

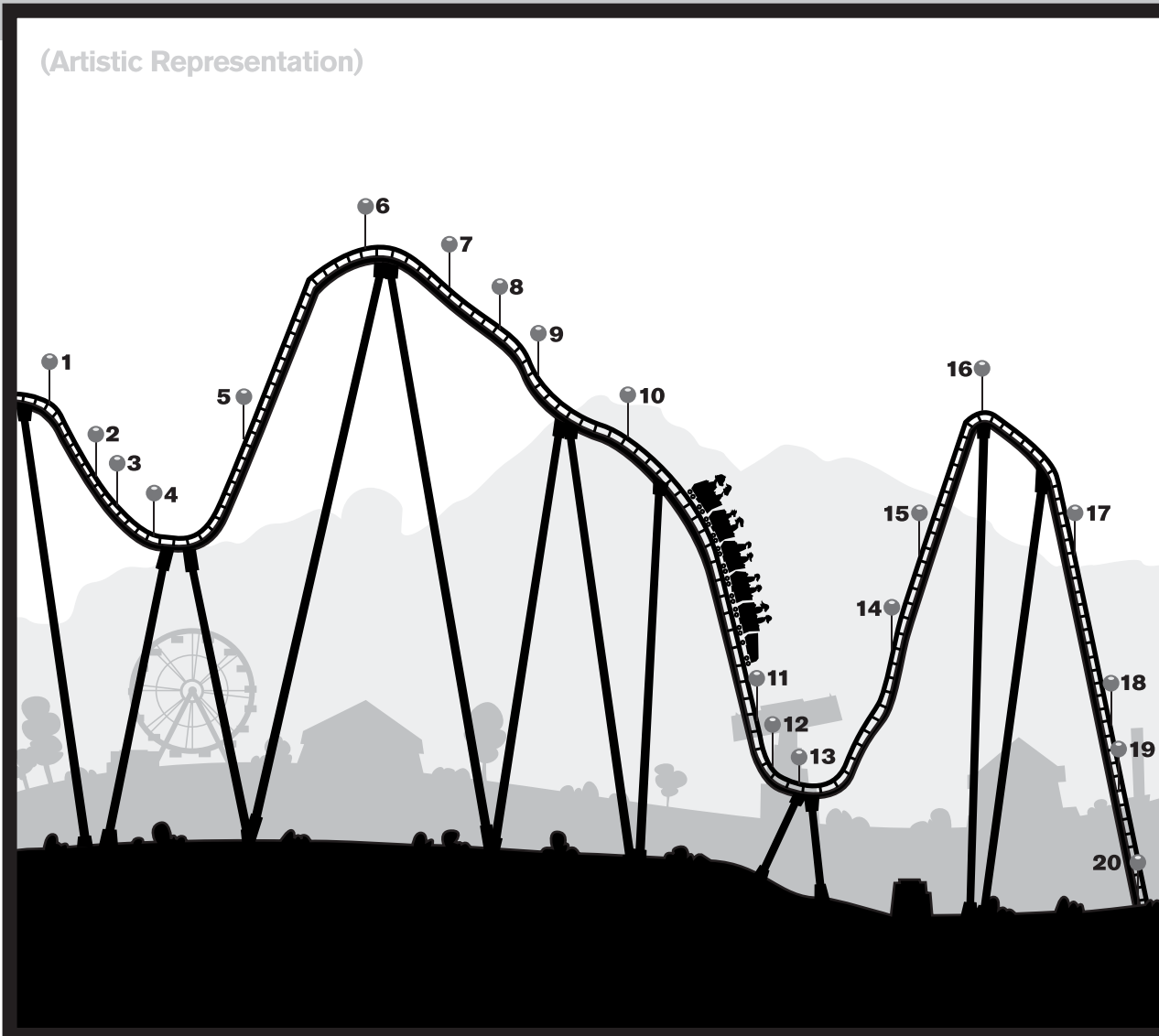
Riding the Fiscal Roller Coaster ▶ Government Revenue in Arizona

Highlights of the
95th Arizona
Town Hall
November 2009



Arizona State Government General Fund Ongoing Revenue Per \$1,000 of Personal Income, 1988 to 2009

(Artistic Representation)



- | | |
|----|---------------------------|
| 1 | Real Estate Crash |
| 2 | Deficit |
| 3 | Rainy-Day Fund Created |
| 4 | 1990-91 Recession |
| 5 | Economic Recovery |
| 6 | Tax Cuts Begin |
| 7 | Rainy-Day Fund Modified |
| 8 | More Tax Cuts |
| 9 | Stock Market Boom |
| 10 | More Tax Cuts |
| 11 | Stock Market Crash |
| 12 | 2001 Recession |
| 13 | Large Deficit |
| 14 | Economic Recovery |
| 15 | Real Estate Boom |
| 16 | Another Round of Tax Cuts |
| 17 | Real Estate Crash |
| 18 | Recession Begins in 2007 |
| 19 | Revenue Plunges |
| 20 | Record-Setting Deficit |

A Snapshot of Revenue in Arizona

- ▶ Government revenue is a system. Examining the parts independently and implementing changes in a piecemeal fashion is likely to result in unintended consequences and a suboptimal system.
- ▶ Government revenue in Arizona is highly cyclical, going up and down with the economic cycle. The state has experienced significant budget deficits in each of the last several economic recessions.
- ▶ Much of the revenue cyclical nature is inherent to the state's highly cyclical economy, but part is due to the design of the revenue system. Changes to the system since the early 1990s have increased the cyclical nature of revenues. Yet demand for most government services is not cyclical, and the demand for some services is countercyclical—rising during recessions as revenues fall.
- ▶ Arizona's revenue system was designed decades ago, though a large number of piecemeal changes to the system have since occurred. The sales tax in particular has not been modified to keep pace with changes over time in consumer expenditures. As a result, government revenues are not expanding at the pace of the economy.
- ▶ Relative to other states, Arizona's revenue system relies more heavily on taxes than

on user fees. Yet the state has a narrow tax base. The state's general fund is highly dependent on only two cyclical taxes: the income tax and the general sales tax. Including local sales taxes as well as the statewide tax, the general sales tax rate in Arizona is high.

- ▶ The cyclical misalignment between public revenues and expenditures could be reduced, but not eliminated. Thus, a mechanism to pay for education, public safety, and other programs when revenues temporarily fall during an economic downturn is a component of a well-functioning revenue system. As currently designed, the state's rainy-day fund in each of the last two recessions has been depleted long before revenues have recovered.
- ▶ The state's recent budget difficulties result from the cyclical nature of government revenues and from a structural deficit—revenue is insufficient on average over the economic cycle to pay for the state's expenditures. While the optimal structure of the revenue system is independent of the amount of revenue that needs to be collected, the adoption of an ideal revenue system while leaving a structural imbalance in place will not result in a well-functioning fiscal system.
- ▶ The overall tax burden in Arizona is lower than in most states and is lower than it was in the past. It is the result of a very low tax burden on individuals, a low burden on small unincorporated businesses, but a relatively high burden on large corporations. The balance between individual and business taxes is

an important consideration in creating a well-functioning revenue system.

- ▶ The driving forces for revenue reform include the severe cyclical nature of the existing system, the failure of the existing system to generate revenues that grow at the pace of the economy, and the existing system's negative impacts on economic competitiveness due to relatively high corporate taxes. Improving the revenue system in each of these regards would raise the rating of the system against the guiding principles of stability, responsiveness, predictability, and competitiveness. The existing system also could be improved on most of the other revenue system guiding principles.

- From Arizona State University's Background Report prepared for the 95th Arizona Town Hall

Prior to the Town Hall session, participants from throughout the state reviewed the comprehensive background report developed by Arizona State University.

To download the complete report, go to www.aztownhall.org.





Report of Recommendations

After reviewing the full background report prepared by ASU, participants in the 95th Arizona Town Hall, convened at the Grand Canyon on November 1-4, 2009. The result: a consensus of recommended actions to be taken to address Arizona's current and future revenue issues.

Reforming Arizona's Revenue Systems

Reform of Arizona's revenue systems should be aimed at clearly delineated objectives, including elimination of structural deficits and keeping Arizona competitive.

The state's revenue systems should:

- (1) provide sufficient revenues for the services that the public needs and is willing to pay for, while providing adequate reserves to protect against future deficits;
- (2) maximize the diversification of revenue sources and avoid disproportionate burdens on specific groups and economic sectors;
- (3) utilize taxes and fees that are transparent, understandable, fair, sustainable and balanced;
- (4) be flexible and able to respond quickly to changing economic conditions;
- (5) include mechanisms to monitor, measure, and adjust collections and expenditures as necessary;
- (6) minimize distortions of business activity;

(7) promote economic growth;

(8) emphasize stability, predictability, efficiency, and simplicity;

(9) promote intergovernmental cooperation and inclusion; and

(10) eliminate unnecessary and wasteful government spending.

Immediate Action

The state of Arizona must take immediate action to resolve its current fiscal crisis. The governor should call the legislature into special session to:

- (1) meet Arizona's constitutional duty to balance the state's budget;
- (2) approve a temporary sales tax increase with a definite sunset provision; and
- (3) consider spending cuts as soon as possible, without referring the issue to voters.

To avoid further cuts in critical services and programs, the legislature should also continue to search for other short-term revenue sources, such as increases to income and property taxes, expansion of the sales tax base, expansion of the application of user fees, reduction of tax credits, and increased revenues from gaming.

Participants of the 95th Arizona Town Hall were a diverse group of people representing a broad spectrum of the public.

Meeting in facilitated small groups for two days, the participants addressed a common set of discussion questions. Trained recorders captured points of consensus which were then evaluated, changed and approved by all participants on the final day.

Long-Term Actions

The need for these immediate stop-gap measures should not deter or distract from a more thorough overhaul and update of Arizona's revenue systems. A long-term vision for state services and the state's revenue system, supported by a comprehensive, long-term strategic plan, is imperative.

The following specific action items should be considered as part of implementing an effective long-term revenue system for Arizona.

- A. Implement secure, stable, flexible, sustainable revenue sources sufficient to provide the services for which the public is willing to pay, while also promoting economic growth, reducing the effects of cyclicity, and increasing stability.
 - (1) Broaden the sales tax base while lowering the tax rate.
 - (2) Reinststate the state property tax.
 - (3) Expand the application of user and impact fees.
 - (4) Evaluate tax credits and sunset or eliminate tax exemptions.
 - (5) Increase efforts to obtain a larger share of federal funds.
 - (6) Increase the cap on the rainy day fund to at least 20% of state general fund expenditures of the prior year, and add restrictions on withdrawal tied to measureable reductions in economic activity.

- (7) Increase excise taxes on gasoline for transportation uses.
 - (8) Critically evaluate expenditures and tie expenditures to revenues.
 - (9) Consider general obligation bonding, severance taxes, exit taxes, visa taxes, and inheritance taxes.
- B. Identify and remove barriers, including structural barriers, to political cooperation and change.
 - (1) Eliminate the supermajority requirement.
 - (2) Require sunset or reaffirmation provisions for initiative measures.
 - (3) Remove term limits and/or lengthen legislative terms.
 - (4) Repeal or amend Arizona's public campaign finance Clean Elections law.
 - (5) Amend the state constitution to add an effective balanced budget requirement, to include provisions for accountability.
 - (6) Create more competitive legislative districts.
 - (7) Amend Proposition 105 to provide for greater spending flexibility (see next page).
 - (8) In order that the Town Hall's proposed changes to the state constitution be considered in a coherent manner, the Town Hall recommends that the legislature study the feasibility of calling a limited

constitutional convention to address the need for an Arizona Constitution that contains a fiscal policy structure adequate to meet contemporary needs.

- C. Improve the efficiency of the revenue system.
 - (1) Reevaluate revenue projection tools to improve accuracy.
 - (2) Reward individuals who identify fraud and waste or who otherwise improve fiscal efficiency.
 - (3) Define and respect the different roles of local and state governments.
- D. Establish performance measures to track the effectiveness of the revenue system and mechanisms to make adjustments as needed.
 - (1) Develop a long-term strategic plan that includes accountability, defined timetables, and assignment of responsibilities.
 - (2) Evaluate expenditures and tie expenditures to revenues.
 - (3) Incorporate a mechanism for spending evaluation and adjustment in the event that revenues fall short of projections.
 - (4) Create an independent agency, equivalent to the federal Congressional Budget Office, that monitors revenues and expenses and makes economic projections on which fiscal adjustments can be based.



“While it is the legislature’s job to implement change, business and community leaders must be involved. Changing Arizona’s tax system will occur only as a result of bipartisan effort.”

- From the 95th Town Hall Report of Recommendations

- (5) Replace annual budgets with a two-year budget process.
- E. Establish a commission or similar “blue ribbon” panel comprised of a diverse group of Arizona citizens, business leaders, community leaders and experts in the field. This commission should:
- (1) be established jointly by the legislative and executive branches to conduct a public process to evaluate the recommendations in this Town Hall report;
 - (2) build a statewide coalition of key stakeholders to assist the commission in publicizing its findings and recommendations so that it can garner the widespread understanding of the issues and support needed for change to occur;
 - (3) be empowered and funded to hire professionals to develop and implement a public outreach plan, taking into account the recommendations in Chapter 19 of the Town Hall Background Report; and
 - (4) present its recommendations to the legislature for an up-or-down vote, without amendment. If not approved by the legislature, the commission’s recommendations should be presented to voters through initiative or referendum.

PROPOSITION 105

Proposition 105, adopted by voters at the 1992 general election, amended Article 9 of the Arizona Constitution to require a “supermajority” or 2/3 vote of the members of each house of the legislature for any net increases in state revenues.

How You Can Have An Impact

- ▶ Make your views on government revenue known to the governor (<http://azgovernor.gov/Contact.asp>).
- ▶ Use resources such as Project Vote Smart (<http://www.vote-smart.org/index.htm>) to find contact information for all of your elected officials including U.S. Senators and Representatives.
- ▶ Keep up to date on relevant programs in your community and action you can take through the Arizona Town Hall website (<http://www.aztownhall.org>).
- ▶ Arrange a program in your community. Arizona Town Hall can provide resources, speakers, and printed materials.
- ▶ Be a change agent. Utilize the wealth of knowledge contained in the full report from the 95th Town Hall to develop partnerships and programs that will help improve Arizona's government revenue systems.
- ▶ To join existing efforts to pursue recommendations from the 95th Arizona Town Hall, contact the Arizona Town Hall office or become part of the Action Communities (<http://actioncommunities.org>).
- ▶ For more information on factors influencing government revenue in Arizona, download the full report from the 95th Arizona Town Hall (<http://www.aztownhall.org/reports/95.asp>).

“A well-planned, highly visible, and well-funded public relations and education campaign and development of a statewide coalition of key stakeholders is necessary to overcome the natural resistance to change, as well as opponents of reform.”

- From the 95th Town Hall Report of Recommendations



We welcome your involvement,
questions, and perspectives.

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