CHILDREN'S ACTION ALLIANCE

State Budget Outlook 2016

What to Look for in the Arizona State Budget

Five Signs of Fiscal Responsibility

The state budget can be a powerful tool to reach our common goals for health, education, security and a vibrant, prosperous future.

Every year in mid-January, Arizona's governor presents his or her budget proposal to the legislature and to the people of the state. This proposal becomes a starting point for public discussion and legislative consideration and negotiation before the new fiscal year begins in July. Adopting a balanced state budget is a major responsibility of our elected leaders. The budget is a blueprint for putting our values and our priorities into action.

All politicians believe in fiscal responsibility. But not all budgets reflect this ideal. Here is a quick guide with what to look for in Governor Ducey's budget. The five signs of fiscal responsibility for the Arizona state budget are:

1. Invests in public education to match resources with expectations for educational achievement.
2. Clearly identifies how new spending or new tax cuts will be paid for—even if they phase in over time.
3. Makes realistic adjustments for higher costs and higher demand in key areas.
4. Sustains strategies that prevent crisis and save on long-term costs and liabilities.
5. Dedicates one-time and ongoing state revenues to build opportunity and strengthen Arizona's economy.

WHAT TO LOOK FOR IN THE BUDGET:
Long term plans for education funding

Tomorrow's economy depends on effective investments in third grade reading success, up-to-date textbooks and technology, safe facilities, and exceptional, experienced teachers.

But Arizona's overall public education system falls far short of these expectations. Since fiscal year 2009, $1.1 billion in annual spending has been cut out of the K-12 budget, contributing to crowded classrooms; outdated textbooks and technology; shortages of arts, sports, school nurses and counselors; and a growing crisis in recruiting and keeping teachers.

In October 2015, the legislature approved sending Proposition 123 to voters to appropriate an average $268 million a year for ten years through the accelerated distribution out of the state land trust and additional general fund dollars. If approved, the plan covers inflation, but leaves other K-12 needs untouched.

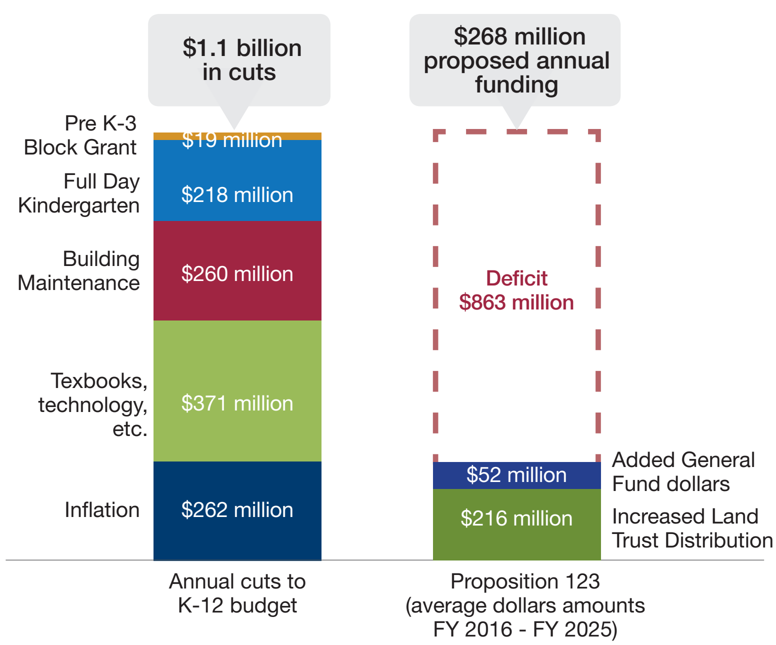
Despite agreement among educators, business leaders, and economists that early education is one of the most important foundations for both educational success and also future job success, Arizona has a $237 million hole in pre-k through kindergarten funding. According to state statute, district schools should be receiving $445 million a year for textbooks, computers, technology, and classroom supplies, but are getting only $63 million. Charter schools are receiving $291 million out of the $310 million they should have.

The 0.6% Proposition 301 sales tax dedicated to public education expires in less than six years—along with more than $500 million in annual funding for K-12 district and charter schools.

What commitments will Governor Ducey's budget make for public education as he campaigns for voters to approve the temporary withdrawal of land trust funds?

What long-term funding plans will Governor Ducey and the legislature establish to meet our educational expectations into the future as both the land trust plan and the Proposition 301 sales tax expire?

Annual Cuts to K-12 Education Far Greater than Inflation Funding in Proposition 123



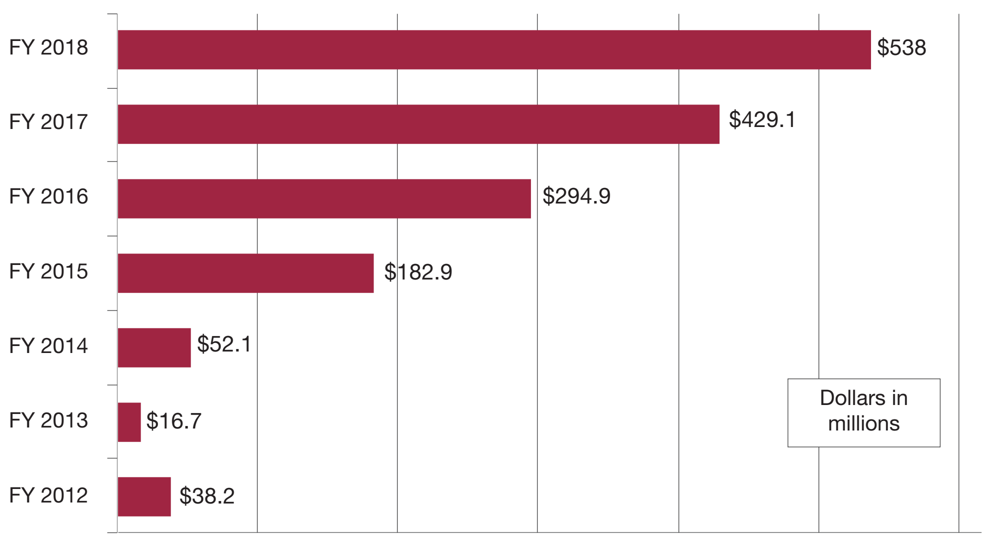
WHAT TO LOOK FOR IN THE BUDGET:
Specific Spending Cuts to Match Proposed Tax Cuts

Even in the depths of the Great Recession, Arizona's legislature passed major tax cuts—a tradition that has been repeated every year since 1990, with the single exception of 2003. The trick used to reduce state revenues by hundreds of millions of dollars and still balance the current budget is to delay effective dates and to phase in large tax cuts over a number of years. The budget is balanced only on the fantasy that the economy will grow enough to make up for the revenue lost to the tax cuts.

Consider the 2011 so-called "Jobs Bill" (HB 2001, 2nd special session). Leading up to this, Arizona revenues had plummeted, leaving policymakers with so few options that in 2010 they reluctantly approved Governor Brewer's plan to refer a temporary 1 cent sales tax to the voters. That sales tax took effect in June 2010, eight months before the "Jobs Bill" was fast tracked through the legislature. Even with the additional revenues from the sales tax, legislative budget staff were projecting the state would end the fiscal year $332 million in the red.

As projected, the first revenue losses coming from the "Jobs Bill" were relatively modest—$38.2 million. Major provisions did not kick in until July 2015. By fiscal year 2018, when this bill is fully phased in, it will cost an estimated $538 million a year—13 times the first year cost. In the meantime, funding for K-12 education, community colleges, universities and other infrastructure important to Arizona's economy has been dramatically cut.

Arizona's "Jobs Bill"
How to Cut Half a Billion Dollars from Revenue in the Midst of the Great Recession



Source: Joint Legislative Budget Committee Staff, Fiscal Note, HB 2001 (2nd Special Session), February 15, 2011.

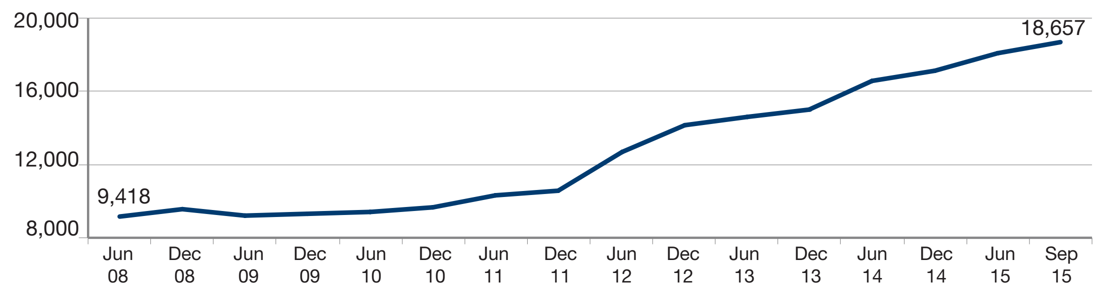
WHAT TO LOOK FOR IN THE BUDGET: Realistic adjustments for inflation and population

It's hard to miss the fact that Arizona's Constitution requires annual inflation adjustments to K-12 funding and that the legislature failed to fully fund those adjustments for several years. There have been budget fights, a lawsuit, a special legislative session, and, in May, a special election to address this issue.

Some other areas of the budget are traditionally adjusted for inflation and population and some are not.

The budgets for AHCCCS and the Department of Corrections are almost always adjusted for expected changes in population. But the budget for foster care doesn't get that same crucial adjustment on a consistent basis. In fact, for FY 2016, the budget was built on the calculation that the number of children in foster care would remain flat -even though the number has been growing steadily since 2012. And funding for child care assistance has been cut dramatically rather than adjusted for the number of families. As a result, qualified working families are routinely moved onto a waiting list with no idea if or when they will be able to participate.

Children in Foster Care, 2008-2015



Source: Department of Child Safety

When it comes to funding inflation and other cost increases, AHCCCS and the Department of Corrections once again are most likely to see yearly adjustments. But the TANF cash assistance levels to help keep the poorest mothers and children out of hunger and homelessness are never adjusted for the cost of living. In fact, the rates were cut by 20 percent in 2009 and today are still based on 36 percent of the 1992 federal poverty level. This makes the maximum monthly amount for a family of 3 in 1992 of $347 worth only $164 in today's dollars.

On the revenue side of the ledger, some things are adjusted for inflation and some are not. For example, due to legislation passed in 2015, the individual income tax brackets are now adjusted each year for inflation. This prevents households from moving into a higher tax bracket if their income has kept pace with the cost of living.

The limit for the individual tax credit for donations to public school extra-curricular activities stays constant and does not go up with inflation. The limit for the individual tax credit for private school tuition scholarships, on the other hand, is adjusted for inflation every year. And the statewide aggregate limit for the corporate tax credit for private school scholarships grows by an incredible 20% each year—doubling every four years.

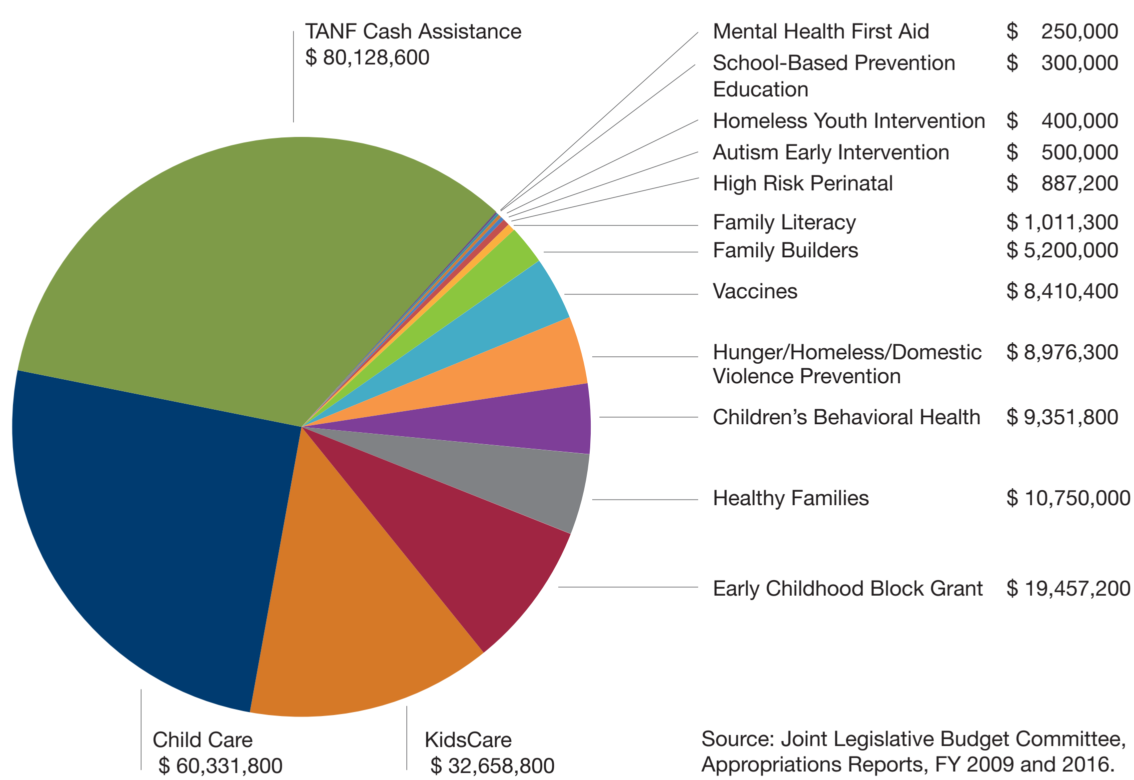
WHAT TO LOOK FOR IN THE BUDGET: Funding strategies that prevent crisis and save on long-term costs and liabilities

"A stitch in time saves nine." "An ounce of prevention is worth a pound of cure." These are proverbs that have been with us for hundreds of years. Our dentist admonishes us to brush frequently to avoid costly cavities or, even worse, root canals. Our mechanic reminds us to keep up on our car maintenance to avoid major repairs down the line. A responsible state budget should reflect these same principles: sustain current year funding strategies that strengthen health care, families, and education and avoid expensive crises in the future.

Since the Great Recession, Arizona has gone in the opposite direction. The legislature has cut out more than $200 million in annual funding for strategies that prevent future problems. Since then, the number of children in foster care has nearly doubled. The rate of children living in poverty and in deep poverty has increased. And our high school graduation rate has gone down. These trends cut deeply into Arizona's economic productivity and multiply basic costs to taxpayers in both state and local governments.

What will Governor Ducey's budget do to prevent hunger, homelessness, child abuse and neglect and family crisis to save costs in future years?

Early Intervention and Prevention Programs Have Been Cut $238 Million Annually Since FY 2009
(General Fund and TANF Dollars)



Source: Joint Legislative Budget Committee, Appropriations Reports, FY 2009 and 2016.

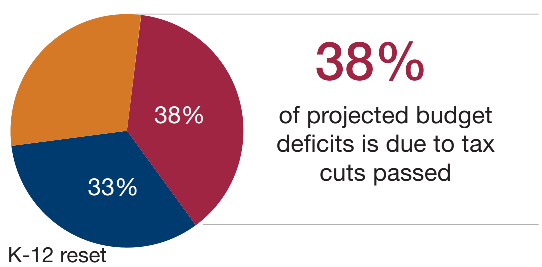
WHAT TO LOOK FOR IN THE BUDGET:
Strategic dedication of one-time and ongoing state revenues

Since the disastrous plummeting of state revenues during the Great Recession, Arizona lawmakers have been focused on re-building our Rainy Day Fund to cushion us during the next recession and building up cash balances. Governor Ducey and legislative leaders have made it a priority to avoid using one-time or temporary revenue spikes to fuel ongoing investments in education, health care, or prevention.

But dedicating short term revenues to tax cuts causes the same mismatch between income and expenses down the road. In fact, tax cuts create an even bigger risk of future state deficits because spending can be cut at any point during any fiscal year by a simple majority vote of the legislature. Reversing or reducing a tax cut or tax credit, on the other hand, requires a two-thirds vote in both the House and the Senate.

The tax cuts passed by the state legislature just since the Great Recession in 2009 accounted for more than one-third of the projected budget shortfall they faced for the current fiscal year. If we hadn't wiped out that $383 million in revenues, we could have avoided ***all*** of the new budget cuts this year to K-12 and higher education, the cuts to child safety and economic security, and the cuts to our health care system.

Tax Cuts Passed Since the Recession Account for More Than One-Third of the FY 2016 $1 Billion Revenue Deficit



Source: Joint Legislative Budget Committee Staff, Finance Advisory Committee.

Without committing to higher spending every year, one-time balances and temporary revenue can be dedicated to upgrade technology in public school classrooms and to repair and upgrade school facilities. Temporary revenues can also be used responsibly to repay debt and to reverse accounting techniques, like rollovers. Arizona currently owes $366 million of annual debt payments and has deferred over $1 billion, "rolling over" payments owed to public schools and contractors with the state into the next fiscal year. If these rollovers aren't paid back, the state will have fewer options when the next recession hits.

Children's Action Alliance

Phoenix Office	Tucson Office
4001 North Third Street, Suite 160	738 North 5th Avenue, Suite 220
Phoenix, AZ 85012	Tucson AZ, 85705
caa@azchildren.org	caa@azchildren.org
Phone: (602) 266-0707	Phone: (520) 329-4930