



## **Position on Governor Brewer's Five-Point Plan to Close the Budget Deficit**

The Governor has put forward a Five-Point Plan to resolve the current budget deficit and ensure that Arizona does not continue to experience such dramatic volatility in revenues. Several components of Governor Brewer's plan are consistent with existing Arizona Chamber policy. Other components require further evaluation and analysis.

- **Governor Brewer's Budget Point #1: Reform the budget process with a focus on longer term needs and resources**

The Governor calls for an increase in the size and restrictions on the use of the Rainy Day Fund. This principle is consistent with the existing Arizona Chamber budget recommendation to ensure that the Rainy Day Fund is used only to help fund productive, established state programs during times of true fiscal emergency. The Chamber also supports an increase in the size of the fund when revenues recover and the budget is no longer in deficit. Saving more money during strong economic times will better help the state to weather future downturns. As a starting recommendation, the Rainy Day Fund should be doubled from its current 7.5% of the budget to its original 15%. We further recommend that the Finance Advisory Committee in conjunction with the Joint Legislative Budget Committee should be charged with regularly reviewing the balance of the Rainy Day Fund to determine the appropriate level of funding moving forward.

The Governor recommends that fund sweeps be limited. This approach is also consistent with the Chamber's long-standing policy that taxes or fees collected from specific tax payers for dedicated purposes should be used for their intended purposes. The Job Training Fund, the Highway Users Revenue Fund, and the Water Quality Assurance Revolving Fund are a few of the funds into which businesses pay that have been swept in recent years. The longer-term goal should be to eliminate the practice of sweeping dedicated funds to balance the state's budget. This will improve fairness for all taxpayers and enhance transparency in the budget process.

The Governor contends that the budgeting process should begin with reasonable revenue estimates. The Chamber agrees that the revenue forecasting process should be structured in a way that is transparent and that yields the most accurate estimates.



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The Governor has stated that the budget should be structurally balanced and not overly reliant on gimmicks and debt. The Arizona Chamber recognizes that having a balanced budget is the primary Constitutional responsibility of the state legislature. Historically, the Chamber has been opposed to the use of accounting gimmicks and debt to solve the state's budget deficit. However, given the current catastrophic state of our economy, limited use of these tools may be necessary short-term options. Debt should be used sparingly and in accordance with sound financial and Constitutional principles. Additionally, the Chamber believes in the use of reverse triggers to adjust appropriations when revenues fall below expectations.

- **Governor Brewer's Budget Point #2: Improve Proposition 105 – The Voter Protection Act**

The Governor recommends allowing flexibility for voter approved program funds during times of fiscal crisis. The Arizona Chamber supports prospective reforms to Proposition 105 that would better allow the legislature and Governor to set and manage the entire state budget. Additionally, the Chamber supports reforms that would increase transparency and prevent abuses of the initiative and referendum processes, including:

- Moving up the deadline for initiative petitions to be filed with the Secretary of State;
- Requiring pre-circulation review of language, content, and constitutionality of initiatives;
- Instituting a ballot title and summary review board; and
- Reducing fraud in the petition signature gathering process.

- **Governor Brewer's Budget Point #3: Further spending cuts, reduce general fund by \$1 billion**

The Governor recommends expenditure reductions of \$1 billion for FY '10. The Arizona Chamber agrees that spending restraint is a necessary element of closing the deficit. Expenditure reductions should be structured in a way that does not impair the ability of the state to leverage federal matching funds or result in cost shift to the private sector, such as an increase in the "hidden healthcare tax" on business.

Education funding accounts for over half of the state's general fund budget. Businesses understand the importance of having a high quality education system at all levels that prepares students to be





productive members of the workforce. For this reason, we believe that changes to education funding should be designed to reward effectiveness and efficiency.

The Arizona Chamber supports adjusting outdated funding formulas, eliminating programs that do not improve academic achievement, and ensuring that resources are better focused on student learning. It is particularly important to limit the state's exposure to the homeowner's rebate and the one percent cap on primary property taxes by capping or phasing out local school district levies that are outside the public school equalization system. Growth in local school district property taxes due to special programs such as excess utilities, desegregation, career ladder, and transportation have resulted in over \$400 million annually in additional state aid in recent years. Action should be taken to more accurately count students for funding purposes. This includes moving from "prior year plus growth" to current year funding, reducing dual enrollment funding for students concurrently enrolled in high school and post-secondary institutions, and eliminating state subsidies for out-of-state students at public universities and community colleges. Additional strides towards performance-based-pay and away from seniority-based pay are warranted, including but not limited to phasing out the Teacher Experience Index (TEI) supplemental funding for certain school districts. Innovative efforts should be made to further expand enrollment in charter schools, some of which are among Arizona's most recognized schools, and which tend to have lower per pupil costs than traditional public schools.

The Chamber continues to support a freeze on all non-essential school construction. The state is not currently experiencing the growth that warrants new building activity. This "moratorium" alone saves the state hundreds of millions of dollars without impairing the classroom instruction. Where necessary, capital funds should be focused on maintenance of existing school buildings, especially in improving safety. The Arizona Chamber has a standing position that the Students FIRST method of funding school construction should be reformed in a way that takes pressure off of the state's general fund. To that end, the Chamber is working with the Arizona Business and Education Coalition (ABEC) to redesign the school finance system, including capital construction.

We continue to support efforts to improve administrative efficiency. During the last election cycle, the Arizona Chamber supported the school district unification ballot propositions that were designed to reduce administrative expenses and channel more money into the classroom. These efforts should be continued.





The Chamber believes that privatization of certain state functions could yield meaningful savings and should be a part of any expenditure reductions plan. For this reason, the Chamber has been working to move forward *SB 1466; Council on Efficient Government*. Experience in other states has shown that, when done correctly, outsourcing of selected government functions can save money while improving service delivery, make government more efficient, and provide more private sector job opportunities.

The Chamber continues to support reforms to the state retirement systems that will ensure the systems are actuarially sound, including strict limits on benefit enhancements. All new state employees should be put on a defined contribution plan rather than the current, unsustainable defined benefit structure.

The state should appropriately utilize the funding provided by the federal American Recovery and Reinvestment Act for its intended purposes, specifically:

- Temporary federal stimulus funds should be used as a bridge during the current fiscal crisis, not a means to create new, ongoing entitlements or spending obligations for the state.
- Increased federal funds for Medicaid should be used to prevent further cuts to AHCCCS in FY 2010 that would contribute to the hidden health care tax paid by business and consumers.
- The state should take advantage of and properly allocate the transportation, energy, and education provisions where funds do not flow directly to offset general fund activities, but could be used to offset some of the effects (i.e., increase to higher education tax credit and Pell Grant).

• **Governor Brewer’s Budget Point #4: Provide tax reform to attract business and more jobs**

The Governor calls for future tax reform to encourage job retention and creation, economic development, and revenue stability. The revitalization of the private sector economy is critical to ensuring the long term health of Arizona’s economy and budget. Arizona’s tax code needs to be substantially revised so that the system encourages economic diversification, improves the state’s competitive position, and enhances the ability of businesses to create jobs. A tax reform package should be passed during the current legislative session with a delayed effective date. Four essential elements should be part of pro-competitive, long-term tax reform:

- Business Property Tax Reduction: First, permanently repeal the statewide equalization rate tax this session. Business property taxes in Arizona are higher than any of our regional competitors





- including California – and are the fifth highest in the nation. The Beacon Hill Institute estimated that a return of this tax would cost Arizona 4,000 jobs. Secondly, the assessment ratio for business property should be brought in line with the assessment ratio for residential property so that the job creators are no longer bearing a disproportionate share of property taxes.
  - Reduce the Corporate Income Tax Rate: The long-term goal should be to eliminate the state’s corporate income tax. In the interim, the corporate income tax rate should be reduced to at least the same level as the individual income tax. The federal corporate income tax is the second highest in the industrialized world and, when combined with the state’s rate, only further deters job creation. Several of Arizona’s competitor states have no corporate income tax. Arizona’s relatively high corporate income tax acts as a repellant to corporate headquarters and other business growth opportunities. Additionally, the insurance premium tax should be reduced to a level commensurate with the corporate income tax.
  - Reduce Capital Gains Taxes: Bring Arizona into conformity with the federal code by creating a separate capital gains tax for both businesses and individuals. Use the same proportion of capital gains tax to ordinary income tax as the federal system. Lowering the capital gains tax will encourage investment in Arizona and help create jobs.
  - Conform the State Net Operating Loss (NOL) Carry Forward to the Federal: Increase the number of years a business can claim a NOL from five to twenty so that it is consistent with the federal period and supportive of the development of new and innovative businesses.
- **Governor Brewer’s Budget Point #5: Temporary tax increase of \$1 billion in revenue to bridge the gap in our budget shortfall**

The Governor’s plan calls for a temporary tax increase of \$1 billion annually. In the past, the Chamber has opposed a tax increase as a way to close the deficit. We recognize, however, that our state leaders have concluded that expenditure reductions alone cannot solve a budget deficit of this magnitude. Therefore, other temporary and permanent revenue enhancing options must be considered. The sale of state assets and securitization of certain revenue streams should be evaluated on a case-by-case basis to



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determine short-term benefits relative to the long-term cost of these types of financing options. The Arizona Chamber believes that the legislature should instruct the Joint Legislative Budget Committee staff to analyze the potential net new revenue to the state that could be realized from an expansion of gaming compared to the possible loss of revenue from tribal gaming.

The Chamber believes that, under these extraordinary circumstances, certain temporary tax increases, such as an increase to the sales (TPT) tax, should be considered if all other options have been exhausted and there is no other viable way of closing the deficit.

If a tax increase is ultimately part of the budget solution, it must be short-term in nature and coupled with a comprehensive tax reform package that would aid in job retention and creation as well as capital formation over a longer time horizon, as described in point #4. Under this scenario, the long-range result has to be a more equitable and balanced tax system. Dynamic econometric modeling should be used to determine the impact of the tax policy changes on job creation and retention and access to capital. The overall package should result in a net decrease in taxes and a net increase in job creation over the long-term.



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