

Safeguarding & Growing Arizona's Economy

Presented by:

House Speaker Kirk Adams (R-Dist.19)

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GPEC Meeting
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Arizona is experiencing severe economic challenges

- ⦿ Tight Credit Conditions
- ⦿ Consumers scaling back purchases, consolidating finances
- ⦿ Huge overhang of housing supply exists
- ⦿ Businesses under pressure to cut costs, streamline operations to adjust to reduced capital base
- ⦿ Sustained retrenchment in economic output & consumption forecasted
 - U-shape recovery path projected

Unemployment figures underscore crux of the problem

- Arizona's unemployment rate is the highest since 1992
- Private sector sustained second largest job loss rate in the nation over the past year, 2nd only to Michigan
- Job growth in Arizona's government sector increased year-over-year
 - Symptom of relative insulation of the public sector to the severe economic challenges facing the state

In the Last 5 Years General Fund Spending Has Grown \$3.7 Billion

FY '04

\$ 6.5 Billion

FY '09*

\$ 10.2 Billion

*June 08 Enacted Budget

Formula and Caseload Spending Has Grown \$2.2 Billion Since FY '04

	<u>\$ in M</u>
Title 19 Medicaid – AHCCCS/DHS/DES	1,063
K-12 – Student growth & 2% Annual Increase	772
Higher Education Enrollment Growth	106
Dept. of Corrections – Prisoner Growth	<u>218</u>
Total	\$ 2,159

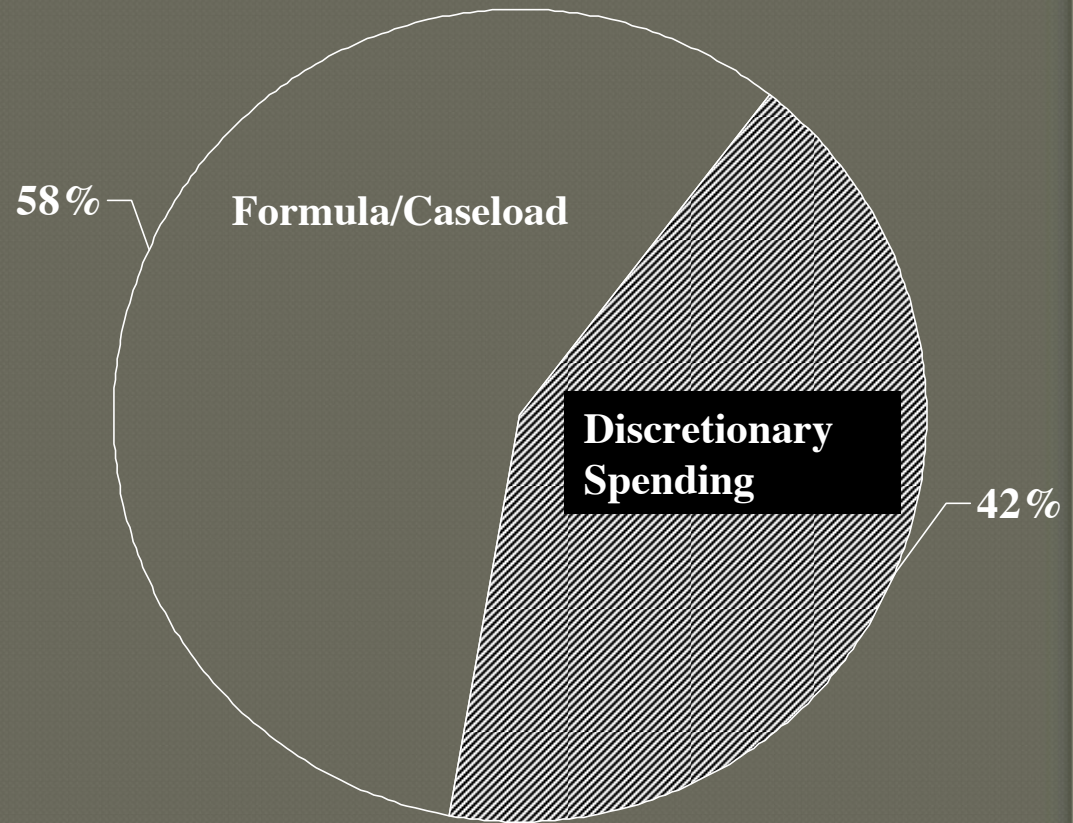
Discretionary Spending Added \$1.6 B to State Budget Since FY '04

	<u>\$ in M</u>
State Employee Pay and Benefit Increases	431
K-12 Formula Backfill/Property Tax Reductions	250
Increase from Half to Full Day Kindergarten	208
Federal Funds Backfill	162
Additional Teacher Pay	151
Debt Service – SFB/Universities	93
Child Protective Services	<u>83</u>
Total	\$ 1,578*

*Total Figure includes \$200 million in other spending increases

Overview of Spending Increases FY 2004 – FY 2009

	<u>\$ in M</u>
Caseload/Formula	2,159
Spending Increases	<u>1,578</u>
Total	\$ 3,737



Risks of Extracting \$3 Billion over the next 3 years from the Private Economy

- Tax increases in the midst of a severe and sustained economic recession impose greater burdens on private sector businesses at a time they can least sustain them
- Makes consumer purchases more expensive
- Tax increases are harmful to job creation and economic growth; extracting \$3 Billion or more from ailing households and businesses erodes the tax base for government spending now and in the medium to long term

Quantifying the Risk

- Study* estimates \$1 Billion tax increase would:
 - Cost 14,400 private sector jobs
 - Real economic output would decline by \$1.2 billion
 - Arizonans total after-tax income would fall by \$760 million, or nearly \$300 per household on average

*Beacon Hill Institute, Suffolk University, Boston, MA

Where Arizona Ranks: Taxation

- TPT collections among the highest of the states already
 - 4th Highest Collections per \$1,000 Income
 - 5th Highest in State/Local Per Capita Taxation
- An 18% TPT increase on Arizonans would:
 - Give Arizona 7th highest TPT/Sales Tax rate among the states
 - Make every city/town in AZ more expensive than NYC
 - Push 30 Arizona cities/towns above the 10% TPT rate
- Commercial property taxes among of most punitive in the Nation
 - Severe handicap on existing Arizona businesses and impediment to business relocation
 - 5th Highest Effective Tax Rate in the nation
- Corporate income tax rates among highest in the region

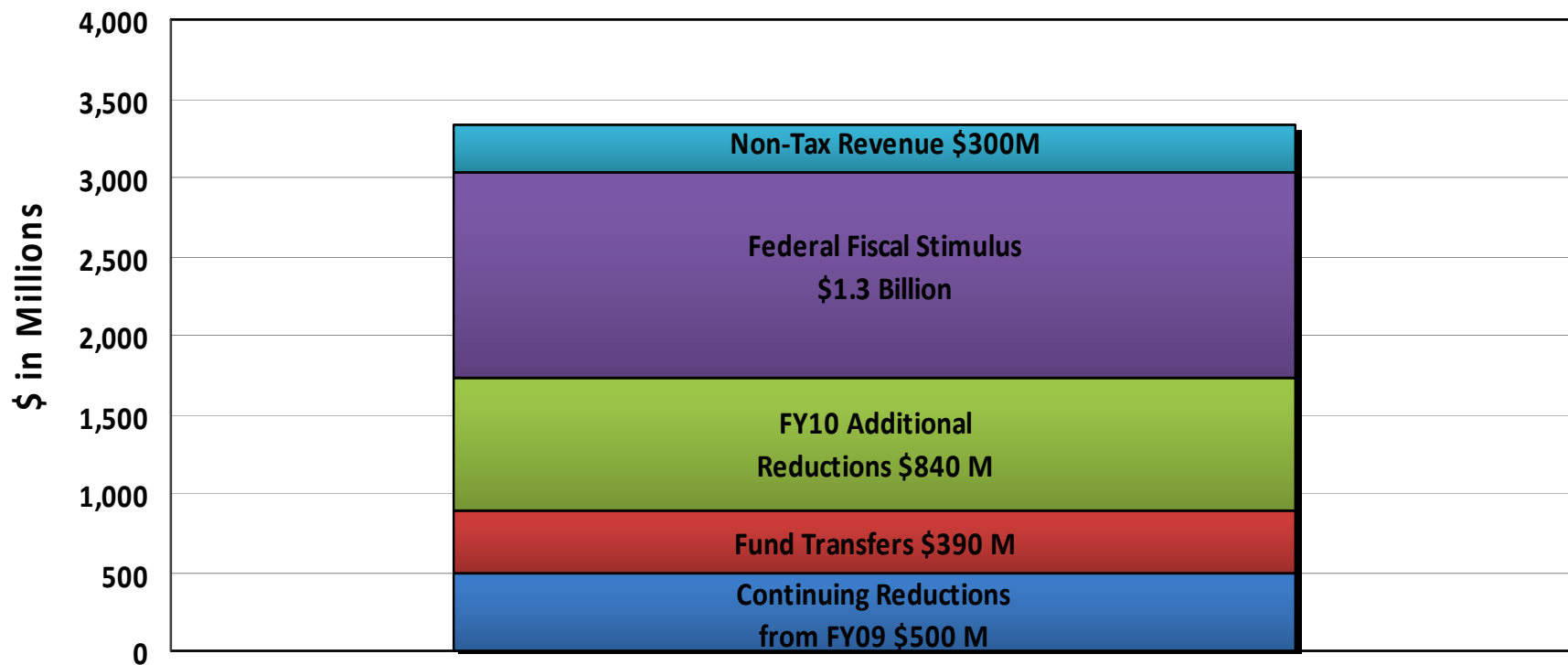
Managing Amid a Downturn

- Recognize the indispensable role private enterprise and households play in making state spending possible
- Craft a Fiscal Policy that rebalances emphasis on easing the burden of the private sector to speed economic recovery that sustains the public sector in the long term
 - Public Sector has grown at an unsustainable rate; substantial, but measured, reductions must occur to reduce structural deficit
 - To greatest extent possible find ways of turning over management of government services/ sale of assets to the private sector; broaden the scope of private economic activity
 - When necessary, consider short/long-term borrowing to shore up fiscal deficits that avoid the risks of a potentially devastating tax increase
- Private enterprise is the water that grows the seed corn

Portfolio Approach to FY10-11 Budgets

- ◉ Spending Reductions
- ◉ Fund Transfers
- ◉ Federal Stimulus
- ◉ Privatization/Concession Agreements
- ◉ Asset Sales
- ◉ Securitization
- ◉ Rollovers

FY10 Budget Deficit Reduction Options



Total Shortfall: \$3.3 Billion

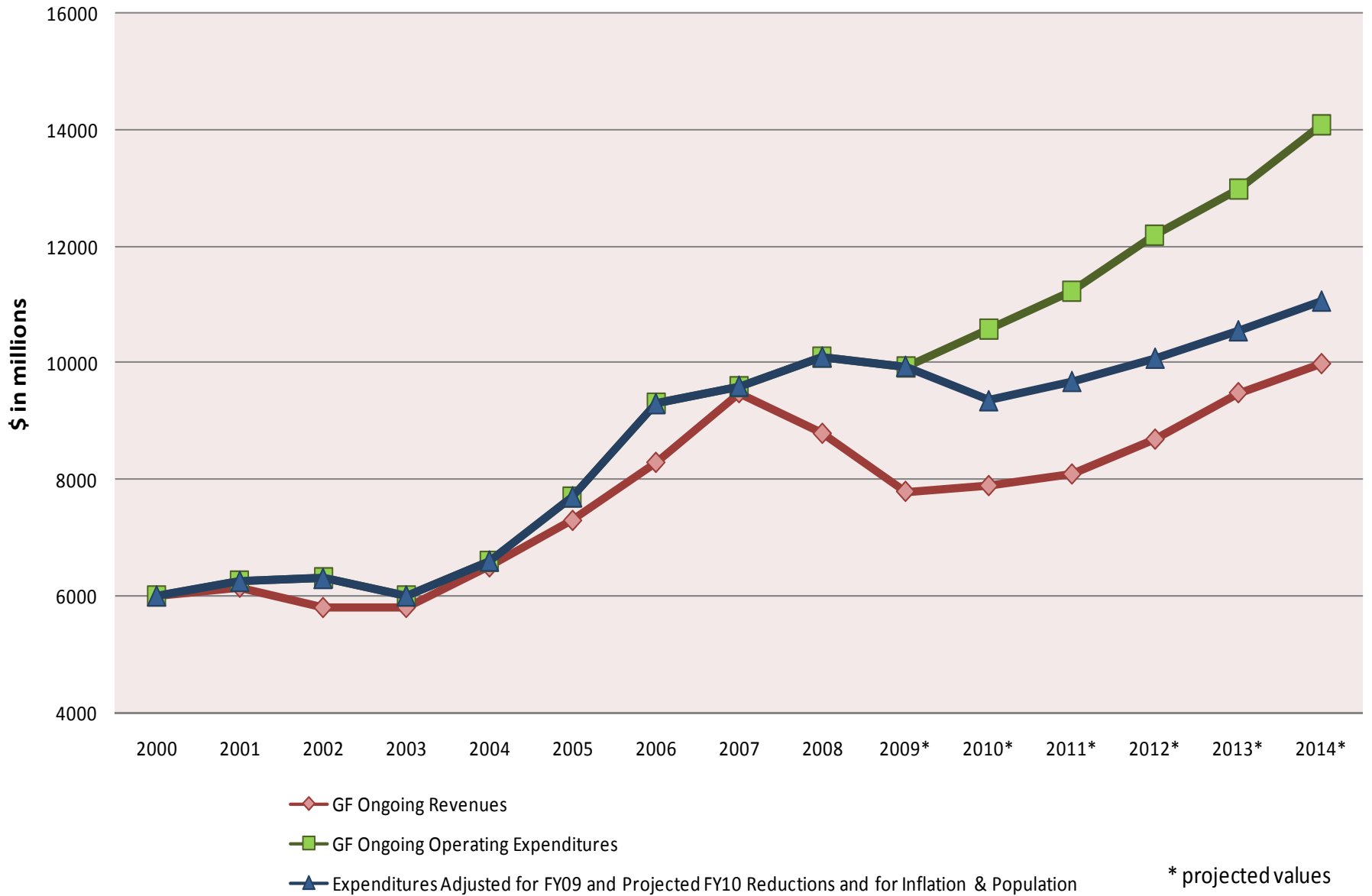
For illustrative purposes, does not constitute an official proposal

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| Continuing Reductions from FY09, \$500 M | Fund Transfers, \$390 M |
| FY10 Additional Reductions, \$840 M | Federal Fiscal Stimulus, \$1.3 Billion |
| Non-Tax Revenues, \$300 M | |

Tax Increases vs. Debt Financing

- Approach to budget akin to managing a company during a severe downturn
 - Borrowing in lieu of passing on a price increase avoids scaring away customer base at the worst time
- Debt financing spreads costs over more than 3 years & allows for early payback as economic conditions improve
 - Unlike previous borrowing proposals to increase ongoing spending, House/Senate intend to protect Arizona families and businesses from the risk of tax increases that impair growth
 - Recognizes spending cuts alone cannot solve FY10 deficit
- Increase in ongoing spending via borrowing likely to be less than foregone revenues from shrinking tax base brought about by tax increase

General Fund Ongoing Revenue and Expenditures



Arizona's Opportunity

- ① The severe economic downturn occurring in Arizona is not simply a budget problem
 - Getting out of the recession requires re-invigorating the private economy
- ① To build a flourishing private sector and robust public services one must address not just fiscal policy, but the tax code as well
- ① Opportunity exists to develop a tax reform package that incentivizes job creation and capital accumulation for Arizona's citizens and businesses