should be set in stone. Such a plan might fall out of favor with election cycles. Any long-term planning process should establish an adaptable plan because it inevitably will be subject to modification. Elected officials must be able to change the plan as long as their changes are made publicly. Some suggested the state adopt an institutional rolling five-year plan, similar to that used by many cities. Any long-term plan also should take into account and adapt to changing economic, demographic, social and political circumstances.

**Arizona must provide for a long-term *fiscal analysis* in the planning process.**

Arizona must provide for a long-term fiscal analysis in the planning process. Most felt that in harsh economic times, maintaining the fiscal planning process may be more difficult to accomplish, but

still is necessary. Some thought, however, that annual or at most bi-annual budgeting is preferable to any long-range fiscal planning process. They believed the marketplace of ideas, which settles into an annual consensus regarding funding priorities, is an expression of our democratic ideals. They felt that beneficial policies or programs will be continued year to year, regardless of what political party is in power; programs that no longer enjoy popular support will be discontinued – and should be. Others agreed that the current budgeting structure does not necessarily hurt government’s ability to set long-term priorities because long-term policy can be achieved through short-term budgeting.

Forecasting can be a useful planning tool. One purpose of forecasting is to assist in the development of a long-term planning process. Government currently uses the universities and administrative agencies to create certain forecasts. Expanding use of forecasts should be considered and tailored to meet the needs and limitations of government. It is important to build in sufficient flexibility to adapt to changes. As new long-term priorities are identified, the state should identify the sources of funding for them, with such funding sources to be included in the budget.

Town Hall identified a number of structural barriers that prevent or inhibit long-term economic planning. These factors include: the short terms and term limits for legislators; the “part-time” nature of the legislature; low legislative salaries; the supermajority vote required to enact changes in the tax laws; the limitations on legislative

amendments of voter approved initiatives; the BSF in its current form; and inequities in the state tax structure.

Town Hall strongly recommends eliminating or correcting some of these structural barriers as follows:

- Repeal term limits;
- Extend state senators' terms to four years;
- Increase public officials' pay;
- Repeal the supermajority vote required for tax increases (Prop. 108) and the limitations on legislative amendments to voter-approved initiatives (Prop. 105);
- Require ballot measures that mandate spending to identify adequate increased funding for the General Fund;
- Reform the tax structure to be simple, fair and adequate.

**Town Hall identified a number of structural barriers that prevent or inhibit long-term economic planning and strongly recommends eliminating or correcting some of these barriers.**

We reaffirm the 79th Arizona Town Hall's recommendations regarding the initiative process calling for "procedural changes necessary to ensure that all initiatives are well drafted, accurately summarized and undergo proper deliberation."

### **Confidence in Government**

There is a lack of confidence in the state's fiscal planning process. Confidence in government is undermined in part because the public is uninformed. Improved education of the electorate is crucial to the success of the fiscal planning process. Some thought that citizens do not feel that they are able to influence public fiscal planning. Citizens need to have more opportunities to be involved in the process. State government should 'follow the time-honored, historical and traditional process of public involvement in government decisions. Examples of outreach to the public include district meetings by state legislators and holding city council meetings in schools. The public has a responsibility to be informed and, therefore, needs to have access to information. Some felt, for example, that state legislative and executive budget deliberations should be more open and accessible to the public.

The media has a key role to play in informing the public and changing perceptions. News coverage of the state budgeting process should be fair, informed, accurate and more expansive, thereby increasing citizens' ability to know what is happening.

Ballot initiatives are one mechanism for voters to participate in the planning process, but some felt that initiatives are often unduly influenced by special interests, which ironically can contribute to voter alienation. Some felt that the perceived gap between citizens and government is due to voter apathy and an unwillingness to become informed about government operations and the positions of elected officials. Others felt that voter apathy is an outcome of the size and complexity of government, and the perception that nothing an individual says or does can affect public policy. Still others felt that voter

disinterest in government is a result of relative prosperity and reflects that Arizonans are essentially satisfied with the performance of their elected officials.

There is a gap between public expectations and government performance. This gap may to some extent remain because we always are hopeful for improved government. Most criticism falls on the federal government, and the sentiment decreases as the level

**There is a gap between public expectations and government performance. There also is a gap between public expectations and the public's willingness to pay.**

of government gets closer to the people. This may be due to the fact that, over time, government has become more complicated and, therefore, it is more challenging to explain its functions to the people. However, government must ultimately increase public confidence through sustained improved performance.

There also is a gap between public expectations and the public's willingness to pay. If government programs are presented in a manner that explains their costs, citizens are better able to choose which programs are most important. Over time, this knowledge may reduce instances of unrealistic expectations. The expectations of the public are short term, while sound fiscal planning requires long-term considerations. Some felt that this gap will remain, given the ever present economic cycles and the absence of realistic information being given to taxpayers.

Town Hall suggested that one way to build public confidence in government is to invite constituent groups to participate in the fiscal planning process, followed by monitoring and sharing of information regarding state spending. Another way to promote public confidence is to take advantage of technology and techniques to survey, gather and assess data to maximize performance and citizen satisfaction. Public policy issues should be presented in a manner that people can understand, using interactive and alternative formats. Other methods that could be explored for the purpose of closing the gap between citizens and government include making the legislative process more open, using electronic media to communicate with constituents, publicizing agency and program plans and reporting their results, and conducting less frequent elections, with fewer ballot initiatives. These methods should give voters an adequate opportunity to inform themselves on the issues with the goal of making elections more meaningful.

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