



Weathering the Storm and Preparing for a Brighter Future: Arizona Chamber Budget Recommendations



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Arizona is a state historically rooted in growth and prosperity. However, the industries that helped our state grow are now experiencing a significant and prolonged contraction. As businesses struggle to make ends meet, their contribution to state revenues declines, further exacerbating the size of the deficit. To complicate matters further, more Arizonans are turning to state services because employers are unable to create and sustain jobs and offer benefits at the levels they have in the recent past.

Global financial markets are unstable, real estate markets remain weak, and credit is extremely tight. These local, national, and international conditions have converged to create a tall challenge for our state's leaders. Arizona now ranks #1 in the nation for the size of its deficit as a percent of the total state budget.

Actions by the Arizona Legislature and Governor, in years of budget surplus, to repay previous fund sweeps and to set aside money for the Rainy Day Fund have put the state in a better position to weather the current downturn. However, other recent actions have limited the choices now available to close the budget deficit. Many of the solutions employed to close the FY 2008 and FY 2009 budget deficits are one-time in nature and cannot be sustained over a longer downturn.

Smart, efficient action now by the Legislature and Governor can resolve Arizona's current budget situation, preserve the essential role of government to protect liberty and public safety, and put us back on the path to prosperity.

Recognizing the importance of the state budget to its member businesses and the state's economy, the Arizona Chamber of Commerce and Industry is continuing the work of its Fiscal Policy Task Force. The purpose of the task force is to:

- Educate chamber members on the state budget and the budget process
- Create a forum for discussion on the state's most important fiscal issues
- Offer policy recommendations to legislators and the Governor that will serve to strengthen the state's economy.

The Chamber's goal is to work with the Governor and members of the Legislature to advance policies that will help the state overcome its current budget challenges, without compounding or prolonging its financial difficulties, and emerge from this economic downturn poised for greater growth and prosperity for all Arizonans. Moreover, the Chamber hopes to offer suggestions that will help mitigate similar fiscal dilemmas in the future.

First among those suggestions is to make cuts to non-essential expenditures. The Chamber supports continuing the hiring freeze for non-critical state government jobs and seeking out opportunities for additional agency spending reductions. In some cases, capital construction projects should be delayed until the state budget recovers. This should include a review of all proposed new school construction to determine if growth still supports the new construction or if building maintenance and renewal or local financing are viable alternatives. The use of debt financing for capital projects, including school construction, should be limited in

duration and designed in a way to ensure it is constitutional, minimizes interest costs, and is repaid as soon as possible.

It is important for the state to continue to improve the business tax and regulatory climate. Business property taxes in Arizona remain among the highest in the nation. Continued progress in that area and in regulatory reform are critical to attracting jobs and establishing a tax base that will help the state's economy in years to come.

Finally, we recommend a variety of tools to prevent the state from returning to this challenging situation. Our recommendations include: budget triggers, additional transparency and accountability for spending increases, further privatization of state activities when cost savings can be realized, reform of the Students FIRST program, and the establishment of a statewide debt policy. These items paired with improvements to Arizona's regulatory and tax climate will make Arizona a more competitive place to do business and will spur further job creation.

I. Guiding Principles for State Budgeting

The Chamber believes:

- Government expenditures should be for programs that serve a public good and that cannot otherwise be provided by the private sector
- Government should be funded by a fair and equitable system of taxation that minimizes the burden to taxpayers and promotes a competitive marketplace
- Government finance should be efficient and transparent

During times of economic downturn, the Chamber believes:

- Lawmakers should reduce expenditures to a level that recurring revenues can sustain
- Lawmakers should budget to the entire length of the projected downturn
- Economic downturns offer an opportunity to review and improve the efficiency and effectiveness of state programs
- Raising taxes during downturns only exacerbates economic distress by discouraging business investment and hampering business growth
- Debt should be incurred sparingly, temporarily, and in accordance with the state constitution

During times of economic growth, the Chamber believes:

- Lawmakers should refrain from growing the state budget at rates higher than recurring revenues can sustain
- Lawmakers should refrain from obligating future general fund receipts ("out year" expenditures)
- The state should first "repay" any outstanding debt, fund transfers, rollovers, or other accounting gimmicks employed to resolve prior years' deficits

- The state should replenish the Rainy Day Fund (Budget Stabilization Fund)
- Expenditures should then prioritize critical state infrastructure, such as roads, water, or technology systems

II. Short-Term Actions and Strategies to Address the Immediate Fiscal Crisis

Reduce Non-Essential Expenditures:

First and foremost, the Legislative and Executive branches must act immediately to make significant expenditure reductions to non-essential programs and activities. Just as lawmakers acted to increase programs in flush budget years, they must now take corresponding action in lean budget years. Reductions are imperative to realign the state's commitments to available revenues and to minimize the deficit in subsequent budget years. When evaluating what cuts to make, the legislature should analyze the impact on the private sector's ability to help the state grow its way out of the deficit.

In particular:

- State agencies should continue hiring freezes in all non-critical areas.
- Reductions should occur in those areas that will not jeopardize the state's competitiveness or economic diversification, impair the ability of the state to leverage federal matching funds, hamper progress on developing the state's transportation infrastructure, or harm education or workforce development.
- Reductions should not be structured in a way that would shift costs to the private sector and result in an in-lieu tax on business.
- Non-essential capital projects should be deferred until the economy returns to growth levels that warrant the investment.
- Automatic statutory expenditure escalators should be reviewed, and where appropriate, suspended until the economy returns to growth levels that were anticipated when the formulas were enacted.

Support a Globally-Competitive Tax Structure: The legislature should advance tax policies that encourage job creation, attract capital investment, and facilitate Arizona's ability to attract and retain businesses in diverse industries.

- To this end, 2009 presents the final opportunity to prevent the tax increase that would result from the reinstatement of the state equalization property tax. The legislature must take affirmative action to avoid the return of this tax and the further drag it would cause to the economy.
- The budget shortfall should not be resolved by raising fees on specific industries, repealing or suspending productive tax policies such as the super-weighted sales factor election, Foreign Trade Zones or Enterprise Zones, repealing or suspending tax credits, deductions, or exemptions that are critical to Arizona's competitiveness, or increasing individual or corporate income or premium taxes.

Maximize Federal Funds:

- The legislature should take full advantage of federal matching funds for eligible programs. Cutting state programs that bring in federal money could result in a net loss to the state that far outweighs any anticipated savings.
- Additionally, the legislature should encourage the U.S. Congress to appropriate sufficient money for chronically underfunded federal mandates.

Implement Revenue-Contingent Appropriations:

- The state should utilize a cascading set of contingent “triggers” to mete out carefully-prioritized, pre-approved successive expenditures (or Rainy Day Fund savings) in the event that actual revenues, by certain dates, exceed the expectations upon which base budget appropriations are calculated.
- The state should utilize a cascading set of contingent “reverse triggers” to effect carefully-prioritized, pre-approved expenditure reductions in the event that actual revenues, by certain dates, fail to meet the expectations upon which base budget appropriations are calculated.
- Public meetings of the Joint Legislative Budget Committee should be used to certify the date certain revenue levels upon which “triggered” expenditures or reductions would be put into effect.

Limit State Government Expenditures Going Forward (Truth-in-Budgeting):

- Require public notice and accountability when the Legislature increases state expenditures by more than the prior year’s budget and the combined percentage increase in the consumer price index and population of the state. Exceeding this spending limit should require approval in a separate resolution with a recorded vote passed by both the House of Representatives and the Senate and approved by the Governor.

Explore Further Privatization of State Government Functions:

- All new and existing spending programs should go through a privatization review to see if that function can be performed less expensively by a private sector entity by contract. Standardized criteria should be used, and these calculations should be similar to the Program Evaluation Review Board (PERB) process of the 1990s.
- The Auditor General’s sunset review process should be augmented to include an analysis of privatization options.

Temporarily Modify School Capital Finance: During the economic downturn and associated budget deficit, the School Facilities Board should not approve any new school construction until the economy recovers unless there is an immediate, critical need and no other method exists to accommodate student population growth.

- Continue to evaluate previously approved new school construction. The School Facilities Board should consider factors such as: any reduction in the 100 day student count, average mileage for students to travel to empty seats at existing schools within

the district, and any reduction in the anticipated student population growth. In every case, health and safety repairs should take precedence over new construction.

- The School Facilities Board should evaluate how it packages school construction projects for either cash or debt financing to determine whether it is possible to debt finance for only the most immediate needs of the project rather than the entire project.
- School districts that have transferred capital funds to their M&O budgets should be required to move those funds back to their capital budgets.
- Building renewal and renovation should occur before new schools are built.
- Local, voter-approved spending for school capital construction, including existing limited access to secondary property taxes, should be used to move forward with any non-emergency based new construction.

Only Utilize Debt Financing for School Capital Construction through FY 2010 with Clear Restrictions: The Arizona Chamber continues its historical opposition to the use of debt financing for the operating expenses of the state. In addition, the Chamber is concerned with the growing burden of debt at the state and local levels and the ability of government to service its ongoing debt financing obligations. It also recognizes that questions exist as to the constitutionality of certain types of debt instruments.

The Arizona Chamber supported the use of debt financing for school construction in FY 2008 and FY 2009 only as a necessary part of a comprehensive plan to close the budget deficit. The Chamber believes that:

- Debt financing should not be used as a means to avoid or forestall program reductions, nor should it be used as a first step to resolving the budget deficit.
- Any General Fund monies freed up from the issuance of debt should be focused exclusively on those activities that support economic growth and diversification and enhance the state's competitive position.
- Any use of debt financing for school construction should be strictly limited to FY 2008, FY 2009, and FY 2010.
- Authorizing statutes should require accelerated repayment as soon as state revenues improve. For example, a budget "trigger" based on revenue growth could require that additional funds be dedicated to the early retirement of financial debt.

III. Long –Term Solutions to Mitigate Future Economic Downturns

Reform the Students FIRST Program:

- Education is a long-standing priority for the Arizona Chamber of Commerce and Industry. The business community recognizes the need to build and maintain an adequate number of schools for the state's growing student population. However, the Students FIRST program needs considerable reform. The program in its current form does not serve the best interest of students or taxpayers and is a burden to the state's General Fund.

- The Arizona Chamber urges the Governor and members of the Legislature to immediately put in place a process that will examine the way that the state finances the construction and maintenance of schools. The Arizona Chamber stands ready to be a constructive partner in developing solutions. The goal of this process should be to implement a new school capital finance program that addresses the requirements of the *Roosevelt v. Bishop* court decision, ensures that school construction is in line with population growth, minimizes the burden on the state's General Fund, and provides safeguards for taxpayers.

Create a Statewide Debt Policy:

- Safeguards should be put in place to ensure the state does not accumulate more debt than it can afford to service.
- The JLBC should publish annually a state debt affordability index.
- The Legislature and Governor should partner with the Arizona Chamber to create a debt policy for the state consistent with fiscally responsible parameters for the use of debt financing for long-term capital assets. The types of debt instruments, terms of financing, the impact of debt on taxation and state expenditures, the state's ability to repay the obligation during the useful life of the asset, identification of appropriate revenue streams for paying off the debt, the total amount of state and local debt outstanding, inflationary expectations, and other sound financial principles should be included in the policy.
- Legal reforms consistent with a thoughtful review of the constitution should be considered so the state has access to optimal, transparent, and straight-forward financing terms.

Preserve the Rainy Day Fund for Its Intended Purpose:

- The Rainy Day Fund should be drawn upon exclusively to help fund productive, established state programs and not to create new programs.
- Most of the Rainy Day Fund was exhausted in FY 2008 and FY 2009 and the remainder is likely to be exhausted in FY 2010. The state should resume contributions to the Rainy Day Fund when revenues improve.

Reform the State Budgeting Process: Due to its importance to the state's economy, state budgeting should be a timely and predictable process. Since establishing a balanced state budget is the primary responsibility of the state legislature, it is critical that the process be structured, transparent, and inclusive. Delayed budget action, especially during economic downturns, magnifies the impact of certain budgetary decisions (such as expenditure reductions), increases uncertainty for state agencies, political subdivisions, and the private sector, and can limit available budgeting options. To ensure the Legislature enacts a state budget in a timely fashion, additional constitutional and statutory provisions should be considered to establish an annual budget schedule and set firm dates for:

- Introducing preliminary legislative budgets and revenue forecasts
- Finalizing revenue estimates
- Completing committee work
- Passing the complete budget

In addition, revisions to the revenue forecasting process should be considered to ensure revenue estimates used for state budgeting purposes are as objective and accurate as possible. Specific ideas include:

- Establishing a joint revenue estimates advisory board
- Formalizing the Finance Advisory Committee and its authority in the state budgeting process
- Augmenting the revenue forecasting tools used by the Legislature and Executive

Enhance Reviews of Agency Budgets and Program Funding Formulas:

- The funding formulas of many key programs are driven by statutes and can be modified by the Legislature. However, there is no systematic review of these formulas. The Legislature should establish a schedule of review by the Auditor General or JLBC for all funding formulas so every major funding formula receives a comprehensive review at least every ten years.
- The Governor's office and the Legislature should review and eliminate redundant, inefficient, or otherwise ineffective programs, especially during hard economic times. Government agency program review should be reinstated.
- Investments in modern computer systems, redesign of administrative processes, and other reforms to agency business practices typically require investments of resources in order to produce long-term savings. During times of economic prosperity, the state should make these investments a priority. The OSPB and State Agencies should annually prepare an efficiency improvement investment plan for evaluation by the JLBC. The JLBC should consider factors such as the potential reduction on application processing time, long-term cost savings of the measure, improvement to customer service, and applicability to other agencies.

Take Measures to Ensure Public Retirement Programs Are Financially Sound:

- The state should take measures to ensure the government retirement systems (ASRS, PSPRS, CORP, EORP) are sound from an actuarial perspective.
- Benefit enhancements that could contribute to the Unfunded Actuarial Accrued Liability (UAAL) of the state should be strictly limited.
- The state should identify ways to enhance investments and minimize the administrative costs of these programs.
- The state should provide a defined contribution option for all new state government employees.

Reform the Initiative Process to Increase Transparency and Prevent Abuses:

- Move up the deadline for initiative petitions to be filed with the Secretary of State.
- Require pre-circulation review of language, content, and constitutionality of initiatives.
- Institute a ballot title and summary review board.
- Reduce fraud in the petition signature gathering process.
- Modify Proposition 105 as passed in 1998 in a prospective way to better allow the Legislature and Governor to set the state budget.

- Consider additional constitutional limits on the ability of the ballot to be used to increase taxes or private sector obligations.

Reduce Wait Times for Government Permits: Every day a business must wait to open because of a delay in a state, county, or city permit, government loses tax dollars and the business loses income. The state should partner with local governments to focus on immediately reducing permit processing timelines for new businesses.

- Create a permit processing task force to streamline permit application processes and develop ways to fast track permits for industries that can generate high levels of tax revenue. The goal is to reduce cycle times and limit barriers to timely permit processing.
- Use this task force to help with the development of a one-stop-shop for small businesses and to make permit applications more consistent across political subdivisions.
- Examine existing state permit timelines mandated by the Administrative Procedures Act and look for reductions in these limits.



The Arizona Chamber of Commerce and Industry is committed to advancing Arizona's competitive position in the global economy by advocating free-market policies that stimulate economic growth and prosperity for all Arizonans.



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