

IMPROVING THE FISCAL SYSTEM OF ARIZONA STATE GOVERNMENT

Prepared for the Arizona School Boards Association

May 2010

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The assistance of Sharla Rex is acknowledged



PREFACE

The support of the Arizona School Boards Association (ASBA) is gratefully acknowledged. However, the recommendations presented in this report are those of the authors only. The sponsorship of the work by the ASBA does not imply that the ASBA endorses these recommendations.

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SUMMARY

Arizona's revenue system has been modified many times over the years, but the changes have occurred in a piecemeal fashion that has failed to recognize that each source of revenue is part of a system—a revenue system that incorporates federal funding, state government revenues, and revenues of local governments (counties, municipalities, school districts, and special districts). Piecemeal changes to the revenue system often have had unintended consequences. For example, becoming more reliant on a general sales tax with a narrow and outdated tax base has increased the cyclical nature of government revenues and has caused those revenues to grow more slowly over the long term.

Further, the revenue system is only a part of the broader fiscal system that includes expenditures and debt. The fiscal system has been largely ignored in Arizona, with changes to the revenue system not being matched to changes in expenditures, and vice versa. For example, decreases in tax rates without compensating reductions in expenditures have caused a fiscal deficit, as has the addition of spending obligations without a revenue source. The result of the piecemeal changes to the revenue system and the absence of a link between revenues and expenditures is a highly dysfunctional fiscal system in Arizona, particularly the portion that relates to state government.

With a focus particularly on state government, this report proposes changes to the fiscal system. These modifications are recommended regardless of the desired amount of revenue; recommendations are specified for each of three revenue scenarios. The recommendations are consistent with, but go beyond, those made by the Citizens Finance Review Commission in 2004. The proposed set of changes to the fiscal system were developed with all of the fiscal system guiding principles in mind, but in particular address the revenue issues of economic competitiveness and stability of revenues and the fiscal issue of accountability.

FISCAL SYSTEM GUIDING PRINCIPLES

Economists and public finance experts years ago reached consensus that a revenue system should exhibit good performance against a set of guiding principles:

1. **Stability:** The revenue system should minimize year-to-year fluctuations in revenues over the economic cycle.
 - Multiple revenue sources should be employed, including taxes, user fees, and federal revenues. Income, wealth, consumption, and transactions all should be taxed.
 - An adequately funded budget stabilization fund should be used to offset the inevitable cyclical fluctuations in revenues.

2. **Responsiveness:** The revenue system should produce revenues that keep pace with long-term growth in the state's economy.
 - The growth of government generally should be targeted to keep pace with economic growth: population plus inflation plus real per capita economic gains. (A system that is responsive to population and inflation only, as suggested in some proposals for an alternative tax and expenditure limit to that currently in the Arizona Constitution, would result in a gradual reduction over time in government services and an inability of state government to respond to emergencies, new technologies, and societal changes.)

- The system should be designed to collect revenues from expanding economic activities.
- Over time, the system should be updated as necessary to keep pace with changing technology, economic mix, and societal structure.

3. **Predictability:** A stable and responsive revenue system produces a predictable stream of revenues, benefiting taxpayers and policymakers.

- The revenue system should be designed based on these guiding principles, then changed only as necessary. Frequent ad hoc changes negatively affect predictability as well as other guiding principles.
- An adequately funded budget stabilization fund greatly enhances predictability.

4. **Efficiency:** Revenue policy should have minimal impacts on economic behavior.

- Revenue sources should be broad based with low marginal tax rates.
- Revenue collections should be matched to public benefits. That is, the direct beneficiaries of government services should pay for the cost of their provision to the extent possible.

5. **Competitiveness:** Revenue policies should promote economic vitality and prosperity.

- The division of the revenue burden between businesses and individuals should be equitable.
- The revenue system should be consistent with that of other states to minimize disincentives for investment. Particular attention should be paid to policies affecting basic (export) industries.

6. **Exportability:** The revenue system should be designed to tax nonresidents as well as residents.

- Taxes paid by tourists, seasonal residents, and other nonresidents as well as by residents should be utilized.
- Taxes and user fees that particularly target visitors also should be employed.

7. **Neutrality:** Differential treatment of similar economic activities should be minimized.

- The use of tax credits and exemptions should be limited.
- Tax credits and exemptions should be periodically evaluated to determine if they contribute to economic development and the common good.

8. **Horizontal Equity:** Revenue policies should treat people of equal means similarly.

- The definition of “equal means” may vary by revenue source, such that the evaluation of horizontal equity needs to be made by source.

9. **Vertical Equity:** The overall tax structure should minimize regressivity.

- Tax payments as a proportion of income should not be higher for those with lower incomes than for other taxpayers.
- Some fiscal experts contend that the overall tax structure (including federal taxes) should be progressive, with tax payments as a proportion of income rising with income.

10. **Simplicity:** The revenue system should be designed to minimize costs of compliance and administration.

- The revenue system should be easily understood by affected businesses and individuals and should minimize compliance costs.
- Revenue rules should be easy to administer by government agencies and should minimize administrative costs.

Each of these 10 guiding principles is specific to the revenue system. However, revenues cannot be examined independently from the rest of the fiscal system. Additional guiding principles apply to a fiscal system. In particular, revenues and expenditures should be linked; this principle is sometimes labeled as **Accountability**:

- Determine the desired level of expenditures per program, then raise sufficient revenues to meet the targeted spending levels on an ongoing basis.
- Changes to the revenue system (such as reductions in tax rates and elimination of revenue sources) should be matched by a commensurate change in expenditures.
- Funding of new programs and changes in the funding level of existing programs should be matched by a change in revenues of a corresponding magnitude.
- Capital expenditures generally should not be paid out of the operating (general) fund.

A key component of accountability is transparency. Detailed reports of revenue sources and amounts and reports of revenue uses and amounts should be readily available.

Another guiding principle of a fiscal system is **intergovernmental complementarity**. State government revenues, expenditures, and debt do not comprise the fiscal system because of the interactions between state government and local governments on one hand, and between the federal government and state government on the other. In particular, state government needs to consider the impact on local governments from changes in state statutes.

Arizona’s fiscal system compares unfavorably to the guiding principles. A qualitative assessment relative to a system of best practices follows:

Guiding Principle	Evaluation	Comments
Stability and Predictability	Poor	Highly cyclical revenues, multiple changes to tax code, poor use of rainy day fund, overemphasis on sales tax, little use of more stable revenue sources
Responsiveness	Poor	Overemphasis on sales tax, whose collections lag behind economic growth due to out-of-date code
Efficiency	Poor	Heavy reliance on certain taxes, some with high tax rates
Competitiveness	Poor	Heavy taxation of corporations and export businesses, particularly through the property tax, though some business tax reductions have been passed in recent years
Exportability	Good	Some of the tax burden is borne by nonresidents
Neutrality	Very Poor	Multiple tax credits and exemptions
Horizontal Equity	Poor	Credits and exemptions are a negative
Vertical Equity	Poor	Heavy and increasing reliance on regressive taxes
Simplicity	Very Poor	Considerable complexity in the tax code of each of the major taxes
Accountability	Very Poor	Repeated violations of the link between revenues and expenditures
Intergovernmental Complementarity	Poor	Limited cooperation between state and local governments, and between the state and federal governments

REVENUE RECOMMENDATIONS

While the following recommendations are consistent with the fiscal guiding principles and with the recommendations made by the Citizens Finance Review Commission in 2004, they particularly emphasize two goals. First, the recommended revenue system directly supports an economic development agenda. Accordingly, the revised tax structure is designed to shift some of the tax burden away from the business sector, where job creation takes place, to individuals who receive most of the direct benefits of public-sector spending. Second, the proposed revenue system is more reliant on sources of revenue that are less volatile. The extreme cyclical nature of revenues during the last 15 years has in part been due to unusual economic cyclical nature, but the alterations to the state's revenue base over that period also increased the volatility of the revenues.

The adoption of a new revenue system is recommended regardless of the amount of revenue to be collected, that is, whether or not revenue increases are desired to combat the persistent deficit in the state government general fund. Three versions of the recommended revenue system are presented:

- Scenario 1: revenue neutral
- Scenario 2: raise \$1.2 billion (eliminate half of the persistent deficit through new revenue)
- Scenario 3: raise \$2.4 billion (eliminate the persistent deficit through added revenue)

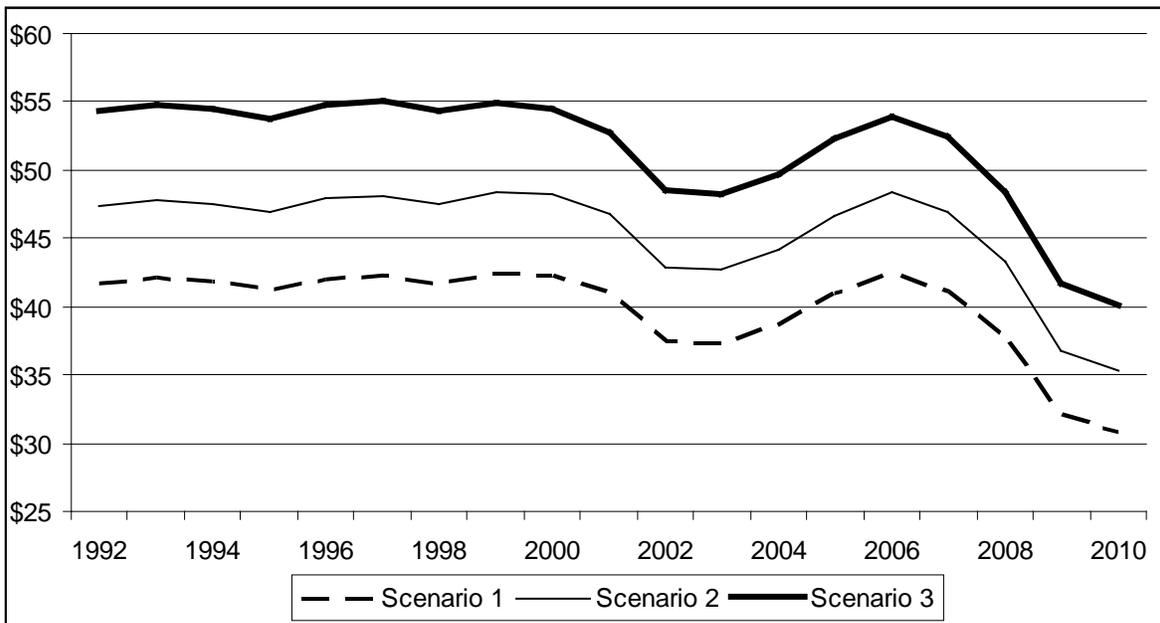
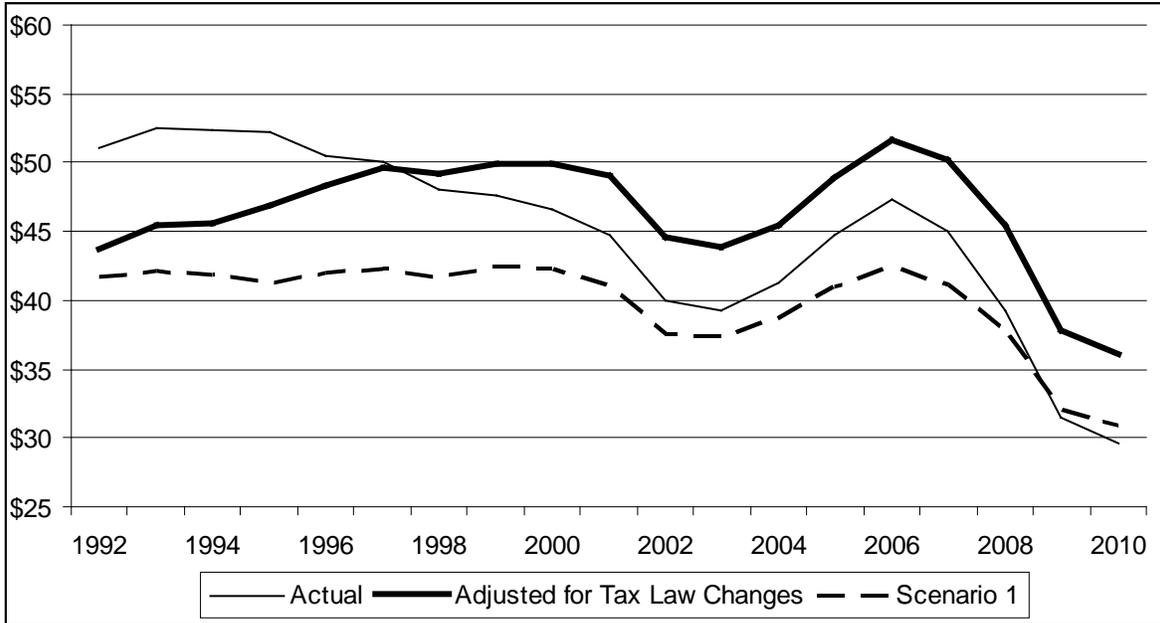
To ensure that the revenue system is optimized relative to all of the guiding principles, changes to the revenue system should be made on a comprehensive basis rather than in a piecemeal fashion. Thus, the following recommendations do NOT constitute a list from which certain changes can be selected and others rejected. The recommendations do not represent the only possible set of improvements to the existing revenue system, but any alternative sets of recommendations must consider the system as a whole and all of the guiding principles.

Based on the concept that the structure of the revenue system should be similar regardless of the amount of revenue to be collected, most of the recommended changes are present in each of the three scenarios. Tax rates vary by scenario to achieve the desired total revenue.

In the top graph of the summary chart on the next page, the amount of state government general fund revenue per \$1,000 of personal income that would have been collected under Scenario 1, the revenue neutral scenario, is compared to actual collections and to what collections would have been had no tax law changes been implemented during the 1990s and 2000s. Revenue under Scenario 1 is more stable than revenue would have been had no tax changes been implemented, rising less on a percentage basis between the 2003 trough and the 2006 peak, and falling less from the 2006 peak through 2010.

Because of the multiple tax reductions implemented since the early 1990s, actual revenue per \$1,000 of personal income has fallen over time, making it difficult to compare to the revenues of the other two lines, which do not display such a downward trend. However, in addition to falling much more from peak to trough in each of the last two cycles, actual revenue rose more between 2003 and 2006 than in the other two lines, indicating that the tax law changes that were made added volatility to the revenue stream as it existed in 1992.

SUMMARY CHART
ONGOING REVENUE PER \$1,000 OF PERSONAL INCOME, ARIZONA STATE
GOVERNMENT GENERAL FUND, FISCAL YEARS 1992 THROUGH 2010



Source: Calculated by authors, based on data from the Arizona Joint Legislative Budget Committee.

Stability is gained in Scenario 1 largely by maintaining a low-rate, broad-based tax structure throughout the period. In particular, the highly volatile revenue sources—sales and income taxes—provide a lesser share of total revenue in Scenario 1, with more stable property taxes, selective sales taxes, and nontax sources making up the difference. That same increase in stability is experienced in Scenarios 2 and 3, as seen in the bottom graph of the summary chart. Revenue in Scenario 2 is about 14 percent higher than in Scenario 1 in every year. Similarly, revenue in Scenario 3 is roughly 14 percent higher than in Scenario 2 throughout the time series.

Thus, the proposed revenue system would achieve one of the primary goals, that of reducing the volatility of government revenues. It is not possible to simulate the effects of the proposed revenue system on economic development and economic competitiveness, the improvement of which is another primary objective of modifying the revenue system. However, to the extent that tax burdens have an effect on economic development and competitiveness, the proposed revenue system provides lower taxes on businesses, particularly export businesses.

Property Tax

The net effect of all of the recommended changes to the property tax is to raise property tax revenue in each of the scenarios, ranging from \$365 million in Scenario 1 to \$965 million in Scenario 3. The share of total general fund revenue provided by the property tax would be considerably higher than under the status quo in each scenario.

An increase in revenue from the property tax is recommended because the property tax produces revenues that are more stable over the course of an economic cycle than the sales or income taxes. In addition, it is underutilized in Arizona relative to the national average. However, business property taxes should be lowered. The tax burden between homeowners and businesses should be shifted to more equitably reflect the use of public resources and to enhance economic development.

Residential property owners receive numerous breaks on their property taxes relative to commercial and industrial property owners. First, the assessment ratio is 10 percent for residential properties, but even after being recently reduced, it will be 20 percent for commercial and industrial properties in 2011. Second, the total amount of property taxes collected on residential properties for primary purposes cannot exceed 1 percent of the parcel's limited property value. Third, residential owners receive a "homeowner's property tax rebate." The rationale for this rebate originally was to assist low-income homeowners, but the rebate was applied to all residential properties.

As a result of these residential tax breaks, the residential property tax burden in most of Arizona is less than half the national average. For example, in Phoenix, the typical property tax on a moderately priced home is more than \$1,000 per year lower than the national norm.

Eliminate the Homeowner's Rebate and 1 Percent Cap

All scenarios. Since the property tax as applied in Arizona is regressive, low-income homeowners should be protected from tax increases resulting from these actions. The first \$xx,000 of the assessed value of improved property (with the precise amount to be determined) should be exempted from the tax.

Eliminate the Personal Property Tax on Business Equipment

All scenarios. The lost revenue from ending the business personal property tax should be offset by the addition of a statewide property tax.

Reinstitute the Statewide Property Tax

All scenarios, with a higher rate in Scenario 3. Apply a uniform assessment ratio to residences and businesses: the current residential rate of 10 percent is suggested. The revenue from the statewide property tax should be dedicated to funding school construction and maintenance. In scenario 3, funding for the School Facilities Board would be removed entirely from the general fund.

Raise the Motor Vehicle License Tax Rate

Scenarios 2 and 3. Since it depends on the value of the vehicle, the license tax is considered to be a property tax. The increase in revenue should be designated to go to the general fund, which received funding from this source in the past.

General Sales Tax

The analysis of the sales tax in this report is relative to the permanent state sales tax rate, not to the temporarily higher tax rate that is in place from June 2010 through May 2013 (additional revenue to the general fund realized from July 2010 through June 2013). The net effect of the sales tax recommendations is to lower sales tax revenue by \$670 million in Scenario 1, to leave sales tax revenue nearly unchanged (a decline of \$85 million) in Scenario 2, and to raise revenue in Scenario 3 by \$500 million. However, in all three scenarios, the share of total state government general fund revenue provided by the sales tax will fall significantly from the existing level of nearly 55 percent to roughly 45 percent.

Lowering the tax rate while extending the base in ways that largely will not affect businesses will effectively lower the business sales tax burden and thus improve economic competitiveness. Broadening the base will result in a more stable revenue stream. Lowering the rate will cause the state to be less highly dependent on the general sales tax for revenue.

Reduce the General Sales Tax Rate

All scenarios. The recommended rate varies by scenario from 3-to-4 percent, down from the permanent statewide rate of 5 percent (not including the 0.6 percent dedicated to education).

Broaden the Tax Base to Include Food to be Consumed at Home

All scenarios. The rate would be set consistently with the rate applied to existing taxable goods. Concerns about regressivity are addressed through a low-income tax credit discussed below.

Broaden the Tax Base to Include Certain Services

All scenarios. Consumer services—personal services (hair care, health clubs, etc.), auto repair services, photography, private professional education services, waste services, building security and maintenance services, veterinary services, and private auto sales—would be taxed. The sales tax also would be reapplied to commercial leases and labor in construction.

Expand the Existing Low-Income Tax Credit for Increased Excise Taxes

All scenarios. Since the sales tax is regressive—low-income families spend higher proportions of their income on items subject to the sales tax than do higher-income individuals—and because low-income households cannot absorb a tax increase (from the broadening of the tax base) as easily as those with higher incomes, the existing low-income tax credit (a refundable credit, not based on income tax liability) should be expanded. The size of the credit will vary by scenario.

Reduce the Number of Sales Tax Exemptions

All scenarios. The numerous sales tax exemptions need to be evaluated. The amount of revenue to be gained from eliminating some of the exemptions is unknown.

Selective Sales Taxes

The net effect of the recommended modifications to selective sales taxes is a revenue gain of \$320 million in Scenario 1 and \$370 million in the other scenarios. State government general fund revenue from “other” taxes would rise in each scenario from zero currently to between 4 and 5 percent of the total revenue. In addition to the following recommendations, all of the taxes that are set at a fixed dollar rate should be converted to a percentage rate so that tax collections rise at the pace of inflation.

The use of selective sales taxes effectively broadens the tax base and reduces cyclicity. Collections from most of these taxes are less volatile than from the general sales and income taxes.

Increase the Tax on Alcoholic Beverages

All scenarios. The modification in this luxury tax should include changing the tax from a fixed dollar figure per unit to a percentage of the price.

Create a Utility Excise Tax

All scenarios. This tax would be applied on power plants for all nonrenewable energy production. Much of the cost would be exported to consumers in other states.

Increase the Motor Vehicle Fuel Tax

All scenarios. Instead of a fixed rate per gallon, which currently is less than the national average, this tax should be shifted to a percentage of the price. A lesser increase in the tax collected is recommended in Scenario 1 than in the other scenarios.

Income Tax

The net effect of the income tax recommendations is to reduce income tax revenue in Scenarios 1 (by \$365 million) and 2 (by \$100 million), and to raise revenue in Scenario 3 by \$165 million. In each scenario, the share of total state government general fund revenue provided by the income tax falls from 34 percent to between 27-and-28 percent.

Individual and corporate income tax collections are volatile, so the decrease in share of total revenue will reduce overall revenue cyclicity. In each scenario, revenue from the corporate income tax decreases in order to improve economic competitiveness.

Review Tax Credits

All scenarios. The public and private school tax credits should be eliminated—recent studies reported by local newspapers have indicated that they have not been effective. Other credits should be reviewed.

Adjust Individual Income Tax Rates

Scenario 1: lower existing rates 10 percent (to a maximum rate of about 4 percent). The decrease in the rate in this scenario is solely to reduce the volatility of general fund revenue; a reduction in the individual income tax rate is expected to have little, if any, effect on economic competitiveness. Scenario 2: no change in rate. Scenario 3: raise existing rates 10 percent (to a maximum rate of about 5 percent).

Set the Corporate Income Tax Rate to be Equal to the Maximum Individual Rate

All Scenarios. The corporate income tax rate would be 4 percent in Scenario 1, 4.5 percent in Scenario 2, and 5 percent in Scenario 3.

Create an Incentive Fund

All Scenarios. Set aside a portion of the corporate income tax collections to be used for targeted incentives, workforce training programs for export-based businesses, or other relocation enticements.

Other Revenue Recommendations

Revenue from other sources is raised in each scenario, by \$350 million in Scenario 1 and \$400 million in the other scenarios. The share of total revenue from such sources would be well above the existing level in each scenario.

The state is overly dependent on taxes to provide revenue; in general tax revenues are more cyclical than fees and other revenues. In addition, the greater use of such fees provides a closer link between those who pay for and receive public services.

Institute a Health Care Provider Fee

All scenarios. A provider fee is a state law that authorizes collecting revenue from specified categories of health care providers. In most states it is used as a mechanism to generate new in-state funds and match them with federal funds so that the state gets additional federal dollars from Medicaid (the AHCCCS program in Arizona). In a majority of cases, the cost of the tax is promised back to providers through an increase in the Medicaid reimbursement rate.

Raise Revenue Through a Combination of Actions

All scenarios, with less revenue raised in Scenario 1. First, expand funding to the Arizona Department of Revenue to increase the number of tax auditors and collectors, thereby raising the net amount of taxes collected. Second, institute a home arrest program for nonviolent offenders (actually a cost savings). Third, examine the fairness and extent of user fees, with the expectation that some fees can/should be raised. Fourth, centralize information on federal funds in an effort to increase the federal grant dollars received. Fifth, improve fiscal practices to raise interest earnings and reduce various expenses.

OTHER FISCAL RECOMMENDATIONS

Even if all of the revenue recommendations are adopted, and even if net revenue is raised by \$2.4 billion as in Scenario 3, the state government general fund will experience a negative balance between revenues and expenditures during every economic down cycle. The only way to avoid spending reductions and/or tax rate increases during an economic recession is to strengthen the budget stabilization fund (BSF).

First, raise the current 7 percent cap on the BSF to 15 percent—or higher if the revenue system is not changed to become less cyclical. Second, change the formula used to allocate funds to the BSF so that more money is transferred into the BSF more quickly following a recession so that a balance of 15 percent can be achieved. Third, tighten the legislation related to the BSF so that BSF funds can be used only to offset cyclical decreases in revenues. Ideally, the operation of the BSF would be placed in the Constitution, with all transfers to and from the BSF made according to the formula.

In addition to strengthening the BSF, accountability needs to be improved. It should be statutorily required that any reduction in tax rates be immediately offset by specified reductions in spending or by increases in other revenues. Similarly, an immediate increase in revenue should be required for any new or expanded spending program, or a comparable amount of other spending should be reduced.

CHAPTER 1

DATA AND DATA MEASURES USED IN THIS REPORT

A particular focus of this report is the state government general fund, which has experienced the most severe imbalances between revenues and expenditures of any of the numerous state and local government funds in Arizona. However, the state's general fund cannot be examined independently of the other funds used by state government, of the finances of the hundreds of local governments in Arizona, or of the revenues received from the federal government. Government revenue in Arizona is one system, regardless of the level of government collecting the revenue. Similarly, government expenditures are a system. Government revenues and expenditures combined comprise (with debt) the fiscal system. Like any system, examining the parts of the revenue system, the expenditure system, or of the fiscal system independently and implementing changes in a piecemeal fashion is likely to result in unintended consequences and a suboptimal system.

DATA

Two primary sources of government revenue and expenditure data for Arizona that are discussed throughout this report are described below. Each source presents data using the state's fiscal year, which runs from July 1 through June 30.

Arizona Joint Legislative Budget Committee

The Arizona Joint Legislative Budget Committee (JLBC) provides state government revenue and expenditure data by fiscal year. Revenue data are available from 1971 through 2009, with a forecast available for 2010. Expenditure (appropriation) data are available for 1979 through 2011. The focus is on ongoing revenues and ongoing expenditures of the state's general fund: revenues raised by state government itself and over which the Legislature has some discretion, excluding transfers to and from other funds. It is the general fund that has been in the news during the last two years because of its large deficit.

Because accounting systems vary by state, it is not possible to directly compare the JLBC's state government data to that of other states. The JLBC data are examined in Chapters 2 and 5.

Census Bureau Government Finance Series

The primary source of data on public-sector revenues and expenditures across the United States is the state and local government finance series compiled by the U.S. Department of Commerce, Census Bureau. (The Census Bureau separately reports public finance data for various components, including state government tax collections and public education finance.) Using a consistent accounting system for all states, the Census Bureau presents in its state and local government finances series fiscal year revenue and expenditure figures for state governments, for the combined total of all local governments by state, and for the combined total of all state and local governments by state. The Census Bureau creates a national total by aggregating the data across all states.

Most of the detail reported by the Census Bureau is for “general” revenues and expenditures, which are the focus of this report. (The Census Bureau also provides information for utility, liquor store, and insurance trust finances.) For Arizona state government, the Census Bureau’s definition of “general” is much broader than the general fund of the Arizona Joint Legislative Budget Committee. Like the state government, local governments utilize special funds as well as a general fund, and are combined by the Census Bureau into its “general” revenues and expenditures.

The revenue reported by the Census Bureau consists of state and local government tax collections, nontax revenue (such as user fees) of state and local governments, and intergovernmental transfers from the federal government to state and local governments. Generally, total expenditures are reported, which consist of capital outlays (purchases of land, buildings, and equipment, and construction of structures) and noncapital expenditures (mostly for current operations). The Census Bureau offers limited detail on capital outlays versus noncapital spending.

The Census Bureau’s government finance series is a rich source of data regarding revenues and expenditures. Its major shortcoming is the lag in publishing the figures: the latest data are for fiscal year 2007. Another weakness of the Census Bureau data is common to that of nearly all sources of public finance data: revenue paid by businesses cannot be separated from that paid by individuals (except that the corporate and individual income taxes have been separated by the Census Bureau in recent years). Similarly, taxes and fees paid by tourists, business travelers, and seasonal residents cannot be isolated from those paid by residents. Thus, tax burdens calculated from the Census Bureau data substantially overstate the direct state and local government taxes paid by the average resident to the home state.

The Census Bureau’s combined state and local government finance data run from fiscal year 1964 through fiscal year 2007, though data for 2001 and 2003 are limited to national totals. In most years, the local government data are derived from a survey of local governments (counties, municipalities, school districts, and special districts), but in years ending in ‘2’ and ‘7’ a census of governments is conducted. Thus, the Census Bureau data in years not ending in ‘2’ or ‘7’ is subject to survey error. In all years, the accuracy of the Census Bureau data is only as good as the data being reported to the Census Bureau by state and local governments across the country.

State government data are examined briefly in Chapters 2 and 5. However, the level of government levying taxes and fees and having responsibility for funding programs varies from state to state. Over time, within any state, these responsibilities may shift between state and local governments. Thus, neither state nor local government finance data alone can be meaningfully compared across states. The combined state and local government data are used most often and are the focus in this report in Chapters 3 and 6.

Comparison of Census Bureau and ATRA Data

The Arizona Tax Research Association (ATRA) has estimated total state and local government taxes collected in Arizona for fiscal years 1980, 1990, and 2000 through 2009. A comparison to the data reported by the Census Bureau is shown in Table 1.1. However, the ATRA total is not directly comparable to the Census Bureau total for two primary reasons.

First, ATRA reports real property tax collections by tax year, not by fiscal year as reported by the Census Bureau. So, the ATRA data need to be adjusted for the timing of the payments received.

Second, the ATRA totals include taxes collected for unemployment compensation and workers compensation. The Census Bureau does not consider these taxes to be general revenues, instead reporting them in its insurance trust fund. So, these taxes must be subtracted from the ATRA total in order to be comparable to the Census Bureau's general revenues.

The result of these adjustments is shown in the right two columns of Table 1.1. Of the eight years that can be compared between the two sources, the Census Bureau reports more revenue than ATRA in four years, including 2007. The Census Bureau understatement is less than 1 percent in three of the other four years. The conclusion is that basing this report on Census Bureau data does not result in an understatement of actual revenues collected in Arizona.

In order to provide additional insight into the annual differences between the ATRA and Census Bureau data, a comparison of the Census Bureau's state government data to that reported by the JLBC and Arizona Department of Revenue (DOR) from 1992 through 2007 was made. This analysis reveals some problems over time in the Census Bureau data. The time series of Census Bureau data relative to the figures reported by DOR (and JLBC) shows various breaks in series in most of the revenue categories. For example, the Census Bureau data for the general sales tax

TABLE 1.1
TOTAL STATE AND LOCAL GOVERNMENT TAXES COLLECTED IN ARIZONA,
SELECTED FISCAL YEARS, 1980 THROUGH 2009

Fiscal Year	ATRA	Census Bureau	Percent Difference*	Adjusted ATRA**	Percent Difference*
1980	\$2,585,074	\$2,738,200	5.9%	\$2,361,133	16.0%
1990	7,263,898	7,040,400	-3.1	6,731,880	4.6
2000	13,740,659	13,333,612	-3.0	13,124,378	1.6
2001	14,466,547			13,817,697	
2002	15,200,913	14,420,322	-5.1	14,551,352	-0.9
2003	15,771,450			15,008,653	
2004	17,411,894	16,481,174	-5.3	16,611,578	-0.8
2005	19,583,007	18,143,242	-7.4	18,547,602	-2.2
2006	22,261,184	21,196,448	-4.8	21,256,266	-0.3
2007	23,940,192	23,334,711	-2.5	22,563,903	3.4
2008	23,733,635			22,427,231	
2009	21,782,254			20,517,759	

* Census Bureau minus ATRA

** Shifts property tax to the year collected and excludes revenue from employee taxes

Note: dollar figures expressed in thousands

Sources: U.S. Department of Commerce, Census Bureau, and Arizona Tax Research Association (ATRA).

for several consecutive years was consistently about 10 percent higher than the DOR figures, suddenly switched to almost equal for several years, then switched again to about 5 percent higher. Such inconsistencies can have a substantial effect on the accuracy of the calculated change over time. Thus, fluctuations in the annual Census Bureau data shown in this report may result in part from data inconsistencies.

In addition to frequently presenting the entire time series of Census Bureau data, it is convenient to compare the 2007 data to that of a particular comparison year. Given the inconsistencies in the Census Bureau time series, the choice of comparison year could distort the findings. To avoid issues regarding sampling error in local government data, the possible comparison years were limited to those ending in '2' and '7.' The criteria used to select the comparison year included the comparability of the comparison year's timing within the economic cycle to that of 2007, and the consistency in the accuracy between the comparison year and 2007 of the Census Bureau's state government revenue data relative to that reported by the DOR/JLBC.

Relative to the DOR data, the Census Bureau's revenues for 2007 are more consistent with the figures reported for 1992 than with the figures reported for 1997 and 2002, though this relationship does not hold for each source of revenue. Another reason to use 1992 as the comparison period is that 1992 marked a turning point in Arizona public finance: the first of a long series of tax law changes that reduced state government revenue took effect in 1993. In terms of the economic cycle, fiscal year 1992 was the first year of economic recovery from a recession, while fiscal year 2007 was near the end of an economic expansion. However, neither 1997 nor 2002 are comparable to 2007 in terms of the point in the economic cycle. Thus, the latest 2007 data are compared particularly to 1992 in this report. (Since the Census Bureau has increased the published detail over time, some revenue and expenditure subcategories are not available for 1992; the comparison is to data for 1993).

STATE COMPARISONS

Cross-state comparisons are valuable because capital is highly mobile in today's economy. Businesses make location decisions in part by comparing the attributes and tax structures of various locations. Recent studies have indicated that the high-paying jobs in expanding 21st century knowledge industries are more mobile than the low-paying jobs that Arizona competed for during the 20th century. Individuals as well as businesses compare states (and local areas) as part of their relocation decision making.

Arizona is ranked among all states throughout this report. In addition, it is compared to eight western states: California, California, Nevada, New Mexico, Oregon, Texas, Utah, and Washington. No standard list of comparison states exists; the list of comparison states varies by purpose, with different groups using different lists even for the same purpose. Some of the common criteria used to select Arizona's comparison state are fast-growing states, the states that are the strongest competitors for economic development, high-technology states, etc. Arizona and the eight western states are commonly included in these various lists.

DATA MEASURES

In order to compare the government finance data of states of widely varying sizes, and to compare data in one state over time as the population changes, the government finance data must

be adjusted. Two measures typically are employed to adjust for size differences in revenues and expenditures: per capita (per person) and per some measure of income (usually “personal income” as reported by the U.S. Bureau of Economic Analysis). If the per capita measure is used to look at data over time, it must be adjusted for inflation.

In this report, the per capita figures are calculated using the average of the beginning and end of the fiscal year population; state population estimates are produced by the Census Bureau just once a year, as of July 1. Personal income and inflation, as measured by the gross domestic product implicit price deflator, are available quarterly. To match to the fiscal year, quarterly personal income and inflation from the third quarter of one calendar year through the second quarter of the next year were averaged.

The per capita and per income measures are limited by not capturing socioeconomic and demographic differences by state that affect the levels of revenues and expenditures. Tourists and seasonal residents are not counted in the population and their incomes are not included in personal income, yet they pay a portion of the public revenues collected in each state—a higher proportion in Arizona than in most states. In addition, most of the public finance data do not distinguish between revenues paid by businesses and those paid by individuals. These limitations are addressed by certain specialized studies of public finance that are discussed in one or more chapters of this report.

Per Capita

The per capita measure is simple and straightforward—for example, total taxes divided by population—but it is criticized for not considering the concept of ability to pay. For example, the same amount of per capita taxes in a state with low incomes will be more of a burden to taxpayers than in a state in which residents have higher incomes. From one perspective, acknowledging differences in income levels (the ability to pay) across states is important. From another perspective, however, a highly progressive tax system can collect average per capita revenue in a state with low incomes without unduly burdening those with low incomes.

Moreover, states with low incomes have greater demands for their public services. Limiting tax collections (and therefore expenditures) to the average ability to pay could compromise the capacity of the state to address income and related issues, helping to perpetuate those problems. Similarly, limiting the amount of spending in a poor state will equate to a lower quality and/or lesser quantity of infrastructure and other government services in that state relative to other states. In turn, subpar infrastructure and government services will limit the poor state’s economic development, perpetuating its status as a poor state.

Another drawback to comparing per capita measures across states is that the cost of living varies by state. Research has shown that a meld of unadjusted and cost-of-living-adjusted data provides the best comparison across states. However, a state-level index of living costs is not regularly produced. Various efforts to produce cost-of-living indexes have consistently shown Arizona’s living costs to be close to the national average. Thus, adjusting for the cost of living has little impact on Arizona’s comparison to the national average, but the ranking of states is different after adjusting for living costs.

While the per capita measure has limitations, so do the alternative methods of comparing government finance data over time and across states. Thus, the per capita measure as well as the income measure (described below) is presented in this report to compare government revenue and expenditure figures *for a given year*. Per capita analyses *over time* are *not* recommended. Inflation-adjusted per capita incomes in the United States rise over time due to productivity gains by an average of close to 2% per year. In an increasingly affluent society, government tax collections per capita can rise without the tax burden increasing. Thus, over time it is important to consider changes in income when analyzing government finance data.

Moreover, a growing and changing economy creates additional costs to the public sector and additional demands for public services, requiring the growth of public revenue to keep pace with economic growth. For example, government agencies and schools have expended substantial monies to acquire computer hardware and software to keep pace with the technological changes.

Relative to Income

The most common way to account for size differences across states and over time is to divide the government revenue or expenditure figures by income. Use of this measure simultaneously adjusts for population growth, inflation, and per capita economic growth. The same sort of adjustment can be made using other economic measures, such as gross domestic product by state. However, when the purpose for using an income measure is to adjust for the ability to pay, the ideal is to use a measure of income that focuses on the cash income of individuals. Measures such as gross product are too broad for that purpose. However, gross product is likely the best adjuster to use to assess business tax burdens.

Various estimates of income are produced by different organizations. Four sources were recently examined (see *The Magnitude and Causes of Arizona's Low Per Capita Income*, February 2010, <http://wpcarey.asu.edu/seid/ccpr/P3reports.cfm>): personal income as estimated by the U.S. Bureau of Economic Analysis (BEA), a variant of personal income estimated by the Tax Foundation, adjusted gross income as reported by the Internal Revenue Service (IRS), and money income reported by the Census Bureau from decennial censuses and the American Community Survey. Use of the two latter measures is limited by the unavailability of a long time series of estimates.

Each income measure has various shortcomings. Personal income, as calculated by the Bureau of Economic Analysis, is designed to measure payments to factors of production, not the money income of households. It is conceptually inappropriate to use as a measure of cash income received during a particular period due to its inclusion of noncash income and income not received by individuals, and its exclusion of capital gains. Its methodology for estimating retirement income is a particular issue for Arizona.

The Tax Foundation adjusts for the most significant shortcomings in the Bureau of Economic Analysis's measure when used as a gauge of cash income. However, since detail by income type is not available, the Tax Foundation's measure cannot be fully evaluated.

The Census Bureau's estimate of income is subject to survey error. In particular, the income of people living in group quarters is extremely high in Arizona relative to the national average.

Other than this issue, the primary concerns with using the Census Bureau's measure are its exclusion of capital gains, its apparent underreporting of most types of income (especially dividends, interest earned, and rental income), and the likelihood of erratic results from year to year due to survey error.

The income measure of the Internal Revenue Service is limited to taxable income and does not reflect the income of those taxpayers with taxable income who do not file a tax return. It measures adjusted income rather than gross income.

In 2007, the latest data available for all four measures, per capita income in Arizona ranged from 7 percent below average based on the Census Bureau's data to 13 percent below average based on the Bureau of Economic Analysis's data. This wide range indicates a need to determine which of the measures may be more accurate for Arizona.

Total income consists of income of various types, including wages, self-employment income, retirement income, capital gains, dividends, and interest earned. Per capita income in Arizona relative to the U.S. average varies across the four measures largely for two reasons: (1) differences in the value of aggregate income by type due to definitional and methodological differences; and (2) variations in the per capita difference in income by type between the national average and Arizona.

The largest single cause of the differing estimates of Arizona's overall per capita income relative to the national average is the very different way the BEA has of handling private retirement income. The BEA indicates that per capita retirement income in Arizona is less than the national average while the IRS and Census Bureau show that it is greater than average. If the goal is to measure cash income received during a year by residents, the BEA's methodology is inappropriate.

The second largest cause of the differences across the measures is in the dividends, interest, and rent (DIR) category. While each measure indicates that Arizona's per capita DIR income is less than the U.S. average, DIR's share of total income is much higher according to the BEA. From the perspective of cash income, the BEA overstates DIR, but the IRS understates it due to only including the taxable portions. It appears that respondents to the Census Bureau surveys underreport DIR (nationally and in Arizona).

Transfer payments other than retirement also are a significant cause of the differing estimates of per capita income in Arizona relative to the national average. This is mostly due to the BEA including medical benefits that the IRS and Census Bureau do not include since these benefits (primarily Medicare and Medicaid) do not represent cash income.

The IRS also differs from the BEA in that the negative effect of low per capita earnings (self employment and wages and salaries) is not as great according to the IRS. However, this is offset by the IRS including capital gains, which are below the per capita average in Arizona.

The income measures from the Tax Foundation and the Internal Revenue Service have the least conceptual objections and are in the middle of the range of estimates of the magnitude of

Arizona's income shortfall. Arizona's per capita income in 2007 was 10.2 percent less than the national average according to the IRS and 11.6 percent below average according to the Tax Foundation. While this differential is relatively small, the differences were larger in the preceding five years. It is not possible to ascertain whether the IRS or the Tax Foundation provides the more accurate gauge of income in Arizona.

Personal Income

Despite its shortcomings as an adjuster for revenue and expenditure data, personal income as reported by the BEA is the most heavily used income measure for such purposes. It has been available annually for decades and is the most promptly and regularly released of the income estimates. Personal income is used in Arizona statutes and in the Constitution for purposes such as the calculation of the appropriation limitation and the operation of the budget stabilization fund.

Despite its limitations, the personal income measure is used in this report. The only alternative that is available for a long-enough time period is the Tax Foundation's income measure. An inability to fully evaluate this measure, as well as its transference of portions of the tax burden across states to the ultimate payer (for example, Alaska's high severance taxes are ultimately paid by consumers throughout the world, not by Alaskans), leads to a hesitation to use the Tax Foundation's income measure.

Revenues and expenditures per \$1,000 of personal income, along with the per capita measure, are used to compare government revenue and expenditure figures *for a given year*. The reader, however, is encouraged to remember that the personal income measure understates income in Arizona relative to other states. The exact magnitude of the understatement of income cannot be pinpointed and varies by year. Relative to the Tax Foundation estimate, the difference in recent years, including 2007, has been only about 1 percentage point, though the difference exceeded 2 percentage points in 1992 and in other earlier years. The differential relative to the IRS estimate is larger at more than 4 percentage points from 2002 through 2006 and 2.5 percentage points in 2007.

Thus, revenues and expenditures per \$1,000 of personal income in Arizona are overstated relative to the national average and to other states. For example, in 2007, state and local government own-source revenue per \$1,000 of personal income was 5 percent below the national average in Arizona, as reported by the Census Bureau. The differential was 6 percent based on the Tax Foundation measure and 7.5 percent based on the IRS data. In contrast, Arizona was 16 percent below average on the per capita measure.

When comparing government revenues and expenditures *over time*, it is important to consider gains in real per person income. Thus, despite its shortcomings, the personal income measure is preferred to the per capita measure when comparing data over time. Measurement issues in the personal income measure have been present for decades, thus its use to adjust the change in revenues and expenditures over time does not significantly bias the estimated changes.

Other Measures

The tax burden is simply the amount of taxes paid relative to income. Various measures of the tax burden are reported in Chapter 4, including the total tax burden based on Census Bureau data. Other than for the income tax, in which the individual and corporate tax receipts are separated, the Census Bureau data cannot be used to differentiate between taxes and fees paid by businesses and those paid by individuals. Thus, the tax burden calculated from the Census Bureau data is an overall tax burden, representing a meld of businesses and individuals.

The Tax Foundation also produces an overall measure of the tax burden (of individuals and businesses combined). It uses an alternative definition of taxes paid from that used by the Census Bureau. The Tax Foundation also uses a measure of income other than personal income.

Ernst and Young estimates the amount of taxes paid by businesses, allowing a business tax burden to be calculated. An individual tax burden can be calculated from the Ernst & Young data by subtracting business taxes from total taxes.

The government of the District of Columbia estimates the tax burden of households using a very different method. It calculates the amount of taxes that would be paid by a hypothetical household at five income levels in the largest city of each state. While the results can provide high-quality information for the hypothetical household, the findings should not be generalized to other households.

An attempt to control revenues and expenditures for socioeconomic and demographic differences, as well as for variations in living costs, from state to state is discussed in Chapter 7.

CHAPTER 2

STATE GOVERNMENT REVENUE

Arizona state government operates numerous funds, such as the emergency telecommunications services revolving fund, state aviation fund, underground storage tank revolving fund, and utility regulation revolving fund. Most are small (less than \$40 million in annual revenue), receive their revenue from narrow sources, and are greatly restricted in how the monies are spent. The highway user revenue fund, in contrast, has received approximately \$1.3 billion in revenue in recent years. It has multiple revenue sources, with the largest being the motor vehicle fuel tax, the vehicle license tax, and the use (diesel) fuel tax. The unemployment compensation fund had funding of just more than \$300 million in recent years, but a large federal reimbursement in fiscal year 2009 pushed the amount to \$587 million.

In contrast, not only is the general fund much larger, but its revenue comes from multiple sources and is expended for multiple uses. The Legislature has considerable discretion over the general fund, which is the primary focus of this chapter. The discussion in this chapter is limited to ongoing revenue collected from Arizona tax and nontax sources. This excludes revenue transferred to the general fund from other funds, which have been significant in recent years, and monies received from the federal government. Federal funding always is significant, but was even more so in the last couple of years due to the large federal stimulus package.

This first part of this chapter relies on state government revenue data from the Arizona Joint Legislative Budget Committee (JLBC). Data run from fiscal years 1971 through 2009, with projections included for the current fiscal year (FY), which runs from July 1, 2009 through June 30, 2010. Unless otherwise noted, years referred to in this chapter are fiscal years.

Ongoing revenue deposited to the general fund as defined by the JLBC is different from the “general” state government revenue defined by the U.S. Census Bureau (discussed later in this chapter). Other than utility and insurance trust funds, the Census Bureau groups Arizona’s many funds into its “general” category.

General fund revenues are highly cyclical. In addition, many statutory tax changes have been made over time that affect the amount of revenue deposited to the general fund. Cyclicity and tax law changes are discussed first. This is followed by a discussion of general fund revenues as reported by the JLBC, then by an analysis of state government general revenues as reported by the Census Bureau. Combined state and local government revenues are discussed in the next chapter.

REVENUE CYCLICALITY AND THE BUDGET STABILIZATION FUND

Economic growth rates around the globe rise and fall over a period of a few-to-several years. The typical cycle consists of a period of economic growth—which sometimes is divided into recovery, expansion, and slowdown phases—and a shorter period during which the size of the economy contracts (after adjustment for inflation). In the United States, the typical economic cycle through the 1950s had a length of only about four years. Since then, some cycles have been longer, up to 10 years in length.

The economy of each region is cyclical, though not all regional economic cycles coincide with the national cycle. The timing of Arizona's economic cycle usually is quite similar to the national average, but the difference in growth rates from the cyclical peak to trough are unusually large. In fact, Arizona has had the second-most cyclical economy in the nation since 1950.

All of the states with the most volatile economies are in the South or West. The common link between these states is their rapid population growth. Nationwide, the construction and real estate sectors experience substantial cyclical. In fast-growing states in which these sectors account for an above-average share of economic activity, the overall economy is relatively more cyclical.

Some industries are not as cyclical as others and some industrial cycles do not follow the national business cycle. Thus, economic diversification can help to reduce the overall cyclical of a regional economy, but the effects of diversification on cyclical are modest.

Relative to the national average, in the typical economic cycle Arizona's economy grows much more rapidly during economic expansions but declines as much during recessions. During expansions, Arizona's much more rapid aggregate economic growth results mostly from its much greater population growth rate, not from a better performance on productivity and prosperity indicators.

Revenue Cyclical

Across the nation, government revenue collections are more cyclical than the economy. Rates of growth in revenue collections are much higher during business expansions and much lower in recessions than growth rates in economic measures, such as personal income. The period of weakness in government revenue growth is longer than the period of slow economic growth.

While government revenues rise and fall during the economic cycle, the overall demand for government services rises at a relatively steady pace throughout the business cycle. Demand for most services rises less rapidly during recessions, but the demand for some public services is countercyclical, rising more during recessions when people lose their jobs and qualify for government-provided healthcare benefits and welfare programs.

Thus, the cyclical of revenues is not matched by a similar cyclical in spending needs. This mismatch between available revenue and spending needs during recessionary periods is at the core of public finance issues. This is discussed in more detail in Chapter 8.

Revenue cyclical in Arizona is among the greatest in the nation, in part due to the high cyclical of its economy and in part due to the structure of the revenue system. State general fund revenue is especially cyclical, since 90 percent of the revenue comes from two highly cyclical sources: the income tax and sales tax.

Income tax revenues—from both the corporate income and the individual income tax—are especially volatile. The volatility of revenue from the individual income tax has increased since the mid-1990s—mostly due to realized capital gains fluctuating widely.

Until recent years, sales and use tax collections in Arizona were more cyclical than the economy but much less volatile than the income taxes. However, sales and use tax collections have fallen substantially during the last three years.

A reduction in the state's economic cyclical volatility would reduce its public revenue volatility. However, economic diversification will do little to reduce the cyclical volatility of the Arizona economy or its public finance. The only way to substantially reduce economic cyclical volatility is to reduce the state's rate of population growth so that construction and real estate are not so important.

Revenue cyclical volatility also can be reduced by widening the tax base and relying more on nontax sources, such as user fees. However, cyclical volatility cannot be eliminated. Thus, the key to managing government finances over an economic cycle is an adequately funded rainy-day fund.

Budget Stabilization Fund

In the private sector, an economic slump reduces demand for goods and services. The drop-off in sales leads to a general reduction in business activity, frequently resulting in layoffs of personnel no longer needed. In the public sector, however, demand for most public functions does not decline and demand for some programs rises countercyclically. Government revenue collections, however, are highly cyclical, falling during economic downturns.

Therefore, it is especially important for the public sector to have funds set aside to offset revenue decreases during an economic decline. In order to minimize the need to enhance revenue and/or reduce spending during an economic downturn, all states have adopted a rainy-day fund, generally known as a budget stabilization fund (BSF). Continued public spending during a recession using BSF monies helps mitigate the impact of a recession. When the economy is strong, use of a rainy-day fund helps control public expenditures by setting aside, rather than spending, excess revenue.

Arizona has had a BSF since 1990. However, it has been modified and weakened in various ways since it was first created. The BSF was originally designed to hold as much as 15 percent of the general fund budget, with payments into and out of the fund dictated by a formula. This formula was modified, the 15 percent cap was lowered to 7 percent, the formula was not followed, and certain expenditures were made from the BSF for purposes other than revenue stabilization. In particular, the reduction in the maximum size of the BSF has resulted in far too little money being put aside to balance the budget during each of the two recessions that have occurred since the BSF was created.

HISTORY OF TAX LAW CHANGES

Significant statutory changes to the Arizona tax code have been implemented over the last 30+ years. Tax collections were reduced significantly between 1979 and 1981. Decreases in property tax rates caused collections to drop in 1979 and 1980, and the sales tax on food to be consumed at home was eliminated in 1981. The substantial reduction in revenue that resulted from these changes was worsened by two economic recessions between calendar years 1980 and 1982. The result was a significant imbalance between revenues and expenditures that was solved by a combination of spending reductions and a temporary increase in the sales tax rate. Even with a strong economic recovery that began in 1983, the budget could not be balanced without

maintaining the higher general sales tax rate. Thus, this higher rate was made permanent in 1984. Despite this rate increase, tax collections per \$1,000 of personal income remained below the levels of the late 1970s.

In the mid-1980s, few changes were made to the tax code. After 1986, the state economy weakened substantially, lowering general fund revenue. At the same time, spending skyrocketed for the Arizona Health Care Cost Containment System (AHCCCS, the state's alternative to Medicaid). (Prior to the mid-1980s, spending on indigent health care was a county, not state, responsibility.) The result of declining revenues and expanding expenditures was a growing budget deficit.

Tax Law Changes Since 1989

Beginning in 1989, the JLBC has estimated the revenue impact of statutory tax law changes, as seen in the leftmost column labeled "Nominal" in Table 2.1. (The estimates are based on when the tax changes took effect, not the year in which they were passed by the Legislature.) The cumulative effect of the tax changes has been estimated in four ways in the table: in unadjusted (nominal) dollars, adjusted for inflation, adjusted for inflation and population growth, and adjusted for inflation, population growth, and real per capita economic growth (as measured by personal income). Cumulative figures are shown starting with the first tax increases in 1989 and also starting with the first tax reductions in 1993.

In order to annually balance the general fund, as required by the Arizona Constitution, tax increases and spending reductions were implemented from 1989 through 1991. Collections were increased from various taxes, most notably the individual income tax. Expressed as a percentage of the general fund, the effects of the tax law changes were large from 1989 through 1991, raising revenue at least 3.6 percent in each of the three years. The cumulative effect of these tax increases was to raise state government general fund revenue by nearly \$450 million per year by 1992 on a nominal basis.

Actual ongoing revenue per \$1,000 of personal income is shown in Chart 2.1 along with an estimate of what the revenue would have been had no tax law changes been passed. Revenue adjusted for the tax law changes would have fallen through 1992 due to the weak economy. However, actual revenue rose due to the tax increases that were implemented between 1989 and 1991.

After 1992, the Arizona economy began to strengthen, causing a cyclical recovery in revenue to begin. The magnitudes of the initial tax cuts passed in 1992 and 1993 were small and/or the reductions were phased in since revenue collections still were weak and continued spending increases for AHCCCS were occurring. The Arizona economy strengthened further during 1994, with growth rates reaching boom conditions in 1995. The cyclical surge in revenue that resulted allowed subsequent tax reductions to be much larger. Between 1995 and 2001, the annual decreases in revenue ranged from 1.8 to 6.5 percent of the size of the general fund. The tax increases of 1989 through 1992 were reversed by 1996 on a nominal basis, by 1997 on a real basis, and by 1998 on a real per capita basis and relative to personal income.

TABLE 2.1
ESTIMATED DOLLAR VALUE OF TAX CHANGES, ARIZONA STATE
GOVERNMENT GENERAL FUND, FISCAL YEARS 1989 THROUGH 2010

Fiscal Year	Cumulative Since 1989					Cumulative Since 1993			
	Nom- inal	Nom- inal	Adjusted for			Nom- inal	Adjusted for		
			Infla- tion*	Infla- tion & Popu- lation*	Per- sonal Income		Infla- tion*	Infla- tion & Popu- lation*	Per- sonal Income
1989	\$121.7	\$121.7	\$195.0	\$195.0	\$121.7				
1990	109.3	231.0	364.0	368.0	237.8				
1991	208.4	439.4	674.0	686.5	459.6				
1992	9.7	449.1	688.1	721.8	494.2				
1993	-19.3	429.7	660.7	720.4	510.4	\$-19.3	\$-27.4	\$-27.4	\$-19.3
1994	-25.5	404.3	625.5	714.8	527.8	-44.8	-62.6	-63.7	-46.4
1995	-120.7	283.6	461.8	582.8	462.0	-165.5	-226.2	-230.2	-171.9
1996	-284.7	-1.1	83.4	227.3	214.6	-450.2	-604.6	-617.7	-470.5
1997	-174.5	-175.6	-144.4	7.2	58.0	-624.7	-832.5	-866.3	-684.4
1998	-172.4	-348.0	-366.3	-214.5	-108.9	-797.1	-1,054.4	-1,115.8	-920.9
1999	-141.8	-489.8	-546.5	-401.1	-260.0	-938.9	-1,234.6	-1,329.2	-1,140.9
2000	-104.6	-594.4	-677.2	-543.2	-386.1	-1,043.5	-1,365.3	-1,497.9	-1,340.1
2001	-157.8	-752.2	-869.7	-750.7	-574.5	-1,201.3	-1,557.8	-1,731.7	-1,604.0
2002	-33.2	-785.4	-909.4	-810.9	-629.2	-1,234.5	-1,597.5	-1,818.7	-1,697.2
2003	12.4	-773.0	-894.9	-818.0	-642.4	-1,222.1	-1,583.0	-1,852.6	-1,753.8
2004	57.4	-715.6	-828.9	-774.8	-631.7	-1,164.7	-1,517.0	-1,838.2	-1,824.1
2005	-4.9	-720.5	-834.4	-806.5	-701.7	-1,169.6	-1,522.5	-1,905.8	-2,016.8
2006	-18.1	-738.6	-853.9	-855.6	-795.7	-1,187.6	-1,541.9	-1,995.5	-2,253.2
2007	-193.8	-932.3	-1,056.2	-1,085.2	-1,050.1	-1,381.4	-1,744.3	-2,261.4	-2,618.5
2008	-217.5	-1,149.8	-1,278.1	-1,333.7	-1,312.3	-1,598.9	-1,966.2	-2,538.6	-2,947.5
2009	-34.6	-1,184.4	-1,312.6	-1,392.4	-1,334.0	-1,633.5	-2,000.7	-2,619.3	-2,953.1
2010	-42.4	-1,226.8	-1,354.6	-1,445.1	-1,349.7	-1,675.9	-2,042.7	-2,681.4	-2,936.5

* Expressed in 2009 dollars

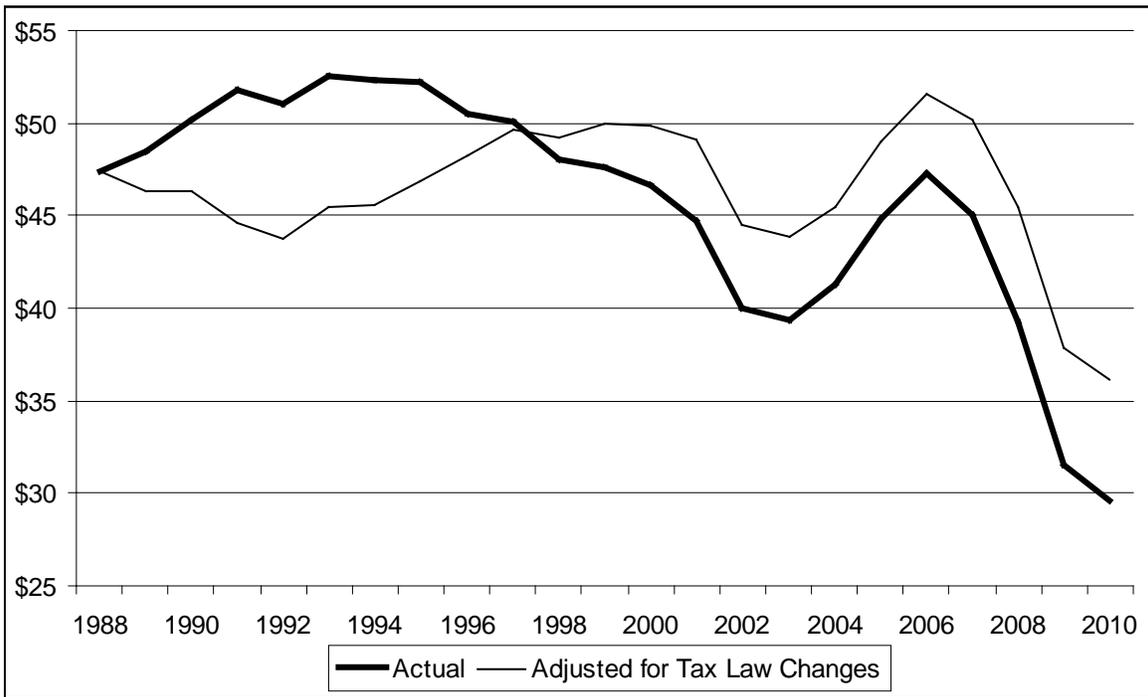
Note: dollar figures expressed in millions

Sources: Arizona Joint Legislative Budget Committee (nominal tax changes) and U.S. Department of Commerce, Census Bureau (population) and Bureau of Economic Analysis (gross national product implicit price deflator and personal income).

As seen in Chart 2.1, after adjusting out the tax law changes, revenue per \$1,000 of personal income rose from less than \$44 at the cyclical trough in 1992 to nearly \$50 in 1997 (a 13 percent increase) and remained at that level through 2001. The rise in revenue was due to the strong economic cycle, which featured a surge in capital gains due to the stock market boom. Despite this, actual revenue per \$1,000 of personal income decreased 14 percent from 1995 through 2001, reflecting the effects of the tax cuts.

An economic recession in 2001 was followed by a weak and slow recovery. This caused revenue after adjusting out the tax law changes to fall sharply in 2002 and to remain low through 2004. Actual revenue was even lower, precluding new tax reductions of any magnitude to be implemented between 2002 and 2006.

CHART 2.1
ONGOING REVENUE PER \$1,000 OF PERSONAL INCOME, ARIZONA STATE
GOVERNMENT GENERAL FUND, FISCAL YEARS 1988 THROUGH 2010



Sources: Arizona Joint Legislative Budget Committee (revenue) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

Strong economic gains boosted by the real estate boom pushed revenue much higher in 2005 and 2006. Adjusted for tax law changes, revenue per \$1,000 of personal income exceeded the level of the late 1990s in 2006 and remained high in 2007. The resulting budget surpluses created the opportunity to pass additional tax cuts that largely took effect in 2007 and 2008. The tax cuts amounted to about 2 percent of the size of the general fund in each of those years. (The effects of the business property tax reductions that were passed in 2005 and phased in over five years are not included in the JLBC’s estimates of effects of the tax law changes.) However, the revenue boom was short-lived as revenues plunged during 2008, 2009, and 2010 as a result of the long and deep economic recession.

Considerable cyclicity in revenue is seen in Chart 2.1, even in the line adjusted for tax law changes. This cyclicity coincides with the sharp fluctuations in capital gains. As a percentage of personal income, capital gains rose from 2.1 percent in tax years 1991 and 1992 to 6.8 percent in tax year 1999, fell to only 2.5 percent in tax year 2002, then soared to 8.1 percent in tax year 2005. In tax year 2007, the latest data, capital gains as a share of personal income still was 7.1 percent. However, capital gains certainly have dropped substantially since then, contributing to the sharp decline in state government revenue since fiscal year 2008.

The historical record clearly indicates that the vast majority of the tax cuts passed since the early 1990s have occurred at times of strong economic growth when a budget surplus was available

(actual revenue collected exceeded both revenue projections and appropriations). Further, the sizes of the surpluses were unusually large from the mid-1990s through 2000 due to the boom in the stock market, which caused capital gains and state tax collections to soar. Surpluses also were very large from 2005 through 2007 and again were due to a surge in capital gains, this time the result primarily of the real estate boom.

As seen in Table 2.1, the cumulative effect of the tax increases and decreases that have been passed since 1989 is between \$1.2 billion and \$1.4 billion, depending on the adjustments for inflation, population, and real per capita economic growth that are used. However, according to the Fiscal 2000 study that was completed in 1989, a structural deficit existed between revenues and expenditures. That is, apart from the declines in revenue caused by the economic slump, revenues and expenditures were out of balance. The tax increases and spending reductions implemented between 1989 and 1992 eliminated that structural deficit. Thus, it is more meaningful to examine the effects of changes to the tax code since 1993, when no structural deficit existed. The cumulative loss in general fund revenue since 1993 is nearly \$1.7 billion on a nominal basis. If inflation and population growth are considered, the magnitude of the net tax cuts since 1992 balloons to \$2.7 billion per year. Considering real per person economic growth as well, the loss of revenue exceeds \$2.9 billion.

Tax Law Changes by Type of Tax

The individual income tax has been disproportionately affected by the changes in tax laws. Since 1992, revenue declines from this tax have accounted for 58 percent of the cumulative total. A series of individual income tax rate reductions were implemented, with significant declines in revenue in 1995 and 1996, from 1998 through 2001, and again in 2007 and 2008 (see Table 2.2). It was not until 2001 that the corporate income tax increases of 1989 and 1991 were offset. New corporate and individual income tax credits also reduced revenue.

The cumulative reduction in sales tax collections was due primarily to a phased-in reduction in the commercial lease rate, implemented from 1994 through 1998. A variety of other sales tax exemptions also have been added to the tax code. The voter-approved increase in the sales tax rate in 2000 does not appear in Table 2.2 since it did not affect the general fund—the revenue was earmarked for education. Property tax cuts occurred primarily in 1997, when the statewide property tax was eliminated. The net decline in other taxes since 1992 was due to the elimination of the general fund portion of the vehicle license tax between 1999 and 2001.

Actual tax collections by type per \$1,000 of personal income are shown in the top graph of Chart 2.2. Collections by type per \$1,000 of personal income after adjustment for the tax law changes are shown in the bottom graph. Income tax collections, both individual and corporate, are highly cyclical. Sales tax collections also are cyclical, with a significant decrease occurring in the current recession. Sales tax revenues also have declined over time as consumer purchases have shifted to untaxed items (such as those purchased over the Internet) and to untaxed services.

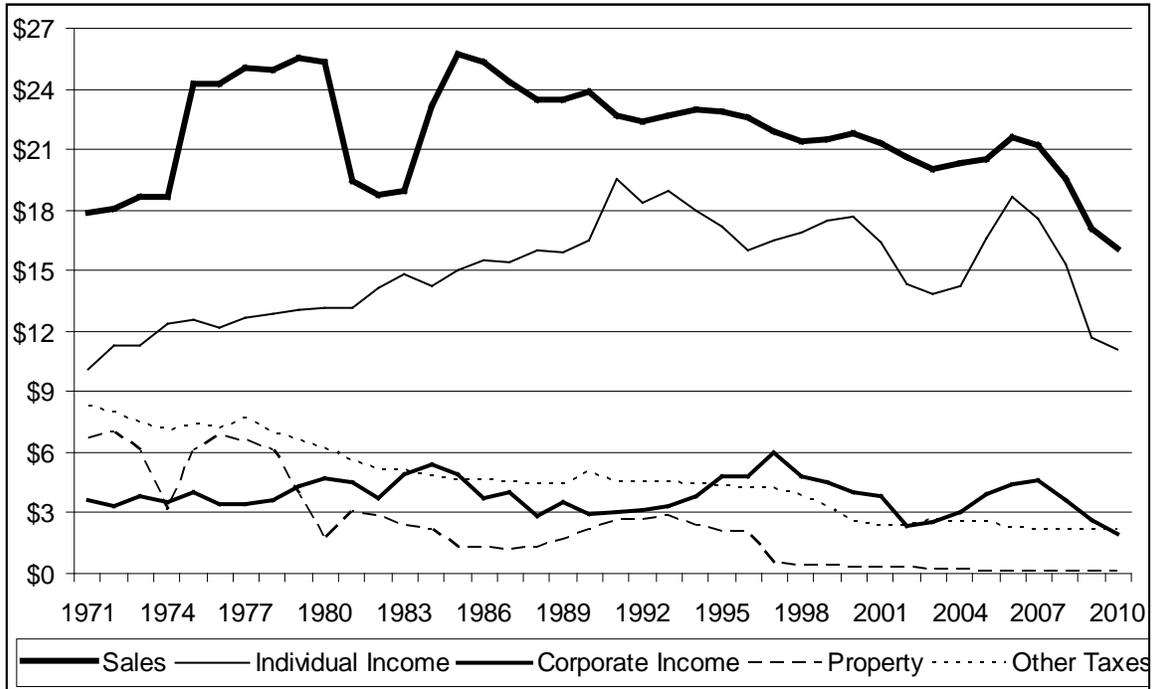
TABLE 2.2
ESTIMATED DOLLAR VALUE OF TAX CHANGES BY TYPE OF TAX, ARIZONA
STATE GOVERNMENT GENERAL FUND, FISCAL YEARS 1989 THROUGH 2010

Fiscal Year	Tax Change in Millions				
	Sales	Individual Income	Corporate Income	Property	Other
Annual					
1989	\$23	\$35	\$29	\$28	\$6
1990	7	64	0	23	16
1991	-4	119	31	50	14
1992	-0	9	0	0	0
1993	-8	-14	0	-1	3
1994	-12	-11	0	-1	-1
1995	-21	-103	4	-1	0
1996	-46	-202	-18	-18	0
1997	-23	-1	-0	-150	0
1998	-60	-115	3	0	-0
1999	-4	-51	-7	0	-80
2000	-8	-27	-14	-0	-55
2001	-4	-83	-46	-0	-25
2002	-0	10	-41	-2	0
2003	-0	11	22	-2	-19
2004	0	0	0	7	50
2005	0	-2	0	-7	4
2006	-1	-14	-3	0	0
2007	-2	-176	-11	0	-5
2008	-0	-186	-32	0	0
2009	0	-4	-30	0	0
2010	0	-9	-33	0	0
Cumulative Through 2010:					
Nominal Dollars					
Since 1989	-163	-750	-146	-74	-92
Since 1993	-189	-977	-206	-175	-128
Adjusted for Inflation					
Since 1989	-206	-826	-138	-74	-109
Since 1993	-248	-1,171	-230	-228	-164
Adjusted for Inflation and Population Growth:					
Since 1989	-279	-897	-101	-46	-119
Since 1993	-356	-1,514	-268	-324	-218
Adjusted for Personal Income:					
Since 1989	-314	-856	-56	-18	-101
Since 1993	-412	-1,648	-270	-375	-229

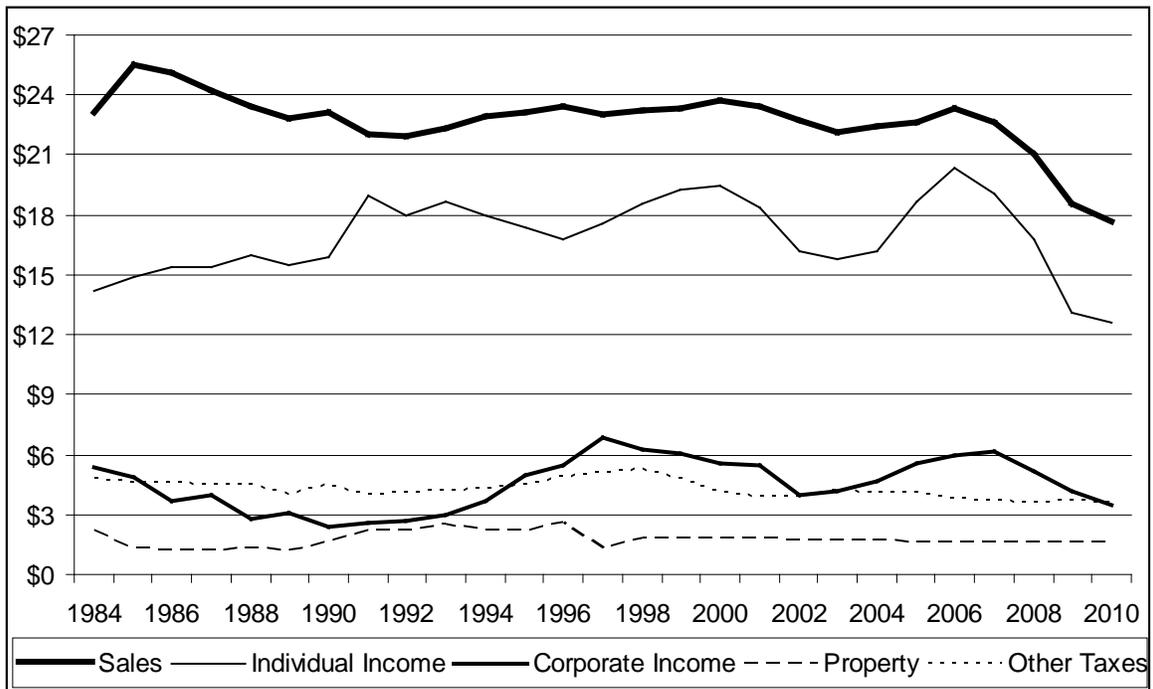
Sources: Arizona Joint Legislative Budget Committee (nominal tax changes) and U.S. Department of Commerce, Census Bureau (population) and Bureau of Economic Analysis (gross national product implicit price deflator and personal income).

CHART 2.2
TAX REVENUE BY SOURCE PER \$1,000 OF PERSONAL INCOME, ARIZONA
STATE GOVERNMENT GENERAL FUND, THROUGH FISCAL YEAR 2010

ACTUAL REVENUE



REVENUE ADJUSTED FOR TAX LAW CHANGES



Sources: Arizona Joint Legislative Budget Committee (revenue) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

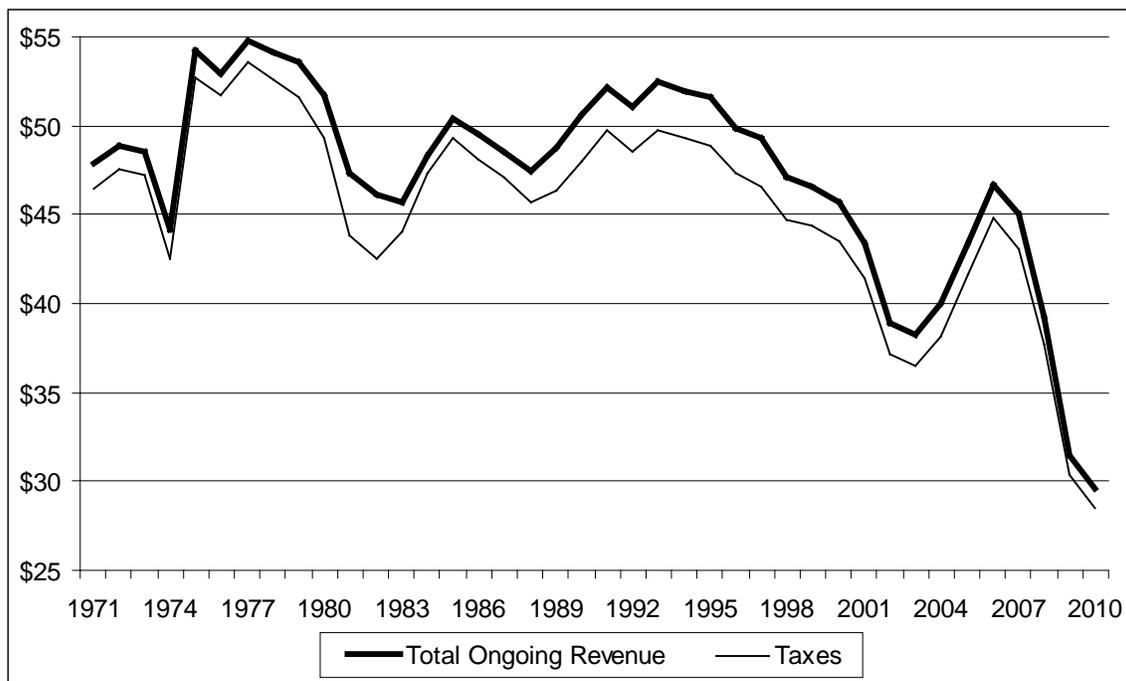
GENERAL FUND ONGOING REVENUE

Actual state government general fund ongoing revenue per \$1,000 of personal income since 1971 is displayed in Chart 2.3. The bulk of the revenue comes from tax collections. The lines plotted in the chart illustrate considerable cyclicity in revenue corresponding to the economic cycle. The lines also fluctuate due to changes made to the tax code.

Revenue per \$1,000 of personal income has declined from the peak level of the mid-to-late 1970s, with most of the decrease occurring since the early 1990s. The decrease in revenue from the early 1990s through 2000 occurred during a long period of strong economic growth and resulted from a series of tax decreases passed by the Arizona Legislature. Tax changes continued to reduce revenue in 2001 and 2002, but the decline in revenue from 2001 through 2003 also was due to a weak economy. The sharp increase in revenue in 2005 and 2006 reflects a strong economy that was boosted by the real estate boom. The large downturn in revenue from 2007 through 2010 is partially due to further tax cuts, but also results from the severe economic recession that began late in calendar year 2007. Ongoing revenue per \$1,000 of personal income in 2009 and 2010 was by far the lowest on record.

As a result of the numerous tax changes over the years, Arizona's state government general fund has experienced a sharp redistribution in revenue sources over the last few decades. Of particular note is the decline in general fund revenue from the property tax, culminating in the state general

CHART 2.3
ACTUAL ONGOING REVENUE PER \$1,000 OF PERSONAL INCOME, ARIZONA STATE GOVERNMENT GENERAL FUND, FISCAL YEARS 1971 THROUGH 2010



Sources: Arizona Joint Legislative Budget Committee (revenue) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

fund portion of the property tax for all practical purposes being eliminated in 1997. In addition, sales tax rates have increased while reductions in personal income tax rates have been implemented. Miscellaneous other revenue sources contribute much less to the general fund than in the past; for example, funds from the vehicle license tax no longer are applied to the general fund.

Revenue Sources

Ongoing revenue to the state government general fund was approximately \$6.9 billion in 2009—\$1.8 billion less than in the prior year and almost \$2.7 billion less than the peak figure of \$9.6 billion in 2007. The two-year decline is 28 percent—before considering inflation or population growth. Revenue from almost all sources declined in 2008 and 2009. Further declines from all major sources are occurring in the current fiscal year.

The general fund receives revenue from several tax and nontax sources, as seen in Table 2.3. However, just two taxes—the sales and use tax and the individual income tax—provided almost 90 percent of the revenue in 2009, compared to 65 percent in 1971 (see Chart 2.4). Thus, the general fund now is very heavily dependent on just two highly volatile taxes.

Sales and Use Tax

The general fund's primary revenue source is sales and use taxes, which account for more than half of the total general fund revenue. In 2009, sales and use tax collections were \$3.76 billion, down nearly \$600 million from the prior year and more than \$700 million from 2007. An additional decrease of between \$200 million and \$300 million is occurring in the current fiscal year. All of these decreases are before considering the effects of inflation and population growth.

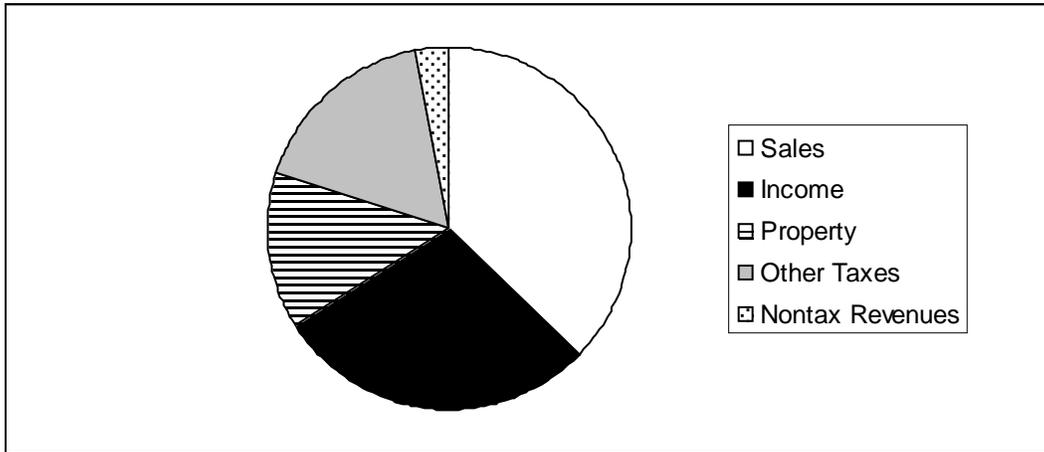
TABLE 2.3
ONGOING REVENUE BY SOURCE, ARIZONA STATE GOVERNMENT
GENERAL FUND, FISCAL YEARS 2007 THROUGH 2010

(Dollar Values in Millions)	2007	2008	2009	2009 Share	2010 (Projected)
TOTAL ONGOING REVENUE	\$9,605	\$8,731	\$6,933	100.0%	\$6,392
Total Taxes	9,186	8,374	6,678	96.3	6,152
Sales and Use	4,513	4,354	3,756	54.2	3,481
Total Income	4,182	3,531	2,432	35.1	2,191
Individual	3,747	3,406	2,568	37.0	2,391
Corporation	986	809	592	8.5	429
Urban Revenue Sharing	-551	-685	-728	-10.5	-629
Property	24	20	18	0.3	20
Luxury	66	61	59	0.8	59
Insurance Premium	400	407	411	5.9	397
Other Taxes	1	2	1	0.0	3
Nontax Revenues	419	356	255	3.7	240
Lottery	53	48	31	0.4	36
Interest	104	95	20	0.3	0
Other	262	213	204	3.0	204

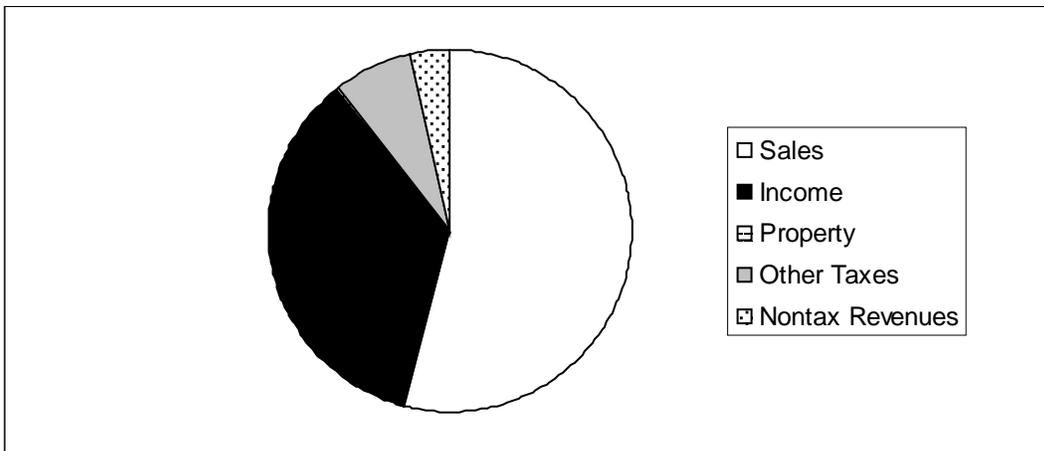
Source: Arizona Joint Legislative Budget Committee (historical) and authors (2010 projection).

**CHART 2.4
SOURCES OF ARIZONA STATE GOVERNMENT GENERAL FUND REVENUE**

FISCAL YEAR 1971



FISCAL YEAR 2009



Source: Arizona Joint Legislative Budget Committee.

Sales and use tax collections per \$1,000 of personal income peaked at more than \$25 in 1985, about equal to the 1979 figure, but have since declined, to \$17 in 2009 and barely more than \$16 in 2010 (see the top graph in Chart 2.2). Despite this decrease, the sales and use tax share of total revenue collections reached its highest figure of 54 percent in 2009 and 2010; the share was less than 37 percent in the early 1970s.

A number of taxes comprise the sales and use category. By far the largest component of the sales and use category is the transaction privilege tax (TPT)—Arizona’s version of a general sales tax in which the seller is responsible for remitting the entire amount of the tax due to the state. Though the overall state tax rate is 5.6 percent, 0.6 percent is dedicated to education; these monies do not enter the general fund. The retail portion of the TPT is the largest source of revenue. The use tax, which contributed \$293 million in general fund revenue in 2009, is applied

to retail purchases of personal property by Arizona businesses in states that levy a sales tax of less than 5.6 percent. (Individuals also are subject to this tax, but enforcement of this provision is limited.) Other sales and use tax sources—severance tax on metalliferous minerals, jet fuel use tax, jet fuel excise tax, severance tax on timber, and rental occupancy tax—provide little general fund revenue.

Income Tax

The income tax is the other primary source of general fund revenue; its share dropped to 35 percent of the total in 2009. The net collection from the individual and corporate income tax less the amount distributed to local governments through urban revenue sharing was \$2.4 billion in 2009, down \$1.1 billion from the prior year and more than \$1.7 billion from 2007. An additional decline of more than \$200 million is forecast for the current fiscal year.

Before the urban revenue sharing distribution, collections from the individual income tax totaled nearly \$2.6 billion in 2009, compared to \$592 million from the corporate income tax. Collections from the individual income tax fell more than \$800 million in 2009 and nearly \$1.2 billion over two years. Collections from the corporate income tax were down \$217 million in 2009 and \$394 million over two years.

Collections from the corporate income tax always have been highly cyclical, but the volatility in individual income tax collections has increased substantially since the mid-1990s, due to the huge cycles in capital gains. After accounting for less than 30 percent of total general fund revenue through most of the 1970s, the total income tax share has fluctuated since then from 30-to-45 percent.

Income tax collections per \$1,000 of personal income in recent years have ranged from nearly \$20 in 1997 to less than \$14 in 2003 to nearly \$21 in 2006, the highest on record. By 2009, the figure was only \$11—the lowest in the 39-year time series. The projected value for 2010 is barely above \$10.

Property Tax

In the 1970s, the property tax was the third largest source of general fund revenue, with collections amounting to more than \$6 per \$1,000 of personal income. A large tax cut in 1980 dropped this figure to less than \$2, and the elimination of the state portion of the tax in 1997 cut general fund collections to just \$0.1 per \$1,000 of personal income in recent years. The \$18 million deposited into the state general fund in 2009 came from land parcels not included in a school district. Property taxes still are collected by local governments and are a major source of revenue.

Other Taxes

A variety of other taxes combined to contribute \$471 million in 2009, close to 7 percent of the state's general fund revenue. Collections were marginally higher than in 2007 and 2008 (before adjustment for inflation and population growth). In the early 1970s, these other taxes accounted for nearly 17 percent of the general fund total. Per \$1,000 of personal income, collections have fallen from more than \$8 to a little more than \$2. Most of the other tax sources have declined in importance.

Per \$1,000 of personal income, luxury tax collections were around \$4 in the early 1970s but now are only \$0.3, estate taxes have dropped from \$1.1 to virtually zero, the pari-mutuel tax dropped from \$0.5 to zero, the motor vehicle license tax fell from around \$1 to zero, and all other taxes combined other than the insurance premium tax declined from \$0.5 to barely more than zero. In contrast, after collections of around \$1.3 per \$1,000 of personal income through most of the time series, the insurance premium tax figure increased in 2003 and 2004 to about \$1.9. It now accounts for most of the collections (\$411 million in 2009) in this category.

Nontax Revenue

Various other sources of revenue contributed \$255 million, or 3.7 percent, of the general fund total in 2009. The state lottery added \$31 million to the general fund. Interest earned dropped sharply to \$20 million. These nontax revenues per \$1,000 of personal income had been near \$2 since the late 1980s, but the 2009 figure was only \$1.2.

GENERAL REVENUE AS DEFINED BY THE CENSUS BUREAU

Caution must be exercised when comparing state government revenue as reported by the Census Bureau in Arizona to that in other states since taxing authority between state and local governments varies by state. The latest complete and verified Census Bureau data for state governments are for 2007. Because of the economic recession that began in 2008, data for 2007 are more representative than those of later years, but the 2007 data do not reflect recent tax law changes. For example, a sizable portion of the last individual income tax reduction was implemented in 2008.

The data for 2007 are summarized in Table 2.4. The Census Bureau reported Arizona state government revenue to be \$26.2 billion, of which \$18.1 billion was raised by the state from its own sources. This compares to only \$9.6 billion in ongoing general fund revenue reported by the JLBC.

Per capita state government revenue in Arizona was 14 percent below the national average, ranking 40th among the 50 states. Yet Arizona's rank among the nine western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington) was near the middle.

As a share of total revenue, intergovernmental revenue from the federal government was above average in Arizona, particularly relative to the other western states, but the per capita figure was 10 percent less than the national average. Own-source revenue per capita was 16 percent below average, with Arizona ranking among the bottom 10 states and seventh among the nine western states.

The Census Bureau categorizes own-source revenue differently from the JLBC. It differentiates between taxes, current charges (largely user fees), and miscellaneous sources of revenue. Since the Census Bureau data include all state funds other than utilities and insurance trust, the list of revenue sources is much longer than those sources used for the general fund.

The mix of revenue sources used by Arizona is considerably different from that of the average state (nationally or in the West). Arizona state government is very heavily dependent on the general sales tax, and also receives an above-average share of its revenue from property taxes.

**TABLE 2.4
GENERAL REVENUE BY SOURCE, ARIZONA STATE GOVERNMENT, FISCAL YEAR 2007**

	Dollars in Thousands	Share of Total	National Share	Western Share	Per Capita			
					Dollars	Ratio to U.S.	50-State Rank*	Western Rank*
TOTAL REVENUE	\$26,192,089	100.00%	100.00%	100.00%	\$4,172.59	85.9%	40	6
From Federal Government	8,123,983	31.02	29.51	26.87	1,294.21	90.3	34	3
Total Own Source	18,068,106	68.98	70.49	73.13	2,878.38	84.1	41	7
Taxes	14,404,976	55.00	51.92	51.57	2,294.82	91.0	34	5
Property	924,995	3.53	0.87	1.13	147.36	349.4	8	2
Sales and Gross Receipts	8,289,660	31.65	24.15	27.36	1,320.60	112.6	15	5
General Sales	6,612,350	25.25	16.35	18.81	1,053.40	132.7	8	3
Selective Sales	1,677,310	6.40	7.80	8.55	267.21	70.5	40	5
Motor Fuels	768,914	2.94	2.51	2.92	122.49	100.6	36	7
Alcoholic Beverages	63,190	0.24	0.35	0.39	10.07	58.4	36	6
Tobacco Products	358,113	1.37	1.05	1.07	57.05	111.9	21	3
Public Utilities	45,346	0.17	0.96	0.46	7.22	15.5	30	6
Other Selective Sales	441,747	1.69	2.93	3.71	70.37	49.5	38	5
Individual Income	3,747,387	14.31	18.23	14.58	596.99	67.4	39	6
Corporate Income	986,170	3.77	3.63	2.20	157.10	89.2	24	3
Motor Vehicle License	213,008	0.81	1.32	1.54	33.93	52.8	47	9
Other Taxes	243,756	0.93	3.73	4.75	38.83	21.5	49	9
Nontax Sources	3,663,130	13.99	18.57	21.56	583.56	64.7	48	8
Current Charges	1,598,695	6.10	9.66	11.20	254.68	54.3	50	9
Education	1,320,741	5.04	5.49	6.44	210.40	79.0	44	7
Higher Education	1,299,577	4.96	5.41	6.38	207.03	78.8	44	7
Other Charges	21,164	0.08	0.08	0.06	3.37	92.2	19	4
Hospitals	0	0.00	2.28	3.18	0.00	0.0	50	9
Highways	11,941	0.05	0.42	0.14	1.90	9.4	33	6
Airports	827	0.00	0.08	0.04	0.13	3.3	18	2
Natural Resources	23,273	0.09	0.17	0.29	3.71	44.7	29	5
Parks and Recreation	33,768	0.13	0.10	0.04	5.38	108.0	18	2
Housing	1,801	0.01	0.05	0.04	0.29	12.8	45	9
Solid Waste Management	3,000	0.01	0.03	0.02	0.48	31.7	19	5
Other Current Charges	203,344	0.78	0.96	0.99	32.39	69.7	32	6
Miscellaneous Revenue	2,064,435	7.88	8.91	10.37	328.88	76.0	39	7
Interest Earned	708,602	2.71	3.29	3.96	112.89	70.7	41	8
Sale of Property	228,697	0.87	0.08	0.09	36.43	959.9	2	1
Other Revenue	1,127,136	4.30	5.48	6.31	179.56	67.4	43	8

* A rank of 1 indicates the highest tax burden; the western states are Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington

Source: U.S. Department of Commerce, Census Bureau (revenue and population).

The Census Bureau considers part of the motor vehicle license tax to be a property tax since it is based on value.

In contrast, the shares of total revenue were below average from the portion of the vehicle license tax not based on value (fees), from selective sales taxes, and from taxes not separately listed. Revenue from nontax sources was particularly low. Arizona was below the per capita norm on all types of current charges except those in the parks and recreation subcategory.

Per capita revenue was considerably less than the national average from nontax sources. Arizona ranked last in per capita receipts from current charges. The per capita amounts also were far below average for selective sales taxes, the individual income tax, the motor vehicle license tax, and from miscellaneous taxes. The state ranked quite low on all of these taxes. In contrast, per capita receipts from the general sales tax were nearly one-third higher than the national average and ranked among the 10 highest states in the nation.

The primary conclusion from this analysis is that Arizona state government utilizes a more narrow set of revenue sources than other states, not collecting any revenue at all from some sources and very low amounts from other sources. It is heavily reliant on one cyclical revenue source, the general sales tax.

CHAPTER 3

STATE AND LOCAL GOVERNMENT GENERAL REVENUE

In this chapter, general revenue as reported by the U.S. Census Bureau is examined. For a discussion of the Census Bureau data, and of the per capita and per \$1,000 of personal income measures used to analyze the data, see Chapter 1. More detail by source of revenue is provided in Appendix A. All references to year in this chapter are to the fiscal year and all references to revenue are to the Census Bureau's definition of general revenue—combined state and local government revenue from all funds except utilities, insurance trust, and liquor stores.

The last year of data for 2007 marks the peak of the economic cycle. Government revenue in Arizona has plunged since then, mostly due to the economic recession but also due to state government tax reductions implemented after 2007. If 2009 or 2010 data were available, Arizona's figures per capita and relative to personal income, and its comparison to the rest of the nation would look very different than detailed in this chapter.

GENERAL REVENUE

Total state and local government revenue in Arizona totaled \$41.3 billion in 2007: \$6,582 per Arizona resident and \$193.75 per \$1,000 of personal income. Total revenue was less than the national average, by 15.2 percent per capita and by 4.7 percent per \$1,000 of personal income. (Since personal income understates income in Arizona relative to the rest of the country, revenue relative to a more accurate measure of money income would be a little further below the national average than indicated by the personal income measure.)

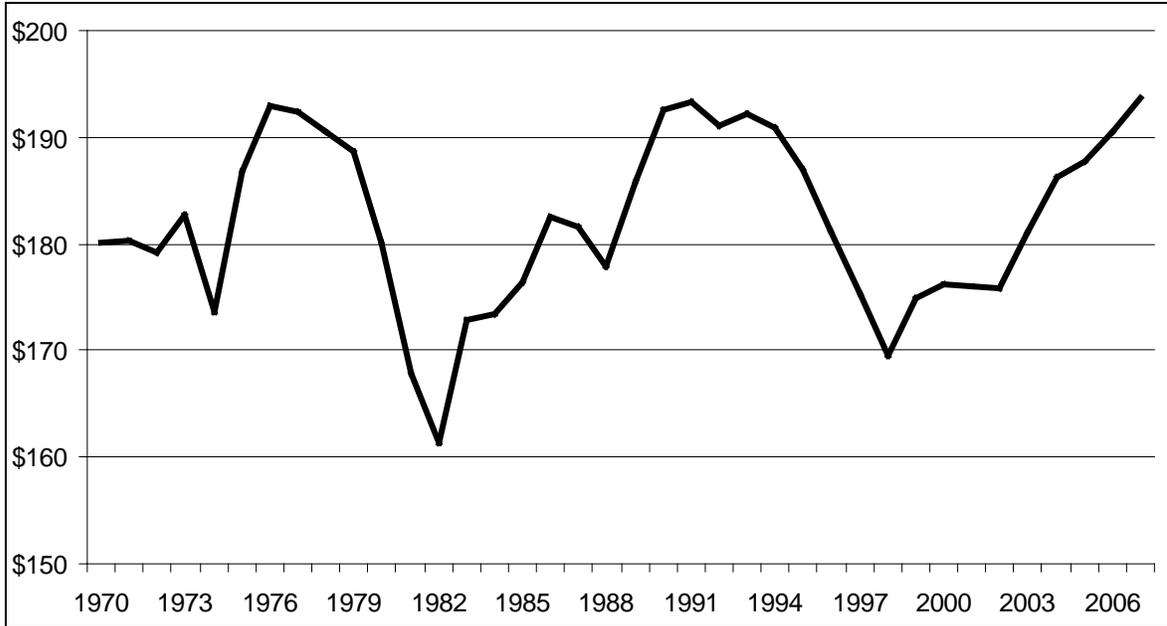
Arizona's per capita state and local government revenue in 2007 ranked 44th among the 51 'states' (including the District of Columbia)—the only states that received less were Arkansas, Idaho, Kentucky, Missouri, New Hampshire, South Dakota, and Tennessee. Arizona ranked last among the nine western states (Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington). Relative to personal income, Arizona's revenue ranked 35th among the 51 states and fifth among the western states, with lower figures in Colorado, Nevada, Texas, and Washington.

Revenue per \$1,000 of personal income in Arizona has fluctuated over time, with no trend apparent (see the top graph of Chart 3.1). The fluctuations result primarily from cyclical variations over the course of an economic cycle, but changes in tax policy and in the amount of federal funding received also contribute.

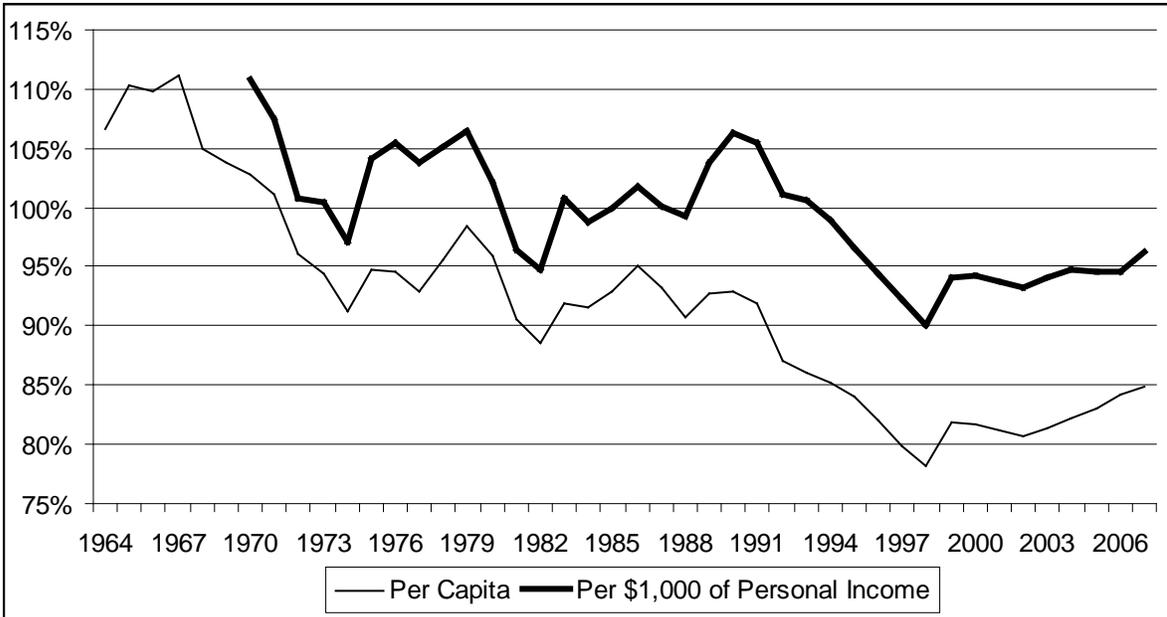
Total revenue per capita and per \$1,000 of personal income also fluctuates greatly in Arizona as a percentage of (ratio to) the national average. Apart from the cyclical fluctuations, the ratios dropped considerably from the 1960s through 1974, and from 1990 through 1998, as seen in the bottom graph of Chart 3.1. The pattern over time of the two measures—revenue per capita and per \$1,000 of personal income—relative to the U.S. average is similar, with the percentage of the national average always higher on the personal income measure. (Because of this similarity, some of the discussion and charts in this chapter address only one of the two measures.)

**CHART 3.1
COMBINED STATE AND LOCAL GOVERNMENT GENERAL REVENUE
IN ARIZONA THROUGH FISCAL YEAR 2007**

PER \$1,000 OF PERSONAL INCOME



AS A PERCENTAGE OF THE NATIONAL AVERAGE



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (revenue and population) and Bureau of Economic Analysis (personal income).

Per capita, revenue in Arizona relative to the U.S. average has been lower in every year since 1992 than in all preceding years. Revenue relative to personal income has been lower in each year since 1996 than in prior years, except for 1981 and 1982. Arizona's per capita revenue has been at least 15 percent less than average since 1995, but through the 1970s and 1980s it generally ranged from only 5-to-10 percent below the national average. Per \$1,000 of personal income, Arizona's figure has been from 4-to-10 percent less than the national average since 1996; before that, the Arizona figure generally fluctuated between 5 percent higher than average to 5 percent lower.

Total revenue per \$1,000 of personal income was 1 percent higher in 2007 than in 1992 in Arizona. That is, total revenue available to state and local governments in Arizona was essentially unchanged over this 15-year period relative to the size of the state's economy. In contrast, revenue rose more than economic growth nationally such that Arizona's 2007 figure as a ratio to the national average was 5 percentage points lower per \$1,000 of personal income (and 2 percentage points lower per capita) than in 1992. Its national rank was between 8 and 10 places lower. (The 1992-to-2007 comparison is detailed in Appendix A.)

GENERAL REVENUE BY SOURCE

The Census Bureau series on state and local government finance provides general revenue for a number of categories and subcategories. Table 3.1 provides a summary of the data for 2007.

Major Categories

The first distinction made by the Census Bureau is between revenue received from the federal government and revenue raised from own sources. Intergovernmental transfers from the federal government to Arizona amounted to \$8.7 billion in 2007, about 21 percent of Arizona state and local government revenue, a slightly higher proportion than the U.S. average. Per capita receipts from the federal government were 11 percent below the national average, with Arizona ranking 37th among all states and fifth in the West. Federal funding to Arizona per \$1,000 of personal income was 1 percent above average, 32nd nationally and fourth in the West.

Arizona's receipt of federal funds relative to personal income rose 27 percent between 1992 and 2007 (see the top graph of Chart 3.2), pushing the state's ratio to the U.S. average up 9 percentage points and its national rank up six places. This increase offset the decrease in tax revenue over the period, resulting in total revenue per \$1,000 of personal income not showing any trend in the top graph of Chart 3.1.

Own-source revenue totaled \$32.6 billion in Arizona in 2007, accounting for 79 percent of all revenue. On a per capita basis, this amounted to \$5,194—16 percent less than the U.S. average, ranking 41st in the nation and last among the western states. Per \$1,000 of personal income, Arizona's own-source revenue was 5 percent below the national average, ranking 37th nationally and sixth in the West. Own-source revenue fell 4 percent relative to personal income between 1992 and 2007, with Arizona's ratio to the U.S. average falling 8 percentage points and its national rank 18 places.

**TABLE 3.1
COMBINED STATE AND LOCAL GOVERNMENT GENERAL REVENUE BY SOURCE IN ARIZONA, FISCAL YEAR 2007**

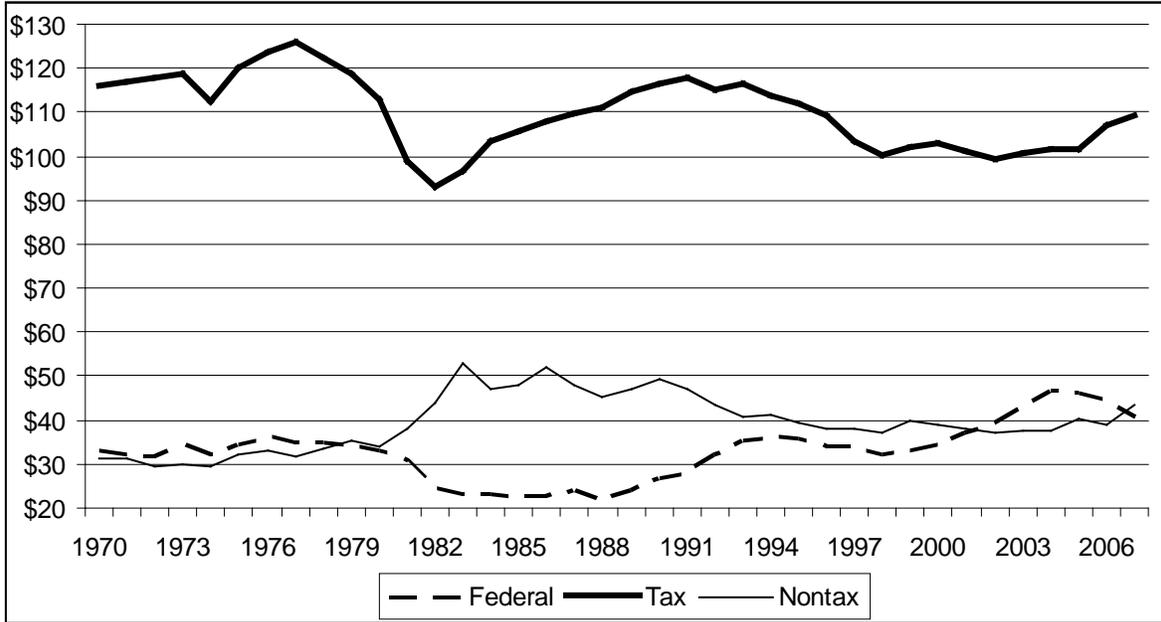
	Dollars in Thousands	Share of Total	Per Capita				Per \$1,000 of Personal Income			
			Dollars	Ratio to U.S.	All State Rank*	Western Rank*	Dollars	Ratio to U.S.	All State Rank*	Western Rank*
TOTAL REVENUE	\$41,318,939	100.00%	\$6,582.41	84.8%	44	9	\$193.75	96.3%	35	5
From Federal Government	8,713,139	21.09	1,388.07	89.1	37	5	40.86	101.2	32	4
Total Own Source	32,605,800	78.91	5,194.35	83.7	41	9	152.89	95.1	37	6
Taxes	23,334,711	56.47	3,717.39	87.5	30	6	109.42	99.3	22	3
Property	6,221,217	15.06	991.09	77.6	34	7	29.17	88.2	30	3
Sales and Gross Receipts	11,299,521	27.35	1,800.10	123.2	8	3	52.98	139.9	7	4
General Sales	9,365,648	22.67	1,492.02	149.6	5	2	43.92	169.9	6	3
Selective Sales	1,933,873	4.68	308.08	66.3	47	8	9.07	75.4	42	6
Motor Fuels	768,914	1.86	122.49	96.9	38	7	3.61	110.1	30	5
Alcoholic Beverages	63,921	0.15	10.18	54.3	36	6	0.30	61.7	31	6
Tobacco Products	358,113	0.87	57.05	108.1	22	3	1.68	122.8	22	3
Public Utilities	200,274	0.48	31.91	35.7	37	8	0.94	40.6	35	8
Other Selective Sales	542,651	1.31	86.45	48.8	43	8	2.54	55.4	42	7
Individual Income	3,747,387	9.07	596.99	61.9	40	6	17.57	70.3	40	6
Corporate Income	986,170	2.39	157.10	77.9	25	3	4.62	88.5	25	4
Motor Vehicle License	238,301	0.58	37.96	54.6	49	9	1.12	62.1	43	9
Other Taxes	842,115	2.04	134.16	48.4	43	8	3.95	55.0	41	8
Nontax Sources	9,271,089	22.44	1,476.95	75.6	49	9	43.47	85.9	44	9
Current Charges	5,157,979	12.48	821.70	70.2	50	9	24.19	79.7	42	9
Education	1,851,784	4.48	295.00	85.5	38	6	8.68	97.1	36	7
Higher Education	1,584,561	3.83	252.43	85.9	40	7	7.43	97.5	36	7
School Lunch Sales	117,101	0.28	18.66	80.9	41	5	0.55	91.9	33	3
Other Charges	150,122	0.37	23.92	85.6	27	5	0.70	97.2	27	5
Hospitals	804,113	1.95	128.10	42.2	37	9	3.77	48.0	37	9
Highways	14,697	0.04	2.34	6.6	45	9	0.07	7.5	43	9
Airports	466,876	1.13	74.38	134.6	10	4	2.19	152.9	8	4
Parking Facilities	4,003	0.01	0.64	10.5	49	9	0.02	11.9	50	9
Natural Resources	112,942	0.27	17.99	133.9	11	4	0.53	152.1	11	4
Parks and Recreation	134,503	0.33	21.43	73.1	33	7	0.63	83.0	29	7
Housing	23,031	0.06	3.67	20.3	51	9	0.11	23.0	50	9
Sewerage	629,089	1.52	100.22	83.2	30	8	2.95	94.5	25	8
Solid Waste Management	380,618	0.92	60.64	125.7	16	5	1.78	142.8	12	4
Other Current Charges	736,323	1.78	117.30	64.2	37	7	3.45	72.9	33	6
Miscellaneous Revenue	4,113,110	9.95	655.25	83.8	38	9	19.29	95.2	31	8
Interest Earned	1,614,668	3.91	257.23	82.9	38	9	7.57	94.2	30	7
Special Assessments	124,490	0.30	19.83	72.8	22	7	0.58	82.7	21	7
Sale of Property	273,600	0.66	43.59	281.5	3	2	1.28	319.8	3	2
Other Revenue	2,100,352	5.08	334.60	78.0	40	8	9.85	88.5	33	8

* A rank of 1 indicates the highest tax burden; the "all state" column includes the District of Columbia; the western states are Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington

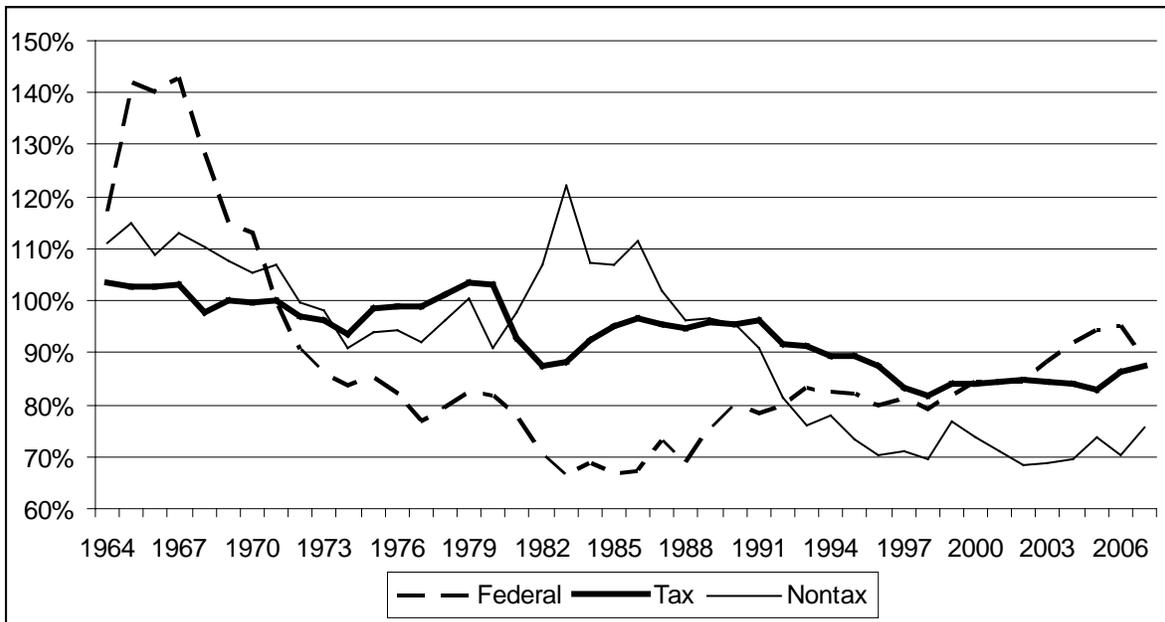
Source: U.S. Department of Commerce: Census Bureau (revenue and population) and Bureau of Economic Analysis (personal income).

**CHART 3.2
COMBINED STATE AND LOCAL GOVERNMENT GENERAL REVENUE
BY MAJOR SOURCE IN ARIZONA, THROUGH FISCAL YEAR 2007**

PER \$1,000 OF PERSONAL INCOME



PER CAPITA AS A PERCENTAGE OF THE NATIONAL AVERAGE



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (revenue and population) and Bureau of Economic Analysis (personal income).

Ignoring the cyclical fluctuations, Arizona's own-source revenue, per capita and relative to personal income, as a ratio to the national average was higher during the 1960s than in subsequent years. From the 1970s into the early 1990s, state and local government own-source revenue in Arizona per \$1,000 of personal income fluctuated near the national average; the per capita figure usually was 5-to-10 percent less than the U.S. average. Own-source revenue received by Arizona governments fell considerably during the 1990s relative to the U.S. average. Since the mid-1990s, the per capita and relative to personal income measures have been substantially below the historical norm.

Own-source revenue in turn is divided into two groupings: tax and nontax. A number of separate taxes are reported by the Census Bureau. Nontax revenue sources consist of current charges (largely user fees) and miscellaneous other sources of revenue, including interest earned.

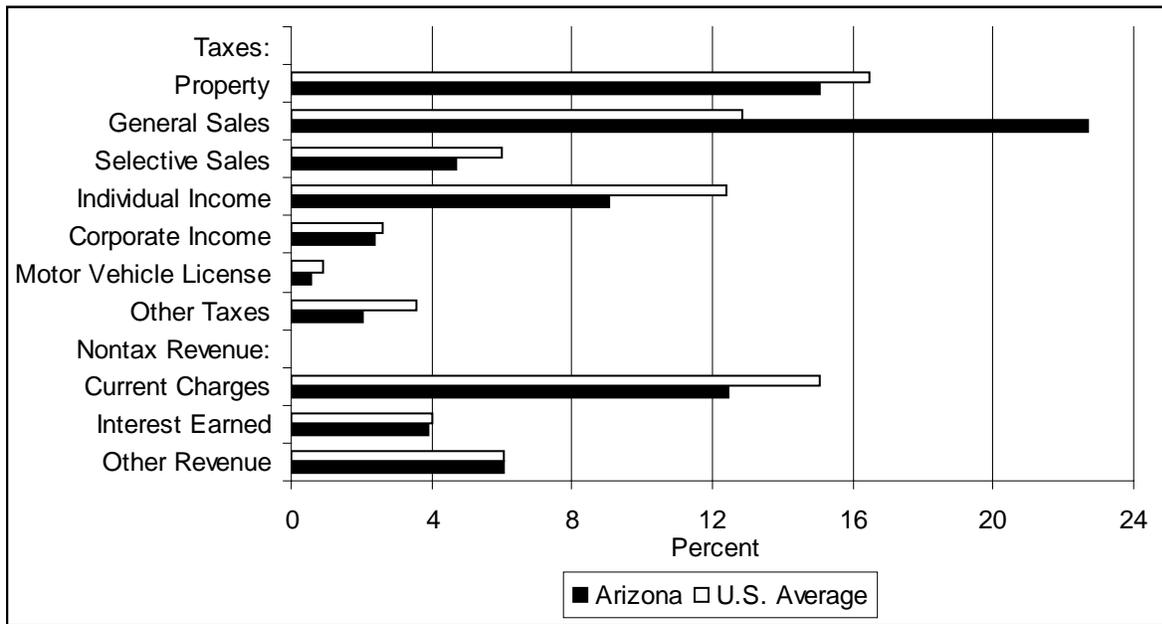
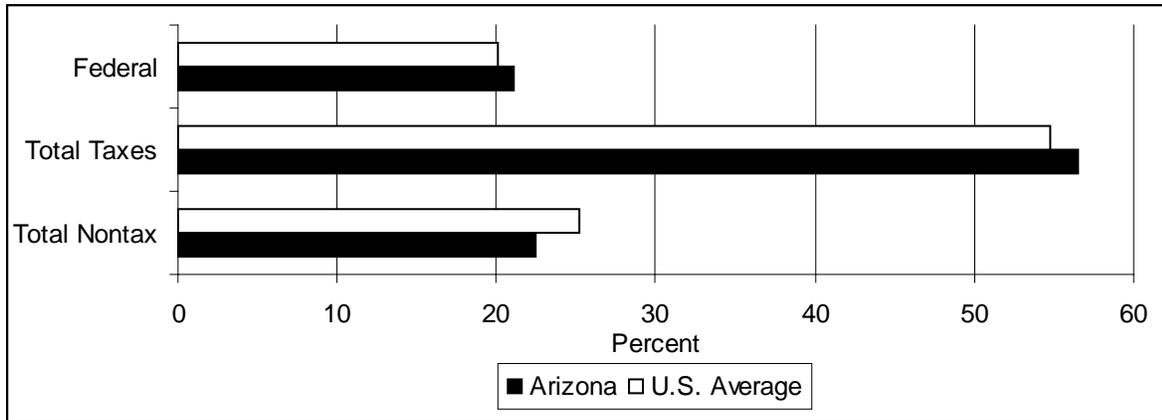
Tax revenue was \$23.3 billion in Arizona in 2007, accounting for 56.5 percent of all revenue, a share 1.7 percentage points above the national average. On a per capita basis, this amounted to \$3,717—12 percent less than the U.S. average, ranking 30th in the nation and sixth among the western states. Per \$1,000 of personal income, Arizona's tax revenue was 1 percent below the national average and ranked 22nd (third in the West). Between 1992 and 2007, tax revenue relative to personal income fell 5 percent. The ratio to the national average dropped 7 percentage points and the national rank declined 12 places. This decline was largely due to the Arizona state government tax cuts. The relative decrease would be much larger if 1992 were compared to 2009 or 2010.

Nontax sources of revenue brought in \$9.3 billion to state and local governments in Arizona in 2007, accounting for 22.4 percent of the total, less than the national share of 25.2 percent. Per capita nontax revenue of \$1,477 was 24 percent less than the national average; Arizona ranked 49th, with Arkansas and Connecticut lower. Per \$1,000 of personal income, Arizona's collections in 2007 were 14 percent below average, 44th in the nation and lowest in the West. Though nontax revenue per \$1,000 of personal income in Arizona was unchanged between 1992 and 2007, the ratio to the U.S. average fell 9 percentage points and the national rank dropped seven places.

A longer time series of revenue from the federal government and from tax and nontax sources is presented in Chart 3.2. Per \$1,000 of personal income, tax revenue in Arizona since 1996 has been lower than in prior years except for the early-to-mid-1980s. Nontax revenue increased during the 1980s, but has fallen off since then. Revenue from the federal government has been higher than in the past since 2001. Relative to the national average, per capita revenue from each of these three major sources has been below average since the late 1980s but was above average from each source back in the 1960s.

Though the tax burden in Arizona is below the national average, the state relies more heavily on taxes (as a share of total revenue) than the national average (see Chart 3.3). The big difference is in the general sales tax, which provided 22.7 percent of government revenue in Arizona in 2007 compared to a national average of only 12.9 percent. Arizona's share of total revenue was less than the national average from each of the other taxes and from current charges.

**CHART 3.3
STATE AND LOCAL GOVERNMENT GENERAL REVENUE BY SOURCE
AS A SHARE OF THE TOTAL IN FISCAL YEAR 2007**



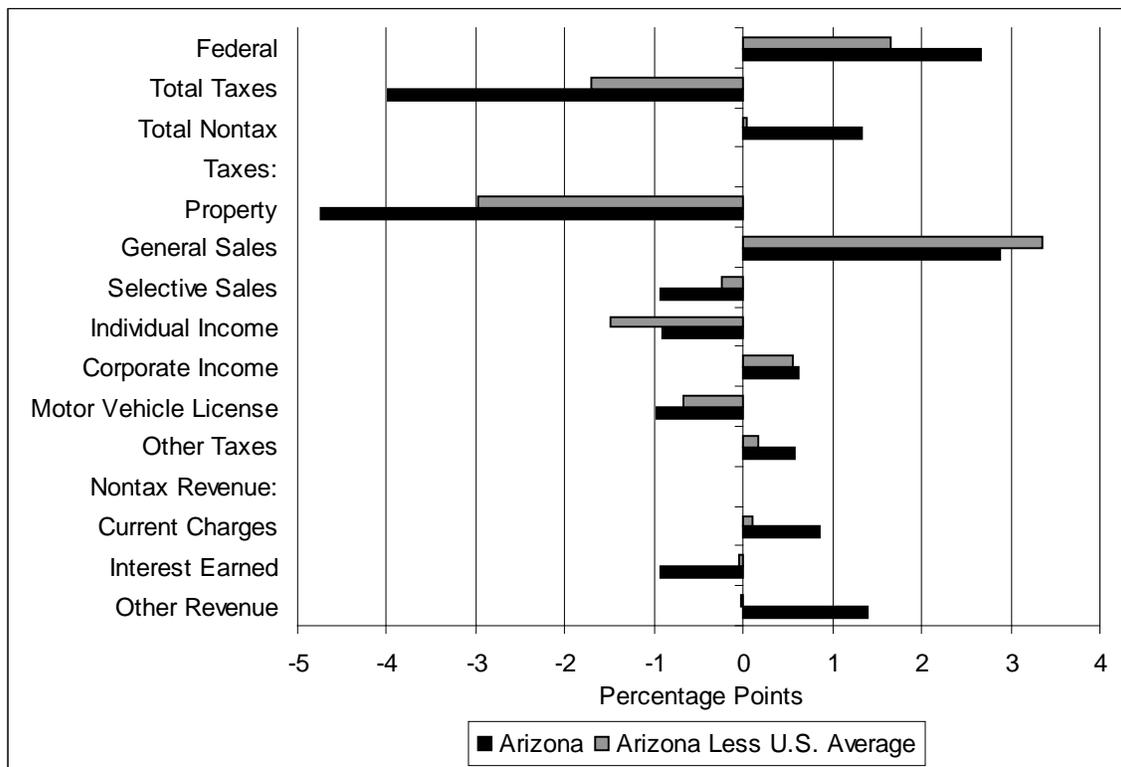
Source: U.S. Department of Commerce, Census Bureau.

The changes in revenue shares between 1993 and 2007 are shown in Chart 3.4. During this period, Arizona governments became less reliant on property taxes and more dependent on the general sales tax. The use of federal funds also increased. These changes in share also occurred relative to the national average.

The history of revenue from the major tax sources is shown in Chart 3.5. The top graph, expressed per \$1,000 of personal income, shows a considerable drop in property taxes in the late 1970s/early 1980s and again during the mid-1990s. Relative to the national average (the bottom graph in Chart 3.5), per capita property tax collections have fallen from above average during the 1960s and again during the mid-to-late 1970s to more than 20 percent below average. Revenue collections from selective sales taxes also have decreased over time and collections from “other” taxes dropped during the mid-1990s.

The economic cycle is especially telling on the income tax data. It appears that income tax collections have not fallen except during the last recession despite the numerous income tax cuts since the early 1990s, but this conclusion would be quite different if current data were available.

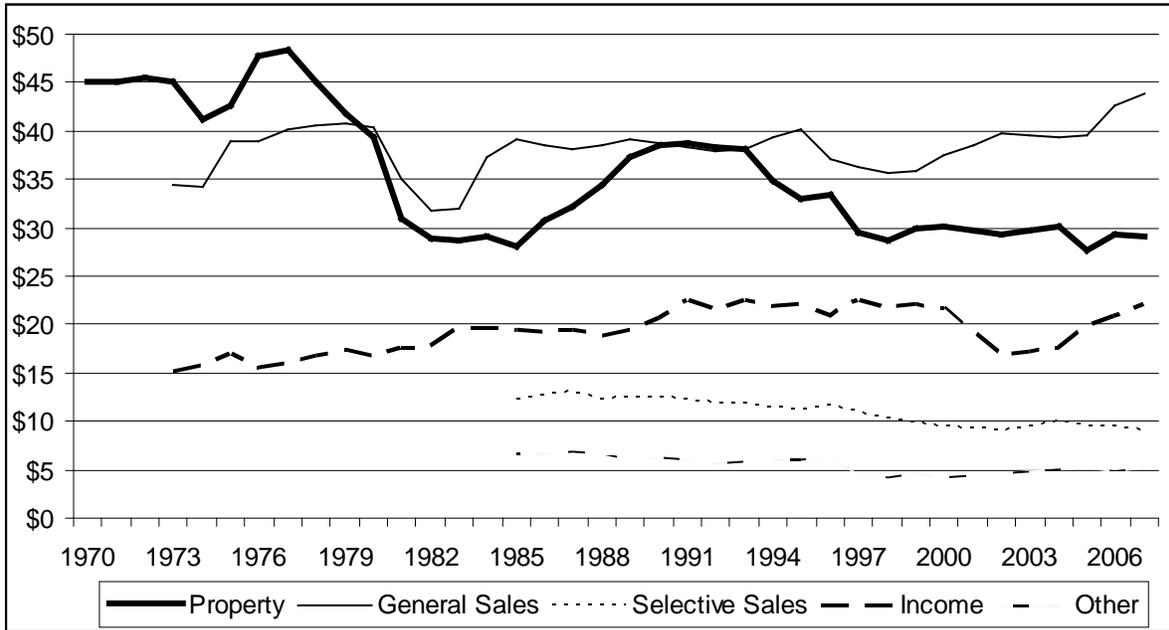
**CHART 3.4
COMBINED STATE AND LOCAL GOVERNMENT GENERAL REVENUE BY SOURCE AS A SHARE OF THE TOTAL IN ARIZONA, CHANGE BETWEEN FISCAL YEARS 1993 AND 2007**



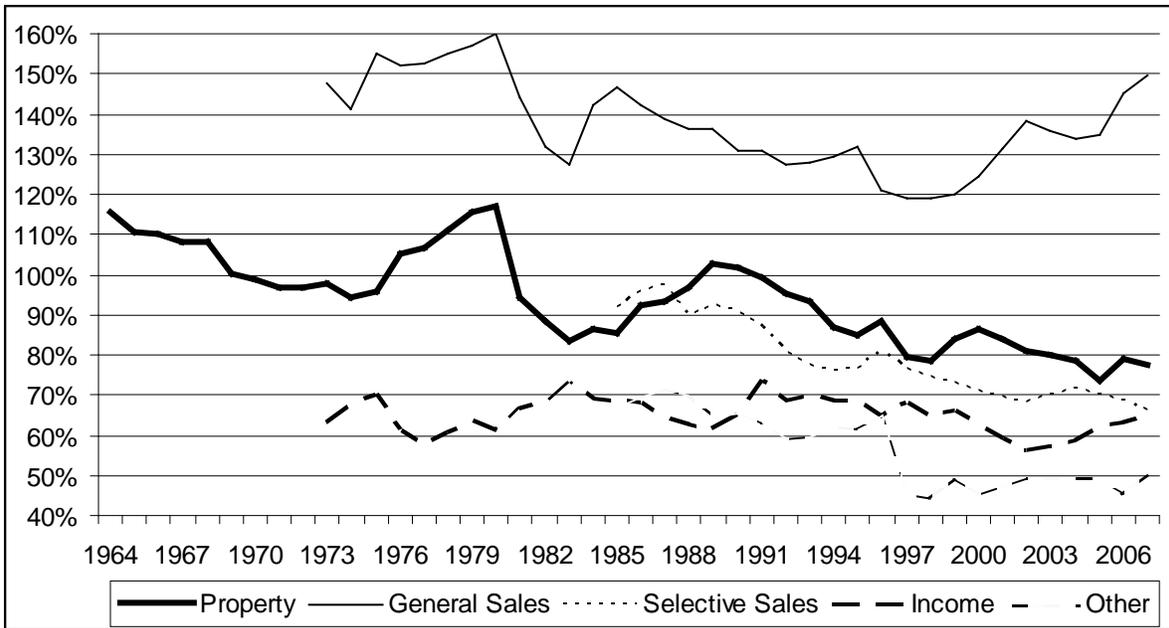
Source: U.S. Department of Commerce, Census Bureau.

**CHART 3.5
COMBINED STATE AND LOCAL GOVERNMENT GENERAL REVENUE
BY TAX SOURCE IN ARIZONA THROUGH FISCAL YEAR 2007**

PER \$1,000 OF PERSONAL INCOME



PER CAPITA AS A PERCENTAGE OF THE NATIONAL AVERAGE



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (revenue and population) and Bureau of Economic Analysis (personal income).

The rise in the general sales tax line at the end of the time series in Chart 3.5 also is a reflection of the temporary boom in the economy.

Property Taxes

Though the state portion of the property tax was eliminated in 1997 and other decreases have occurred over time, the property tax remains a major source of revenue to local governments. Combined state and local government property tax collections in 2007 totaled \$6.2 billion, 15 percent of all state and local government revenue. This includes motor vehicle license taxes based on vehicle value, which are classified as property taxes by the Census Bureau. On a per capita basis, Arizona's property tax collections of \$991 were 22 percent less than the national average, ranking 34th overall and seventh among the western states. Relative to personal income, collections were 12 percent below average, 30th in the nation but third in the West. Between 1992 and 2007, property tax collections in Arizona fell 24 percent relative to personal income. The ratio to the national average dropped 23 percentage points and the national rank went down 12 places.

Sales and Gross Receipts Taxes

The sales and gross receipts category includes the general sales tax (transaction privilege tax in Arizona) and selective sales taxes.

General Sales Tax

The general sales tax was the largest single source of revenue in Arizona in 2007, with collections of \$9.4 billion accounting for 22.7 percent of total, 10 percentage points higher than the national average share. The state's use of this tax was far above the norm. Per capita, collections were \$1,492 in 2007—50 percent above average, ranking fifth in the nation and second in the West. Relative to personal income, collections were 70 percent above average, sixth in the nation and third in the West. States with higher collections included Arkansas (relative to personal income), Hawaii, Louisiana, New Mexico (relative to personal income), Washington, and Wyoming (per capita).

Between 1992 and 2007, revenue from the general sales tax rose 16 percent in Arizona relative to personal income. The state's ratio to the U.S. average went up 22 percentage points.

Selective Sales Taxes

Selective sales taxes are taxes assessed on certain commodities or services separate from the general sales tax. Arizona governments collected \$1.9 billion from all selective sales taxes in 2007—less than 5 percent of total revenue compared to a national average share of 6 percent. Per capita collections were 34 percent below average, ranking 47th nationally and eighth among the western states. Georgia, Idaho, Oregon, and Wyoming had lower collections per capita. Relative to personal income, revenue from selective sales taxes was 25 percent below average in Arizona, ranking 42nd among all states and sixth in the West. Between 1993 and 2007, collections fell 23 percent relative to personal income, with the ratio to the national average falling 15 percentage points and the national rank 9 places.

The various selective sales taxes are shown in Table 3.1. Per capita and relative to personal income, Arizona was far below the national norm on collections from alcoholic beverages,

public utilities, and miscellaneous other selective sales taxes. Arizona was above average on the tobacco products tax and average (per capita) on the motor fuels tax.

Per \$1,000 of personal income, collections and the ratio to the national average fell significantly from 1993 through 2007 in the motor fuels, public utilities, and alcoholic beverages categories. In contrast, due to the voter-approved initiative raising tobacco taxes in 2002, Arizona went from below to above the national average on tobacco tax collections per \$1,000 of personal income.

Income Taxes

The Census Bureau did not subdivide income taxes into individual and corporate components until 1993.

Individual Income Tax

The individual income tax provided revenue of \$3.7 billion in Arizona in 2007. This was only 9.1 percent of all revenue; the national share was 12.4 percent. Revenue of \$597 per resident was 38 percent below the national per capita average. Relative to personal income, Arizona's individual income tax collections were 30 percent less than average. Arizona ranked 40th overall and sixth in the West on both measures. Nine states (including three western states) do not tax wage and salary income, so only two states that use the individual income tax collected less per capita. Between 1993 and 2007, collections per \$1,000 of personal income dropped 8 percent. The ratio to the national average fell 15 percentage points and the national rank dropped 4 places.

Corporate Income Tax

The corporate income tax raised \$986 million in Arizona in 2007. Its share of total revenue was 2.4 percent, compared to a national average of 2.6 percent. On a per capita basis, Arizona's collections were 22 percent below average, but ranked 25th overall and third in the West. Relative to personal income, collections were 11 percent below average, 25th nationally and fourth in the West. Corporate collections are highly cyclical, so the 36 percent increase relative to personal income between 1993 and 2007 is misleading, comparing an economic recovery year to a cyclical peak.

Other Taxes

The Census Bureau considers the portion of the motor vehicle license tax based on the value of the vehicle to be a property tax—a different categorization than used by the state of Arizona. Thus, for Arizona, the Census Bureau's vehicle license tax category is limited to various fees. Using this definition, \$238 million was collected from this source in Arizona in 2007. The share of total revenue was below the national average. The per capita figure was less than half the national average, third lowest in the national and last in the West. Per \$1,000 of personal income, the 2007 revenue was 38 percent less than the national average and ranked 43rd nationally and last among the western states. Relative to personal income, collections fell 62 percent in Arizona between 1992 and 2007, causing the ratio to the U.S. average to fall 70 percentage points; the national rank dropped 31 places. This large decline, however, may reflect an inconsistency over time in the Census Bureau's reporting.

Collections from miscellaneous other taxes amounted to \$842 million in Arizona in 2007. Arizona's collections were far less than the national average: 52 percent below average per capita (ranked

43rd) and 45 percent below average relative to personal income (ranked 41st). One western state was lower on each measure. While still very low in 2007, collections rose 41 percent relative to personal income between 1993 and 2007, pushing up the ratio to the U.S. average and the national rank.

Current Charges

Current charges are defined by the Census Bureau as payments for the provision of specific services that benefit the person charged. They consist primarily of user fees, with maintenance assessments also included.

Total current charges in Arizona amounted to \$5.2 billion in 2007. The 12.5 percent share of all revenue was less than the U.S. average of 15.1 percent. Per capita collections were 30 percent below the national average, second lowest in the nation (Connecticut was lower). Collections per \$1,000 of personal income were 20 percent below average, 42nd in the nation and last among the western states. Though collections rose 7 percent relative to personal income between 1992 and 2007, Arizona fell somewhat further behind the national norm.

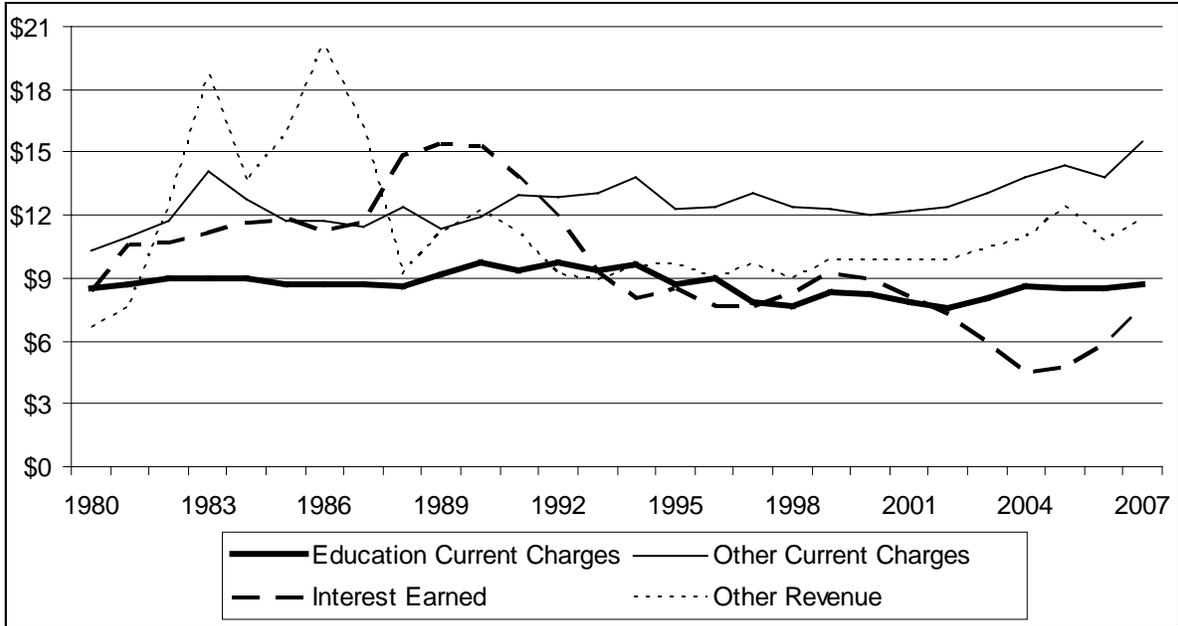
Of the many categories of current charges shown in Table 3.1, Arizona collected less than average in most. In Chart 3.6, education current charges are separated from the others. Education charges per \$1,000 of personal income have largely been steady, but have fallen relative to the national average since 1990. Other charges rose in recent years relative to personal income.

Other Revenue Sources

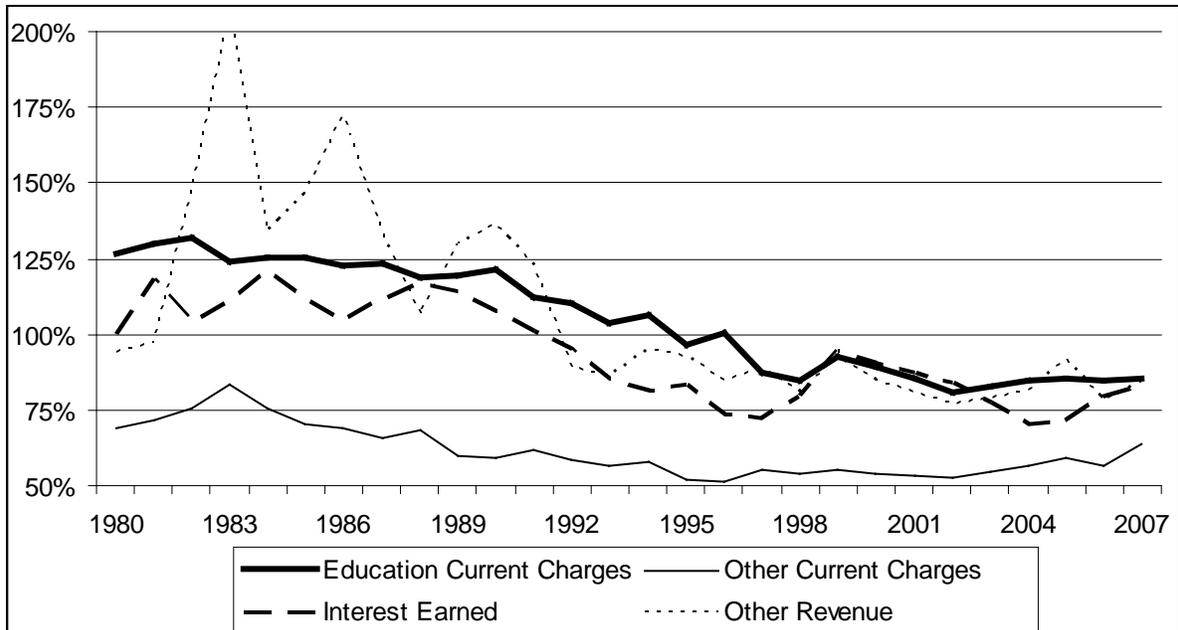
Miscellaneous other sources of revenue accounted for 10 percent of the total in 2007, nationally and in Arizona. However, Arizona was 16 percent below the per capita average and 5 percent less relative to personal income, falling further below average between 1992 and 2007. Arizona was below average per capita and relative to personal income in the two large subcategories of interest earned and miscellaneous “other” sources of revenue, ranking in the 30s nationally on both and near the bottom of the western states. The state fell further below average in both between the early 1990s and 2007.

**CHART 3.6
COMBINED STATE AND LOCAL GOVERNMENT GENERAL REVENUE
BY NONTAX SOURCE IN ARIZONA, FISCAL YEARS 1980 THROUGH 2007**

PER \$1,000 OF PERSONAL INCOME



PER CAPITA AS A PERCENTAGE OF THE NATIONAL AVERAGE



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (revenue and population) and Bureau of Economic Analysis (personal income).

CHAPTER 4 TAX BURDEN

The tax burden is simply the amount of taxes paid relative to income. Various measures are available. Some present the combined tax burden of individuals and businesses, but separate measures of the business tax burden and the individual tax burden are available or can be constructed.

Various methodologies have been used to calculate tax burdens. Most can be classified as a “macro” approach in which aggregate taxes paid, typically as reported by the U.S. Census Bureau, are divided by a measure of size—commonly population or personal income—so that states can be directly compared. In contrast, the “micro” approach creates a hypothetical household or business, then works through the actual tax code to determine the tax payments that the hypothetical household or business would need to make in each state.

Though some data are available separately for state government taxes and local government taxes, the most meaningful comparisons of tax burdens across states combine state and local government taxes. The government jurisdiction—state government or local governments (counties, cities and towns, school districts, and special districts)—responsible for taxing and spending varies by state.

In general, when comparing taxes over time, it is important to look at a long time series or to ensure that the comparison year is comparable to the latest year in terms of its point within the economic cycle. Tax collections are cyclical and some states, including Arizona, experience particularly large cyclical variations.

BUSINESS TAX BURDEN

Business taxes can be defined as taxes imposed on the purchase, ownership, or use of inputs in a productive activity. In addition to federal taxes, such as payroll taxes for Social Security and Medicare, businesses are potentially subject to a number of state and local government taxes:

- **Property:** Nationally, this is the largest source of business tax payments. Personal property (such as equipment) may be taxed as well as real property.
- **General sales:** The second-largest source of business tax payments nationally, sales taxes are applied to business purchases of equipment or materials. However, businesses in Arizona benefit from numerous exemptions from the sales tax. For example, articles to be incorporated into a manufactured product and wholesale goods are exempt from the tax.
- **Income:** Corporations pay a corporate income tax, but most businesses are not incorporated—their income taxes are paid through the individual income tax.
- **Business license.**
- **Unemployment insurance.**
- **Gross receipts:** These taxes often are paid in lieu of corporate income or property taxes. Taxes on insurance premiums and public utilities are examples.
- **Excise:** Selective sales taxes, such as the tax on motor vehicle fuel.

- Other: Severance taxes, levied on the extraction of natural resources such as oil, are an example. (Arizona has limited opportunities to impose severance taxes; this tax has become an insignificant source of revenue in the state in recent decades.)

The Payment of Business Taxes

While businesses technically pay the various taxes levied upon them, the actual burden of business taxes may fall on a number of parties, including the business (paid out of business income), consumers (higher prices of goods and services), workers (lower wages), and owners of land (lower land values and rents). It is difficult to ascertain the final burden in all cases. In this chapter, a “business tax” refers to any tax whose initial incidence rests with business owners, even though the ultimate burden of the tax may fall on other entities. (Technically, Arizona’s sales tax is a transaction privilege tax paid by businesses, but the portion of the revenue collected from sales to individuals is not included in this chapter as a business tax.)

Taxes are just one of many business expenses that play a role in determining the price of a good or service. Many companies that sell goods and services to Arizona residents have a “captive” market—for example, a Phoenix resident is not going to travel to New Mexico to buy their groceries. Further, these companies are subject to the same state tax code. Under these conditions, a company generally is able to pass the expense of taxes to the consumer in the form of a higher price for their good or service.

In contrast, businesses that primarily sell to customers outside the state have difficulty recovering their local expenses (including tax payments) in higher prices because they are subject to international competition. If local business taxes are high, this may suppress the number of business facilities located in the area, which in turn may hold down land prices and/or wages. However, if lower costs in wages or rents are not sufficient to offset a high business tax burden, an exporter may simply choose not to locate in an area.

Ernst & Young Business Tax Burden

Ernst & Young (E&Y) has produced a very detailed analysis of business taxes (for the Council on State Taxation). An estimate of the actual taxes paid by businesses by state in fiscal year 2008 is provided in each of seven categories. Taxes paid to state governments are shown separately from taxes paid to local governments. Total taxes paid by businesses and individuals combined are also provided. Conceptually, the methodology used in the study is strong. In practice, the shortcoming is that business payments in many of the tax components had to be estimated. Still, it appears that E&Y expended considerable effort in estimating these figures.

In order to compare business taxes across states, E&Y provides three measures. First and foremost, total state and local government tax dollars paid by businesses are adjusted by private-sector gross domestic product by state to provide a measure of the total effective tax rate (tax burden) by state. Business taxes amounted to 4.71 percent of private-sector gross product in Arizona in 2008, marginally less than the national average. Arizona ranked 24th among the 51 ‘states’ (including the District of Columbia) and fourth among nine western states. In the West, New Mexico, Texas, and Washington had higher business tax burdens. Though often cited as having high taxes, the business tax burden in California was slightly lower than in Arizona and ranked 32nd nationally.

Second, E&Y estimates the percentage of all taxes that are paid by businesses. In 2008, businesses paid 49.9 percent of all state and local government taxes in Arizona, a greater share than the national average of 44.1 percent. This share tied for 15th highest nationally and tied for fourth highest in the West. The business share was higher for local government taxes than for state government taxes in Arizona and nationally. In Arizona, the business share was above the national average for both state and local taxes, though more so for local taxes.

Third, E&Y estimates the ratio of state and local government business taxes relative to benefits received by businesses, an indicator originally developed by the Federal Reserve Bank of Chicago. The latest data for this measure are for 2006. The ratio of business taxes to benefits in Arizona was 1.64, less than the national average of 1.83. Arizona's ratio ranked 38th nationally and sixth in the West. In every state, the business tax burden is greater than the benefits businesses receive—all states shift the tax burden from individuals to businesses to some degree.

Though businesses pay a higher-than-average share of all taxes in Arizona, the business tax burden—both as a share of gross product and relative to benefits received—is below the national average in Arizona. Similarly, business taxes are below average in Arizona based on the per capita and per \$1,000 of personal income measures used to measure total and individual tax burdens, though not as far below average as nonbusiness taxes.

E&Y warns, however, that a measure of the overall business tax burden is just a starting point for comparing tax burdens across states. They note the importance of the structure and composition of business taxes. The example cited in their report is of two states with equivalent overall business tax burdens. One state, however, imposes higher origin-based taxes on business capital (property and sales taxes). Thus, its taxes on capital-intensive manufacturers are relatively high while taxes on labor-intensive service industries are relatively low. This places the state at a competitive disadvantage in attracting plant and equipment and thus may hinder economic growth even though its overall business tax burden is the same as the other state.

The Ernst & Young business tax study has been done for the last several years. Little change has occurred in Arizona's business tax burden relative to the national average.

Analysis by Tax

Ernst & Young estimates business taxes in seven categories, as seen in Table 4.1. Arizona's business tax burden (as a percentage of private-sector gross product) among all 50 states and the District of Columbia in 2008 was very high on the sales tax. The property tax burden was a little higher than the national average but ranked in the middle of all states, though it was second highest among the nine western states. All other business tax burdens were at least 16 percent below the national average. The excise/gross receipts and corporate income tax burdens ranked only slightly better than the middle of the states nationally, while the individual income, unemployment insurance, and license and other taxes in Arizona were among the lowest in the nation and in the West, with the tax burden of each at least 46 percent less than the national average.

Thus, the only two business taxes that are not low in Arizona are the two that provide the most tax revenue, not only in Arizona but nationally. The property and sales taxes disproportionately

**TABLE 4.1
COMBINED STATE AND LOCAL GOVERNMENT BUSINESS TAX BURDEN
MEASURED AS A PERCENTAGE OF PRIVATE-SECTOR GROSS PRODUCT BY
TYPE OF TAX IN ARIZONA, FISCAL YEAR 2008**

Tax	Percentage of Gross Product	Difference from National Average	Rank Among 51 'States'**	Rank Among Nine Western States***
TOTAL	4.71%	-1%	24	4
Property and Sales Combined	3.38	23	11	2
Property	1.76	5	27	2
Sales	1.62	54	7	3
Excise and Gross Receipts	0.46	-16	29	6
Corporate Income	0.37	-20	30	4
Individual Income*	0.14	-59	41	6
Unemployment Insurance	0.09	-46	45	8
License and Other	0.28	-46	39	8

* On business income

** A rank of 1 indicates the highest tax burden; includes the District of Columbia

*** A rank of 1 indicates the highest tax burden; the western states are Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington

Source: Ernst & Young, "Total State and Local Business Taxes: 50-State Estimates for Fiscal Year 2008," January 2009.

hit capital-intensive businesses such as manufacturers. Therefore, a conclusion of average business taxes in Arizona based on the overall business tax burden measure is misleading in terms of economic development.

Economic development focuses on companies that export their products (goods and services) to customers outside of Arizona. These export companies drive the economy; companies that serve local customers (the bulk of the companies) respond to conditions in the export sector. Export activities in Arizona include agriculture, manufacturing, tourism, and some services, but high-technology manufacturers and mining companies historically have been among the state's most important exporters. Manufacturing and mining companies are capital intensive: they have large facilities with considerable equipment. With the combined property and sales tax burden one of the highest in the country, and second highest in the West (only Washington was higher), the overall state and local government tax burden of these capital-intensive companies is above average in Arizona. In contrast, the tax burden of local service firms is below average.

The combined 2008 sales and property tax burden in Arizona of 3.38 percent of private-sector gross product compares to a national average of 2.74 percent. This tax burden was lower than the national average in six of the western states, including California at 2.28 percent. Thus, Arizona is not even close to competitive on these key taxes.

The tax burden on capital-intensive export companies is even higher in Arizona than indicated by the Ernst & Young data because the property tax burden of such companies is higher than the average of all businesses as reported by E&Y. More detail on the property tax is available from a

study produced by the Minnesota Taxpayers Association. This group undertakes detailed calculations to determine the total state and local government property tax burden in the largest city of each state. (The second largest city is used in Illinois and New York since property taxes in Chicago and New York City are not representative of the state. Calculations also are made for a representative rural area in each state, but these results were not analyzed for this paper.) Calculations are made for various property values in each of four property classifications: residential, commercial, industrial, and apartment. The market value is assumed to be the same in all cities so that the results reflect differences in the tax codes across states rather than differences in property values. (The residential property tax also is calculated based on the median value by state.)

For the nonresidential categories, the total property value is split between real and personal property. In the case of apartments and commercial properties, personal property equates to fixtures. For industrial properties, personal property includes fixtures, machinery and equipment, and inventories. Property taxes for the industrial classification were calculated three ways, using two differing assumptions of the percentage of the total value made up by personal property, and using state-specific personal property shares.

Property taxes as estimated by the Minnesota Taxpayers Association for tax year 2008 are summarized in Table 4.2. The property tax burden of homeowners was low in Arizona at 42-to-44 percent less than the national average. The tax burden on apartments was comparably low.

In contrast, commercial property taxes in Arizona were more than the national average, especially at higher valuations. Arizona had the highest taxes among the nine western states at valuations of \$1 million or more.

For industrial properties with a low valuation, the property tax burden in Arizona was less than the U.S. average and ranked among the middle of the states. In contrast, the property tax burden in Arizona was quite high for industrial properties of higher valuations, particularly for those with a high percentage of personal property: Arizona ranked among the 10 highest industrial property tax burdens in the nation, and second highest in the western states.

INDIVIDUAL TAX BURDEN

A study produced by the government of the District of Columbia uses a “micro” approach to assessing the tax burden of households. Using the actual tax laws in each state, it calculates the amount of taxes that would be paid by a hypothetical household at five income levels. Since the property tax within states varies by locality, the calculations are made for the largest city in each state. Not all taxes are estimated, but the three major tax sources (income, property, and sales) as well as automobile-related taxes are included. While the results can provide high-quality information for the hypothetical household, the findings should not be generalized to other households. Though this study has been produced annually over the last decade, the authors of the study warn against using it as a time series due to changes in methodology.

The results of the 2008 District of Columbia study are summarized in Table 4.3. The overall tax burden (the sum of the four tax categories) was substantially below the norm in Phoenix except in the lowest income category. The income tax and property tax burdens were quite low, the sales tax

TABLE 4.2
URBAN PROPERTY TAX BURDEN MEASURED AS THE AMOUNT OF TAX PAID
BY PROPERTY CLASSIFICATION IN ARIZONA, TAX YEAR 2008

Property Classification and Value	Rank Among 51 States*	Difference from National Average	Rank Among Nine Western States**
Residential (“homestead”)			
\$150,000	40	56%	7
\$300,000	39	58	6
Median Value	38	57	7
Commercial			
\$100,000	22	103	3
\$1 million	17	119	1
\$25 million	15	127	1
Industrial***			
\$100,000	31	81	5
\$1 million	12	132	2
\$25 million	10	138	2
Industrial****			
\$100,000	21	93	3
\$1 million	9	140	2
\$25 million	9	145	2
Industrial*****			
\$100,000	25	88	5
\$1 million	10	141	2
\$25 million	8	147	2
Apartment			
\$600,000	42	59	6

* A rank of 1 indicates the highest tax; includes the District of Columbia

** A rank of 1 indicates the highest tax; the western states are Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington

*** Assumes that half of the value is in personal property

**** Assumes that 60 percent of the value is in personal property

***** Assumes that the percentage of the value that is personal property is equal to the average by state

Source: Minnesota Taxpayers Association, “50-State Property Tax Comparison Study,” April 2009.

burden was very high, and the automobile taxes ranged from low at the lowest income level to higher than in the median state at higher income levels.

Compared to the largest city in each of the western states, the tax burden in Phoenix ranged from highest at the \$25,000 income level to lowest at the \$50,000 level. It ranked third or fourth lowest among the nine cities at each of the three highest incomes. Overall, Nevada and Texas had the lowest individual tax burdens among these nine states at each income level. Except at the lowest income level, the highest tax burden was in California.

The sales tax burden in Arizona was the highest in the West at each income level; the property tax burden was lowest except for second lowest at the highest income. The income tax burden was in the middle at all incomes (three of the western states do not levy an income tax) and the auto-related taxes ranged from below average at lower incomes to above average at higher incomes.

**TABLE 4.3
COMBINED STATE AND LOCAL GOVERNMENT INDIVIDUAL TAX BURDEN
IN PHOENIX, ARIZONA, 2008**

	Household Income				
	\$25,000	\$50,000	\$75,000	\$100,000	\$150,000
Rank Among 51 'States' *					
Income Tax	25	39	39	40	41
Property Tax	24	46	47	46	47
Sales Tax	2	2	2	2	2
Automobile Taxes	39	24 tie	26	16	16
Sum of Four Tax Categories	14	45	41	40	41
Taxes as a Percentage of Income					
Sum of Four Tax Categories	11.6%	5.9%	5.8%	6.3%	5.7%
Difference from Average State	0.7	-2.3	-2.2	-1.9	-2.1
Difference from Median State	0.8	-1.8	-2.2	-1.9	-2.7

* A rank of 1 indicates the highest tax of 51 cities: the largest city of each state and the District of Columbia

Source: Government of the District of Columbia, *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison*.

It is also possible to estimate the individual tax burden using the data produced by Ernst & Young. Subtracting business taxes from the total taxes that E&Y reports provides an estimate of individual taxes. Per capita, Arizona ranked 45th in the nation in 2008, with an individual tax burden 35 percent less than the national average. Per \$1,000 of personal income, Arizona ranked 42nd at 25 percent less than the national average. Two western states (New Mexico and Texas) had a lower tax burden on both measures.

OVERALL TAX BURDEN

Other than for the income tax, for which the individual and corporate tax receipts are separated, the Census Bureau data cannot be used to differentiate between taxes and fees paid by businesses and those paid by individuals. Thus, the tax burden calculated from the Census Bureau data is an overall tax burden, representing a meld of businesses and individuals.

The Tax Foundation provides an alternative measure of the overall tax burden. It defines taxes differently than does the Census Bureau and uses a different gauge of income in order to compare states. However, both datasets are based on the “macro” approach to measuring tax burden.

Census Bureau

As calculated by aggregate tax collections, the overall tax burden in Arizona measured on a per capita basis was 12 percent less than the national average in 2007. It ranked 30th nationally and sixth in the West. Per \$1,000 of personal income, the tax burden did not compare as favorably, just 1 percent less than the national average, ranking 22nd nationally and third in the West.

As measured in this way, the tax burden in Arizona fluctuates with the economic cycle. Without any changes in tax rates, tax receipts relative to income are higher during an economic expansion than those during an economic recession. While this cyclicity is common to all states, it is much more

pronounced in Arizona, such that the state's rank among the states also rises and falls with the economic cycle.

Tax rates and other aspects of the tax code (such as tax credits and exemptions) of state and local governments are constantly changing, which also contributes to the temporal pattern of Arizona's tax burden. The tax burden measured per \$1,000 of personal income is displayed in the top graph of Chart 4.1. The increase in the measured tax burden in 2006 and 2007 was due to the economic boom. Even with this increase, the tax burden in 2007 was less than during the 1970s, late 1980s, and early 1990s. When data for 2008, 2009, and 2010 become available, the apparent tax burden will plunge.

The bottom graph of Chart 4.1 demonstrates that the tax burden in Arizona has fallen substantially since the 1960s relative to other states, though in an erratic manner. Per \$1,000 of personal income, the tax burden in Arizona was greater than the national average through the mid-1990s, other than during the early 1980s. It has been consistently less than the U.S. average since 1997, even at the peak of the cycle in 2007. The tax burden in Arizona is further below the national average based on the per capita measure. On this basis, the tax burden was slightly higher than the national average during the 1960s and again in the late 1970s, but has fallen significantly since then. Per capita taxes collected in Arizona in 2007 at the peak of the economic cycle were 12.5 percent below the national average.

The tax burden in Arizona in 2007 is compared to other western states in Chart 4.2. Per capita taxes in Arizona were only higher than those in Oregon, Texas and Utah. In contrast, the tax burden relative to income was third highest. The state's comparative tax burden with the western states fluctuates with the economic cycle.

Tax Foundation

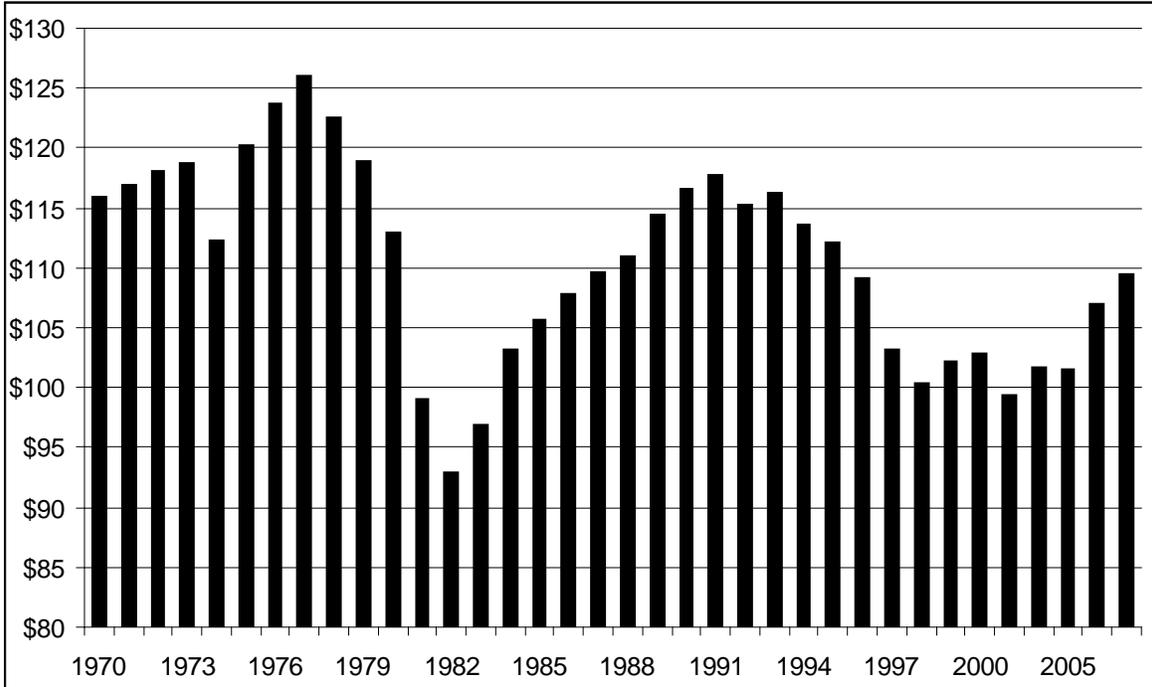
The Tax Foundation's measure of tax burden is defined to answer the question "How much are the residents of a state paying to state and local governments, regardless of the state in which the government is located?" In order to answer this question, tax burdens are shifted as necessary from the state of collection to the state of residence of the taxpayer. In addition to the geographic shifting of the tax burden, the Tax Foundation measure is different from the Census Bureau measure in the way in which both taxes and income are defined.

As calculated by the Tax Foundation, the state and local government tax burden in Arizona—defined as per capita taxes as a share of per capita income— was about equal to the national average at around 10 percent of income from 1977 (the first year available) through 1979. However, Arizona ranked above the median state (with between the 17th- and 20th-highest tax burden) during those years. Since 1981, when it fell to less than 9 percent of income, Arizona's tax burden has always been lower than the U.S. average.

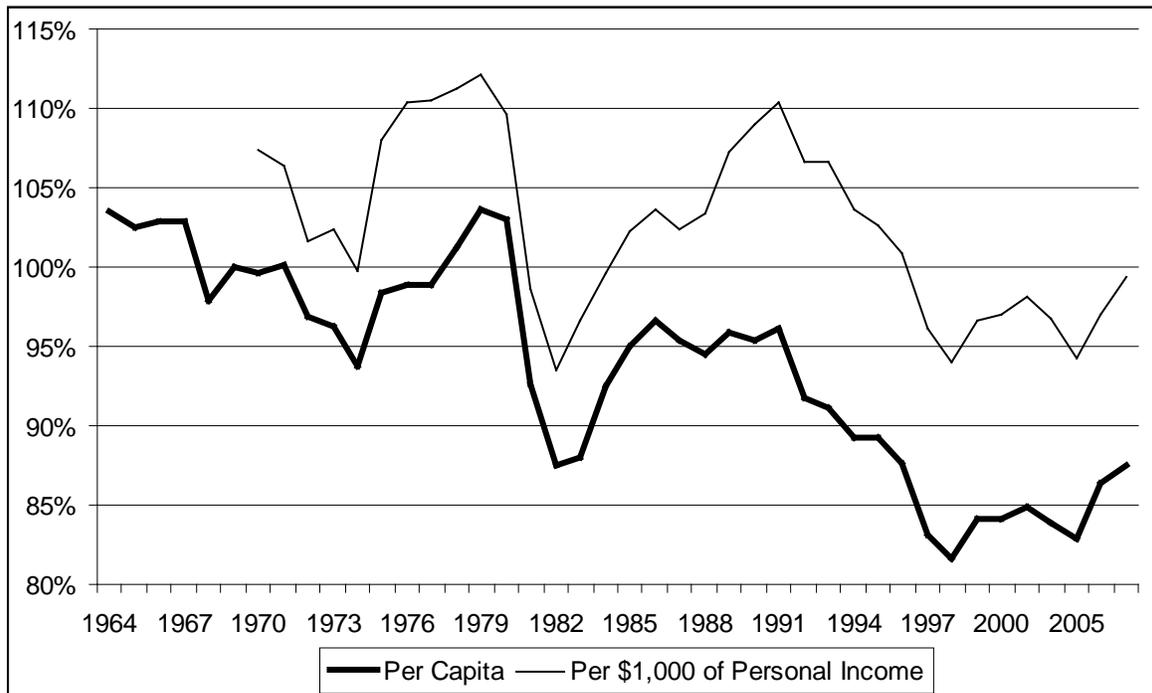
State government tax reductions from 1979 through 1981 sent the burden down. An inability to balance the budget led to a subsequent tax increase in 1983, but the burden during the rest of the 1980s remained less than in the late 1970s. When the economy slowed in the late 1980s, state government revenue was insufficient to meet the needs, causing spending reductions and further tax increases. The tax burden approached the national average in 1991 when Arizona ranked 25th

**CHART 4.1
COMBINED STATE AND LOCAL GOVERNMENT TOTAL TAX BURDEN
IN ARIZONA, THROUGH FISCAL YEAR 2007**

PER \$1,000 OF PERSONAL INCOME

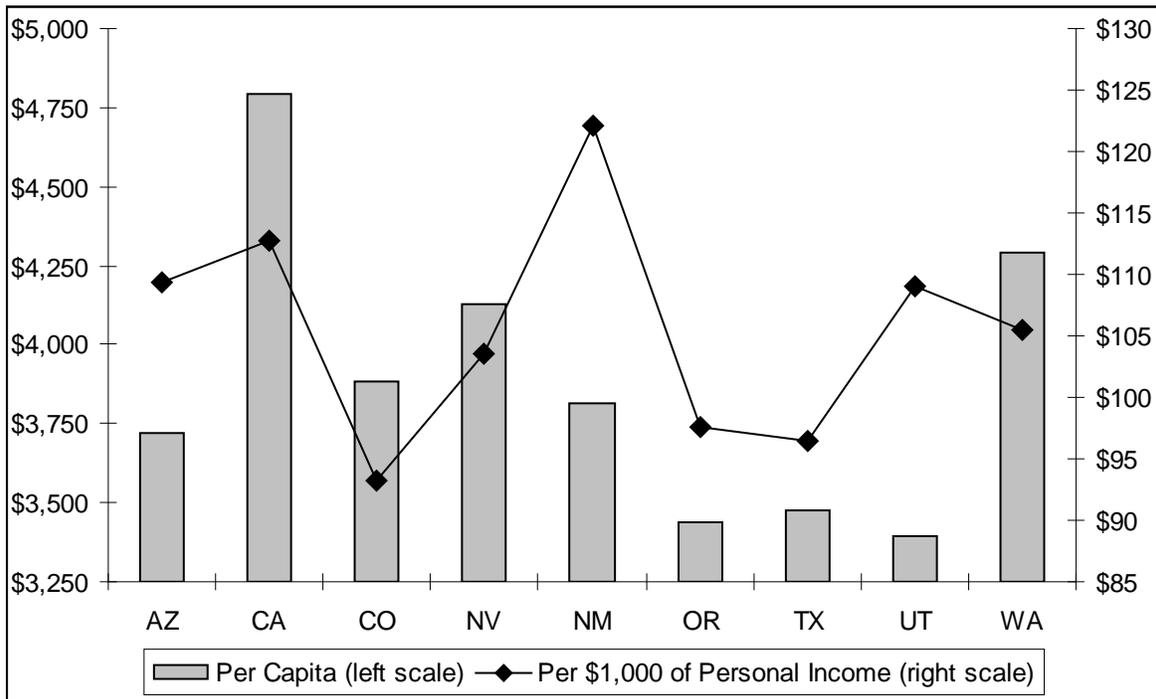


AS A RATIO TO THE NATIONAL AVERAGE



Sources: U.S. Department of Commerce, Census Bureau (taxes and population) and Bureau of Economic Analysis (personal income).

**CHART 4.2
COMBINED STATE AND LOCAL GOVERNMENT TOTAL TAX BURDEN
IN WESTERN STATES, FISCAL YEAR 2007**



Sources: U.S. Department of Commerce, Census Bureau (taxes and population) and Bureau of Economic Analysis (personal income).

among the states. However, even after these increases, the tax burden remained below the pre-1980 level as well as below the national average (see Chart 4.3).

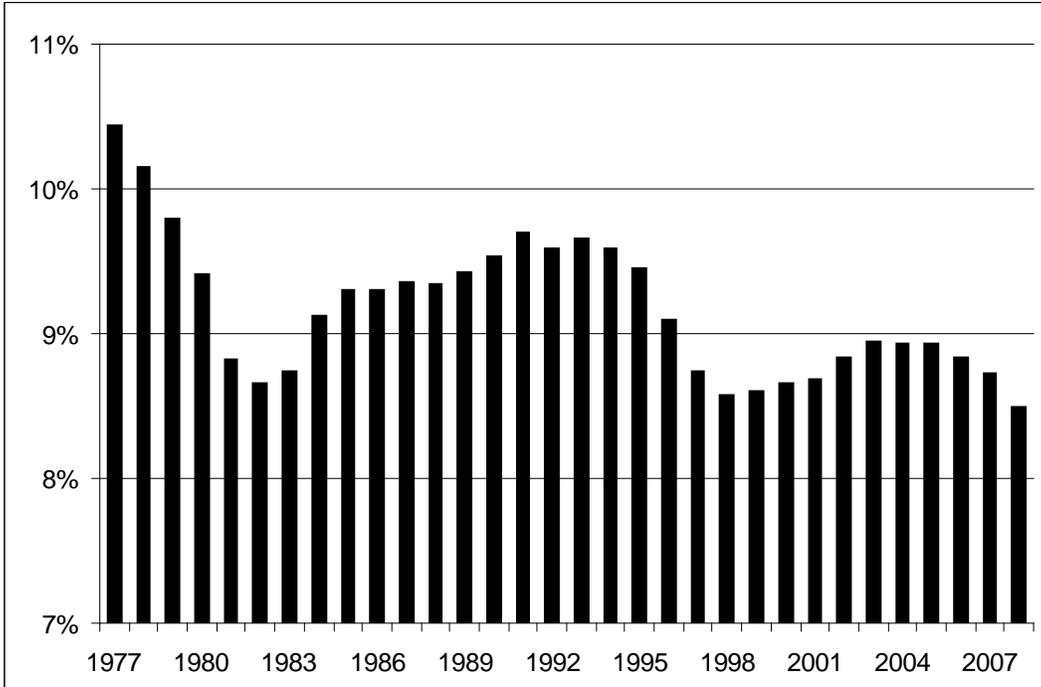
A series of state government tax cuts began in the early 1990s, lowering the tax burden to below the level of the early 1980s. Since 1991, Arizona's tax burden has declined from 9.7 percent of per capita income to 8.5 percent in 2008. The national average tax burden barely dropped during this period and was 9.7 percent in 2008. The burden in Arizona in 2008 was 1.2 percentage points less than the national average, the largest differential on record. Arizona ranked 41st (10th lowest) among the 50 states, its lowest rank on record, down from a rank of 17th highest in 1977.

Among the subset of nine western states, Arizona's tax burden ranked seventh (third lowest) in 2008 (see Chart 4.4). It had ranked as high as fourth highest in 1979.

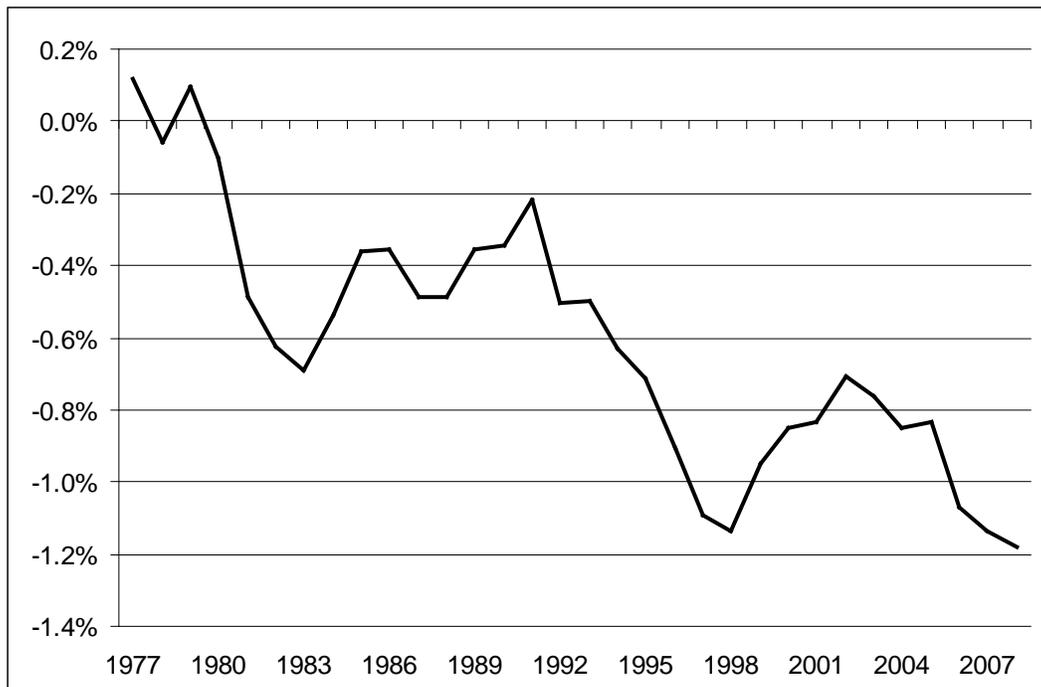
Thus, the Tax Foundation results are consistent with the Census Bureau data in showing that the overall tax burden in Arizona is among the lowest in the country and has fallen significantly over time, particularly since the early 1990s. This consistency is significant given that the Tax Foundation's method of estimating taxes is very different from that of the Census Bureau. Further, the Tax Foundation's measure of income is different from the personal income measure used to adjust the Census Bureau data.

**CHART 4.3
COMBINED STATE AND LOCAL GOVERNMENT TOTAL TAX BURDEN
IN ARIZONA, 1977 THROUGH 2008**

AS A PERCENTAGE OF INCOME

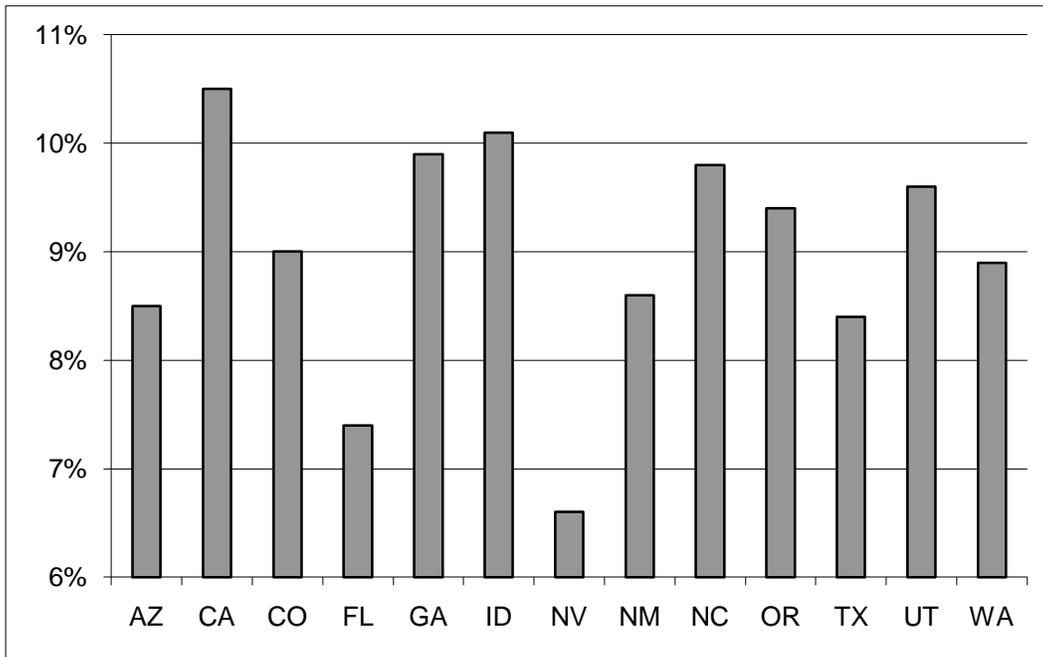


RELATIVE TO THE NATIONAL AVERAGE



Source: Tax Foundation, "State-Local Tax Burdens Dip as Income Growth Outpaces Tax Growth," August 2008.

**CHART 4.4
COMBINED STATE AND LOCAL GOVERNMENT TOTAL TAX BURDEN
IN WESTERN STATES, 2008**



Source: Tax Foundation, “State-Local Tax Burdens Dip as Income Growth Outpaces Tax Growth,” August 2008.

CONCLUSION

The overall tax burden in Arizona is lower than in most states, and lower than it was in the past. Six measures of the overall tax burden—three per capita and three relative to income—are summarized in Table 4.4. The two measures calculated from Census Bureau data show a higher tax burden than the others. Most of the discrepancy derives from the latest Census Bureau data being for fiscal year 2007—prior to the onset of the recession—while the other indicators are for the recessionary year of 2008.

This low overall burden is the result of a very low tax burden for individuals and a moderate tax burden for businesses. All of the measures agree that Arizona’s individual tax burden is among the lowest in the nation at about 25 percent less than the national average, except at the lowest income level measured. The individual income and residential property taxes are very low. In contrast, the sales tax burden is quite high. Other than these three major taxes, Arizona’s tax burden on individuals is relatively low on all other taxes combined.

While the overall business tax burden data suggest a moderate-to-below-average burden in Arizona, this disguises the variation in the relative burden by type of business. Small unincorporated businesses have a relatively low tax burden while the taxes paid by large corporations, particularly manufacturers and other capital-intensive companies, are relatively high. The differential in tax burden between small and large businesses results from two factors. Business property taxes are moderate for properties with a low valuation but quite high for large

businesses. In addition, unincorporated businesses file under the individual income tax code, which results in a lesser relative tax burden than for businesses filing under the corporate income tax code.

The tax burden in Arizona is very low on most business taxes. However, the sales tax burden is quite high and the average property tax burden is somewhat above average. While property taxes on properties of low valuation are below the national average, taxes on higher-value properties are considerably higher than the national average. Thus, large companies, especially those classified as industrial and having a considerable amount of personal property, have a very high property tax burden.

Despite low overall taxes, Arizona's tax code is not favorable for economic development, particularly for manufacturers and for other companies that own considerable property. Arizona's tax code is particularly harsh for high-technology manufacturers, which have been declining as a share of the Arizona economy more than the national norm.

TABLE 4.4
SUMMARY OF THE COMBINED STATE AND LOCAL GOVERNMENT
TAX BURDEN IN ARIZONA

	Value	Ratio to U.S. Average	Rank Among 51 'States'*	Rank Among 9 Western States**
OVERALL TAX BURDEN				
CB: Per Capita	\$3,717	88%	30	6
E&Y: Per Capita	\$3,188	72	46	9
TF: Per Capita	\$3,244	76	41	8
CB: Per \$1,000 of Personal Income	\$109.42	99	22	3
E&Y: Per \$1,000 of Personal Income	\$92.20	83	47	9
TF: Percentage of Income	8.5%	88	41	7
INDIVIDUAL TAX BURDEN				
DC: \$25,000	\$2,911	107	14	1
DC: \$50,000	\$2,962	73	45	9
DC: \$75,000	\$4,327	72	41	7
DC: \$100,000	\$6,290	77	40	6
DC: \$150,000	\$8,786	75	41	6
E&Y: Per Capita	\$1,602	65	45	7
E&Y: Per \$1,000 of Personal Income	\$46.32	75	42	7
BUSINESS TAX BURDEN				
E&Y: Percentage of Gross Product	4.71%	99	24	4
E&Y: Per Capita	\$1,586	82	38	7
E&Y: Per \$1,000 of Personal Income	\$45.87	94	33	6

* A rank of 1 indicates the highest tax; includes the District of Columbia

** A rank of 1 indicates the highest tax; the western states are Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington

Sources:

DC: District of Columbia study, measured at five household income levels, 2008

E&Y: Ernst & Young, 2008

CB: Census Bureau, 2007

TF: Tax Foundation, 2008

CHAPTER 5

STATE GOVERNMENT EXPENDITURES

The first part of this chapter relies on state government appropriation (expenditure) data from the Arizona Joint Legislative Budget Committee. Data run from fiscal years 1979 through 2011 (the JLBC revenue data go back to 1971 but the earliest expenditure data are for 1979). Unless otherwise noted, years referred to in this chapter are fiscal years. The discussion in this chapter is limited to ongoing expenditures—excluding, for example, transfers to the Budget Stabilization Fund and payments made in response to a court order.

Ongoing expenditures from the general fund as defined by the JLBC are different from the state government general expenditures defined by the U.S. Census Bureau (discussed later in this chapter). Other than utility and insurance trust funds, the Census Bureau groups Arizona's many funds into its "general" category. Combined state and local government expenditures are discussed in the next chapter.

COUNTERCYCLICALITY OF NEEDS

In the public sector, most public programs experience only a reduction in the *rate of increase* in demand during the typical economic recession. Most government functions are tied to the population, which continues to grow (though less rapidly) during most economic slumps. For example, the number of students to educate generally does not decline, nor does the need for police, fire, and correctional services. While the demand for a few services falls off, such as inspections of buildings under construction, demand for some public-sector functions is countercyclical. For example, the demand for unemployment insurance benefits rises during recessions, as does the number of people eligible for public welfare. Enrollment in community colleges and universities frequently increases during slumps because of limited employment opportunities.

Actual spending is one measure of the demand for services, but since state and local governments must produce a balanced budget each year, spending is constrained by available revenues. Expenditures often are reduced during recessions. For this reason, as well as the addition and deletion of government programs for other reasons, a time series of government spending does not adequately illustrate the cyclical pattern of public demand.

Caseloads also provide an indication of the demand for public services, but changes in eligibility requirements can affect these figures as well. Typically, caseloads begin to rise a little before the official beginning of a recession, then rise rapidly through the recession. During the last two economic cycles, caseloads continued to rise at a rapid pace for about two years after the official end of the recession. In each case, the two years were marked by slow economic growth in which unemployment continued to rise. The total increase in caseloads from the trough shortly before the recession to the peak two years after the end of the recession may exceed 100 percent. Once caseloads peak, they fall steadily throughout the expansionary period. The total decline may be on the order of 50 percent.

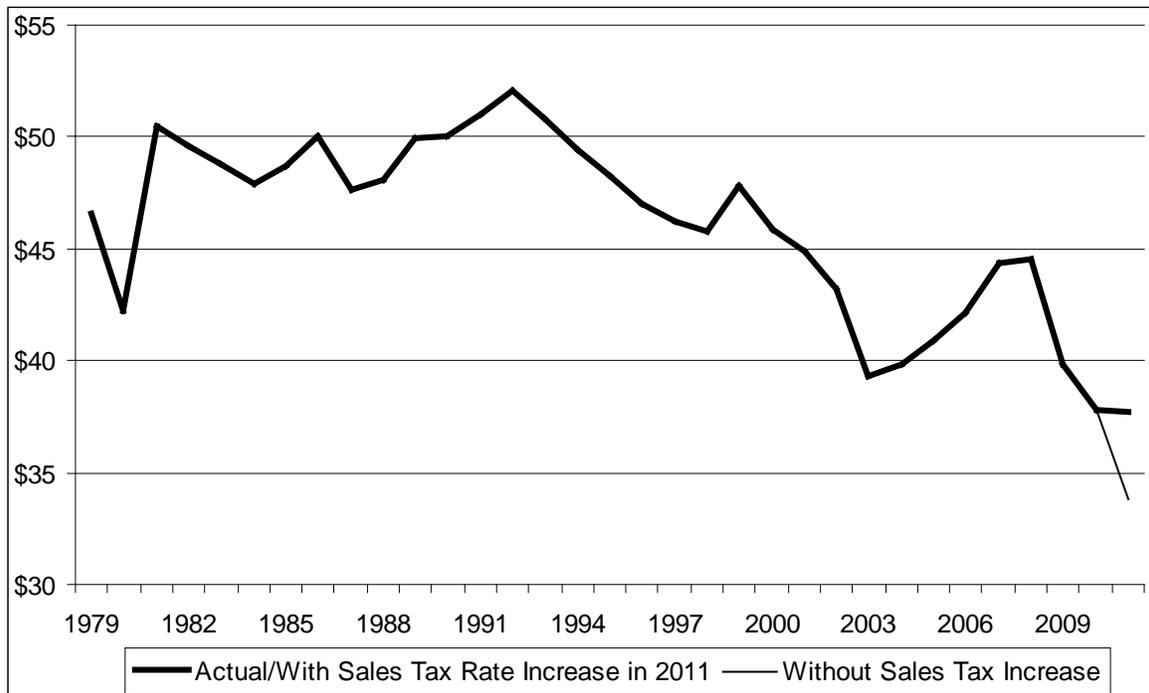
GENERAL FUND ONGOING EXPENDITURES

State government general fund expenditures per \$1,000 of personal income since 1979 are displayed in Chart 5.1. In general, expenditures relative to income have gone up and down with the economic cycle. These fluctuations have not been related to variations in demand for public services but instead have been due to legislative actions in response to the cyclical variations in revenue.

Apart from the cyclical fluctuations, ongoing general fund spending relative to personal income has trended down since the early 1990s. It dropped from a peak in 1992 to below the historical norm in 1998. This was a period of strong economic growth during which demands on the welfare system were muted but overall population growth was at record levels. The spending decreases were coincident to more substantial declines in revenue that resulted from a series of tax reductions.

The large decrease in expenditures per \$1,000 in personal income between 2000 and 2003 was a result of a substantial drop in revenues due to a weak economy and to the large tax decreases implemented between 1995 and 2001. The overall spending drop occurred despite a considerable increase in demand for welfare programs.

CHART 5.1
ONGOING EXPENDITURES PER \$1,000 OF PERSONAL INCOME, ARIZONA STATE GOVERNMENT GENERAL FUND, FISCAL YEARS 1979 THROUGH 2011



Sources: Arizona Joint Legislative Budget Committee (expenditures) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

The subsequent increase in expenditures after 2003 reflects a recovery from the record low spending figure, enabled by a surge in revenue resulting from the strong economy that was enhanced by the real estate boom. Despite the increase in expenditures per \$1,000 in personal income between 2003 and 2008, the 2008 level was lower than in all but one year between 1979 and 2001.

The downturn in the economy, made worse by the real estate bust, caused a huge decrease in revenue beginning in 2008. In response, a substantial decrease in spending occurred in 2009, with a further drop in 2010. If not for the federal stimulus monies, the spending declines in 2009 and 2010 would have been larger. Based on the enacted appropriations for 2011 and a projection of personal income, expenditures per \$1,000 of personal income will fall only marginally further from the all-time low set in 2010 because of the temporary increase in the sales tax rate. Due to the temporary nature of this revenue, Chart 5.1 includes what spending per \$1,000 of personal income would have been without this increase in rate.

Ongoing general fund expenditures in 2010 totaled less than \$8.2 billion, down \$2 billion (19 percent) from the original budget for 2008, before considering population growth and inflation. During 2010, budget cuts from the original appropriation totaled \$1.2 billion, about the same as in the prior year. The total of midyear budget cuts over the last three years has been \$2.6 billion. The appropriation for ongoing expenditures for 2011 is a little higher than the final budget for 2010 at \$8.4 billion. Had voters not approved the sales tax measure, the appropriation would have been reduced by \$862.4 million to less than \$7.6 billion.

Expenditures by Category

The JLBC classifies state government expenditures into several categories, with a varying number of subcategories per category (see Table 5.1). Only general fund appropriations are included in the table; most state programs receive funding from other sources as well as the general fund. Thus, it is not possible to determine the overall effect on an agency from changes in the general fund appropriation.

Education will receive nearly 55 percent of the general fund appropriation in 2011. Health and welfare is the other large category of expenditures, accounting for 29 percent of the total. The protection and safety category is slated to receive 13 percent of the spending. All of the rest of state government will receive only 4 percent of the general fund appropriations—only \$342 million.

As large as education's share will be in 2011, it will be smaller than in the past (see Chart 5.2), dropping from 69 percent in 1979 to less than 55 percent in 2011. (The 2011 data in this and in succeeding charts include the additional revenue from the temporary increase in the sales tax rate.) Offsetting this decline in share is a gain in the share of expenditures for health and welfare, rising from 16 percent in 1979 to 29 percent in 2011. The protection and safety share will rise from 6 percent in 1979 to 13 percent in 2011, while the share of all other spending will fall from more than 8 percent to 4 percent.

Health and welfare spending per \$1,000 of personal income rose substantially in the 1980s and has fluctuated since then, as seen in Chart 5.3. Protection and safety spending per \$1,000 of

**TABLE 5.1
ONGOING EXPENDITURES BY CATEGORY, ARIZONA STATE GOVERNMENT
GENERAL FUND, FISCAL YEARS 2008 THROUGH 2011**

(Dollar Values in Millions)	2008	2009	2010	2011*	2011^	Share	
						2011*	2011^
TOTAL GENERAL FUND	\$9,909.8	\$8,778.8	\$8,157.1	\$8,448.1	\$7,585.7	100.0%	100.0%
Total Education	5,726.2	4,907.0	4,679.2	4,613.3	4,058.8	54.6	53.5
Department of Education	3,946.2	3,707.9	3,515.1	3,491.1	3,062.5	41.3	40.4
Universities/Regents	1,093.1	938.9	891.7	890.3	783.1	10.5	10.3
Community Colleges, Arizona	170.7	138.7	135.3	135.3	120.1	1.6	1.6
School Facilities Board	481.3	87.8	104.8	67.6	66.6	0.8	0.9
School for the Deaf and the Blind	21.4	21.3	21.3	21.3	19.2	0.3	0.3
Other	13.5	12.4	11.0	7.7	7.3	0.1	0.1
Total Health and Welfare	2,581.5	2,383.9	2,118.8	2,423.6	2,218.4	28.7	29.2
AHCCCS	1,227.4	1,179.8	1,134.6	1,290.3	1,176.3	15.3	15.5
Department of Economic Security	754.6	642.7	532.0	633.5	583.0	7.5	7.7
Department of Health Services	572.0	533.6	432.3	485.6	445.6	5.7	5.9
Dept of Environmental Quality	17.3	19.7	12.8	7.0	6.7	0.1	0.1
Department of Veterans' Services	8.7	8.0	7.0	5.5	5.2	0.1	0.1
Other	1.4	0.2	0.1	1.7	1.6	0.0	0.0
Total Protection and Safety	1,111.2	1,068.5	985.3	1,069.2	987.6	12.7	13.0
Department of Corrections	884.3	925.6	866.4	955.2	892.0	11.3	11.8
Dept of Juvenile Corrections	79.8	72.2	63.3	58.3	52.5	0.7	0.7
Department of Public Safety	133.4	55.4	43.6	43.6	32.6	0.5	0.4
Dept Emergency & Military Affairs	10.9	12.4	10.5	10.5	8.9	0.1	0.1
Other	2.8	2.9	1.5	1.6	1.6	0.0	0.0
Total Inspection and Regulation	48.1	40.7	33.2	30.5	27.2	0.4	0.4
Department of Agriculture	11.9	10.2	8.6	8.6	8.2	0.1	0.1
Department of Insurance	7.2	6.4	5.6	5.6	5.4	0.1	0.1
Department of Racing	2.7	2.3	5.7	3.9	3.7	0.0	0.0
Department of Real Estate	4.4	3.7	3.0	3.0	2.9	0.0	0.0
Department of Financial Institutions	3.9	3.3	3.0	3.0	2.8	0.0	0.0
Dept of Fire, Building, and Life Safety	3.6	3.1	2.2	2.0	0.1	0.0	0.0
Corporation Commission	5.7	4.2	0.6	0.6	0.6	0.0	0.0
Department of Liquor Licenses	3.5	3.0	0.7	0.0	0.0	0.0	0.0
Other	5.2	4.5	3.8	3.8	3.5	0.0	0.0
Total Natural Resources	78.4	54.2	45.3	38.6	38.0	0.5	0.5
Parks Board	27.8	23.6	20.0	20.0	20.0	0.2	0.2
Department of Water Resources	22.3	11.6	16.9	7.1	6.8	0.1	0.1
State Forester	0.0	0.0	0.0	6.0	5.9	0.1	0.1
Land Department	26.1	16.9	6.6	3.7	3.7	0.0	0.0
Other	2.2	2.0	1.8	1.8	1.6	0.0	0.0
Total Transportation	0.1	0.1	0.1	0.1	0.1	0.0	0.0
Total General Government	364.2	324.4	295.3	273.0	255.7	3.2	3.4
Courts	126.6	121.9	119.5	110.5	100.1	1.3	1.3
Legislature	54.1	51.4	51.6	51.6	49.6	0.6	0.7
Department of Revenue	74.4	64.4	37.6	44.8	42.7	0.5	0.6
Attorney General	24.0	21.6	18.0	18.0	17.1	0.2	0.2
Department of Administration	31.3	19.3	17.8	17.4	17.1	0.2	0.2
Secretary of State	7.0	6.8	18.4	13.5	12.8	0.2	0.2
Office of the Governor	7.0	7.4	7.0	7.0	6.7	0.1	0.1
Department of Commerce	13.5	6.5	6.2	3.6	3.5	0.0	0.0
Treasurer	5.1	4.7	3.6	1.1	0.9	0.0	0.0
Office of Tourism	14.4	14.3	10.7	0.0	0.0	0.0	0.0
Other	6.9	6.0	4.8	5.5	5.2	0.1	0.1

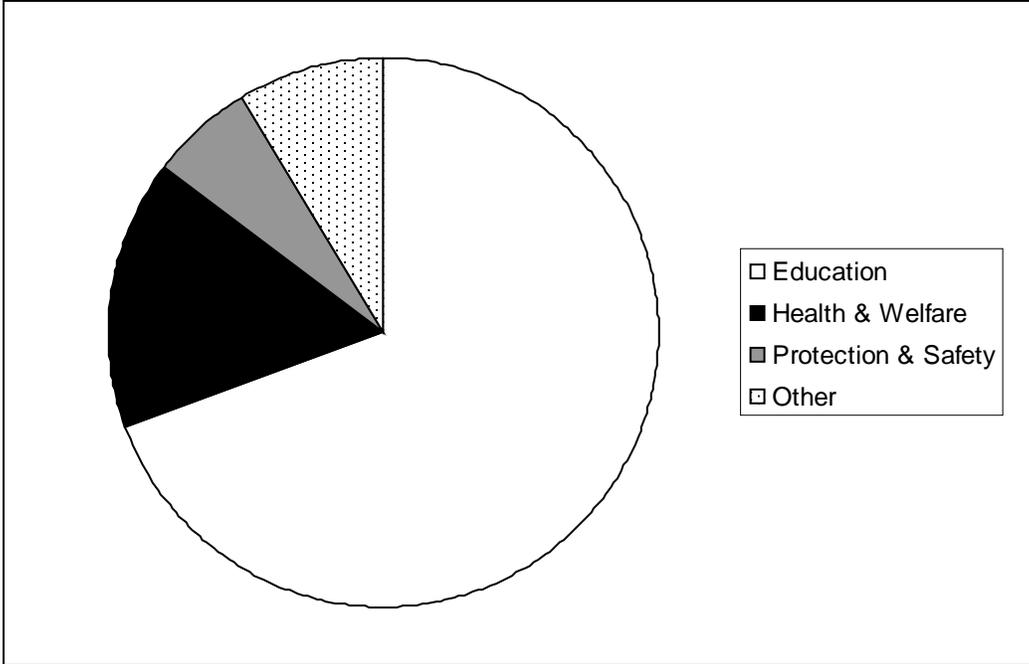
* Actual

^ Had the sales tax rate increase not been passed by voters

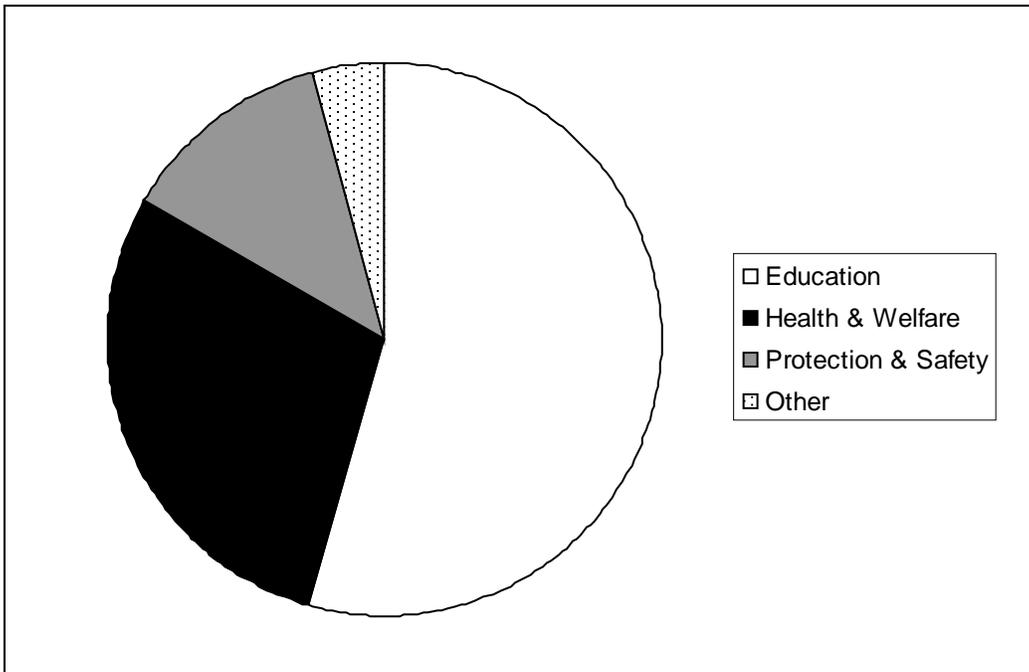
Source: Arizona Joint Legislative Budget Committee.

**CHART 5.2
SHARE OF TOTAL EXPENDITURES BY CATEGORY,
ARIZONA STATE GOVERNMENT GENERAL FUND**

FISCAL YEAR 1979

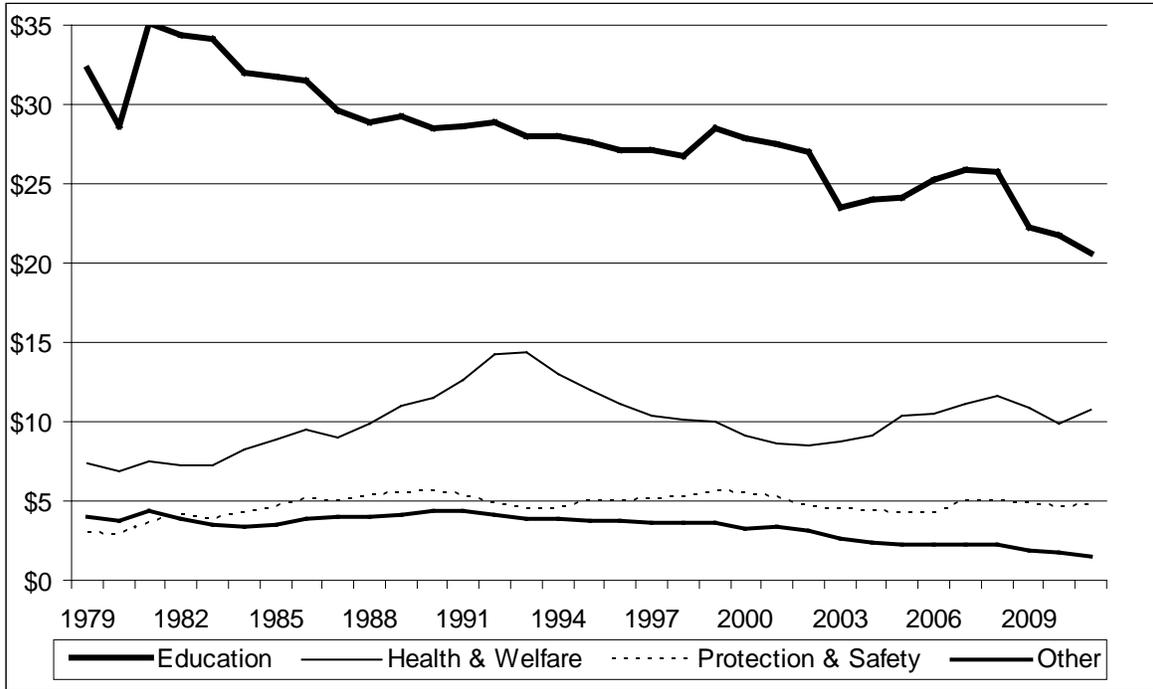


FISCAL YEAR 2011



Source: Arizona Joint Legislative Budget Committee.

**CHART 5.3
ONGOING EXPENDITURES PER \$1,000 OF PERSONAL INCOME BY MAJOR
CATEGORY, ARIZONA STATE GOVERNMENT GENERAL FUND,
FISCAL YEARS 1979 THROUGH 2011**



Sources: Arizona Joint Legislative Budget Committee (expenditures) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

personal income also rose during the 1980s and has remained largely steady since then. In contrast, education funding per \$1,000 of personal income has fallen since 1981, accounting for most of the decrease in overall spending relative to income. Expenditures relative to income also have decreased in the balance of the general fund.

Education

Elementary and secondary (K-12) education (listed in Table 5.1 as the “Department of Education”) will receive \$3.5 billion in 2011: 76 percent of the education funding and 41 percent of ongoing general fund appropriations. Over time, K-12’s share of the general fund has varied from 37 percent to 51 percent and has been between 40 and 43 percent since 2005. Another \$68 million is scheduled to go to the School Facilities Board to build and maintain the physical infrastructure of schools. Before 1999, this capital spending was not part of the general fund, financed instead through long-term debt of school districts. Its share of the general fund goes up and down with the economic cycle; it was 5 percent in 2008 but will be below 1 percent in 2011.

Expenditures for the Board of Regents and the universities is scheduled to be \$890 million in 2011, just more than 10 percent of the total general fund. Community colleges, which also are funded by local governments, receive much lesser general fund support, at \$135 million in 2011,

only 1.6 percent of the general fund. As a share of the general fund, higher education expenditures have almost fallen in half from 1979.

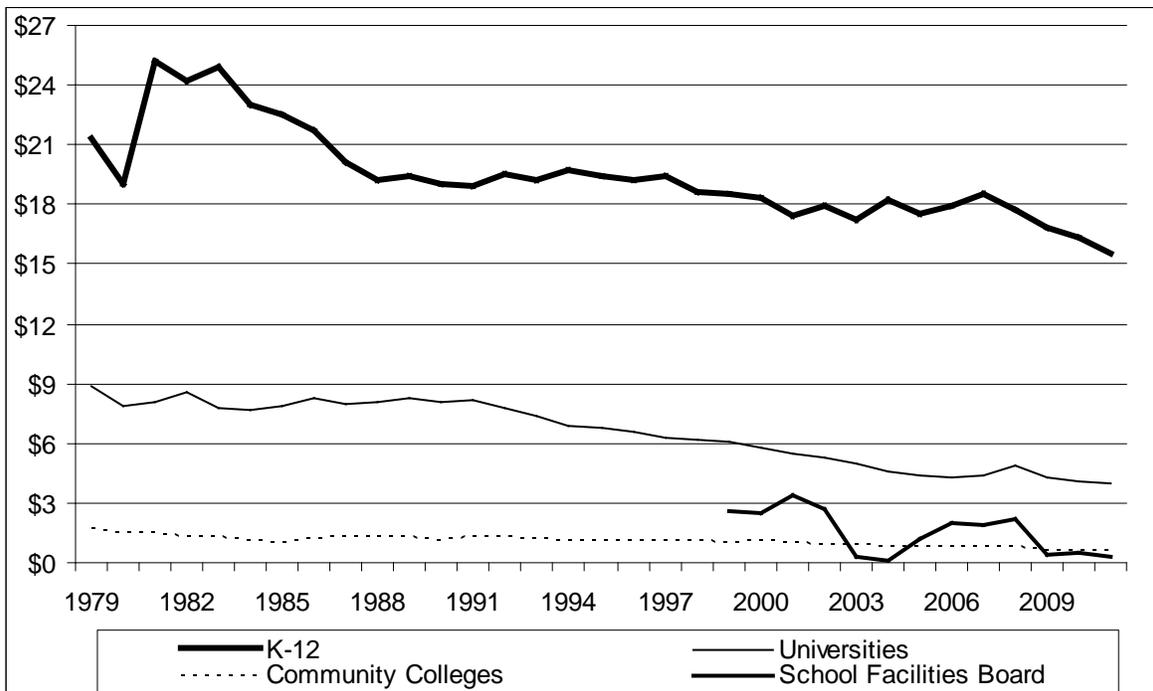
Total expenditures for education will drop \$1.1 billion (19 percent) between 2008 and 2011—before considering inflation and increases in enrollment. The cuts to K-12 education will total \$455 million (12 percent). The university system will lose \$203 million (19 percent).

The decline in education spending per \$1,000 of personal income that is shown in Chart 5.3 totals 36 percent from the 1981 peak. Initially, decreases occurred primarily in the K-12 subcategory, as seen in Chart 5.4. The decline between the 1981 peak and 1988 was 24 percent. K-12 spending relative to personal income fell only a little further through 2007 but has since dropped more, for a total decline of 35 percent from the 1981 peak. Since 1991, spending per \$1,000 of personal income has dropped in half for the university system.

Health and Welfare

Health and welfare appropriations will total \$2.4 billion in 2011. This is 29 percent of the ongoing general fund total, the highest share on record and up from 26 percent in 2010.

**CHART 5.4
EDUCATION EXPENDITURES PER \$1,000 OF PERSONAL INCOME
BY SUBCATEGORY, ARIZONA STATE GOVERNMENT GENERAL FUND,
FISCAL YEARS 1979 THROUGH 2011**



Sources: Arizona Joint Legislative Budget Committee (expenditures) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

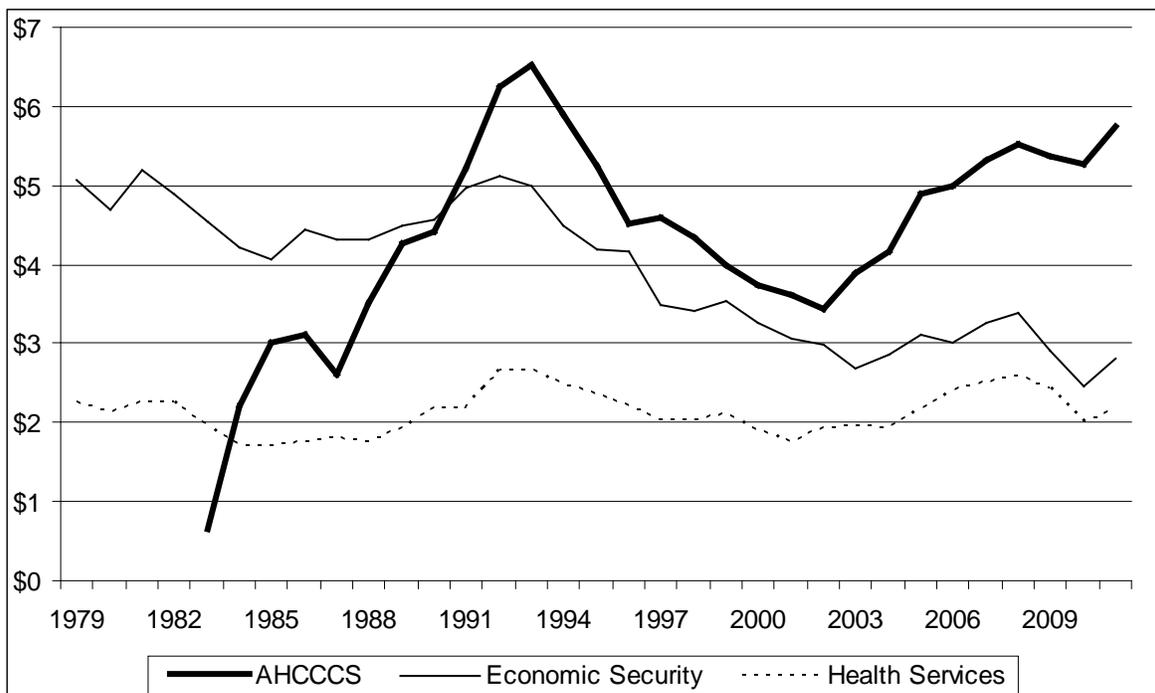
The Arizona Health Care Cost Containment System (AHCCCS: Arizona’s alternative to Medicaid) receives a little more than half of the spending in this category. After dropping from the 2008 level, the appropriation will rise to nearly \$1.3 billion in 2011, accounting for a record 15 percent of the ongoing general fund budget—despite the sharp reductions in coverage that have been passed by the Arizona Legislature.

Spending for AHCCCS accounts for most of the volatility in health and welfare spending over time that is seen in Chart 5.3. Per \$1,000 of personal income, AHCCCS funding has gone from zero in 1982 to a peak of \$6.53 in 1993, down to \$3.44 in 2002, then back up to \$5.52 in 2008. It will be slightly higher than that in 2011.

The Departments of Economic Security (DES) and Health Services (DHS) account for most of the remainder of the health and welfare category. The appropriation for each has dropped substantially since 2008, but is scheduled to increase in 2011; caseloads have risen.

As a share of the general fund, funding for DES dropped from 11 percent in 1980 to less than 7 percent in 2010, but will be 7.5 percent in 2011. Funding per \$1,000 of personal income declined by half between 1979 and 2010 but will be a little higher in 2011 (see Chart 5.5). Since many of the agency’s programs experience countercyclical demand, DES funding in the past was higher

**CHART 5.5
HEALTH AND WELFARE EXPENDITURES PER \$1,000 OF PERSONAL INCOME
BY SUBCATEGORY, ARIZONA STATE GOVERNMENT GENERAL FUND,
FISCAL YEARS 1979 THROUGH 2011**



Sources: Arizona Joint Legislative Budget Committee (expenditures) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

during recessions and lower during economic expansions, but this pattern has broken down in the past two decades.

The Department of Health Services has received funding that has fluctuated around \$2 per \$1,000 of personal income throughout the time series. Its share of the general fund has increased somewhat over time, to around 6 percent in recent years.

Protection and Safety

The appropriation for this category will rise in 2011 back to the 2009 level of \$1.07 billion. Expenditures in this category will amount to 13 percent of the ongoing general fund total, the highest on record and double the share of 1979. The Department of Corrections and the Department of Juvenile Corrections combined will receive just more than \$1 billion in 2011. Thus, the correctional system receives about 95 percent of the category's funding.

The Department of Public Safety receives most of the rest of this category's funding, but the amount has fluctuated widely over the years. The amount has dropped considerably in recent years.

Per \$1,000 of personal income, protection and safety expenditures climbed from around \$3 in 1980 to \$5 in 2007 and 2008 before slipping a bit (see Chart 5.6). Expenditures for corrections have increased from around \$2 to \$4.50 per \$1,000 of personal income. Though the court system is included in the general government category by the JLBC, it is an integral part of the public safety system. Its funding relative to personal income continues to drop from the late 1990s peak.

Other

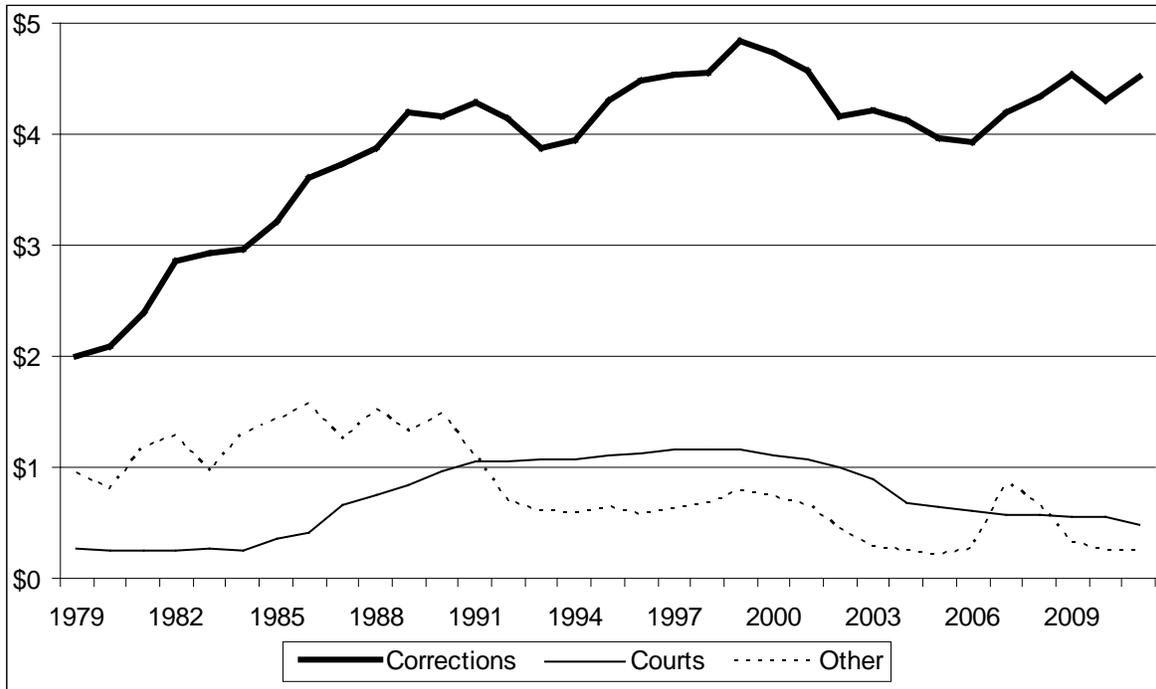
Other than education, health and welfare, and protection and safety, the rest of state government will receive only 4 percent of the ongoing general fund appropriation in 2011—only \$342 million in 2011. The share of the general fund has dropped from more than 8 percent; spending per \$1,000 of personal income has dropped from \$4 to less than \$2. Declines have occurred in most of the subcategories. The court system was the only subcategory receiving more than 1 percent of the general fund total in 2008.

APPROPRIATION LIMIT

The Arizona Constitution has since 1979 limited appropriations as a percentage of personal income. The definition of appropriation used in the Constitution for this purpose is broader than the general fund. Originally the limit was 7 percent of personal income, but the limit varies with changes in government spending responsibilities: between the federal government and the state government, and also between state government and local governments. As seen in Chart 5.7, appropriations have been less than the limit by at least 0.5 percentage points in every year since 1990. General fund spending peaked at 5.2 percent of personal income in 1992. It has been less than 4 percent since 2009.

Arizona's constitutional limitation on expenditures is consistent with traditional limitations that incorporate population growth, inflation, and real per capita economic growth, such as measured by personal income, to control the growth of government revenues or expenditures. The rationale is that if the growth rate of government revenues is equal to the economic growth rate, the tax

CHART 5.6
PROTECTION AND SAFETY EXPENDITURES PER \$1,000 OF PERSONAL INCOME
BY SUBCATEGORY, ARIZONA STATE GOVERNMENT GENERAL FUND,
FISCAL YEARS 1979 THROUGH 2011



Notes: The JLBC includes the court system in its “general government” category; corrections includes juvenile corrections.

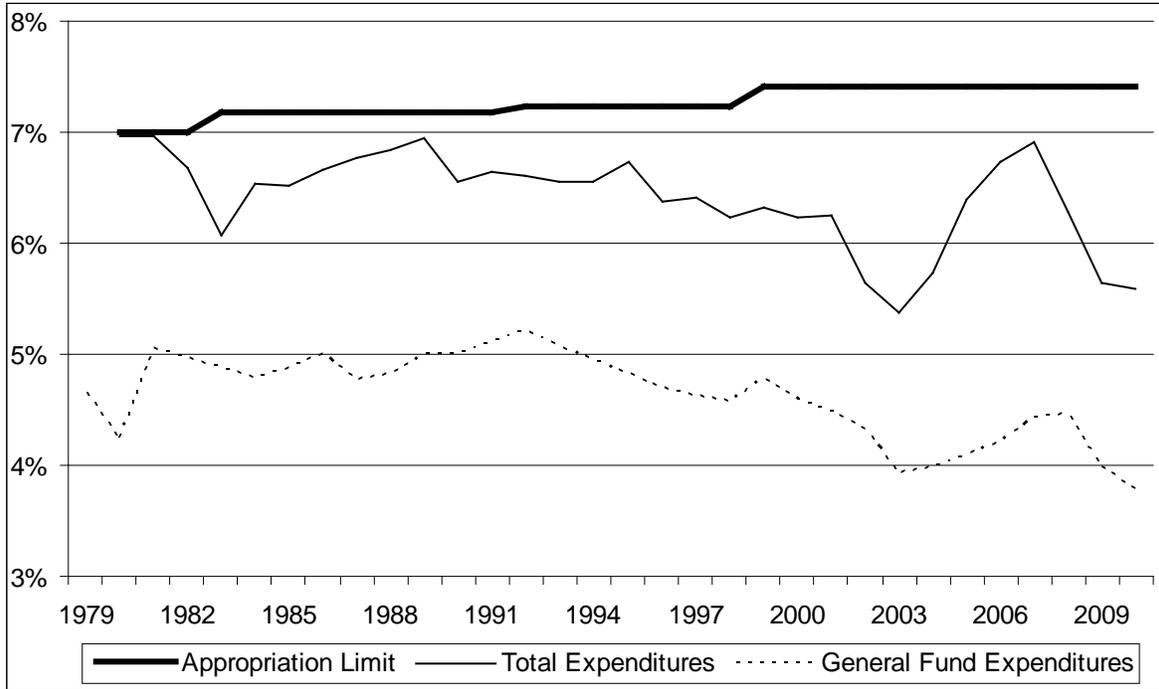
Sources: Arizona Joint Legislative Budget Committee (expenditures) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

burden remains steady. More recently, however, a push has been made by certain conservative groups to control government revenue and expenditure growth to simply inflation and population growth. Doing so causes government to shrink relative to the size of the economy, over time greatly restricting the ability of the public sector to respond to the demands of the populace.

Limiting revenues and expenditures to population and inflation means that government can only furnish the services that it currently provides. If another need arises, no revenue exists to pay for it. For example, governments could not have purchased computers when the technology became available, at least not without reducing existing services. Since health care inflation is much greater than overall inflation, health care services would have to be continually reduced—or funding would have to be reduced for other programs. In general, if the growth of government is restricted from keeping pace with economic growth, the quality and/or quantity of public services will continually lower over time.

Had a limitation of inflation and population growth been in place in 1912, when Arizona became a state, Arizona today would still look much as it did in 1912: dirt roads, schools without indoor

CHART 5.7
EXPENDITURES AND CONSTITUTIONAL APPROPRIATION LIMIT
AS A PERCENTAGE OF PERSONAL INCOME, ARIZONA STATE GOVERNMENT,
FISCAL YEARS 1979 THROUGH 2010



Sources: Arizona Joint Legislative Budget Committee (expenditures and limit) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

plumbing or air conditioning, government records kept in handwritten ledgers, etc. What would now be considered Third-World conditions would have kept economic development in the state at Third-World standards, in turn causing the living standards of Arizonans to be similar to those of the undeveloped world.

GENERAL EXPENDITURES AS DEFINED BY THE CENSUS BUREAU

Caution must be exercised when comparing state government expenditures in Arizona to those in other states since spending authority between state and local governments varies by state. The latest detailed Census Bureau data for state governments are for 2007, which are summarized in Table 5.2.

State government general expenditures as defined by the Census Bureau were \$15.6 billion in 2007, about 65 percent more than the general fund expenditures as defined by the JLBC. Per capita, Arizona’s expenditures were 23 percent less than the national average. Arizona ranked second lowest in the country, with only Nevada lower.

Capital outlays are included in the Census Bureau figures. Despite the rapid growth of the state’s population, which creates a need for spending on capital projects such as highways, Arizona state government spends little on capital outlays. Other than capital outlays, per capita spending in

**TABLE 5.2
GENERAL EXPENDITURES BY CATEGORY, ARIZONA STATE GOVERNMENT, FISCAL YEAR 2007**

	Dollars in Thousands	Share of Total	National Share	Western Share	Per Capita			
					Dollars	Ratio to U.S.	All State Rank*	Western Rank*
TOTAL EXPENDITURES	\$15,627,690	100.00%	100.00%	100.00%	\$2,489.61	77.3%	49	8
Education Services	3,320,962	21.25	22.41	25.81	529.05	73.3	48	9
Education	3,311,152	21.19	22.36	25.77	527.49	73.3	48	9
Higher Education	2,773,270	17.75	17.64	22.43	441.80	77.8	45	9
Elementary and Secondary	0	0.00	0.85	0.05	0.00	0.0	37	7
Other Education	537,882	3.44	3.86	3.29	85.69	68.9	41	5
Libraries	9,810	0.06	0.04	0.04	1.56	109.4	27	4
Social Services	7,806,757	49.95	44.13	40.33	1,243.67	87.5	36	4
Public Welfare	6,296,006	40.29	34.80	29.31	1,003.00	89.5	35	3
Cash Assistance Payments	163,238	1.04	1.09	1.24	26.01	74.3	36	6
Vendor Payments	4,900,287	31.36	29.04	23.25	780.65	83.5	38	2
Other Public Welfare	1,232,481	7.89	4.67	4.81	196.34	130.5	18	3
Hospitals	70,260	0.45	4.90	6.34	11.19	7.1	49	9
Health	1,381,856	8.84	3.91	4.08	220.14	174.9	10	3
Employment Security Admin	53,177	0.34	0.41	0.41	8.47	64.0	44	7
Veterans' Services	5,458	0.03	0.11	0.19	0.87	25.3	27	5
Transportation	1,254,764	8.03	9.46	9.50	199.89	65.6	47	7
Highways	1,248,531	7.99	9.14	9.49	198.90	67.6	47	7
Air Transportation	6,233	0.04	0.17	0.02	0.99	18.3	28	3
Public Safety	1,294,568	8.28	6.63	7.68	206.23	96.6	21	5
Police Protection	243,270	1.56	1.18	1.30	38.75	102.2	22	5
Corrections	898,226	5.75	4.56	5.13	143.09	97.5	23	6
Protective Inspection & Regulation	153,072	0.98	0.90	1.26	24.39	84.3	27	6
Environment and Housing	511,806	3.27	3.87	3.59	81.53	65.5	42	6
Natural Resources	331,673	2.12	2.06	2.45	52.84	79.7	33	6
Parks and Recreation	102,959	0.66	0.54	0.47	16.40	94.9	28	4
Housing & Community Development	72,424	0.46	0.90	0.47	11.54	39.7	35	6
Sewerage	0	0.00	0.14	0.04	0.00	0.0	40	7
Solid Waste Management	4,750	0.03	0.23	0.15	0.76	10.2	35	5
Government Administration	1,124,964	7.20	9.33	9.62	179.22	59.7	45	8
Financial Administration	366,210	2.34	2.28	2.55	58.34	79.4	34	7
Judicial and Legal	186,713	1.19	1.96	1.91	29.74	47.2	40	6
General Public Buildings	34,915	0.22	0.36	0.55	5.56	47.5	36	6
Other Government Admin	70,717	0.45	0.50	0.73	11.27	70.3	41	8

(continued)

TABLE 5.2 (continued)
GENERAL EXPENDITURES BY CATEGORY, ARIZONA STATE GOVERNMENT, FISCAL YEAR 2007

	Dollars in Thousands	Share of Total	National Share	Western Share	Per Capita			
					Dollars	Ratio to U.S.	All State Rank*	Western Rank*
Interest on General Debt	\$466,409	2.98%	4.22%	3.88%	\$74.30	54.6%	42	8
Misc Commercial Activities	0	0.00	0.05	0.00	0.00	0.0	32	5
Other and Unallocable	313,869	2.01	4.12	3.47	50.00	37.7	47	9
CAPITAL OUTLAYS:								
Total	1,313,849	8.41	10.93	12.06	209.31	59.5	49	9
Education	351,377	2.25	2.45	3.08	55.98	70.8	42	9
Higher Education	343,570	2.20	2.21	3.03	54.73	76.9	40	9
Elementary and Secondary	0	0.00	0.18	0.00	0.00	0.0	33	5
Hospitals	1,948	0.01	0.28	0.55	0.31	3.5	39	8
Highways	767,323	4.91	6.34	6.49	122.24	59.9	44	7
Corrections	10,986	0.07	0.19	0.32	1.75	28.0	38	8
Natural Resources	19,255	0.12	0.34	0.33	3.07	27.6	41	7
Parks and Recreation	32,022	0.20	0.12	0.10	5.10	130.2	17	4
Sewerage	0	0.00	0.08	0.00	0.00	0.0	33	6
Solid Waste	30	0.00	0.03	0.00	0.00	0.6	32	5
Other	130,908	0.84	1.10	1.19	20.85	59.0	37	7
OTHER THAN CAPITAL:								
Total	14,313,841	91.59	89.07	87.94	2,280.30	79.5	46	6
Education	2,959,775	18.94	19.91	22.69	471.51	73.6	48	9
Higher Education	2,429,700	15.55	15.43	19.39	387.07	77.9	48	9
Elementary and Secondary	0	0.00	0.68	0.05	0.00	0.0	35	7
Hospitals	68,312	0.44	4.62	5.79	10.88	7.3	49	9
Highways	481,208	3.08	2.81	3.00	76.66	84.9	35	7
Corrections	887,240	5.68	4.36	4.80	141.34	100.6	22	5
Natural Resources	312,418	2.00	1.71	2.12	49.77	90.2	31	6
Parks and Recreation	70,937	0.45	0.42	0.38	11.30	84.5	28	4
Sewerage	0	0.00	0.06	0.04	0.00	0.0	33	5
Solid Waste	4,720	0.03	0.20	0.15	0.75	11.4	34	5
Other	9,529,231	60.98	54.98	48.97	1,518.08	85.8	39	5

* A rank of 1 indicates the highest tax burden; the all-state ranking includes the District of Columbia; the western states are Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington

Source: U.S. Department of Commerce, Census Bureau (revenue and population).

Arizona was 20 percent below the national average, higher than only four states in the nation—but higher than three western states (Colorado, Nevada, and Texas).

The Census Bureau classifies expenditures differently from the JLBC. It uses six primary categories; the “government administration” category would more accurately be called “miscellaneous government” since functions other than administration are included.

As a share of the total, Arizona’s general spending is somewhat different from the averages of the nation and the western states. In particular, a greater share of state government spending in 2007 went to the social services category, particularly to public welfare. The spending share also was a little higher in the public safety category, mostly for corrections.

In contrast, Arizona spent a lesser share of the total for education, which in the context of the Census Bureau’s accounting system primarily consists of higher education at the state government level. (Though education is the main recipient of general fund monies according to the JLBC, the Census Bureau considers this spending to be made by school districts.) Arizona’s shares also were lower for transportation (highways), government administration, interest on debt, and “other and unallocable.”

Per capita, state government spending in 2007 was below the national average in each of the major categories, and in most of the subcategories. Arizona ranked last in the West and third-lowest nationally in the education services category, which consists primarily of higher education. Per capita spending was 27 percent less than the national average. Per capita spending was 40 percent below average in the government administration category, ranking 45th nationally and eighth in the West. Arizona also was far below average in the transportation and environment and housing categories. Per capita spending was closer to the national norm in the social services and public safety categories; Arizona ranked in the middle of the western states in each.

CHAPTER 6

STATE AND LOCAL GOVERNMENT GENERAL EXPENDITURES

In this chapter, general expenditures as reported by the U.S. Census Bureau are examined. For a discussion of the Census Bureau data, and of the per capita and per \$1,000 of personal income measures used to analyze the data, see Chapter 1. More detail by category of expenditure is provided in Appendix B. All references to year in this chapter are to the fiscal year and all references to expenditures are to the Census Bureau's definition of general expenditures—expenditures from all funds except utilities, insurance trust, and liquor stores. All figures are for state and local government expenditures combined.

GENERAL EXPENDITURES

Total state and local government expenditures in Arizona totaled \$39.4 billion in 2007: \$6,279 per Arizona resident and \$184.83 per \$1,000 of personal income. Total expenditures were less than the national average, by 16.6 percent per capita and by 5.3 percent per \$1,000 of personal income. (Since personal income understates income in Arizona relative to the rest of the country, expenditures relative to a more accurate measure of money income would be a little further below the national average than indicated by the personal income measure.)

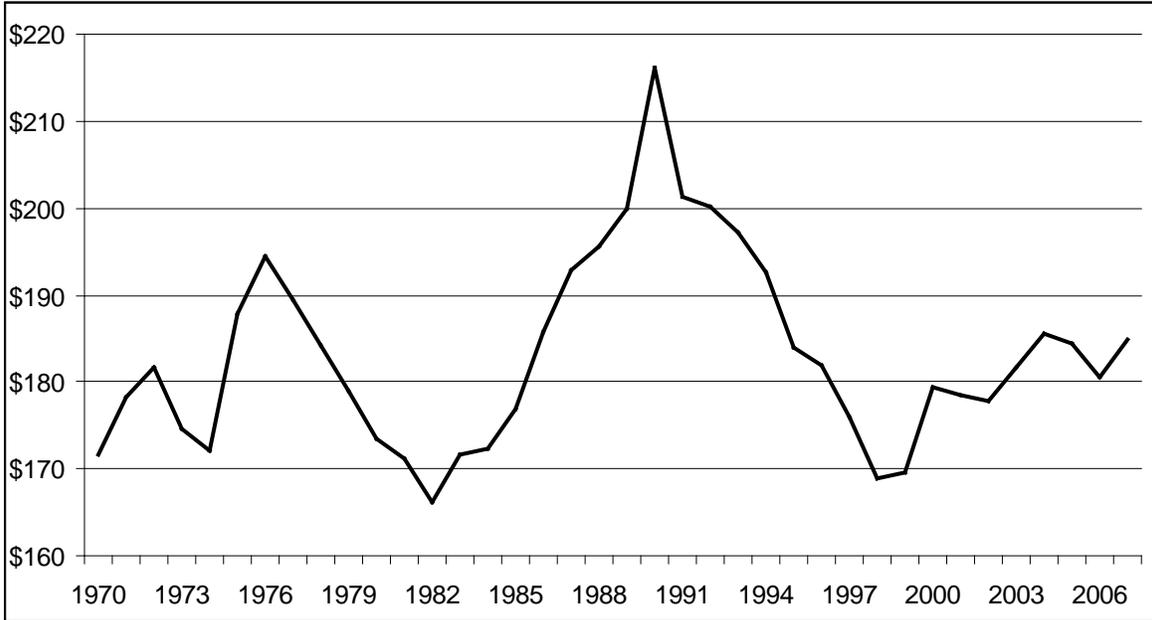
Arizona's per capita state and local government spending in 2007 ranked 46th among the 51 'states' (including the District of Columbia)—the only states that spent less were Arkansas, Idaho, Missouri, Tennessee, and Texas. Arizona ranked eighth among the nine western states (Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington), with Texas spending only fractionally less. Relative to personal income, Arizona ranked 37th among the 51 states and sixth among the western states, with lower figures in Colorado, Nevada, and Texas.

Total expenditures per \$1,000 of personal income in Arizona have fluctuated over time, with the level since the late 1990s similar to that of the 1970s (see the top graph of Chart 6.1). Nationally, expenditures have increased, such that total expenditures per capita and per \$1,000 of personal income as a percentage of the national average have fallen considerably since 1990 in Arizona. As seen in the bottom graph of Chart 6.1, the pattern over time of per capita expenditures and expenditures per \$1,000 of personal income is very similar, with the percentage of the national average always on the personal income measure. (Because of this similarity, some of the discussion and charts in this chapter address only one of the two measures.)

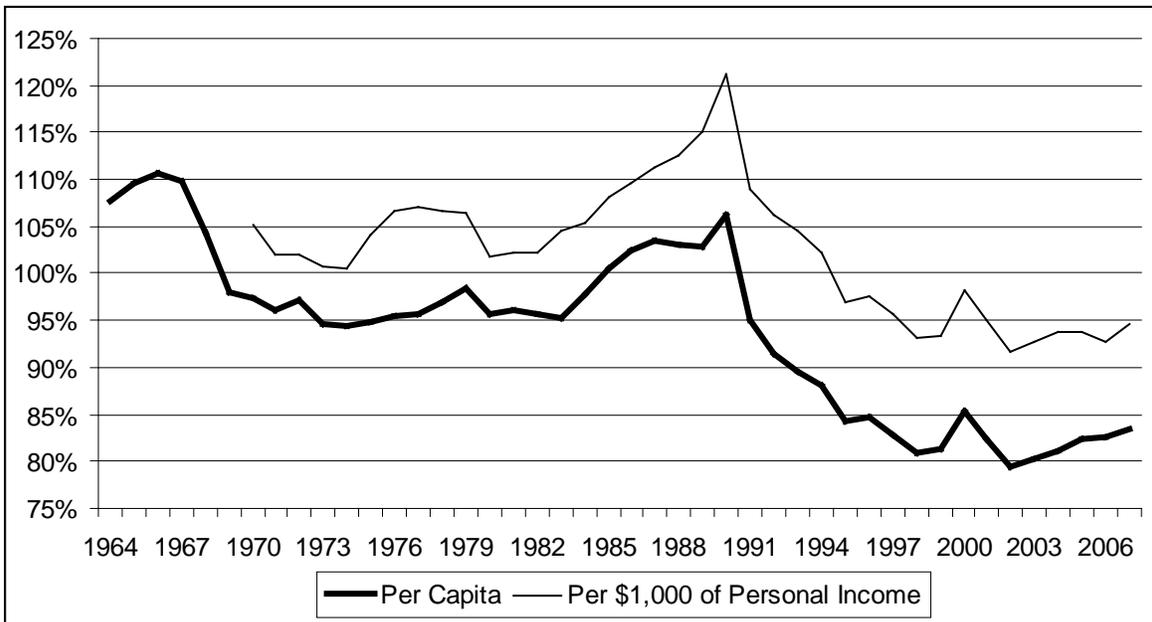
Per capita, expenditures in Arizona relative to the U.S. average have been lower in every year since 1992 than in all preceding years; the same is true relative to personal income since 1995. Arizona's per capita spending figure has been at least 15 percent less than average since 1995, but historically it ranged from 5 percent below to 10 percent above the national average. Per \$1,000 of personal income, Arizona's figure has been from 2-to-8 percent less than the national average since 1995; before that, the Arizona figure always had been higher than average.

**CHART 6.1
COMBINED STATE AND LOCAL GOVERNMENT GENERAL EXPENDITURES
IN ARIZONA, THROUGH FISCAL YEAR 2007**

PER \$1,000 OF PERSONAL INCOME



AS A PERCENTAGE OF THE NATIONAL AVERAGE



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (expenditures and population) and Bureau of Economic Analysis (personal income).

Total expenditures per \$1,000 of personal income were 8 percent lower in 2007 than in 1992 in Arizona. That is, expenditures by state and local governments in Arizona fell over this 15-year period relative to the size of the state's economy. In contrast, expenditures relative to personal income rose a little nationally. Thus, as a ratio to the national average, Arizona's 2007 figure was 12 percentage points lower per \$1,000 of personal income (and 8 percentage points lower per capita) than in 1992. Its national rank was 16 places lower, and its western rank was one place lower, in 2007 than in 1992 on both measures. (The 1992-to-2007 comparison is detailed in Appendix B.)

General expenditures consist of four types:

- Current operations: compensation of employees, purchases of supplies and materials, lease payments, payments for contractual services, etc.
- Capital outlays: expenditures for the purchase of land and existing buildings, purchase of equipment, and construction of buildings and other improvements.
- Assistance and subsidies: such as grants for scholarships.
- Interest payments for outstanding debt.

The Census Bureau does not distinguish between current operations and assistance/subsidies among general expenditures, but the latter account for only 1.5 percent of total expenditures nationally. Capital outlays account for 13 percent of general expenditures nationally; interest on debt accounts for 4 percent. Thus, current operations spending is the most common type, accounting for approximately 82 percent of all general expenditures.

Capital Outlays

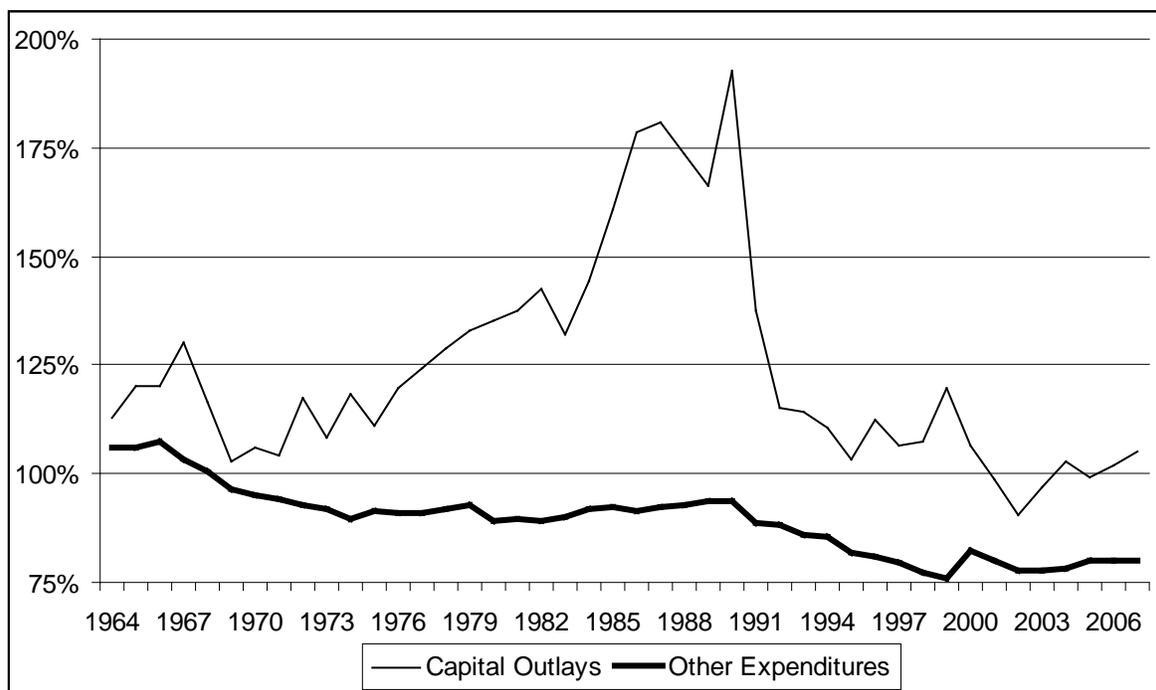
Because of Arizona's rapid population growth, strong demand for new schools, roads, and other types of physical infrastructure—capital spending—exists. Spending for capital outlays tends to be erratic from year to year. The spike in overall expenditures that occurred during the 1980s and peaked in 1990, as seen in Chart 6.1, resulted entirely from unusually high capital outlays, as seen in Chart 6.2.

Total state and local government capital outlays in Arizona totaled \$6.3 billion in 2007, nearly 16 percent of total expenditures; nationally, capital outlays accounted for only 12.7 percent of total expenditures. Capital outlays amounted to \$1,004 per Arizona resident and \$29.54 per \$1,000 of personal income. These figures were higher than the national average, by 5.0 percent per capita and by 19.2 percent per \$1,000 of personal income.

Arizona's per capita capital outlays in 2007 ranked 18th nationally but only sixth among the nine western states, most of which also have high demands caused by a growing population. Relative to personal income, Arizona ranked 15th among the 51 states and fourth among the western states.

In nearly all years, per capita capital outlays in Arizona have been greater than the national average. Since the mid-1990s, capital outlays relative to the national average have been similar to, or less than, those from the mid-1960s through mid-1970s, and considerably lower than those from the late 1970s through early 1990s.

CHART 6.2
COMBINED STATE AND LOCAL GOVERNMENT PER CAPITA GENERAL
EXPENDITURES IN ARIZONA AS A PERCENTAGE OF THE NATIONAL AVERAGE,
FISCAL YEARS 1964 THROUGH 2007



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau.

Total capital outlays in Arizona in 2007 were 3 percent lower than in 1992 per \$1,000 of personal income. As a percentage of the national average, Arizona’s 2007 figure was 10-to-15 percentage points lower per capita and per \$1,000 of personal income than in 1992; its rank was four-to-seven places lower nationally, and one-to-two places lower among the western states.

Expenditures Other Than Capital Outlays

Because of the very different nature (generally funded by long-term debt) and erratic temporal pattern of capital outlays, most comparisons of government spending across states and over time concentrate on noncapital expenditures. However, the Census Bureau provides a breakout of capital outlays only for the total and for selected subcategories.

Expenditures other than capital outlays totaled \$33.1 billion in 2007 in Arizona, 84.0 percent of total expenditures; the national share was higher at 87.3 percent. Noncapital spending amounted to \$5,276 per Arizona resident and \$155.29 per \$1,000 of personal income. Noncapital spending was lower than the national average, by 20 percent per capita and by 9 percent per \$1,000 of personal income.

Arizona's per capita noncapital spending in 2007 ranked 48th nationally—higher than only Idaho, South Dakota, and Tennessee—and was the least of the nine western states. Relative to personal income, Arizona ranked 41st among the 51 states and sixth among the western states.

As seen in Chart 6.2, noncapital spending did not contribute to the increase in overall spending from the late 1970s through 1991. Instead, noncapital spending as a ratio to the national average declined during the late 1960s and early 1970s, held largely steady through 1990, dropped again during the 1990s, and mostly has held steady during the 2000s. Since the mid-1990s, per capita noncapital spending generally has been 20-to-24 percent less than the national average; it was above average during the 1960s and about 10 percent below average through most of the 1970s and 1980s.

Compared to 1992, total noncapital spending in Arizona in 2007 was 9 percent lower per \$1,000 of personal income. As a percentage of the national average, Arizona's noncapital spending fell 8-to-11 percentage points per capita and per \$1,000 of personal income between 1992 and 2007; the state's rank dropped 15-to-19 places nationally, and one-to-two places among the western states. Thus, even after excluding capital outlays, government spending in Arizona dropped between 1992 and 2007 relative to the size of the state's economy and relative to the national average.

GENERAL EXPENDITURES BY CATEGORY

The Census Bureau series on state and local government finance provides general expenditures for a number of categories and subcategories. However, the split between capital outlays and other types of expenditures are provided only for selected subcategories. Table 6.1 provides a summary of the data for 2007.

Rather than simply present the general expenditure data per capita and per \$1,000 of personal income, it would be desirable to assess the need to spend in each category. However, this is a prohibitively large task. The Representative Expenditure System, using data for 2002, is discussed in Chapter 4. It is likely that Arizona's needs since 2002 have continued to exceed the national average. Thus, overall spending, which is below the national norm both per capita and relative to personal income, is even further below average once Arizona's needs are considered.

Major Categories

The Census Bureau expresses most (93 percent in Arizona in 2007) state and local government general spending in terms of six major categories: education services, social services, transportation, public safety, environment and housing, and government administration. The latter category is somewhat misnamed since it includes expenditures that would not normally be considered as administration. Other categories of spending are interest paid on general debt, the very small miscellaneous commercial activities category, and the other and unallocable category.

The history of total general expenditures (including capital outlays) in each of these six categories is shown in Chart 6.3, expressed per \$1,000 of personal income. Expenditures for social services doubled between 1980 and 2007. Expenditures for public safety also climbed. In contrast, spending on education and transportation fell, with little change in the environment and housing and government administration categories.

**TABLE 6.1
COMBINED STATE AND LOCAL GOVERNMENT GENERAL EXPENDITURES BY CATEGORY IN ARIZONA, FISCAL YEAR 2007**

	Dollars in Thousands	Share of Total	Per Capita				Per \$1,000 of Personal Income			
			Dollars	Ratio to U.S.	All State Rank*	Western Rank*	Dollars	Ratio to U.S.	All State Rank*	Western Rank*
TOTAL EXPENDITURES	\$39,416,869	100.00%	\$6,279.40	83.4%	46	8	\$184.83	94.7%	37	6
Education Services	13,158,882	33.38	2,096.31	79.9	48	9	61.70	90.7	40	7
Education	12,972,448	32.91	2,066.61	79.9	48	9	60.83	90.7	40	7
Higher Education	3,925,486	9.96	625.36	91.8	33	8	18.41	104.3	29	6
Elementary and Secondary	8,509,080	21.59	1,355.56	76.0	47	8	39.90	86.4	45	7
Other Education	537,882	1.36	85.69	68.9	41	5	2.52	78.2	38	5
Libraries	186,434	0.47	29.70	82.8	30	7	0.87	94.0	29	8
Social Services	9,402,619	23.85	1,497.91	77.2	43	5	44.09	87.6	36	5
Public Welfare	6,577,168	16.69	1,047.79	81.8	38	4	30.84	92.9	30	2
Cash Assistance Payments	171,937	0.44	27.39	41.8	40	7	0.81	47.4	39	7
Vendor Payments	4,918,149	12.48	783.50	82.3	39	2	23.06	93.4	30	2
Other Public Welfare	1,487,082	3.77	236.90	90.0	24	4	6.97	102.2	22	4
Hospitals	1,146,562	2.91	182.66	46.3	40	9	5.38	52.5	37	9
Health	1,620,254	4.11	258.12	103.9	17	3	7.60	118.1	15	4
Employment Security Admin	53,177	0.13	8.47	63.9	45	7	0.25	72.5	41	6
Veterans' Services	5,458	0.01	0.87	25.3	27	5	0.03	28.8	23	5
Transportation	3,287,775	8.34	523.77	91.9	36	7	15.42	104.3	33	7
Highways	2,706,253	6.87	431.13	89.3	35	8	12.69	101.5	33	7
Air Transportation	576,589	1.46	91.85	137.3	12	4	2.70	155.9	8	3
Parking Facilities	4,933	0.01	0.79	16.4	44	8	0.02	18.6	44	8
Public Safety	4,782,777	12.13	761.93	112.5	11	3	22.43	127.8	6	4
Police Protection	2,046,230	5.19	325.98	116.3	10	3	9.59	132.1	4	3
Fire Protection	859,808	2.18	136.97	111.6	13	4	4.03	126.7	7	3
Corrections	1,545,176	3.92	246.16	108.5	13	5	7.25	123.2	6	4
Protective Inspection & Regul	331,563	0.84	52.82	111.7	9	5	1.55	126.9	8	5
Environment and Housing	3,693,128	9.37	588.34	98.5	20	5	17.32	111.8	16	6
Natural Resources	625,756	1.59	99.69	103.7	23	5	2.93	117.8	22	6
Parks and Recreation	1,030,478	2.61	164.16	131.2	10	3	4.83	149.0	9	5
Housing & Comm Developmt	472,286	1.20	75.24	49.1	40	8	2.21	55.8	42	8
Sewerage	1,203,939	3.05	191.80	130.7	8	3	5.65	148.5	6	3
Solid Waste Management	360,669	0.92	57.46	75.1	32	4	1.69	85.4	30	4
Government Administration	2,404,911	6.10	383.12	96.0	28	7	11.28	109.1	20	7
Financial Administration	656,311	1.67	104.56	79.1	39	8	3.08	89.8	30	6
Judicial and Legal	911,530	2.31	145.21	112.4	11	3	4.27	127.7	6	3
General Public Buildings	228,313	0.58	36.37	78.3	36	6	1.07	88.9	32	6
Other Government Admin	608,757	1.54	96.98	106.4	20	6	2.85	120.9	18	6

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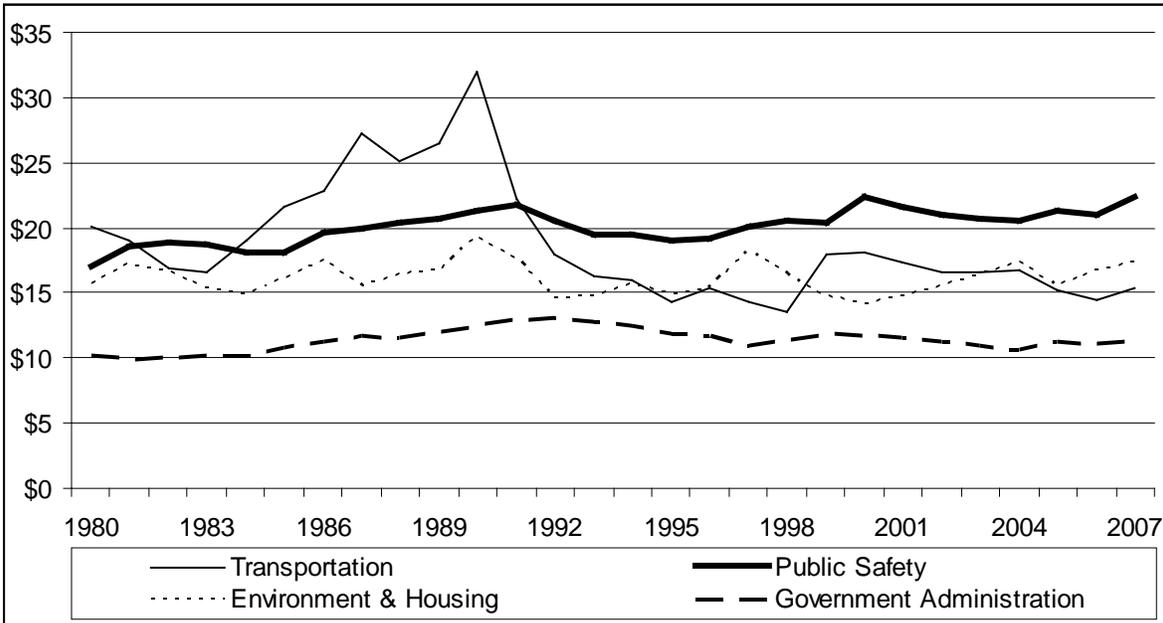
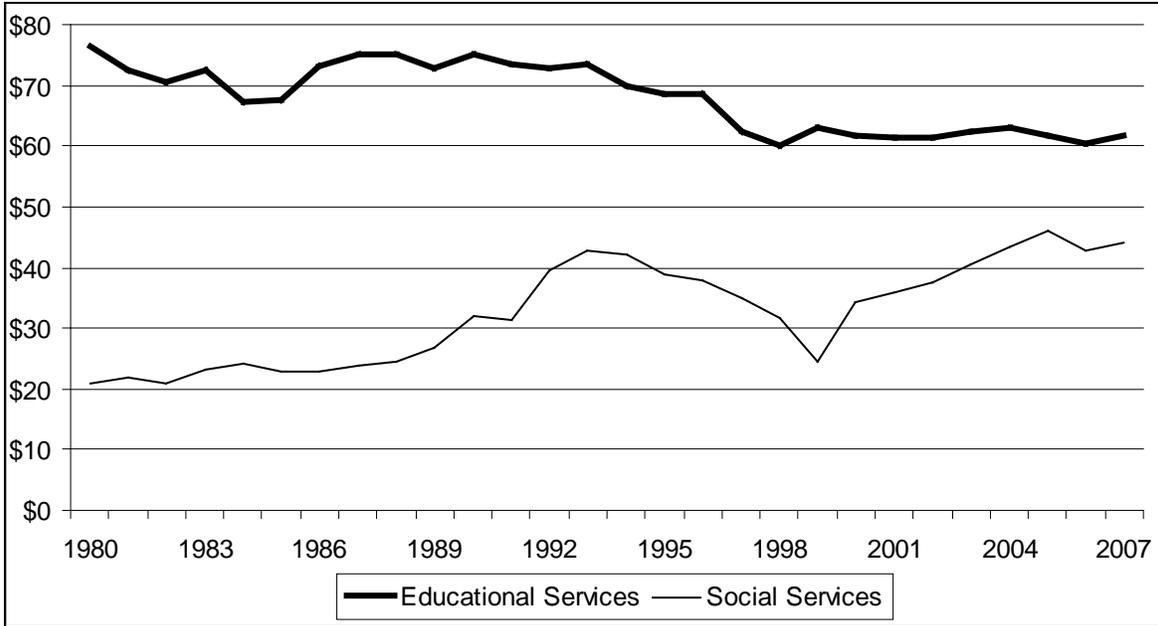
TABLE 6.1 (continued)
COMBINED STATE AND LOCAL GOVERNMENT GENERAL EXPENDITURES BY CATEGORY IN ARIZONA, FISCAL YEAR 2007

	Dollars in Thousands	Share of Total	Per Capita				Per \$1,000 of Personal Income			
			Dollars	Ratio to U.S.	All State Rank*	Western Rank*	Dollars	Ratio to U.S.	All State Rank*	Western Rank*
Interest on General Debt	\$1,354,352	3.44%	\$215.76	69.6%	39	8	\$6.35	79.1%	36	8
Misc Commercial Activities	3,442	0.01	0.55	3.5	48	9	0.02	4.0	47	9
Other and Unallocable	1,328,983	3.37	211.72	53.1	43	8	6.23	60.3	39	7
CAPITAL OUTLAYS:										
Total	6,299,168	15.98	1,003.50	105.0	18	6	29.54	119.2	15	4
Education	1,975,872	5.01	314.77	103.3	19	7	9.26	117.3	13	6
Higher Education	531,178	1.35	84.62	100.2	27	7	2.49	113.8	24	6
Elementary and Secondary	1,436,887	3.65	228.91	105.0	14	5	6.74	119.2	11	4
Hospitals	38,039	0.10	6.06	24.2	36	8	0.18	27.5	33	8
Highways	1,525,967	3.87	243.10	87.5	33	7	7.16	99.4	31	7
Corrections	29,220	0.07	4.65	43.2	39	8	0.14	49.1	37	9
Natural Resources	109,262	0.28	17.41	82.4	18	6	0.51	93.5	17	6
Parks and Recreation	441,566	1.12	70.34	209.3	4	1	2.07	237.7	2	1
Sewerage	753,424	1.91	120.03	205.4	3	1	3.53	233.3	2	1
Solid Waste	39,691	0.10	6.32	77.9	21	4	0.19	88.5	22	4
Other	1,386,127	3.52	220.82	102.1	19	5	6.50	116.0	14	5
OTHER THAN CAPITAL:										
Total	33,117,701	84.02	5,275.90	80.2	48	9	155.29	91.1	41	6
Education	10,996,576	27.90	1,751.84	76.7	50	9	51.56	87.1	44	7
Higher Education	3,394,308	8.61	540.74	90.6	36	8	15.92	103.0	30	6
Elementary and Secondary	7,072,193	17.94	1,126.65	72.0	50	8	33.16	81.8	48	7
Hospitals	1,108,523	2.81	176.60	47.7	41	9	5.20	54.2	37	9
Highways	1,180,286	2.99	188.03	91.9	36	6	5.53	104.3	32	6
Corrections	1,515,956	3.85	241.50	111.7	10	3	7.11	126.9	5	3
Natural Resources	516,494	1.31	82.28	109.8	26	5	2.42	124.7	25	5
Parks and Recreation	588,912	1.49	93.82	102.5	21	8	2.76	116.5	15	7
Sewerage	450,515	1.14	71.77	81.3	34	7	2.11	92.4	27	6
Solid Waste	320,978	0.81	51.13	74.8	34	4	1.51	85.0	32	4
Other	16,439,461	41.71	2,618.93	82.4	37	7	77.09	93.5	30	4

* A rank of 1 indicates the highest tax burden; the "all state" column includes the District of Columbia; the western states are Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington

Source: U.S. Department of Commerce: Census Bureau (expenditures and population) and Bureau of Economic Analysis (personal income).

CHART 6.3
COMBINED STATE AND LOCAL GOVERNMENT GENERAL EXPENDITURES
PER \$1,000 OF PERSONAL INCOME, BY CATEGORY IN ARIZONA,
FISCAL YEARS 1980 THROUGH 2007



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (expenditures) and Bureau of Economic Analysis (personal income).

In Chart 6.4, general expenditures by category are expressed as a percentage of the per capita national average. Social services spending rose on this basis, but remained substantially below the U.S. average. Education expenditures fell more precipitously on this measure than in dollars relative to personal income, from above to considerably below the national average.

Spending in each of the other categories was less relative to the U.S. average in recent years than during the 1980s and early 1990s. In 2007, per capita spending was above the national average only for public safety.

Between 1992 and 2007, as a share of total general expenditures, social services rose from 20 percent to 24 percent while education dropped from 36 percent to 33 percent. The shares for public safety and environment and housing each rose 2 percentage points, offset by a large drop in the interest paid share.

Education Services

Spending in 2007 for educational services, which includes libraries as well as education, totaled \$13.2 billion in Arizona. Less than 2 percent of the total (\$186 million) was for libraries. Arizona's spending on libraries was less than the national average per capita and per \$1,000 of personal income, ranking a little below the median of the states and near the bottom of the western states. Between 1992 and 2007, spending for libraries decreased per \$1,000 of personal income and fell as a ratio to the national average, both per capita and per \$1,000 of personal income.

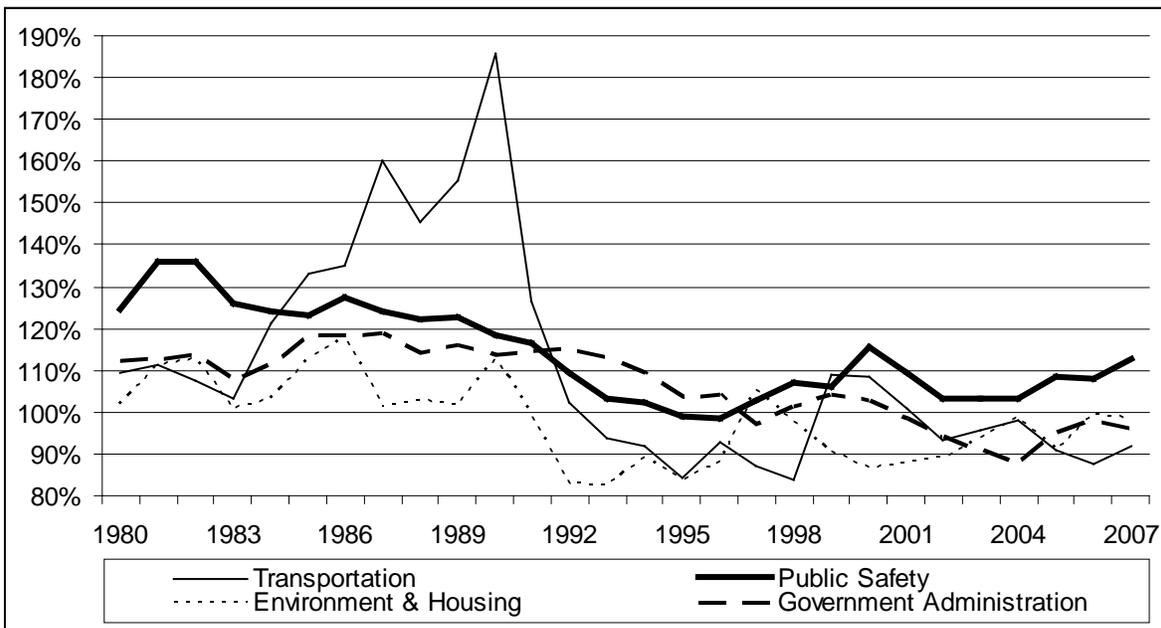
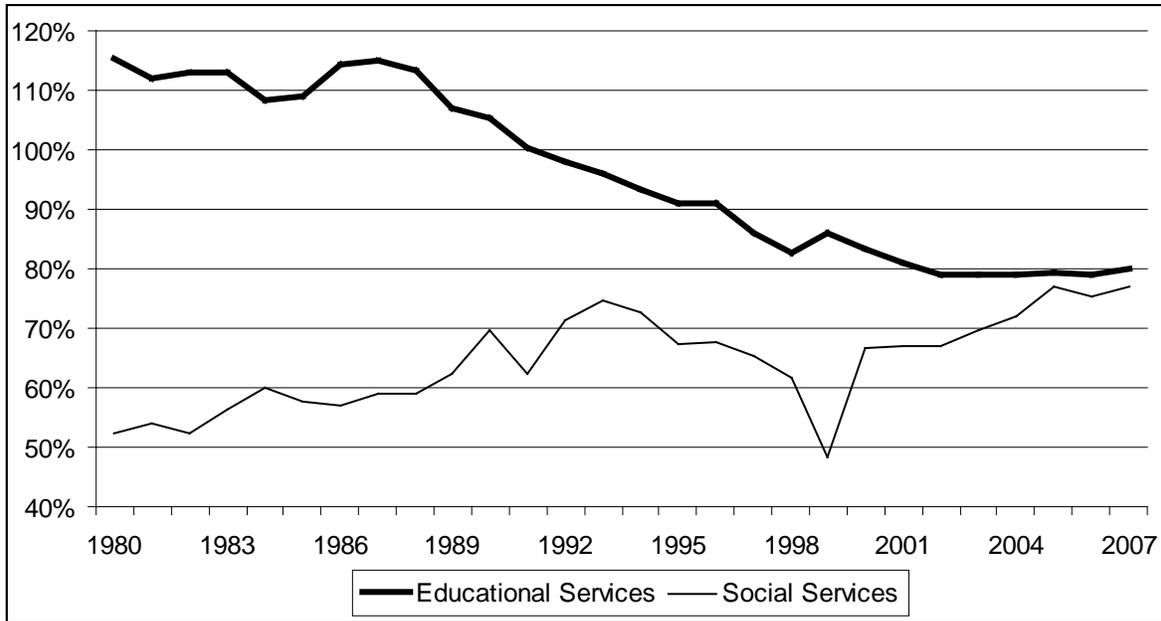
The rest of this subsection focuses on education, which consists of elementary and secondary (K-12) education, higher education (community colleges and universities), and a much smaller "other" education subcategory, which includes schools for the deaf, blind, and handicapped; adult, vocational, and special education operating outside of school districts; and payments to individuals for tuition, scholarships, and other financial aid.

Expenditures for education in Arizona in 2007 totaled nearly \$13 billion, just less than one-third of all expenditures. Nationally, education accounted for more than one-third of all expenditures. Per capita expenditures were \$2,067 in 2007 in Arizona—20 percent less than the national average, third lowest in the country and the lowest in the West. Education spending per \$1,000 of personal income was \$60.83—9 percent below the U.S. average, ranking 40th nationally and seventh among the western states.

Education spending per \$1,000 of personal income fell 15 percent in Arizona between 1992 and 2007. As a percentage of the national average, the decline based on the per capita and personal income measures was from 13-to-18 percentage points. The national rank dropped between 20 and 22 places on each measure, with the western rank falling two places.

Expenditures for elementary and secondary education have been more than twice as much as for higher education in recent years. As seen in the top graph of Chart 6.5, spending per \$1,000 of personal income for K-12 education since 1998 has been lower than in any prior year except 1984. Higher education spending per \$1,000 of personal income also has dropped, being lower since 1993 than in all prior years. Spending for other education has largely held steady.

CHART 6.4
COMBINED STATE AND LOCAL GOVERNMENT PER CAPITA GENERAL EXPENDITURES BY CATEGORY IN ARIZONA AS A PERCENTAGE OF THE NATIONAL AVERAGE, FISCAL YEARS 1980 THROUGH 2007

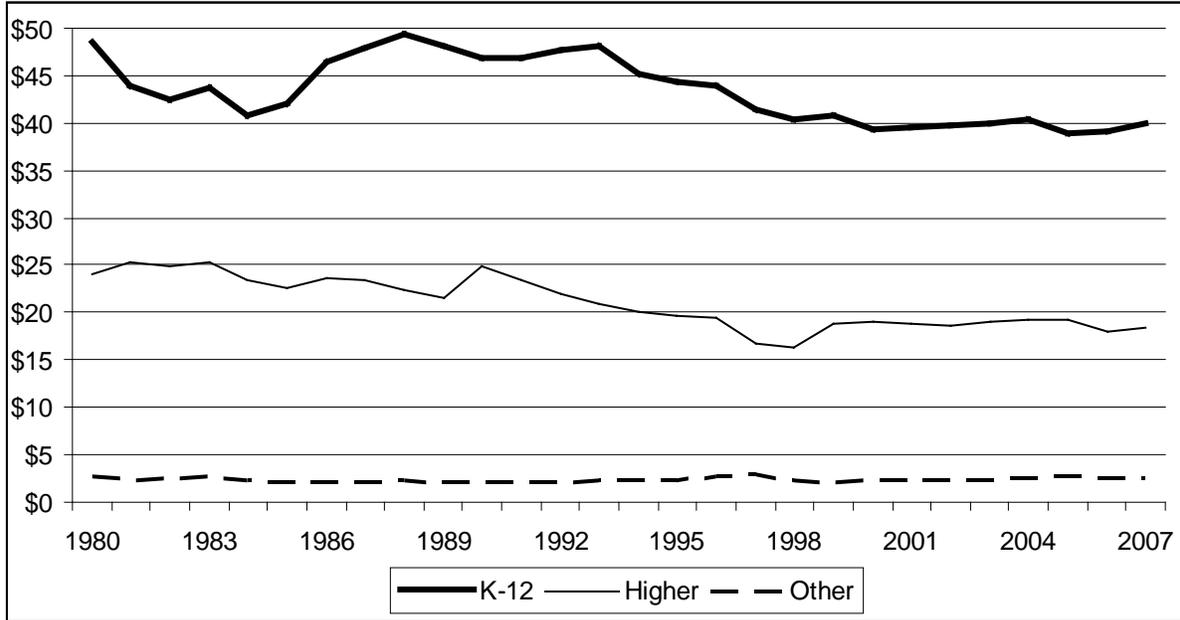


Note: Data for 2001 and 2003 are estimated.

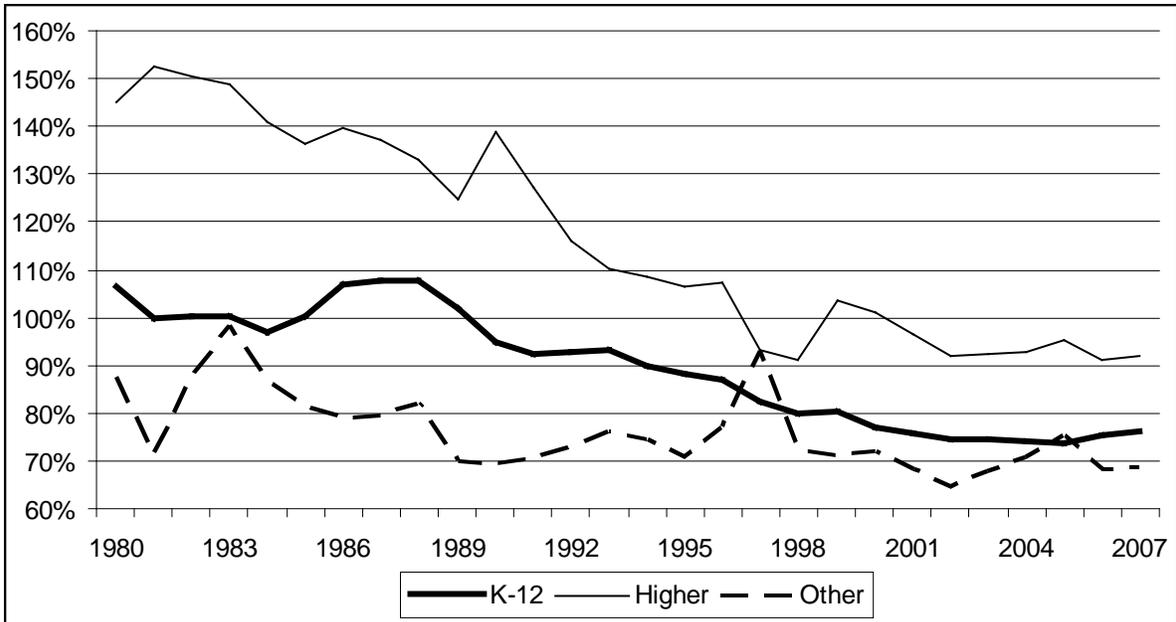
Source: U.S. Department of Commerce, Census Bureau.

**CHART 6.5
COMBINED STATE AND LOCAL GOVERNMENT GENERAL EXPENDITURES
FOR EDUCATION IN ARIZONA, FISCAL YEARS 1980 THROUGH 2007**

PER \$1,000 OF PERSONAL INCOME



PER CAPITA AS A PERCENTAGE OF THE NATIONAL AVERAGE



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (expenditures and population) and Bureau of Economic Analysis (personal income).

As a percentage to the national average, per capita spending has fallen in all three subcategories (see the bottom graph of Chart 6.5). The decrease in higher education has been from around 50 percent higher than the national average in the early 1980s to 5-to-10 percent below average in recent years. K-12 spending fell from above the national average to more than 20 percent below.

The totals discussed so far have included capital outlays. In Chart 6.6, the focus is on noncapital spending for education: funds actually being used to educate children and adults. A large decline in noncapital spending per \$1,000 of personal income has occurred in both K-12 education and higher education (the top graph of Chart 6.6). Decreases are even larger relative to the national average (the bottom graph), with large and nearly steady declines occurring in both K-12 and higher education, both per capita and per \$1,000 of personal income.

K-12 Education

Various measures of the expenditures for elementary and secondary education are examined in this subsection: total, capital, and noncapital using both the per capita and per \$1,000 of personal income measures; and noncapital per student and per student per \$1,000 of per capita personal income. Total K-12 spending in Arizona in 2007 was \$8.5 billion: 21.6 percent of all expenditures. The national share was 23.7 percent. Per capita, spending of \$1,356 was 24 percent less than the U.S. average and fifth lowest in the nation (second lowest in the West). Expenditures per \$1,000 of personal income were 14 percent less than average, the seventh lowest in the nation and third lowest among the western states.

Total K-12 expenditures in Arizona dropped 16 percent per \$1,000 of personal income between 1992 and 2007. The ratio to the national average fell 21 percentage points and the national rank dropped 22 places. Decreases were not quite as large on a per capita basis.

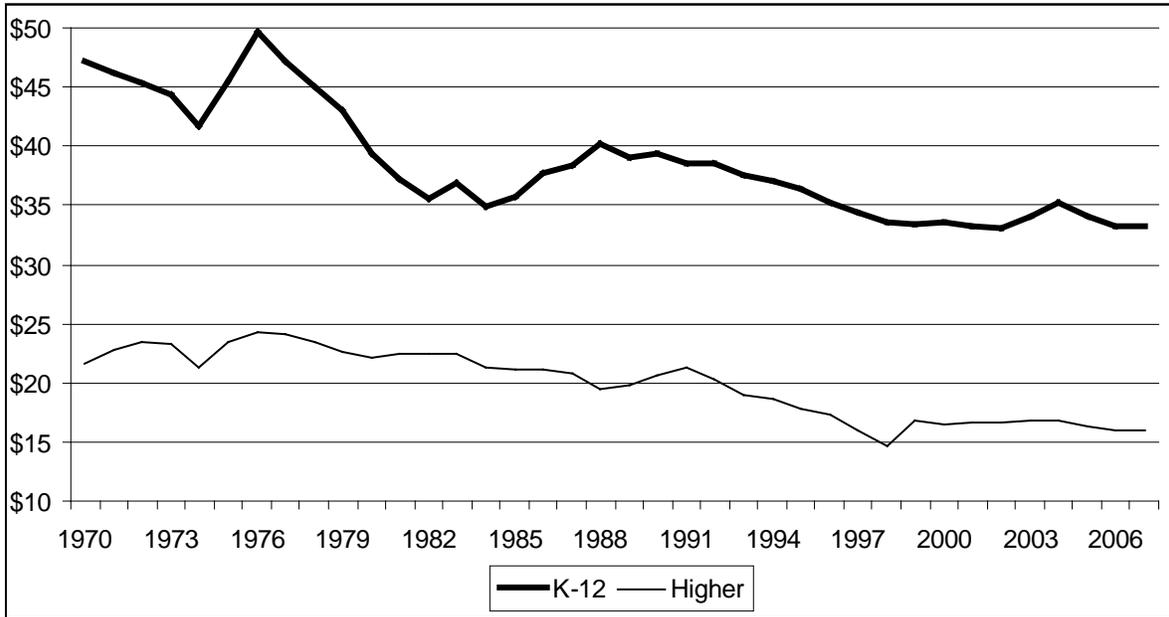
Elementary and secondary school noncapital spending was even further below the national average in 2007 at 28 percent lower per capita and 18 percent less per \$1,000 of personal income. Only one state (Utah) had a lower per capita figure; three states (Colorado, Florida, and Utah) were lower per \$1,000 of personal income. The 1992-to-2007 decrease was 14 percent per \$1,000 of personal income, a decrease of 14 percentage points relative to the national average and a drop of 13 places on the national ranking.

It is more meaningful to compare education expenditures per student than per capita. The demand for education is higher in Arizona than the national average for both K-12 and higher education, measured both by enrollment per capita and enrollment relative to personal income. Thus, Arizona education expenditures are further below the national average per student than either per capita or relative to personal income.

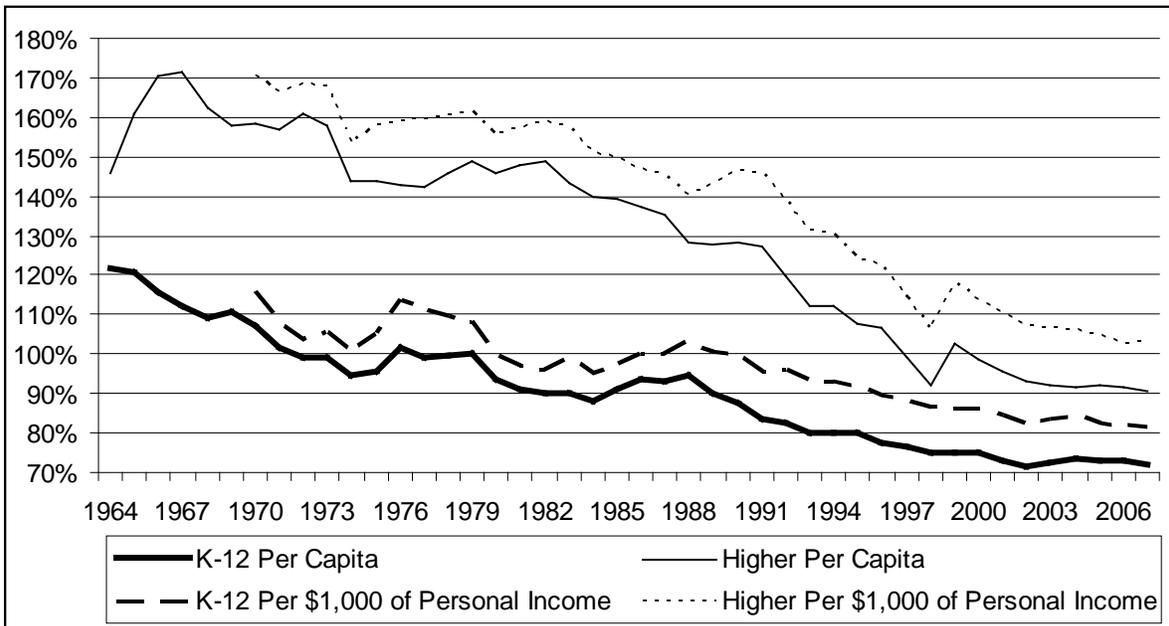
However, the per student measure, and the alternative measure of per student per \$1,000 of per capita personal income, are incomplete measures of education spending needs. The cost of educating disadvantaged students—those living in poverty or for whom English is not their first language—is higher than the cost of educating other students. A high percentage of Arizona's children live in poverty and the percentage of students needing to learn English is among the highest in the country. Thus, based on need, K-12 education spending is even further below the national average than indicated by the per student measure.

**CHART 6.6
COMBINED STATE AND LOCAL GOVERNMENT NONCAPITAL GENERAL
EXPENDITURES FOR EDUCATION IN ARIZONA, THROUGH FISCAL YEAR 2007**

PER \$1,000 OF PERSONAL INCOME



AS A PERCENTAGE OF THE NATIONAL AVERAGE



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (expenditures and population) and Bureau of Economic Analysis (personal income).

Noncapital general education expenditures per K-12 student in 2007 in Arizona (\$6,620) were 30 percent below the national average. The only states with lower spending were Idaho and Utah. Per student per \$1,000 of per capita personal income, expenditures were 21 percent below the U.S. average. On this measure, only Utah was lower.

Between 1992 and 2007, per student noncapital spending adjusted for per capita personal income fell 14 percent in Arizona. This was a decline of 14 percentage points relative to the national average, 13 places on the national ranking, and three places on the western ranking. On the per student measure, the decrease in the ratio to the U.S. average was 10 percentage points and the decline in the national rank was eight places.

The graphs in Chart 6.7 look at a longer time period. From 1970 through 1990, noncapital expenditures per K-12 student per \$1,000 of per capita personal income fluctuated in Arizona around the national average. Since then, the national average has risen a bit further while the Arizona figure has fallen from more than \$240 to less than \$200. As a percentage of the national average, expenditures per student and per student per \$1,000 of per capita personal income have followed a similar pattern, each falling from above the national average through the early 1970s to far below average in recent years. Most of the decline has occurred since the late 1980s.

Thus, all overall and noncapital measures of K-12 spending indicate that the level in Arizona is well below the U.S. average and falling over time relative to other states and to Arizona's spending in the past. Noncapital spending per student is nearly the lowest in the country.

Capital outlays for K-12 education per \$1,000 of personal income generally have been higher than the U.S. average, no surprise given the rapid growth in Arizona's school-age population. However, the differential from the U.S. average over the last several years has been much smaller than in the preceding years. Though ranking among the middle of the western states in 2007, Arizona's capital spending was among the 15 highest in the country.

Higher Education

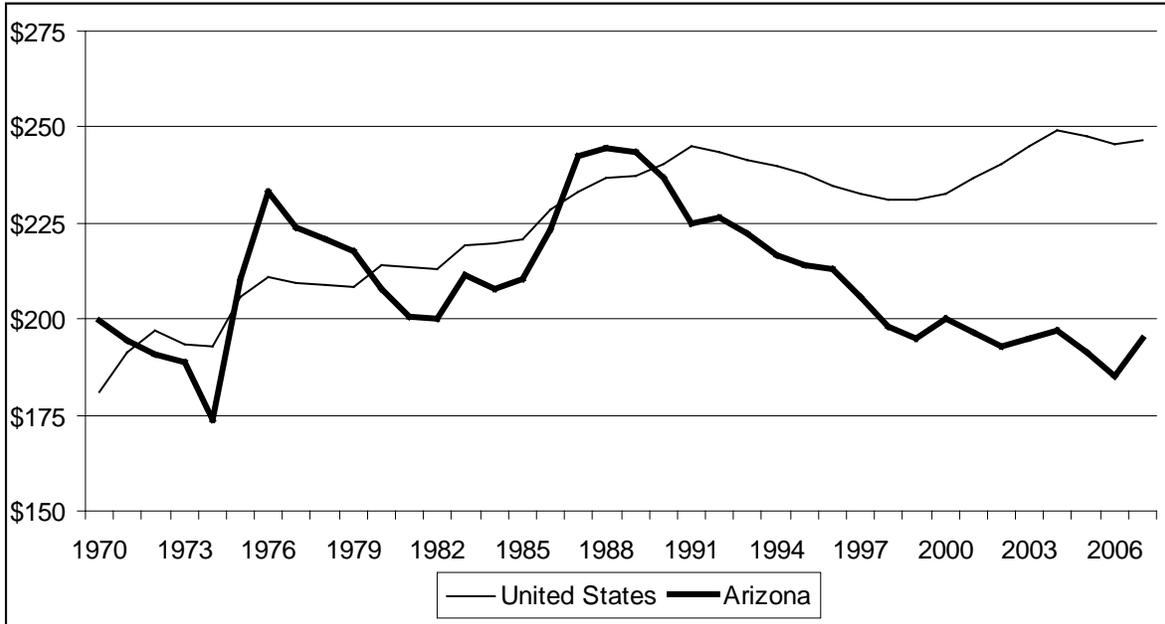
The same measures of the general funding for K-12 education are examined in this subsection for higher education. Total higher education spending in Arizona in 2007 was \$3.9 billion: 10.0 percent of all general expenditures, compared to a national share of 9.0 percent. Per capita, spending of \$625 was 8 percent less than the U.S. average, ranking 33rd in the nation but second lowest in the West. Expenditures per \$1,000 of personal income were 4 percent above average, ranking 29th in the nation and sixth among the western states.

Total higher education expenditures in Arizona dropped 16 percent per \$1,000 of personal income between 1992 and 2007. The ratio to the national average fell 30 percentage points and the national rank dropped 17 places. Decreases were not quite as large on a per capita basis.

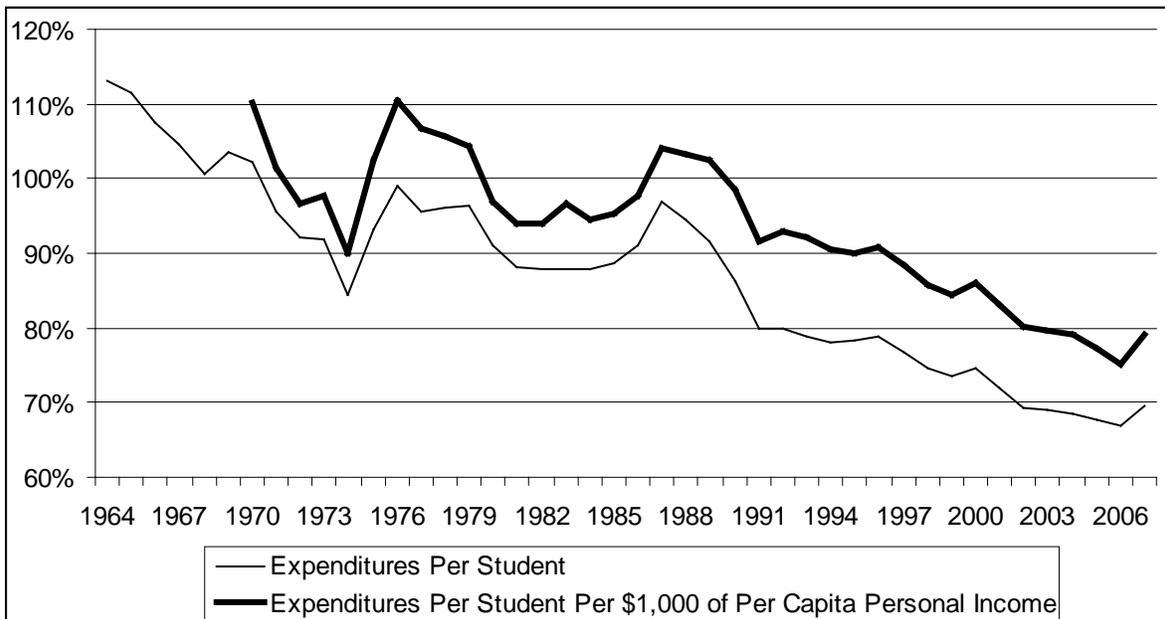
Noncapital spending for higher education in Arizona relative to the national average was just a bit lower than total spending in 2007: 9 percent lower per capita and 3 percent more per \$1,000 of personal income. Arizona ranked 36th (eighth in the West) per capita and 30th (sixth in the West) relative to personal income. The 1992-to-2007 decrease was 21 percent per \$1,000 of

**CHART 6.7
COMBINED STATE AND LOCAL GOVERNMENT NONCAPITAL GENERAL
EXPENDITURES PER STUDENT FOR K-12 EDUCATION IN ARIZONA,
THROUGH FISCAL YEAR 2007**

PER \$1,000 OF PER CAPITA PERSONAL INCOME



ARIZONA AS A PERCENTAGE OF THE NATIONAL AVERAGE



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (expenditures) and Bureau of Economic Analysis (per capita personal income), and U.S. Department of Education, National Center for Education Statistics (enrollment).

personal income, a decrease of 36 percentage points relative to the national average and a drop of 19 places on the national ranking.

Higher education enrollment is measured on a full-time-equivalent (FTE) basis. Arizona's higher education expenditures per FTE student are considerably further below the national average than based on the per capita measure. In 2007, noncapital higher education expenditures per FTE student in Arizona averaged \$16,713. At 12 percent below the national average, only four states had a lesser figure: Florida, Georgia, Idaho, and West Virginia. Relative to per capita personal income, the per FTE student expenditures were only marginally less than the U.S. average, ranking 33rd nationally and sixth among the western states.

Between 1992 and 2007, per FTE student noncapital spending adjusted for per capita personal income slipped 1 percent in Arizona. This was a decline of 6 percentage points relative to the national average and 5 places on the national ranking. On the per FTE student measure, the decrease in the ratio to the U.S. average was 3 percentage points and the decline in the national rank was eight places.

The graphs in Chart 6.8 look at a somewhat longer time period. From 1985 through 1996, noncapital higher education expenditures per FTE student per \$1,000 of per capita personal income in Arizona were above the national average. Since then, Arizona has been lower than the national average, though only marginally so in some years. As a percentage of the national average, noncapital expenditures per FTE student and per FTE student per \$1,000 of per capita personal income have followed a similar pattern, each falling from above the national average in the mid-1980s to below average. The lowest ratios occurred in 1997 and 1998.

Thus, per FTE student, noncapital expenditures for higher education in Arizona fell considerably during the 1980s and 1990s. They now are below the U.S. average.

Capital outlays for higher education per \$1,000 of personal income have fluctuated in Arizona from about the same as the U.S. average to higher in some years. Arizona ranks in the middle of the states nationally and below the middle of the western states.

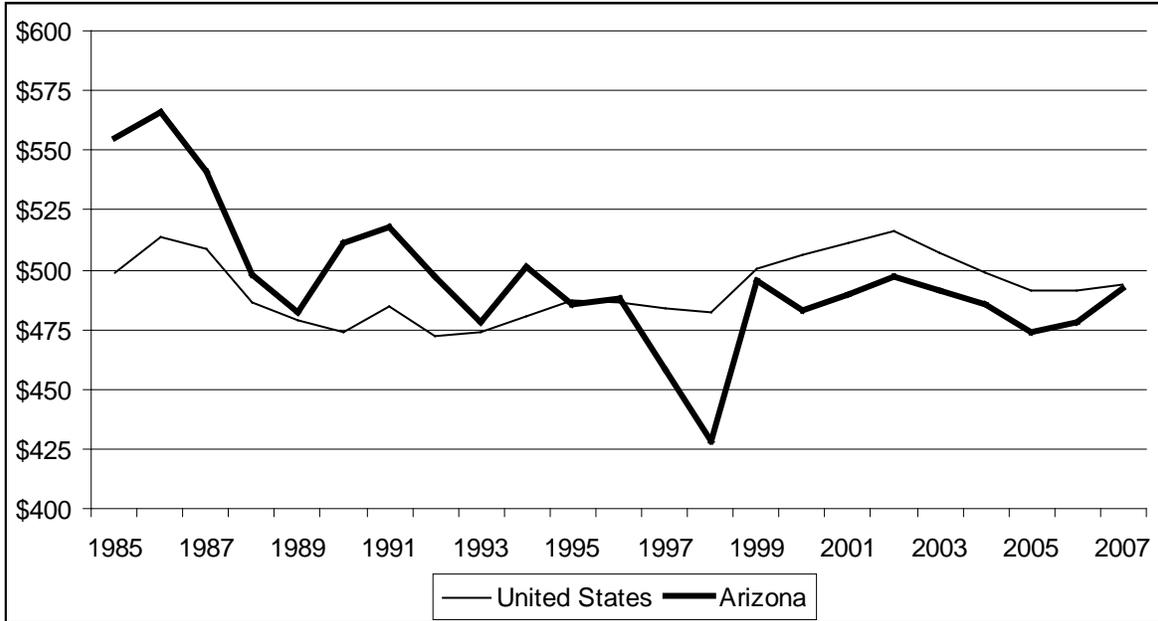
Social Services

After education, the next largest category of government spending is for social services, which accounted for nearly 24 percent of the Arizona total and almost 26 percent of the national total in 2007. Public welfare is the major subcategory, accounting for 70 percent of the social services spending in Arizona and 66 percent nationally. Also included in the social services category are public hospitals, other health programs, veterans' services, and employment security administration, though spending in each of the last two subcategories accounts for only a fraction of the total.

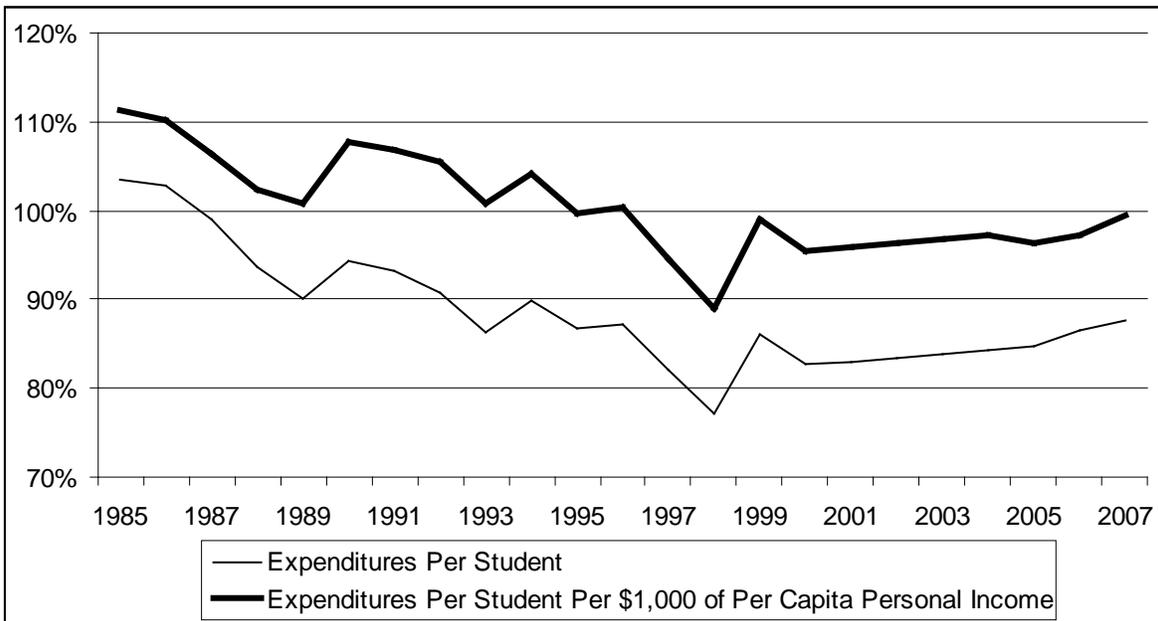
In 2007, Arizona state and local governments spent \$9.4 billion on social services, or \$1,498 per capita. This per capita amount was 23 percent below the national per capita average and ranked 43rd nationally (but in the middle of the western states). Relative to personal income, spending was 12 percent below average, 36th in the nation. Between 1992 and 2007, spending in Arizona increased 11 percent relative to personal income, pushing up the percentage of the national average by 5 percentage points, but not affecting the state's ranking.

**CHART 6.8
COMBINED STATE AND LOCAL GOVERNMENT NONCAPITAL GENERAL
EXPENDITURES PER FULL-TIME-EQUIVALENT STUDENT FOR HIGHER
EDUCATION IN ARIZONA, FISCAL YEARS 1985 THROUGH 2007**

PER \$1,000 OF PER CAPITA PERSONAL INCOME



ARIZONA AS A PERCENTAGE OF THE NATIONAL AVERAGE



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (expenditures) and Bureau of Economic Analysis (per capita personal income), and U.S. Department of Education, National Center for Education Statistics (enrollment).

Per capita welfare spending in Arizona in 2007 was 18 percent less than the national per capita average, ranking 38th nationally and fourth among the western states. Per \$1,000 of personal income, welfare spending was 7 percent below average, ranking 30th nationally and second in the West. Between 1992 and 2007, welfare spending rose 10 percent relative to personal income, an increase marginally less than the U.S. average. Arizona's ranking fell over this period. Chart 6.9 shows the changes since 1980. A substantial increase in spending relative to personal income occurred from 1980 through 1993. Since then, spending has fluctuated. The per capita ratio to the national average peaked in 1993 at less than 90 percent.

Three-fourths of Arizona's public welfare spending in 2007 was in the subcategory of "vendor payments," which consists almost entirely of AHCCCS/Medicaid. Vendor payments in Arizona in 2007 were 18 percent below the national per capita average and 7 percent less relative to personal income. The per capita rank was 39th (but second in the West) and the rank relative to personal income was 30th (also second in the West). Relative to the national Medicaid average, AHCCCS spending has fluctuated over time, with a large dip from 1998 through 2000.

Public spending for hospitals (the operation of public hospitals and reimbursements to private hospitals for patients covered by Medicaid) in 2007 was 54 percent below the per capita average in Arizona, 40th in the nation and last in the West. Relative to personal income, Arizona was 47 percent below average, ranking 37th. This was not as far below average as in 1992 but was not higher than the figures in the mid-1980s.

Other health expenditures—community health care programs, regulation of air and water quality, etc.—were a little above the per capita average in Arizona in 2007, ranking 17th nationally and third among the western states. Arizona had been below average prior to 2003.

Public Safety

Public safety was the next largest category of general expenditures, accounting for 12 percent of total spending by Arizona governments in 2007. Police protection and corrections were the largest subcategories.

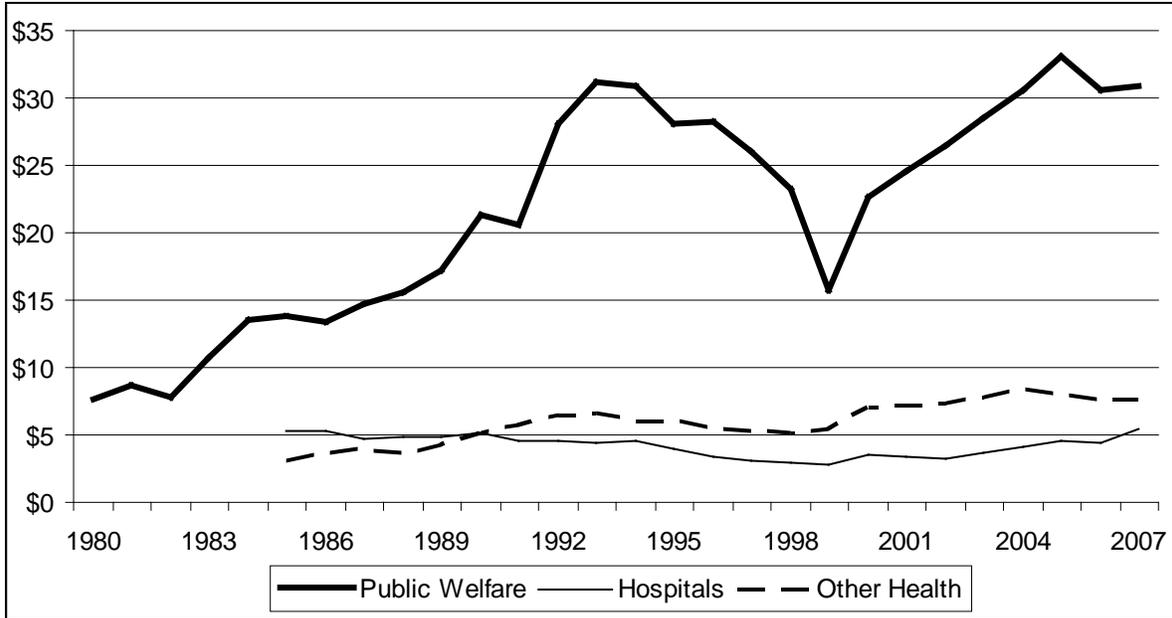
Arizona's public safety spending totaled \$4.8 billion in 2007, or \$762 per person. This was 13 percent above the national per capita average, the 11th highest figure in the nation, and third highest among the western states. Relative to personal income, spending was 28 percent above average, ranking sixth among all states and fourth in the West. Relative to personal income, spending rose 9 percent between 1992 and 2007, about equal to the national average.

Arizona's public safety spending in 2007 was above average and ranked among the top 10 states relative to personal income in each of the category's four components. The per capita ranks and per capita spending relative to the national average were not quite as high.

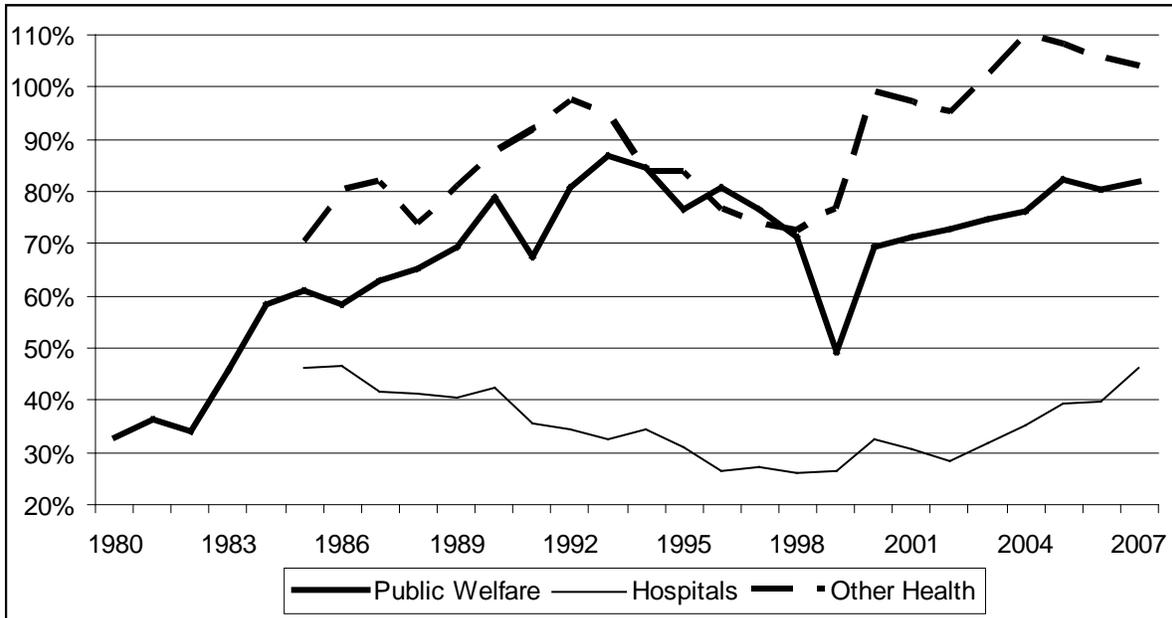
Spending for police protection in 2007 was 16 percent above the national per capita average and 32 percent higher than average relative to personal income. Spending relative to personal income rose in 2007 to a level above that of the preceding 15 years (see Chart 6.10).

**CHART 6.9
COMBINED STATE AND LOCAL GOVERNMENT GENERAL EXPENDITURES
FOR SOCIAL SERVICES IN ARIZONA, FISCAL YEARS 1980 THROUGH 2007**

PER \$1,000 OF PERSONAL INCOME



PER CAPITA AS A PERCENTAGE OF THE NATIONAL AVERAGE

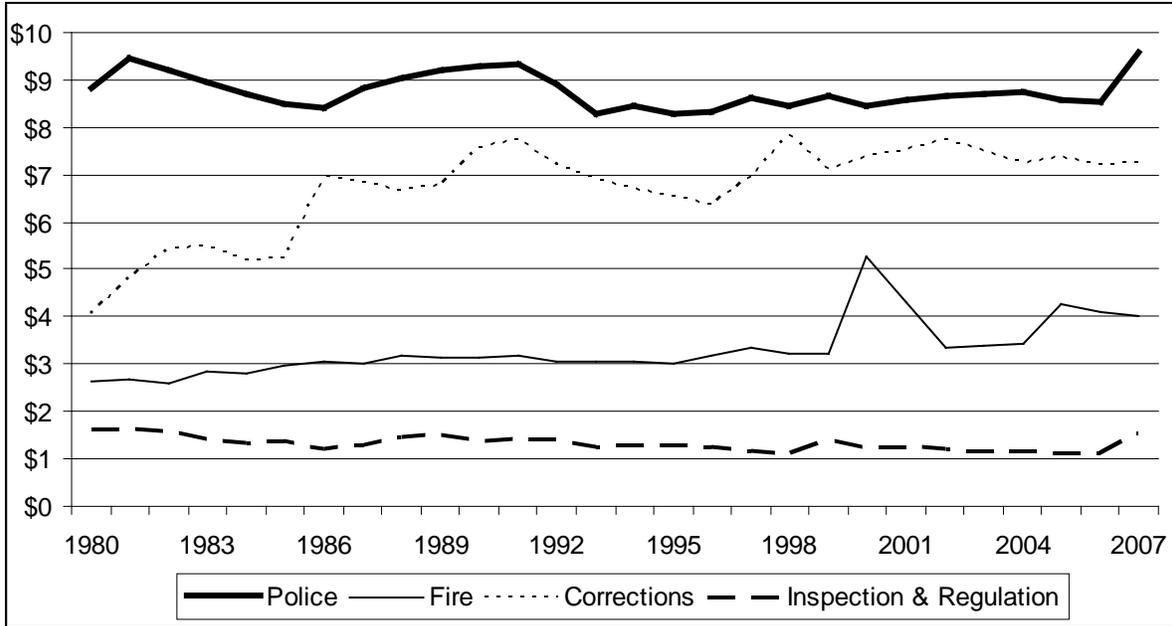


Note: Data for 2001 and 2003 are estimated.

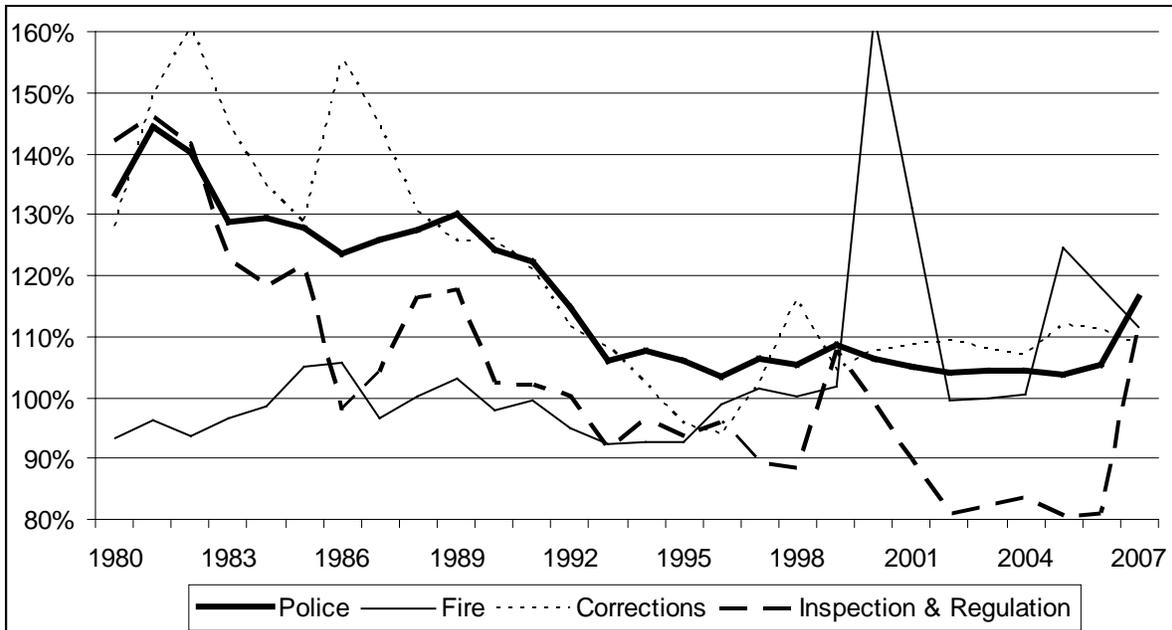
Source: U.S. Department of Commerce, Census Bureau (expenditures and population) and Bureau of Economic Analysis (personal income).

**CHART 6.10
COMBINED STATE AND LOCAL GOVERNMENT GENERAL EXPENDITURES
FOR PUBLIC SAFETY IN ARIZONA, FISCAL YEARS 1980 THROUGH 2007**

PER \$1,000 OF PERSONAL INCOME



PER CAPITA AS A PERCENTAGE OF THE NATIONAL AVERAGE



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (expenditures and population) and Bureau of Economic Analysis (personal income).

Spending for the correctional system was 8 percent above the national per capita average in 2007; the differential was 23 percent relative to personal income. After a substantial rise in spending during the 1980s, no trend has been present since 1992; the state has fallen back a little relative to the national average.

Expenditures for fire protection in 2007 were 12 percent above the national per capita average and 27 percent above average relative to personal income. Spending relative to personal income rose 32 percent between 1992 and 2007, pushing up the ratio to the national average by 17 percentage points and the national ranking by six places.

The final component includes the regulation and inspection of private establishments for the protection of the public, such as health inspections of restaurants. Per capita expenditures in 2007 were 12 percent above the national average, but the ratio to the national average has been highly volatile by year.

Environment and Housing

The environment and housing category accounted for 9 percent of all spending by state and local governments in Arizona in 2007, compared to a national average share of 8 percent. Arizona's spending was 1 percent less than the national per capita average and 12 percent more than the average relative to personal income. Arizona ranked 20th nationally on a per capita basis and 16th relative to personal income. Arizona ranked among the middle of the western states on both measures in 2007.

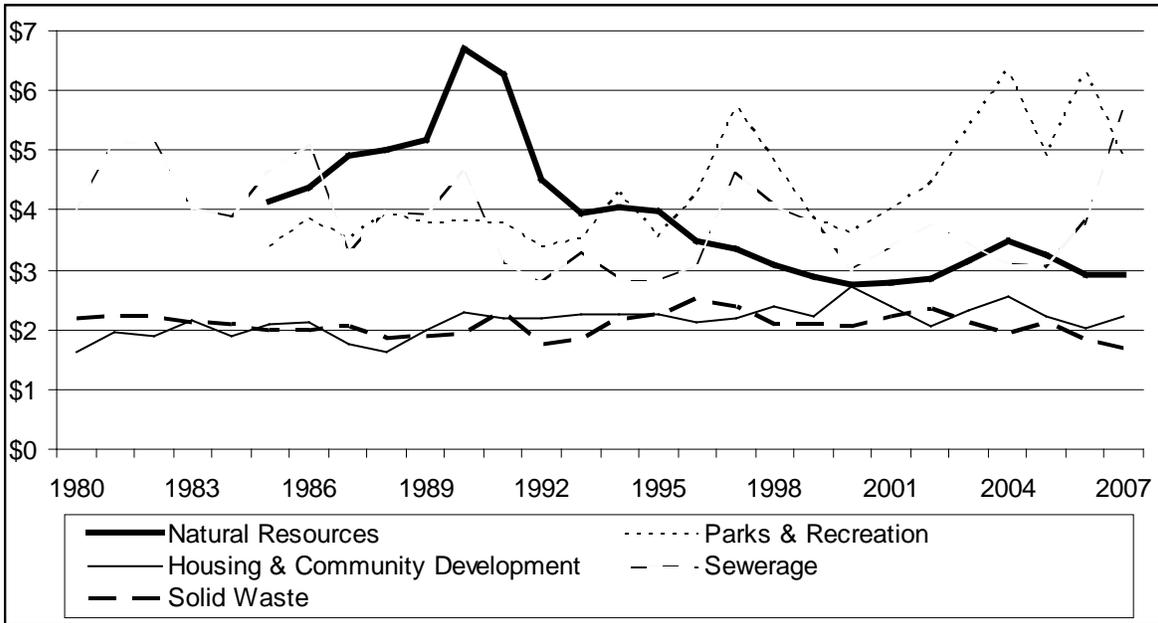
Spending in this category rose between 1992 and 2007, by 18 percent relative to personal income, raising the ratio to the national average by 15 percentage points and the national rank by nine places. The spending increased primarily in the parks and recreation subcategory, which accounted for more than one-fourth of the category total. Arizona moved up to a top ten rank. The increase in this subcategory was entirely in capital outlays, which soared after 2002. Per capita and relative to personal income, capital outlays were the highest in the West and among the five highest in the nation.

Expenditures in Arizona in 2007 also were above average in the natural resources subcategory, due to high noncapital expenditures. This subcategory includes expenditures related to water resources, mineral resources, agriculture, game and fish, etc. In 2007, Arizona was 4 percent above the national per capita average and 18 percent higher relative to personal income. The state ranked in the middle of all states and of the western states. Natural resources spending dropped 35 percent relative to income between 1992 and 2007, with the ratio to the national average dropping 61 percentage points.

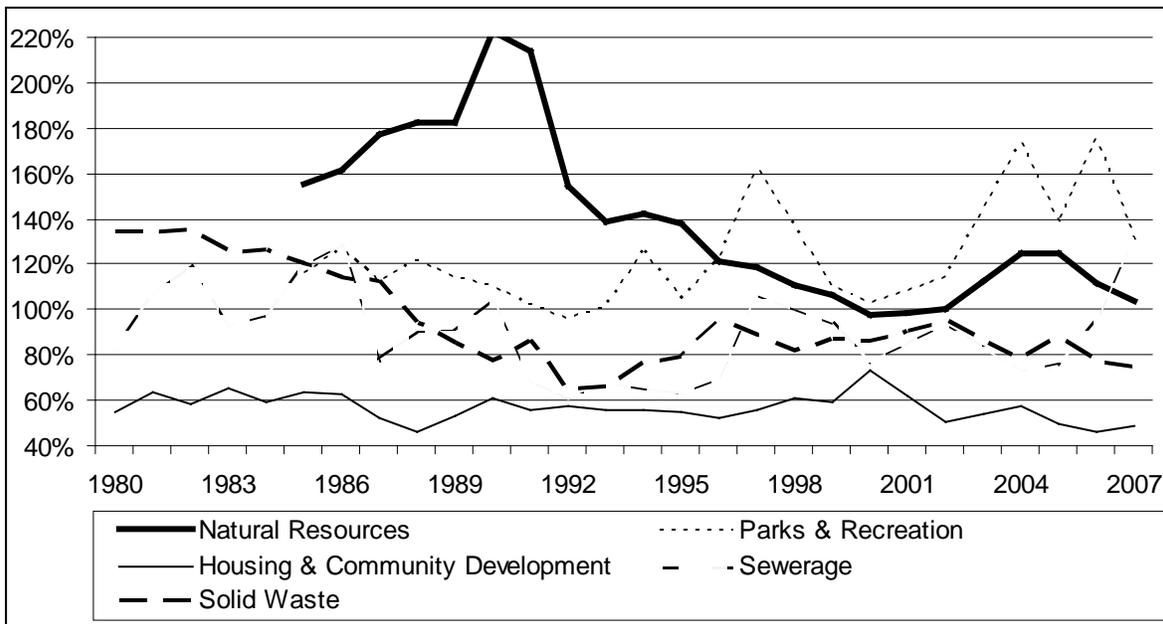
In the sewerage subcategory, the largest of the five subcategories in Arizona in 2007, spending also was above the national average, by 31 percent per capita and 49 percent relative to personal income. The state ranked in the top ten and third in the West on both measures. The above-average spending was due to capital outlays related to the state's fast growth; noncapital expenditures were below average. A large increase in spending occurred between 1992 and 2007, both relative to personal income and as a ratio to the national average, as seen in Chart 6.11.

**CHART 6.11
COMBINED STATE AND LOCAL GOVERNMENT GENERAL EXPENDITURES
FOR ENVIRONMENT AND HOUSING IN ARIZONA,
FISCAL YEARS 1980 THROUGH 2007**

PER \$1,000 OF PERSONAL INCOME



PER CAPITA AS A PERCENTAGE OF THE NATIONAL AVERAGE



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (expenditures and population) and Bureau of Economic Analysis (personal income).

In contrast, spending in 2007 in Arizona was below average in the other two subcategories. In solid waste management, Arizona was 25 percent below the national per capita average, ranking below the middle of the states, though fourth among the western states. Spending fell a bit between 1992 and 2007 relative to personal income, but not as much as the national average.

In the housing and community development subcategory, spending in Arizona was far below the U.S. average: 51 percent below per capita and 44 percent less relative to personal income. Arizona ranked 42nd relative to personal income and eighth in the West. Spending in Arizona was flat relative to personal income though spending increased nationally.

Transportation

Expenditures for transportation (\$3.3 billion) accounted for 8.3 percent of the Arizona total in 2007, a little higher share than the national average of 7.6 percent. Per capita spending was 8 percent below average, ranking 36th overall and seventh in the West. Spending per \$1,000 of personal income was 4 percent higher than the U.S. average but ranked 33rd nationally and seventh in the West. Transportation spending in Arizona decreased between 1992 and 2007 relative to personal income, with the ratio to the national average falling 14 percentage points and the national rank dropping 10 places.

Most (82 percent) of Arizona's transportation spending in 2007 was in the highways subcategory, which includes expenditures for streets, sidewalks and bridges. More than half of the highway spending in 2007 was for capital outlays. Highway expenditures are shown in Chart 6.12. Capital outlays for highways shot up during the 1980s and peaked in 1990, but were down to the level of the early 1980s by 1992. Since then, capital outlays have continued to decline, particularly relative to the national average. In 2007, capital outlays for highways were below the national average, despite the state's rapid population growth and traffic congestion. Arizona ranked below the middle of the states nationally and seventh among the western states.

Noncapital spending for highways in Arizona was 8 percent below the national per capita average but 4 percent higher than average per \$1,000 of personal income in 2007. The state ranked below the middle nationally and in the West. Noncapital spending was unchanged relative to personal income between 1992 and 2007, but the national average fell.

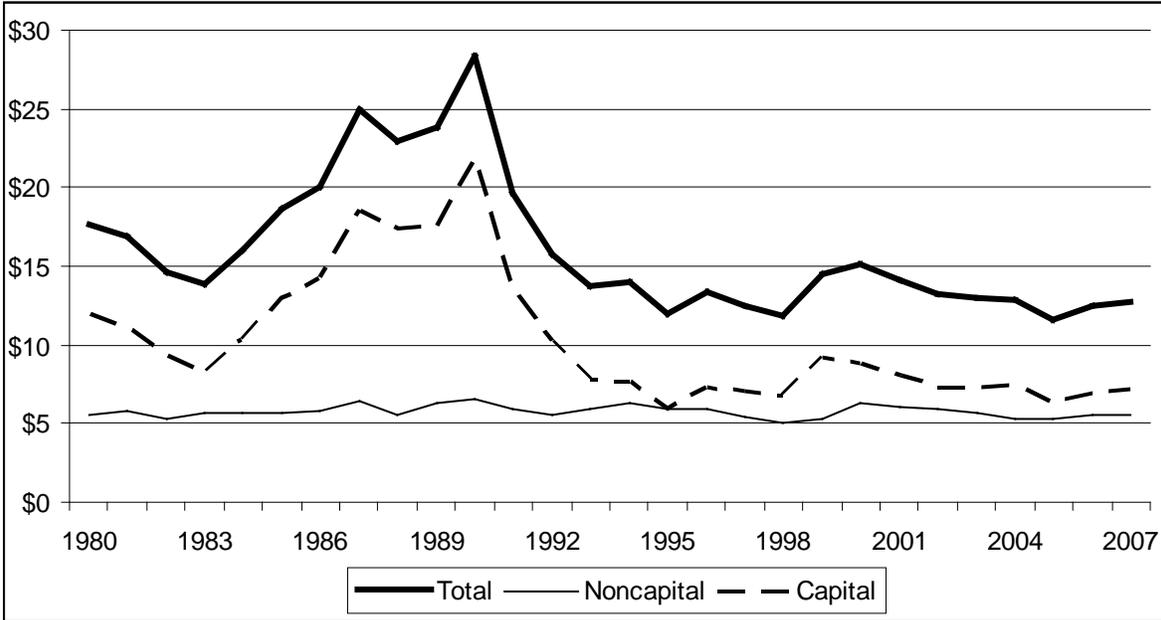
The only other component of transportation of any size was air transportation, which primarily consists of expenditures related to airports. Spending was considerably above average in Arizona in 2007, by 56 percent relative to personal income, with the state ranking eighth nationally and third in the West. Spending increased substantially between 1992 and 2007, by 33 percent relative to personal income, pushing the ratio to the national average up considerably.

Government Administration

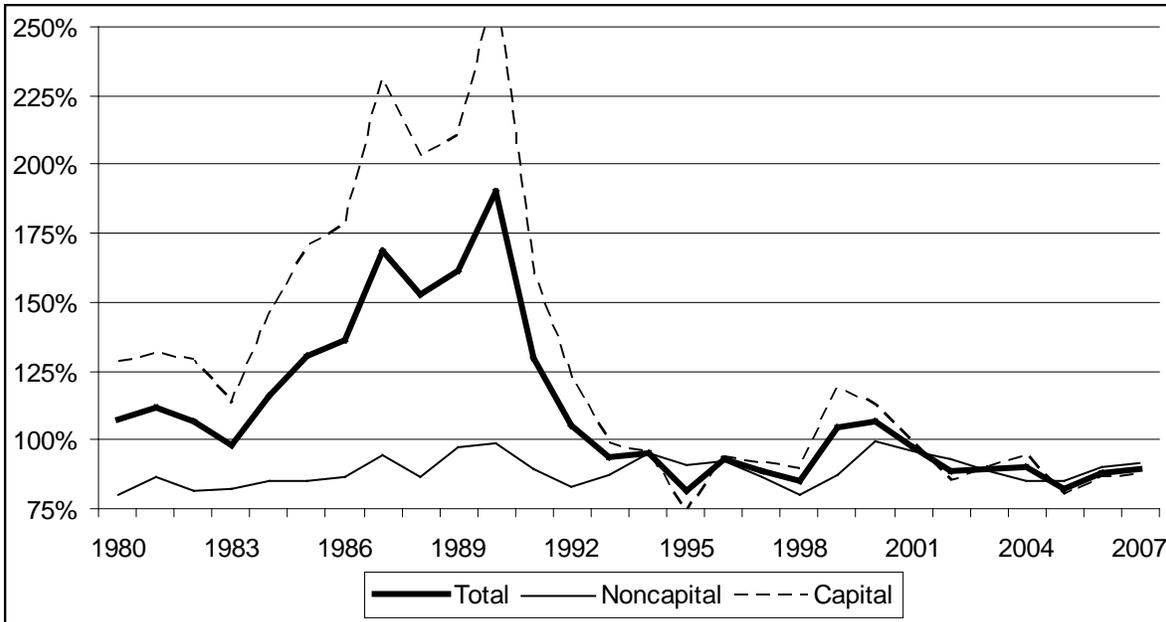
Spending on government administration—which includes the judicial and legal systems, financial administration, the maintenance and operation of public buildings not associated with a specific agency, and various other programs—accounted for 6.1 percent of state and local government expenditures in Arizona in 2007, compared to a national average share of 5.3 percent. Expenditures in Arizona were 4 percent below the national per capita average but 9 percent above the average relative to personal income. Arizona ranked among the middle of the states nationally, but was

**CHART 6.12
COMBINED STATE AND LOCAL GOVERNMENT GENERAL EXPENDITURES
FOR HIGHWAYS IN ARIZONA, FISCAL YEARS 1980 THROUGH 2007**

PER \$1,000 OF PERSONAL INCOME



PER CAPITA AS A PERCENTAGE OF THE NATIONAL AVERAGE



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (expenditures and population) and Bureau of Economic Analysis (personal income).

seventh among the western states on both measures. Expenditures per \$1,000 of personal income dropped 14 percent between 1992 and 2007, causing the ratio to the national average to fall 25 percentage points and the national rank to drop 11 places.

Of the four subcategories, spending in Arizona in 2007 was greatest for the judicial and legal system. Consistent with the above-average expenditures for police protection and corrections, spending for the judicial and legal system also was above average, by 12 percent per capita and 28 percent relative to personal income. Arizona ranked third among the western states and between sixth and 11th nationally on both measures. However, spending dropped relative to personal income between 1992 and 2007, with a significant drop in the ratio to the national average. As seen in Chart 6.13, spending had increased considerably between the mid-1980s and 1992.

Spending was below average in Arizona in 2007 in the financial administration and general public buildings subcategories. Arizona ranked below the middle of the states nationally and in the West in both subcategories. Spending for public buildings was flat between 1992 and 2007 relative to personal income, but spending on financial administration fell considerably, with a large drop in the ratio to the national average.

Expenditures in Arizona were above average in 2007 in the “other” government administration subcategory, which includes legislative bodies, government-wide staff services, etc. While the state ranked in the top 20 nationally, it was sixth among the western states. Though spending increased between 1992 and 2007 relative to personal income, the increase was not as great as the national average.

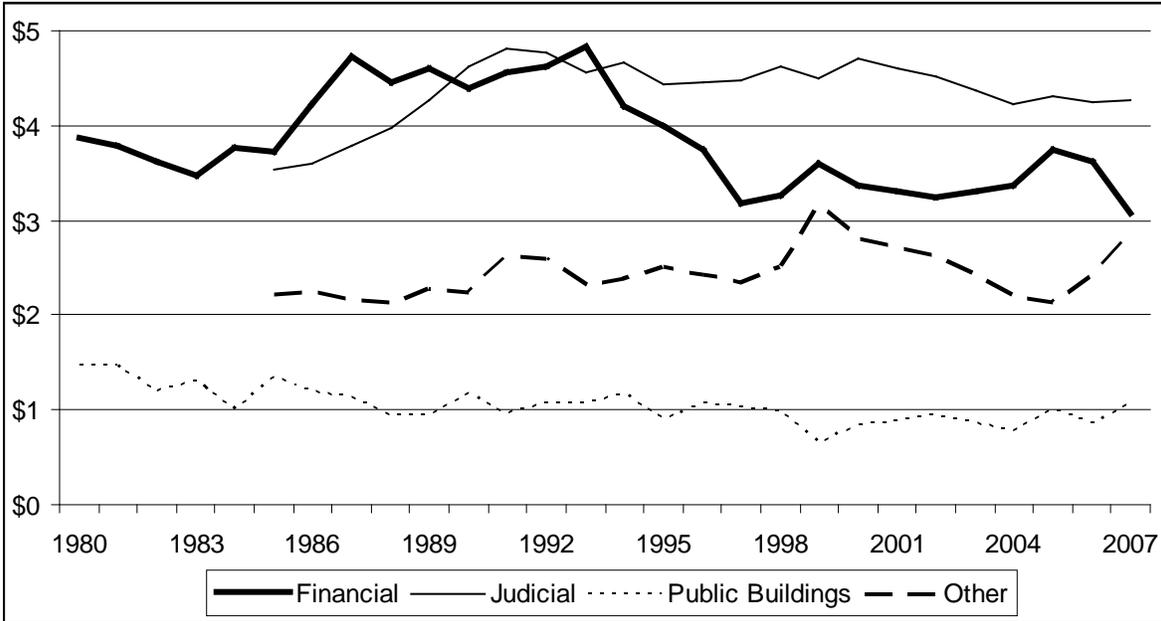
Other Expenditures

Interest payments on general debt totaled nearly \$1.4 billion in 2007, or 3.4 percent of the total expenditures in Arizona. Interest expense was well below the national average on per capita and personal income bases. Between 1992 and 2007, interest payments fell sharply per \$1,000 of personal income and as a percentage of the national average, both per capita and per \$1,000 of personal income. The per capita rank dropped from 19th to 39th nationally and from fourth to eighth in the West; relative to personal income, the rank fell from 11th to 36th nationally and from second to eighth among the western states.

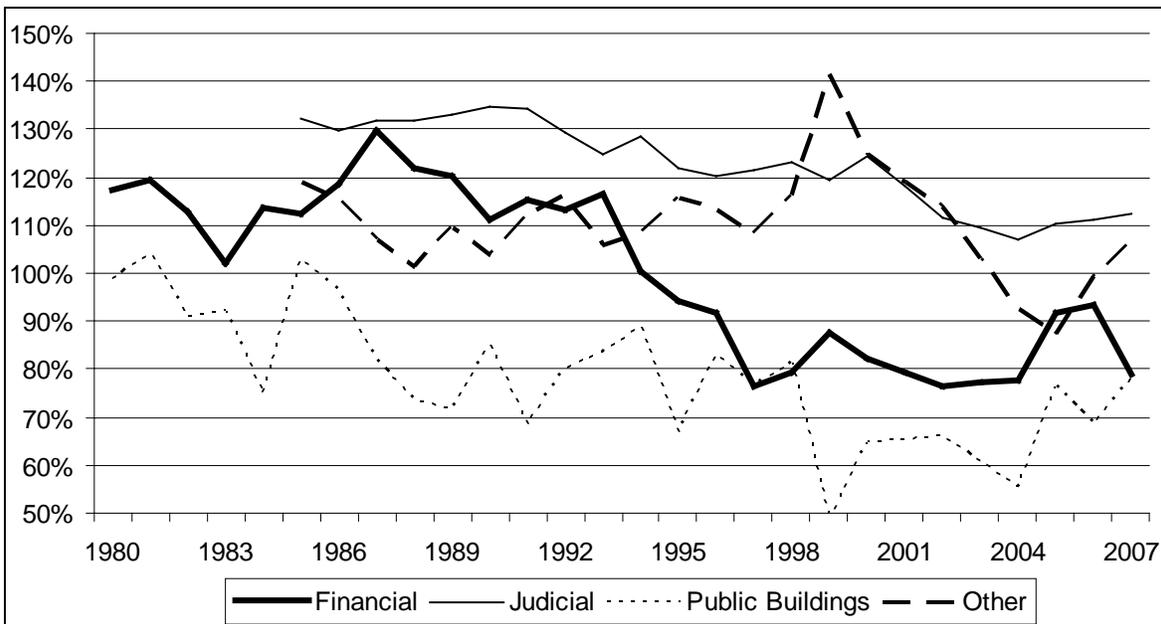
The total of other and unallocable general expenditures was nearly equal to the interest payments in Arizona in 2007. Per capita and per \$1,000 of personal income, the Arizona figures were even further below the U.S. average and ranked quite low among the states. Between 1993 and 2007, these expenditures rose a little relative to personal income, but the percentage of the national average was unchanged. The ranks hardly changed.

**CHART 6.13
 COMBINED STATE AND LOCAL GOVERNMENT GENERAL EXPENDITURES
 FOR GOVERNMENT ADMINISTRATION IN ARIZONA,
 FISCAL YEARS 1980 THROUGH 2007**

PER \$1,000 OF PERSONAL INCOME



PER CAPITA AS A PERCENTAGE OF THE NATIONAL AVERAGE



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (expenditures and population) and Bureau of Economic Analysis (personal income).

CHAPTER 7

REPRESENTATIVE REVENUES AND REPRESENTATIVE EXPENDITURES

The Advisory Commission on Intergovernmental Relations pioneered the concept of representative revenues and representative expenditures. Since the demise of this organization in 1995, the Federal Reserve Bank of Boston has continued to occasionally produce these data. Unfortunately, the latest data are for fiscal year 2002. Not only are these data becoming dated, but since fiscal year 2002 was a recessionary year, the results do not depict the average conditions over an economic cycle for a state like Arizona that has such a cyclical economy and fiscal system. References to years in this chapter are to fiscal years.

REPRESENTATIVE REVENUES

The Representative Revenue System consists of the multitude of revenue sources used by state and local governments across the nation. It includes the revenue bases (for example, for the motor fuels tax, the number of gallons of fuel sold) and the representative rates (for example, the national average gasoline tax per gallon). For each state, the *revenue capacity* is calculated by applying the national average tax rate (user fee/other average revenue rate) to the revenue base in the state.

Revenue capacity is expressed as a per capita dollar figure; the *revenue capacity index* compares the per capita revenue capacity in a state to the national average. The *revenue effort index* is the ratio of *actual revenues* to revenue capacity, based on the per capita figures of each.

In 2002, the revenue capacity nationally was \$4,659, the same as actual revenue collected per capita. The revenue capacity in Arizona was \$4,147, only 89 percent of the national average. Arizona's subpar revenue capacity in large part reflects the state's below-average incomes. Arizona's revenue capacity ranked tied for 39th among the 50 states, and ranked seventh among the nine western states (the capacity in Utah and New Mexico was lower).

Because of its highly cyclical economy, Arizona's revenue capacity index goes up and down with the economic cycle. Thus, its index of 89 in 2002 was not representative of the average year; revenue capacity at the peaks of economic cycles in the 1980s and 1990s approached the national average. Since 2002, the state's revenue capacity likely again approached the U.S. average in the mid-2000s, but probably is currently below the 2002 index.

Actual per capita revenue collected in Arizona in 2002 was \$3,682, only 79 percent of the national average and 89 percent of the state's revenue capacity. Actual per capita collections were third lowest in the nation, with only Arkansas and Tennessee having lower figures. The revenue effort ranked tied for 43rd nationally and tied with Nevada for lowest in the West.

REPRESENTATIVE EXPENDITURES

The Representative Expenditure System is the collection of per capita expenditures that prevail in the entire nation over a standard bundle of services provided by state and local governments. For each state, these representative expenditures are adjusted for workload factors in the state to

determine the *expenditure need* in the state. Workload factors consist of socioeconomic and demographic characteristics and variations in the costs of inputs. The latter adjusts for cost-of-living differences across states. The former considers income and other factors that determine the percentage of the population who are eligible for various forms of public assistance, the percentage of the population who are of school age, etc.

Expenditure need is expressed as a per capita dollar figure; the *expenditure need index* compares the per capita expenditure need in a state to the national average. The *expenditure effort index* is the ratio of *actual expenditures* to expenditure need, based on the per capita figures of each.

In 2002, the expenditure need nationally was \$6,007, the same as actual expenditures per capita. The expenditure need in Arizona was \$6,128—102 percent of the national average. A number of factors affect expenditure need; Arizona's slightly higher-than-average need is related to its slightly higher proportion of school-age children, its relatively high proportion of residents eligible for public welfare due to their subpar income, etc. Arizona's expenditure need ranked tied for 15th among the 50 states, and ranked fifth among the nine western states.

Actual per capita expenditures in Arizona in 2002 totaled \$4,745, only 79 percent of the national average and 77 percent of the state's expenditure need. Actual per capita expenditures were the lowest in the nation. Only Arkansas had a lower expenditure effort.

Expenditure need in Arizona does not vary nearly as much over the economic cycle as revenue capacity. Generally, expenditure need does not change very fast over time. Thus, in an effort to update these 2002 figures with the 2007 Census Bureau data, the expenditure need index in each state is assumed to be equal to the 2002 figure. Expenditure need in 2007 based on the 2002 index is compared to actual per capita expenditures in 2007, during the expansionary phase of the economic cycle.

Actual per capita expenditures in Arizona in 2007 were 83 percent of the national average, a slightly higher ratio than in 2002. Arizona ranked 46th in the nation and second lowest in the West (the figure in Texas was marginally lower). The expenditure effort index, based on the 2007 actual expenditures and the 2002 expenditure need index, was 82 percent in Arizona—tied for 46th in the nation and higher than only Texas in the West—again slightly higher than in 2002. Thus, while not quite as low as in 2002, Arizona's actual expenditure ratio and expenditure effort index in 2007 still were among the five lowest in the country.

FISCAL CAPACITY

The *fiscal capacity index* is calculated as the ratio of the revenue capacity index to the expenditure need index. The *fiscal gap*, expressed in dollars, is the difference between expenditure need and revenue capacity. The fiscal gap is positive in all states since all states supplement revenues raised from their own state and local government sources with monies received from the federal government.

In 2002, Arizona's fiscal capacity was only 87 percent of the national average. The state ranked 38th nationally and sixth among the western states (Texas, Utah, and New Mexico were lower).

CONCLUSION

A summary of Arizona’s representative revenues and expenditures in 2002 is shown in Table 7.1. The expenditure need in Arizona was a little higher than the national average, but the revenue capacity was considerably less than the national capacity. Thus, the state’s fiscal capacity was below average. All but one state with a below-average fiscal capacity also had a below-average expenditure effort. These states have little choice but to be below average on expenditure effort because of their low revenue capacity.

The differential between the fiscal capacity index and the expenditure effort index says something about the choices made by a state’s elected officials and electorate regarding the provision of public services. Among states with a below-average fiscal capacity, several—most notably New Mexico, West Virginia, South Carolina, and North Dakota—had an expenditure effort index considerably higher than their fiscal capacity index. These states make an effort to provide public services despite limited revenues.

In contrast, in some states with a subpar fiscal capacity, the expenditure effort index was even further below average than the fiscal capacity index. Arizona was the most extreme example of states with a fiscal capacity more than a few percent less than the national average, with an expenditure effort index 10 points below the fiscal capacity index and a expenditure effort rank 11 places less than the fiscal capacity rank. States with an expenditure effort index less than the fiscal capacity index demonstrate a disinclination to provide public services (except for states with a high fiscal capacity index, which can have a lower expenditure effort index and still provide average or above-average levels of public services). The only states with an expenditure effort more than a few percent below the national average that had at least as large a negative differential as Arizona between the expenditure effort index and the fiscal capacity index were New Hampshire, Florida, Virginia, and Missouri.

TABLE 7.1
MEASURES OF REPRESENTATIVE REVENUES AND REPRESENTATIVE
EXPENDITURES IN ARIZONA, COMBINED STATE AND LOCAL GOVERNMENTS,
FISCAL YEAR 2002

Index	Ratio to U.S. Average	50-State Rank	Western Rank
Revenue Capacity	89%	39t	7
Actual Revenues	79	48	9
Revenue Effort	89	43t	8t
Expenditure Need	102	15t	5
Actual Expenditures	79	50	9
Expenditure Effort	77	49	9
Fiscal Capacity	87	38	6

t: tie

Source: Federal Reserve Bank of Boston, New England Public Policy Center, “Measuring Fiscal Disparities Across the U.S. States: A Representative Revenue System/Representative Expenditure System Approach, Fiscal Year 2002.”

TABLE 7.2
COMPARISON OF FISCAL CAPACITY AND EXPENDITURE EFFORT
IN WESTERN STATES, COMBINED STATE AND LOCAL GOVERNMENTS,
FISCAL YEAR 2002

	Fiscal Capacity Index		Expenditure Effort Index		Difference	
	Index	Rank	Index	Rank	Index	Rank
Nevada	123	6	99	23	-24	-17
Colorado	122	7	108	16	-14	-9
Washington	109	15	110	13	1	2
California	106	18	108	16	2	2
Oregon	106	18	116	8	10	10
Arizona	87	38	77	49	-10	-11
Texas	86	39	79	47	-7	-8
Utah	83	42	90	34	7	8
New Mexico	79	44	95	28	16	16

Source: Federal Reserve Bank of Boston, New England Public Policy Center, "Measuring Fiscal Disparities Across the U.S. States: A Representative Revenue System/Representative Expenditure System Approach, Fiscal Year 2002."

The figures for the western states are shown in Table 7.2. Four of the western states had much lower fiscal capacities than the other five states. Among those four states, the expenditure effort index was lower than the fiscal capacity index in Arizona and Texas, but higher in Utah and New Mexico. Thus, despite a similar fiscal capacity, per capita state and local government expenditures varied widely among these states.

Arizona's very low expenditure effort despite a not-as-low fiscal capacity indicates a choice made by public officials, and by the electorate voting for those officials, to keep the size of government small—to not provide the same level of public services as other states with a limited revenue capacity. Moreover, the state's expenditure effort has declined over time despite its revenue capacity not trending down.

Though data on representative revenues and expenditures are not available for the current period, the current state government general fund figures allow a consistent conclusion to be drawn. As seen in Chart 5.1, ongoing expenditures per \$1,000 of personal income have fallen since the early 1990s. In each of the last two recessions, this figure has been at record lows. Thus, while the state's revenue capacity is low and falls during economic recessions, revenues and expenditures fall even more. Much greater revenues could be collected without the tax burden reaching high levels.

CHAPTER 8

STATE GOVERNMENT DEFICIT

The deficit in the state government general fund is the driving force behind discussions of public sector finance in Arizona. Because of this deficit, monies are being transferred from other state government funds to the general fund, endangering these nongeneral fund programs; shifts to local governments of state government responsibilities are under consideration; reductions in the sharing of state government monies with local governments have been considered; considerable state government borrowing has been undertaken, raising costs in the future; very sizable spending reductions have been and are being implemented; and changes to laws and the Arizona Constitution are being considered.

Any discussion of public-sector fiscal deficits is complicated by differing definitions of terms and the multiple ways of calculating a deficit. In general terms, a deficit occurs when revenues are less than expenditures.

Discussions of deficits usually refer to the expected deficit during the current fiscal year and/or to predicted deficits in following years. Thus, the size of the deficit is dependent on projections of both revenues and expenditures; estimates of the size of the deficit may vary from one analyst to another. Unless otherwise noted, years in this chapter refer to fiscal years.

TOTAL DEFICIT

Since 2008—when the onset of the latest recession and the implementation of the last substantial tax cut caused revenues to decline—discussions of state government finance have been dominated by the large total deficit in the general fund. The Governor’s Office of Strategic Planning and Budget (OSPB) and the Joint Legislative Budget Committee differentiate between two types of deficits. They call the deficit between ongoing revenues and ongoing expenditures a “structural” deficit. This deficit is synonymous with the total deficit between ongoing revenues and ongoing expenditures. The JLBC estimates the size of this deficit at \$3.3 billion in the current year, following the legislative actions taken in March.

The magnitude of this “structural” deficit varies by year due to the economic cycle; the JLBC projects a smaller deficit of \$2.2 billion in 2011, largely due to the spending reductions passed by the Legislature in March, but also due to a cyclical rebound in revenue that is expected to begin next year. The OSPB and JLBC each expect a very large deficit to remain in coming years. However, this is based on a very conservative economic outlook—one in which the economy and public revenues recover extremely slowly from the recession that has just ended. Consistent with this pessimistic outlook, spending demands related to welfare programs continue to rise significantly in the JLBC, and especially the OSPB, forecasts.

The second deficit defined by the OSPB and JLBC is the budget deficit in the general fund that remains after one-time efforts to resolve the structural deficit in any year. Because of the use of fund transfers, federal government stimulus monies, revenues from the sale-leaseback of state facilities, and spending reductions, the large deficit that existed earlier in the current year has been resolved.

Estimates of the size of the total deficit vary, but a figure of \$4.0 billion is assumed. This was calculated by starting with the original appropriation for 2008, increasing it somewhat to account for caseload increases since 2008, and subtracting ongoing revenue in the current year.

The total deficit can be divided into two portions. A “cyclical” deficit is a temporary deficit during an economic downturn largely due to a cyclical decline in revenue (but also due to a countercyclical increase in demand for certain public services). A “persistent” deficit is due to a fundamental imbalance between revenues and expenditures that does not vary with the economic cycle. The persistent portion of the deficit is more accurately termed a “structural” deficit, but because the OSPB and the JLBC give this term a different meaning, “persistent” is used in this report.

PERSISTENT DEFICIT

A persistent deficit is caused by permanent reductions in revenues not adequately matched by reductions in expenditures and/or by adding spending obligations without raising a commensurate amount of revenue. Barring further actions, a persistent deficit will remain as a constant share of the total budget. Alternatively, a persistent deficit can be thought of as the average total deficit over the course of an entire economic cycle, in which cyclical deficits and surpluses net to zero. The federal government, which does not have a requirement to balance revenues and expenditures, has such a persistent deficit.

Arizona created a persistent deficit in the state government general fund between 1979 and 1981 when various revenue sources were reduced without a compensating decrease in spending. That persistent deficit was briefly resolved when tax revenues were increased and spending was reduced around 1990. However, a new persistent deficit was introduced beginning in the early 1990s when tax cuts were initiated without an adequate reduction in expenditures to offset the loss of revenue. The size of the persistent deficit has continued to grow through the current time due to a long series of tax cuts being implemented and phased in—even in 2009, modest reductions in revenues were passed by the Legislature—and due to new spending demands being added to the general fund without a revenue source. Though expenditures for some programs have been reduced relative to the size of the economy since the early 1990s, the reductions prior to 2009 were not nearly large enough to offset the lost revenue and the increased spending requirements in other programs.

A large persistent deficit in the state’s general fund is present despite a constitutional requirement to annually balance the budget. During the two prior economic expansions, the cyclical surplus exceeded the persistent deficit. During economic downturns, the total deficit has been temporarily resolved largely through one-time corrections, such as transfers into the general fund from the rainy-day fund and other state government funds, and through reductions in expenditures.

Assuming that none of the spending reductions passed in the last two years are permanent, the size of the persistent deficit in the state’s general fund is estimated to be \$2.2 billion in the current year and \$2.3 billion in the next year. The increase in size is largely the result of the expanding size of the budget, though modest tax cuts continue to be implemented as well. With no further actions being taken, the persistent deficit could reach \$2.9 billion in 2015.

The magnitude of the persistent deficit was estimated as follows. Historically, general fund revenues and expenditures averaged a little more than \$49 per \$1,000 of personal income. The tax reductions passed since the early 1990s have totaled nearly \$1.7 billion before adjustment for population growth, inflation, and real per capita economic growth. After these adjustments, the value of the tax reductions in the current fiscal year reaches nearly \$3 billion, or close to \$14 per \$1,000 of personal income. Using the originally budgeted appropriations for fiscal year 2008—the latest figures before the recession began—expenditures had fallen close to \$4 per \$1,000 of personal income from the long-term average. Thus, despite the additional spending obligations added to the general fund for school construction and for the expansion of AHCCCS and other programs, net spending had fallen. The \$10 greater decline in revenues than expenditures per \$1,000 of personal income equates to a \$2.2 billion persistent deficit in the current year.

CYCLICAL DEFICIT

All governments experience cyclical imbalances between revenues and expenditures due to the cyclicity of revenue streams being greater than the cyclicity of economic growth, and because of the countercyclicity of some demands on the public sector. During economic expansions, the cyclical fiscal imbalance takes the form of a surplus. During economic recessions, the cyclical imbalance between revenues and expenditures takes the form of a deficit.

Government fiscal surpluses should always be considered to be temporary. Neither permanent spending increases nor permanent tax reductions should be implemented on the basis of a temporary surplus. Instead, cyclical surpluses should be saved to be used to mitigate the inevitable cyclical deficits that will follow. Utilizing savings to offset a loss of revenue during a recession means that neither spending reductions nor tax increases—both of which have a negative effect on the economy—are necessary during an economic downturn.

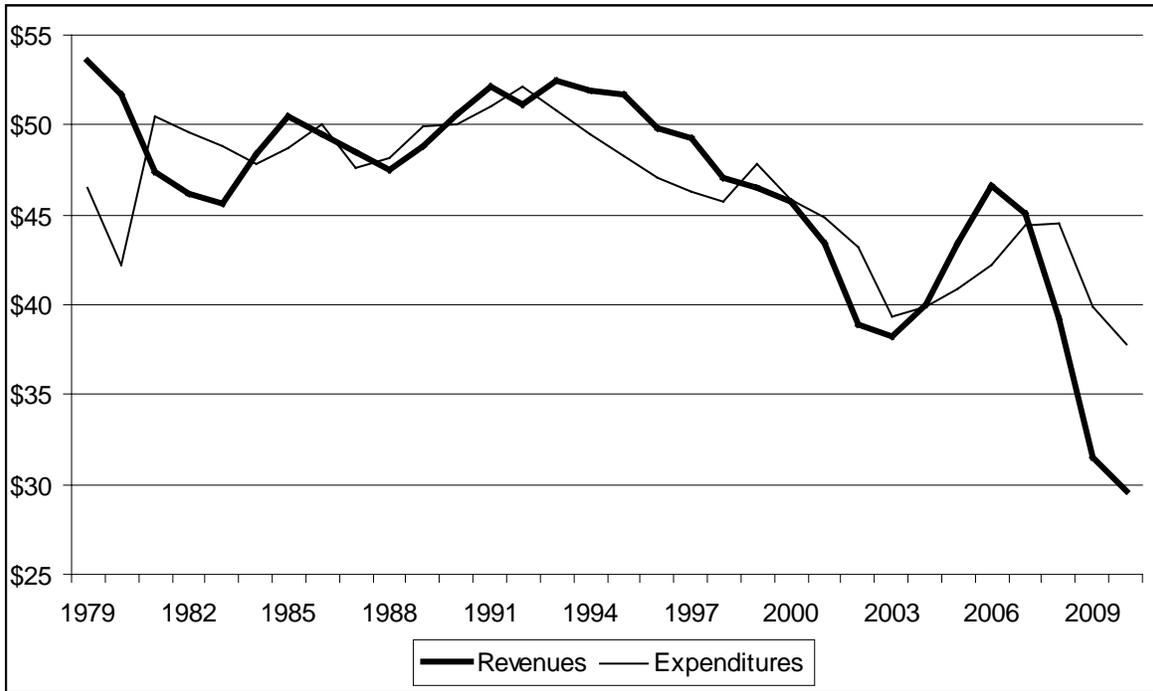
The cyclical deficit is estimated to be about \$1.8 billion (total deficit of \$4.0 billion less the persistent deficit of \$2.2 billion) in the current year. This is the largest cyclical deficit of this down cycle.

CAUSES OF THE DEFICIT

The causes of the large deficit in the state government general fund have been debated, with some claiming that “excessive spending” has played a significant role. However, a review of the data makes clear that a massive decline in revenue is the cause of the deficit (see Chart 8.1). Through the mid-1990s, ongoing revenue (total revenue excluding one-time shifts of funds) averaged just less than \$50 per \$1,000 of personal income. That is, nearly 5 percent of personal income was paid to the state government general fund to support public education (K-20), public safety, health and welfare programs, and a host of other state government services.

Ongoing revenue per \$1,000 of personal income has trended down since the mid-1990s. It has been below the historical norm since the late 1990s. This decline is largely due to the long series of tax cuts implemented since then, but in addition revenue collections have not kept pace with economic growth due to the heavy reliance on the sales tax. The narrow base of the sales tax on nonfood goods ensures that it will not produce revenue that keeps pace with economic growth as consumers continue to shift their purchases to untaxed services and untaxed goods purchased over the Internet.

CHART 8.1
ONGOING REVENUES AND ONGOING EXPENDITURES PER \$1,000 OF
PERSONAL INCOME, ARIZONA STATE GOVERNMENT GENERAL FUND,
FISCAL YEARS 1979 THROUGH 2010



Source: Arizona Joint Legislative Budget Committee (revenues and expenditures) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

In addition to the downward trend, ongoing revenue has been highly cyclical over the last decade. Even at the peak of the last economic expansion in 2006, during the real estate boom, ongoing revenue per \$1,000 of personal income did not reach the long-term norm. Ongoing revenue has plummeted since then, largely due to the length and depth of the economic recession, but also as a consequence of the most recent tax reductions. A very large decrease in personal income taxes was phased in during 2007 and 2008.

General fund revenues have fallen far more than incomes during this economic recession, such that revenues in 2009 and 2010 accounted for only about 3 percent of Arizona income, instead of the historically typical 5 percent. Even after adjusting for the negative effects on income from the recession, the state government tax burden borne by Arizonans is now by far the lowest in the state's history. Thus, Arizonans in aggregate have the means to pay far more in public revenue than they are being asked to contribute.

Ongoing expenditures have to be relatively consistent with ongoing revenues due to the state's balanced budget requirement. However, as seen in Chart 8.1, the two lines can differ due to one-time actions taken to balance the budget. Like ongoing revenues, ongoing expenditures have been consistently well below the historical norm of about \$49 per \$1,000 of personal income

since the mid-1990s (except for a figure near \$49 in 1999) and have been highly cyclical over the last decade.

Much attention has been given to the rise in expenditures between 2003 and 2008. This increase, however, came from an all-time low. Even at the peak, ongoing expenditures per \$1,000 of personal income were less than \$45: nearly 10 percent less than the historical norm. Thus, no justification exists for claims that abnormally high spending in the mid-2000s caused the state's current fiscal difficulties.

Despite the addition of various spending obligations to the general fund, such as school construction, overall spending relative to personal income has fallen since the early 1990s. Though expenditures relative to personal income have dropped since 2008 to historical lows, expenditures have not dropped as much as revenues in the current recession. Even in 2011, ongoing expenditures will be greater than ongoing revenue. This is possible due to continued one-time adjustments being used, including the use of the remaining federal stimulus monies.

ACTIONS TAKEN TO REDUCE THE DEFICIT

Most of the actions taken to reduce the budget deficit have been of a one-time or temporary nature: transfers from the budget stabilization fund and from other funds, the sale-leaseback of state facilities and other borrowing, and the use of federal stimulus monies. These efforts can be considered to be appropriate responses to the cyclical deficit, but do nothing to permanently reduce the persistent deficit. In fact, borrowing increases the size of the persistent deficit for the length of the payback period. Assuming that reverse fund transfers will be made at some point in the coming years to offset the use of monies from other state government funds, this action also adds to future obligations.

In contrast, the shifting of government responsibilities to local governments represents a permanent action that reduces the size of the state's persistent deficit—but creates a persistent deficit for each local government to which spending obligations have been shifted. So far, the only action taken that can be considered to be a reduction to the persistent state general fund deficit without creating such deficits in other governments is spending reductions, assuming that those reductions are made permanent. The other action to resolve a persistent deficit—increasing revenue—has not yet been used to any significant degree, even though a decline in revenue is wholly the cause of the deficit.

More than one way exists of estimating the amount of spending reductions implemented during the last couple of years. The latest budget for 2010—after the adjustments made in March 2010—includes less than \$8.2 billion in general fund appropriations (see Table 5.1). This is nearly \$2.0 billion (19 percent) less than the original budget for 2008—before considering inflation and population growth—as seen in Table 8.1. The table also includes the amount of spending reductions through 2011.

Another way of looking at spending reductions is to compare the final budget for each year to the original appropriation. The midyear reductions were \$203 million in 2008, \$1,183 million in 2009, and \$1,204 million in 2010. The sum of midyear reductions over the three years is nearly \$2.6 billion.

TABLE 8.1
COMPARISON OF BUDGETS, SELECTED AGENCIES, ARIZONA STATE
GOVERNMENT GENERAL FUND, FISCAL YEARS 2008 THROUGH 2011
(Unadjusted for Inflation and Population Growth)

Dollars in Millions	2008*	2010 Versus 2008**		Sum***	2011 Versus 2008	
	Dollars	\$ Change	% Change	\$ Change	\$ Change	% Change
TOTAL	\$10,113	\$-1,956	-19%	-\$2,590	\$-1,665	-16%
EDUCATION	5,801	-1,122	-19	-1,576	-1,188	-20
Dept. of Education	4,027	-512	-13	-1,397	-536	-13
School Facilities Board	479	-374	-78	-20	-411	-86
Community Colleges	168	-32	-19	-6	-33	-20
Universities	1,092	-200	-18	-150	-202	-18
HEALTH AND WELFARE	2,690	-571	-21	-875	-266	-10
AHCCCS	1,274	-139	-11	-343	16	1
Dept. of Economic Security	797	-265	-33	-403	-163	-20
Dept. of Health Services	578	-146	-25	-110	-92	-16
PROTECTION & SAFETY	1,123	-138	-12	-66	-54	-5
Corrections	891	-24	-3	-42	64	7
Juvenile Corrections	80	-17	-21	-8	-22	-28
Dept. of Public Safety	135	-91	-68	-10	-91	-67
INSPECTION & REGULATION	49	-16	-32	-9	-18	-37
NATURAL RESOURCES	79	-34	-43	-21	-40	-51
GENERAL GOVERNMENT	370	-75	-20	-42	-97	-26
Courts	127	-7	-6	-6	-16	-13
Dept. of Revenue	74	-37	-50	-13	-29	-39
Legislature	57	-6	-10	-11	-5	-9

* Original appropriation for fiscal year 2008

** Comparison of the appropriation for fiscal year 2010 as passed in March 2010 to the original appropriation for fiscal year 2008

*** The sum of the midyear budget adjustments in fiscal years 2008, 2009 and 2010

Source: Arizona Joint Legislative Budget Committee.

None of these estimates of the spending reductions are satisfactory since they do not include the effects of inflation or of changes in caseloads. The estimates of the reductions in appropriations from the general fund can be very misleading when looking at the budgets of individual agencies. Since the funding for most state agencies comes not only from the general fund, but also from other state funds and from other sources (particularly the federal government), great caution must be exercised in drawing any conclusions from Table 8.1. A good example is the 68 percent decline between 2008 and 2010 in general fund appropriations for the Department of Public Safety. Most of this decrease was offset by an increase in funding from other sources.

Comparing the latest budget for 2010 to the original budget for 2008, the roughly \$2 billion in general fund spending reductions passed—not adjusting for inflation and growth in demand—have disproportionately affected some programs. The correctional system has hardly had a decrease, while the appropriations to some programs have dropped by 30 percent or more.

If these spending reductions are permanent, then the persistent deficit has largely been resolved. In this case, the very low state government spending in 2007 relative to the state's historical record and relative to other states, discussed in Chapter 5, is greatly and permanently understated. To the extent that state government spending reductions have not been offset by spending increases by local governments, then the state's low ranking on state and local government expenditures in 2007, discussed in Chapter 6, will lower further.

OUTLOOK

The economic and revenue forecasts being used by the JLBC and OSPB are considered to be unrealistically pessimistic. In essence, these forecasts assume that something radical happened to Arizona in the last three years that represents a permanent ratcheting down of one or more of the components of revenue growth:

- Population growth
- Income growth per person
- Revenue collections relative to income

A similar pessimism was present in the late 1980s and early 1990s, during the state's previous long, deep down cycle relative to the nation that was the result of a boom-bust cycle in real estate. The 1987-92 economic slump was followed by more than a decade of population and economic growth in Arizona that set records for numeric gains in employment and population. Indeed, the historical record in Arizona is that forecasts issued during economic recessions have been too pessimistic, while those issued at times of strong economic growth have proven to be too optimistic.

Population and economic growth in Arizona is expected to be slower in the future than during the period from the mid-1990s through mid-2000s because of the passage of the employer sanctions law and other factors that will cause undocumented immigration to become lesser (discussed in Chapter 12). However, population growth likely will remain comparable to that during the 1970s and 1980s. Otherwise, just as was the case in the early 1990s, there is little evidence of any structural changes in Arizona now that suggest much slower population or economic growth in the future. Instead, the state simply has experienced a recession in recent years, one longer and deeper than normal due to gross imbalances in real estate.

Even with slower population growth in the future, economic and revenue growth in Arizona is likely to be considerably higher than that assumed by the OSPB and JLBC. Economic growth is expected to be slow for a couple of years, then accelerate substantially, similar to past recoveries. However, revenues per \$1,000 of personal income are expected to rise back to only around \$36—even with a forecast of much more significant economic and revenue growth than projected by the JLBC and OSPB. This level will be far below the historical norm of nearly \$50.

The cyclical deficit will shrink over the next few years, then become a cyclical surplus. However, the demands on this cyclical increase in revenue will be great. The cyclical rise in revenue first will have to be used to offset the loss of the one-time federal stimulus funds. After that, the increase in cyclical revenue will have multiple competing uses: replenish the budget stabilization fund, reverse the extensive fund transfers used in recent years, and restore funding to some of the programs that have received reductions in the last two years. In addition, the

threat remains of continued large increases in health care costs, and demands will exist to increase spending on neglected physical infrastructure. Moreover, the expiration of the temporary sales tax revenues in fiscal year 2014 will result in a huge drop off in revenue.

Thus, the outlook is bleak for any significant restoration of spending reductions. In fact, if the November 2010 ballot propositions regarding the redirection of tobacco taxes and Growing Smarter funds to unrestricted general fund use are not passed, then additional spending reductions will be necessary. In the third section of this report, suggestions to improve the revenue system are made, with options to increase the state's overall revenues.

CHAPTER 9

FISCAL SYSTEM GUIDING PRINCIPLES

Like most states, 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. Since the revenue system has not changed as substantially as the evolution of the economy, government revenues are not expanding at the pace of the economy.

The optimal structure of the revenue system is independent of the amount of revenue that needs to be collected. But adoption of an ideal revenue system while leaving a structural imbalance in place will not result in a well-functioning fiscal system.

The driving forces for revenue reform include the severe cyclical nature of the existing system (more volatile than in the past and compared to other states), the failure of the existing system to generate revenues that grow at the pace of the economy, and the existing system's negative impact on economic competitiveness due to high taxes levied on large, export businesses. These issues argue for revenue reform regardless of whether the total amount of revenue to be collected is to be modified.

Changing the revenue system to be less cyclical, more responsive to economic growth, and more balanced between business and individual tax burdens would raise the rating of the system against the guiding principles of stability, responsiveness, predictability, and competitiveness. Yet the existing system also could be improved on most of the other revenue system guiding principles, including efficiency (the existing system has a narrow tax base with high tax rates), neutrality and horizontal equity (the system has multiple tax credits and exemptions), vertical equity (the current system is highly reliant on regressive taxes), and simplicity (the property tax and sales tax codes in particular are unusually complex).

BACKGROUND: DESIRABLE REVENUE SYSTEM POLICIES

This chapter draws from a variety of sources to arrive at the guiding principles of a high-quality revenue system. These principles are derived from public finance and economics literature, dating back to Adam Smith's *Wealth of Nations* in 1776. His four principles—equity, simplicity of compliance, economy of administration, and explicitness—are still relevant today.

Since the revenue issues Arizona faces are common to many states, these issues have been thoroughly discussed by groups such as the National Conference of State Legislatures (NCSL) and the National Governors Association (NGA). Considerable agreement has existed for a couple of decades on solutions to the issues.

Financing State Government in the 1990s

Even at the time of this 1993 joint publication of the NCSL and NGA, state tax policy was outdated in most states, largely having been put into place decades earlier (primarily during the 1930s) and haphazardly adapted since then. Little has changed since 1993. The result is an inefficient and unreliable revenue system used by many state governments.

The means by which wealth is generated and the ways in which income is expended have changed substantially since the 1930s. In particular, manufacturing and consumption of goods have proportionally decreased, replaced in importance by services. Interstate and international trade has advanced. The share of purchases from catalogs and the Internet have increased. The changing age distribution of the population affects the composition of income and the amount and composition of consumption. With these economic and demographic changes predicted to continue, the negative revenue impacts from outdated fiscal systems will continue to worsen. The sales tax, personal income tax, and business taxes have been especially impacted by the tax code not keeping pace with economic change.

General recommendations in *Financing State Government in the 1990s* included (1) review fundamental and structural issues in the ways that changing economic conditions are affecting tax structure, (2) consider tax policy as a system, not as a set of unrelated components, (3) evaluate the impact of economic development incentives on tax policy, and (4) cooperate with other states. Among the specific recommendations of the NCSL and NGA was to

- Expand the sales tax base. While taxing many services is desirable, business services should be excluded since the sales tax is a tax on consumers and should not be applied to components of production.
- Reconsider removing the sales tax on food. Exempting groceries is “an expensive way to benefit the poor since affluent people receive a greater gain.”
- Expand the use of personal income taxes.
- Review exemptions, deductions, and exclusions from the income tax.
- Reconsider tax breaks for the elderly without adjustment for income levels.

Principles of a High-Quality State Revenue System

Work on the first edition of this NCSL publication began in the 1980s. The fourth edition was released in 2001 and updated in 2007. The latest edition identifies additional concerns that emerged during the 1990s:

- The evolution of fiscal federalism. Despite fluctuating federal intergovernmental aid, Congress has delegated increased responsibilities to state and local governments, with state governments in turn placing additional mandates on local governments.
- Pressures on state revenue systems. Rapidly escalating costs for some programs—especially Medicaid (AHCCCS in Arizona), other health care, and corrections—have strained the ability of revenue systems to produce sufficient funds.
- The changing nature of state revenue systems. Tax bases have become narrower and less responsive to economic growth as consumption patterns have shifted from goods to services, as tax limitation movements have restricted property taxation, and as large portions of total personal income have been exempted from the income tax.
- Intensified interstate and international economic competition. States have re-examined the competitiveness of existing tax structures and have modified tax policies to enhance economic development.

The NCSL report emphasizes the “system” in “revenue system”—interrelationships exist among the revenue sources such that the whole set of sources should be considered as a group. A revenue system can more easily meet such goals as equity and minimal economic impact than can individual revenue measures.

A single model for a high-quality revenue system can be developed. However, state-to-state differences in economic structure, resources, demographics, and citizen attitudes mean that the ideal model will look somewhat different in each state.

The NCSL report also discusses the distribution of taxes between businesses and individuals. Resolving this issue is complex; taxing businesses presents many difficulties. The main justification for taxing businesses is that they receive public services, such as police protection and highways—taxes are the price paid for these services. This suggests that businesses should pay taxes regardless of their profits, which in turn suggests that a corporation income tax should not be the only or major means of collecting taxes from businesses. Another reason for taxing businesses is administrative efficiency. Businesses are intermediaries in economic processes from which it is administratively convenient to collect taxes. However, as discussed in Chapter 4, the business tax burden in all states is greater than the benefits received by businesses.

Governing

Governing magazine periodically publishes results of its ongoing Government Performance Project. An in-depth analysis of state tax systems was published in the February 2003 issue. This study found that the tax system in most states was inadequate to meet the needs of the 21st century, that most systems were unfair by not assessing the lowest possible rates on the widest possible base of taxpayers, and that budgets for tax collection agencies were being reduced. *Governing* notes that regardless of the amount of revenue that is desired, balanced revenue sources are critical to any system.

The current difficulties faced by almost all state governments and the similar revenue shortfalls experienced during the prior recession were predicted years ago by those who understand the cyclicity of economic growth and revenue flows. The states (including Arizona) broke two fundamental rules of finance: do not pay for ongoing expenses with one-time revenues and do not reduce prices (tax rates) in response to a transitory surge in revenues.

The importance of the three major tax sources—general sales, personal income, and property—is highlighted in the report, with corporate taxes also considered an important fourth source. Relatively balanced reliance among the major sources is considered the best policy given differences in cyclicity across the revenue sources. Generally, income tax collections are considered to be the most cyclical of the major tax sources, followed by sales tax collections; property tax collections usually exhibit less cyclicity.

The sales tax has become increasingly used by state and local governments, yet its tax base has not kept pace with economic change. The magazine states that relying on the sales tax as currently structured is increasingly limiting, due to the shift in consumption from taxed goods to untaxed goods and services. The rising use of sales tax exemptions also limits collections.

Corporations still contribute significantly to state and local government revenue through the sales and property taxes, but *Governing* reports that the share of revenue from the corporate income tax is falling. One reason for this is that states are changing the formulas that determine the corporate income tax due, with many shifting to tax formulas based heavily on the portion of

sales that take place in the state. Corporate tax collections also are falling due to increased use of incentives for economic development purposes.

Some businesses avoid or reduce their income tax liability by the way in which they incorporate (e.g. limited liability partnerships are subject to the individual income tax, not the corporate income tax). Some companies with multiple locations shift income to a holding company in another state or country with a low tax burden. Some analysts argue that with interstate competition and the political power of large corporations, it is not possible to apply the corporate income tax effectively, fairly, and efficiently at the state level. Others think the corporate income tax should be restructured so that it is broad based with low tax rates.

FISCAL SYSTEM GUIDING PRINCIPLES

The guiding principles listed below were developed based on multiple inputs, including a literature review of reports such as those described above, the principles identified by “Fiscal 2000” (a study of Arizona’s fiscal system conducted in 1989), and the Citizens Finance Review Commission (CFRC) guiding principles. (The CFRC studied Arizona’s fiscal system in 2003.)

While agreement exists nationally regarding the guiding principles, the list of principles can be organized and grouped in a number of ways, and the terminology and definitions of terms can vary. Thus, the 10 revenue system principles listed below, which are ordered from the broadest considerations to more micro concepts, differ in terminology and number from the principles identified by other groups.

1. **Stability:** The revenue system should minimize year-to-year fluctuations in revenues over the economic cycle.

- Multiple revenue sources should be employed, including taxes, user fees, and federal revenues. Income, wealth, consumption, and transactions all should be taxed.
- An adequately funded budget stabilization fund should be used to offset the inevitable cyclical fluctuations in revenues.

2. **Responsiveness:** The revenue system should produce revenues that keep pace with long-term growth in the state’s economy.

- The growth of government generally should be targeted to keep pace with economic growth: population plus inflation plus real per capita economic gains. (A system that is responsive to population and inflation only, as suggested in some proposals for an alternative tax and expenditure limit to that currently in the Arizona Constitution, would result in a gradual reduction over time in government services and an inability of the state government to respond to new technologies and emergencies.)
- The system should be designed to collect revenues from expanding activities.
- Over time, the system should be updated as necessary to keep pace with changing technology, economic mix, and societal structure.

3. **Predictability:** A stable and responsive revenue system produces a predictable stream of revenues, benefiting taxpayers and policymakers.

- The revenue system should be designed based on these guiding principles, then changed only as necessary. Frequent ad hoc changes negatively affect predictability as well as other guiding principles.
 - An adequately funded budget stabilization fund greatly enhances predictability.
4. **Efficiency:** Revenue policy should have minimal impacts on economic behavior.
- Revenue sources should be broad based with low marginal tax rates.
 - Revenue collections should be matched to public benefits. That is, the direct beneficiaries of government services should pay for the cost of their provision to the extent possible.
5. **Competitiveness:** Revenue policies should promote economic vitality and prosperity.
- The division of the revenue burden between businesses and individuals should be equitable.
 - The revenue system should be consistent with that of other states to minimize disincentives for investment. Particular attention should be paid to policies affecting basic (export) industries.
6. **Exportability:** The revenue system should be designed to tax nonresidents as well as residents.
- Taxes paid by tourists, seasonal residents, and other nonresidents as well as by residents should be utilized.
 - Taxes and user fees that particularly target visitors also should be employed.
7. **Neutrality:** Differential treatment of similar economic activities should be minimized.
- The use of tax credits and exemptions should be limited.
 - Tax credits and exemptions should be periodically evaluated to determine if they contribute to economic development and the common good.
8. **Horizontal Equity:** Revenue policies should treat people of equal means similarly.
- The definition of “equal means” may vary by revenue source, such that the evaluation of horizontal equity needs to be made by source.
9. **Vertical Equity:** The overall tax structure should minimize regressivity.
- Tax payments as a proportion of income should not be higher for those with lower incomes than for other taxpayers.
 - Some fiscal experts contend that the overall tax structure (including federal taxes) should be progressive, with tax payments as a proportion of income rising with income.
10. **Simplicity:** The revenue system should be designed to minimize costs of compliance and administration.
- The revenue system should be easily understood by affected businesses and individuals and should minimize compliance costs.
 - Revenue rules should be easy to administer by government agencies and should minimize administrative costs.

Each of these 10 guiding principles is specific to the revenue system. However, revenues cannot be examined independently from the rest of the fiscal system—expenditures and debt. Additional guiding principles apply to a fiscal system. In particular, revenues and expenditures should be linked; this principle is sometimes labeled as **Accountability**:

- Determine the desired level of expenditures per program, then raise sufficient revenue to meet the targeted spending levels on an ongoing basis.
- Changes to the revenue system (such as reductions in tax rates and elimination of revenue sources) should be matched by a commensurate change in expenditures.
- Funding of new programs and changes in the funding level of existing programs should be matched by a change in revenues of a corresponding magnitude.
- Capital expenditures generally should not be paid out of the operating (general) fund.

A key component of accountability is transparency. Detailed reports of revenue sources and amounts and of revenue uses and amounts should be readily available.

Another guiding principle of a fiscal system is **intergovernmental complementarity**. State government revenues, expenditures, and debt do not comprise the fiscal system because of the interactions between state government and local governments on one hand, and between the federal government and state government on the other. In particular, state government needs to consider the impact on local governments from changes in the state's revenue system. Adherence to this principle does not require that state government be given more control over federal funding.

EVALUATION OF ARIZONA'S REVENUE SYSTEM RELATIVE TO THE GUIDING PRINCIPLES

The February 2003 issue of *Governing* magazine rated the states' revenue systems in three categories:

- Adequacy of revenue. Revenues should be reliable, come from balanced and multiple sources, be responsive to structural changes in the economy, be competitive in comparison to other states, and be adequate in both the short term and long term.
- Fairness to taxpayers. The revenue system should consist of broad revenue bases with low rates and few exemptions, be progressive, and treat similar taxpayers equitably.
- Management of system. The revenue system should feature a simple and visible tax code that facilitates taxpayer compliance, be fairly and efficiently administered, provide data and analytical capabilities; and be subject to accurate revenue projections.

On each measure, Arizona received a rating of 2 on a four-point scale (where 4 is best).

Governing described this rating as "The state could continue to function as it currently does into the foreseeable future. But there are clear elements to the tax system that would benefit from change."

The 2008 version of "Grading the States" published in *Governing* evaluated state governments in four categories: information, people, infrastructure, and money. Arizona received a C+ grade in the money category, which consists of five subcategories. Arizona received a mid-level grade on four: long-term outlook; budget process; contracting and purchasing; and financial analysis and reporting. Its structural balance was rated as a weakness.

Qualitative Assessment

Based on the literature review and data analysis, a qualitative assessment was made of how well each of Arizona’s larger tax sources currently compare to each of the guiding principles. A weighted sum (based on share of total revenue contributed by each source) of these evaluations resulted in the qualitative assessment of the overall system shown in Table 9.1. Arizona’s current revenue system receives a poor evaluation relative to a system of best practices on most of the guiding principles: stability, predictability, responsiveness, efficiency, competitiveness, neutrality, horizontal equity, vertical equity, and simplicity. In addition, the fiscal system receives a very poor rating on accountability, given the structural deficit, lack of linkage between changes in revenues and changes in expenditures, and inclusion of capital expenditures in the operating fund.

The evaluation of the revenue system used in Arizona in the early 1990s would not have been nearly as negative as the current assessment. Of the numerous piecemeal changes made to the revenue system since that time, many have been contrary to the guiding principles. These changes can be grouped into two categories:

- Narrowing of the revenue base. The revenue base used for the state government general fund in particular has been narrowed by the elimination of the state property tax, the removal of proceeds from the vehicle license tax being deposited into the general fund,

**TABLE 9.1
A QUALITATIVE ASSESSMENT OF THE OVERALL COMBINED STATE AND
LOCAL GOVERNMENT FISCAL SYSTEM AS CURRENTLY STRUCTURED
IN ARIZONA**

Guiding Principle	Evaluation*	Comments
Stability and Predictability	Poor	Highly cyclical revenues, multiple changes to tax code, poor use of rainy day fund, overemphasis on sales tax, little use of more stable revenue sources
Responsiveness	Poor	Overemphasis on sales tax, whose collections lag behind economic growth due to out-of-date code
Efficiency	Poor	Heavy reliance on certain taxes, some with high tax rates
Competitiveness	Poor-to-OK	Heavy taxation of businesses, particularly on the property tax, though some business tax reductions have been passed in recent years
Exportability	Good	Some of the tax burden is borne by nonresidents
Neutrality	Very Poor	Multiple tax credits and exemptions
Horizontal Equity	Poor	Credits and exemptions are a negative
Vertical Equity	Poor	Heavy and increasing reliance on regressive taxes
Simplicity	Very Poor	Considerable complexity in the tax code of each of the major taxes
Accountability	Very Poor	Repeated violations of the link between revenues and expenditures
Intergovernmental Complementarity	Poor	Limited cooperation between state and local governments, and between the state and federal governments

* Relative to a system of best practices.

Source: Authors’ evaluation.

and by reductions in/elimination of various lesser revenue sources. This narrowing of the revenue base has had significant negative effects on the guiding principles of stability, predictability, responsiveness, efficiency, and vertical equity.

- Expansion of the number of tax credits and exemptions. The use of tax credits and exemptions exploded in the 1990s, resulting in negative effects on neutrality, horizontal equity, and simplicity.

In addition, the revenue system in Arizona continues to be limited by the following factors:

- An out-of-date tax code. This is particularly a problem with the sales tax. Responsiveness is particularly hindered by this condition.
- Over-reliance on business taxes. This particularly has a negative impact on competitiveness.
- Complexity of the tax code. While complexity is present in each of the major taxes, it is especially a problem with property taxes.

TABLE 9.2
A QUALITATIVE ASSESSMENT OF THE COMBINED STATE AND LOCAL
GOVERNMENT GENERAL SALES TAX IN ARIZONA

Guiding Principle	Evaluation*	Comments
As Currently Structured		
Stability and Predictability	Poor	Limited to nonfood goods
Responsiveness	Poor	Services and Internet not taxed
Efficiency	Poor	High tax rate on narrow base; across jurisdictions, lack of standardization causes distortions
Competitiveness	Poor	High tax rate
Exportability	Good	
Neutrality	Poor	Large number of exemptions
Horizontal Equity	Poor	Exemptions reduce equity
Vertical Equity	Poor	Highly regressive
Simplicity	Poor	Differing rates, bases, and exemptions/credits across state and local governments
As Potentially Improved		
Stability and Predictability	OK	Broaden base to include Internet sales, food, and many services
Responsiveness	OK	Broaden base
Efficiency	Good	Lower tax rate on broader base; streamline code
Competitiveness	OK	Lower tax rate
Exportability	Good	
Neutrality	Good	Reduce exemptions
Horizontal Equity	Good	Reduce exemptions
Vertical Equity	OK	Broaden base
Simplicity	Good	Simplify tax code

* Relative to a system of best practices.

Source: Authors' evaluation.

No revenue system can be designed to excel in all criteria since some of the guiding principles partially conflict with others. However, a much-improved system could be created by applying generally accepted best principles of revenue policy to Arizona’s system. A system that achieves an OK-to-good evaluation against each of the guiding principles is feasible to create.

Tables 9.2 through 9.4 provide a qualitative assessment of each of the three major tax sources and evaluate each as potentially improved. The general sales tax currently compares least favorably and has the greatest potential for improvement. In contrast, there is not much room for improvement in the individual income tax.

Modifications to the current mix of revenue sources would put the state’s revenue system more in line with a best-practices revenue system. Some tax bases would be broadened. Some tax rates would be increased but other tax rates would be decreased. In making such changes, experts agree that the revenue system as a whole, not as a set of unrelated components, be examined. The ideal system would look essentially the same regardless of the desired amount of revenues to be collected. Total revenues could be raised or lowered by adjusting tax rates and user fees.

**TABLE 9.3
A QUALITATIVE ASSESSMENT OF THE PROPERTY TAX IN ARIZONA**

Guiding Principle	Evaluation*	Comments
As Currently Structured		
Stability and Predictability	Usually Good	Generally not very cyclical, but exaggerated real estate cycles have occurred in recent years
Responsiveness	Good	Property values rise with real economic growth
Efficiency	Poor	Property taxes on businesses are high
Competitiveness	Poor	High business taxes, particularly tax on equipment
Exportability	OK	Out-of-state property owners are taxed
Neutrality	Poor	Different rates by category of property
Horizontal Equity	OK	
Vertical Equity	OK	A mix of progressive and regressive elements
Simplicity	Very Poor	Multiple rates, assessments; varies by jurisdiction
As Potentially Improved		
Stability and Predictability	Good	Reinstate the property tax for the state general fund
Responsiveness	Good	
Efficiency	OK	Lower the tax burden on businesses
Competitiveness	OK	Reduce commercial/industrial assessment rates; reduce/eliminate business personal property tax
Exportability	OK	
Neutrality	Good	Standardize assessment rates
Horizontal Equity	Good	Standardize assessment rates
Vertical Equity	OK	
Simplicity	OK	Many simplifications possible

* Relative to a system of best practices.

Source: Authors’ evaluation.

In addition, strengthening the budget stabilization fund by increasing the amount that can be placed into the fund and by making transfers to and from the fund strictly formula driven, not subject to appropriation, would greatly enhance stability and predictability of revenue flows. Cyclical deficits could be eliminated except in the most severe recessions.

TABLE 9.4
A QUALITATIVE ASSESSMENT OF THE INDIVIDUAL INCOME TAX IN ARIZONA

Guiding Principle	Evaluation*	Comments
As Currently Structured		
Stability and Predictability	Poor	Cyclical
Responsiveness	Good	
Efficiency	Good	
Competitiveness	Good	Low tax burden
Exportability	Poor	Applies only to those earning income in Arizona
Neutrality	Poor	Many credits
Horizontal Equity	OK	
Vertical Equity	Good	But not as progressive as in many states
Simplicity	Poor	Mostly resulting from the complex federal code
As Potentially Improved		
Stability and Predictability	Poor	
Responsiveness	Good	Index tax brackets
Efficiency	Good	
Competitiveness	OK	
Exportability	Poor	
Neutrality	OK	Reduce use of exemptions and credits
Horizontal Equity	OK	
Vertical Equity	Good	Modify tax rates and brackets to raise progressivity
Simplicity	Poor	

* Relative to a system of best practices.

Source: Authors' evaluation.

CHAPTER 10

REGIONAL ECONOMICS AND ECONOMIC DEVELOPMENT

Given that one of the primary reasons for fiscal reform in Arizona is to lower certain business taxes—not just for reasons of parity with individual taxpayers, but to enhance economic development—the operation of a regional economy, such as that of a state, is discussed in this chapter. First, though, a summary of the nature of national economic growth is presented.

NATIONAL ECONOMIC GROWTH

Economic growth and development occurs in stages. Once development begins, it proceeds in similar ways across countries:

- In the early stage of development, labor flows *from* agriculture *into* industry and services.
- In a later stage, labor flows *from* agriculture and industry *into* services.
- As countries further progress, they purchase modern capital such as machinery and equipment from the advanced economies and adopt the advanced production techniques appropriate for their level of development. Countries in this so-called “catch-up” phase of development become competitive relative to the leading countries.
- When the catch-up phase comes to an end, the country has a developed economy and enters the advanced phase of economic growth. Innovation through technological progress then becomes the key to further growth.

Existing industries in developed economies are subjected to global competition from the next wave of low-wage global competitors in their own catch-up phase. As “catch-up” countries compete successfully at lower costs for the older established industries, firms in these industries in the advanced economy are forced to exit the market. Unable to compete on wages and other cost factors, leading economies must innovate in order to continue to grow economically.

Policies and institutions that promote competition and facilitate entry of firms and industries with new technologies and exit of companies and industries that utilize old and inefficient technologies are instrumental to economic gains in an advanced economy. Markets that work most effectively will allocate resources freely across competing uses to the ones that are most likely to result in growth. By extension, protection of industries, firms, products, and jobs reduces efficient turnover.

Economic Growth in the United States

The United States has a developed economy. As discussed in Chapter 11, the private sector is not always well-suited to efficiently provide various public goods. Thus, in order for the nation to successfully compete, the federal government must be an active participant.

The federal government in particular is a key player in supporting research. Because ideas are the product, research and development (R&D) is not like other products. Knowledge cannot easily be restricted. Its ownership is difficult to determine and even more difficult to confine. As such, the development of R&D provides spillover benefits to other users of the ideas, and hence, the broader economy. It follows that the developers of R&D cannot obtain the full rate of return for the invention because of the spillover. Hence, the private-sector will underproduce R&D from the perspective of societal interests, and the government can be justified in intervening.

Intellectual property regulations and subsidies for basic research are common methods of intervention.

R&D has an obvious direct effect on innovation, and hence productivity, and an indirect effect of causing accumulation of new technologically efficient capital. The secondary effect can be very large. Furthermore, advances in R&D create new knowledge that becomes available to others at no cost, inducing still more innovations at lower cost than the original discovery. R&D is especially crucial for the invention process of leading economies. In contrast, emerging economies can simply adopt the leading technologies from the developer of the technology.

Each of the states within the United States has a developed economy. The states compete not only with each other but with countries around the world. Countries in the catch-up phase are the competition for products using older technologies while other developed countries compete for newer products.

For a local economy to be competitive, state and local governments must provide certain services:

- Government has a role in providing economically efficient access to the market for education. Without government intervention, the private sector will underproduce educational services, human capital accumulation will be inefficiently low, and growth in living standards will suffer. Moreover, to compete in a developed economy, research universities must be present. The closer to the technological frontier, the greater is the impact from expenditures by state governments for research universities. Higher education also improves economic performance because education is required for many high-skilled jobs and for producing cutting-edge technology. Education also gives workers the flexibility to adjust to technological innovation.
- Modern physical infrastructure must be present to compete economically. There is a role for government involvement with respect to efficient transportation and communication networks, including cost-effective access to private or public “rights of way” in corridors, trenches, conduits, tower sites, etc.
- Just as the federal government should get out of the way of market forces, state and local governments should not protect existing companies and industries.

Enough revenue must be collected from taxes and other sources to pay for the public institutions and infrastructure that promote growth, without imposing excessive tax rates. In the advanced stage of economic growth, cost factors, including tax burdens, become less important than in the earlier stages of growth, while education and research and development become more important.

REGIONAL ECONOMIC DRIVERS

A significant dichotomy exists in the nature of economic activities in any region. Relatively few companies sell the majority of their goods and services to customers located outside the region, but these companies form the region’s economic base and are responsible for the health and growth of the regional economy. In contrast, most companies predominantly sell their goods and services to local residents and local businesses. These “population-serving” activities respond to conditions within the economic base and do not cause economic growth.

Export, or basic, activities take many forms. The classic examples are agriculture and mining, whose locations are dependent on local attributes of the land. These sectors are not mobile. Tourism and retirement migration also are basic economic activities. They are similar to agriculture and mining in that their presence is in part due to local natural attributes (such as climate, mountains, and bodies of water). However, the aspects of quality of life that are determined by human decisions and activities also influence the number of tourists and retirement-aged migrants that any region receives.

In contrast, most companies that form the economic base can locate anywhere. For example, regions within the United States compete with one another and with the rest of the world for manufacturing facilities. Other examples of mobile basic industries include insurance carriers, software producers, call centers, and some components of the wholesale trade and transportation sectors.

The presence in a region of mobile export businesses is due to the region's economic competitiveness (business climate). A long list of regional factors, discussed in a following section, determine the business climate and influence location decisions of manufacturers and other mobile export businesses.

Just as private-sector markets that work most effectively allocate resources freely across competing uses to the ones that are most likely to result in growth, public-sector policies need to distinguish between economic-base and population-serving industries to the extent possible in order to maximize economic competitiveness and growth. For example, providing tax cuts and incentives to population-serving companies serves no economic purpose.

However, not all export industries have an equal effect on the regional economy. The wage level is one important distinction. A low-paying base industry such as tourism has a much lesser impact per employee than does a high-paying base industry, such as high-technology manufacturing. A second practical distinction is the industry's prospect for growth. Some base industries are unlikely to be a source of future growth. Mining, for example, is limited by dwindling natural resources. Many of the mature manufacturing industries have limited growth prospects.

The United States, and each of its states, has a developed economy. It cannot compete on the basis of cost with competition now coming from countries such as China and India. In the past, Arizona attempted to attract cost-sensitive operations but that strategy is no longer viable. Instead, Arizona and the rest of the country in the 21st century must compete based on innovation and the development of new and better technologies. Because of this, education and research and development have become particularly important factors in determining the economic competitiveness of a region.

EXPORT-BASED BUSINESSES AND PUBLIC FISCAL POLICY

The favorable flow of funds argument that proponents of export-based regional growth make can lead to a tax and regulatory environment that favors these base industries over businesses and workers that exclusively serve local markets. This is manifested in special enterprise zone treatment for base industry site locations, special rules for corporate tax burden apportionment

formulas that reduce base industry income tax burdens, and other targeted tax relief. Economic development professionals make a strong case that it is these types of incentives that attract and retain these wealth-generating, mobile base industries in states and regions.

While it is prudent for state fiscal policymakers to be cognizant of this argument as well as the benefits that base industry attraction and retention can bring, it is important to remember the basics of economic growth and wealth formation articulated at the beginning of this chapter. It is also noteworthy that there may be opportunities to attract wealth to a region—in a manner analogous to base industry wealth attraction—based on the value of the region’s human capital and its capacity for innovative idea creation. Capital flows from credit markets, venture capitalists, traditional investment pools, and other sources to financial opportunities. This flow can inject prosperity into a region in the same manner as do base industries.

Thus public policy must recognize that wealth creation for a region is not exclusively a race to attract mobile base industries with carefully crafted taxes and incentives—though these will no doubt be important to some businesses. A more overarching wealth-creation strategy is to build the region’s human capital base—to be known for the highest quality workforce, not just the lowest tax and regulatory burden. Further, investments in growth-supporting infrastructure, including transportation, communications, and education, need to be part of the strategy as well.

A competition with other regions based on building a workforce endowed with the greatest human capital and the highest quality growth-supporting infrastructure is likely to benefit all parties. It is workforce quality that can attract and retain base industries and it is human capital and quality infrastructure that are the keys to raising productivity levels and returns on investment in all—local and external market serving—businesses. Financial capital will flow to reap the returns that these productive opportunities offer. With this flow, regions will grow and individuals will prosper.

AGGREGATE ECONOMIC GROWTH VERSUS GAINS IN PRODUCTIVITY AND PROSPERITY

Just as a dichotomy exists in the nature of economic activities, economic indicators can be placed into two categories. Some, such as employment, measure aggregate size and growth. Others measure the level and growth of productivity and prosperity.

Historically, the emphasis in Arizona has been on aggregate economic growth. While employment generally has been the most widely used indicator due to its timeliness, it does not reflect differences in wage levels. An aggregate economic measure that is expressed in dollars, such as gross product or personal income, is more informative.

Less attention has been placed on productivity and prosperity indicators in Arizona, even though the health of the economy is gauged by such measures rather than by aggregate economic indicators. Productivity growth, not aggregate growth, leads to gains in prosperity: the ultimate economic goal. Aggregate growth rates are unrelated to gains in productivity and prosperity.

Productivity and prosperity indicators are measured per person or per employee. Such indicators are appropriate to use to compare regions of widely varying sizes, and to compare data for one

region as it grows over time. Any economic indicator measured in dollars must be adjusted for inflation if data for one time period are compared to another period.

FACTORS IMPORTANT TO ECONOMIC COMPETITIVENESS AND ECONOMIC DEVELOPMENT

A region must be economically competitive to become more prosperous. Competitiveness is determined by a long list of regional attributes, sometimes called the business climate. Economic competitiveness is necessary for all three forms of economic development: attracting companies to move to the region, encouraging existing companies to remain and expand in the region, and fostering new businesses.

The most important factors considered by the average company when looking to move or to locate a new facility includes

- The quality and availability of the workforce.
- The quality and availability of the physical infrastructure. Transportation—airports and surface transportation—and utilities are most often mentioned.
- Cost factors. Labor costs are the most important of the cost factors, but tax burdens, real estate costs, and energy costs all are common considerations. Once a region has been selected as a finalist in a company’s site selection process, the availability and flexibility of incentives often makes a difference.

Other regional attributes of importance include the availability of land and buildings and the regulatory environment.

Some of the important location factors, such as labor and real estate costs, are largely beyond the purview of public policy. In contrast, the public sector is largely responsible for the transportation infrastructure and public education; the latter is a significant contributor to workforce quality. While taxes can be an important location factor, they must be evaluated in the broad context that they are the price paid for the public infrastructure and public services that are important to businesses.

The regional factors deemed most important vary by company and by industry. Yet most rankings of location factors do not distinguish between the many kinds of export activities. The list of important location factors can be very different for the high-paying, high-technology industries that are expected to lead the nation’s economic growth during the 21st century (through the rest of this report, these are referred to as the “key base industries”) than for base industries employing old technology. Even within the key base industries, the list of factors important to siting a headquarters or research and development facility can be quite different from the most important factors in locating a manufacturing plant or some other type of facility.

In order to distinguish between the different base industries and different types of facilities within these industries, economic development experts in the Phoenix area were polled regarding what they believed to be the most important factors. They were asked to differentiate between the type of company facility and were asked to list the factors most important to each of eight export industry clusters that either were already of particular significance in the Phoenix area or were a target for future growth. The selected clusters were aerospace, bioindustry, call centers, environmental technology, plastics, software, transportation, and “high tech” (other than the

high-tech clusters mentioned specifically, and including electronics). Each of these clusters was selected either in the original Arizona Strategic Planning for Economic Development effort during the early 1990s or shortly thereafter. Several, but not all, of these clusters are high paying and are heavy users/producers of technology.

In general, the most important factors for headquarters/R&D facilities and for manufacturing/other types of company facilities were labor costs, the availability of a skilled workforce, and educational opportunities and quality. For manufacturing/other types of facilities, the cost of utilities and the airport infrastructure also were rated very highly, though neither of these even made the list of important factors for headquarters/R&D facilities.

Several other factors also were considered to be important. Those on the list of both headquarters/R&D facilities and manufacturing/other facilities included the availability of land and leased space, the telecommunications infrastructure, and the education infrastructure. The proximity to universities and research centers also was on the list for headquarters/R&D facilities. For manufacturing/other facilities, land costs and lease rates, power and water availability, and regulations also were considered to be important.

Notably lacking from this listing are business taxes and incentives. Each was considered to be important for certain types of facilities in some clusters, but overall was not considered to be as important as the factors mentioned above for the selected clusters. Also notable is that two of the three most important factors to all types of facilities are related to education: the availability of a skilled workforce, and educational opportunities and quality (important to the company as a component of a skilled workforce and important to the company's employees as a component of their quality of life). Two additional education factors were considered to be important: the education infrastructure and proximity to universities and research centers.

Thus, if the goal is simply for Arizona to grow, then business taxes and incentives are among the few top factors that can be influenced by public policy, along with the transportation infrastructure and the quality of the workforce. However, if the goal is to improve job quality and raise the standard of living of Arizonans by expanding the key base industries, then the most important factors that can be influenced by public policy largely fall into two categories: (1) education and workforce skills, and (2) the quality and availability of the physical infrastructure (not just transportation).

Education and Job Training

Arizona's economic competitiveness is hampered by the poor quality of its workforce. Achievement tests indicate that Arizona's elementary and high school students do not perform as well as their peers nationally. A lower proportion of the adults who were educated in Arizona have completed high school. Many employers report difficulty finding enough individuals with basic work skills.

These limited educational attainments and work skills are a particular disadvantage in the key base industries. These high-wage companies require sophisticated technological skills, even among workers who are not required to have a college degree. Historically, companies located in Arizona have relied on in-migrants to fill many of their jobs, but it is more expensive for

companies to import skilled workers from outside the state and considerable competition for these skilled workers exists.

Even if attracting workers was not an issue for employers, the poor educational achievement and attainment of Arizona students is creating an underclass among its residents. The state's poverty rate is regularly higher than the national average and the workforce participation rate, even among those in the prime working ages of 25 to 54, is below average. Some of these struggling Arizonans are working, but in low-wage jobs, while others do not work, largely due to an inability to compete for available jobs. Not only do people in this group not contribute much to Arizona's economy, they disproportionately use public services due to their low incomes and lack of health insurance.

While a number of factors contribute to the low educational achievement and attainment of the state's residents, the state's education infrastructure is a significant concern. Arizona spends less on elementary and secondary education than nearly every other state, and public investment in higher education also is below average; spending for education has fallen in relative terms over time (as discussed in Chapter 6). Little support is provided for research; the funding for Science Foundation Arizona has been eliminated. For a state as large as Arizona—in terms of geographic area and population—having only three state universities means that few locations in the state offer the proximity to research universities that many companies in the key base industries require. Further, potential employees for such companies are concerned about the quality of the educational system that their children will attend.

The other aspect to producing a quality workforce consists of job training. While some job training occurs within the public education system, particularly at community colleges, the state has a variety of other job training programs. However, these programs are viewed as inadequate by many employers, especially those in the key base industries.

Infrastructure

The availability of a quality infrastructure is consistently rated as one of the most important factors affecting economic development. The physical infrastructure of the state, particularly its transportation system, already is a concern. Reports produced in 2008 detailed the amount of spending that is needed to improve the state's existing infrastructure to be economically competitive and then to keep up with the expected growth in the Arizona population. Capital spending in the state, especially for transportation, has consistently been lower relative to other states than would be expected of a state that generally ranks second in the nation in population growth.

The availability and quality of the physical infrastructure in Arizona generally is not perceived favorably. With the limited investment in infrastructure in the state and with the size of the budget difficulties facing state and local governments that will continue even after the end of the recession, the state's physical infrastructure is at risk of becoming a major negative factor to its economic competitiveness.

CHAPTER 11

THE INTERFACE BETWEEN THE ECONOMY AND PUBLIC FINANCE

Government cannot control economic growth, but it can influence the economy by creating an attractive environment for economic growth. While tax policy is one of the economic development factors—all else equal, the lower the taxes the better—the uses of tax revenue and other revenue to create a quality infrastructure and a strong quality of life are keys to economic growth.

THE ECONOMIC RATIONALE FOR GOVERNMENT

The private sector efficiently provides most goods and services, using the price as the mechanism to balance supply and demand. Competition among companies ensures that goods and services are provided efficiently and are priced equitably. Government intervenes in the private-sector economy when these conditions are not met—that is, when a perfectly competitive private-sector market does not exist or when markets produce more (such as pollution) or less (for example, public safety) than is socially desirable. Economists describe these private-sector limitations as “market failures.”

The private sector is not well suited to efficiently provide various “public goods,” including those best provided by state and local governments:

- The private sector generally cannot provide adequate physical infrastructure. Building infrastructure requires high upfront capital expenditures that can be recovered only over a long time period. Charging fees, such as for residential streets, is problematic. Thus, if left to the private sector, a less-than-optimal supply of physical infrastructure would exist. Yet, the benefits of infrastructure affect both societal welfare and economic development. Schools and public hospitals directly affect education and health levels. Roads and airport facilities directly enhance economic development as well as serve individuals. Because of the expense and financing requirements of capital infrastructure, government intervention is often necessary.
- In some cases it is impractical or inefficient for private-sector companies to compete to provide a public service. Sellers and buyers that are large enough to affect prices attempt to underproduce and realize higher prices for their output than the prices that would be determined by an efficient, competitive market. Government may intervene to control prices—such as for electricity—or may otherwise regulate such private-sector activities. In the case of the provision of utilities, a monopoly originally was granted because of the inefficiency of building and maintaining multiple water pipelines or electricity transmission lines to serve the same residents and businesses.
- Some services, such as garbage collection, are provided either directly by municipalities or are contracted to a single private-sector company because of efficiency issues. For example, having the garbage truck stop at each house in succession rather than drive long distances between customers is more cost effective.

A second reason for the existence of the public sector is that the citizens of developed nations have come to believe that the collective whole, administered through the public sector, should

provide a safety net for individuals and families. Historical abuses of disadvantaged individuals and severe repercussions from circumstances out of the control of individuals, such as job losses and other hardships during the Great Depression, led to these social welfare concerns.

All taxpayers contribute to the funding for the safety net, even though they may never utilize its features. As demonstrated in the severe recession that is just ending, individuals and families that never before had experienced a need for public assistance lost their jobs, health insurance, and homes.

Public education is a special example of the social welfare motivation for the existence of the public sector. Most parents could not afford to pay the cost of schooling for their children at the time the schooling is consumed. Parents usually are relatively young and do not earn as much as they will later in life. However, their needs are greater than they will be later in life: they experience many expenses related to their children, they need to build up their savings account for a “rainy day,” and they need to purchase assets such as homes and automobiles. Thus, the costs of educating their children are spread throughout their taxpaying lifetime. Those who do not have children still contribute because of the societal benefits of an educated populace, including lower crime rates, less need for public services, and higher wages for all.

TAXES AND USER FEES AS PRICES

An ongoing issue at any level of government is to relate the public services provided to mechanisms of paying for those services. In many cases, government must provide some minimum level of service because of the limitations of the private sector described earlier. Spending beyond that minimal level depends upon the community’s demand for that service. However, the necessary provision as well as any desired increment does not come free—the service must be paid for by taxes or user fees. It is difficult to determine whether the jurisdiction should determine the level of service and then raise enough revenue to fund that service level or whether the jurisdiction should determine how much revenue should be raised and then determine how much of the service can be provided with those revenues.

Public opinion polls do not provide useful insight to answer this question since respondents often indicate that the levels of most services should increase while at the same time indicating that state and local governments should cut taxes. For example, in a January 2009 survey, a higher proportion of respondents wanted to increase spending than decrease spending on elementary and secondary education, mass transit, freeways, police, universities, and fire protection. Only for prisons and corrections did a greater proportion want to spend less than to spend more. In the same survey, 93 percent of the respondents wanted to cut state taxes.

Two basic principles underlie a revenue system. First, if a service provides a benefit to a resident, the resident should pay for that benefit. For example, if a household visits a state park, they should anticipate paying a park entrance fee. Just as with any private good or service, if the household believes that the benefits received from the park exceed the entrance fee, they should be glad that they are getting a good deal. However, if they believe that the benefits are less than the entrance fee, they should not visit the park. Note that benefit charges have nothing to do with the household’s income—both rich and poor households pay the same entrance fee in this example—just as private-sector goods and services are not priced based on the ability to pay.

Property taxes, if thought of as an entrance charge to living in a jurisdiction that provides a particular bundle of services, are sometimes conceptualized as benefit taxes.

Ability to pay (a household's capacity for paying a tax) is the second principle underlying a tax system (determining how to charge for public goods and services). An example of this type of tax is the state income tax—its rates increase slightly as a taxpayer's income goes up. The concept is that wealthier people can afford that last dollar in tax payments easier than poor people can. When ability-to-pay taxes are utilized, it is sometimes necessary to remind people that these taxes are going to finance a portion of government services, and it is necessary to look at both services received as well as taxes paid.

Economists generally believe that residents should be taxed for the public services they consume while businesses ought to be taxed for the public services they consume. However, based on this principle, businesses are overtaxed throughout the nation.

Financing the construction of infrastructure represents a separate challenge. Typically, such expenditures are done through debt issuance, though "pay as you go" also is used, particularly in Arizona. Pay as you go implies that no capital investment is made until enough savings have been accumulated to pay for that investment, which may take several years of earmarking money in a special fund. If these savings can be protected (and given the continuing fund sweeps that occur in Arizona, this is demonstrably unlikely), the principal advantage of pay-as-you-go finance is that it minimizes the overburdening of future generations of Arizona residents since they will not have to pay debt service. However, pay as you go also means that current residents are not getting the benefits of the unbuilt infrastructure, that the economic growth that the infrastructure would stimulate is not occurring, and that once the infrastructure is built, future residents will be enjoying the benefits without having had to pay for them.

Debt finance increases intergenerational equity because debt is typically paid back over a period of 30 years, implying that future inhabitants will be paying a share of the project's cost as they enjoy the project's benefits. In addition, inflation will have less effect on the price of the project because of the quicker completion. Further, state and local debt is subsidized through a variety of mechanisms, including the ability to issue the debt at tax-exempt rates (which are below market).

THE RELATIONSHIP BETWEEN TAXES AND ECONOMIC GROWTH/PUBLIC REVENUES

This section examines the conceptual basis for a relationship between tax burdens and economic growth and between tax burdens and public revenues. The following section explicitly examines the empirical record in Arizona.

Tax Rates and Economic Growth

Nearly any position on the relationship between state and local government taxes and economic performance is supported in the published literature. However, the bulk of the modern literature indicates that state and local government taxes have only a small effect on economic growth. Many factors affect economic growth, as discussed in Chapter 10.

Despite the attention given to taxes, state and local government tax payments are a minor expense for most businesses. All state and local government taxes and most federal government taxes—Social Security and payroll taxes, unemployment insurance taxes, excise taxes, import and tariff duties, business license and privilege taxes, and the environmental tax but not the federal income tax—combined account for only a little more than 2 percent of the operating income of the average business. Thus, state and local government taxes are less than 2 percent of business operating income for most businesses—a lesser expense than the compensation of company officers.

Moreover, taxes represent the price paid for government services consumed. Many state and local government services—such as the education of children and the provision of police protection—are of high value to individuals and businesses alike.

State and local government business taxes receive attention because many state and local governments grant tax incentives, tax credits, and tax exemptions to businesses. A rational profit-seeking business will avail itself of such opportunities. In site location decisions, such tax breaks are a deciding factor only if two or more locations are viewed essentially equally on all other factors.

State and local government tax policies can have an appreciable effect on economic performance only under specific conditions. An effect will only occur when tax policies are focused on export businesses. In general, the effect will be greatest when a tax burden on a specific tax, such as the business personal property tax, that is high relative to competitor states is lowered significantly. Otherwise, tax policy is an inefficient way to stimulate the economy. Investment in infrastructure and education has been shown to have a greater effect on economic growth. Thus, while state and local government taxes are not nearly as economically important as sometimes portrayed, taxes are one of the location factors considered by export businesses and therefore play a role in determining a state's economic competitiveness.

Tax Rates and Government Revenues

Supply-side economics is based on the concept that tax rate reductions stimulate economic growth, with the stimulus so great that government revenue rises despite the lower tax rates. The “Laffer Curve” popularized this theory.

The economist Arthur Laffer brought the relationship between taxes and economic performance into the popular literature in the 1970s. However, the analytical foundations of his Laffer Curve were established centuries ago. Moreover, the curve is a mathematical relationship (Rolle's Theorem).

The concept is simple. A single tax rate produces the greatest government revenue: the revenue-maximizing rate (RMR). Setting rates below the RMR leaves governments with less than maximum revenue but setting rates higher than the RMR stifles the economy, resulting in lower tax collections despite the higher rate. The relationship between tax rates and revenue collected follows a curve. The exact shape of the curve can vary by specific circumstances, but the end points always are the same: No tax results in no public revenue while a 100 percent tax rate would cause all legal economic activity to cease. The difficulties in real-world application of this

relationship are to identify the tax rate that constitutes the RMR, and to describe the exact shape of the curve.

Laffer originally discussed the relationship between tax rates and tax revenue in the context of national tax rates, particularly the federal income tax, which was quite high in the 1970s. The concept also is valid at a regional level such as a state. However, state tax rates are low relative to the federal income tax rate. Thus, a decrease in a state tax rate is less likely to have a supply-side effect and any effect likely is small.

On the other hand, a state tax by definition is narrower than a national tax and thus is more likely to have a RMR that is being exceeded in reality. This is because states compete for export-oriented economic activity, much of which is mobile (not tied to a particular place as in the case of a mine). Capital and labor move easily throughout the country.

While tax rates may influence capital and labor mobility across the states and give rise to Laffer-type effects, capital and labor move for a host of reasons. The amount and quality of public infrastructure (such as airports, roads, and schools) available in a region—amenities supported by state and local government tax revenue—are among the factors influencing economic growth. So the RMR in a state or region will be the rate that allows sufficient investment in public amenities that foster economic growth without imposing tax burdens that stifle growth.

For a tax cut to result in a positive effect on economic growth and government revenue, the existing tax rate must be higher than the RMR. For much of a positive effect to result, the tax rate must be very high and be lowered to near the RMR. Such a situation is most likely in the case of a narrow tax. In addition, a much greater economic impact is likely from a reduction in a business tax with a rate above the RMR than in a personal tax with a high tax rate. In particular, the business tax being lowered must be of significant importance to export companies.

Over time, some supply-side enthusiasts have moved to a position that any tax cut is good for the economy and enhances public revenue—which violates the Laffer Curve. Further, the idea that lower taxes always are better ignores the reality that taxes are the price paid for public services demanded by businesses.

Empirical evidence exists that public infrastructure plays a role in increasing business investment, job creation, and economic growth. Similarly, tax reductions financed by cutting education, infrastructure spending, and other services valued by businesses likely will have a negative effect on economic performance.

One argument sometimes used to justify tax reductions is that taxes remove money from the economy. In reality, tax revenue is spent in much the same way as private-sector revenue: paying employees, purchasing materials from the private sector, etc. On average, a higher portion of public-sector spending is for wages and salaries while private-sector firms spend a higher portion of their revenue on raw materials and manufactured goods, much of which must be purchased from outside the region. Because of this, public-sector expenditures stay within the state's economy to a greater extent than private-sector expenditures. In other words, the in-state multiplier effect is higher for public-sector spending than for private-sector spending.

TAXES AND ECONOMIC GROWTH/PUBLIC REVENUE IN ARIZONA

Background: Taxes and Economic Growth

Compared to other states, Arizona's tax burden is very low on individuals, but this has little effect on the state's export sectors that drive economic growth. The tax burden for small unincorporated businesses is low relative to other states, but since relatively few small businesses are part of the economic base, their low tax burden has relatively little effect on the economy.

In contrast, the taxes paid by large businesses, especially some of the most desired export businesses, are relatively high, reducing the state's economic competitiveness. The difference in relative tax burden between small unincorporated businesses and large incorporated companies stems from two factors: (1) unincorporated businesses file income taxes on the individual tax form—individual tax rates are lower than the corporate tax rate; and (2) property taxes for commercial and industrial property of larger companies (those with a high assessed value) are high relative to other states while other business property tax burdens are moderate.

Despite business tax burdens being of significance to economic competitiveness and despite the relatively high tax burden borne by many of Arizona's leading companies, relatively few of the tax cuts implemented since the early 1990s have benefitted export businesses. The early rounds of tax cuts almost entirely were focused on individuals. Overall, the tax cuts have been dominated by reductions to the personal income tax. However, even in the early 1990s, the individual income tax rate in Arizona was less than the average of the states. Using the Laffer Curve, this suggests that the individual income tax cuts in Arizona should not have had much of an effect on the state's economic performance.

As in other states, businesses pay more for public services than the costs they place on state and local governments in Arizona. In contrast, individuals in Arizona do not adequately pay for the public services they use. The reduction in the individual tax burden over the last 15 years means that businesses subsidize individuals even more than in the past. This is of little significance to the population-serving businesses, which can pass the taxes on to their customers since all of their competitors are subject to the same taxes. Export companies are not able to pass on local costs since their competitors are overwhelmingly located in other regions and other countries.

The other tax cuts have been a mixture of reductions that have benefitted individuals and businesses. Some of the tax reductions that affected businesses should have had a positive effect on export companies as well as on population-serving businesses. Examples are the elimination of the state property tax and the commercial lease portion of the sales tax. However, the tax decreases that benefitted export companies were relatively small, so any effect on the economy also likely was small.

Background: Taxes and Public Revenue

A policy of state government tax reductions has been present in Arizona since the early 1990s. Most of the tax cuts, particularly during the 1990s, have been made to individual tax rates that already were less than the national average and lower than the historical rates in Arizona. Thus, based on the Laffer Curve, Arizona was not generally in a position to benefit from this series of tax cuts, in terms of enhanced government revenue.

For a *net* positive effect to accrue on government finance from a state government tax cut, the state must have underutilized resources. For example, if a state with higher-than-optimal tax rates also has high unemployment and high commercial and industrial vacancy rates, then a reduction in taxes to near the optimal point might stimulate economic growth, putting more residents to work and more highly utilizing existing facilities. Since labor to support the faster economic growth would not have to be imported to the state, population growth would not accelerate. Thus, the increase in government revenue would not be offset by the need to increase public spending to support new residents.

Except during recessions, Arizona has had neither high unemployment rates nor high commercial/industrial vacancy rates. Many jobs created in Arizona are filled by labor imported into the state from other states and other countries. Thus, even assuming that tax cuts in Arizona did have an effect on economic growth, the requirement of excess capacity was not met in order for a net benefit to public finance to accrue. If lowered taxes had stimulated the Arizona economy, then even more labor would have had to have been imported into the state, both for the construction of the facilities needed to house these economic activities and for the permanent employment created. Thus, while public revenue would have increased, the need for public spending also would have risen. Unless the incomes of the imported workers were above the existing average (considerably so if the worker had or would have school-age children), the taxes paid by new residents would not have covered the costs of providing them with public services.

An example of a tax reduction that might have a more noticeable net positive effect on economic growth and public-sector finance in Arizona is the business personal property tax, a narrow tax that has been demonstrably high relative to other places. It is a tax that disproportionately affects some businesses, particularly manufacturers who use considerable equipment in their operation. High-tech manufacturers, such as semiconductor plants, are among those with considerable equipment. These companies pay high wages. Lower business property taxes might encourage companies to expand facilities in Arizona. Although much of the labor force needed for an expansion would be imported, the high wages of these new workers could result in a net positive effect even on public-sector finance.

The size, nature and timing of the tax cuts in Arizona, combined with the conceptual basis for supply-side economics, suggest that little positive effect either on government revenue or on economic growth should have occurred as a result of these cuts. The next two subsections examine the empirical data on economic growth and government revenue to see if a positive effect of the tax cuts, or a negative effect of tax increases, is perceptible in Arizona over the last 30 years.

Empirical Evidence of the Effects of Tax Changes on Economic Growth

In the last 30 years, Arizonans have experienced two periods of state government tax reductions and one period of tax increases. A series of tax law changes were made from 1979 through 1984, resulting in a significant net tax cut. Following a period of considerable tax increases from 1989 through 1991, substantial tax decreases have been passed since the early 1990s, implemented particularly from 1995 through 2001 and again in 2007 and 2008.

A comparison of the timing of tax law changes and fluctuations in economic growth over the last 30 years indicates that decreases in state taxes in Arizona generally have occurred at times of strong economic growth and budget surpluses, allowing taxes to be cut while still balancing the budget in the near term as required by the Arizona Constitution. Tax increases have occurred at times of economic recession and budget deficits. The inverse correlation between the percentage change in economic growth and the tax change as a share of general fund expenditures is strongest when economic growth in the prior year is compared to the tax change.

Though some argue that reductions in tax rates almost instantaneously have an effect on economic growth, in reality it takes time for a business to plan for a relocation or expansion. Moreover, the tax burden is only one of many factors that affect a location decision. Based on these other factors, notably the point in time within the economic cycle, a business may not be ready to make a location change/expansion for years, even if they are favorably impressed with a location and its reductions in tax burden. Thus, any positive effects from the tax cuts implemented between 1979 and 1981 that were immediately followed by two economic recessions likely would not have occurred until after 1982. The implementation of more recent tax reductions particularly occurred between 1995 and 2001, with some further reductions in the last few years. If these tax cuts were to have an economic impact, the impact should have been realized after the 2001 recession, if not before.

To test whether Arizona's tax changes have had an effect, economic performance in Arizona must be examined relative to the national average. Two tests have been conducted, one of aggregate economic growth, the other of economic growth per capita and per employee. In both cases, if Arizona's tax cuts from 1979 through 1981 had impacted economic growth, one would expect that average growth rates in Arizona relative to the national average in the 1982-91 economic cycle would have been higher than those in the 1975-82 economic cycle. Assuming that tax changes had an effect on economic performance, the tax increases of the 1989-91 period should have lowered economic growth in the early 1990s, but the subsequent tax reductions should have had an impact by the late 1990s, so it is unclear whether the average differential growth rate in the 1991-2001 cycle should have been higher or lower than in the prior cycle. However, the substantial tax reductions passed since the early 1990s should have boosted the state's economic growth relative to the national average during the economic cycle that began at the end of 2001.

The average growth rates in three measures in Arizona relative to the national average over the last four economic cycles are presented in Table 11.1. Average economic growth in Arizona relative to the national average in the 1982-91 economic cycle was not higher than in the 1975-82 cycle; it was actually lower. Similarly, average growth rates in Arizona (not relative to the nation) also were lower in the 1982-91 cycle. So, no evidence exists that the tax reductions from 1979 through 1981 had any effect on the state's economic growth.

Economic growth in Arizona in the latest economic cycle has been lower than in the prior cycles. The state's economic growth relative to the U.S. average is either the lowest or second-lowest of the four cycles on each of the three economic measures, even though the state's tax burden relative to the national average since the late 1990s has been the lowest on record.

TABLE 11.1
ANNUAL AVERAGE ECONOMIC GROWTH BY ECONOMIC CYCLE,
ARIZONA AND UNITED STATES, 1975 THROUGH 2008

	1975-82	1982-91	1991-2001	2001-08
Arizona:				
Employment	5.0%	4.2%	4.0%	2.9%
Personal Income	6.0	4.9	6.1	3.9
Earnings	5.2	4.8	6.7	3.0
Difference, Arizona Less U.S. Average:				
Employment	2.9	2.1	2.2	1.5
Personal Income	2.7	1.6	2.2	1.9
Earnings	2.7	1.4	2.7	1.4

Note: Economic growth in dollar measures was inflation-adjusted by the GDP implicit price deflator

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

The relationship between the tax burden and per capita and per employee measures of economic growth is examined with a different methodology. Annual data are used, with both the tax burden and the economic measures in Arizona expressed as ratios to the national average.

As seen in Chart 11.1, the tax burden in Arizona has fallen over time, though in an erratic pattern. The sharp decrease in taxes from 1979 through 1981 was partially offset in the following few years, then taxes rose further from 1989 through 1991. Since then the tax burden has fallen; the fluctuations in the lines also reflect the economic cycle. If tax cuts were good for the economy, then the significant drop in the tax burden lines should result in increases in the economic performance lines, though with some time lag. Instead, the economic measures plunged through the 1980s and early 1990s, then partially rebounded through 2006 before falling further. No correlation at all exists between the Census Bureau tax burden and the economic measures, even after lagging the economic data. A modest correlation exists between the Tax Foundation tax burden and the economic measures, but in the wrong direction: as the tax burden has declined, economic performance has worsened.

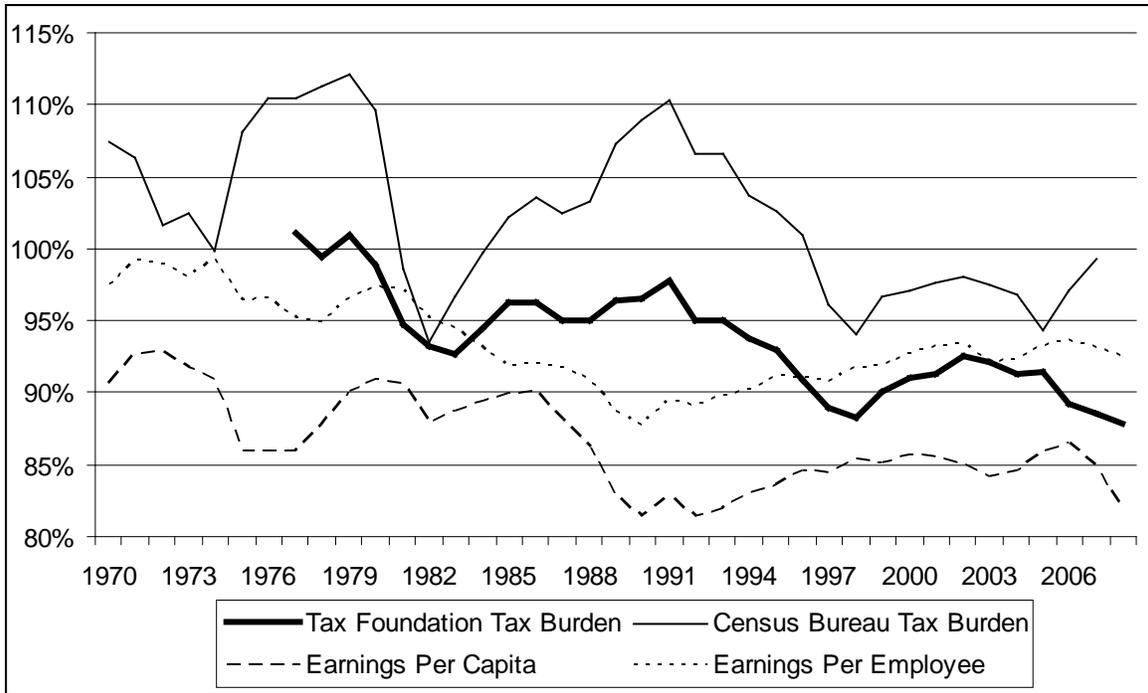
Thus, the substantial net tax decrease over time has not caused Arizona's economic growth—whether measured in aggregate terms or per person/per employee—in recent years to be stronger than in the past, or stronger relative to the national average. The empirical evidence in Arizona regarding the lack of relationship between the state's tax cuts and increases and subsequent economic growth matches the conceptual analysis previously discussed.

Empirical Evidence of the Effects of Tax Changes on Public Revenue

Just as an effect on economic growth from tax changes in Arizona is not perceptible, a comparison of changes in tax laws and changes in tax revenues fails to demonstrate a supply-side effect on revenues. In fact, tax cuts have resulted in revenue reductions and tax increases have boosted revenues.

Following reductions to the property tax and sales tax between fiscal years 1979 and 1981, general fund tax revenue per \$1,000 of personal income plunged, in part due to an economic

CHART 11.1
COMPARISON BETWEEN THE COMBINED STATE AND LOCAL GOVERNMENT
TAX BURDEN AND ECONOMIC GROWTH MEASURED AS RATIOS TO THE
NATIONAL AVERAGE IN ARIZONA, 1970 THROUGH 2008



Source: U.S. Department of Commerce, Bureau of Economic Analysis and Census Bureau, and Tax Foundation.

recession. Despite a strong economic recovery, tax revenue per \$1,000 of personal income throughout the 1980s remained below that of the late 1970s (see Chart 2.3). As the Arizona economy weakened in the late 1980s, tax revenue per \$1,000 of personal income declined. The tax increases from fiscal years 1989 through 1991 boosted revenue, even as the economy fell into recession. Tax revenue per \$1,000 of personal income peaked in 1993 and then began to fall despite the strengthening economy and the stock market boom that caused a surge in capital gains. This countercyclical decline was the result of the long series of tax cuts passed during the 1990s. Thus, as in the 1980s, the tax cuts during the 1990s had the effect of lowering revenue, not raising it as predicted by some supply-side adherents. This is clearly seen in Chart 2.1, which compares actual tax revenue to what would have been received had tax changes not been implemented.

Tax revenue in Arizona continued to fall through and after the 2001 recession and as capital gains turned into capital losses, bottoming out in 2003. Tax revenue per \$1,000 of personal income rose considerably during the next three years as the economy improved and capital gains returned due to the real estate boom. The 2006 peak, however, was considerably less than the peaks of the preceding economic cycles. Since 2006, tax revenue per \$1,000 of personal income has dropped substantially. The level in 2009 and 2010 was far below that of any of the preceding 38 years.

THE ECONOMIC EFFECTS OF PUBLIC SPENDING

An increase in government spending, all else equal, results in a short-term economic stimulus. Increased federal spending during a recession, as exemplified by the stimulus package passed in 2009, is commonly used, usually with the express purpose of putting unemployed workers back into a job. The cost of doing so is to raise the size of the federal deficit.

It is more difficult for state and local governments to stimulate the local economy because of the annual requirement to balance the budget. This effectively limits the ability of state and local governments to combat deficits and economic ills resulting from cyclical factors. State and local governments can stimulate the economy in the near term only through long-term borrowing, which raises government costs in the longer term due to the debt service.

Just as an increase in government spending produces a short-term economic stimulus, a decrease in public spending has a detrimental short-term impact on the economy. Any reduction in government spending is accomplished through some combination of reduced direct expenditures for goods and services purchased from the private sector, reductions in wages of government employees, layoffs of government employees, and reductions in support for public welfare and health care recipients. All of these methods result in less business for local private-sector companies. As a result, some private-sector companies are forced to lay off employees, and in extreme cases, some businesses fail. In turn, laid-off workers pay less in taxes to state and local governments, and place greater demands on public services, such as unemployment compensation. Thus, if state and local governments reduce spending in order to offset a cyclical deficit, this worsens economic conditions during a recession, in turn lowering government revenues even more.

An increase in taxes or user fees to combat a cyclical deficit also has a negative effect on the economy, but the ramifications are smaller than if spending is reduced. This is primarily due to some taxpayers being able to pay the additional taxes out of savings rather than by reducing their spending in the private sector. The expected impact on employment from resolving the current \$2.2 billion persistent deficit entirely through spending reductions is contrasted to the impact from increasing revenues in Table 11.2. Even if the spending reductions are used, 45 percent of the employment losses occur in the private sector.

The best solution to a cyclical deficit is to have enough rainy-day funds set aside. Spending savings during a recession avoids having to negatively affect the economy by reducing spending or by increasing taxes.

TABLE 11.2
EFFECT ON EMPLOYMENT OF ELIMINATING THE \$2.2 BILLION PERSISTENT
DEFICIT IN THE ARIZONA STATE GOVERNMENT GENERAL FUND

	Spending Reduction	Revenue Increase	Difference
IMPLAN Model	-59,400	-33,000	-26,400
REMI Model	-48,400	-37,400	-11,000
Private Sector	-22,000	-26,400	4,400
Public Sector	-26,400	-11,000	-15,400

Sources: IMPLAN and REMI economic models.

CHAPTER 12

AN EVALUATION OF, AND OUTLOOK FOR, THE ARIZONA ECONOMY

Arizona had the weakest economy in the nation during the recession that lasted from late 2007 through late 2009, in terms of employment change. This, of course, is not representative of the state's long-term aggregate economic growth, just as the boom conditions present from 2004 through 2006 were not representative. Arizonans have a tendency to become too optimistic when economic conditions are strong, and too pessimistic when they are weak. The following evaluation avoids these cyclical extremes by focusing on long-term averages and on productivity and prosperity measures. However, even these measures are relatively volatile in Arizona over the course of an economic cycle.

Unless otherwise noted, years in this chapter refer to calendar years.

AN EVALUATION OF ARIZONA'S ECONOMY

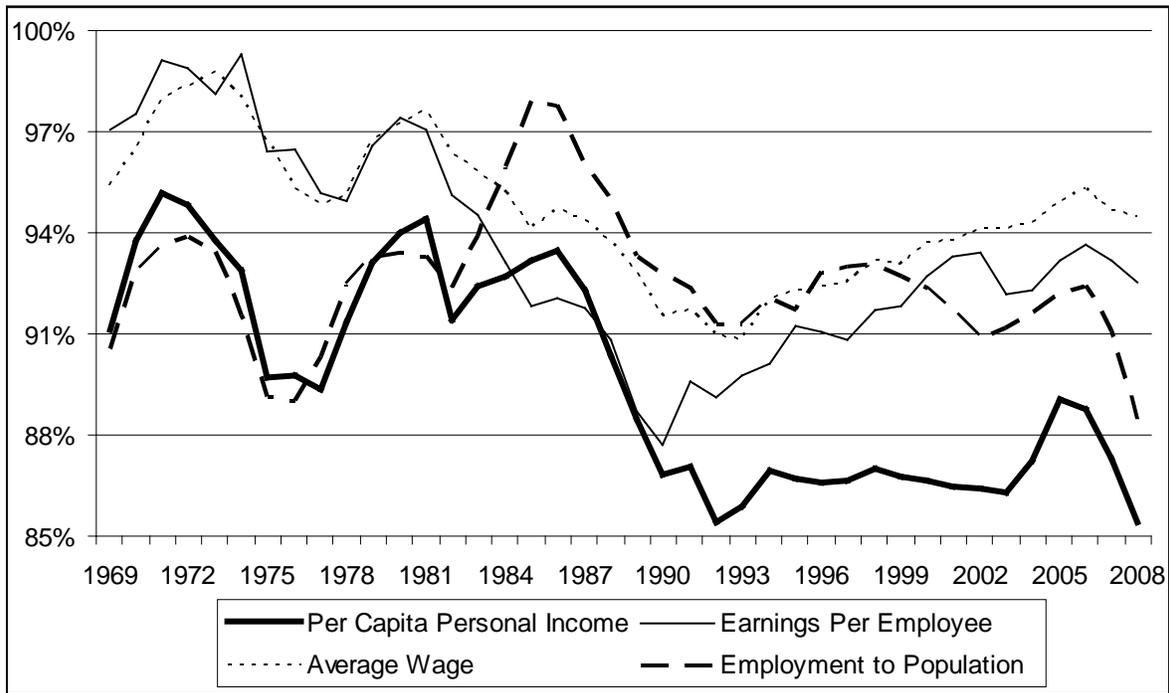
While many Arizonans have long focused on growth and increasing size (of the economy and population), such a focus has resulted in nearly the most cyclical economy in the nation. Cyclicity is damaging to individuals, who experience economic dislocations, such as reduced work hours, lower wages, and loss of jobs, during recessions. The cyclicity of the economy also affects the public sector, which in Arizona generally is either struggling to keep up with population growth or facing a significant cyclical deficit. As discussed in the first report from the Arizona Strategic Planning and Economic Development effort in 1990, the emphasis instead should be on measures of productivity and economic well-being.

In the near term, of course, employment issues cannot be ignored due to the substantial job losses experienced in Arizona over the last two-plus years and the state's relatively high unemployment rate. Most of the following discussion of economic policies, however, focuses on the longer term and on public policies that will enhance the productivity of the state's workforce, improve the economic standard of living, and reduce, to the extent possible, the cyclical dislocations that occur every time the economy slows.

An evaluation of productivity and prosperity measures indicates that Arizona's economic performance has been mediocre for decades, but that the state compares less favorably now relative to the national average than it did during the 1970s and early 1980s (see Chart 12.1). Significant deterioration occurred in each of the measures relative to the national average during the 1980s and early 1990s. Though the per employee measures as a ratio to the U.S. average bounced back from the early 1990s through 2006, they remained below the levels of the 1970s and early 1980s.

As seen in Table 12.1, Arizona in 2008 ranked just above the middle of the 51 'states' on the per employee measures, though Arizona's value was from 5-to-7 percent below the national average. Arizona ranked much lower on the per capita measures, which were 15-to-18 percent less than the U.S. average. The poorer performance on the per capita measures results from Arizona's very low workforce participation rate. In 2008, Arizona's rate was second lowest in the nation (only

**CHART 12.1
PRODUCTIVITY AND PROSPERITY MEASURES IN ARIZONA
AS A RATIO TO THE NATIONAL AVERAGE, 1969 THROUGH 2008**



Source: Calculated from U.S. Department of Commerce, Bureau of Economic Analysis data.

West Virginia had a lower value) at 11 percent below average. On those measures that Arizona did not rank last among the western states, the states with lower figures were New Mexico, Oregon, and Utah.

Some of the factors causing this subpar performance on productivity and prosperity indicators, such as wage levels, are not under the control of policymakers. Others, however, can be influenced directly or indirectly.

Job quality is the starting point to prosperity. Defined only on the basis of wages, Arizona's job quality in 2004 (the latest data) was about 2 percent less than the national average, but ranked 23rd nationally and sixth in the West. Arizona's occupational mix was only marginally below the national average, but its industrial mix was nearly 2 percent below average. If a broader measure of job quality were available, one that includes benefits such as health insurance, Arizona probably would compare less favorably since the state is further below average on nonwage compensation than on wages and salaries. The low wages and benefits likely relates to the state's poor economic competitiveness for the key base industries, which not only pay higher wages but also offer better nonwage compensation packages.

While a diversification of Arizona's economy is often suggested as a cure for its ills, the reality is that the economy is relatively diversified. However, as seen in its below-average industrial

TABLE 12.1
PRODUCTIVITY AND PROSPERITY MEASURES IN ARIZONA, 2008

	Value	Ratio to U.S. Average	National Rank*	Western Rank**
Per Capita Gross Product	\$38,289	82.2%	41	9
Per Capita Personal Income	\$34,335	85.4	42	7
Per Employee Gross Product	\$72,410	92.9	23	6
Per Employee Earnings	\$46,496	92.5	23	6
Per Employee Wages	\$43,192	94.5	22	6
Employment-to-Population Ratio	52.9%	88.5	50	9

* A rank of 1 indicates the highest value among the 50 states and the District of Columbia

** A rank of 1 indicates the highest value among the nine western states (Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington)

Source: Calculated from U.S. Department of Commerce, Bureau of Economic Analysis data.

mix, the diversification has been attained by an overabundance of low-paying industries. Thus, strategies to diversify the economy need to focus on the key base industries that pay well.

An overdependence on the cyclical construction and real estate sectors has often been mentioned as a problem, but only a small portion of construction-real estate serves as an economic driver. The reality is that these sectors respond to growth in the state's economic base and will remain disproportionately large in Arizona as long as the state's growth rate remains high. Arizona is a fast-growing state primarily due to natural factors such as climate, but the state's long-present pro-growth stance also has contributed to its fast growth. A focus on growth does not benefit productivity or prosperity. Across the nation, the rates of population and employment growth are unrelated to gains in productivity or prosperity. However, fast growth is the largest factor contributing to the state's very cyclical economy, and thus a de-emphasis on overall rates of growth in favor of targeted growth of the key base industries is recommended.

Wages in Arizona are below average, even after considering the cost of living. The low average wage is in part due to the below-average job quality, a factor that can be addressed by public policy. However, much of the below-average wage is apparently due to the willingness of individuals to work for lower wages in Arizona in exchange for perceived noneconomic advantages of living in the state (climate, lifestyle, etc.).

Incomes in Arizona are further below average than wages. While a number of factors contribute to the low incomes, the major factor other than the low wages is the low workforce participation rate in Arizona. The below-average employment-to-population ratio is in part due to the state's slightly above-average shares of its residents who are children or senior citizens. Early retirees who move to the state when they retire also contribute to the low ratio. However, even among the prime working-age population of those 25-to-54 years of age, the workforce participation rate is below average.

The low workforce participation rate may in part result from factors that cannot be influenced by public policy, such as cultural norms regarding the workforce participation of women. However,

some of the low participation almost certainly is a result of the uncompetitive job skills of some individuals who grew up in Arizona. They are outcompeted for available jobs by in-migrants with stronger skills and educational attainments.

Workforce participation rates are particularly low in some of Arizona's less-populous counties where educational attainments are the weakest. In certain rural parts of the state, including some of the American Indian reservations, weak job creation also contributes to the low workforce participation. Thus, while the state needs to concentrate on the key base industries, it must have a flexible plan that focuses on other base industries in some rural areas of the state.

BASELINE ECONOMIC OUTLOOK

The Arizona economy has just begun to recover from its longest and deepest downturn since the 1930s. After experiencing little or no loss of employment during the previous several recessions, Arizona lost nearly 300,000 jobs—11 percent of its wage and salary workforce—between late 2007 and late 2009.

While the Arizona economy recovered rapidly from some of its prior recessions, such as in 1983, the recoveries from each of the last two recessions were much slower. Given the extent of the real estate problems still to be resolved, the upcoming recovery is likely to also be slow. Modest economic growth is expected to begin in 2010 and continue through 2011. Growth should then accelerate, but the peak job level of 2007 is not expected to be reattained until 2014.

Economic growth is unlikely to be as strong in the upcoming expansion as in the last two. The very fast growth in those cycles should be viewed as aberrations. The booms in the stock market during the late 1990s and in the real estate market in 2004 and 2005 were driven by the large number of Americans born during the baby boom (1946 through 1964) who had relatively high earnings and savings coupled with a willingness to assume risk. Since the baby-boom generation is now nearing retirement, these individuals likely will become more cautious in their investment strategies and therefore may not drive a temporary boom during the next economic expansion. If a boom does not develop, the temporary surges in public revenues that caused budget surpluses in Arizona during the mid-to-late 1990s and mid-2000s will not recur.

The other reason to expect slower growth than in the two prior expansions is that the number of immigrants moving to Arizona should be far lower than it was between the mid-1990s and mid-2000s. During the 1990s, young Americans aging into the workforce were comparatively few in number, a result of the lower number of births during the 1970s. There were not enough Americans to fill all of the jobs being created, providing the opportunity for immigrants to move to the United States. This influx stimulated economic growth further.

Many more Americans now are aging into the workforce due to the sizable increase in the number of births during the 1980s, reducing job opportunities for immigrants. In addition, Mexico's demographics are changing; fewer Mexicans will need to leave the country to find work. In Arizona, the employer sanctions law likely will be the most important factor limiting undocumented immigration. Thus, slower population growth and lesser employment growth are likely in Arizona in coming years relative to the period from the mid-1990s through the mid-2000s.

PUBLIC EXPENDITURES AND ECONOMIC COMPETITIVENESS

Arizona's fast growth, other than during recessions, is an indication that its export base is growing quickly despite the state's economic competitiveness not being rated as a strength. (Evaluations of the state's business climate range from good to poor.) It is likely that Arizona's natural attractions—including climate, open spaces, and lifestyle—continue to offset its weaknesses, at least for some types of base economic activities. However, the state's subpar job quality, with no improvement occurring over time, is a sign that these natural attributes are not enough to compensate for its shortcomings among the key base industries.

Ignoring for the moment the state's fiscal problems, the state should continue to grow for a long time even if positive actions to improve economic competitiveness are not undertaken. Of course, the quality of the growth will remain a concern, as will the high cyclicality of the economy.

The possibility of not reversing the substantial spending reductions already made over the last two years and of possible further reductions in public expenditures clouds this outlook. Reductions in public programs important to the key base industries—education, job training, and provision and maintenance of infrastructure—will have serious long-term consequences.

Within the general fund, reductions in spending for education likely will have the most serious negative consequences on economic development. With education accounting for more than half of the general fund and with health and welfare programs having been cut so much so far, education is scheduled for significant and disproportionate further reductions if the May ballot measure to temporarily raise the sales tax rate does not pass. Even if the ballot proposition passes, education will remain at risk of further reductions in appropriations. Unless other steps are taken, a persistent budget deficit will recur when the temporary sales tax ends. Continued rapid increases in health costs likely will continue to pinch revenues that otherwise might be used for education.

Reductions in spending in the K-12 system are likely to result in a greater proportion of students unprepared to pursue higher education and unprepared to compete for jobs in the 21st-century economy. University tuition already has increased substantially. Further spending reductions for higher education not only would reduce the quality of the education offered, but could result in a lesser number of students pursuing higher education due to the likely additional increases in tuition that would result. The lowering in workforce quality from reductions in K-12 and higher education spending likely would end any pretense the state has of attracting the key base industries.

The other aspect to producing a quality workforce consists of job training. It is hard to imagine improving the existing system without an infusion of additional funds—that will be unavailable given the current revenue system.

Other than K-12 school construction, infrastructure maintenance and repair is largely funded from outside the general fund. However, with the current revenue system, it will be difficult to replenish other state funds for the substantial amounts of monies have been transferred into the general fund. Further, a state unwilling to pay for basic general fund services such as public

welfare and education is not likely to have the willingness to commit enough funds to provide a quality infrastructure. A deteriorating infrastructure likely will have a significant negative effect on economic competitiveness.

Other than workforce/education and infrastructure issues, the other primary issue of concern to the state's economic competitiveness is the high tax burden borne by many export businesses and the shortage of incentives available to help attract high-quality employers. While the solution is obvious—reduce selected business tax rates and provide more funding for incentives—taking these actions will reduce public revenues, forcing even larger spending reductions. Thus, unless offset by revenue increases paid by individuals, business tax cuts could easily have a counterproductive effect, with the negative effects of spending reductions for state services that are of value to employers more than offsetting the improvement in economic competitiveness from lower taxes.

Spending reductions for a few programs will have immediate negative effects on the economy. For example, tourism likely will suffer from the closures in the state parks system. Closed parks also could have a negative effect on retirement migration.

However, spending reductions for many programs will not have an immediately perceptible effect on the economy. For example, it takes more than a decade for a child to complete their K-12 education; a failure to spend adequately to maintain infrastructure does not result in the immediate deterioration of that infrastructure. Thus, spending reductions that have already gradually occurred in some programs over the last 15 years may only now be starting to have a significant negative effect. For example, general fund spending on the university system exceeded \$7.60 per \$1,000 of personal income every year through FY 1992. Since then, it has fallen. It will be less than \$4 in fiscal year 2011, a decrease of roughly half.

Thus, while it may appear that certain types of spending can be reduced without significant ill effects, it may simply be that the negative effects have yet to manifest themselves. When the problems do become apparent, it will be very difficult to reverse years of neglect in a short period of time—even if there is a strong desire to do so.

CHAPTER 13

THE CITIZENS FINANCE REVIEW COMMISSION

When it was created, the expressed purpose of the Citizens Finance Review Commission (CFRC) was to “develop a series of recommendations that will advise the Governor on a course to stimulate Arizona’s economy for the long term. In particular, the Commission will develop recommendations that address fiscal and tax policies that are simple, low and fair and support Arizona’s growing economy.” The CFRC met repeatedly during 2003 and issued their final report *A Fiscal Toolbox* in January 2004.

RECOMMENDATIONS OF THE CFRC

The CFRC made 36 recommendations (see Table 13.1). Most are as timely today as they were when written six years ago. All dealt in some way with the revenue system of the Arizona state government. All recommendations were developed under an assumption of revenue neutrality—the CFRC made no recommendation whether overall revenues should be increased or decreased. In fact, the level of desired revenue has little effect on the design of a revenue system.

While 90 percent of the public conversation about taxes is around adequacy, the CFRC’s analysis was more comprehensive. The stability of revenues over time was an important consideration, but this was just one of many factors considered by the commission—all of the guiding principles discussed in Chapter 9 were weighed.

The commission found a number of shortcomings in the state’s revenue system, independent of the amount of desired revenues. In particular, the general fund relies predominantly on the income tax and the transaction privilege tax (sales tax); sales tax revenue across the country is shrinking or failing to grow at the pace of the rest of the economy due to a narrow and outdated tax base; Arizona’s transaction privilege tax system is complex to administer; the transaction privilege tax has many exemptions; the property tax system is highly complex and favors and subsidizes residents in numerous ways; and the income tax system has numerous tax credits.

Most tax analysts argue that changes in tax policy should not be done piecemeal. The revenue system needs to be considered in totality and adjusted as a whole. Every change affects a host of other taxpayers and policies. For example, when Nevada undertook a major study of tax policy in 2002, the task force placed all of its findings into one package that was intended to be introduced as one legislative bill.

In the following discussion, the CFRC’s recommendations have been organized primarily by revenue source. Multiple recommendations were made regarding each of the major tax sources.

Transaction Privilege (Sales) Tax

The means by which wealth is generated and the ways in which income is expended have changed substantially since the 1930s. In particular, manufacturing and consumption of goods have proportionately decreased in favor of services. Interstate and international trade has increased. Consumer purchases from catalogs and the Internet have increased. Yet the structure of the state’s sales tax remains nearly the same as in the 1930s.

TABLE 13.1
SUMMARY OF RECOMMENDATIONS
OF THE CITIZENS FINANCE REVIEW COMMISSION

- 1 Move toward reducing overall business property tax burdens.
- 2 Reduce the business personal property tax on locally assessed business personal property.
- 3 Apply a uniform assessment ratio on all future voter-approved property tax funded bonds and overrides.
- 4 Align the TPT to more appropriately mirror the state's economy by expanding the tax base.
- 5 Carefully examine the effectiveness of the possessory interest tax to determine if it is functioning the way it was intended, i.e. an in-lieu property tax.
- 6 Assign the specific responsibility for long-term planning to a particular agency or committee.
- 7 In addition to the current practice of cost accounting, utilize accrual accounting on a selective basis to provide the state's financial policymakers with long-term planning budget data.
- 8 Centralize information about federal funds in an effort to increase the federal grant dollars received.
- 9 Increase the current limit on the budget stabilization fund to its original 15 percent cap and take measures to make "raids" on the fund more difficult.
- 10 Utilize capital financing tools (bonding) for long-term capital assets with debt service tied to specific revenue streams.
- 11 Establish high-level tax policy guidelines to be used to test the soundness of future proposed transaction privilege tax exemptions.
- 12 Do not depend on general fund revenues to finance new school construction, but instead implement a process for new school construction using local school district, county, or state property taxes.
- 13 Where possible, phase in major changes—or phase out changes—to the tax structure over time.
- 14 Remove the constitutional requirement that raising tax rates requires two-thirds affirmative vote, reverting to a simple majority requirement.
- 15 Hire a consultant to examine the fairness and extent of miscellaneous taxes and fees imposed by the state for services.
- 16 Decrease revenue loss by increasing spending on revenue enforcement until cost-benefit equilibrium is reached, and implement a system that makes tax avoidance more difficult.
- 17 Replace unit-based fees and taxes with percentage-based fees and taxes.
- 18 Maximize the "time value" of money by increasing interest earnings through the use of frequent deposits, longer-term, higher-interest accounts, and other fiscal measures.
- 19 Have as few corporate and personal income tax credits as possible.
- 20 Follow the federal income tax returns as much as possible.
- 21 The cities and state should pursue greater transaction privilege tax uniformity.
- 22 Include a sunset provision to each transaction privilege tax exemption to periodically compare the public policy supporting the tax exemption against the evolving state of the state.
- 23 Do not adopt a gross receipts or expanded franchise tax as a replacement for corporate income tax.
- 24 Phase out the homeowner's rebate.
- 25 Do not reinstate the "throwback rule" in the corporate income tax calculation.
- 26 Continue to impose the estate tax on the amount that is equal to the state tax credit provided for in the federal tax code even though the credit is scheduled to be phased out.
- 27 Do not adopt a real estate transfer tax.
- 28 Re-enact the option of a state property tax, applied on a uniform assessment ratio.
- 29 Broaden the transaction privilege tax base by including "personal" services or "consumer" services.
- 30 Broaden the TPT tax base by including certain transactions that currently are tax exempt.
- 31 Withhold income tax from nonresidents.
- 32 Retain certain low-income tax credits.
- 33 In conjunction with eliminating certain exemptions and broadening the transaction privilege tax base, lower the rate accordingly.
- 34 Eliminate the 1 percent constitutional cap on residential property tax.
- 35 Review the effectiveness of private-school tuition tax credits and the extracurricular public-school tax credit.
- 36 Do not adopt a single flat rate for personal income tax purposes.

Source: Citizens Finance Review Commission, *A Fiscal Tool Box* (January 2004).

Broaden the Sales Tax Base

The CFRC supported the idea of aligning the state transaction privilege tax base to more appropriately mirror the state's economy by expanding the tax base to include some services. To determine which services, the commission weighed the practicalities of administrative ease, competitive effects, and the likelihood that the consumer would attempt tax avoidance by purchasing the service in another state. Studying the experiences of other jurisdictions, the commission determined that certain services—often called “consumer” or “personal” services—should be included in the tax base. These services are consumed by the ultimate end user, are not likely to be purchased in another state to avoid taxation, and generally have an obvious site of the transaction (for administrative ease). Examples include dry cleaning, personal grooming services, automobile tune-ups, dating services, and massages.

Broadening Arizona's transaction privilege tax base by taxing services would have the effect of enhancing the revenue system's stability, responsiveness, and predictability. The CFRC suggested that by expanding the transaction privilege tax base, the state could lower the relatively high tax rate, promoting efficiency, competitiveness, and vertical equity.

Reduce the Number of Exemptions

The CFRC specifically identified 220 separate exemptions to the transaction privilege tax base written into the Arizona statutes as of 2003. The commissioners agreed that there were too many exemptions in the transaction privilege tax base, and recommended that each exemption be examined by a review team. Further, the CFRC recommended all transaction privilege tax exemptions be subject to sunset provisions that would require public policymakers to periodically compare the public policy supporting the tax exemption—there are some widely accepted public-policy reasons for certain sales tax exemptions—to the evolution of the state.

In conjunction with eliminating certain exemptions and broadening the tax base, the CFRC recommended lowering the transaction privilege tax rate.

Develop a More Uniform Transaction Privilege Tax Base

The Arizona Tax Research Association has pointed out the need for more uniformity in the state and municipal sales tax base. Localities have the power to impose a level of transaction privilege tax in addition to the state's 5.6 percent transaction privilege tax and can customize their tax base, using their own definition of taxable and exempt transactions. The CFRC agreed that cities and the state should pursue greater tax uniformity.

Businesses that collect the sales tax must adhere to a complex transaction privilege tax system that is different from city to city. Imagine the complex tax collection system with which a chain retailer such as Target must contend: applying different tax rates on the same product from city to city and taxing food and certain other items in some cities but not in others. Not only will greater uniformity simplify the transaction privilege tax system and lower the cost of compliance, it will be the first step in moving the state toward compliance with a movement to create a uniform interstate sales tax system that would make it possible to begin taxing Internet sales of goods. However, resistance is high since this type of uniformity comes at the price of loss of local control.

The University of Tennessee estimated the sales and use taxes not collected on electronic commerce by state in 2007. The estimated amount in Arizona was \$235.2 million, or 3 percent of the entire sales tax due. This percentage was sixth highest in the country and second highest among nine western states. Had the percentage been a more typical 2.5 percent instead of 3 percent, the state would have realized an additional \$39 million in revenue.

The movement to create legislation that would allow states to collect taxes on Internet-based sellers of goods is called the streamlined sales tax agreement. Twenty-two states have adopted the tax simplification measures in the agreement.

The streamlined sales tax agreement is a way states could voluntarily agree to allow taxation of sales that states could not otherwise tax because the states do not have legal jurisdiction over buyers and sellers in other states. One of the key procedural requirements of the streamlined sales tax agreement is that states would have to agree to a uniform sales tax base throughout the state. Arizona's transaction privilege tax system is so customized from city to city that proponents of the streamlined sales tax agreement say Arizona is one of the three states that would undergo the most dramatic changes by enacting a uniform tax base. Traditional brick-and-mortar businesses support the streamlined sales tax agreement for reasons of simplicity and because the current tax system requires local bookstores, for instance, to collect sales tax but does not require Amazon and other Internet-based companies to collect or remit sales tax.

Income Tax

While several CFRC recommendations applied to either the personal income tax or the corporate income tax, most were of the nature of not recommending a suggested change or of recommending the continuance of existing policies. The exceptions were three recommendations related to income tax credits.

Until 1981, there were no corporate income tax credits in Arizona. The number of corporate income tax credits began rising quickly in 1996. Some argue tax credits are a fiscal tool to influence corporate behavior. Critics argue that tax credits have little or no influence over business decisions, reduce government revenue, and complicate the tax code.

The CFRC investigated Arizona's various corporate tax credits, the policy goals they were supposed to attain, and the frequency of their use by corporate taxpayers. Based on that investigation, the CFRC determined that all corporate tax credits should be reviewed periodically and recommended that all but the following credits that were available in 2003 should be phased out: research and development, enterprise zones, defense restructuring, school site donation, and technology training.

As of 2003, there were at least 20 individual income tax credits in Arizona's tax code, yet at least eight were claimed by fewer than 10 income tax filers in 2000. Applying the same analysis used for corporate tax credits to individual income tax credits, the CFRC suggested phasing out all but the following individual tax credits that were available in 2003: clean elections (because it is ballot approved and cannot be altered except by public vote), family tax credit, property tax credit for low-income seniors, private-school tax credit, and extracurricular activity public-

school tax credit. The continuance of the two tax credits related to schools was recommended for further study.

The number of income tax credits varies over time. Currently, 31 individual income tax credits are listed in statute (Title 43, Chapter 10, Article 5). Twenty-one corporate income tax credits are listed in Title 43, Chapter 11, Article 6. Some of these can be claimed only on carry-forward amounts.

Property Tax

The state property tax was revoked in 1996, eliminating the most stable source of revenue for the general fund. (The property tax continues to be assessed by most local governments and is administered by the counties.) The CFRC recommended that the option of a state property tax be re-enacted. However, the recommendation specified that the state property tax should be applied using a uniform assessment ratio for all classes of properties.

Property taxes are determined based on property value and an assessment ratio that varies across nine property classes. Most businesses have an assessment ratio twice that of residential homeowners. The CFRC recommended that the current classifications that apply a higher assessment ratio to businesses than to residential homes be simplified so the same assessment ratios apply regardless of the use of the real property.

In a myriad of ways, Arizona's property tax system favors residential owners over business owners. The first three CFRC recommendations addressed the reduction of business property taxes and applying a uniform assessment ratio.

Phase Out the Homeowner's Rebate

Residential property taxes in Arizona are very low, as noted in Chapter 4. One way the state has subsidized residential homeowners is the homeowner's rebate. In 2010, every residential homeowner's primary property tax bill will be automatically reduced by 40 percent, up to a dollar limit of \$600. Originally, the homeowner's rebate was designed to provide assistance to low-wage households. But it is a subsidy that is applied to all homeowners irrespective of wealth. The burden of the lost tax revenue is shifted to the remainder of the real property tax base, and felt most by business property owners. The CFRC recommended that the homeowner's rebate be phased out.

Eliminate the 1 Percent Constitutional Cap on Residential Property Tax

A 1 percent constitutional cap on the primary property tax is applied to residential homeowners. This residential property tax cap affects almost all other property tax reforms. The cap acts as an artificial ceiling on the primary property tax and is applied only to residential property owners. The cap has frustrated state tax policy administrators who recognize the "disconnect" it creates between the spending decisions of local government and the residents' burden of bearing the cost of local government spending. This is particularly true for residents in districts that have already hit the 1 percent cap and know they will not have to pay for any further spending. Instead, the additional expenses are absorbed by business taxpayers and the general fund.

The CFRC recommended that this cap be eliminated. Some CFRC commissioners recommended replacing the 1 percent cap with an income tax credit or a rebate for property taxes paid by low-income residents.

Fees for Government Services

The vast majority of Arizona state government general fund revenue comes from tax sources. User fees are among the minor sources of revenue. Fees are used more extensively in many states.

The CFRC felt that fees charged for services need to reflect the fair market value of the services provided, or at least cover the real cost of providing the services. Although some regulatory agencies cover their own costs through fees collected from the groups they regulate or serve, many do not. The result is that some groups receive services subsidized by the taxpayers.

Agencies that provide welfare services do not have an opportunity to charge adequate user fees. Welfare-oriented services are charged at below-market or no cost. Other services could be charged at fair-market value and subsidize the welfare-oriented services. The CFRC recommended that further study be done on miscellaneous taxes and fees.

Recommendations Not Specific to Taxes or Fees

Since the CFRC took a comprehensive look at the state's revenue system, many of its recommendations were not specific to a particular tax or fee.

Link Revenues and Expenditures

Budget managers, whether for a government, a business, or a household, all know to match revenue types to expenditure types. In general, long-term spending patterns should be matched to long-term revenue patterns, short-term spending should be tied to short-term revenues, and one-time spending handled by one-time revenues. Individuals pay for groceries with immediately available funds, but finance the purchase of their homes. Businesses pay for wages with ready cash, but finance new building construction. Many budgetary analysts recommend states follow this example and finance, through bonding, long-term capital assets with debt service tied to specific, long-term, recurring revenue streams. Two CFRC recommendations addressed this issue.

Budget analysts also generally agree that implementation of new government programs and expansion of existing programs should not be allowed without making a commensurate change in the revenue system to provide the funding needed. This assures the public consider the cost of the services it demands and makes a rational cost-benefit analysis. (In 2004, Arizona voters instituted by ballot initiative the requirement that initiatives proposing new programs must include a designated revenue source.) Similarly, tax cuts should not be allowed without spending reductions being made at the same time (or offsetting revenue enhancements being implemented).

Strengthen the Budget Stabilization Fund

Almost all analysts who have studied Arizona's tax policy agree that Arizona's tax revenue is highly cyclical and follows the cyclical pattern of the national economy. A number of the

CFRC's recommendations—most notably, the broadening of the sales tax base, the increased reliance on residential property taxes, and greater use of user fees—will have the effect of reducing the cyclical instability in state government revenues. But considerable cyclical volatility will remain. Because no regulatory policy can change the state economy's sensitivity to the national economic cycle, most tax policymakers address how to be prepared for the inevitable fluctuations.

Nearly all tax and budget analysts support a strong and well-funded budget stabilization fund. Monies are deposited into this rainy-day fund during times of strong economic growth and surplus revenues and are withdrawn during the inevitable periods of economic downturn that reduce tax collections. When Arizona's BSF was originally created in 1990, the fund was capped at 15 percent of the general fund budget. But in 1995, state policymakers lowered the BSF cap to 5 percent of the general fund budget. Instead of depositing monies into the BSF as specified in the original legislation, permanent tax cuts were instead implemented. Later, the cap was raised to its current 7 percent, but a fund of this size did not provide nearly enough monies to offset the cyclical loss of revenue in each of the subsequent two recessions.

In addition to the inadequate size of the fund, monies have been removed from the BSF for purposes other than budget stabilization. Thus, the CFRC recommended both that the higher cap be restored and that "raids" on the fund be made more difficult.

Procedural and Miscellaneous Other Suggestions

Among the other CFRC recommendations was the replacement of unit-based fees and taxes with percentage-based fees and taxes. For example, many of the selective sales taxes, such as those on alcoholic beverages and gasoline, are at a fixed dollar figure per quantity purchased, which does not adjust for the effects of inflation.

Several CFRC recommendations addressed procedural issues, including enhancing the state's long-term planning, using accrual accounting as well as cost accounting, centralizing information on federal funds in an effort to increase federal grant dollars, increasing revenue enforcement, and maximizing interest earnings. Finally, the CFRC also recommended that the two-thirds requirement to pass a tax increase be returned to a simple majority vote.

CHAPTER 14

AN EXAMINATION OF THE CURRENT REVENUE SYSTEM IN ARIZONA

This chapter incorporates information from the preceding chapters of this report and adds detail for each of the larger sources of public-sector revenue in Arizona. While this chapter separately analyzes each revenue source, experts recommend that revenues be considered as part of a system and that any revenue reform be considered from a comprehensive rather than piecemeal perspective. All references to years in this chapter apply to the state's July 1–June 30 fiscal year.

NONTAX REVENUE

User Fees

State government charges fees for industries it regulates and for some of the services it provides. Conceptually, fees are designed to align the cost of a particular public service with the use of the service. In contrast, taxes are typically designed with respect to broad bases and provide revenue to support an array of public services.

User fees are most efficient when the cost of the charge provides sufficient revenue to support the delivery of a quality service. Inefficiencies can arise when governmental departments assigned the role of delivering the service are partially funded from the charges and partially funded from general revenues. Problems also can arise from fee structures that are fixed through time with no allowance for inflation or other pressures on the cost of service delivery.

The Arizona Joint Legislative Budget Committee reports that the category of “licenses, fees, and permits” accounts for only 2 percent of the state general fund revenue. However, using 2007 data from the U.S. Census Bureau, which incorporates other funds than just the general fund, current charges (predominantly user fees) accounted for 6 percent of state government revenues. Charges contributed more than 14 percent of local government revenue and 12.5 percent of combined state and local government revenue.

As defined by the Census Bureau, per capita state government current charges in Arizona in 2007 were 46 percent less than the national average, and the local government figure was 19 percent less than average. The shortfall was \$214 per person at the state level and \$134 per person among local governments. If the per capita dollar figures had equaled the national averages, Arizona's revenue from current charges would have been \$1.3 billion higher for state government and \$0.8 billion higher for local governments.

State government collections of current charges for higher education—the largest category nationally, consisting largely of tuition—were 21 percent less than the national per capita average in Arizona, but the local government figure was 45 percent higher than average (due to local government funding of community colleges). The combined figure was 14 percent less (\$41 per person) than average. If the combined per capita dollar figure had equaled the national average, Arizona's user fees from higher education would have been \$261 million higher.

Arizona's low overall collection of current charges relative to the U.S. average is in part explained by the relatively small number of public hospitals in the state. Fees for public hospitals on a per capita basis at the combined state and local government level in Arizona were 58 percent below the national average in 2007. If the combined per capita figure had equaled the national average, collections would have been \$1.1 billion higher.

This suggests that Arizona's public health care system is unusual in comparison with other states. In Arizona, health care is provided to citizens who qualify for public assistance (e.g. through AHCCCS) through private providers, with the financing based on general revenues. In other states, public-sector hospitals provide more of the services, collecting a greater share of user fees from the patients (or their insurance providers). Moreover, some 40 states now impose some form of "hospital-provider fee."

Other than the hospital and higher education categories, Arizona governments collected \$0.8 billion less in current charges than if the per capita figure had equaled the national average. A shortfall occurred in many categories, particularly highways.

According to the CFRC, "Based on comparative data of certain fees and a recent report of aggregate fees collected for services of the states, the commission believes that the fees charged do not accurately reflect the fair market value of the services provided or even cover the real cost of providing the service." As a result, certain groups receive services subsidized by taxpayers. Therefore, the CFRC recommended that "The state should hire a consultant to examine the fairness and extent of miscellaneous taxes and fees imposed by the state for services."

In addition to comparisons with rates charged in other states and with the cost of service delivery in Arizona, a study of fees also should consider strategic objectives. As the economy and requirements for economic development have evolved, certain state and local government services have increased in importance. In the evolving knowledge economy, higher education is more important than ever, yet higher education funding in Arizona is faltering at the same time that the higher education price index is rising at a faster rate than overall inflation. The transportation network and other components of the physical infrastructure also are of key importance. Costs of building and maintaining the transportation infrastructure have increased rapidly in recent years and Arizona has made limited investments in the last 15 years.

For the state to make significant investments in transportation and other physical infrastructure projects in the future, a greater application of user fees may be required. Similarly, additional investment in higher education may require higher tuition assessments (though university tuition has increased substantially since 2007).

Federal Funds

Federal funds are a significant source of state and local government funding. In 2007, using the broad Census Bureau accounting, federal funds accounted for 31 percent of state government revenue and 21 percent of combined state and local government revenue. Despite these high shares, Arizona's receipt of federal funds was below the per capita average.

In 2007, federal funding to Arizona governments on a per capita basis was 11 percent less than the U.S. average. The per person shortfall in Arizona of \$170 multiplied by the number of Arizona residents results in a shortage of just more than \$1 billion relative to the U.S. average.

Based on the Census Bureau's *Consolidated Federal Funds Report* for 2007, Arizona's per capita grant receipts were at the national average from the federal Department of Health and Human Services, which accounted for 57 percent of the grants nationally. Arizona's per person figure from the U.S. Department of Education, which was responsible for 7 percent of the grants, was a little above average, while it was below average by a similar degree from the U.S. Department of Agriculture. In contrast, Arizona's per person receipts were more than 30 percent below average from the U.S. Department of Housing and Urban Development (HUD), from the U.S. Department of Transportation (DOT), and from the balance of the federal funding sources. Arizona's shortfall amounted to \$541 million from DOT, \$250 million from HUD, and \$298 million from other sources.

The CFRC recommended that "The state should centralize information about federal funds in an effort to increase the federal grant dollars it receives." This recommendation was based on information that Arizona consistently receives relatively little federal grant dollars compared to other states, and that Arizona uses a decentralized method of managing federal funds.

State and local governments have little discretion over the use of these federal funds, which must be spent for specific purposes. The primary way to increase federal funding is to participate in more programs in which the federal government matches local spending. In many programs, the federal government matches a dollar spent by the state with more than \$1 of federal monies. Congressional action also might direct more federal monies to Arizona.

Other Nontax Revenue

The Census Bureau identifies four other categories of nontax government revenues:

- Interest earned. In 2007, Arizona's per capita figure was 29 percent below average in state government, but the local government figure was nearly equal to the national average for local governments. If the per capita dollar figure had equaled the national average, Arizona's interest earnings would have been \$294 million higher for state government.
- Special assessments. This category primarily applies to local governments. Arizona was below the national per capita average in 2007, but this is not a significant source of government funding.
- Sale of property. The 2007 per capita revenue for state government was far higher than average while the local government figure was below average.
- Miscellaneous. In 2007, Arizona's per capita figure was 33 percent below average in state government and slightly below average at the local government level. If the per capita dollar figures had equaled the national averages, Arizona's miscellaneous revenue would have been \$545 million higher for state government and \$49 million higher for local governments.

The CFRC recommended several actions to improve on the state's fiscal procedures in terms of money management and long-term planning, as discussed in Chapter 13.

TAX REVENUE

Most states rely on a combination of three major taxes to provide the majority of nonfederal government revenue: general sales tax, property tax, and income tax (individual and corporate). Commentators refer to these taxes as the “three-legged stool” of government revenue, implying the need for all three tax bases and a relatively equal reliance on all three to create the most balanced tax structure. These three taxes are each broad based and apply to somewhat different aspects of the economy: consumption, wealth, and earnings, respectively. Each is somewhat differentially affected by the economic cycle.

Nationally, these three taxes accounted for nearly 56 percent of own-source state and local government revenues in fiscal year 2007. More narrowly applied taxes accounted for an additional 13 percent. The most commonly levied of these other taxes are luxury (or “sin”) taxes (e.g., taxes applied on alcoholic beverages, cigarettes, and gambling), gasoline taxes, mineral taxes (taxes applied on the extraction of minerals), and the real estate transfer tax.

In Arizona, any state revenue increase requires a two-thirds majority vote by the Legislature, but revenue reductions only require a simple majority. The CFRC recommended that “The state should remove the constitutional requirement that raising tax rates requires two-thirds affirmative vote, reverting to a simple majority requirement.” The CFRC’s rationale was that this requirement will hinder comprehensive revenue reform and argues that the requirement was not intended to make changes such as a revenue-neutral broadening and lowering of the general sales tax rate more difficult to accomplish.

General Sales Tax

Arizona’s transaction privilege tax—commonly referred to as the general sales tax—is part of the broader JLBC category of “sales and use” taxes. Use taxes apply to goods purchased in states without a sales tax and to several specialized categories, such as a mining severance tax. The general sales tax is applied to 16 categories; a 5.6 percent tax (the rate will be 6.6 percent for the next three years) is levied in most. In 2009, the retail category accounted for 45 percent of the revenue and the restaurant and bar category contributed 9 percent. The other major categories were contracting, which generated 17 percent of the revenue, and utilities, with 11 percent. The revenue from the state tax is shared with counties and municipalities through a complex system of formulas.

General fund revenue from the sales and use tax peaked at \$4.5 billion in 2007. It totaled less than \$3.8 billion in 2009 and is projected to be only \$3.5 billion in 2010. This figure does not include revenue from the 0.6 percent of the sales tax that is earmarked for education, nor does it include the monies distributed to local governments.

As in much of the nation, the general sales tax rate has climbed over time in Arizona, with increases in the statewide rate and in the rates assessed by local governments. Based only on the statewide rate, more than half of the states have a higher rate than Arizona’s 5.6 percent. Arizona’s statewide tax rate is at the median of the nine western states. However, calculating an average overall sales tax rate that includes county and municipal sales taxes, Arizona’s overall sales tax rate is higher than that in most states, though in the middle of the western states.

Despite the increases in the overall tax rate, several legislative changes over the past 15 years have lowered collections from the general sales tax. In 1993, the commercial lease tax was eliminated at a cost at the time of \$96 million. New tax exemptions, particularly in the early 1990s, took millions of additional dollars from the revenue stream. In 1996, the prime contracting sales tax was lowered, at a cost of \$30 million.

The general sales tax is a regressive tax: lower-income people pay higher shares of their income in sales tax than do higher-income consumers. Arizona is among the majority of states that applies a general sales tax but excludes food intended for consumption at home from taxation as a means of reducing regressivity. Several of the states that tax food do so at a lower rate than that of other items, or offset the tax by offering a rebate or income tax credit to low-income households. Almost all of the states, including Arizona, that assess the general sales tax exclude prescription drugs.

As in most states, the general sales tax in Arizona is applied largely to goods, not services, and does not reflect the 21st-century economy. Indeed, the general sales tax code was written in the 1930s when goods made up a much greater share of consumer purchases. As consumer spending has shifted from goods to services, growth in general sales tax collections have not been keeping pace with the growth of the economy because of the tax's dependence on goods. Untaxed purchases of goods over the Internet have exacerbated this trend. In Arizona, taxable retail sales as a share of personal income have steadily fallen over the last 25 years. At the cyclical peak, the share was 32 percent in the mid-1980s, 30 percent in the mid-1990s, and 28 percent in the mid-2000s. At the cyclical trough, the share fell from 28 percent in the early 1990s to 27 percent in the early 2000s to only 23 percent in 2008.

Despite its narrow base, Arizona is heavily reliant on the general sales tax. Though the statewide rate is lower than in most states, per capita state government collections in 2007 were 33 percent (\$259) higher than the national average, according to the Census Bureau data. Per capita local government collections were 116 percent (\$236) higher than the national average, demonstrating Arizona's above-average use of the sales tax by local governments. Arizona's general sales tax collections were \$1.6 billion higher based on the statewide tax and \$1.5 billion higher based on local taxes than if the per capita dollar figures had equaled the national averages. Given the cyclical peak in 2007 that was exaggerated by the real estate boom, these figures overstate the averages for an economic cycle.

The heavy dependence on the sales tax in Arizona is verified by the government of the District of Columbia study discussed in Chapter 4. Using 2008 data, the sales tax burden in Phoenix was second highest among the 51 cities at each of the five income levels. It was higher only in Memphis, Tennessee. Further, the regressivity of the tax was verified, with the sales tax amounting to 2 percent of gross income at the \$150,000 income level but 4 percent at the \$25,000 level.

Given these high sales tax burdens and Arizona's collections from income and property taxes being substantially below average, the state is unusually dependent on sales and use taxes. According to the JLBC, 54 percent of the general fund revenue in 2009 came from the sales and use tax. Using the broader Census Bureau accounting, the dominance is not as high, but 25

percent of all state government revenue, and 23 percent of state and local government revenue, came from the general sales tax in 2007.

In addition to high tax rates and a narrow base, sales tax exemptions are a concern in Arizona. Many sales tax exemptions have been passed since 1980. According to the Morrison Institute for Public Policy, the number of exemptions rose from 22 in 1980 to 121 in 1999. The Arizona Transaction Privilege Tax Exemption Study Group that met in 2001 identified 194 exemptions and omissions, recommending that 79 be retained, 113 repealed, and further study done on two. Estimated revenue from the repeal of the 113 exemptions exceeded \$900 million.

The CFRC counted more than 220 exemptions in 2003. It did not do an in-depth study of the exemptions, but noted that “a number of exemptions seem to be ineffective, inexplicable or unique to Arizona’s tax code.”

Using a broad definition of exemptions, the Arizona Department of Revenue estimated that \$9.1 billion in additional revenue could have been raised in 2009 at a 5 percent tax rate if all exemptions were ended. Including preferential tax rates and tax credits, the total reaches \$9.5 billion. Some of the largest dollar effects are from exemptions that likely should not be eliminated, such as health care, business services, professional services, and wholesale trade. Still, the potential revenue enhancement from broadening the sales tax to include some services and by removing other exemptions reaches into the billions of dollars, even at tax rates less than 5 percent.

As currently structured, Arizona’s general sales tax compares poorly against the revenue system guiding principles, as discussed in Chapter 9. Broadening the tax base, reducing the number of exemptions, lowering the tax rate, and simplifying the tax code would move the general sales tax from its current poor evaluation to a strong performance relative to the guiding principles. Several of the CFRC’s recommendations addressed these issues (see Chapter 13).

Selective Sales Taxes

Selective sales taxes are tax levies selectively imposed on particular kinds of commodities or services, or on gross receipts of particular businesses. Nationally, the most common are taxes on motor fuels, alcoholic beverages, tobacco products, insurance premiums, and public utilities. Other common targets include pari-mutuel betting and amusements. Included in the selective sales tax category are accompanying license taxes that may be applied to these selective commodities.

According to the JLBC, the insurance premium tax accounted for 5.9 percent of ongoing general fund revenue in 2009, up from 4.2 percent two years before. Unlike virtually all other revenue sources, collections from the insurance premium tax did not fall in 2009. Luxury tax (liquor and tobacco) receipts did fall, but not as much as from the general sales and income taxes, but luxury taxes contributed less than 1 percent of state government general fund revenues in 2009. Proceeds from the motor fuels tax do not go into the general fund; most of the revenue is placed in the highway user revenue fund.

Using the broader Census Bureau accounting (which classifies the motor fuels tax collections as general revenue), selective sales taxes accounted for 6.4 percent of state government revenue in 2007, but only 1 percent of local government revenue. Combined, the share was 4.7 percent, less than the U.S. average of 6.0 percent. Per capita collections of selective sales taxes were 29 percent less than the national average for state governments and 52 percent less for local governments. The \$112 per person shortfall in state government cumulates to \$702 million across the entire Arizona population. The local government shortfall of \$44 amounts to another \$279 million.

One CFRC recommendation addressed selective sales taxes: “The state should replace unit-based fees and taxes with percentage-based fees and taxes.” Without legislative adjustments, which are infrequent, these per-unit sources do not keep pace with inflation.

Motor Fuels

All states apply an excise tax on sales of motor fuels, with the tax rate typically on a cents-per-gallon basis. In some states, the tax rate varies slightly between sales of gasoline, diesel fuel, and gasohol. In Arizona, the excise tax on each type of motor vehicle fuel is 18 cents per gallon. The total tax is 19 cents; only nine states (one in the West) have a lower rate. However, the per capita collection in 2007 was only 3 percent less than the national average. A number of factors could account for near-average per capita collections despite one of the lowest rates: gasoline sales to tourists and seasonal residents, longer-than-average distances traveled in Arizona, vehicles with lower average miles per gallon, etc.

The motor fuels tax compares favorably to the guiding principles. The only strong downside is that it is regressive. Its responsiveness could be improved by indexing the rate to inflation. The state has not adjusted the tax since 1991. The median of the states is 24 cents, and 16 states (including three of the western states) charge more than 30 cents per gallon.

Tobacco

All states levy a tax on cigarettes, but tobacco-producing states have very low rates, resulting in a very wide range in tax rates across states, from just 7 cents to \$3.46 per 20-cigarette pack. In a few states, counties and cities may impose an additional tax. Arizona’s \$2 cigarette tax is tied for seventh highest with five other states. Per capita collections of the tobacco tax in 2007 were only 8 percent more than the national average. The tax rate is not indexed to inflation. Other tobacco products such as cigars and snuff also are taxed, but the tax rate is calculated by differing means across the states.

The tobacco tax has a mediocre rating relative to the guiding principles, in part due to its regressive nature. In addition, declining sales of tobacco products over time translate into declining government revenue from this source.

Alcoholic Beverages

All states tax alcoholic beverages. In most states, the excise tax is in addition to the general sales tax. Tax rates per gallon differ between beer, wine, and distilled spirits. In addition to the excise taxes, license taxes are included in this subcategory. States may require licenses for manufacturing, importing, wholesaling, and retailing alcoholic beverages.

Among the 33 states that allow sales of distilled spirits outside of state-run liquor stores, Arizona's tax of \$3 per gallon ranks 21st. Of the 47 states that permit sales of wine outside state stores, Arizona's tax of 84 cents per gallon ranks 17th. Arizona's tax rate of 16 cents per gallon on beer ranks tied for 30th.

According to the JLBC, the liquor tax raised \$64 million in 2009, but less than \$29 million went into the general fund. The corrections fund received \$24 million while the remainder was placed into various other funds. The alcoholic beverage license tax added \$6.6 million, with \$5 million going to the general fund and the remainder to various other funds.

Using Census Bureau data, state and local government collections from alcohol taxes in Arizona were 46 percent less than the national average on a per capita basis in 2007. If the per capita amount had equaled the national average, an additional \$54 million would have been generated.

Except for regressivity, this tax compares favorably to the guiding principles. Indexing of the tax rates to inflation would improve responsiveness.

Public Utilities

This category includes taxes imposed on public utilities, including telephone companies, power companies, and public passenger and freight distribution companies. The taxes are based on gross receipts, gross earnings, or units of service sold. Also included in this subcategory are license taxes on the same types of companies. Tax rates are not consistently applied by type of public utility, thus comparative rate information with other states is not available. The public utilities tax compares favorably to the guiding principles.

The JLBC classifies these levies as "in-lieu" taxes. Amounts collected generally are small, and some of the revenue does not enter the general fund. According to Census Bureau data for 2007, Arizona makes little use of this tax. The per capita collection of state and local governments was 64 percent below the national average, with state government 84 percent below average and local governments 42 percent below average. If the combined per capita dollar figure had equaled the national average, Arizona's collections would have been \$361 million higher.

Other Selective Sales Taxes

Other selective sales taxes include the amusements and pari-mutuels subcategories, as well as lesser selective taxes such as on fuels other than motor fuel. Some license taxes also are included in this subcategory. In addition, the Census Bureau includes the insurance premium tax in this category.

According to the JLBC, collections from most of these taxes are minimal. The exception is the insurance premium tax, which is applied to net insurance premiums received by insurance companies for risks that exist in Arizona. It includes life insurance, health insurance, fire insurance, vehicle insurance, and other insurance. The rate in Arizona generally is 2 percent. The JLBC reports revenue of \$441 million in 2008, with \$411 million being placed in the general fund. The remainder was transferred to local governments and to the public safety retirement system.

Based on the Census Bureau data, per capita collections of all other selective sales taxes by state and local governments in Arizona was 51 percent below the national average in 2007, with state government 50 percent below average and local governments 54 percent below average. If the combined per capita dollar figure had equaled the national average, Arizona's collections would have been \$569 million higher, with \$451 million of this realized by state government.

Property Tax

The property tax is a tax on the market value of privately owned property. Real property includes land, buildings, and other improvements to the land, such as mobile/manufactured homes that are permanently affixed to land that is owned by the owner of the mobile home. Most states apply the property tax on a selected basis on privately owned personal property within the jurisdiction. The most common property tax on personal property incorporates motor vehicle registration and license fees that are based on the value of the vehicle. Personal property used for commercial purposes, such as equipment and machinery, also is taxed.

The overall property tax rate usually consists of multiple tax rates of several overlapping jurisdictions, such as county, municipality, school district, and special district. The result is a complex system that makes it difficult to compare the property tax from one place to another.

Property taxes across the nation largely are levied by local governments. Arizona levied a statewide tax through 1996. Property tax revenue to the general fund fell \$150 million in the following year when the tax was repealed.

Using the Census Bureau's accounting system, a greater amount of property tax is shown as general revenue to state government, in part due to the inclusion of the vehicle license tax as a property tax. Still, the property tax accounted for less than 4 percent of total state government revenue in 2007. The per capita state government figure was higher than the national average.

In contrast, though property taxes accounted for 21 percent of local government revenue, this share was less than the national average of nearly 28 percent. Local government per capita property taxes in Arizona were 32 percent less than the national average in 2007. Per capita property tax collections of state and local governments combined were 22 percent (\$295) less than the U.S. average in Arizona. Arizona's property tax collections were \$1.8 billion lower than if the per capita dollar figure had equaled the national average.

These overall property tax comparisons do not reveal the large differences in tax burden between residential and business properties. Business property taxes are quite high relative to residential property taxes, as discussed in Chapter 4. Several legislative measures, currently being phased in, are reducing the property taxes on businesses. Still, once the changes are phased in, the assessment ratio on most commercial and industrial owners in the state will be 20 percent—twice as high as the residential property tax ratio. (The assessed value of a property is multiplied by the assessment ratio. The resulting net assessed valuation is multiplied by the tax rate to determine the tax liability.)

Residential property owners in Arizona enjoy very low residential property tax burdens. At each income level other than the lowest one, the property tax in Phoenix was less than half that of the

average city in the District of Columbia tax study in 2008; Phoenix ranked 46th or 47th among the 51 cities. Even for those families earning \$50,000, the property tax in Phoenix was \$1,000 lower than the median, and \$1,100 lower than the average, of the 51 cities.

The Tax Foundation has released a ranking by county of residential property taxes in 2008. Among the 790 counties in the nation with a population of at least 65,000, all 10 Arizona counties included in the listing were ranked below the median on all three measures presented: median property tax assessed in dollars, median tax as a percentage of median home value, and median tax as a percentage of median homeowners' income. Maricopa County's ranks were 480th, 664th, and 546th respectively.

Relative to the revenue system guiding principles, Arizona's property tax system currently has a mediocre rating. Efficiency and competitiveness are negatively affected by the high property taxes on businesses, neutrality is compromised by different assessment ratios by category of property, and the system is highly complex, due to multiple rates and assessments and large variations by jurisdiction.

Usually, the stability and predictability of property tax collections are strong positive features, but distorted real estate cycles in the 1980s and again in recent years took away these advantages. Apart from these distortions, the responsiveness of the tax is good as property values typically rise with real economic growth.

Several of the CFRC recommendations were related to the property tax. The commission suggested re-enacting the option of a state property tax, applied on a uniform assessment ratio (the assessment ratio for residential, commercial, and other property categories would be the same); eliminating the 1-percent constitutional cap on residential property tax; phasing out the homeowner's rebate; reducing overall business property tax burdens, particularly the business personal property tax on locally assessed business personal property; and applying a uniform assessment ratio on all future voter-approved property tax-funded bonds and overrides. In addition, the CFRC recommended using property taxes to fund school construction.

Individual Income Tax

The complexities of the income tax code make it difficult to compare tax rates from one state to another. Most states have a progressive structure where the personal tax rate increases with income. But the number of tax brackets and the dollar range of the brackets vary widely by state. Other features differ by state as well, including the amount of personal exemptions (if any) and deductibility of various items, such as health care expenses and federal income tax paid. A look at individual income tax brackets across the states reveals that at 4.54 percent, Arizona's top bracket rate is low in comparison with most states and the threshold level to which it applies (\$150,000 for single filers) is very high in comparison with other states. A few states—but not Arizona—allow a local income tax to be levied in addition to a state rate.

All studies that have compared the individual income tax liability in Arizona relative to other states show that the tax burden in Arizona is quite low. According to the District of Columbia study using 2008 tax rates, nine states do not levy an income tax on wages. Among the remaining states and District of Columbia, Phoenix ranked second-to-fourth lowest at the four

highest income levels. In contrast, at the lowest income level, Phoenix was at the median of the 51 cities (though the tax burden was only \$116).

According to Census Bureau data for 2007, the per capita individual income tax collection of state and local governments in Arizona was 38 percent (\$367) below the national average. If the combined per capita dollar figure had equaled the national average, Arizona's collections would have been \$2.3 billion higher. The individual income tax provided only 14 percent of state government general revenue in 2007; the share was only 9 percent for state and local governments combined.

Using the JLBC's definition of the general fund, individual income tax revenue peaked at \$3.7 billion in 2007, was down to less than \$2.6 billion in 2009 and is projected in 2010 to be around \$2.4 billion. It accounted for 37 percent of total revenue in 2009. However, this overstates the impact, since a portion of income tax collections are shared with cities and towns ("urban revenue sharing"). The net revenue from the individual and corporate income tax combined less revenue sharing reached \$4.2 billion (43.5 percent of general fund revenue) in 2007 but is projected to be only \$2.2 billion in 2010 (34 percent of general fund revenue).

Always a volatile source of revenue, income tax revenue in recent years has varied even more widely due to the volatility of capital gains. Net capital gains reported by Arizonans to the Internal Revenue Service peaked at \$8.4 billion in 2000, fell to \$3.6 billion in 2002, then soared to \$15.2 billion in 2006. The latest data for 2007 show only a small decline, but the decrease certainly was much larger in 2008 and 2009. As a percentage of personal income, capital gains went from nearly 7 percent in 1999 to 2.5 percent in 2002 to 8 percent in 2005. With the real estate bust and the weakness in the stock market, current shares certainly are much lower.

Individual income tax rates in Arizona have been reduced several times since the early 1990s, resulting in a very large cumulative decline—even considering earlier income tax increases passed in 1989 and 1990. Rates currently are about 35 percent lower than in 1990. The first large tax cut was passed in 1994; the JLBC estimated its impact at the time as an estimated \$107 million. Subsequent large reductions occurred in 1995 (\$200 million), 1997 (\$111 million), 1998 (\$50 million), and 2006 (\$334 million). Other changes to the individual income tax code since the early 1990s, including the implementation of numerous tax credits, lowered revenue further.

The individual income tax currently compares more favorably against the guiding principles than the general sales and property taxes, but less opportunity exists for improvement. Reducing the number of tax credits would improve the neutrality of the individual income tax. Tax brackets could be indexed for inflation.

Corporate Income Tax

Many states apply a flat tax rate to corporate income. In most states that apply the corporate income tax progressively by using multiple tax rates and brackets, the top tax rate is applied at a relatively low income level. This makes comparing Arizona's 6.968 percent rate more straightforward than comparing personal income tax rates across the states. Compared to the top tax rate by state, Arizona's corporate rate is at the median of all states. However, among the nine

western states, only California and New Mexico have a higher top tax rate, and New Mexico's higher rate does not apply until taxable income tops \$1 million.

A multistate corporation's income is divided among the states it operates in based on a formula related to the percentage of employees, real property, and sales that occur within the state. Each state, however, may calculate the formula differently. In recent years, a number of states, including Arizona, have changed their employee, real property, and sales tax formula to more heavily weight the sales factor. Thus, the percentage of total corporate income that is taxed by a state relies more and more on that percentage of sales that occurs within the state. This benefits companies that export their goods out of the state.

According to the JLBC, the corporate income tax accounted for 8.5 percent of general fund revenue in 2009, but this is before the deduction for urban revenue sharing is considered. Collections from the corporate income tax are highly volatile from year to year. According to the Census Bureau, the corporate income tax was responsible for 3.8 percent of state government tax revenue in Arizona in 2007, slightly above the national average. The corporate income tax accounted for only 2.4 percent of all state and local government revenue in Arizona in fiscal year 2007, a slightly lower share than the national average.

Based on the Ernst & Young study, the corporate income tax burden in Arizona is below average when compared to all states, but ranks fourth among the nine western states. The corporate income tax generally does not compare favorably to the guiding principles, receiving the second worst overall evaluation among the larger tax sources. In addition to its cyclicity, the tax has many credits and the tax code is complex. The tax code is outdated in that it was written largely with manufacturers in mind and does not handle the growing interstate and international activity well.

Income Tax Credits

A number of tax credits are present in the corporate income tax code and in the individual income tax code. Tax credits are subtracted directly from tax liability on a dollar-for-dollar basis. Some of the tax credits implemented by the Legislature are available only for a few years, so the number available is constantly fluctuating. The impact of these tax credits is difficult to assess, with estimates taking a long time to be released. For some credits, no estimates are released either due to a lack of information or because too few claimed the credit to disclose the total.

Until 1981, no corporate income tax credits existed. The Arizona Department of Revenue included 18 in their latest tax expenditure report, with the general fund not realizing at least \$118 million in claimed corporate tax credits in tax year 2006. The DOR included 27 individual tax credits in their latest report. In tax year 2007, the individual credits removed at least \$256 million from the general fund.

Of these totals, \$98 million was claimed by individuals for the public school extracurricular activity credit and the private school tuition organization credit. Corporations claimed an additional \$10 million for the latter. The private school tuition tax credit has recently been criticized by the *Arizona Republic* and the *East Valley Tribune* as not achieving its stated goals. A legal challenge to the constitutionality of this credit also is pending.

The CFRC noted that “it appears most of the corporate tax credits are ineffective at promoting the anticipated behavior or outcome and some, like the alternative fuels credit, had unexpected, adverse outcomes.” The CFRC recommended that all but five of the 14 corporate tax credits, and all but six of 24 individual income tax credits, that were available in 2003 be phased out. More generally, the CFRC recommended that the state should have as few corporate and personal income tax credits as possible, should review the effectiveness of private school tuition tax credits and the extracurricular public school tax credit, and should retain certain low-income tax credits.

Vehicle License Tax

The motor vehicle license tax is an annual tax separate from the one-time sales tax levied when a vehicle is purchased. States use a multitude of methods to determine the tax. In Arizona, a value-based vehicle license tax is assessed in lieu of a property tax. Relative to the guiding principles, the vehicle license tax compares quite favorably except in terms of its exportability, since it applies only to residents.

The Legislature reduced the state portion of the vehicle license tax in 1998 and ended the deposit to the general fund in the following year. According to the JLBC, state government revenue from this tax fell from more than \$160 million in 1998 to zero in 2002.

According to Census Bureau accounting, the portion of the vehicle license tax that is based on value is classified as a property tax. The Census Bureau’s vehicle license tax category is limited to fees for licenses, title registration, license plates, vehicle inspection, and the like. Using this definition, per capita collections of state and local governments in Arizona were 45 percent below average in 2007. Approximately \$198 million more would have been collected if per capita collections had equaled the national average.

The District of Columbia tax burden study includes the vehicle license tax as one of several taxes (e.g. the gas tax) making up its automotive category; data for the individual components are not available. Overall, automotive-related taxes in Phoenix in 2008 were below average at the lowest income level, near the national median at the \$50,000 and \$75,000 income levels, but above the norm at the two highest incomes.

Other Taxes

Various other taxes are used in Arizona, including license taxes not included in other categories, severance taxes, and death and gift taxes. Additional taxes are applied in some states but not in Arizona, most notably the real estate transfer tax.

State government in particular uses few of these other taxes. According to the Census Bureau, its per capita collections in the miscellaneous tax category were 78 percent less than the national average in 2007. Local government collections were just 1 percent less than average. Nearly \$900 million more would have been collected if per capita collections of other taxes had equaled the national average.

CHAPTER 15

RECOMMENDED CHANGES TO THE FISCAL SYSTEM

The recommendations presented in this chapter follow from the analyses presented throughout this report and are consistent with the recommendations of the Citizens Finance Review Commission (CFRC), as presented in Chapter 13. Two concerns are particularly reflected in these recommendations.

First, the recommended revenue system directly supports an economic development agenda. Accordingly, the revised tax structure is designed to shift some of the tax burden away from the business sector, where job creation takes place, to individuals who receive most of the direct benefits of public-sector spending. In the revised structure, businesses continue to contribute a significant share of the revenues, but their share declines. Individuals are asked to contribute more, with the ability to pay a strong consideration in determining the nature of the revenue system as it applies to individuals. In particular, this proposal shifts property tax burdens away from businesses to residential property owners, lowers other taxes paid by businesses, and designates an incentive fund to be used for economic development. In addition to meeting economic development goals, this shifting of the tax burden toward individuals is intended to improve parity, which was distorted by so many of the tax cuts implemented since the early 1990s being directed toward individuals.

Second, the proposed revenue system is more reliant on sources of revenue that are less volatile. The extreme cyclicity of revenues during the last 15 years has in part been due to unusual economic cyclicity, but the alterations to the state's revenue base over that period also increased the volatility of the revenues. Specifically, this proposal broadens the sales tax base to less cyclical sources, lowers the reliance on the sales tax by lowering the tax rate, lessens the reliance on the income tax, increases the use of property taxes (which are more stable than the sales and income taxes), raises more revenue from relatively stable selective sales taxes, and increases the reliance on user fees and other nontax sources of revenue. The cyclicity of revenue cannot be avoided but the proposed revenue system will be less volatile than the existing system. The remaining cyclicity requires that a strong budget stabilization fund be in place, a key recommendation for strengthening the fiscal system.

Nearly all of the revenue recommendations apply specifically to the state government general fund, which has such a large persistent deficit. The exception is that the changes to the general sales tax also will apply to the distribution base: a portion of state sales tax revenues are shared with counties and municipalities, with just under 80 percent of the total deposited to the general fund. Some of the recommendations could be generalized to apply to other state government funds and to local governments.

The adoption of a new revenue system is recommended regardless of the amount of revenue to be collected, that is, whether or not revenue increases are desired to combat the persistent deficit. Three versions of the recommended revenue system are presented:

- Scenario 1: revenue neutral
- Scenario 2: raise \$1.2 billion
- Scenario 3: raise \$2.4 billion

The latter amount was selected so that the persistent deficit in the state government general fund would be completely eliminated while restoring appropriations to a level based on the initial budget for 2008. Raising \$1.2 billion represents an alternative where the persistent deficit is eliminated half by revenue increases and half by permanent spending reductions. The revenue-neutral option assumes that the spending reductions passed during the last two years become permanent and that additional permanent reductions may be necessary if the November 2010 ballot measures fail or when the temporarily higher sales tax rate ends in 2013.

Illustrations of the impact of these revenue system changes are undertaken with respect to estimates of fiscal year 2010 revenue flows. The fiscal year 2010 data are based on estimates of general fund revenue taken from information available on the OSPB and JLBC websites, from estimates of state and local government revenues based on data collected by ATRA, and from estimates of the revenue consistent with the accounting system used by the Census Bureau.

REVENUE RECOMMENDATIONS

To ensure that the revenue system is optimized relative to all of the guiding principles, changes to the revenue system should be made on a comprehensive basis rather than in a piecemeal fashion. Thus, the recommendations do NOT constitute a list from which certain changes can be selected and others rejected. The recommendations do not represent the only possible set of improvements to the existing revenue system, but any alternative sets of recommendations must consider the system as a whole and all of the guiding principles.

Based on the concept that the structure of the revenue system should be similar regardless of the amount of revenue to be collected, most of the recommended changes are present in each of the three scenarios, with tax rates varying by scenario to achieve the desired total revenue. The estimated revenue effects of the recommendations are summarized by scenario in Table 15.1. In Table 15.2, the shares of revenue that each revenue source would contribute to the general fund are compared to the estimated shares during the current fiscal year.

Property Tax

The CFRC made several recommendations regarding the property tax—reduce overall business property tax burdens, reduce the business personal property tax, re-enact the option of a state property tax, move toward uniform assessment ratios, phase out the homeowner’s rebate, and eliminate the 1 percent cap on the residential property tax—that are in line with the following proposals. The rationale for increasing revenue from the property tax and for the other property tax recommendations includes the current underutilization of the tax relative to other states and to Arizona’s past, broadening the tax base of the general fund away from sales and income taxes, creating revenues that are more stable over the course of an economic cycle, and shifting the tax burden between homeowners and businesses to more equitably reflect the use of public resources and to enhance economic development. The property tax provides a relatively stable source of revenue that better matches the stable spending needs of the general fund than the other major revenue sources.

The net effect of all of the recommended changes to the property tax is to raise property tax revenue in each of the scenarios, ranging from \$365 million in Scenario 1 to \$965 million in

**TABLE 15.1
REVENUE IMPACT TO STATE GOVERNMENT GENERAL FUND OF
RECOMMENDED CHANGES TO THE REVENUE SYSTEM, FISCAL YEAR 2010**

(Dollars in Millions)	Scenario 1: No Net Change	Scenario 2: +\$1,200 Million	Scenario 3: +\$2,400 Million
PROPERTY TAX	\$365	\$615	\$965
Eliminate Homeowners Rebate	365	365	365
End Business Personal Property Tax	-250	-250	-250
Add Statewide Property Tax	250	250	600
Raise Vehicle License Tax		250	250
GENERAL SALES TAX	-670	-85	500
Reduce Rate	-1,752	-1,313	-876
Tax Food to be Consumed at Home	316	368	421
Tax Selected Services	866	1,010	1,155
Tax Credit	-100	-150	-200
SELECTIVE SALES TAX	320	370	370
Raise Tax on Alcoholic Beverages	20	20	20
Add Tax on Exported Utilities	225	225	225
Increase Motor Vehicle Fuel Tax	75	125	125
INDIVIDUAL INCOME TAX	-140	100	340
Change Rate	-240		240
Eliminate School Tax Credits	100	100	100
CORPORATE INCOME TAX	-225	-200	-175
Reduce Rate	-175	-150	-125
Create Incentive Fund	-50	-50	-50
LICENSES AND FEES	350	400	400
Hospital Provider	250	250	250
Other	100	150	150

**TABLE 15.2
SHARES OF REVENUE UNDER VARIOUS SCENARIOS, ARIZONA STATE
GOVERNMENT GENERAL FUND, FISCAL YEAR 2010**

	Actual*	Scenario			Change in Share From Actual*		
		1	2	3	1	2	3
TOTAL TAX	96.2%	91.0%	91.6%	92.6%	-5.2	-4.6	-3.6
Sales	54.5	45.2	44.9	44.6	-9.3	-9.6	-9.9
Total Income	34.3	28.0	27.5	27.1	-6.3	-6.8	-7.2
Individual	37.4	34.5	32.7	31.4	-2.9	-4.7	-6.0
Corporate	6.7	3.1	3.0	2.9	-3.6	-3.7	-3.8
Urban Revenue Sharing	-9.8	-9.6	-8.3	-7.2	0.2	1.5	2.6
Property	0.3	5.9	8.3	11.3	5.6	8.0	11.0
Luxury	0.9	1.2	1.0	0.9	0.3	0.1	0.0
Insurance Premium	6.2	6.1	5.2	4.6	-0.1	-1.0	-1.6
Other Taxes	0.0	4.6	4.6	4.1	4.6	4.6	4.1
TOTAL NONTAX	3.8	9.0	8.4	7.4	5.2	4.6	3.6
Licenses and Fees	2.1	7.5	7.1	6.2	5.4	4.9	4.1
Other	1.7	1.6	1.4	1.2	-0.1	-0.3	-0.5

* Projection for 2010

Source (Tables 15.1 and 15.2): Calculated by authors, based on data from the Arizona Joint Legislative Budget Committee.

Scenario 3. The share of total general fund revenue provided by the property tax would be considerably higher than under the status quo in each scenario, but highest in Scenario 3. Three recommendations will result in increased revenue and one reduces revenue.

Residential property owners receive numerous breaks on their property taxes relative to commercial and industrial property owners. First, the assessment ratio is 10 percent for residential properties, but even after being recently reduced, it will be 20 percent for commercial and industrial properties in 2011. Second, the total amount of property taxes collected on residential properties for primary purposes cannot exceed 1 percent of the parcel's limited property value. Third, residential owners receive a "homeowner's property tax rebate." The rationale for this rebate originally was to assist low-income homeowners, but the rebate was applied to all residential properties. Effective in tax year 2010, the rebate is 40 percent of the primary school district tax levy, up to a maximum of \$600. Effectively, this is a subsidy of residential property owners.

According to the District of Columbia tax burden study, the residential property tax in Arizona is among the lowest in the country. As a result of these residential tax breaks, the residential property tax burden in most of Arizona is less than half the national average. For example, in Phoenix, the typical property tax on a moderately priced home is more than \$1,000 per year lower than the national norm. Thus, the tax could be increased considerably, as recommended, without becoming out of line.

Eliminate the Homeowner's Rebate and 1 Percent Cap

The homeowner's rebate is estimated to remove about \$425 million from the general fund. It is proposed that it be eliminated in all scenarios. The constitutional 1 percent cap on residential real estate taxes for primary purposes also should be eliminated in all scenarios. While an estimate does not exist of the amount of revenue that would be realized from eliminating the cap, it is expected to be small. In order to protect low-income homeowners from tax increases resulting from these actions, the first \$xx,000 of the assessed value of improved property (with the precise amount to be determined) could be exempted from the tax. With such a tax credit for low-income homeowners in place, the net revenue gain is estimated to be \$365 million. This recommendation is the same in all three scenarios.

The District of Columbia study shows that the property tax as applied in Arizona is regressive, with high-income homeowners paying a lesser share of their income than lower-income homeowners. Exempting the first \$xx,000 would eliminate this regressivity.

Add a Statewide Property Tax

A statewide property tax was in effect until 1997. It is recommended that this tax be resumed in all scenarios with a uniform assessment ratio applied to residences and businesses; the 10 percent assessment ratio currently applied to residences is suggested. The cost of restoring this tax is minimal since properties subject to a statewide property tax already are taxed by local governments. Despite the advantages of raising revenue from the property tax, the additional revenue to be gained has been limited since statewide property taxes are not widely used in other states as a revenue source for state government.

The statewide tax rate would be applied to the limited property value, not the full cash value. The proposal to raise \$250 million in the first and second scenarios would equate to a modest rate compared to that levied by school districts, community colleges, and counties. The rate would be less than it was in the mid-1990s before the state property tax was eliminated.

The statewide property tax would be about the same as the state equalization rate reinstated in fall 2009. The homeowner's rebate or "additional state aid to education" will then be paid to the schools by taxpayers directly through property tax collections. This would start to narrow the wide gap in the tax burden between residential and commercial/industrial properties.

The amount to be raised would be greater in Scenario 3 at \$600 million. Still, this is not substantially higher than collections were in 1996, after adjusting for inflation and the growth of the state.

It is recommended that the revenue from the statewide property tax be dedicated to funding school construction and maintenance. In scenario 3, funding for the School Facilities Board would be removed entirely from the general fund. The inclusion of capital spending in the general fund is generally considered to be inappropriate and the construction and maintenance of schools should have a dedicated revenue stream. The CFRC recommended generally that capital financing tools be used for long-term capital assets with debt service tied to specific revenue streams and specifically that the general fund not be used to finance school construction, with a new process adopted that utilizes local school district, county, or state property taxes.

Eliminate the Personal Property Tax on Business Equipment

In each scenario, the elimination of the personal property tax applied to business equipment is recommended. The business personal property tax is the prime candidate to achieve the Laffer Curve effect of an increase in revenue despite a decrease in taxes. The business property tax is a narrow tax that has been demonstrably high relative to other places. It is a tax that disproportionately affects some businesses, particularly manufacturers who use considerable equipment in their operation. High-tech manufacturers, such as semiconductor plants, are among those with considerable equipment. These companies pay high wages. Lower business property taxes might encourage companies to expand facilities in Arizona. Although most of the labor force needed for an expansion would be imported, the high wages of these new workers could result in a net positive effect even on public-sector finance.

Raise the Motor Vehicle License Tax Rate

The vehicle license tax is not considered to be a property tax in the state's accounting system, but since it depends on the value of the vehicle, the Census Bureau includes it as a property tax. A portion of the vehicle license tax was deposited to the state government general fund before 1999. The recommendation is to increase the motor vehicle license tax by 25 percent, with the estimated \$250 million increase in revenue be designated to go to the general fund. This recommendation applies to scenarios 2 and 3.

General Sales Tax

The analysis of the sales tax recommendations is made relative to the permanent state sales tax rate of 5 percent (the 0.6 percent dedicated to education that is not deposited into the general

fund is not included), not to the temporarily higher tax rate that is in place from June 2010 through May 2013. Five changes to the general sales tax are recommended in each scenario, with the tax rate varying by scenario. The net effect is to lower sales tax revenue by \$670 million in Scenario 1, to leave sales tax revenue nearly unchanged (a decline of \$85 million) in Scenario 2, and to raise revenue in Scenario 3 by \$500 million. However, in all three scenarios, the share of total state general fund revenue provided by the sales tax will fall significantly from the existing level of nearly 55 percent to roughly 45 percent.

The CFRC made several recommendations regarding the sales tax—expand the tax base to better mirror the state’s economy, broaden the tax base to include consumer services, broaden the tax base by including certain transactions that currently are exempt, lower the tax rate in conjunction with eliminating certain exemptions and broadening the tax base, establish policy guidelines to test the soundness of future proposed tax exemptions, and include a sunset provision to each exemption—that are in line with the proposals of this paper.

The state is highly dependent on the general sales tax for revenue despite its narrow base. Broadening its base will result in a more stable revenue stream. As currently structured, the tax compares unfavorably to the fiscal guiding principles, with its regressivity one of the issues. Businesses pay an above-average amount in sales taxes in Arizona. Lowering the tax rate while extending the base in ways that largely will not affect businesses will effectively lower the business sales tax burden and thus improve economic competitiveness.

Reduce the General Sales Tax Rate

All three scenarios include a recommendation to lower the sales tax rate. The recommended rate varies by scenario, with the current statewide rate of 5 percent—not including the 0.6 percent dedicated to education—lowered to 3 percent in the revenue-neutral scenario, to 3.5 percent in the scenario to raise \$1.2 billion, and to 4 percent in the option to raise \$2.4 billion. The reduction in revenue is significant, ranging from \$876 million in Scenario 3 to \$1,752 million in Scenario 1.

Broaden the Tax Base to Include Food to be Consumed at Home

The state taxed food to be consumed at home until 1981. Many municipalities still tax these food items today. The primary rationale for bringing back this tax is to broaden the sales tax base in order to reduce cyclicity and to enhance the ability of the sales tax to grow at the rate of the economy. Revenue received from a sales tax on food to be consumed at home is more stable than the substantial cyclicity present through most of the rest of the sales tax base. Concerns about regressivity are addressed through a low-income tax credit discussed below. The rate would be set consistently with the rate applied to existing taxable goods—that is, it varies by scenario, causing a revenue gain ranging from \$316 million in Scenario 1 to \$421 million in Scenario 3.

Broaden the Tax Base to Include Certain Services

Further broadening of the sales tax base is recommended to include consumer services, commercial leases, and labor in construction. Consumer services include personal services (hair care, health clubs, etc.), auto repair services, photography, private professional education services, waste services, building security and maintenance services, veterinary services, and private auto sales. This broadening will result in less cyclical variation in tax collections and

growth in revenues that better keep pace with economic growth. These services would be taxed at the same rate as goods, with the rate varying by scenario. The increase in revenue would be significant, ranging from \$866 million (at a tax rate of 3 percent) in Scenario 1 to \$1,155 million (at a tax rate of 4 percent) in Scenario 3.

Expand the Existing Low-Income Tax Credit for Increased Excise Taxes

Since the sales tax is regressive—low-income families spend higher proportions of their income on items subject to the sales tax than do higher-income individuals—and because low-income households cannot absorb a tax increase as easily as those with higher incomes, a low-income tax credit should be applied to offset the broadening of the sales tax base. The CFRC generally recommended that certain low-income tax credits be retained. Individuals using food stamps can be exempted from the sales tax on food at the point of purchase.

The existing low-income tax credit for increased excise taxes was intended to mitigate the increase in sales taxes paid when voters approved a 0.6 percentage-point increase in the general sales tax rate in 2000. (The proceeds of that tax directly benefit education and are not part of the general fund.) The current credit is available to individuals earning no more than \$12,500 and to those filing as head of household or married filing jointly earning no more than \$25,000. The credit is \$25 per person, up to a maximum \$100 for a household. This is a refundable credit, not based on income tax liability.

The existing credit could simply be revised to increase the \$25 per person credit limit to reflect the proposed expansion of the tax base to include food to be consumed at home. However, an alternative way of structuring the tax credit is recommended.

Rather than the arbitrary maximum income figures of \$12,500 and \$25,000, the maximum allowable income should be tied to the federal poverty level, which varies with household size and is adjusted annually to reflect inflation. In 2009, for example, the poverty level was \$10,830 for a single person and \$22,050 for a family of four. Any tax filer earning less than 150 percent of the poverty level would receive the full tax credit, with the size of the credit gradually decreasing with income, up to a maximum of 200 percent of the federal poverty level. The current household limit, which effectively confines the existing credit to four people per household, could be removed.

The expansion of the low-income credit is recommended in all three scenarios even though the recommended reduction in the sales tax rate will more than offset the increase in taxes paid by broadening the sales tax base in the revenue neutral scenario and will largely match the effect of the broadening in Scenario 2. However, the size of the tax credit should vary by scenario, with the recommendation that the size of the credit should be \$100 million in Scenario 1 rising to \$200 million in Scenario 3.

Reduce the Number of Sales Tax Exemptions

The numerous sales tax exemptions need to be evaluated. Many of these exemptions are believed to serve little useful purpose and to violate the fiscal guiding principles, particularly those of neutrality and horizontal equity. The amount of revenue to be gained from eliminating some of the exemptions is unknown and has not been included in the estimates shown in Table 15.1.

Selective Sales Taxes

Three specific recommendations are made related to selective sales taxes; two increase the tax rate of an existing tax and the third creates a new tax. All three are included in each scenario, with a combined revenue gain of \$320 million in Scenario 1 and \$370 million in the other scenarios. Using the JLBC accounting, state general fund revenue from “other” taxes would rise from nearly zero to between 4-and-5 percent of total revenue in each scenario.

In addition, it is recommended that all of the taxes that are set at a fixed dollar rate be converted to a percentage rate so that tax collections rise at the pace of inflation. The CFRC recommended that unit-based fees and taxes be replaced with percentage-based fees and taxes.

The use of selective sales taxes effectively broadens the tax base and reduces cyclicity. Collections from most of these taxes are less volatile than from the general sales and income taxes.

Increase the Tax on Alcoholic Beverages

A 25 percent increase in the luxury tax on alcoholic beverages is recommended, raising about \$20 million in each scenario. The modification in the luxury tax should include changing the tax from a fixed dollar figure per unit to a percentage of the price. Tax collections from alcoholic beverages currently are far below the national average.

Create a Utility Excise Tax

This tax would be applied on power plants for all nonrenewable energy production. Much of the cost would be exported to consumers in other states. A rate of one-tenth of one percent per kilowatt hour would raise around \$225 million in each of the scenarios. Tax collections from public utilities currently are far below the national average.

Increase the Motor Vehicle Fuel Tax

Arizona’s tax rate is well below the national average. An increase of five cents—to the national median—would raise about \$125 million in Scenarios 2 and 3. A lesser increase is recommended in Scenario 1. Instead of a fixed rate per gallon, this tax should be shifted to a percentage of the price.

Income Tax

Four primary changes are proposed to the income tax in each scenario, two each to the individual tax and the corporate tax. The net effect of these changes is to reduce income tax revenue in Scenarios 1 (by \$365 million) and 2 (by \$100 million), and to raise revenue in Scenario 3 by \$165 million. In each scenario, the share of total state general fund revenue provided by the income tax falls from 34 percent to between 27-and-28 percent.

Revenue from the corporate income tax decreases in each scenario in order to improve economic competitiveness. The individual and corporate income taxes are volatile, so the decrease in share of total revenue will reduce the overall revenue cyclicity.

Individual Income Tax

In each scenario, the public and private school tax credits are proposed to be eliminated, raising revenue by about \$100 million. Other credits should be reviewed. The CFRC recommended that corporate and personal income tax credits be used as little as possible. It particularly suggested a review of the effectiveness of the private-school tuition and extracurricular public-school tax credits. Recent studies reported by local newspapers have indicated that they have not been effective.

In Scenario 1, a 10 percent decrease in individual income tax rates is recommended, lowering the maximum rate to about 4 percent. The decrease in the rate in this scenario is solely to reduce the volatility of general fund revenue; a reduction in the individual income tax rate is expected to have little, if any, effect on economic competitiveness. Always cyclical, individual income tax revenues have become more volatile in recent years due to extreme variations in realized capital gains.

In Scenario 2, no change in tax rates is suggested, keeping the maximum rate near 4.5 percent. An increase in tax rates of 10 percent is included in Scenario 3, reversing the tax cut that was implemented in 2007 and 2008. The maximum rate would be about 5 percent. Revenue would be reduced in Scenario 1 by \$240 million and increased in Scenario 3 by the same amount.

Corporate Income Tax

The corporate income tax rate is lowered in each scenario to be equal to the maximum individual income tax rate. The reduction in revenue would range between \$125 million in Scenario 3 and \$175 million in Scenario 1. In addition, a portion of the corporate income tax collections are recommended to be set aside for use in targeted incentives, workforce training programs for export-based businesses, or other relocation enticements. The use of these funds, suggested at \$50 million per year, should be restricted to base industries that pay high wages. All incentives should include “claw-back” provisions that require a business to pay back an incentive if the business does not deliver on the stated provisions, such as creating a certain number of jobs in Arizona.

Other Revenue-Raising Suggestions

Revenue from other sources is raised in each scenario, by \$350 million in Scenario 1 and \$400 million in the other scenarios. The share of total revenue from such sources would be well above the existing level in each scenario.

The state is overly dependent on taxes to provide revenue; in general tax revenues are more cyclical than fees and other revenues. In addition, the greater use of such fees provides a closer link between those who pay for and receive public services.

In each of the scenarios, the implementation of a health care provider fee that could raise \$250 million is recommended. According to the National Conference of State Legislatures (NCSL), a provider fee is a state law that authorizes collecting revenue from specified categories of health care providers. In most states it is used as a mechanism to generate new in-state funds and match them with federal funds so that the state gets additional federal Medicaid dollars (the AHCCCS program in Arizona). In a majority of cases, the cost of the tax is promised back to providers

through an increase in the Medicaid reimbursement rate. Beyond Medicaid, states have the policy option to tax most types of providers and services, including health care, and to designate or earmark the revenue for any state purpose.

Under federal law and regulations, a state's ability to use provider-specific taxes to fund their state share of Medicaid expenditures is limited. Those taxes cannot generally exceed 25 percent of the state (or nonfederal) share of Medicaid expenditures, and the state cannot provide a guarantee to the providers that the taxes will be returned to them. Despite these federal limitations, many states are now using or considering the use of provider taxes, sometimes to supplement static or declining provider reimbursement rates. In part this is because of a federal "safe harbor"—if the taxes returned to a provider are less than 6 percent of the provider's revenues, the prohibition on guaranteeing the return of tax funds is not violated. As a result, a state can currently impose a provider tax of 5.5 percent of revenues, return those revenues directly back to those providers in the form of a Medicaid payment, and receive a federal match for those amounts.

Each scenario also includes additional revenue from various sources: \$100 million in Scenario 1 and \$150 million in the other scenarios. These amounts would be raised through a combination of various actions.

First, funding to the Arizona Department of Revenue should be expanded in order to collect a higher proportion of the taxes due. Even with the restoration of some funding in the budget for 2011, spending reductions have disproportionately affected the DOR. In order to implement these reductions, the number of tax auditors and collectors has been significantly reduced. Even before these recent declines, the number of auditors and collectors had fallen since the mid-1990s—despite a large increase in the number of Arizona tax filers during this period. A substantial increase in the number of auditors and collectors could occur before the cost of adding these positions would outweigh the additional revenue collected. The CFRC recommended decreasing revenue loss by increasing spending on revenue enforcement until cost-benefit equilibrium is reached, and to implement a system that makes tax avoidance more difficult. Estimates of the amount of revenue that could be realized from this recommendation vary but could total around \$50 million.

Second, instituting a home arrest program for nonviolent offenders—really a cost savings—could reduce Department of Corrections costs by \$22 million. Third, the CFRC recommendation to hire a consultant to examine the fairness and extent of fees should be adopted. Though the amount of revenue to be gained is unclear, it is assumed that this review will reveal those fees that are too low to cover costs and that are low relative to national averages. Fourth, the CFRC recommendation that information on federal funds be centralized in an effort to increase the federal grant dollars received should be adopted. No estimate of the additional revenue is available. Fifth, the CFRC made several recommendations to improve fiscal practices that might result in savings:

- Assign the specific responsibility for long-term planning to a particular agency or committee;
- In addition to the current practice of cost accounting, utilize accrual accounting on a selective basis to provide long-term planning data;

- Maximize the time-value of money by increasing interest earnings through the use of frequent deposits, longer-term, higher-interest accounts, and other fiscal measures.

REVENUE EFFECTS FROM IMPLEMENTING THE RECOMMENDATIONS

State Government General Fund

The amount of state general fund revenue per \$1,000 of personal income that would have been collected under Scenario 1, the revenue neutral scenario, is compared to actual collections and to what collections would have been had no tax law changes been implemented during the 1990s and 2000s in the top graph of Chart 15.1. Revenue under Scenario 1 is more stable than the revenue would have been had no tax changes been implemented, rising less on a percentage basis between the 2003 trough and the 2006 peak, and falling less from the 2006 peak through 2010. It is difficult to compare the cyclicity of actual collections to the other two lines because of the downward slope of actual collections resulting from the tax reductions implemented since the early 1990s. However, in addition to falling much more from peak to trough in each of the last two cycles, actual revenues rose more between 2003 and 2006 than in the other two lines, indicating that the tax law changes that were made added volatility to the revenue stream as it existed in 1992.

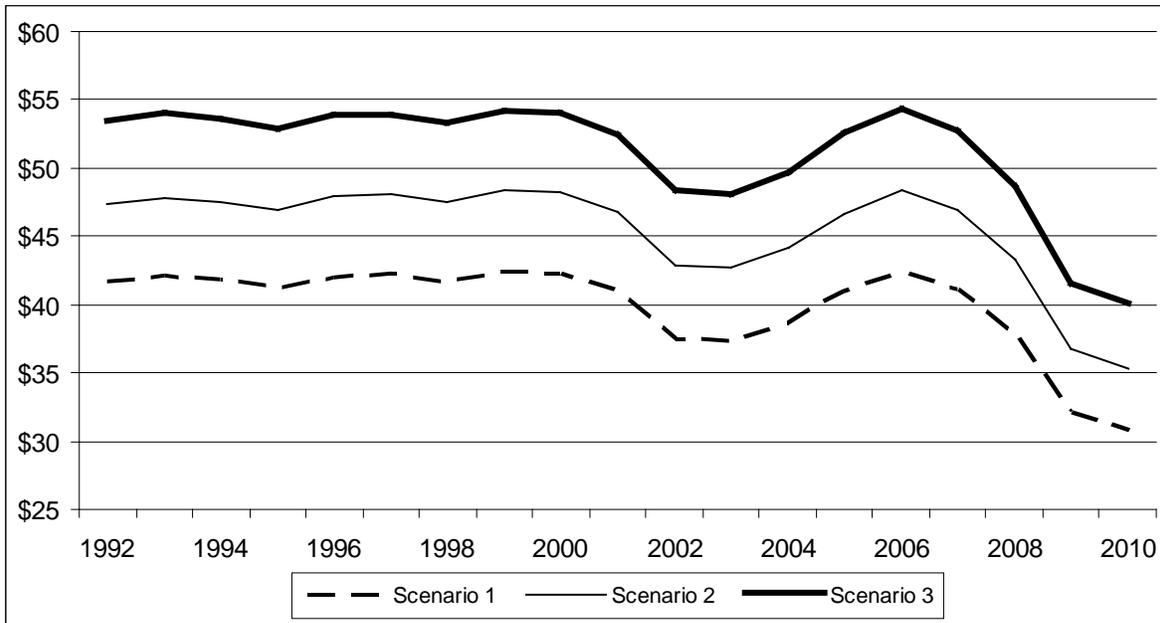
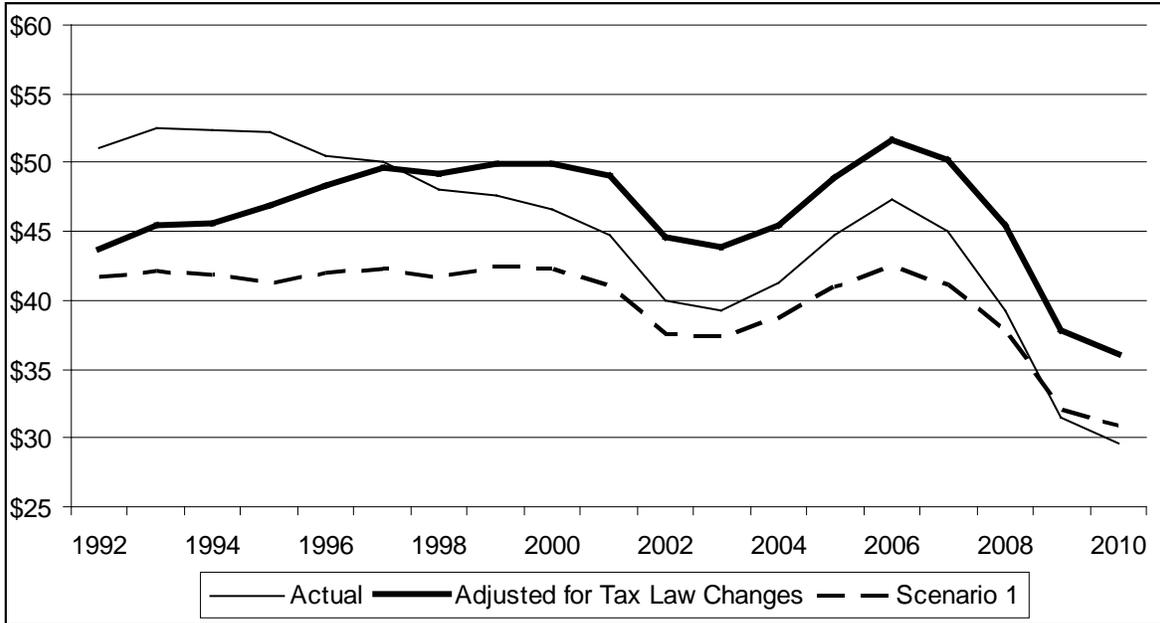
Stability is gained in Scenario 1 largely by maintaining a low-rate, broad-based tax structure throughout the period. In particular, the highly volatile revenue sources—sales and income taxes—provide a lesser share of total revenue in Scenario 1, with more stable property taxes, selective sales taxes, and nontax sources making up the difference. That same increase in stability is experienced in Scenarios 2 and 3, as seen in the bottom graph of Chart 15.1. Revenue in Scenario 2 is about 14 percent higher than in Scenario 1 in every year. Similarly, revenue in Scenario 3 is roughly 14 percent higher than in Scenario 2 throughout the time series. Projected revenue through 2015 in each scenario is provided in Appendix C.

Thus, the proposed revenue system would achieve one of the primary goals, that of reducing the volatility of government revenues. It is not possible to simulate the effects of the proposed revenue system on economic development and economic competitiveness, the improvement of which is another primary objective of modifying the revenue system. However, to the extent that tax burdens have an effect on economic development and competitiveness (see the discussion in Chapters 10 and 11), the proposed revenue system provides lower taxes on businesses, particularly export businesses.

State and Local Government General Revenue

The impact of the proposed tax code changes on total state and local government tax burdens is examined in this subsection, based on the actual data reported by the Census Bureau. Estimates for the levels of collections that would have prevailed had the proposed tax structure been in place historically are based on estimates formulated by the authors, access to historical data from the Arizona Department of Revenue's tax expenditures report, historical data maintained by the Arizona Tax Research Association, and data obtained historically on personal income, inflation, and population growth from the U.S. Department of Commerce's Census Bureau and the Bureau of Economic Analysis. The figures are summarized in Table 15.3, based on aggregate tax

CHART 15.1
ONGOING REVENUE PER \$1,000 OF PERSONAL INCOME, ARIZONA STATE
GOVERNMENT GENERAL FUND, FISCAL YEARS 1992 THROUGH 2010



Source: Calculated by authors, based on data from the Arizona Joint Legislative Budget Committee.

collections, tax revenue per \$1,000 of personal income, and per capita tax revenue, adjusted for inflation.

Due to the length and depth of the recession, actual declines in total state and local government revenues have occurred since 2007, even on an unadjusted basis. A slightly larger percentage drop has occurred relative to personal income, with a considerably larger decrease on a real per capita basis. As a share of overall personal income, the combined state and local government tax burden in 2010 is lower than at any time since the first year of the time series analyzed (1993). For perspective, \$1 of revenue per \$1,000 of personal income currently represents about \$215 million in revenue. So if the tax burden were the same as it was in 1993, Arizonans would be paying \$4 billion more in combined state and local tax revenues in 2010 than actually paid.

TABLE 15.3
COMBINED STATE AND LOCAL GOVERNMENT TAX COLLECTIONS IN ARIZONA,
SELECTED FISCAL YEARS, 1993 THROUGH 2010

Fiscal Year	Dollars in Thousands	Per \$1,000 of Personal Income	Per Capita (Inflation Adjusted)
ACTUAL			
1993	\$8,374,060	\$116.37	\$2,968
1997	10,424,677	104.92	2,919
2002	14,420,322	101.96	3,213
2007	23,334,711	109.42	3,881
2010	21,062,174	97.62	3,161
SCENARIO 1			
1993	7,751,183	107.72	2,747
1997	9,657,072	97.19	2,704
2002	13,868,182	98.05	3,090
2007	22,138,265	103.81	3,682
2010	21,062,174	97.62	3,161
SCENARIO 2			
1993	8,225,549	114.31	2,916
1997	10,320,702	103.87	2,890
2002	14,757,551	104.34	3,288
2007	23,563,352	110.49	3,919
2010	22,262,174	103.18	3,341
SCENARIO 3			
1993	8,809,586	122.43	3,123
1997	11,124,520	111.96	3,115
2002	15,691,515	110.94	3,496
2007	24,894,295	116.73	4,141
2010	23,462,174	108.74	3,521

Source: Calculated by authors, based on data from the U.S. Department of Commerce, Census Bureau.

OTHER RECOMMENDATIONS

Even if all of the revenue recommendations are adopted, and even if net revenue is raised by \$2.4 billion as in Scenario 3, the state government general fund will experience a negative balance between revenues and expenditures during every economic down cycle. The only way to avoid spending reductions and/or revenue increases during an economic recession is to strengthen the budget stabilization fund. The CFRC recommended that the limit on the BSF be raised to 15 percent and that measures be taken to make raids on the fund more difficult.

Three recommendations are made regarding the operation of the BSF. First, the current 7 percent cap on the BSF needs to be raised. If the revenue system is changed as recommended, a BSF balance of 15 percent should be adequate in all but the worst recessions. However, if the revenue system is not changed to become less cyclical, the cap on the BSF should be raised to more than 15 percent.

Second, the formula used to allocate funds to the BSF should be changed so that more money is transferred into the BSF more quickly following a recession. Starting with no balance in the BSF coming out of a recession, the current funding formula will not provide anywhere close to a 15 percent balance during a typical economic expansion.

Third, the legislation related to the BSF should be tightened so that BSF funds can be used only to offset cyclical decreases in revenues. Ideally, the operation of the BSF would be placed in the Constitution, with all transfers to and from the BSF made according to the formula, unless three-fourths of the Legislature votes to override the Constitution.

In addition to strengthening the BSF, accountability needs to be improved. It should be statutorily required that any reduction in tax rates be immediately offset by specified reductions in spending or by increases in other revenues. Similarly, an immediate increase in revenue should be required for any new or expanded spending program, or a comparable amount of other spending should be reduced.

APPENDIX A

STATE AND LOCAL GOVERNMENT GENERAL REVENUE: DETAIL

In this appendix, which supplements Chapter 3, detail is provided on one page for each general revenue category used by the Census Bureau. Following a brief description of the category, the dollar value in Arizona and the share of total revenue in Arizona and the United States in fiscal year 2007 is provided.

Next, the fiscal year 2007 dollar value in Arizona is expressed per capita and per \$1,000 of personal income, with Arizona's figure as a percentage of the national average and its ranks among all 51 'states' (including the District of Columbia) and among the nine western states (Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington) shown for each measure. In all cases, the ratio to the national average is higher for the personal income measure than the per capita measure due to Arizona's low average income. However, as discussed in Chapter 1, the personal income measure understates income in Arizona relative to other states and the national average. Thus, Arizona's revenue relative to income is not quite as high as a percentage of the national average as indicated by the personal income measure.

The next table on each page looks at the change between fiscal years 1992 and 2007, both in per capita terms and per \$1,000 of personal income. (For some categories, the data for fiscal year 1992 are not available, so the comparison is between fiscal years 1993 and 2007.) The change is expressed as the percent change in the dollar value in Arizona, in the ratio to (percentage of) the national average, in the national rank, and in the rank among the western states.

Finally, a chart is provided that displays the year-by-year revenue per \$1,000 of personal income for Arizona and for the United States. Data for Arizona for fiscal years 2001 and 2003 are not available; the values for those fiscal years were estimated as midway between the values of the preceding and succeeding years.

TOTAL GENERAL REVENUE

Total revenue from all sources, including the federal government, except for revenues generated by public utilities, liquor stores, and insurance trusts (which primarily consist of retirement contributions).

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$41,318,939	100%	100%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$6,582.41	84.8%	44	9
Per \$1,000 of Personal Income	193.75	96.3	35	5

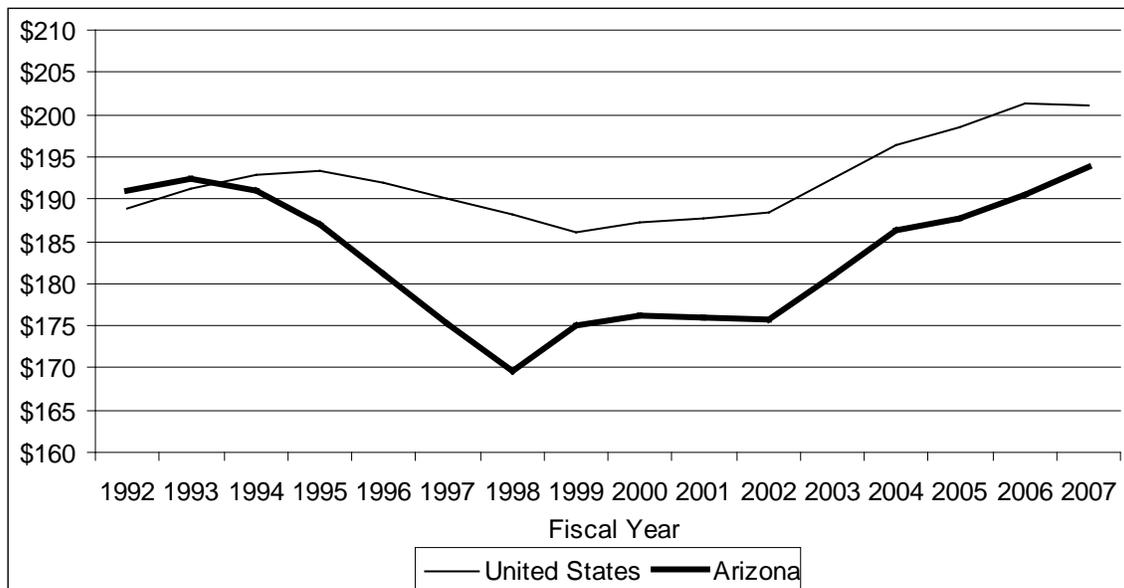
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	43%	Per Capita	-8
Per \$1,000 of Personal Income	1%	Per \$1,000 of Personal Income	-10
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-2	Per Capita	-2
Per \$1,000 of Personal Income	-5	Per \$1,000 of Personal Income	0

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT TOTAL GENERAL REVENUE COLLECTED PER \$1,000 OF PERSONAL INCOME



INTERGOVERNMENTAL REVENUE FROM THE FEDERAL GOVERNMENT

Federal aid to state and local governments, including grants.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$8,713,139	21.09%	20.08%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$1,388.07	89.1%	37	5
Per \$1,000 of Personal Income	40.86	101.2	32	4

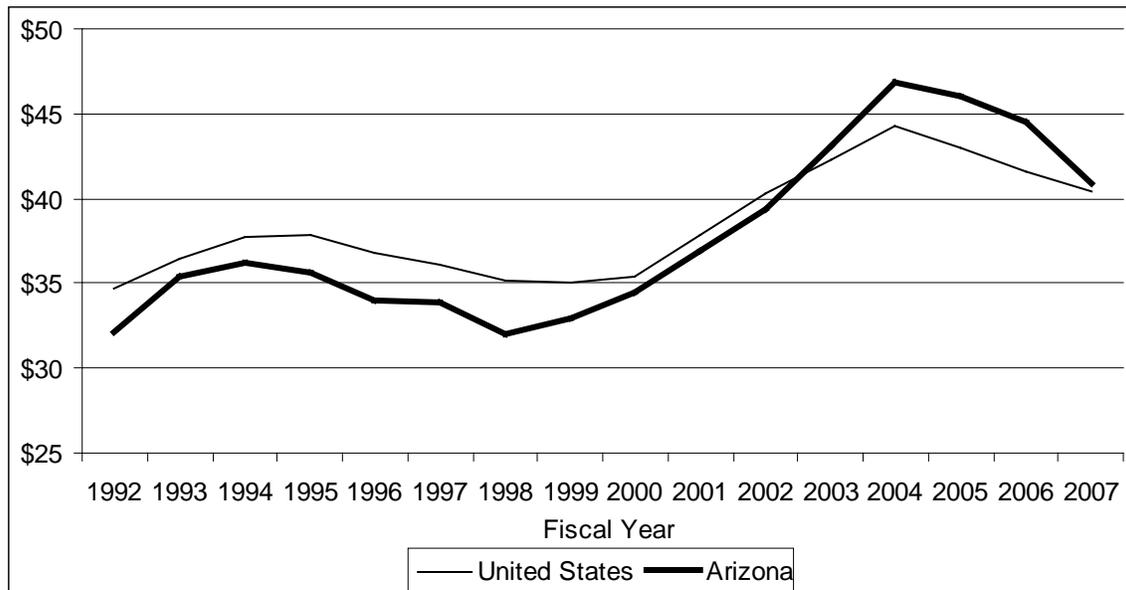
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	79%	Per Capita	10
Per \$1,000 of Personal Income	27%	Per \$1,000 of Personal Income	6
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	9	Per Capita	2
Per \$1,000 of Personal Income	9	Per \$1,000 of Personal Income	1

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT INTERGOVERNMENTAL REVENUE COLLECTED PER \$1,000 OF PERSONAL INCOME



OWN-SOURCE REVENUE

All revenue raised by state and local governments from tax and nontax sources, but excludes revenue received from the federal government.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$32,605,800	78.91%	79.92%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$5,194.35	83.7%	41	9
Per \$1,000 of Personal Income	152.89	95.1	37	6

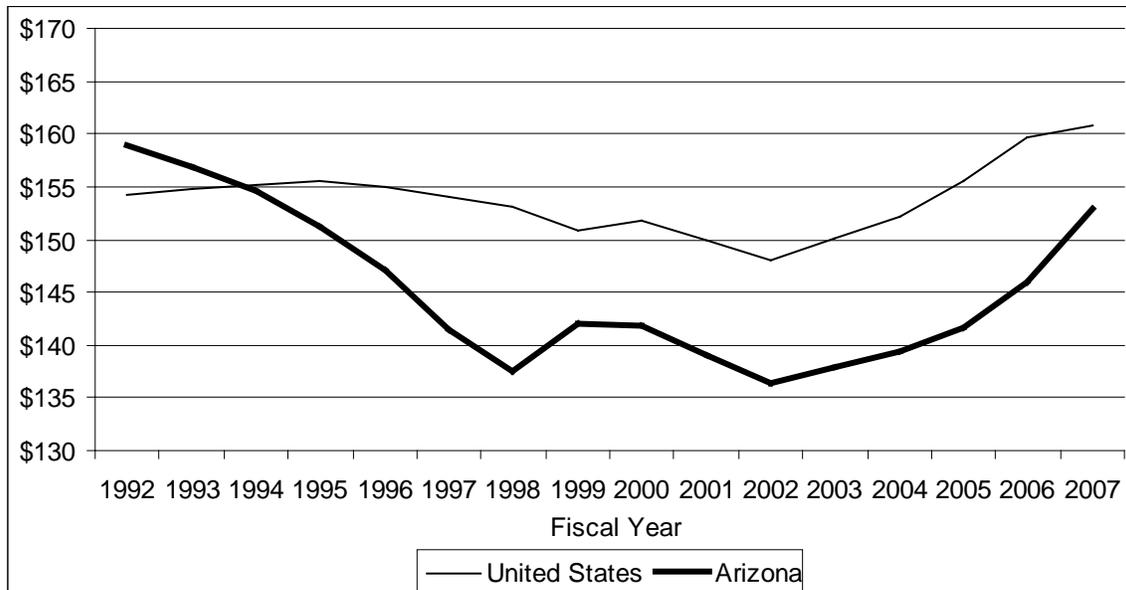
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	35%	Per Capita	-8
Per \$1,000 of Personal Income	-4%	Per \$1,000 of Personal Income	-18
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-5	Per Capita	-2
Per \$1,000 of Personal Income	-8	Per \$1,000 of Personal Income	-2

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT OWN-SOURCE REVENUE COLLECTED PER \$1,000 OF PERSONAL INCOME



TOTAL TAXES

Total of all taxes levied by state and local governments.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$23,334,711	56.47%	54.77%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$3,717.39	87.5%	30	6
Per \$1,000 of Personal Income	109.42	99.3	22	3

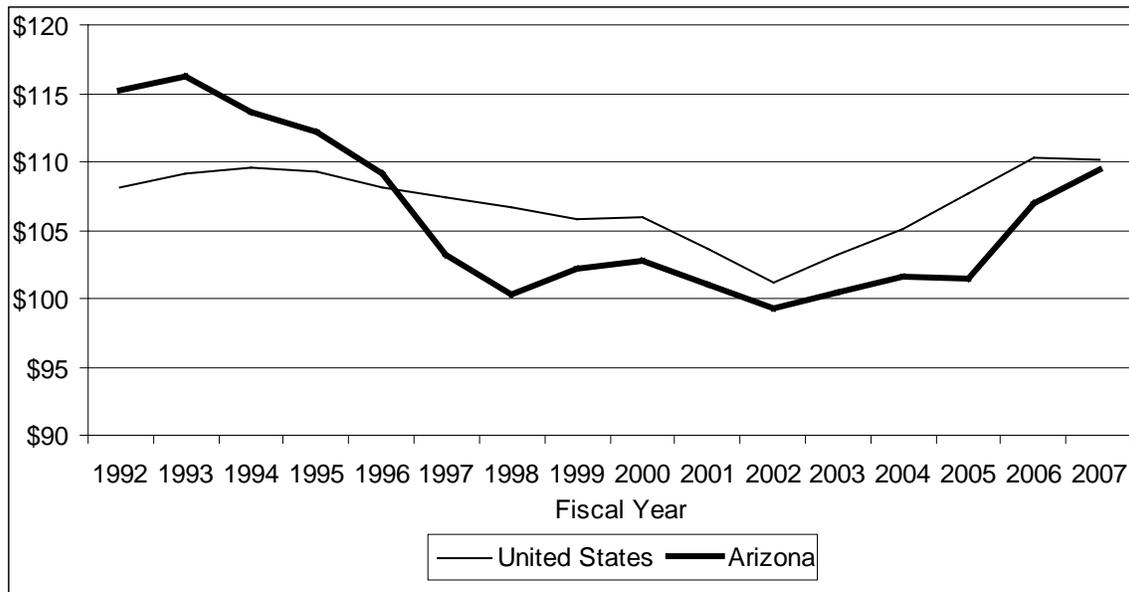
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	34%	Per Capita	-3
Per \$1,000 of Personal Income	-5%	Per \$1,000 of Personal Income	-12
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-4	Per Capita	0
Per \$1,000 of Personal Income	-7	Per \$1,000 of Personal Income	-2

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT TOTAL TAXES COLLECTED PER \$1,000 OF PERSONAL INCOME



PROPERTY TAX

Taxes applied based on value. Includes general property taxes on real property (land and buildings) and personal property (equipment used by businesses and manufactured housing), and vehicle license taxes based on value (as assessed in Arizona).

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$6,221,217	15.06%	16.45%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$991.09	77.6%	34	7
Per \$1,000 of Personal Income	29.17	88.2	30	3

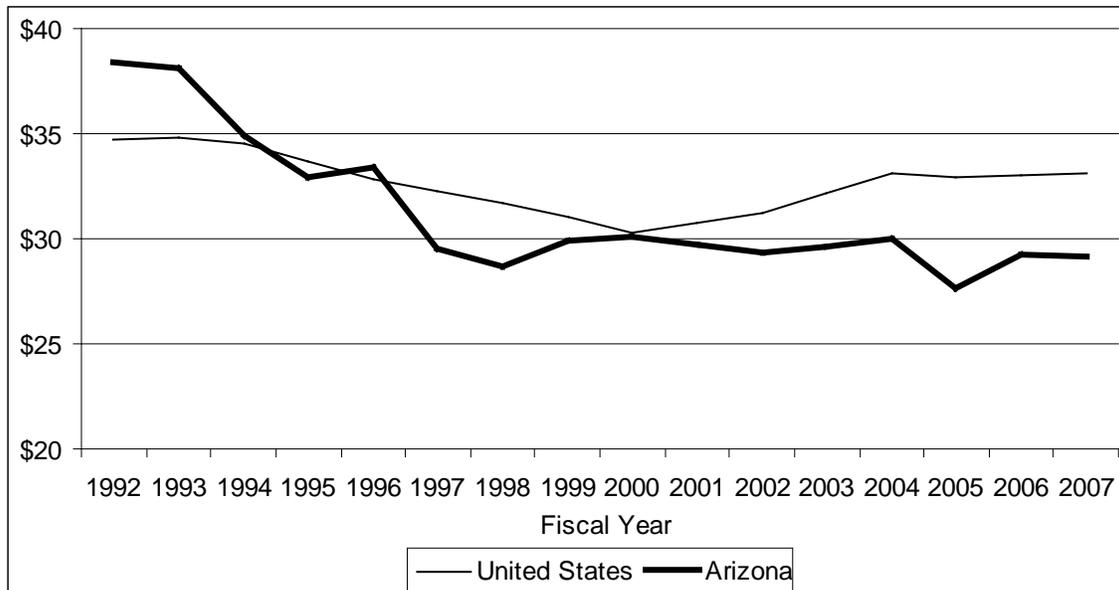
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	7%	Per Capita	-8
Per \$1,000 of Personal Income	-24%	Per \$1,000 of Personal Income	-12
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-18	Per Capita	-1
Per \$1,000 of Personal Income	-23	Per \$1,000 of Personal Income	0

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT PROPERTY TAX COLLECTED PER \$1,000 OF PERSONAL INCOME



SALES AND GROSS RECEIPTS TAXES

Summation of the general sales tax and selective sales taxes.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$11,299,521	27.35%	18.83%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$1,800.10	123.2%	8	3
Per \$1,000 of Personal Income	52.98	139.9	7	4

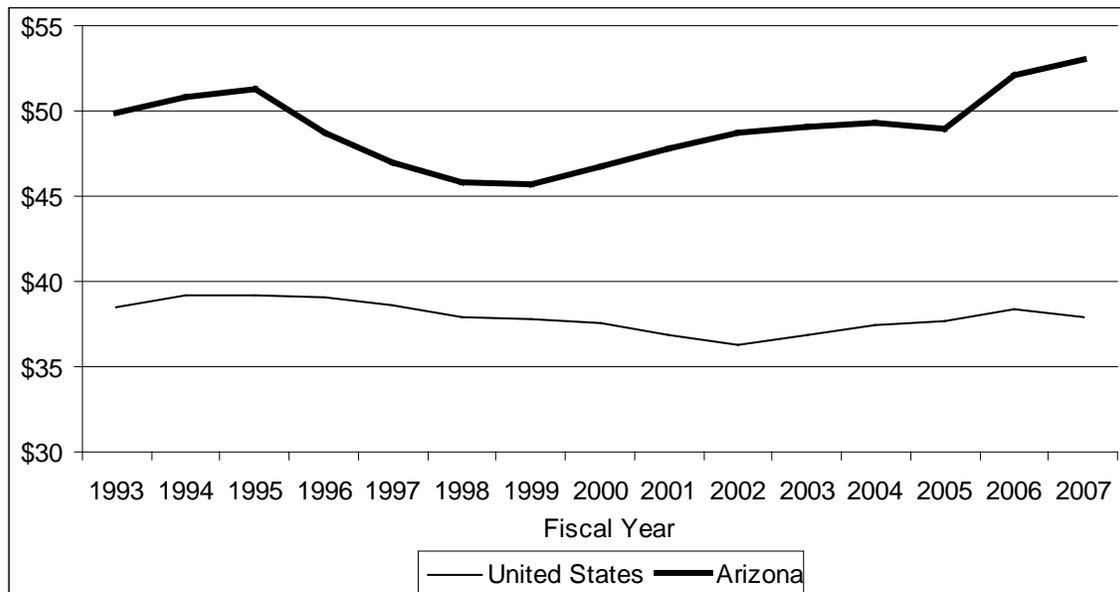
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	48%	Per Capita	3
Per \$1,000 of Personal Income	6%	Per \$1,000 of Personal Income	3
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	11	Per Capita	2
Per \$1,000 of Personal Income	10	Per \$1,000 of Personal Income	1

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT SALES AND GROSS RECEIPTS TAXES COLLECTED PER \$1,000 OF PERSONAL INCOME



GENERAL SALES TAX

Tax applied to the retail purchase of goods and services. Arizona's transaction privilege tax is classified as a general sales tax.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$9,365,648	22.67%	12.85%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$1,492.02	149.6%	5	2
Per \$1,000 of Personal Income	43.92	169.9	6	3

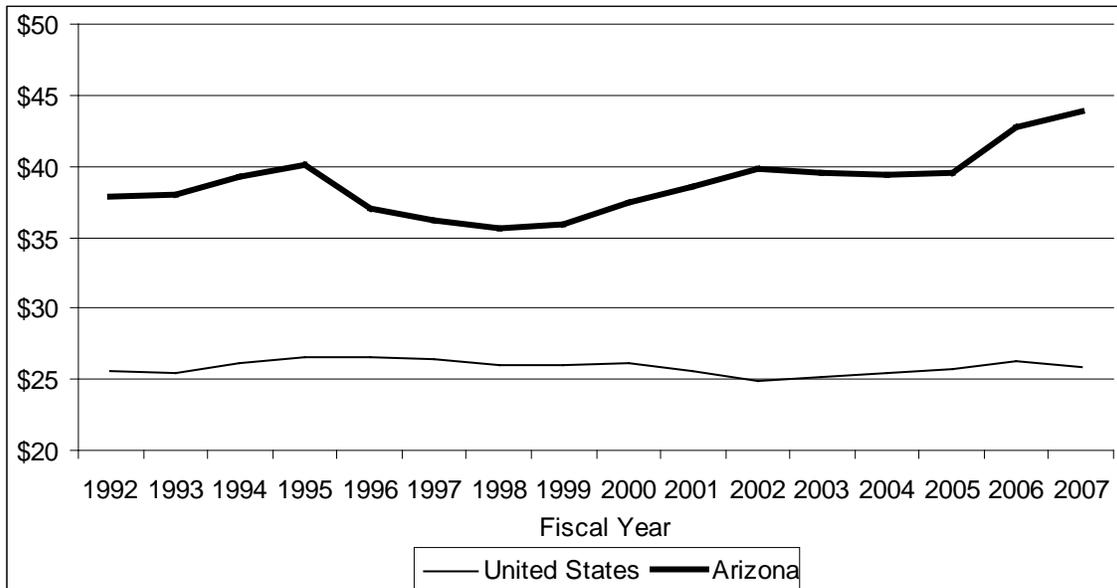
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	63%	Per Capita	1
Per \$1,000 of Personal Income	16%	Per \$1,000 of Personal Income	-1
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	22	Per Capita	2
Per \$1,000 of Personal Income	22	Per \$1,000 of Personal Income	0

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT GENERAL SALES TAX COLLECTED PER \$1,000 OF PERSONAL INCOME



TOTAL SELECTIVE SALES TAXES

Taxes imposed on the sale of particular commodities or services apart from the general sales tax.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$1,933,873	4.68%	5.98%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$308.08	66.3%	47	8
Per \$1,000 of Personal Income	9.07	75.4	42	6

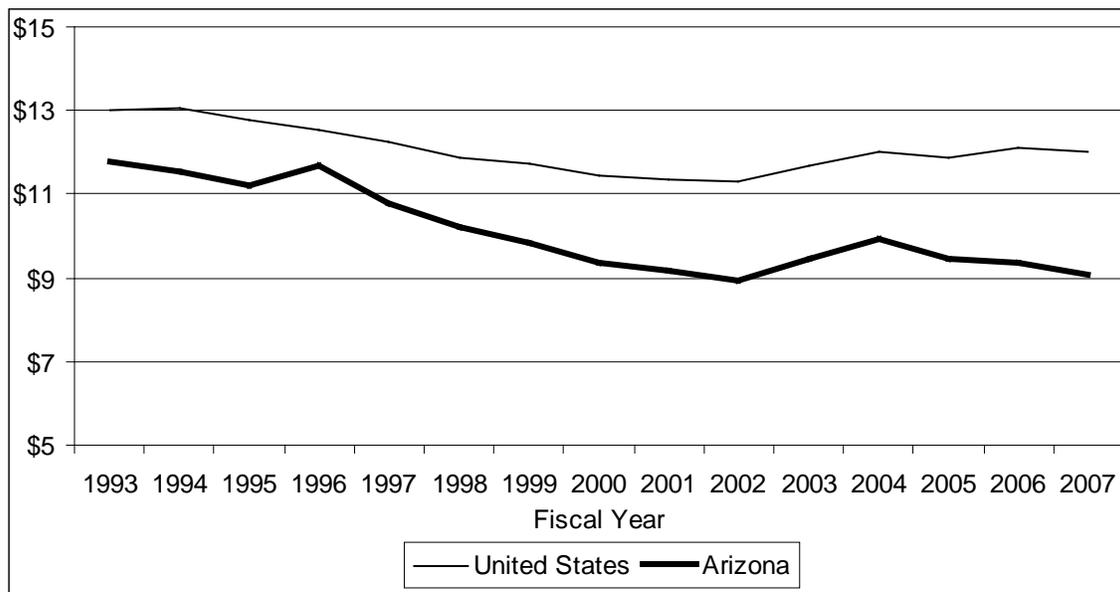
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	7%	Per Capita	-9
Per \$1,000 of Personal Income	-23%	Per \$1,000 of Personal Income	-9
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-11	Per Capita	-2
Per \$1,000 of Personal Income	-15	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT TOTAL SELECTIVE SALES TAXES COLLECTED PER \$1,000 OF PERSONAL INCOME



MOTOR FUELS TAX

Selective sales tax on gasoline and other fuels used in motor vehicles and aircraft.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$768,914	1.86%	1.63%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$122.49	96.9%	38	7
Per \$1,000 of Personal Income	3.61	110.1	30	5

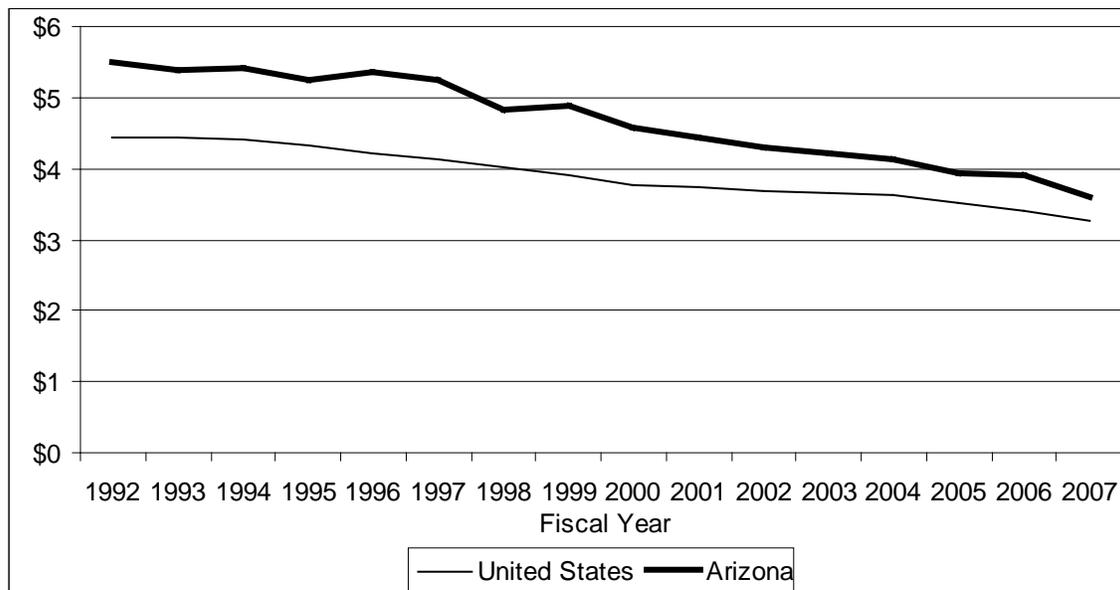
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-8%	Per Capita	-5
Per \$1,000 of Personal Income	-35%	Per \$1,000 of Personal Income	-9
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-10	Per Capita	-1
Per \$1,000 of Personal Income	-14	Per \$1,000 of Personal Income	0

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT MOTOR FUELS TAX COLLECTED PER \$1,000 OF PERSONAL INCOME



ALCOHOLIC BEVERAGES TAX

Selective sales tax on sale of alcoholic beverages at government-operated liquor stores or at private-sector businesses.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$63,921	0.15%	0.24%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$10.18	54.3%	36	6
Per \$1,000 of Personal Income	0.30	61.7	31	6

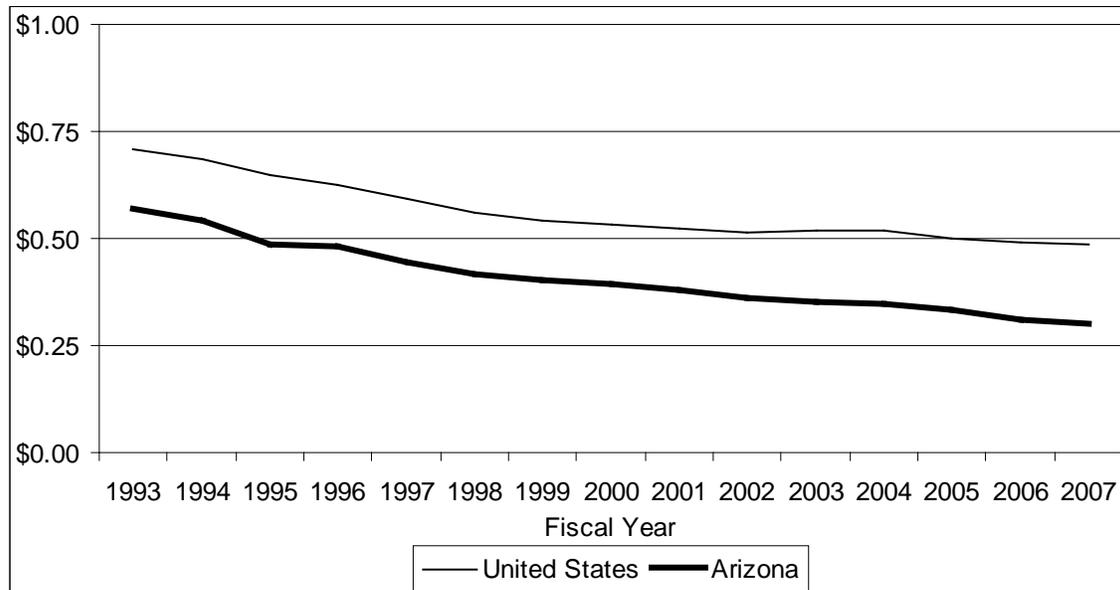
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-27%	Per Capita	-7
Per \$1,000 of Personal Income	-47%	Per \$1,000 of Personal Income	-5
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-14	Per Capita	-2
Per \$1,000 of Personal Income	-18	Per \$1,000 of Personal Income	-2

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT ALCOHOLIC BEVERAGES TAX COLLECTED PER \$1,000 OF PERSONAL INCOME



TOBACCO PRODUCTS TAX

Selective sales tax on tobacco products, including cigarettes and cigars.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$358,113	0.87%	0.68%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$57.05	108.1%	22	3
Per \$1,000 of Personal Income	1.68	122.8	22	3

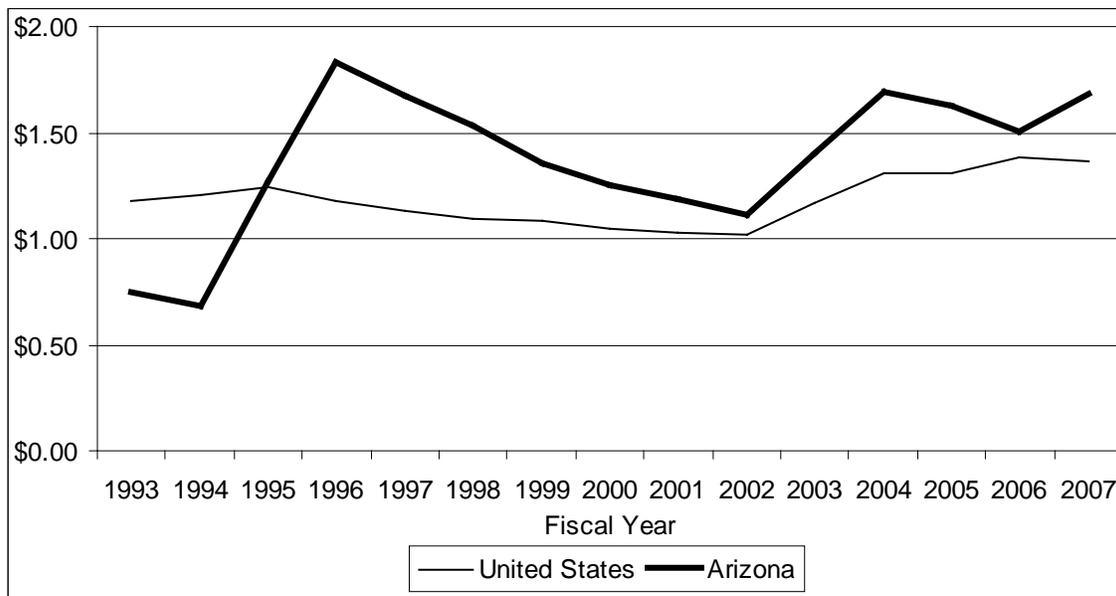
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	213%	Per Capita	22
Per \$1,000 of Personal Income	125%	Per \$1,000 of Personal Income	22
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	54	Per Capita	5
Per \$1,000 of Personal Income	60	Per \$1,000 of Personal Income	5

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT TOBACCO PRODUCTS TAX COLLECTED PER \$1,000 OF PERSONAL INCOME



PUBLIC UTILITIES TAX

Selective sales tax imposed on public utilities based on gross receipts, units of service sold, or similar measures.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$200,274	0.48%	1.15%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$31.91	35.7%	37	8
Per \$1,000 of Personal Income	0.94	40.6	35	8

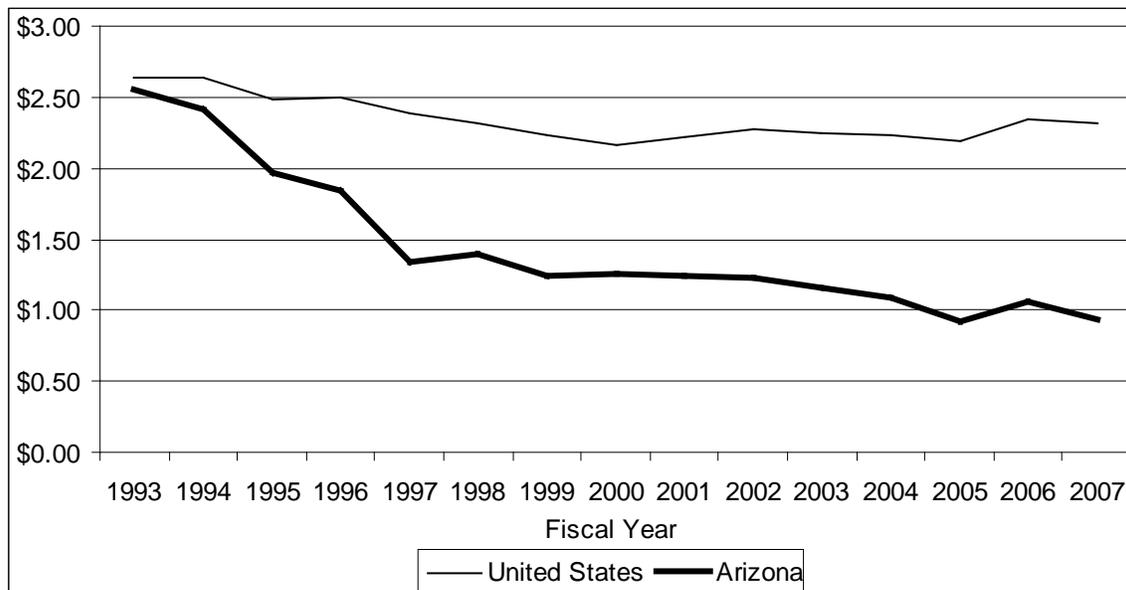
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-49%	Per Capita	-19
Per \$1,000 of Personal Income	-63%	Per \$1,000 of Personal Income	-19
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-47	Per Capita	-5
Per \$1,000 of Personal Income	-56	Per \$1,000 of Personal Income	-6

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT PUBLIC UTILITIES TAX COLLECTED PER \$1,000 OF PERSONAL INCOME



OTHER SELECTIVE SALES TAXES

Taxes on amusement admission charges, amounts wagered, hotel and motel rates, and a number of other commodities, businesses, and services.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$542,651	1.31%	2.28%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$86.45	48.8%	43	8
Per \$1,000 of Personal Income	2.54	55.4	42	7

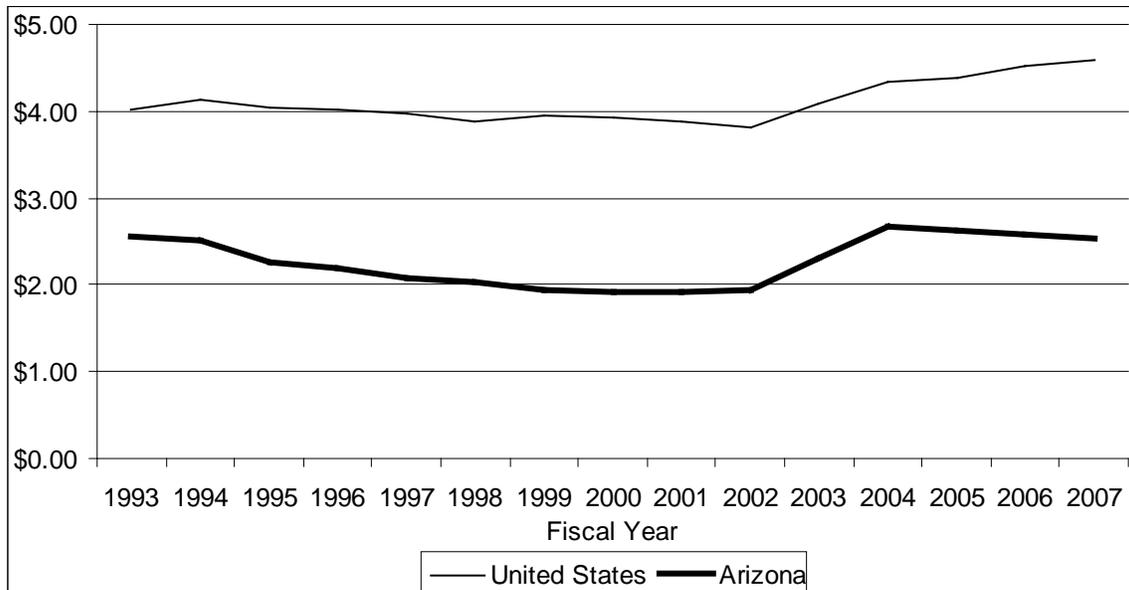
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	38%	Per Capita	-4
Per \$1,000 of Personal Income	-0%	Per \$1,000 of Personal Income	-6
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-6	Per Capita	-1
Per \$1,000 of Personal Income	-8	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT OTHER SELECTIVE SALES TAXES COLLECTED PER \$1,000 OF PERSONAL INCOME



INDIVIDUAL INCOME TAX

Taxes on the wages, salaries, interest and dividend earnings, and other sources of income of individuals.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$3,747,387	9.07%	12.42%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$596.99	61.9%	40	6
Per \$1,000 of Personal Income	17.57	70.3	40	6

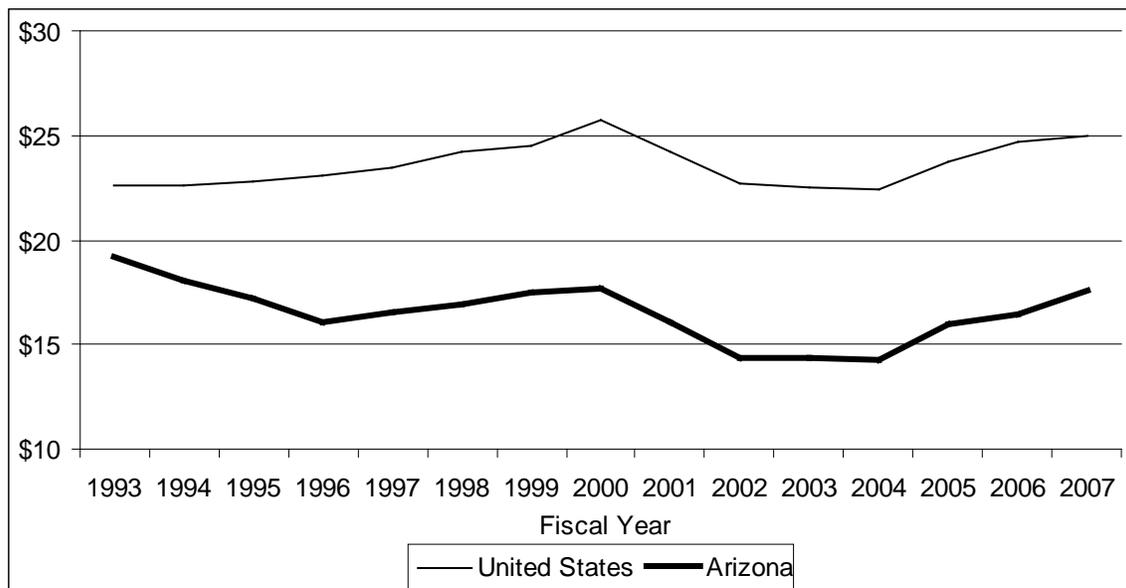
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	27%	Per Capita	-4
Per \$1,000 of Personal Income	-8%	Per \$1,000 of Personal Income	-4
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-11	Per Capita	-1
Per \$1,000 of Personal Income	-15	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT INDIVIDUAL INCOME TAX COLLECTED PER \$1,000 OF PERSONAL INCOME



CORPORATE INCOME TAX

Tax on the net income of corporations.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$986,170	2.39%	2.60%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$157.10	77.9%	25	3
Per \$1,000 of Personal Income	4.62	88.5	25	4

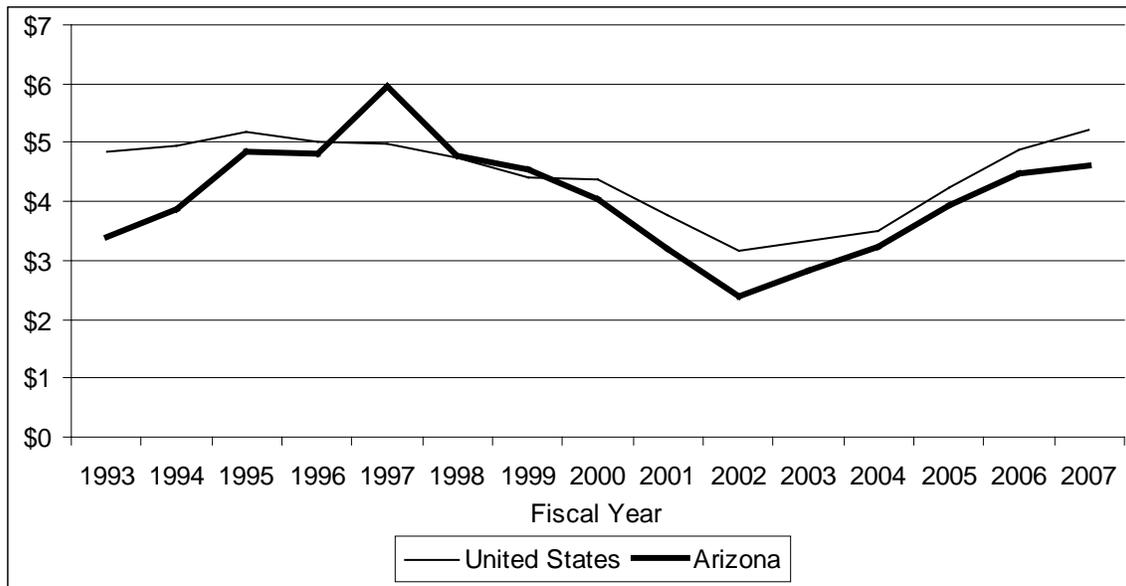
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	89%	Per Capita	5
Per \$1,000 of Personal Income	36%	Per \$1,000 of Personal Income	3
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	18	Per Capita	0
Per \$1,000 of Personal Income	18	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT CORPORATE INCOME TAX COLLECTED PER \$1,000 OF PERSONAL INCOME



MOTOR VEHICLE LICENSE TAX

Licenses imposed on owners and operators of motor vehicles, including fees for title registration, license plates, vehicle inspection, etc. Taxes based on the value of a vehicle are not included—these are classified as property taxes.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$238,301	0.58%	0.90%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$37.96	54.6%	49	9
Per \$1,000 of Personal Income	1.12	62.1	43	9

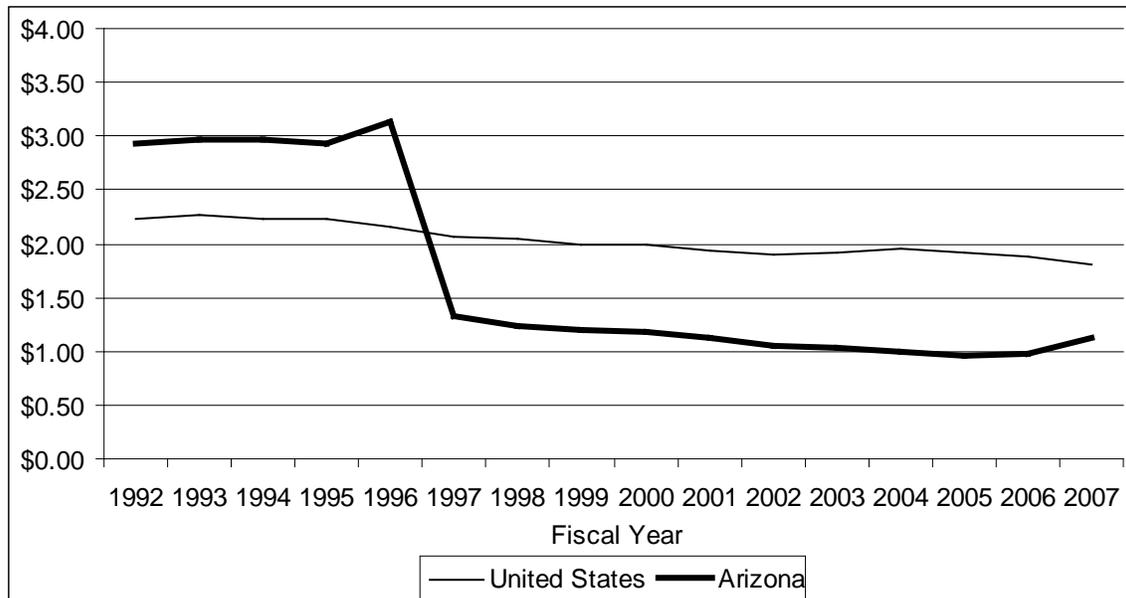
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-46%	Per Capita	-34
Per \$1,000 of Personal Income	-62%	Per \$1,000 of Personal Income	-31
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-59	Per Capita	-5
Per \$1,000 of Personal Income	-70	Per \$1,000 of Personal Income	-6

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

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*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT MOTOR VEHICLE LICENSE TAX COLLECTED PER \$1,000 OF PERSONAL INCOME



OTHER TAXES

Death and gift taxes, severance taxes, and a variety of other taxes.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$842,115	2.04%	3.57%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$134.16	48.4%	43	8
Per \$1,000 of Personal Income	3.95	55.0	41	8

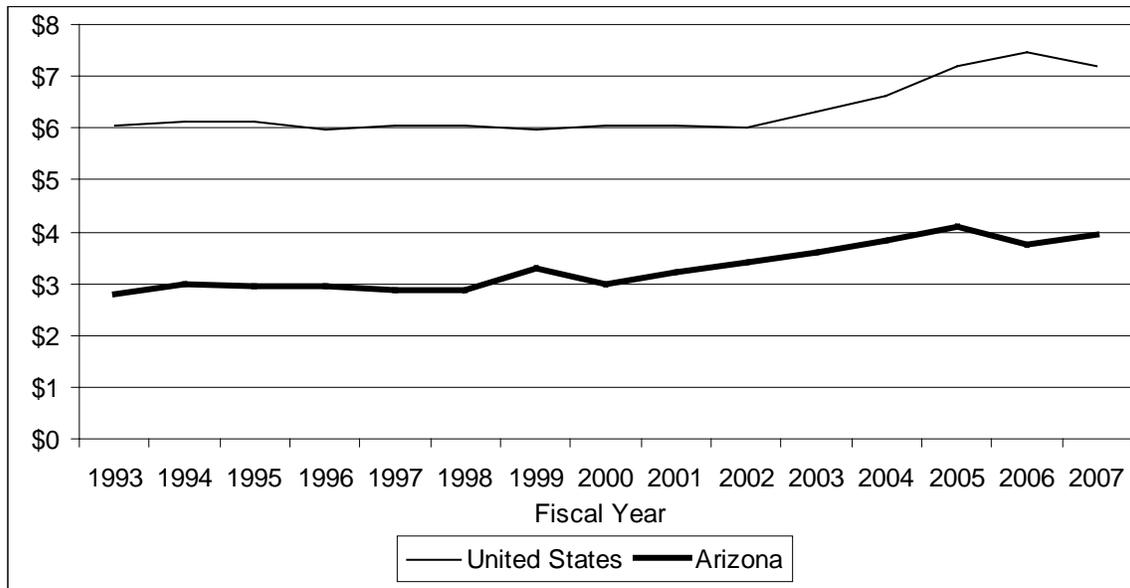
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	96%	Per Capita	6
Per \$1,000 of Personal Income	41%	Per \$1,000 of Personal Income	6
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	9	Per Capita	1
Per \$1,000 of Personal Income	9	Per \$1,000 of Personal Income	1

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STATE AND LOCAL GOVERNMENT OTHER TAXES COLLECTED PER \$1,000 OF PERSONAL INCOME



NONTAX TOTAL

Summation of current charges (user fees), interest earned, and miscellaneous other nontax revenue.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$9,271,089	22.44%	25.16%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$1,476.95	75.6%	49	9
Per \$1,000 of Personal Income	43.47	85.9	44	9

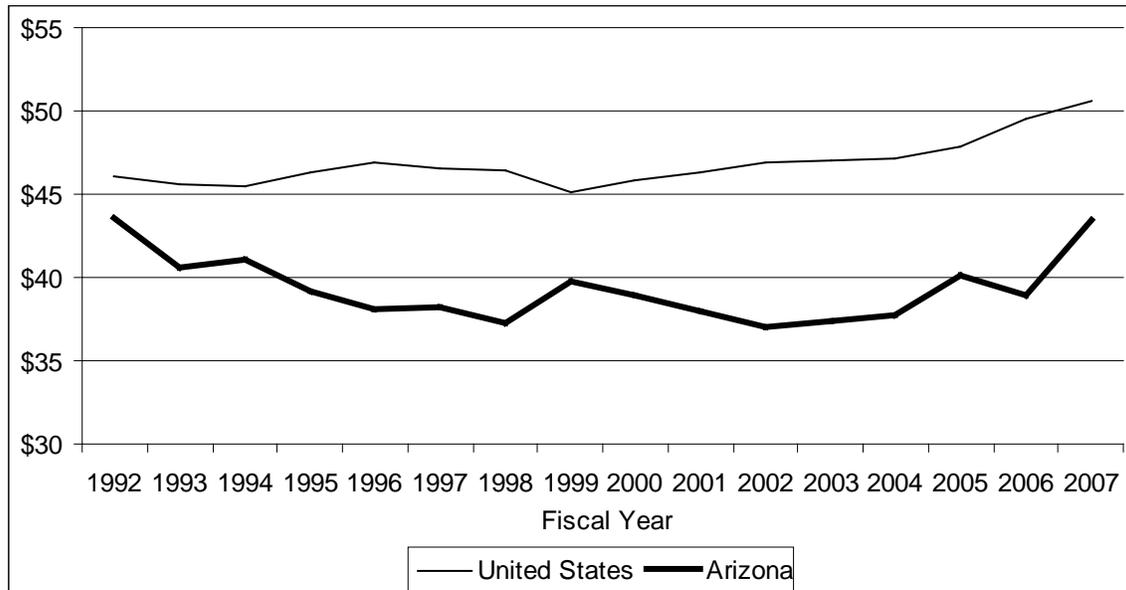
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	40%	Per Capita	-3
Per \$1,000 of Personal Income	-0%	Per \$1,000 of Personal Income	-7
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-6	Per Capita	0
Per \$1,000 of Personal Income	-9	Per \$1,000 of Personal Income	0

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STATE AND LOCAL GOVERNMENT TOTAL NONTAX REVENUE COLLECTED PER \$1,000 OF PERSONAL INCOME



TOTAL CURRENT CHARGES

Payments for the provision of specific services that benefit the person charged, including user fees and maintenance assessments. An example is garbage collection.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$5,157,979	12.48%	15.08%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$821.70	70.2%	50	9
Per \$1,000 of Personal Income	24.19	79.7	42	9

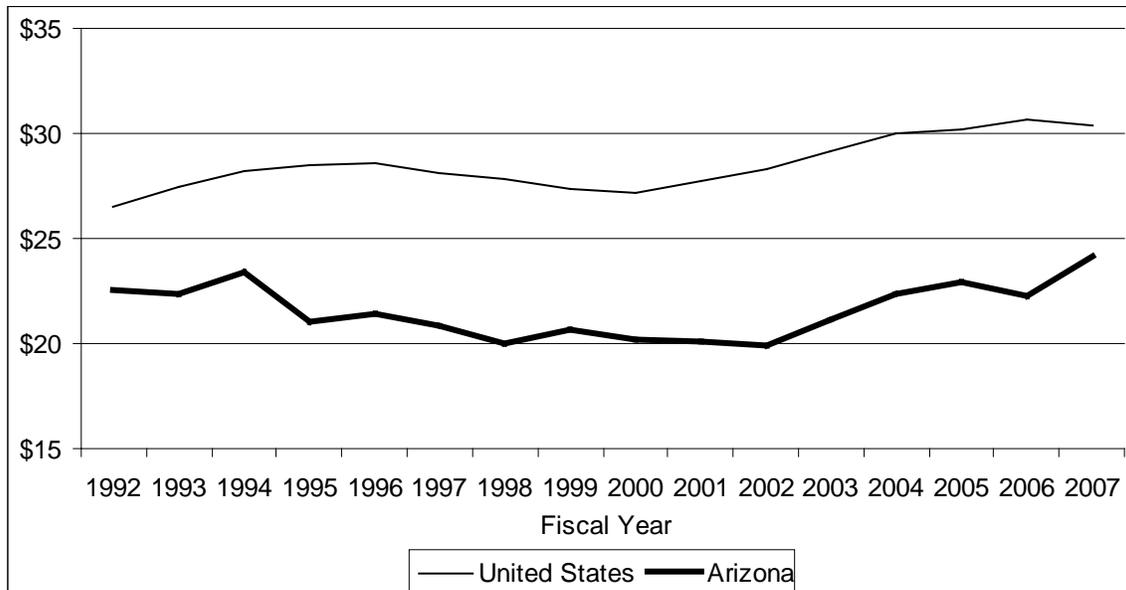
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	51%	Per Capita	-4
Per \$1,000 of Personal Income	7%	Per \$1,000 of Personal Income	-3
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-3	Per Capita	0
Per \$1,000 of Personal Income	-5	Per \$1,000 of Personal Income	0

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STATE AND LOCAL GOVERNMENT TOTAL CURRENT CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



CURRENT CHARGES: EDUCATION

Primarily consists of tuition and fees at institutions of higher education, but also includes receipts from school lunch sales and other charges.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$1,851,784	4.48%	4.44%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$295.00	85.5%	38	6
Per \$1,000 of Personal Income	8.68	97.1	36	7

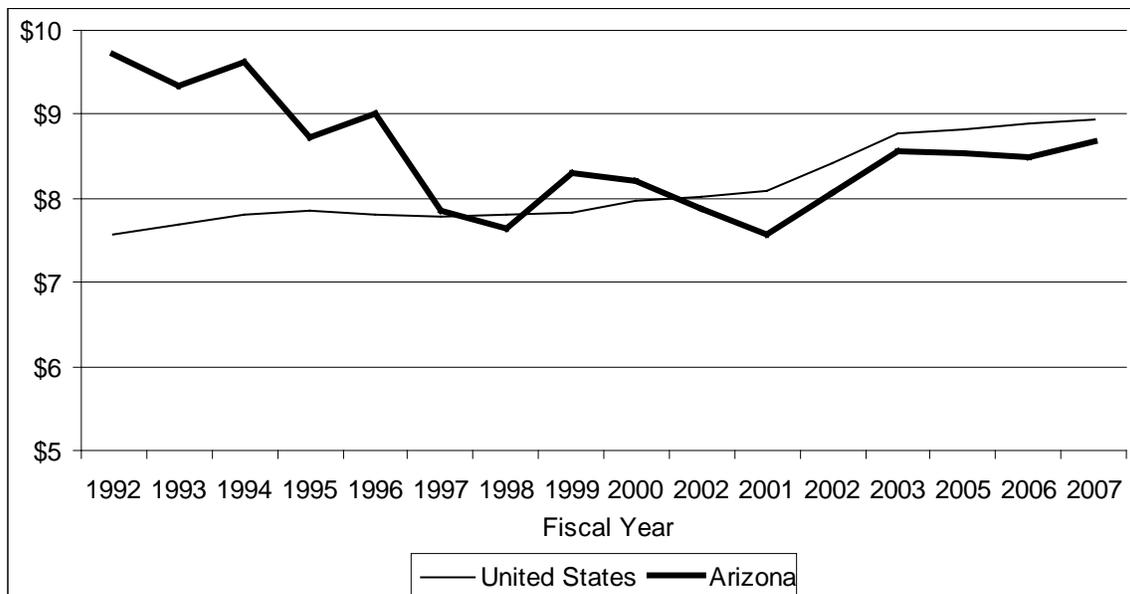
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	26%	Per Capita	-15
Per \$1,000 of Personal Income	-11%	Per \$1,000 of Personal Income	-14
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-25	Per Capita	-1
Per \$1,000 of Personal Income	-31	Per \$1,000 of Personal Income	-3

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STATE AND LOCAL GOVERNMENT EDUCATION CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



CURRENT CHARGES: HIGHER EDUCATION

Tuition, fees, and other charges at community colleges and universities.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$1,584,561	3.83%	3.79%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$252.43	85.9%	40	7
Per \$1,000 of Personal Income	7.43	97.5	36	7

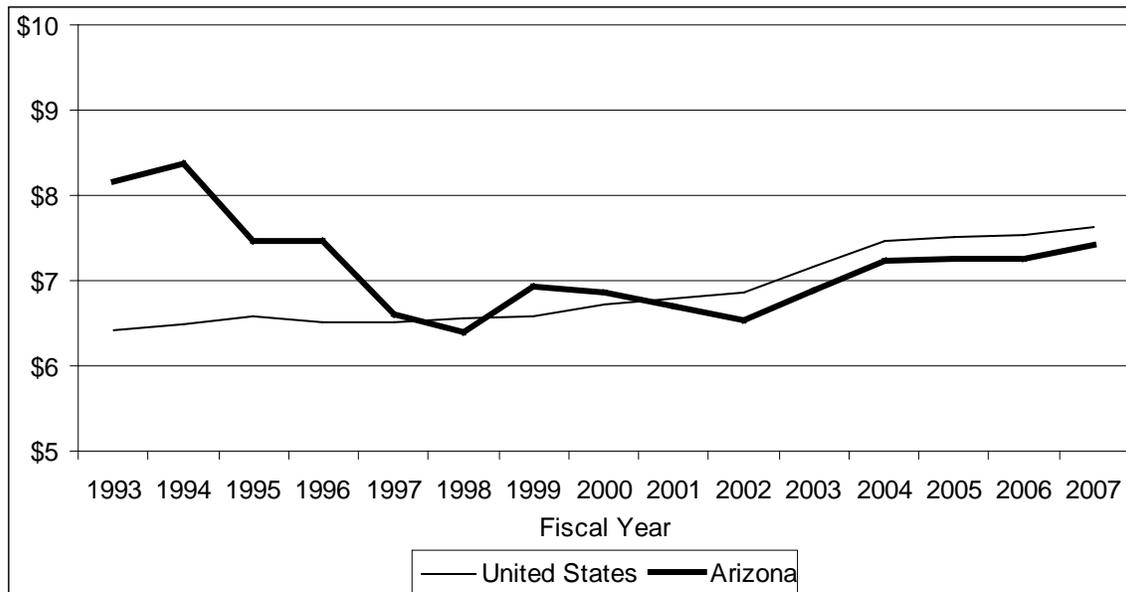
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	26%	Per Capita	-12
Per \$1,000 of Personal Income	-9%	Per \$1,000 of Personal Income	-14
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-23	Per Capita	-2
Per \$1,000 of Personal Income	-30	Per \$1,000 of Personal Income	-3

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STATE AND LOCAL GOVERNMENT HIGHER EDUCATION CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



CURRENT CHARGES: SCHOOL LUNCHES

Gross receipts from sale of milk and school lunches.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$117,101	0.28%	0.30%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$18.66	80.9%	41	5
Per \$1,000 of Personal Income	0.55	91.9	33	3

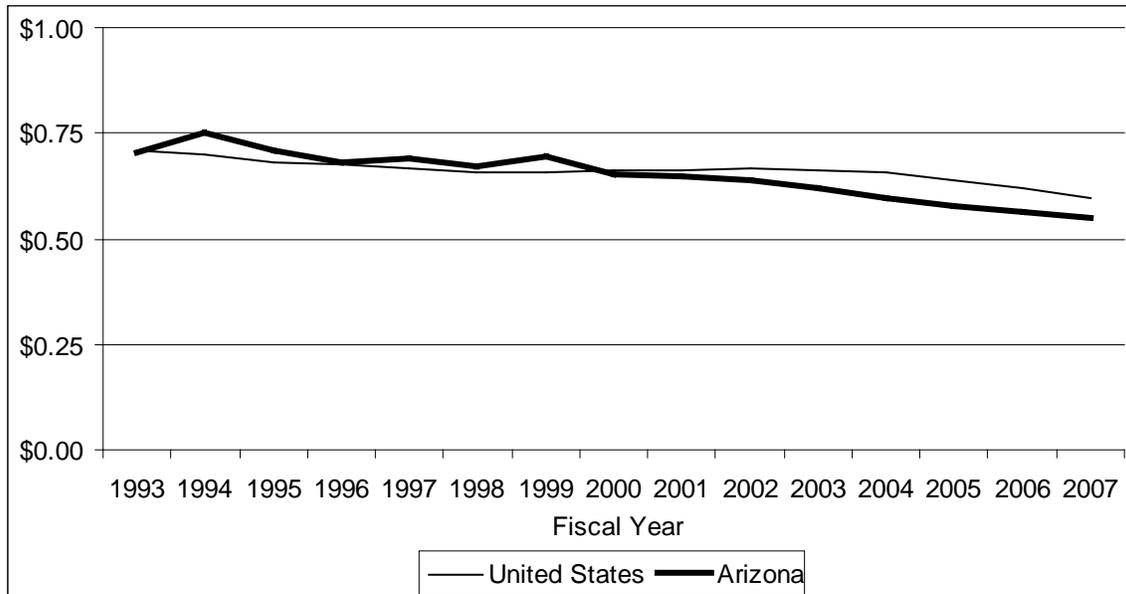
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	8%	Per Capita	-1
Per \$1,000 of Personal Income	-22%	Per \$1,000 of Personal Income	-2
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-4	Per Capita	1
Per \$1,000 of Personal Income	-8	Per \$1,000 of Personal Income	1

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STATE AND LOCAL GOVERNMENT SCHOOL LUNCH CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



CURRENT CHARGES: OTHER EDUCATION

Revenues from athletic contests, sale or rental of text books, student activity funds, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$150,122	0.37%	0.35%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$23.92	85.6%	27	5
Per \$1,000 of Personal Income	0.70	97.2	27	5

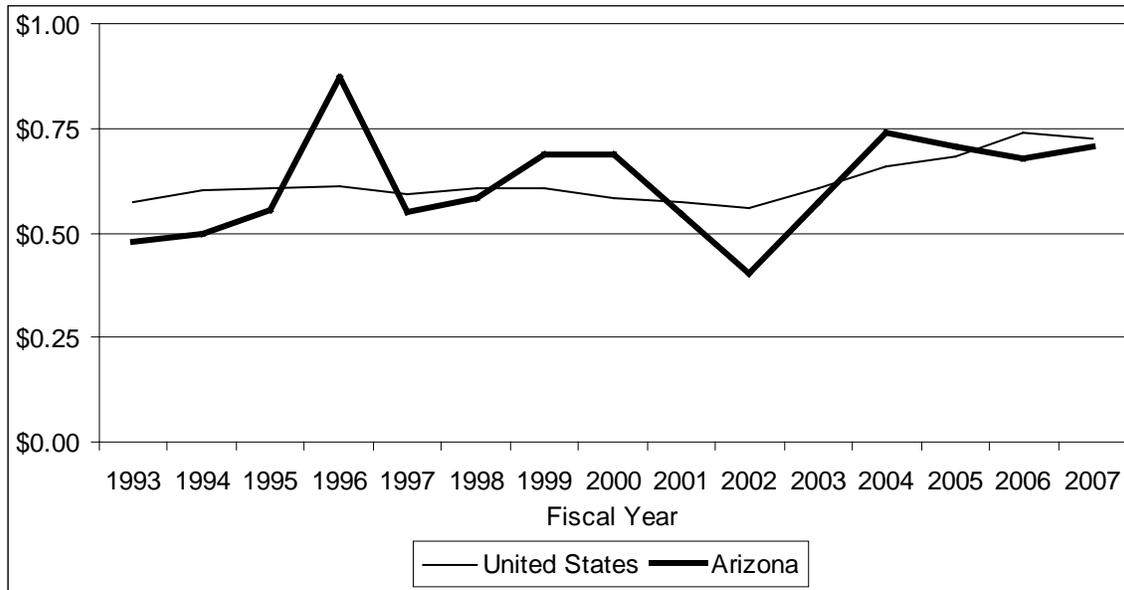
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	103%	Per Capita	2
Per \$1,000 of Personal Income	46%	Per \$1,000 of Personal Income	0
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	14	Per Capita	2
Per \$1,000 of Personal Income	13	Per \$1,000 of Personal Income	2

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STATE AND LOCAL GOVERNMENT OTHER EDUCATION CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



CURRENT CHARGES: HOSPITALS

Charges at public hospitals received from patients, private insurance companies, and public insurance programs such as Medicare.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$804,113	1.95%	3.91%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$128.10	42.2%	37	9
Per \$1,000 of Personal Income	3.77	48.0	37	9

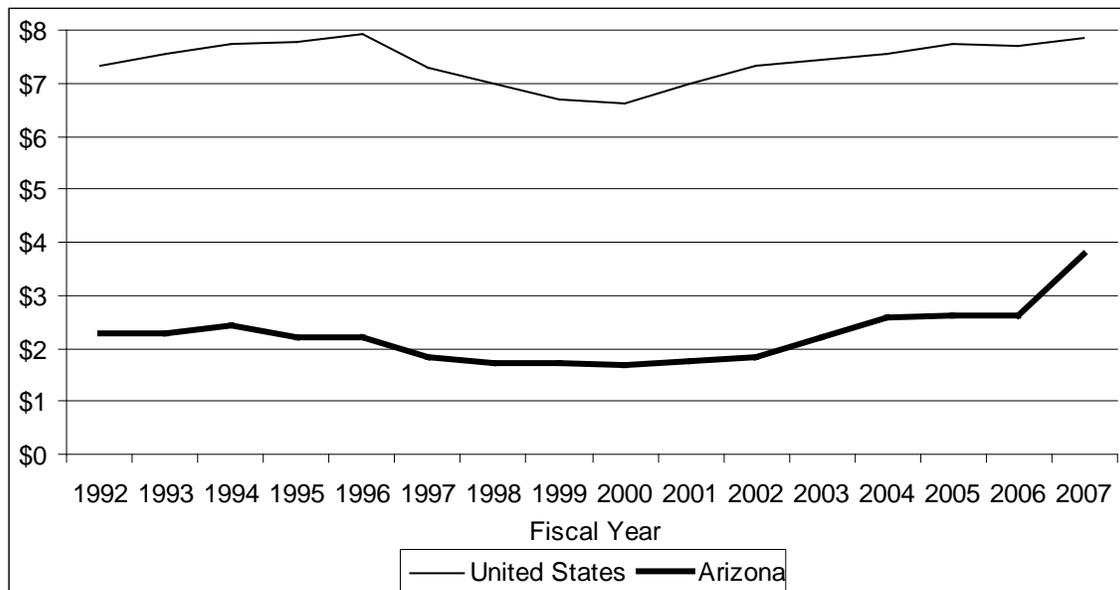
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	133%	Per Capita	6
Per \$1,000 of Personal Income	66%	Per \$1,000 of Personal Income	4
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	15	Per Capita	0
Per \$1,000 of Personal Income	17	Per \$1,000 of Personal Income	0

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STATE AND LOCAL GOVERNMENT HOSPITAL CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



CURRENT CHARGES: HIGHWAYS

Toll roads and maintenance assessments.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$14,697	0.04%	0.46%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$2.34	6.6%	45	9
Per \$1,000 of Personal Income	0.07	7.5	43	9

Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	208%	Per Capita	1
Per \$1,000 of Personal Income	121%	Per \$1,000 of Personal Income	3
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	4	Per Capita	-1
Per \$1,000 of Personal Income	4	Per \$1,000 of Personal Income	-1

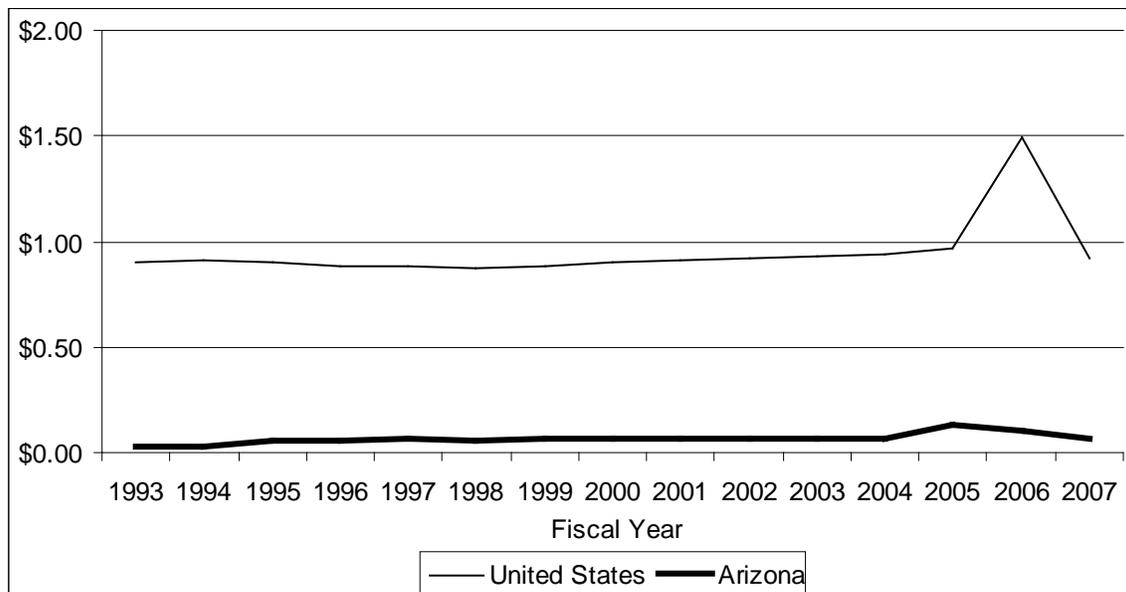
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**** Dollar values are too small to produce a meaningful percent change

STATE AND LOCAL GOVERNMENT HIGHWAY CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



CURRENT CHARGES: AIRPORTS

Charges for use of airport facilities including landing fees, terminal rents, and parking fees.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$466,876	1.13%	0.71%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$74.38	134.6%	10	4
Per \$1,000 of Personal Income	2.19	152.9	8	4

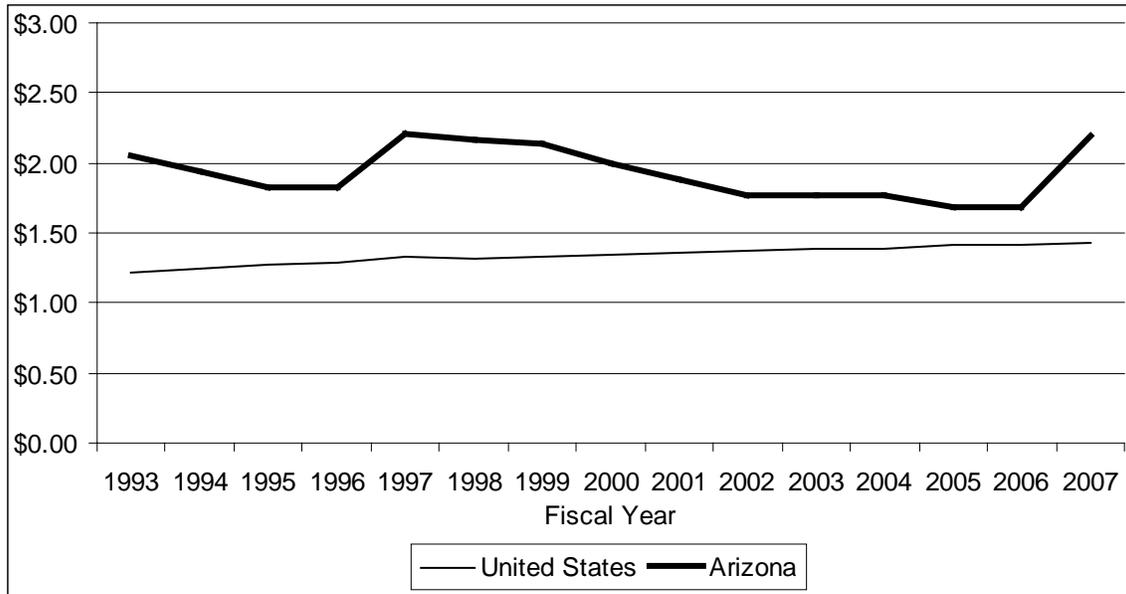
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	49%	Per Capita	-2
Per \$1,000 of Personal Income	7%	Per \$1,000 of Personal Income	-1
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-9	Per Capita	0
Per \$1,000 of Personal Income	-15	Per \$1,000 of Personal Income	-1

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STATE AND LOCAL GOVERNMENT AIRPORT CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



CURRENT CHARGES: PARKING FACILITIES

Revenue from parking meters and government-owned parking lots and garages.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$4,003	0.01%	0.08%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$0.64	10.5%	49	9
Per \$1,000 of Personal Income	0.02	11.9	50	9

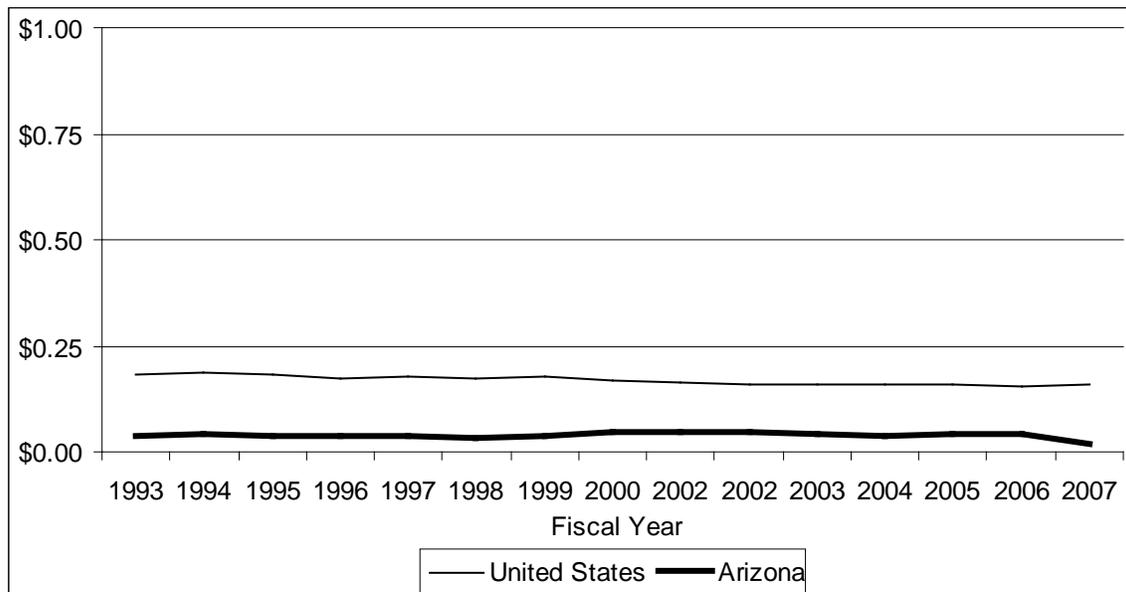
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-32%	Per Capita	-2
Per \$1,000 of Personal Income	-51%	Per \$1,000 of Personal Income	-3
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-7	Per Capita	-1
Per \$1,000 of Personal Income	-9	Per \$1,000 of Personal Income	0

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STATE AND LOCAL GOVERNMENT PARKING FACILITY CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



CURRENT CHARGES: NATURAL RESOURCES

Sale of timber, minerals, and other natural products from public lands.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$112,942	0.27%	0.17%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$17.99	133.9%	11	4
Per \$1,000 of Personal Income	0.53	152.1	11	4

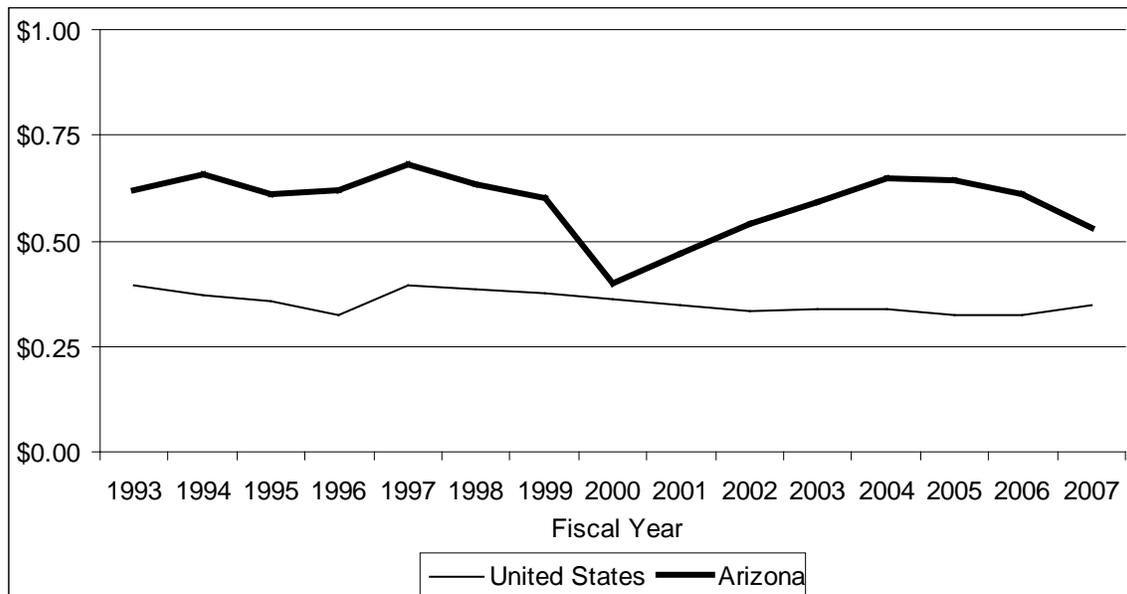
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	19%	Per Capita	2
Per \$1,000 of Personal Income	-14%	Per \$1,000 of Personal Income	1
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	0	Per Capita	1
Per \$1,000 of Personal Income	-5	Per \$1,000 of Personal Income	1

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STATE AND LOCAL GOVERNMENT NATURAL RESOURCES CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



CURRENT CHARGES: PARKS AND RECREATION

Gross revenue of facilities operated by a government (such as a swimming pool or golf course) and of auxiliary facilities in public recreation areas (such as a gift shop). Also, lease or use fees from stadiums and convention centers.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$134,503	0.33%	0.38%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$21.43	73.1%	33	7
Per \$1,000 of Personal Income	0.63	83.0	29	7

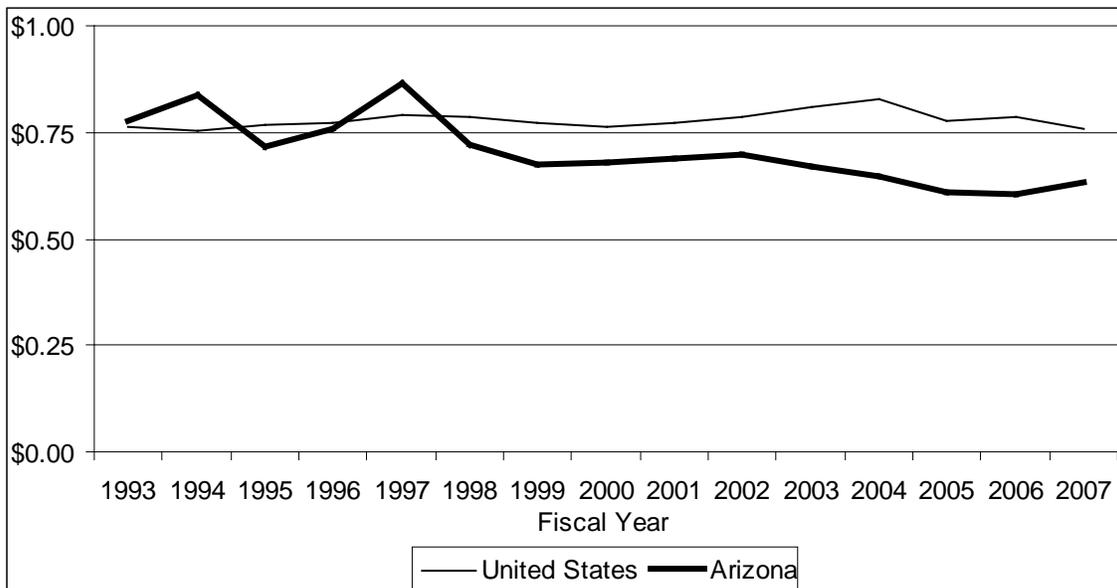
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	12%	Per Capita	-9
Per \$1,000 of Personal Income	-19%	Per \$1,000 of Personal Income	-7
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-14	Per Capita	0
Per \$1,000 of Personal Income	-19	Per \$1,000 of Personal Income	0

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STATE AND LOCAL GOVERNMENT PARKS AND RECREATION CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



CURRENT CHARGES: HOUSING

Revenue from operation of public housing projects.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$23,031	0.06%	0.23%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$3.67	20.3%	51	9
Per \$1,000 of Personal Income	0.11	23.0	50	9

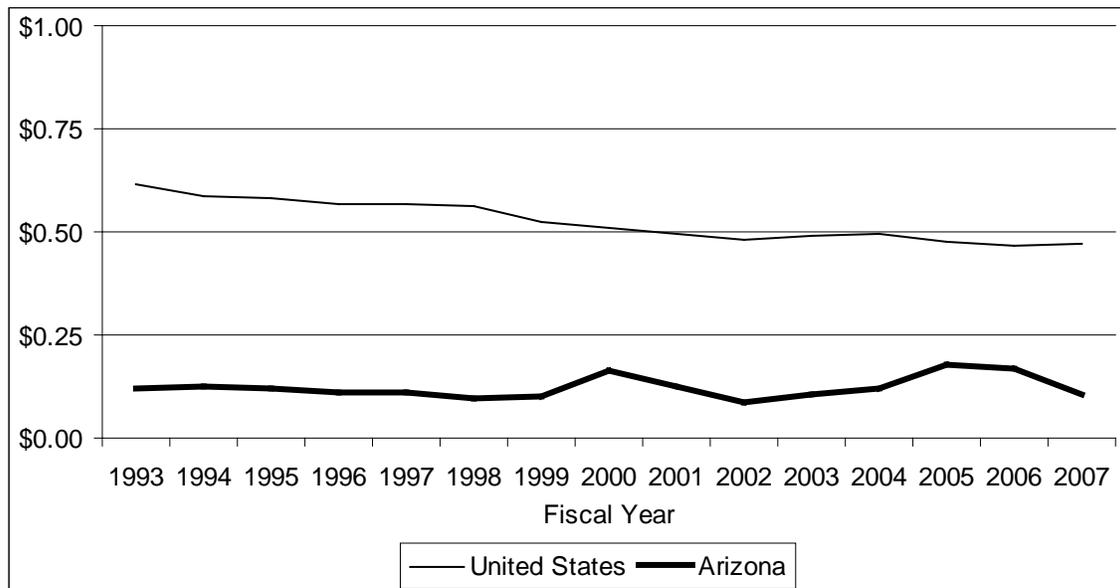
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	23%	Per Capita	-1
Per \$1,000 of Personal Income	-12%	Per \$1,000 of Personal Income	0
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	3	Per Capita	0
Per \$1,000 of Personal Income	3	Per \$1,000 of Personal Income	0

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STATE AND LOCAL GOVERNMENT HOUSING CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



CURRENT CHARGES: SEWERAGE

Charges for sewage collection and disposal, including connection fees.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$629,089	1.52%	1.55%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$100.22	83.2%	30	8
Per \$1,000 of Personal Income	2.95	94.5	25	8

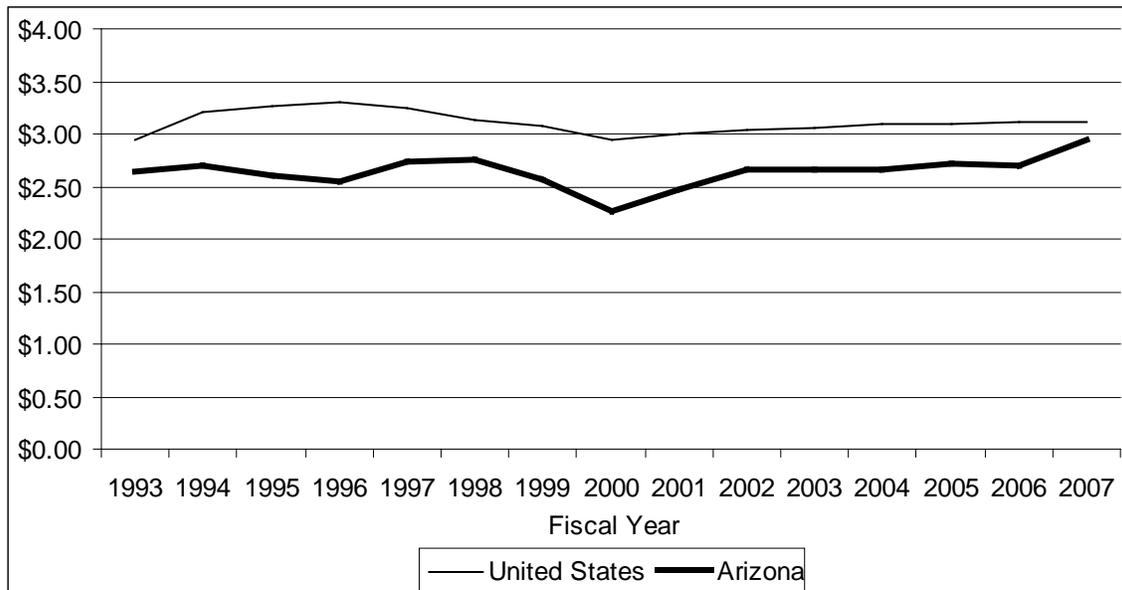
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	56%	Per Capita	-1
Per \$1,000 of Personal Income	12%	Per \$1,000 of Personal Income	2
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	6	Per Capita	0
Per \$1,000 of Personal Income	5	Per \$1,000 of Personal Income	0

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STATE AND LOCAL GOVERNMENT SEWERAGE CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



CURRENT CHARGES: SOLID WASTE MANAGEMENT

Fees for garbage collection and disposal, for the operation of landfills, for the cleanup of hazardous waste, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$380,618	0.92%	0.62%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$60.64	125.7%	16	5
Per \$1,000 of Personal Income	1.78	142.8	12	4

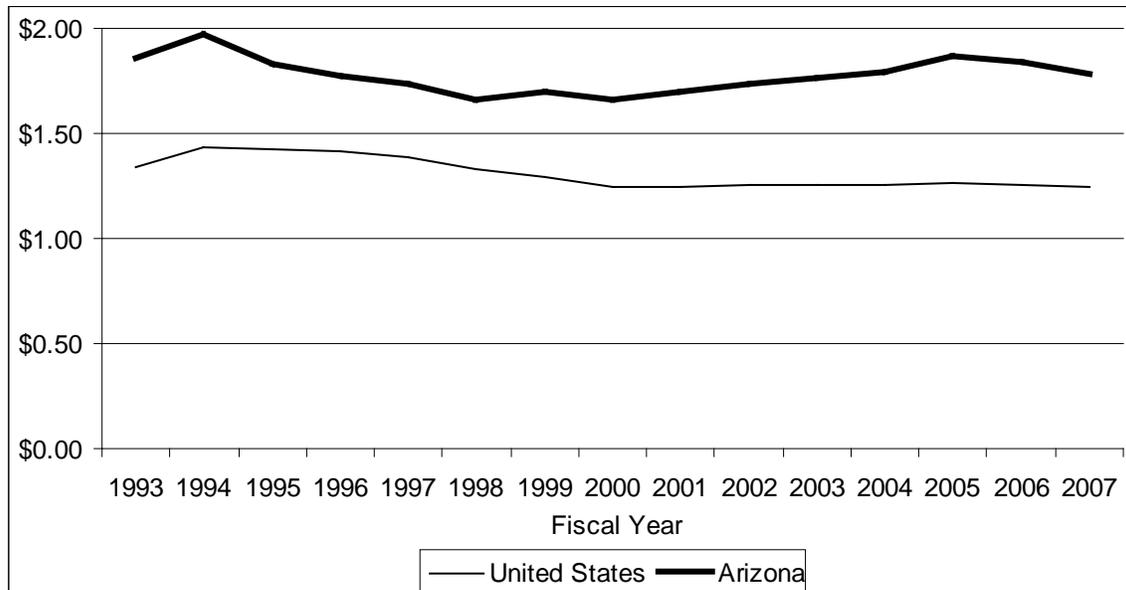
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	34%	Per Capita	-2
Per \$1,000 of Personal Income	-4%	Per \$1,000 of Personal Income	-1
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	7	Per Capita	-1
Per \$1,000 of Personal Income	4	Per \$1,000 of Personal Income	0

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*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT SOLID WASTE CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



OTHER CURRENT CHARGES

Examples include court and recording fees, public library fees, and fees assessed for public welfare programs.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$736,323	1.78%	2.36%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$117.30	64.2%	37	7
Per \$1,000 of Personal Income	3.45	72.9	33	6

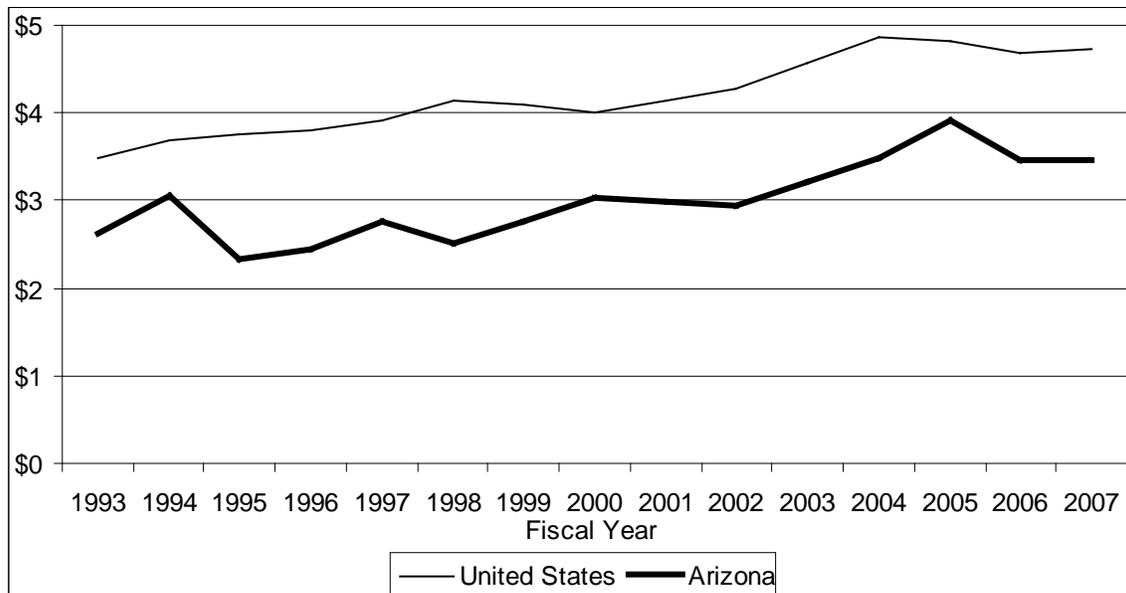
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	83%	Per Capita	2
Per \$1,000 of Personal Income	32%	Per \$1,000 of Personal Income	-1
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	0	Per Capita	1
Per \$1,000 of Personal Income	-2	Per \$1,000 of Personal Income	1

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT OTHER CHARGES COLLECTED PER \$1,000 OF PERSONAL INCOME



MISCELLANEOUS REVENUE

Revenue from interest earnings, special assessments, sale of property, and a host of other sources.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$4,113,110	9.95%	10.08%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$655.25	83.8%	38	9
Per \$1,000 of Personal Income	19.29	95.2	31	8

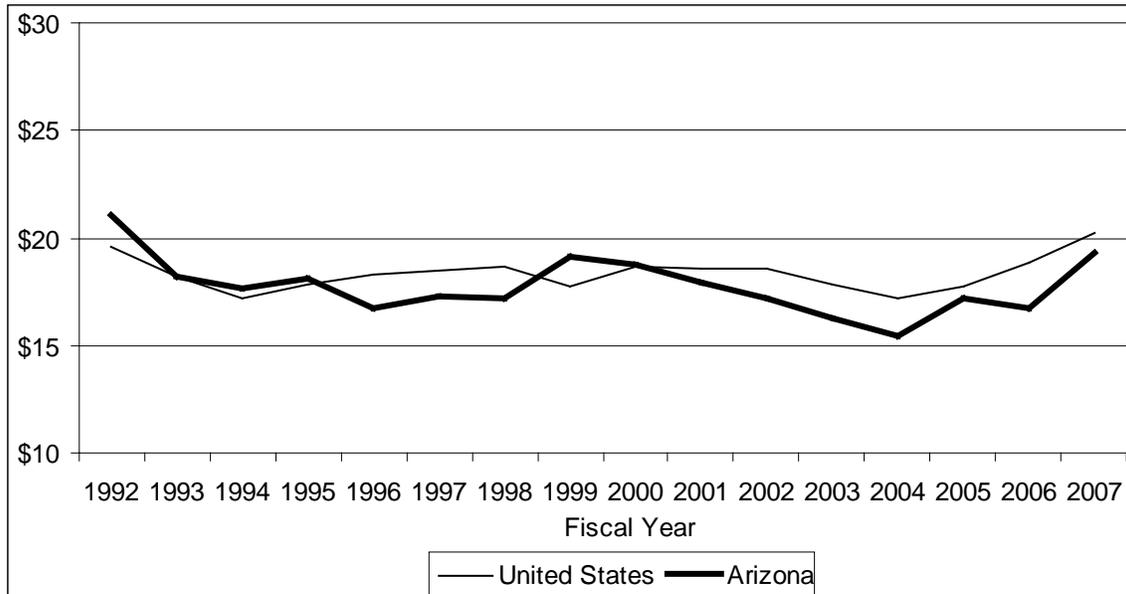
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	29%	Per Capita	-9
Per \$1,000 of Personal Income	-8%	Per \$1,000 of Personal Income	-14
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-9	Per Capita	-2
Per \$1,000 of Personal Income	-12	Per \$1,000 of Personal Income	-3

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT MISCELLANEOUS REVENUE COLLECTED PER \$1,000 OF PERSONAL INCOME



INTEREST EARNINGS

Amounts earned from all interest-bearing deposits and accounts.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$1,614,668	3.91%	4.00%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$257.23	82.9%	38	9
Per \$1,000 of Personal Income	7.57	94.2	30	7

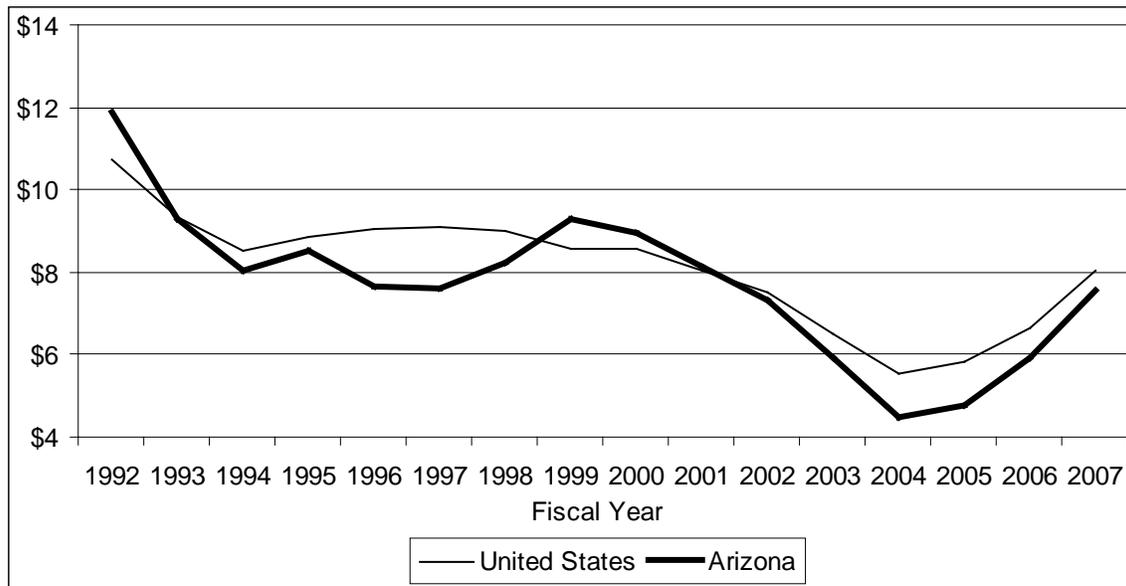
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-10%	Per Capita	-10
Per \$1,000 of Personal Income	-36%	Per \$1,000 of Personal Income	-9
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-13	Per Capita	-1
Per \$1,000 of Personal Income	-17	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT INTEREST EARNINGS COLLECTED PER \$1,000 OF PERSONAL INCOME



SPECIAL ASSESSMENTS

Impact fees to extend physical infrastructure to new developments and assessments for the improvement of infrastructure.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$124,490	0.30%	0.35%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$19.83	72.8%	22	7
Per \$1,000 of Personal Income	0.58	82.7	21	7

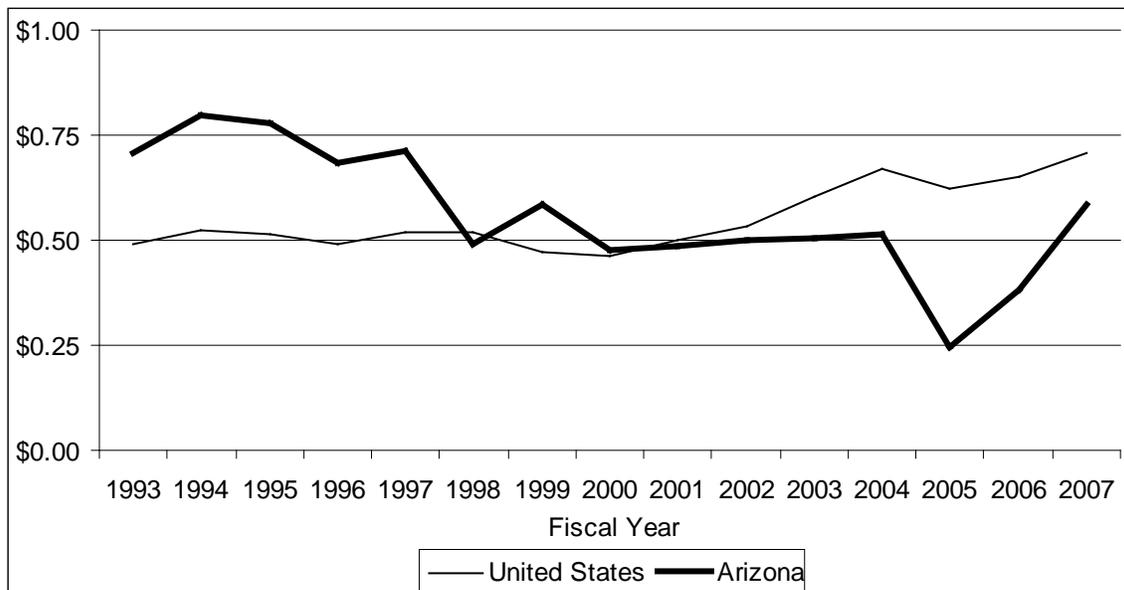
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	14%	Per Capita	-7
Per \$1,000 of Personal Income	-18%	Per \$1,000 of Personal Income	-8
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-51	Per Capita	-1
Per \$1,000 of Personal Income	-63	Per \$1,000 of Personal Income	-2

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT SPECIAL ASSESSMENTS COLLECTED PER \$1,000 OF PERSONAL INCOME



SALE OF PROPERTY

Amounts received from the sale of real property, such as land and buildings, and other capital assets.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$273,600	0.66%	0.20%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$43.59	281.5%	3	2
Per \$1,000 of Personal Income	1.28	319.8	3	2

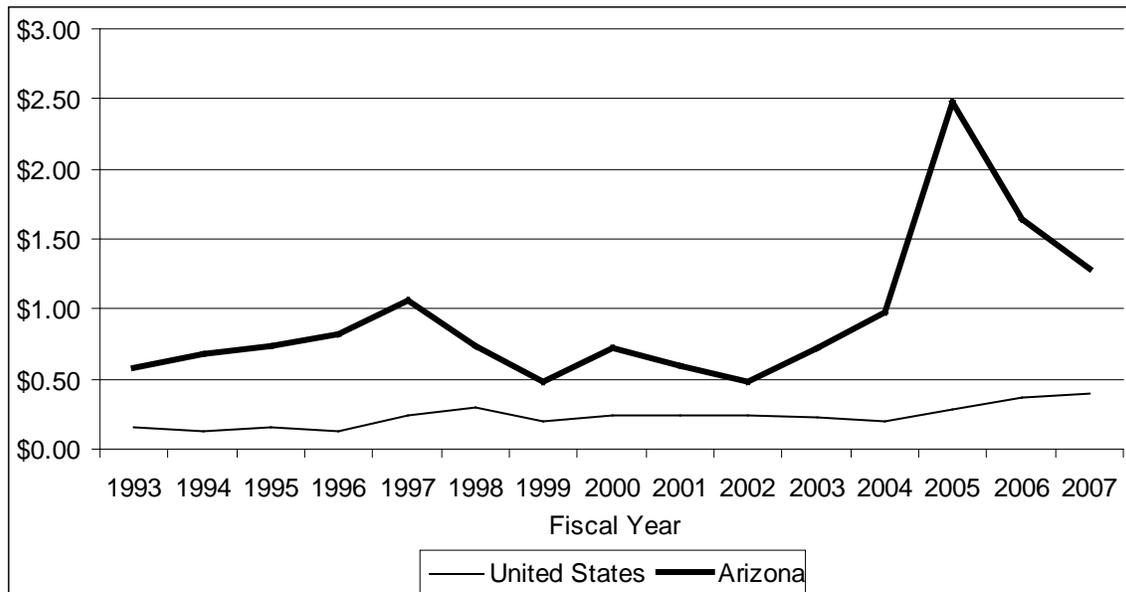
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	205%	Per Capita	2
Per \$1,000 of Personal Income	119%	Per \$1,000 of Personal Income	2
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-43	Per Capita	0
Per \$1,000 of Personal Income	-59	Per \$1,000 of Personal Income	0

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT REVENUE FROM SALE OF PROPERTY PER \$1,000 OF PERSONAL INCOME



MISCELLANEOUS REVENUE

Revenue received from lotteries, rents, fines and forfeits, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Revenue	
	\$ in 000	Arizona	United States
2007	\$2,100,352	5.08%	5.53%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$334.60	78.0%	40	8
Per \$1,000 of Personal Income	9.85	88.5	33	8

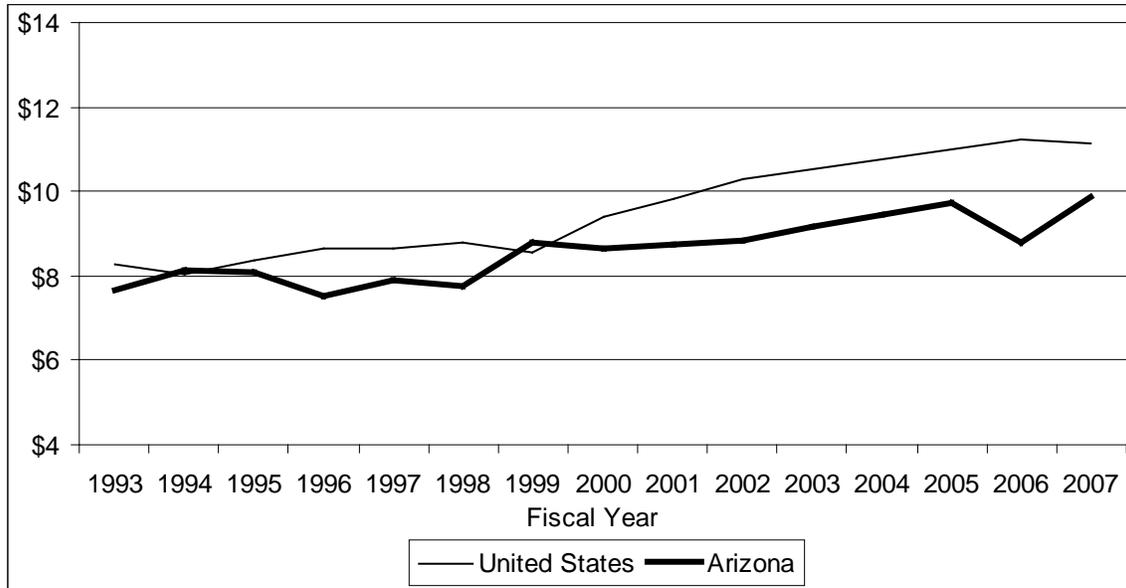
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	79%	Per Capita	-9
Per \$1,000 of Personal Income	29%	Per \$1,000 of Personal Income	-7
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-1	Per Capita	-1
Per \$1,000 of Personal Income	-4	Per \$1,000 of Personal Income	-2

* 50 states plus District of Columbia; a rank of 1 represents the highest revenue

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest revenue

*** A negative change in rank means that revenue fell relative to other states

STATE AND LOCAL GOVERNMENT MISCELLANEOUS REVENUE COLLECTED PER \$1,000 OF PERSONAL INCOME



APPENDIX B STATE AND LOCAL GOVERNMENT GENERAL EXPENDITURES: DETAIL

In this appendix, which supplements Chapter 6, detail is provided on one page for each general expenditure category used by the Census Bureau. Following a brief description of the category, the dollar value in Arizona and the share of total expenditures in Arizona and the United States in fiscal year 2007 is provided.

Next, the fiscal year 2007 dollar value in Arizona is expressed per capita and per \$1,000 of personal income, with Arizona's figure as a percentage of the national average and its ranks among all 51 'states' (including the District of Columbia) and among the nine western states (Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington) shown for each measure. In all cases, the ratio to the national average is higher for the personal income measure than the per capita measure due to Arizona's low average income. However, as discussed in Chapter 1, the personal income measure understates income in Arizona relative to other states and the national average. Thus, Arizona's expenditures relative to income are not quite as high as a percentage of the national average as indicated by the personal income measure.

The next table on each page looks at the change between fiscal years 1992 and 2007, both in per capita terms and per \$1,000 of personal income. (For some categories, the data for fiscal year 1992 are not available, so the comparison is between fiscal years 1993 and 2007.) The change is expressed as the percent change in the dollar value in Arizona, in the ratio to (percentage of) the national average, in the national rank, and in the rank among the western states.

Finally, a chart is provided that displays the year-by-year expenditure per \$1,000 of personal income for Arizona and for the United States. Data for Arizona for fiscal years 2001 and 2003 are not available; the values for those fiscal years were estimated as midway between the values of the preceding and succeeding years.

TOTAL GENERAL EXPENDITURES

Total expenditures for all purposes, including capital outlays, except intergovernmental expenditures and those related to public utilities, liquor stores, and insurance trusts.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$39,416,869	100%	100%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$6,279.40	83.4%	46	8
Per \$1,000 of Personal Income	184.83	94.7	37	6

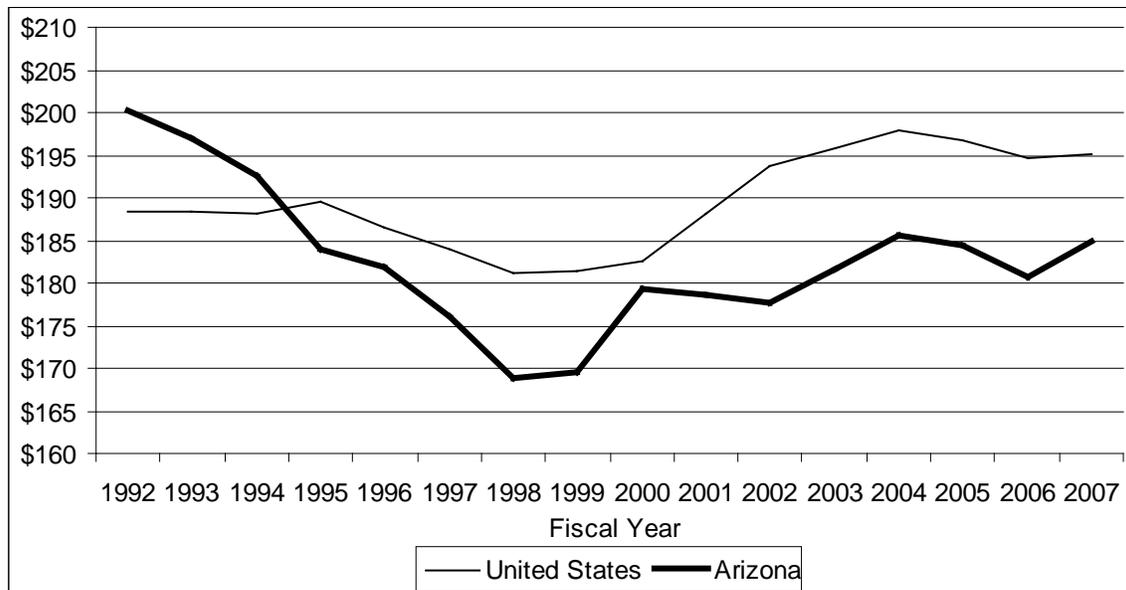
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	30%	Per Capita	-16
Per \$1,000 of Personal Income	-8%	Per \$1,000 of Personal Income	-16
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-8	Per Capita	-1
Per \$1,000 of Personal Income	-12	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT TOTAL GENERAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



EDUCATION SERVICES

Summation of expenditures for education and libraries.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$13,158,882	33.38%	34.83%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$2,096.31	79.9%	48	9
Per \$1,000 of Personal Income	61.70	90.7	40	7

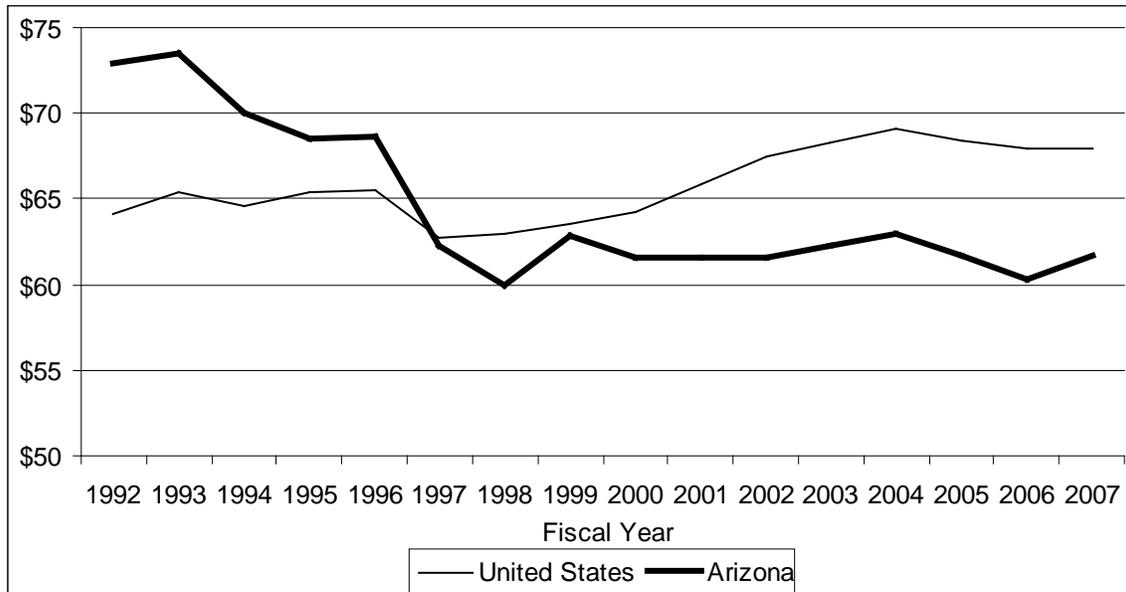
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	19%	Per Capita	-21
Per \$1,000 of Personal Income	-15%	Per \$1,000 of Personal Income	-21
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-18	Per Capita	-2
Per \$1,000 of Personal Income	-23	Per \$1,000 of Personal Income	-2

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT EDUCATION SERVICES EXPENDITURES PER \$1,000 OF PERSONAL INCOME



EDUCATION

Summation of expenditures for elementary and secondary, higher, and other education.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$12,972,448	32.91%	34.35%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$2,066.61	79.9%	48	9
Per \$1,000 of Personal Income	60.83	90.7	40	7

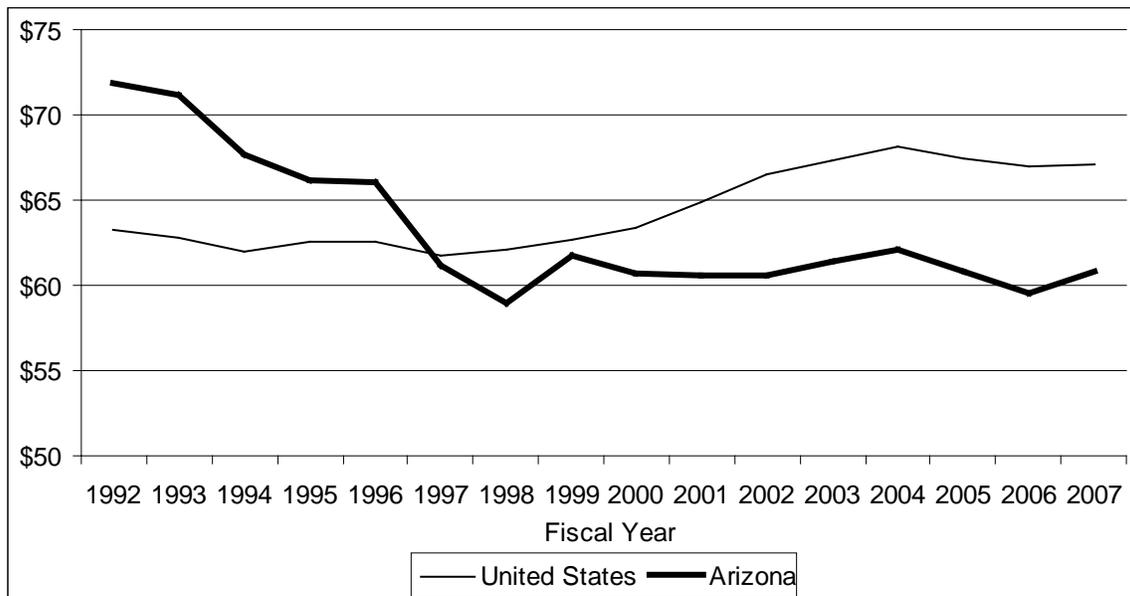
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	19%	Per Capita	-22
Per \$1,000 of Personal Income	-15%	Per \$1,000 of Personal Income	-20
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-18	Per Capita	-2
Per \$1,000 of Personal Income	-13	Per \$1,000 of Personal Income	-2

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT EDUCATION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



HIGHER EDUCATION

Expenditures for degree-granting institutions operated by state and local governments, including community colleges and universities. Includes operation of dormitories, bookstores, athletic facilities, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$3,925,486	9.96%	9.04%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$625.36	91.8%	33	8
Per \$1,000 of Personal Income	18.41	104.3	29	6

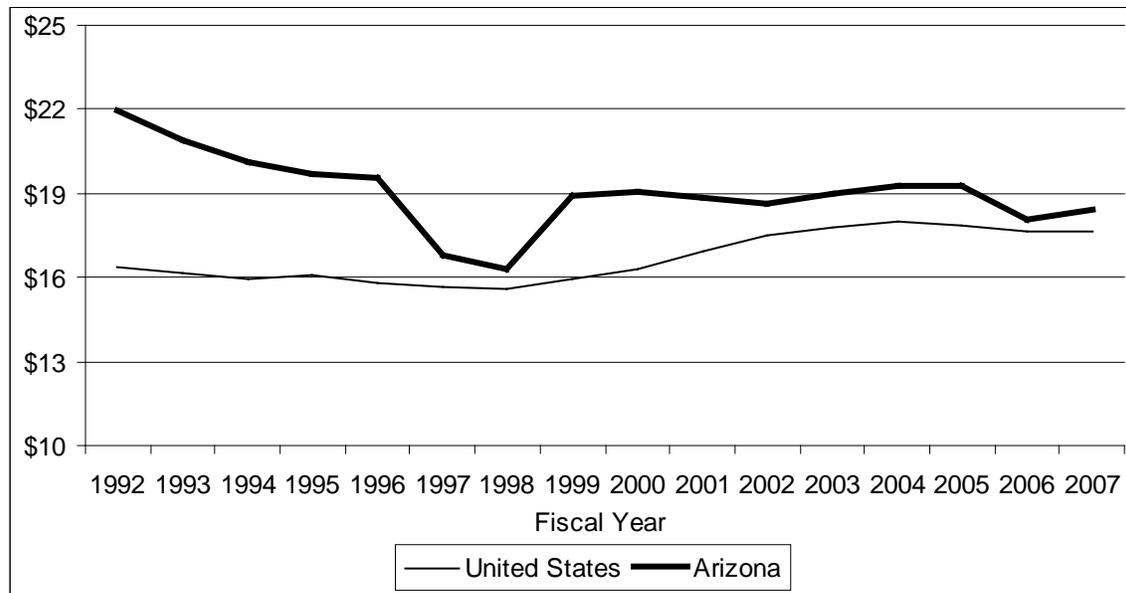
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	18%	Per Capita	-15
Per \$1,000 of Personal Income	-16%	Per \$1,000 of Personal Income	-17
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-24	Per Capita	-2
Per \$1,000 of Personal Income	-30	Per \$1,000 of Personal Income	-3

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT HIGHER EDUCATION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



ELEMENTARY AND SECONDARY EDUCATION

Expenditures for the operation, maintenance, and construction of public schools and related facilities.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$8,509,080	21.59%	23.66%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$1,355.56	76.0%	47	8
Per \$1,000 of Personal Income	39.90	86.4	45	7

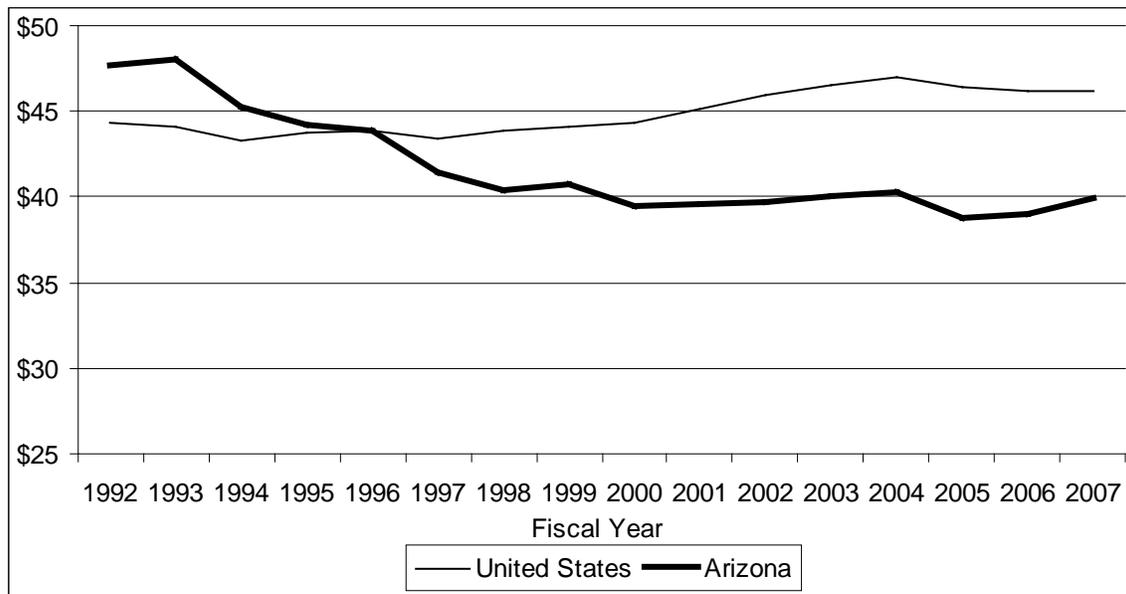
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	18%	Per Capita	-16
Per \$1,000 of Personal Income	-16%	Per \$1,000 of Personal Income	-22
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-17	Per Capita	0
Per \$1,000 of Personal Income	-21	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT ELEMENTARY AND SECONDARY EDUCATION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



OTHER EDUCATION

Includes programs for adult, vocational, or special education operating outside of school districts; programs and institutions for the blind, deaf, and other handicapped; and payments to individuals for tuition, scholarships, and other financial aid.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$537,882	1.36%	1.65%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$85.69	68.9%	41	5
Per \$1,000 of Personal Income	2.52	78.2	38	5

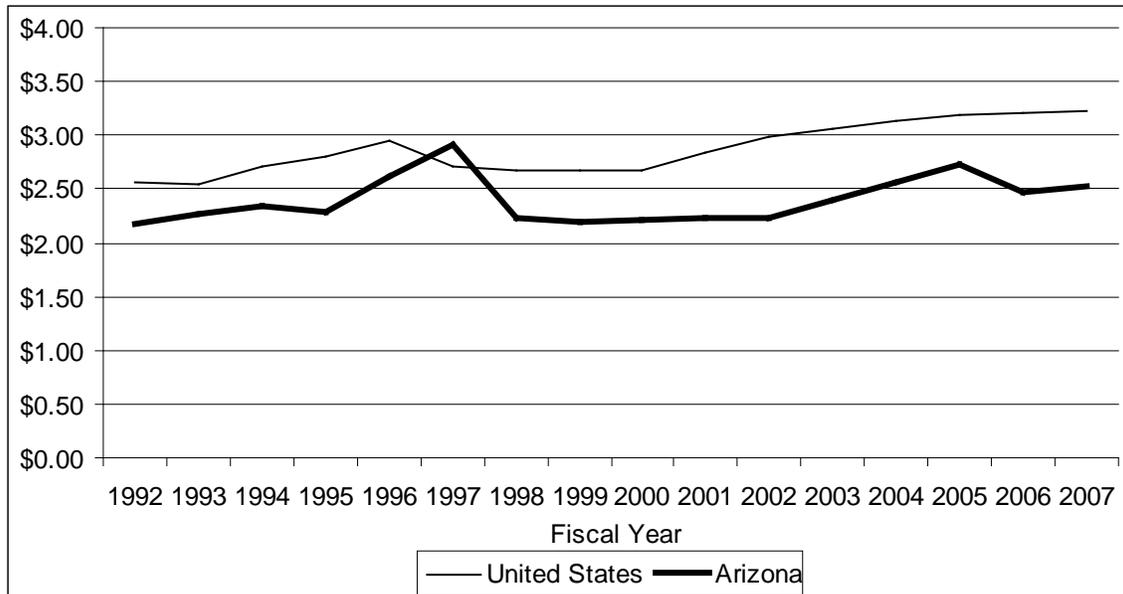
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	63%	Per Capita	4
Per \$1,000 of Personal Income	16%	Per \$1,000 of Personal Income	-2
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-4	Per Capita	1
Per \$1,000 of Personal Income	-6	Per \$1,000 of Personal Income	0

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT OTHER EDUCATION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



LIBRARIES

Expenditures for the establishment and operation of public libraries, including bookmobiles.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$186,434	0.47%	0.48%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$29.70	82.8%	30	7
Per \$1,000 of Personal Income	0.87	94.0	29	8

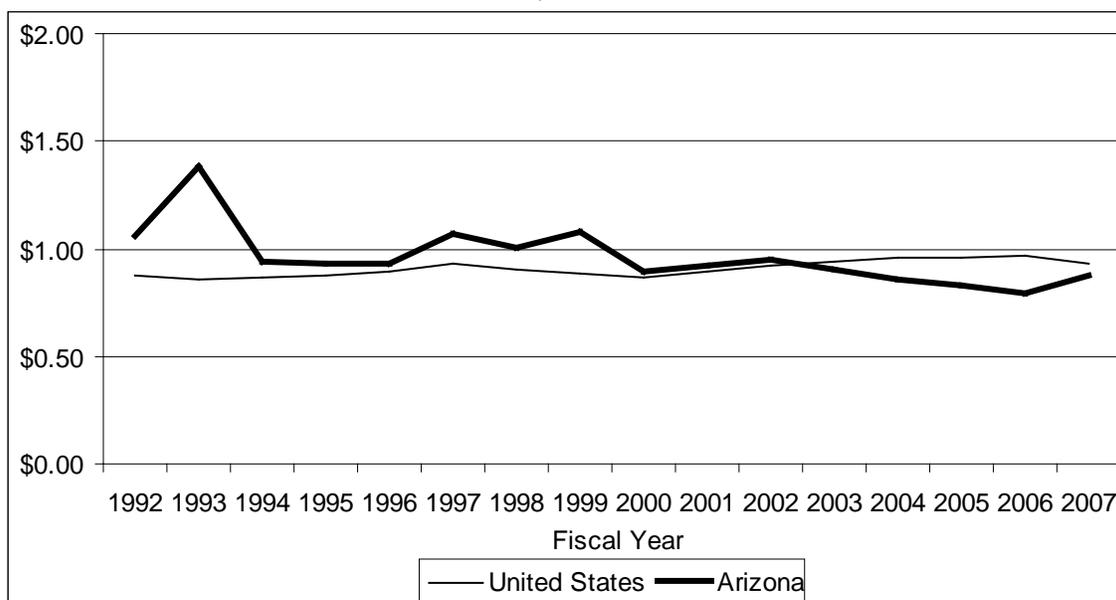
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	16%	Per Capita	-9
Per \$1,000 of Personal Income	-18%	Per \$1,000 of Personal Income	-14
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-22	Per Capita	-1
Per \$1,000 of Personal Income	-27	Per \$1,000 of Personal Income	-2

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT LIBRARIES EXPENDITURES PER \$1,000 OF PERSONAL INCOME



SOCIAL SERVICES AND INCOME MAINTENANCE

Summation of expenditures for public welfare, hospitals, other health, employment security administration, and veterans' services.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$9,402,619	23.85%	25.77%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$1,497.91	77.2%	43	5
Per \$1,000 of Personal Income	44.09	87.6	36	5

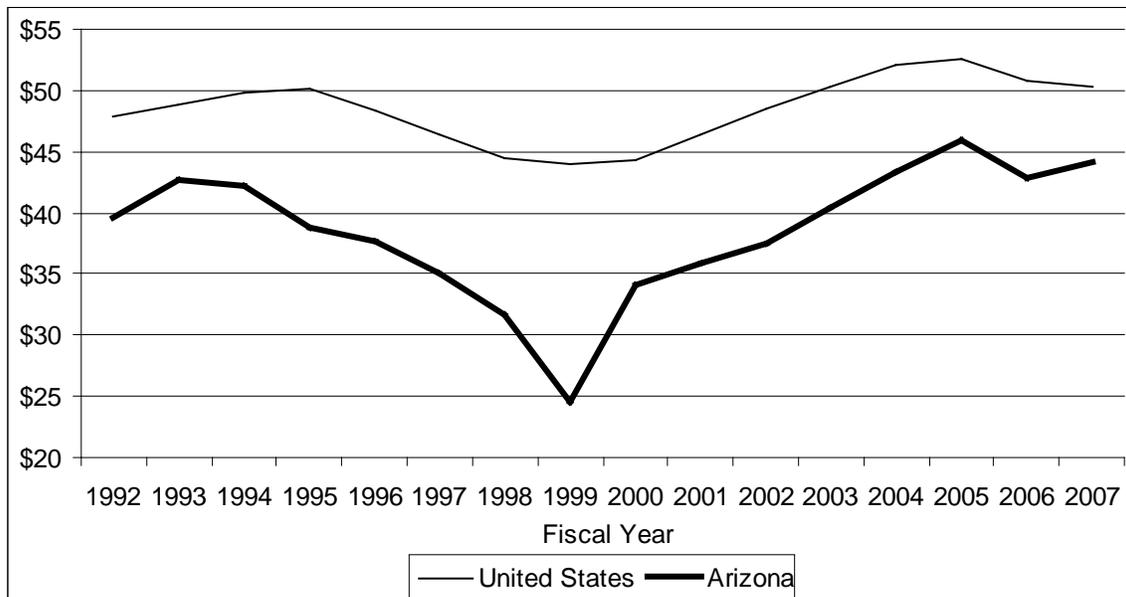
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	56%	Per Capita	0
Per \$1,000 of Personal Income	11%	Per \$1,000 of Personal Income	0
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	6	Per Capita	2
Per \$1,000 of Personal Income	5	Per \$1,000 of Personal Income	1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT SOCIAL SERVICES AND INCOME MAINTENANCE EXPENDITURES PER \$1,000 OF PERSONAL INCOME



PUBLIC WELFARE

Summation of cash assistance payments, vendor payments, and other public welfare.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$6,577,168	16.69%	17.01%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$1,047.79	81.8%	38	4
Per \$1,000 of Personal Income	30.84	92.9	30	2

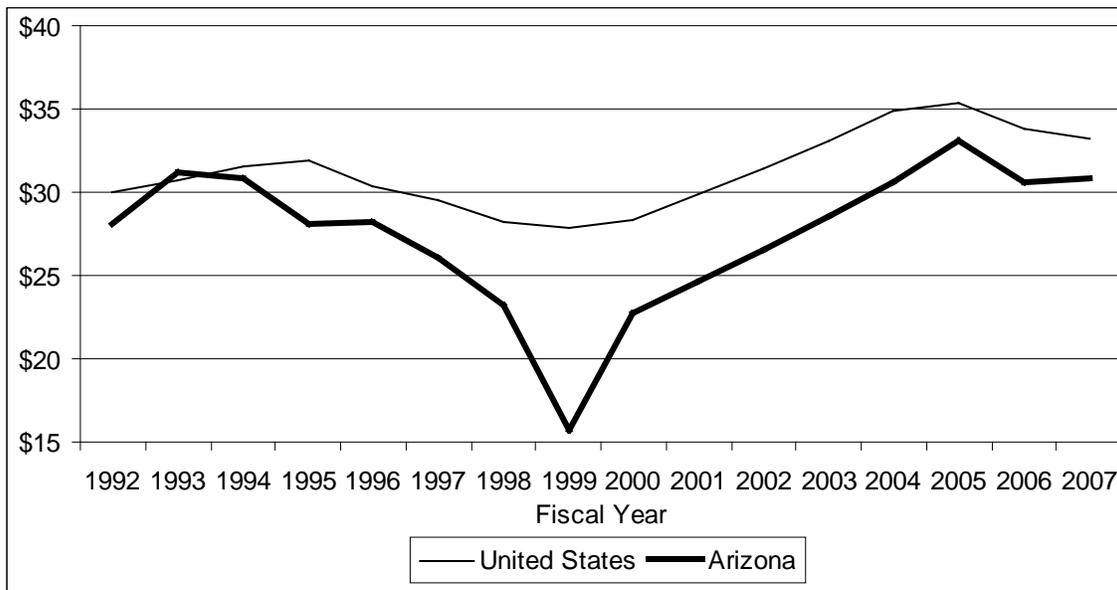
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	55%	Per Capita	-7
Per \$1,000 of Personal Income	10%	Per \$1,000 of Personal Income	-5
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	1	Per Capita	-1
Per \$1,000 of Personal Income	-1	Per \$1,000 of Personal Income	1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT PUBLIC WELFARE EXPENDITURES PER \$1,000 OF PERSONAL INCOME



CASH ASSISTANCE PAYMENTS

Cash payments made directly to individuals contingent on need, including general assistance, emergency relief, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$171,937	0.44%	0.87%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$27.39	41.8%	40	7
Per \$1,000 of Personal Income	0.81	47.4	39	7

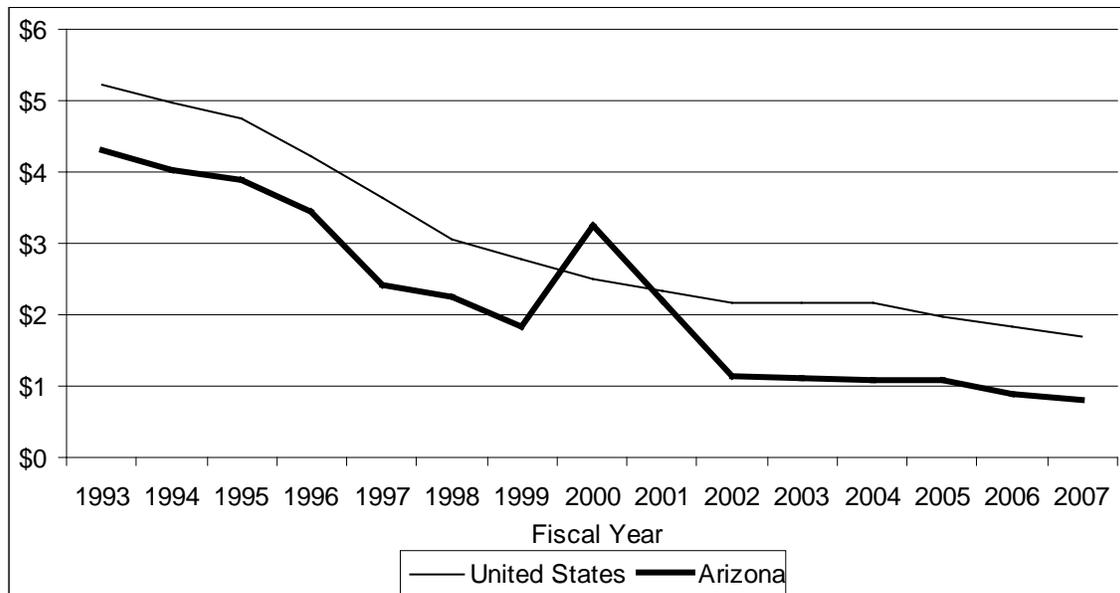
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-74%	Per Capita	-17
Per \$1,000 of Personal Income	-81%	Per \$1,000 of Personal Income	-20
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-29	Per Capita	-3
Per \$1,000 of Personal Income	-35	Per \$1,000 of Personal Income	-3

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT CASH ASSISTANCE PAYMENTS PER \$1,000 OF PERSONAL INCOME



VENDOR PAYMENTS

Public welfare payments made directly to vendors for medical assistance and other programs.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$4,918,149	12.48%	12.64%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$783.50	82.3%	39	2
Per \$1,000 of Personal Income	23.06	93.4	30	2

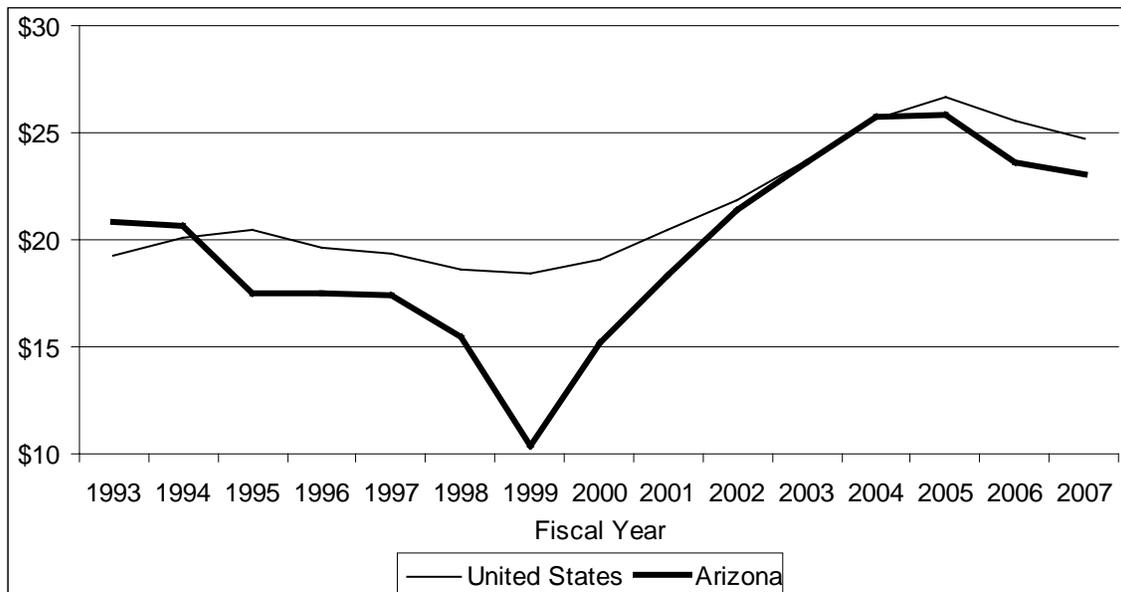
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	54%	Per Capita	-11
Per \$1,000 of Personal Income	11%	Per \$1,000 of Personal Income	-10
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-10	Per Capita	0
Per \$1,000 of Personal Income	-15	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT VENDOR PAYMENTS PER \$1,000 OF PERSONAL INCOME



OTHER PUBLIC WELFARE

Expenditures for provision, construction, and maintenance of nursing homes and welfare institutions owned and operated by a government for the benefit of needy persons; administration of public welfare programs; services for children, such as foster care; social services for physically disabled; etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,487,082	3.77%	3.49%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$236.90	90.0%	24	4
Per \$1,000 of Personal Income	6.97	102.2	22	4

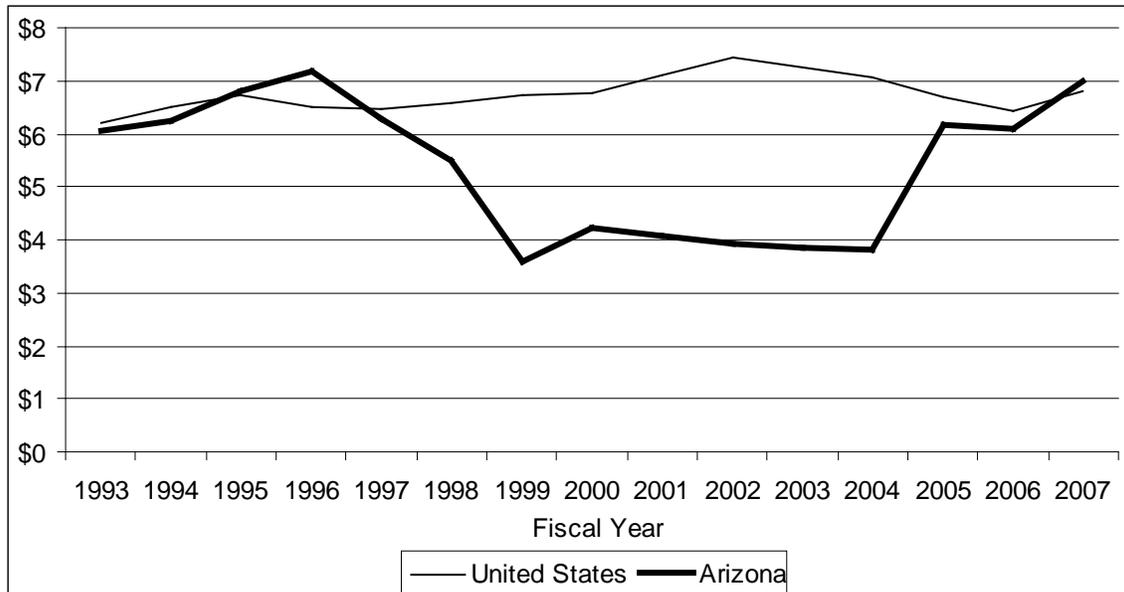
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	60%	Per Capita	5
Per \$1,000 of Personal Income	15%	Per \$1,000 of Personal Income	3
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	6	Per Capita	1
Per \$1,000 of Personal Income	4	Per \$1,000 of Personal Income	1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT OTHER PUBLIC WELFARE EXPENDITURES PER \$1,000 OF PERSONAL INCOME



HOSPITALS

Expenditures related to a government's own hospitals as well as expenditures for the provision of care in other hospitals.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,146,562	2.91%	5.24%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$182.66	46.3%	40	9
Per \$1,000 of Personal Income	5.38	52.5	37	9

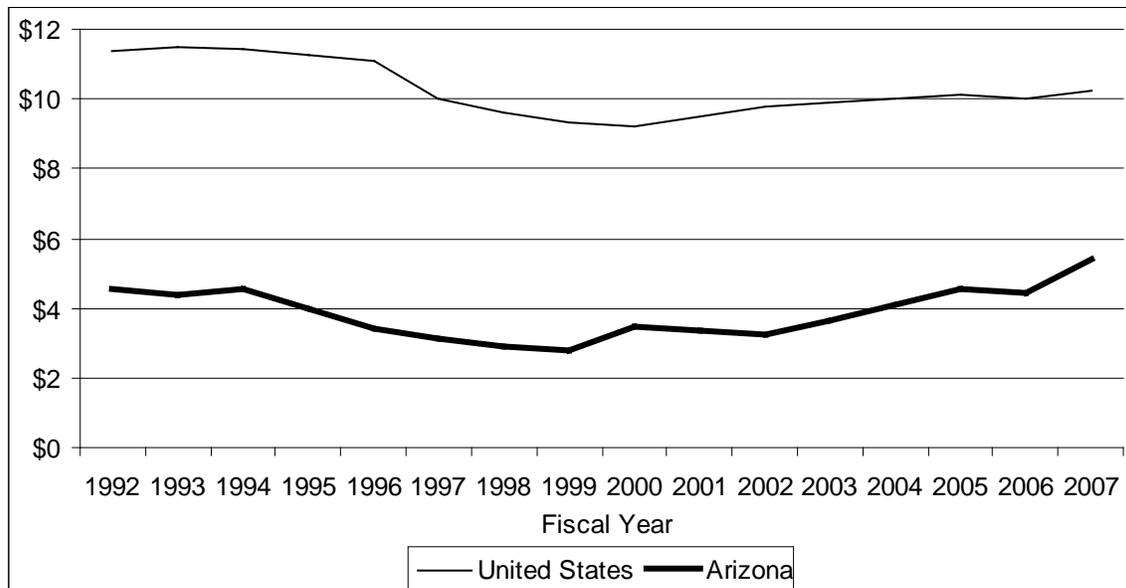
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	65%	Per Capita	7
Per \$1,000 of Personal Income	18%	Per \$1,000 of Personal Income	10
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	12	Per Capita	0
Per \$1,000 of Personal Income	12	Per \$1,000 of Personal Income	0

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

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STATE AND LOCAL GOVERNMENT HOSPITALS EXPENDITURES PER \$1,000 OF PERSONAL INCOME



HEALTH

Expenditures for the provision of services for the improvement of public health other than hospital care.
Includes community health care programs, regulation of air and water quality, animal control, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,620,254	4.11%	3.30%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$258.12	103.9%	17	3
Per \$1,000 of Personal Income	7.60	118.1	15	4

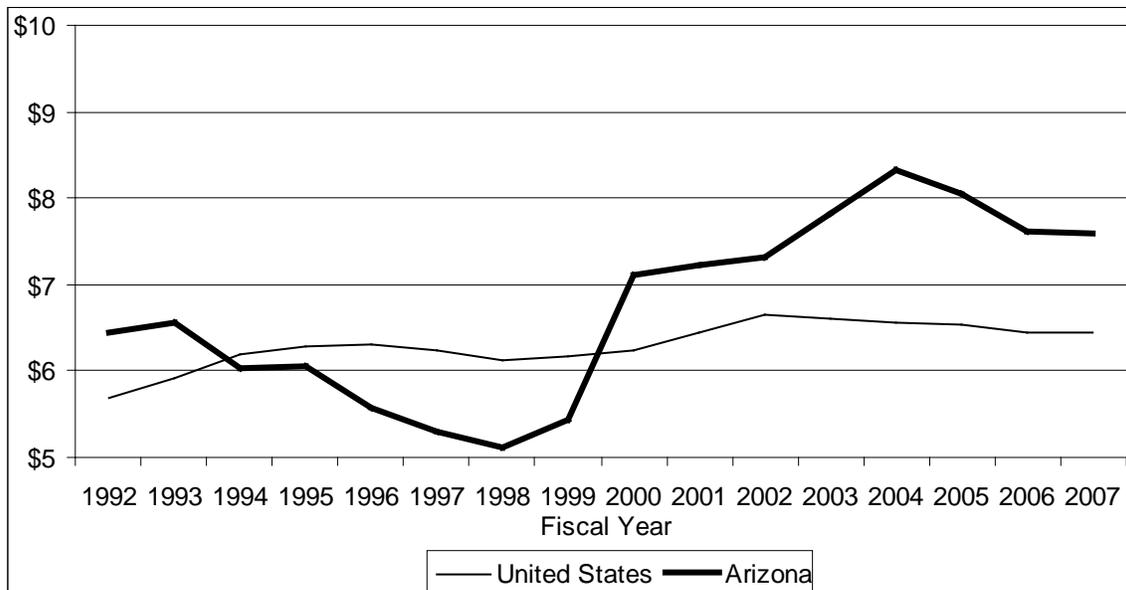
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	66%	Per Capita	4
Per \$1,000 of Personal Income	18%	Per \$1,000 of Personal Income	1
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	6	Per Capita	2
Per \$1,000 of Personal Income	5	Per \$1,000 of Personal Income	1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT HEALTH EXPENDITURES PER \$1,000 OF PERSONAL INCOME



EMPLOYMENT SECURITY ADMINISTRATION

Administrative costs for unemployment compensation, employment services, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$53,177	0.13%	0.18%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$8.47	63.9%	45	7
Per \$1,000 of Personal Income	0.25	72.5	41	6

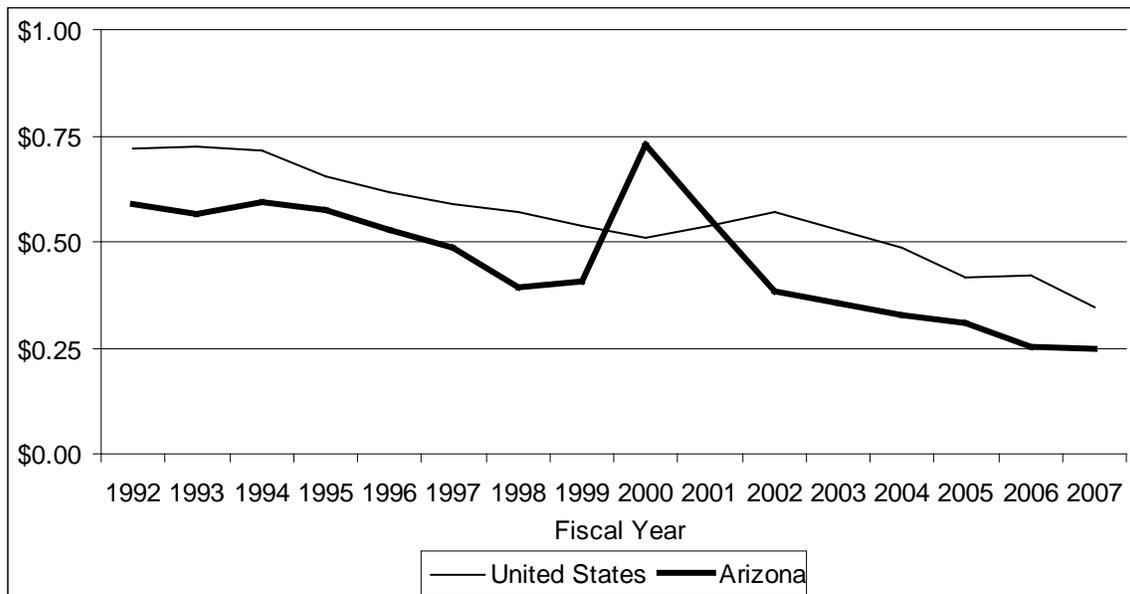
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-41%	Per Capita	2
Per \$1,000 of Personal Income	-58%	Per \$1,000 of Personal Income	2
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-7	Per Capita	2
Per \$1,000 of Personal Income	-9	Per \$1,000 of Personal Income	3

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

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STATE AND LOCAL GOVERNMENT EMPLOYMENT SECURITY ADMINISTRATION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



VETERANS' SERVICES

Expenditures for veterans' services not classified elsewhere.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$5,458	0.01%	0.05%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$0.87	25.3%	27	5
Per \$1,000 of Personal Income	0.03	28.8	23	5

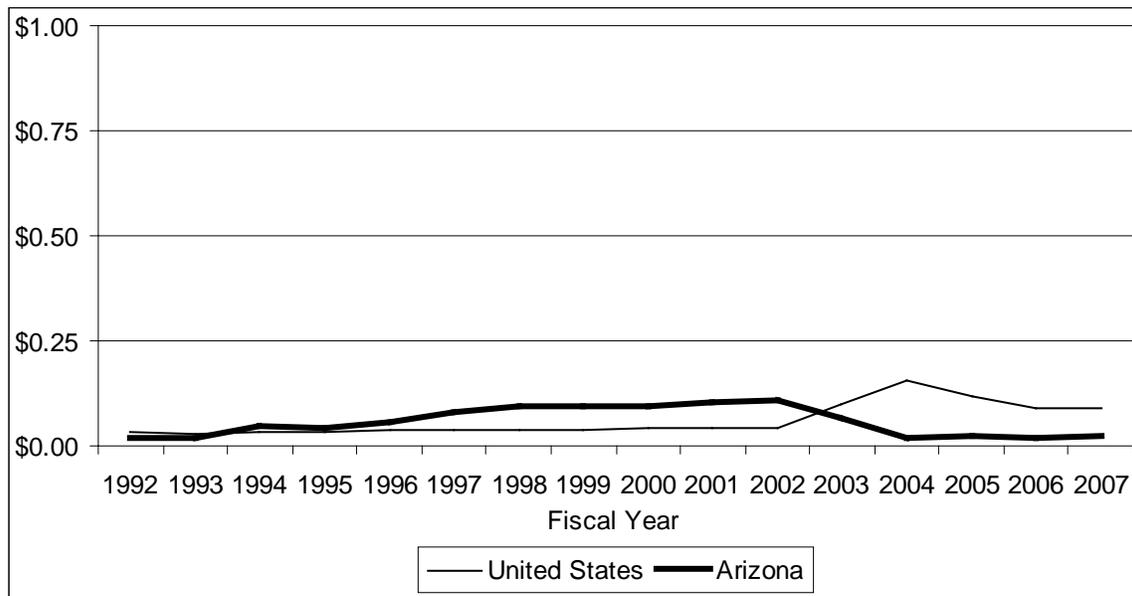
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	97%	Per Capita	8
Per \$1,000 of Personal Income	40%	Per \$1,000 of Personal Income	9
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-23	Per Capita	2
Per \$1,000 of Personal Income	-27	Per \$1,000 of Personal Income	2

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STATE AND LOCAL GOVERNMENT VETERANS' SERVICES EXPENDITURES PER \$1,000 OF PERSONAL INCOME



TRANSPORTATION

Summation of expenditures for highways, airports, parking facilities, and port facilities.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$3,287,775	8.34%	7.57%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$523.77	91.9%	36	7
Per \$1,000 of Personal Income	15.42	104.3	33	7

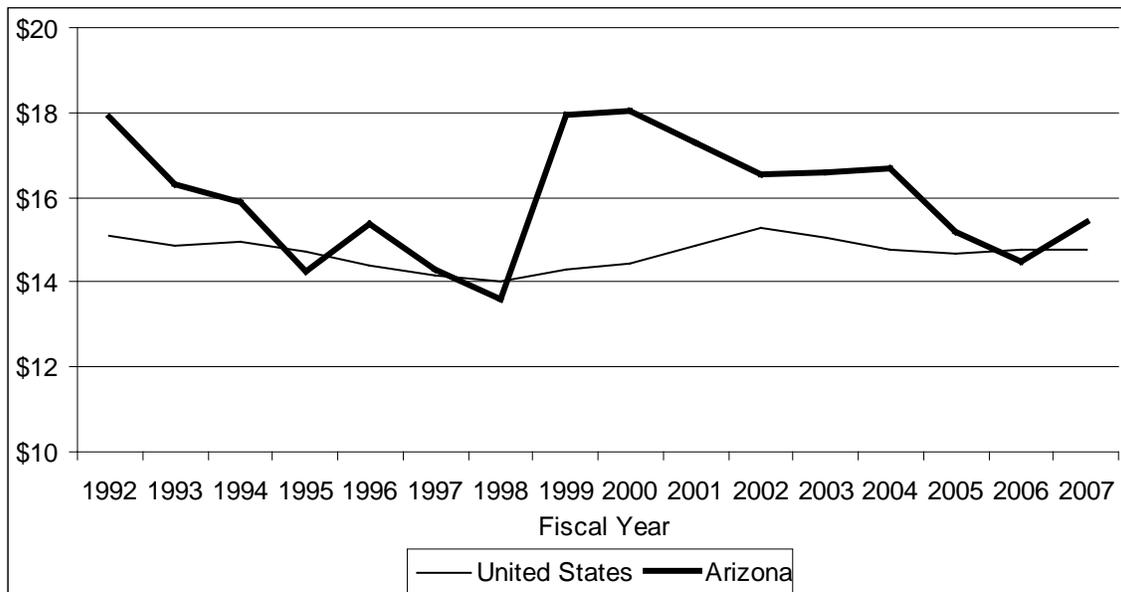
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	21%	Per Capita	-5
Per \$1,000 of Personal Income	-14%	Per \$1,000 of Personal Income	-10
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-10	Per Capita	-1
Per \$1,000 of Personal Income	-14	Per \$1,000 of Personal Income	-3

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT TRANSPORTATION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



HIGHWAYS

Expenditures for the maintenance, operation, repair, and construction of highways, streets, sidewalks, bridges, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$2,706,253	6.87%	6.41%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$431.13	89.3%	35	8
Per \$1,000 of Personal Income	12.69	101.5	33	7

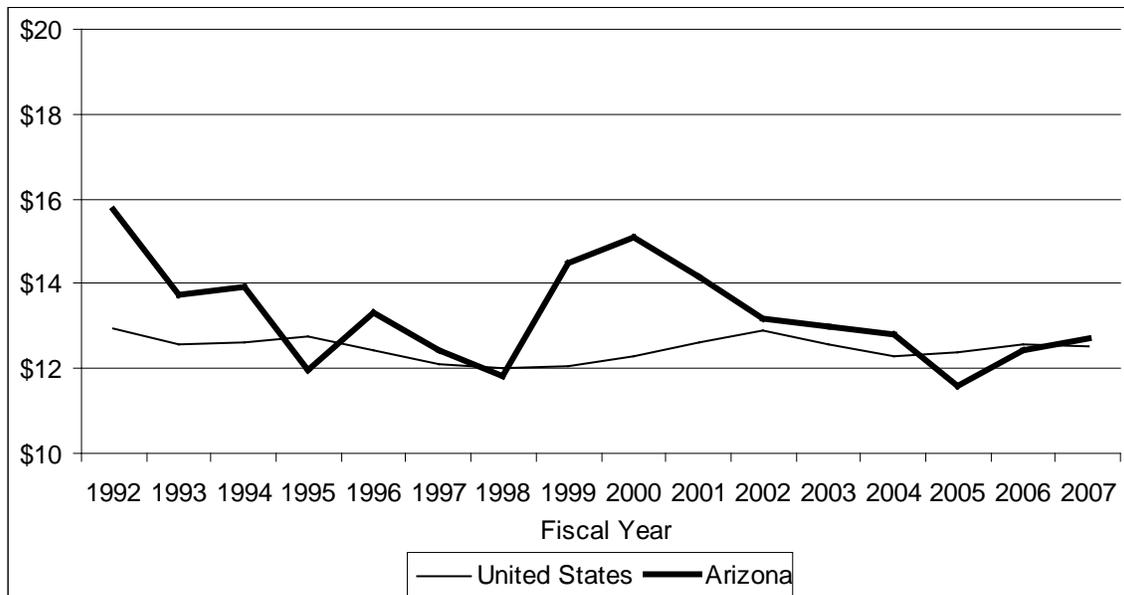
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	13%	Per Capita	-6
Per \$1,000 of Personal Income	-19%	Per \$1,000 of Personal Income	-10
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-16	Per Capita	-4
Per \$1,000 of Personal Income	-20	Per \$1,000 of Personal Income	-5

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

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STATE AND LOCAL GOVERNMENT HIGHWAYS EXPENDITURES PER \$1,000 OF PERSONAL INCOME



AIR TRANSPORTATION

Expenditures for the provision, operation, support, and construction of airport facilities serving the public on a scheduled or unscheduled basis.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$576,589	1.46%	0.89%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$91.85	137.3%	12	4
Per \$1,000 of Personal Income	2.70	155.9	8	3

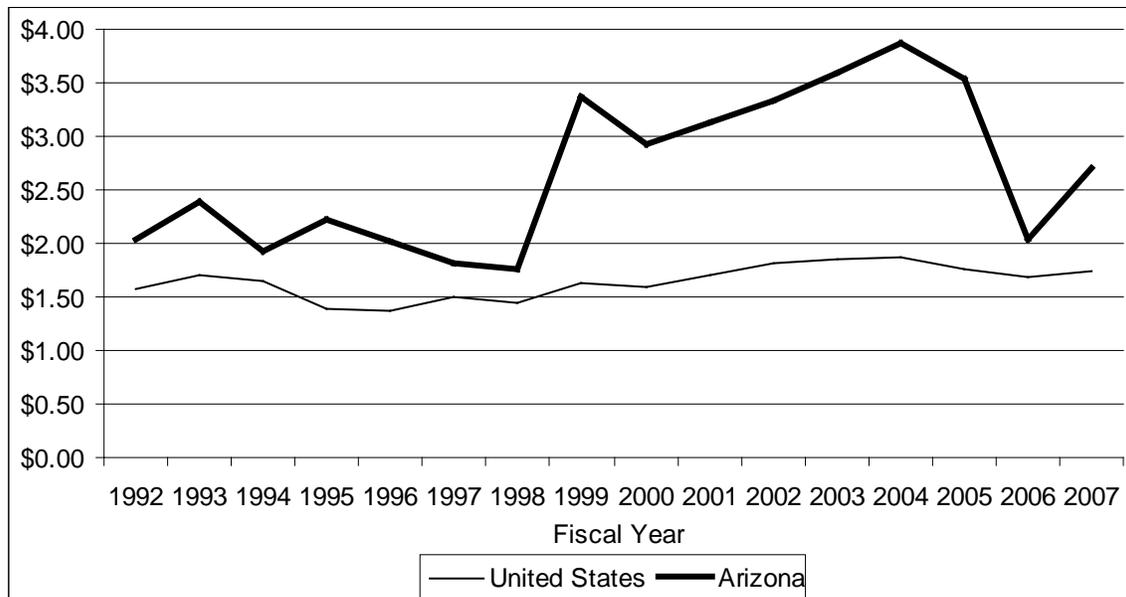
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	87%	Per Capita	2
Per \$1,000 of Personal Income	33%	Per \$1,000 of Personal Income	3
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	26	Per Capita	1
Per \$1,000 of Personal Income	27	Per \$1,000 of Personal Income	2

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

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STATE AND LOCAL GOVERNMENT AIR TRANSPORTATION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



PARKING FACILITIES

Expenditures for the provision, maintenance, operation, and construction of public parking facilities, including parking meters.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$4,933	0.01%	0.06%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$0.79	16.4%	44	8
Per \$1,000 of Personal Income	0.02	18.6	44	8

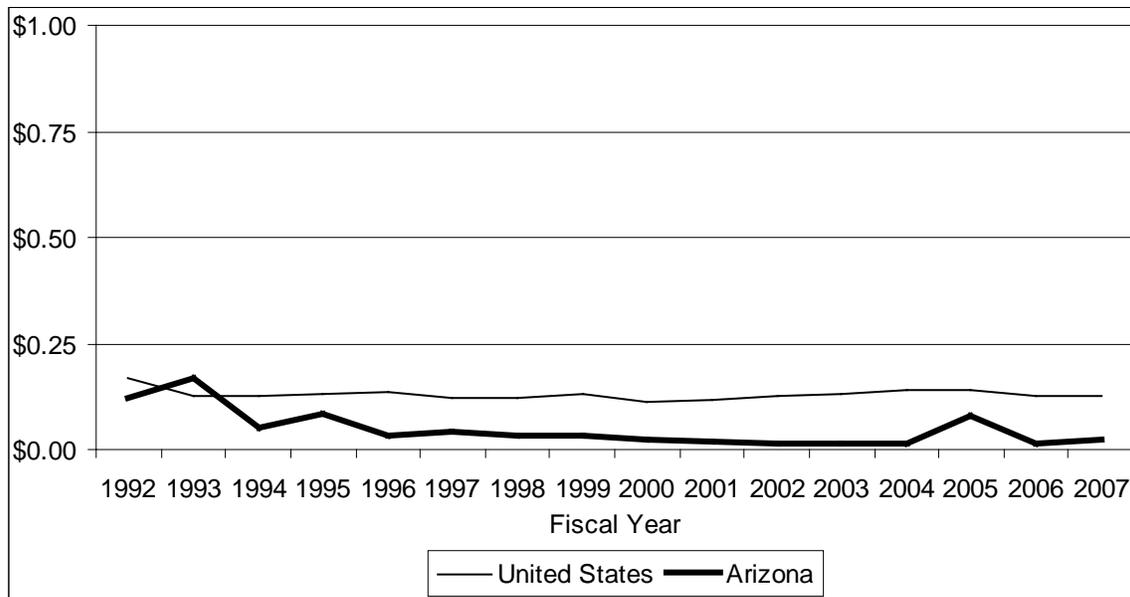
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-73%	Per Capita	-15
Per \$1,000 of Personal Income	-81%	Per \$1,000 of Personal Income	-16
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-46	Per Capita	-4
Per \$1,000 of Personal Income	-54	Per \$1,000 of Personal Income	-4

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT PARKING FACILITIES EXPENDITURES PER \$1,000 OF PERSONAL INCOME



PUBLIC SAFETY

Summation of expenditures for police protection, fire protection, corrections, and protective inspection and regulation.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$4,782,777	12.13%	8.99%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$761.93	112.5%	11	3
Per \$1,000 of Personal Income	22.43	127.8	6	4

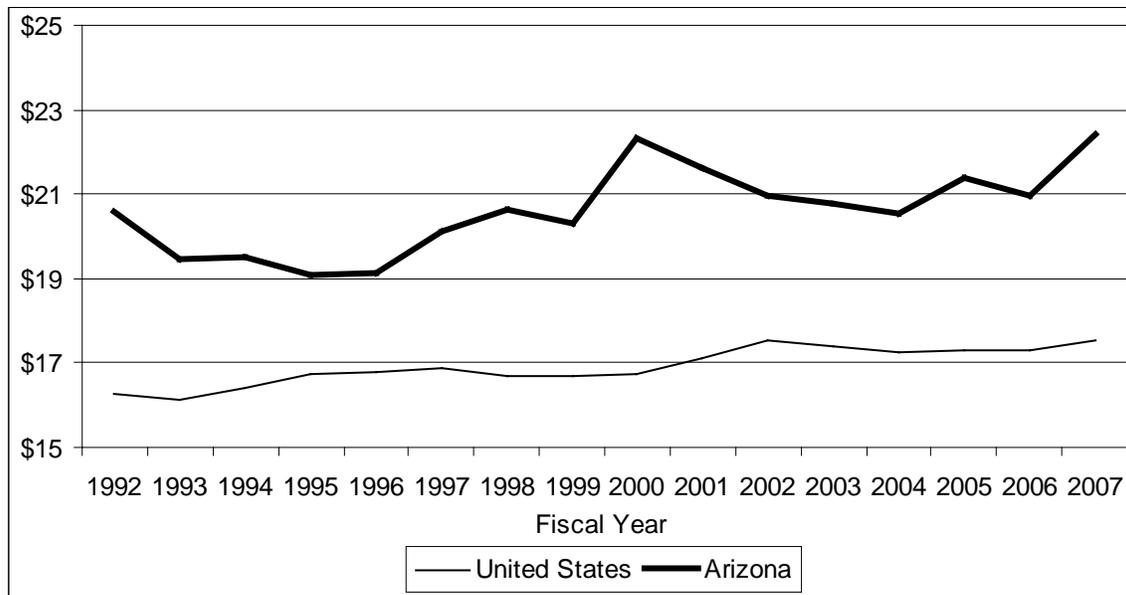
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	53%	Per Capita	1
Per \$1,000 of Personal Income	9%	Per \$1,000 of Personal Income	0
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	3	Per Capita	1
Per \$1,000 of Personal Income	1	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT PUBLIC SAFETY EXPENDITURES PER \$1,000 OF PERSONAL INCOME



POLICE PROTECTION

Expenditures for general police, sheriff, state police, and related activities. Includes crime labs, medical examiners, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$2,046,230	5.19%	3.72%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$325.98	116.3%	10	3
Per \$1,000 of Personal Income	9.59	132.1	4	3

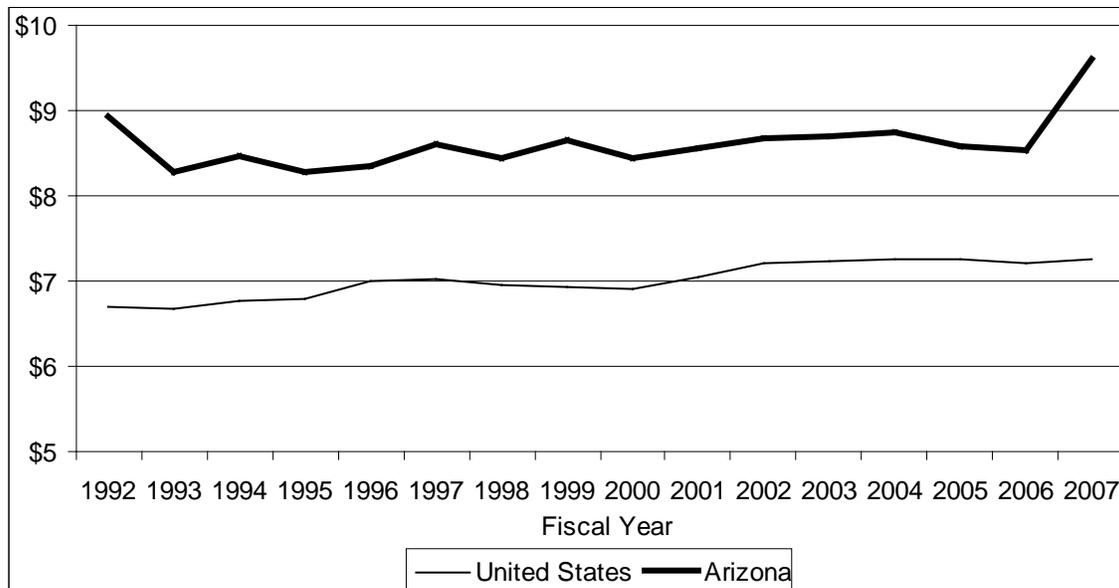
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	51%	Per Capita	-2
Per \$1,000 of Personal Income	7%	Per \$1,000 of Personal Income	0
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	1	Per Capita	0
Per \$1,000 of Personal Income	-1	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT POLICE PROTECTION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



FIRE PROTECTION

Expenditures for the prevention, avoidance, and suppression of fires and for the provision of ambulance and rescue services provided by fire protection agencies.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$859,808	2.18%	1.63%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$136.97	111.6%	13	4
Per \$1,000 of Personal Income	4.03	126.7	7	3

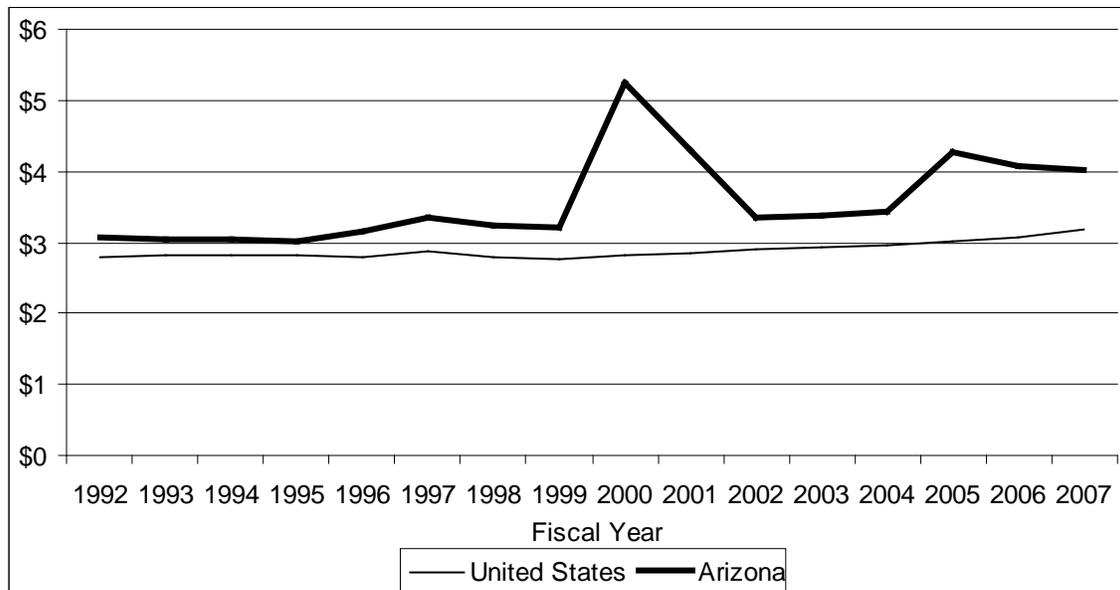
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	85%	Per Capita	8
Per \$1,000 of Personal Income	32%	Per \$1,000 of Personal Income	6
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	17	Per Capita	2
Per \$1,000 of Personal Income	17	Per \$1,000 of Personal Income	2

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT FIRE PROTECTION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



CORRECTIONS

Expenditures for institutions and for the confinement, correction, and rehabilitation of convicted adults and juveniles and for the detention of individuals charged with a crime. Includes probation offices, nonresidential halfway houses, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,545,176	3.92%	3.01%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$246.16	108.5%	13	5
Per \$1,000 of Personal Income	7.25	123.2	6	4

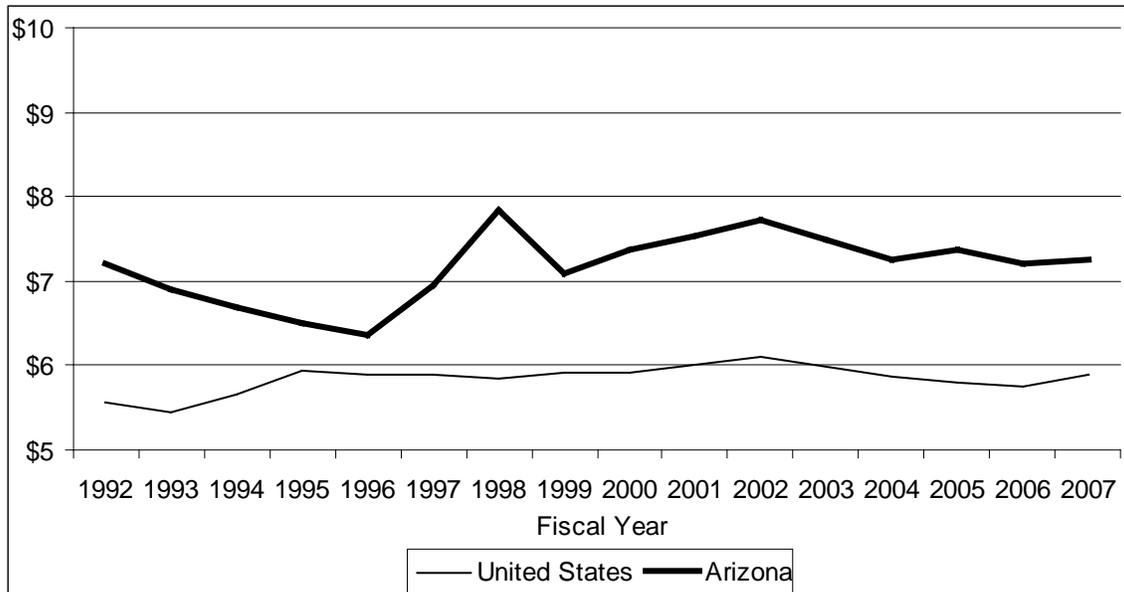
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	41%	Per Capita	-2
Per \$1,000 of Personal Income	1%	Per \$1,000 of Personal Income	0
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-3	Per Capita	-1
Per \$1,000 of Personal Income	-6	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT CORRECTIONS EXPENDITURES PER \$1,000 OF PERSONAL INCOME



PROTECTIVE INSPECTION AND REGULATION

Expenditures for the regulation and inspection of private establishments for the protection of the public.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$331,563	0.84%	0.63%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$52.82	111.7%	9	5
Per \$1,000 of Personal Income	1.55	126.9	8	5

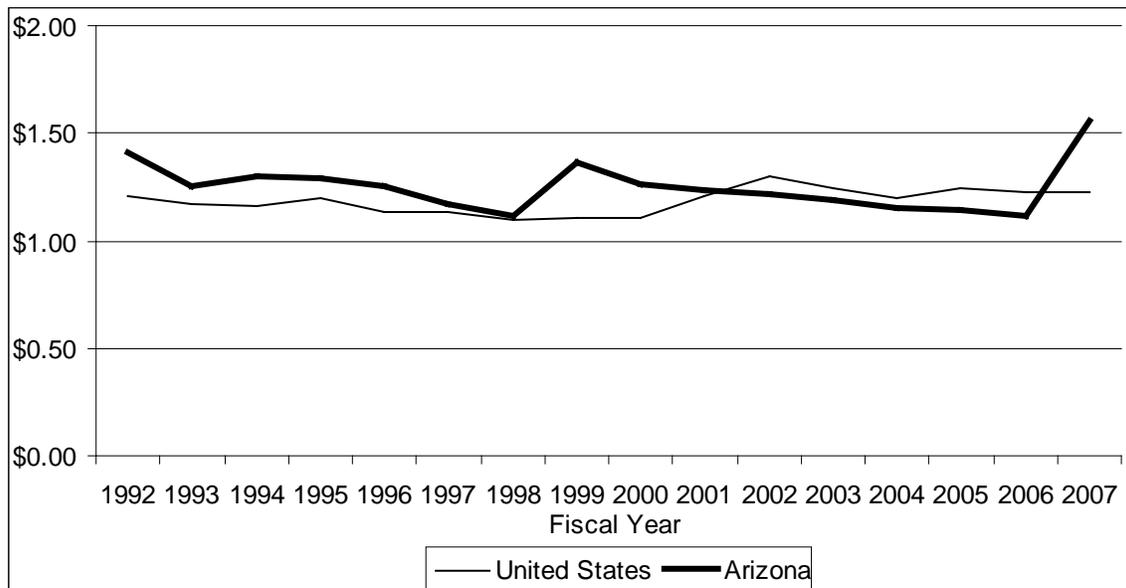
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	56%	Per Capita	8
Per \$1,000 of Personal Income	11%	Per \$1,000 of Personal Income	4
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	12	Per Capita	1
Per \$1,000 of Personal Income	11	Per \$1,000 of Personal Income	1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT PROTECTIVE INSPECTION AND REGULATION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



ENVIRONMENT AND HOUSING

Summation of expenditures for natural resources, parks and recreation, housing and community development, sewerage, and solid waste management.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$3,693,128	9.37%	7.93%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$588.34	98.5%	20	5
Per \$1,000 of Personal Income	17.32	111.8	16	6

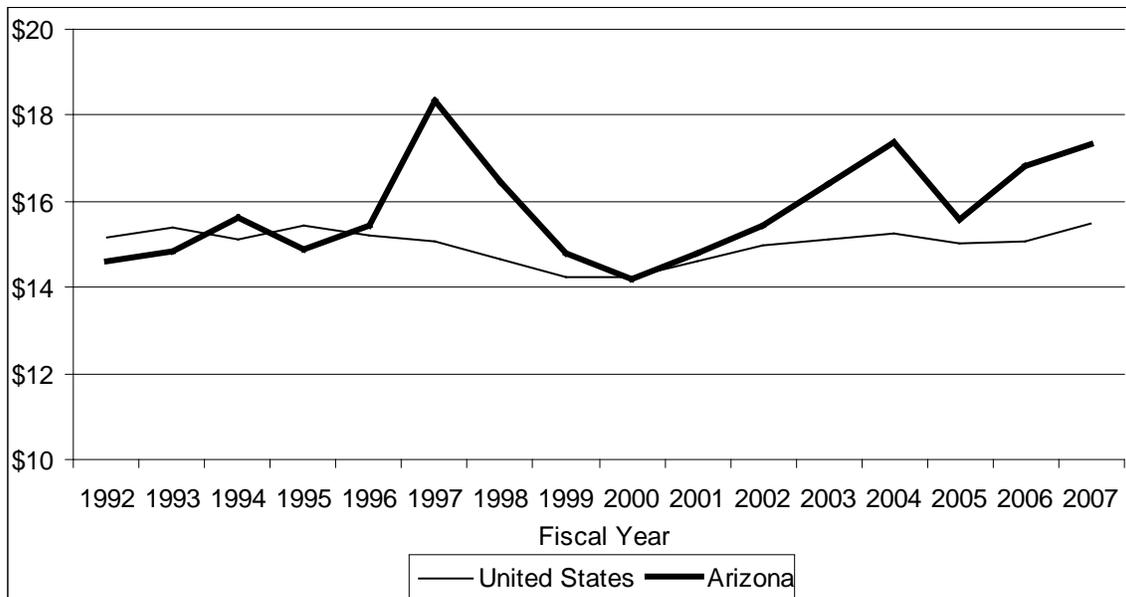
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	67%	Per Capita	10
Per \$1,000 of Personal Income	18%	Per \$1,000 of Personal Income	9
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	12	Per Capita	2
Per \$1,000 of Personal Income	15	Per \$1,000 of Personal Income	1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT ENVIRONMENT AND HOUSING EXPENDITURES PER \$1,000 OF PERSONAL INCOME



NATURAL RESOURCES

Expenditures related to water resources, mineral resources, agriculture, game and fish, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$625,756	1.59%	1.28%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$99.69	103.7%	23	5
Per \$1,000 of Personal Income	2.93	117.8	22	6

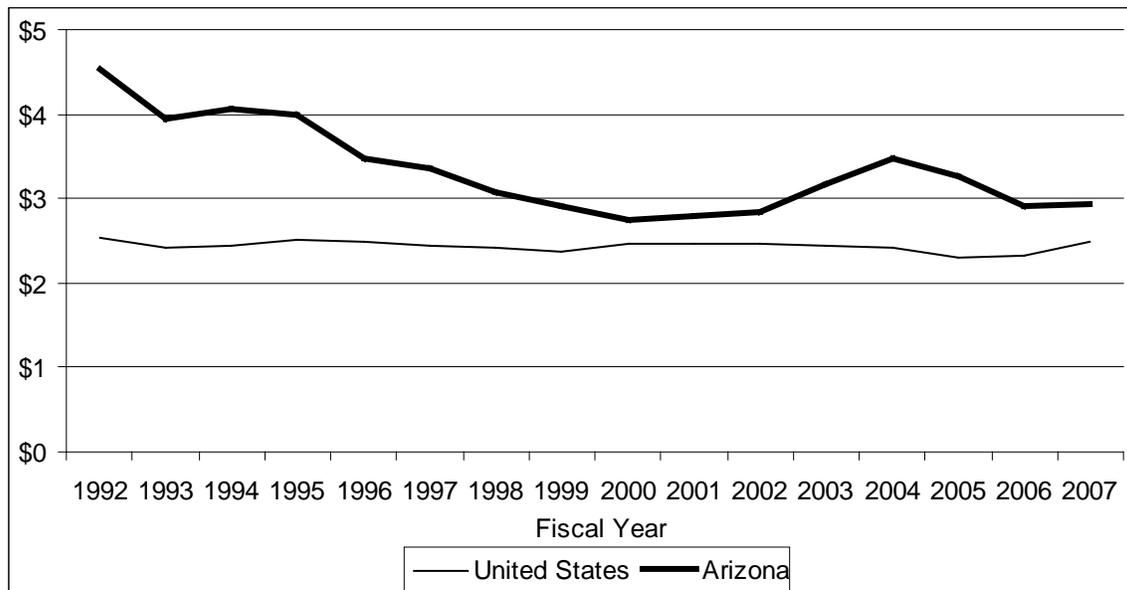
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-9%	Per Capita	-9
Per \$1,000 of Personal Income	-35%	Per \$1,000 of Personal Income	-12
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-50	Per Capita	0
Per \$1,000 of Personal Income	-61	Per \$1,000 of Personal Income	-4

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT NATURAL RESOURCES EXPENDITURES PER \$1,000 OF PERSONAL INCOME



PARKS AND RECREATION

Expenditures for the provision and support of recreational and cultural-scientific facilities maintained for residents and visitors. Includes golf courses, swimming pools, parks, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,030,478	2.61%	1.66%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$164.16	131.2%	10	3
Per \$1,000 of Personal Income	4.83	149.0	9	5

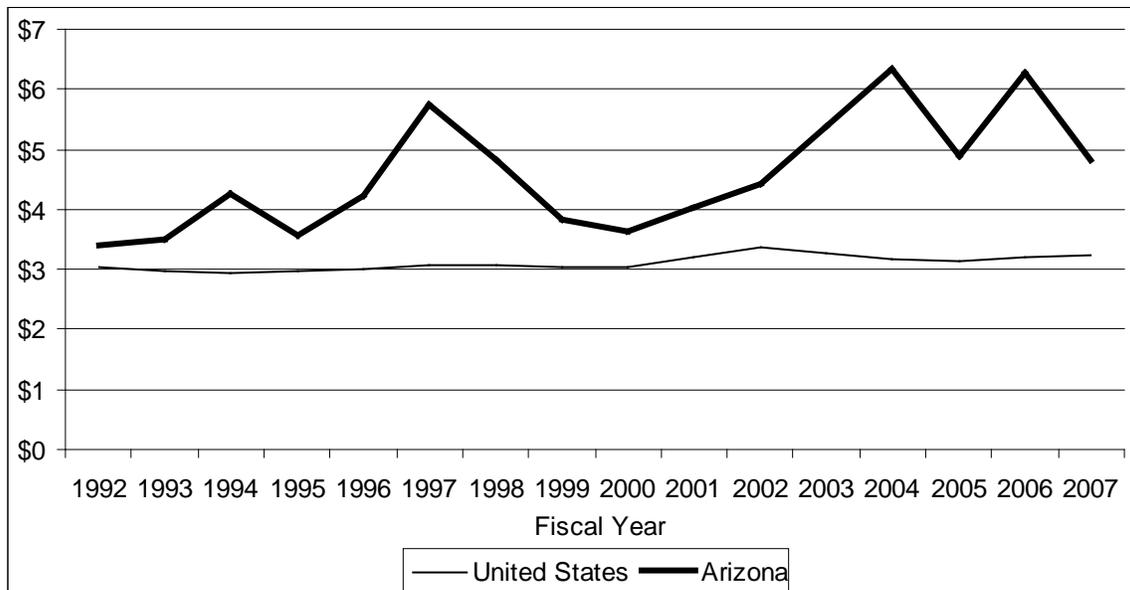
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	101%	Per Capita	12
Per \$1,000 of Personal Income	43%	Per \$1,000 of Personal Income	9
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	35	Per Capita	5
Per \$1,000 of Personal Income	38	Per \$1,000 of Personal Income	3

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT PARKS AND RECREATION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



HOUSING AND COMMUNITY DEVELOPMENT

Expenditures for the support, operation, and construction of housing and redevelopment projects.
Includes rent subsidies, promotion of homeownership, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$472,286	1.20%	2.03%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$75.24	49.1%	40	8
Per \$1,000 of Personal Income	2.21	55.8	42	8

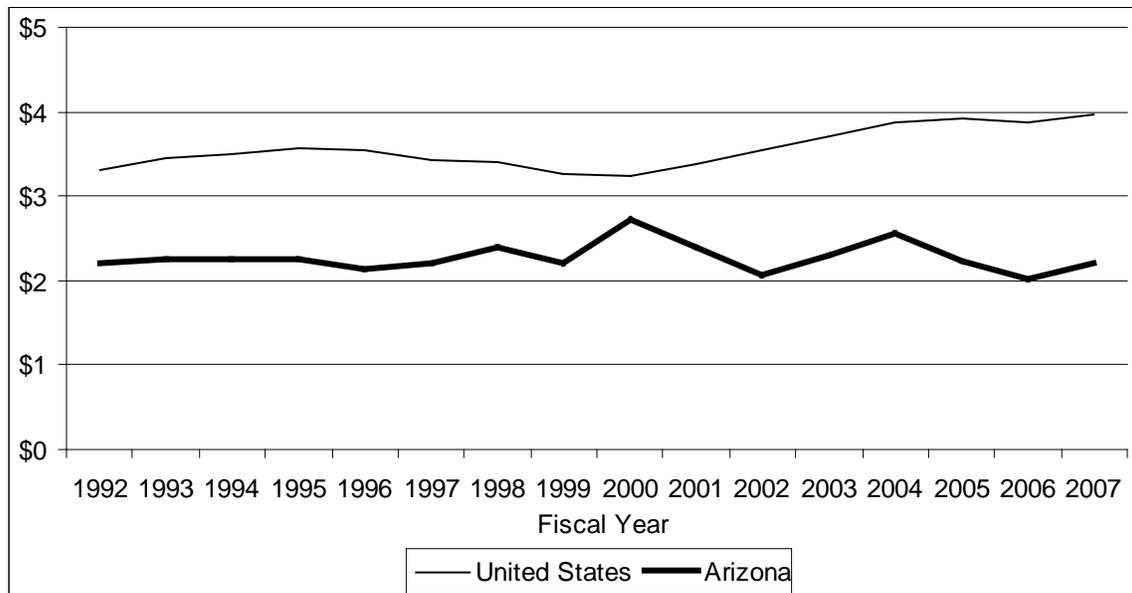
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	42%	Per Capita	-6
Per \$1,000 of Personal Income	1%	Per \$1,000 of Personal Income	-8
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-8	Per Capita	-1
Per \$1,000 of Personal Income	-11	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT HOUSING AND COMMUNITY DEVELOPMENT EXPENDITURES PER \$1,000 OF PERSONAL INCOME



SEWERAGE

Expenditures for the provision, maintenance, and operation of sanitary and storm sewer systems and sewage disposal and treatment.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,203,939	3.05%	1.95%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$191.80	130.7%	8	3
Per \$1,000 of Personal Income	5.65	148.5	6	3

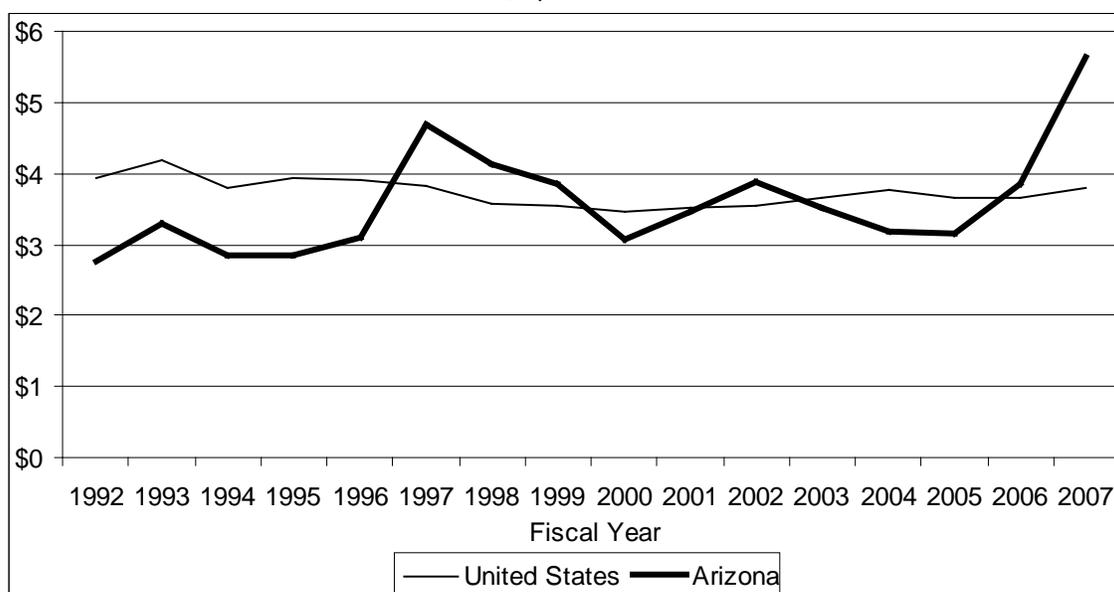
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	189%	Per Capita	31
Per \$1,000 of Personal Income	105%	Per \$1,000 of Personal Income	35
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	71	Per Capita	5
Per \$1,000 of Personal Income	79	Per \$1,000 of Personal Income	6

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** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

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STATE AND LOCAL GOVERNMENT SEWERAGE EXPENDITURES PER \$1,000 OF PERSONAL INCOME



SOLID WASTE MANAGEMENT

Expenditures for the collection, removal, and disposal of garbage and hazardous wastes and for the cleaning of streets.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$360,669	0.92%	1.01%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$57.46	75.1%	32	4
Per \$1,000 of Personal Income	1.69	85.4	30	4

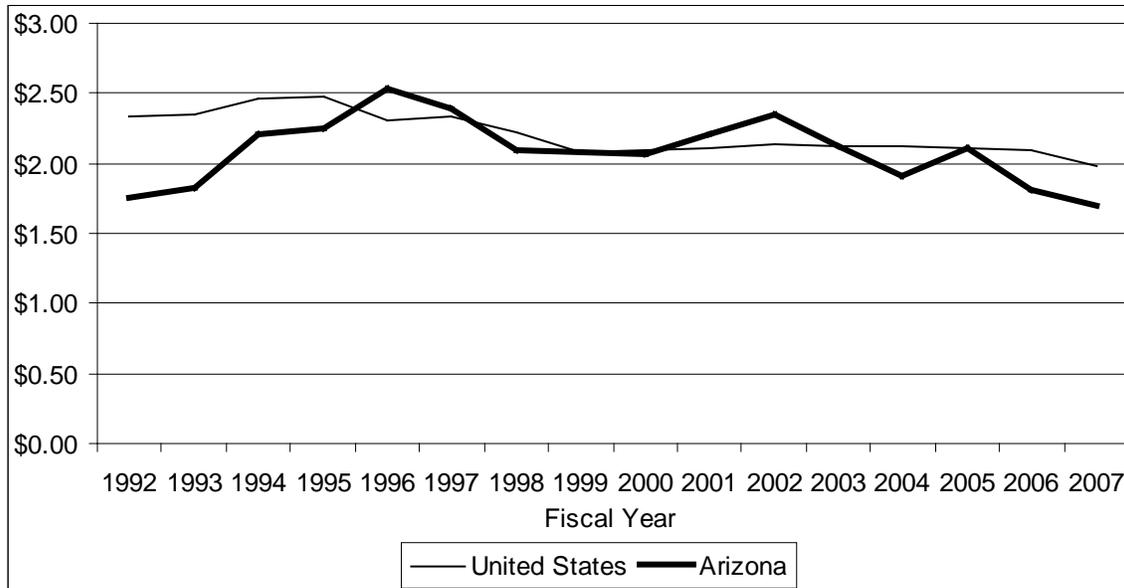
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	35%	Per Capita	1
Per \$1,000 of Personal Income	-4%	Per \$1,000 of Personal Income	2
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	10	Per Capita	2
Per \$1,000 of Personal Income	10	Per \$1,000 of Personal Income	2

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT SOLID WASTE MANAGEMENT EXPENDITURES PER \$1,000 OF PERSONAL INCOME



GOVERNMENT ADMINISTRATION

Summation of expenditures for financial administration, judicial and legal, general public buildings, and other government administration.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$2,404,911	6.10%	5.30%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$383.12	96.0%	28	7
Per \$1,000 of Personal Income	11.28	109.1	20	7

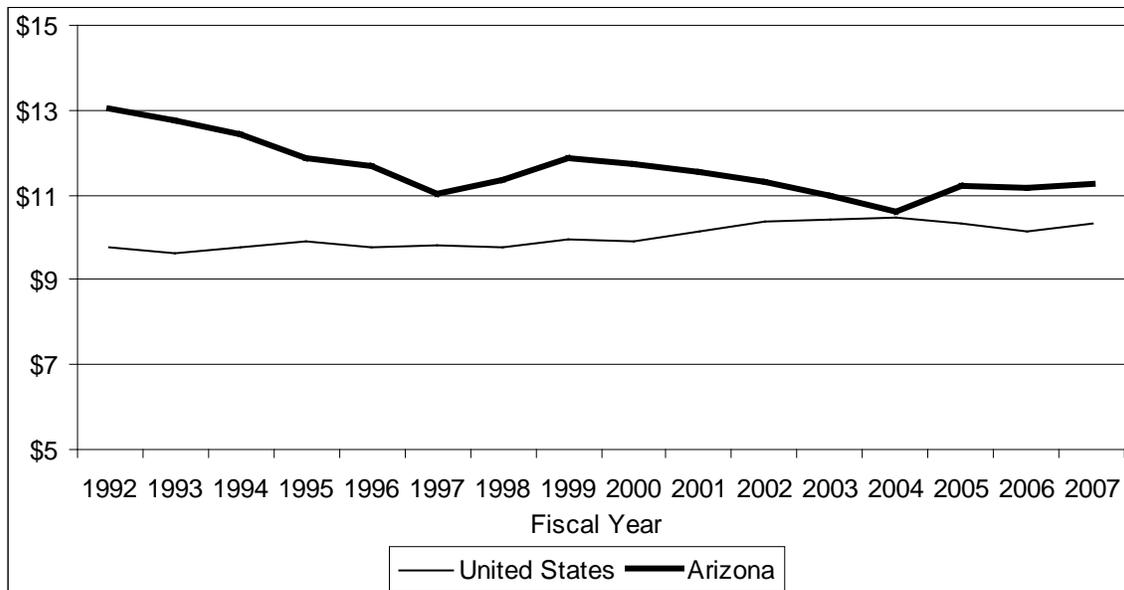
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	22%	Per Capita	-17
Per \$1,000 of Personal Income	-14%	Per \$1,000 of Personal Income	-11
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-19	Per Capita	-3
Per \$1,000 of Personal Income	-25	Per \$1,000 of Personal Income	-3

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT ADMINISTRATION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



FINANCIAL ADMINISTRATION

Expenditures for agencies concerned with tax assessment and collection, accounting, auditing, budgeting, purchasing, custody of funds, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$656,311	1.67%	1.75%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$104.56	79.1%	39	8
Per \$1,000 of Personal Income	3.08	89.8	30	6

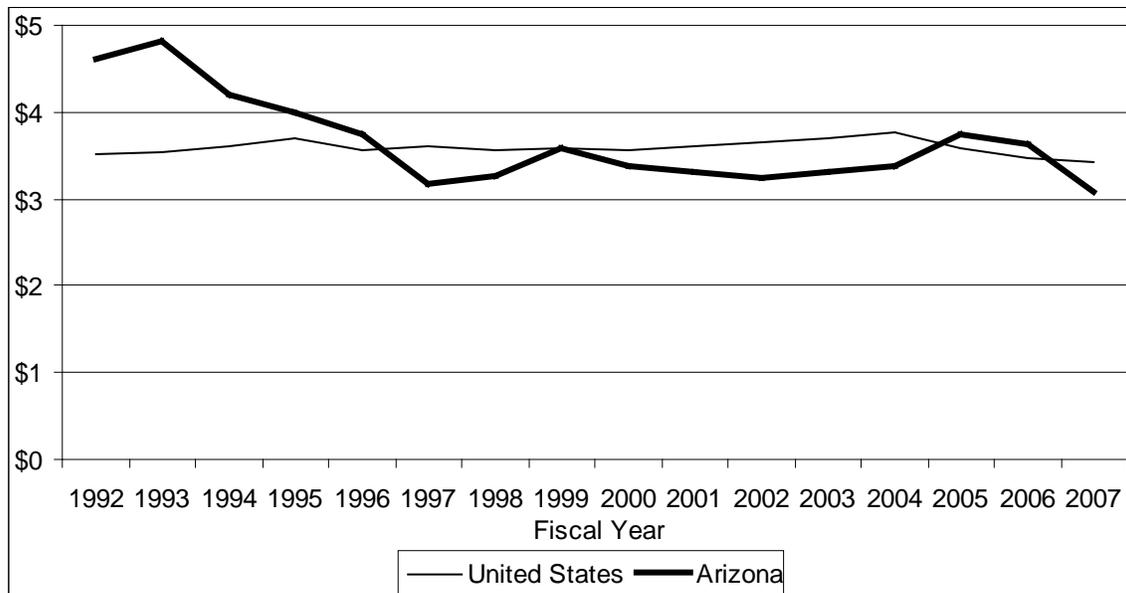
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-6%	Per Capita	-20
Per \$1,000 of Personal Income	-33%	Per \$1,000 of Personal Income	-19
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-34	Per Capita	-1
Per \$1,000 of Personal Income	-42	Per \$1,000 of Personal Income	-2

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

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STATE AND LOCAL GOVERNMENT FINANCIAL ADMINISTRATION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



JUDICIAL AND LEGAL

Expenditures for criminal and civil courts, legal services, and legal counseling of needy persons.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$911,530	2.31%	1.71%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$145.21	112.4%	11	3
Per \$1,000 of Personal Income	4.27	127.7	6	3

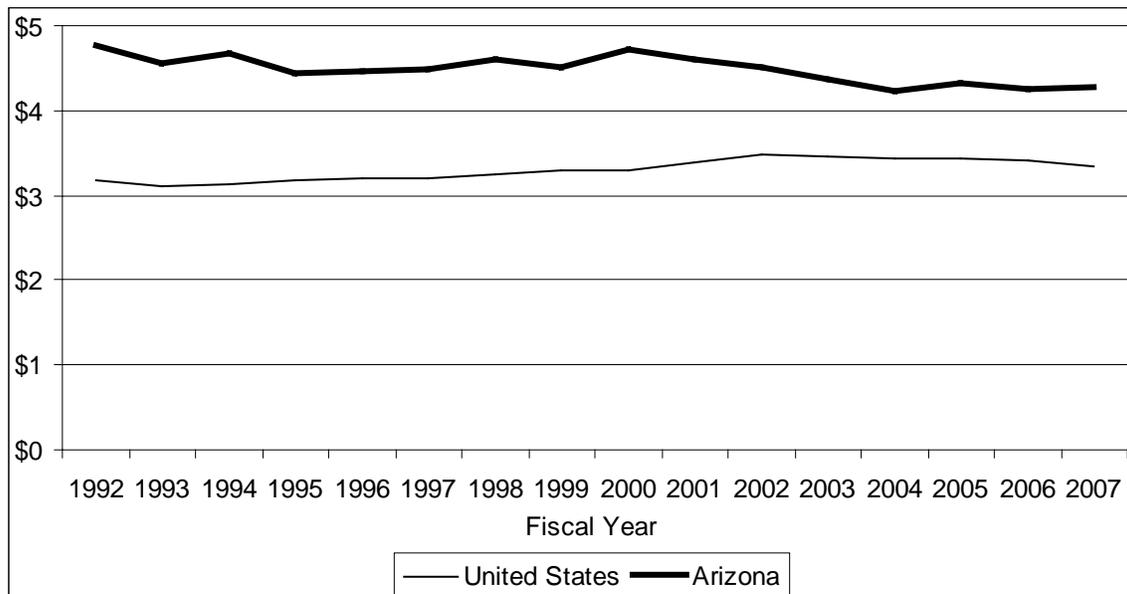
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	26%	Per Capita	-4
Per \$1,000 of Personal Income	-10%	Per \$1,000 of Personal Income	-2
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-17	Per Capita	0
Per \$1,000 of Personal Income	-23	Per \$1,000 of Personal Income	-2

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

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*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT JUDICIAL AND LEGAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



GENERAL PUBLIC BUILDINGS

Expenditures for the maintenance, operation, equipping, and construction of public buildings not associated with a specific agency.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$228,313	0.58%	0.62%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$36.37	78.3%	36	6
Per \$1,000 of Personal Income	1.07	88.9	32	6

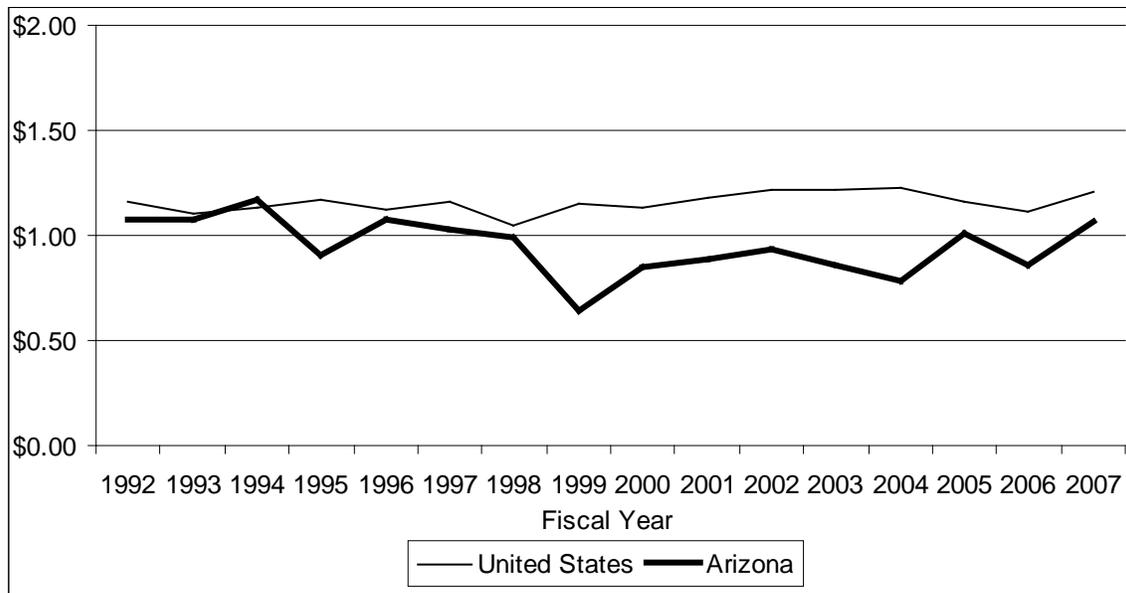
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	40%	Per Capita	-1
Per \$1,000 of Personal Income	-1%	Per \$1,000 of Personal Income	-1
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-2	Per Capita	1
Per \$1,000 of Personal Income	-4	Per \$1,000 of Personal Income	0

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

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STATE AND LOCAL GOVERNMENT GENERAL PUBLIC BUILDINGS EXPENDITURES PER \$1,000 OF PERSONAL INCOME



OTHER GOVERNMENT ADMINISTRATION

Includes legislative bodies, government-wide staff services (such as personnel), etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$608,757	1.54%	1.21%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$96.98	106.4%	20	6
Per \$1,000 of Personal Income	2.85	120.9	18	6

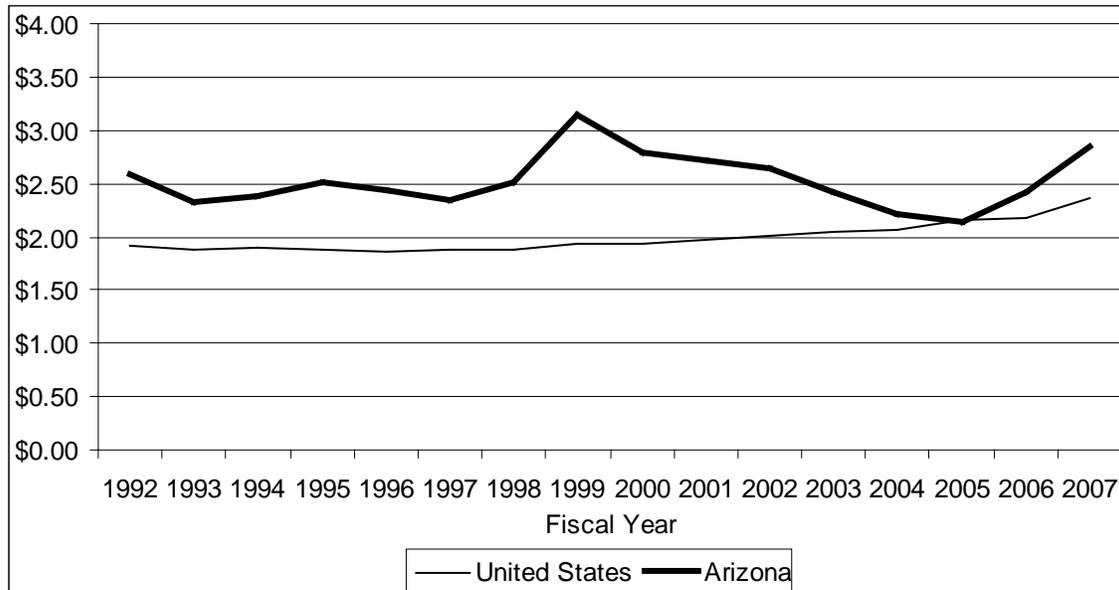
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	55%	Per Capita	-4
Per \$1,000 of Personal Income	10%	Per \$1,000 of Personal Income	-9
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-10	Per Capita	1
Per \$1,000 of Personal Income	-14	Per \$1,000 of Personal Income	-2

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

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*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT OTHER ADMINISTRATION EXPENDITURES PER \$1,000 OF PERSONAL INCOME



INTEREST ON GENERAL DEBT

Amounts paid for the use of borrowed monies.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,354,352	3.44%	4.11%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$215.76	69.6%	39	8
Per \$1,000 of Personal Income	6.35	79.1	36	8

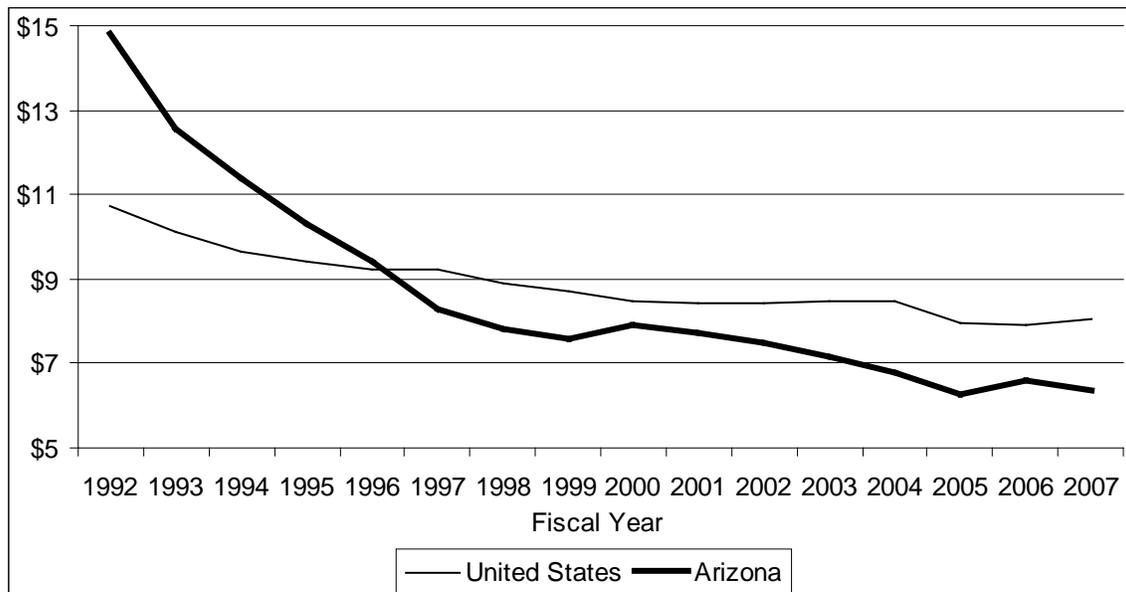
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-40%	Per Capita	-20
Per \$1,000 of Personal Income	-57%	Per \$1,000 of Personal Income	-25
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-50	Per Capita	-4
Per \$1,000 of Personal Income	-59	Per \$1,000 of Personal Income	-6

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT INTEREST ON GENERAL DEBT EXPENDITURES PER \$1,000 OF PERSONAL INCOME



MISCELLANEOUS COMMERCIAL ACTIVITIES

Expenditures for the provision and operation of publicly owned commercial facilities not classified elsewhere, such as a cemetery.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$3,442	0.01%	0.21%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$0.55	3.5%	48	9
Per \$1,000 of Personal Income	0.02	4.0	47	9

Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	^%	Per Capita	-23
Per \$1,000 of Personal Income	^%	Per \$1,000 of Personal Income	-22
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	4	Per Capita	-2
Per \$1,000 of Personal Income	4	Per \$1,000 of Personal Income	-2

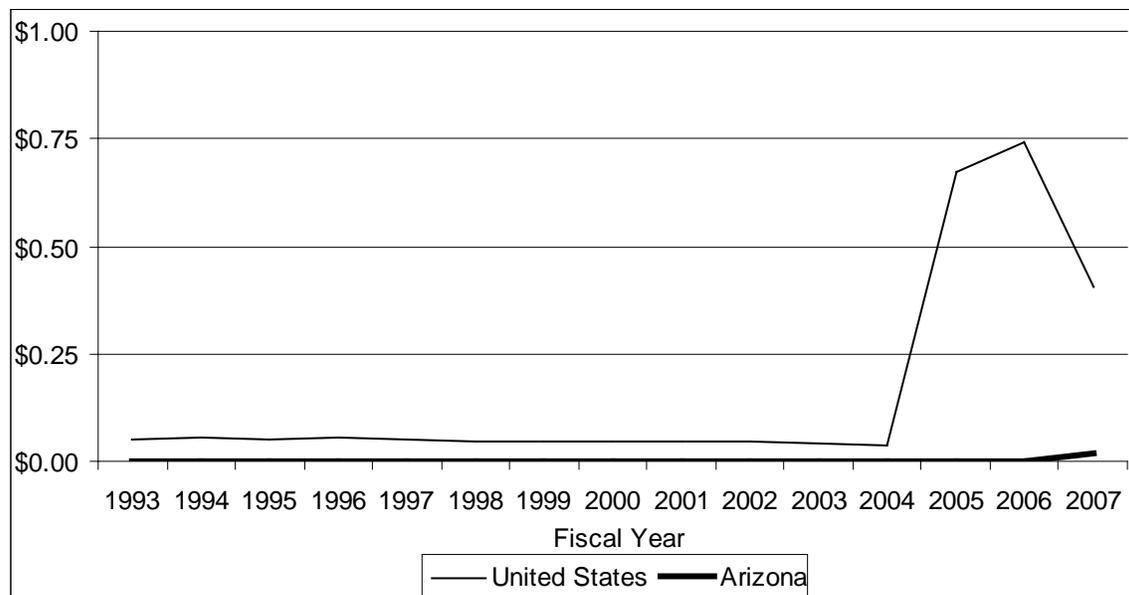
* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

^ Value was zero in 1993

STATE AND LOCAL GOVERNMENT MISCELLANEOUS COMMERCIAL ACTIVITIES EXPENDITURES PER \$1,000 OF PERSONAL INCOME



OTHER AND UNALLOCABLE EXPENDITURES

Expenditures for multifunctional activities that cannot be separated into specific functions, including central service agencies such as motor pools, economic development activities, National Guard, compensation for injury, etc.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,328,983	3.37%	5.29%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$211.72	53.1%	43	8
Per \$1,000 of Personal Income	6.23	60.3	39	7

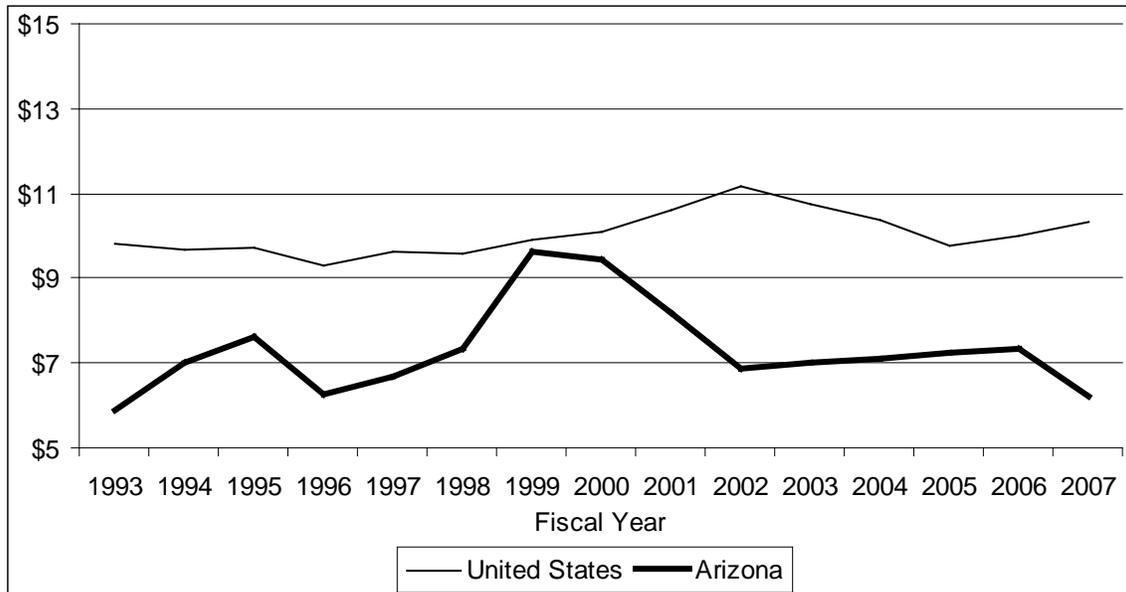
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	47%	Per Capita	-2
Per \$1,000 of Personal Income	6%	Per \$1,000 of Personal Income	2
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	2	Per Capita	0
Per \$1,000 of Personal Income	0	Per \$1,000 of Personal Income	0

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT OTHER AND UNALLOCABLE EXPENDITURES PER \$1,000 OF PERSONAL INCOME



TOTAL CAPITAL OUTLAYS

Expenditures for the purchase of land and existing buildings, purchase of equipment, and construction of buildings and other improvements.

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$6,299,168	15.98%	12.69%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$1,003.50	105.0%	18	6
Per \$1,000 of Personal Income	29.54	119.2	15	4

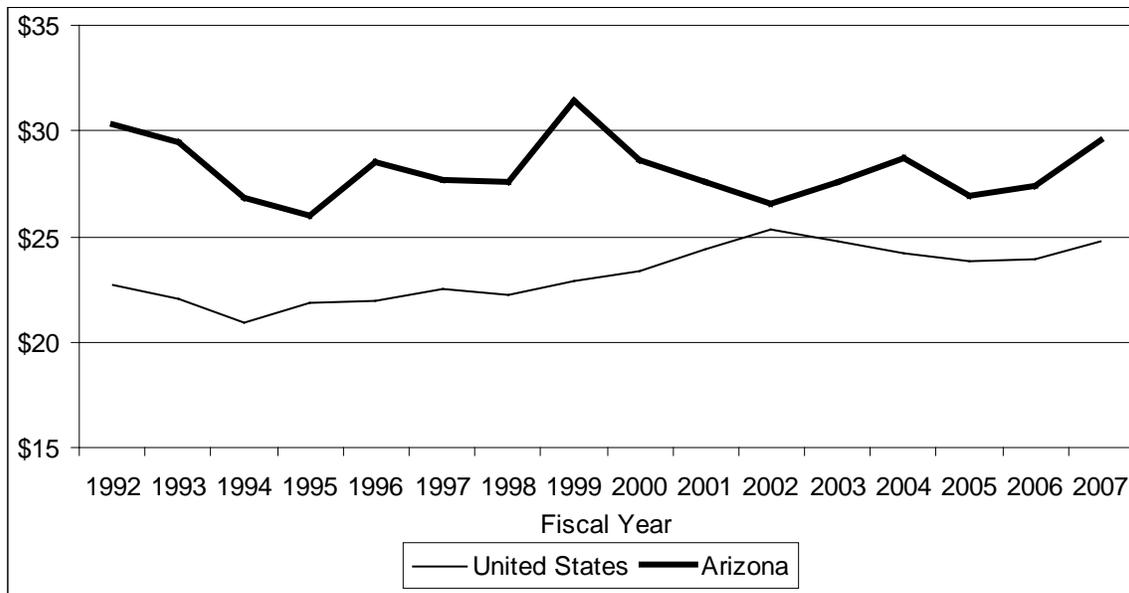
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	37%	Per Capita	-4
Per \$1,000 of Personal Income	-3%	Per \$1,000 of Personal Income	-7
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-10	Per Capita	-2
Per \$1,000 of Personal Income	-15	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

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STATE AND LOCAL GOVERNMENT TOTAL CAPITAL OUTLAYS PER \$1,000 OF PERSONAL INCOME



EDUCATION CAPITAL OUTLAYS

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,975,872	5.01%	4.05%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$314.77	103.3%	19	7
Per \$1,000 of Personal Income	9.26	117.3	13	6

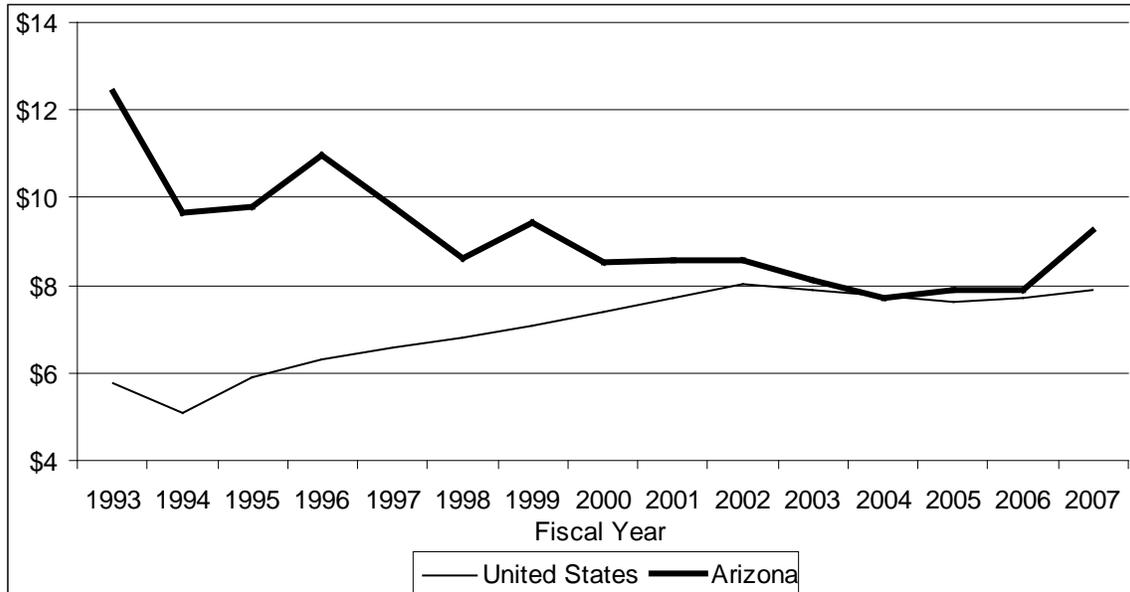
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	4%	Per Capita	-16
Per \$1,000 of Personal Income	-25%	Per \$1,000 of Personal Income	-10
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-81	Per Capita	-5
Per \$1,000 of Personal Income	-98	Per \$1,000 of Personal Income	-5

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT EDUCATION CAPITAL OUTLAYS PER \$1,000 OF PERSONAL INCOME



HIGHER EDUCATION CAPITAL OUTLAYS

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$531,178	1.35%	1.12%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$84.62	100.2%	27	7
Per \$1,000 of Personal Income	2.49	113.8	24	6

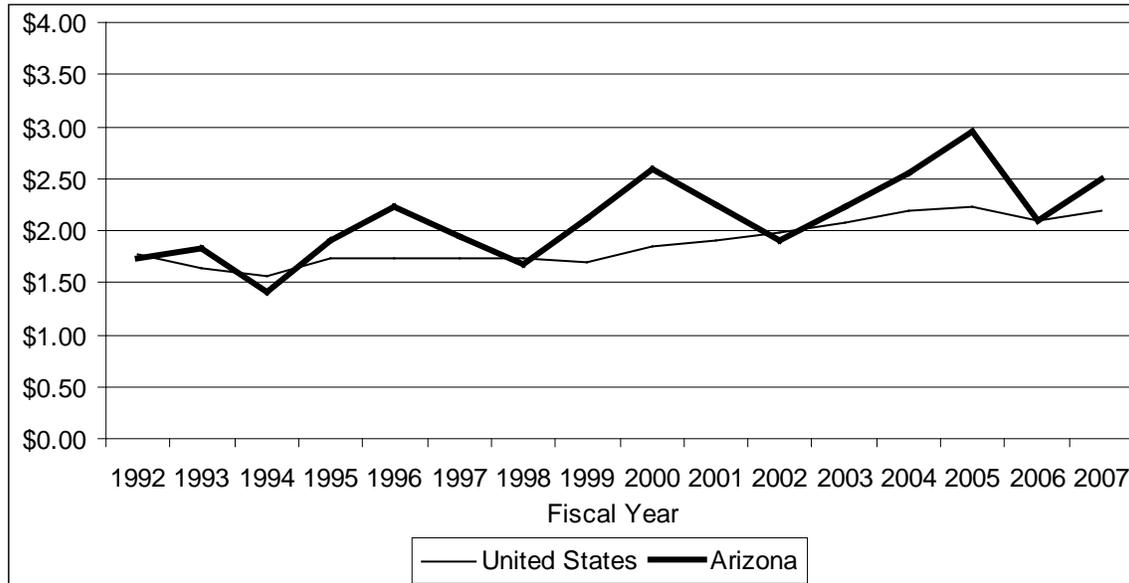
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	101%	Per Capita	7
Per \$1,000 of Personal Income	43%	Per \$1,000 of Personal Income	4
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	16	Per Capita	1
Per \$1,000 of Personal Income	16	Per \$1,000 of Personal Income	1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT HIGHER EDUCATION CAPITAL OUTLAYS PER \$1,000 OF PERSONAL INCOME



ELEMENTARY AND SECONDARY EDUCATION CAPITAL OUTLAYS

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,436,887	3.65%	2.90%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$228.91	105.0%	14	5
Per \$1,000 of Personal Income	6.74	119.2	11	4

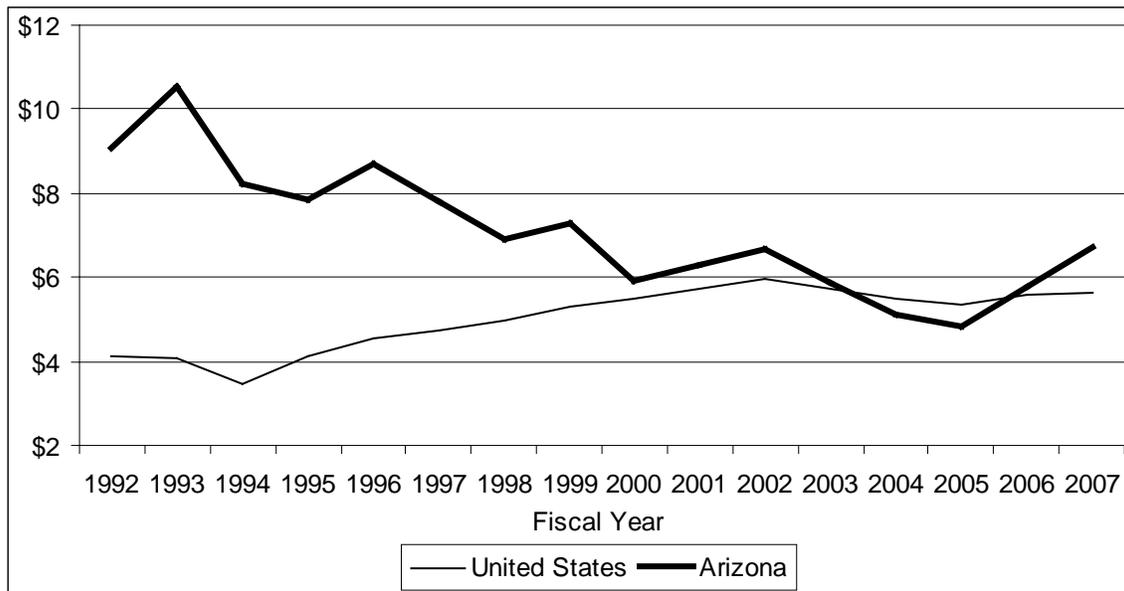
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	5%	Per Capita	-11
Per \$1,000 of Personal Income	-26%	Per \$1,000 of Personal Income	-9
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-84	Per Capita	-2
Per \$1,000 of Personal Income	-100	Per \$1,000 of Personal Income	-2

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT ELEMENTARY AND SECONDARY EDUCATION CAPITAL OUTLAYS PER \$1,000 OF PERSONAL INCOME



HOSPITALS CAPITAL OUTLAYS

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$38,039	0.10%	0.33%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$6.06	24.2%	36	8
Per \$1,000 of Personal Income	0.18	27.5	33	8

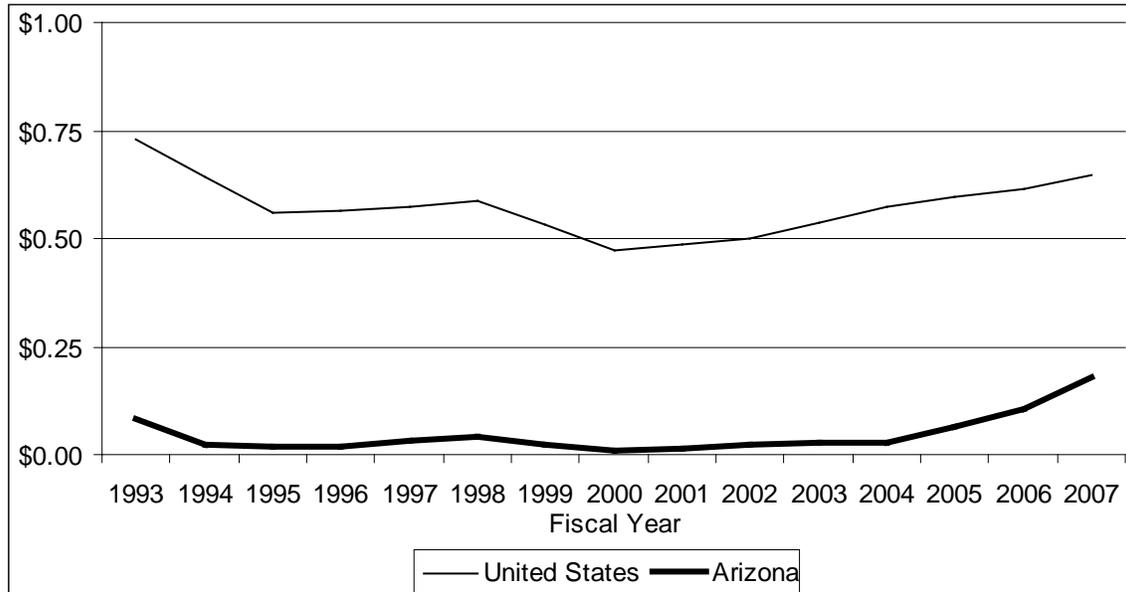
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	203%	Per Capita	8
Per \$1,000 of Personal Income	118%	Per \$1,000 of Personal Income	11
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	15	Per Capita	1
Per \$1,000 of Personal Income	16	Per \$1,000 of Personal Income	1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT HOSPITALS CAPITAL OUTLAYS PER \$1,000 OF PERSONAL INCOME



HIGHWAYS CAPITAL OUTLAYS

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,525,967	3.87%	3.69%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$243.10	87.5%	33	7
Per \$1,000 of Personal Income	7.16	99.4	31	7

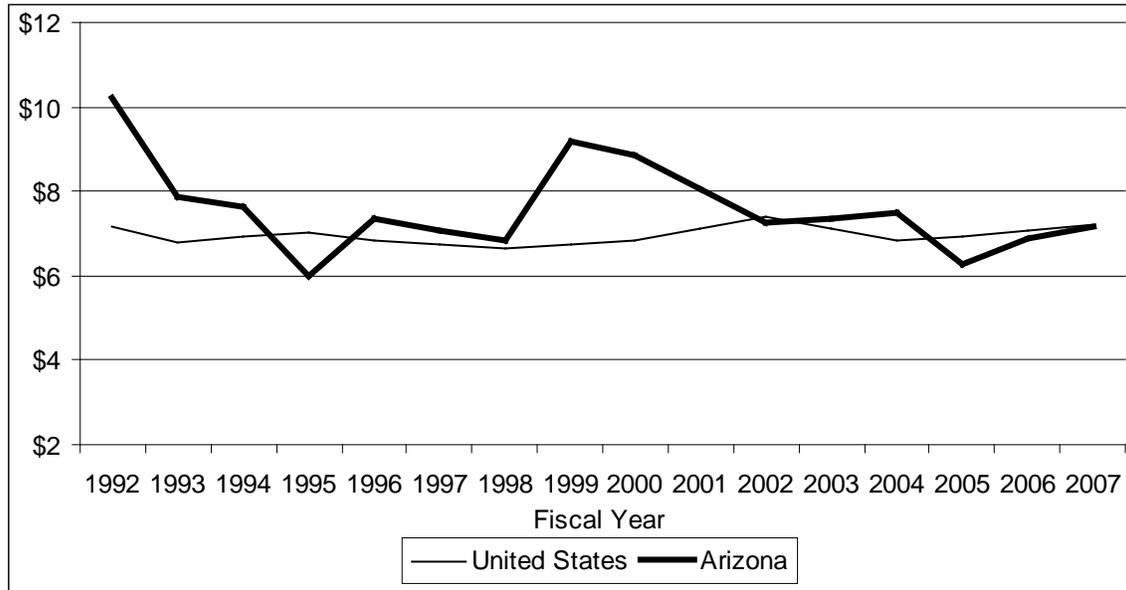
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-2%	Per Capita	-12
Per \$1,000 of Personal Income	-30%	Per \$1,000 of Personal Income	-13
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-35	Per Capita	-4
Per \$1,000 of Personal Income	-43	Per \$1,000 of Personal Income	-4

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT HIGHWAYS CAPITAL OUTLAYS PER \$1,000 OF PERSONAL INCOME



CORRECTIONS CAPITAL OUTLAYS

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$29,220	0.07%	0.14%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$4.65	43.2%	39	8
Per \$1,000 of Personal Income	0.14	49.1	37	9

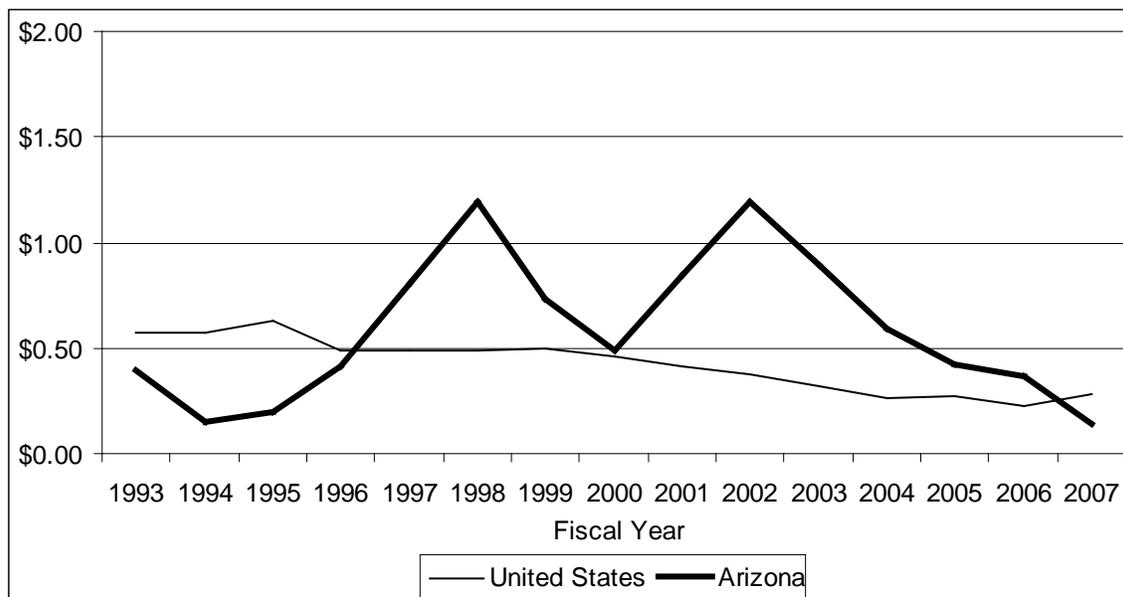
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-52%	Per Capita	-10
Per \$1,000 of Personal Income	-65%	Per \$1,000 of Personal Income	-9
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-15	Per Capita	-2
Per \$1,000 of Personal Income	-19	Per \$1,000 of Personal Income	-3

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT CORRECTIONS CAPITAL OUTLAYS PER \$1,000 OF PERSONAL INCOME



NATURAL RESOURCES CAPITAL OUTLAYS

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$109,262	0.28%	0.28%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$17.41	82.4%	18	6
Per \$1,000 of Personal Income	0.51	93.5	17	6

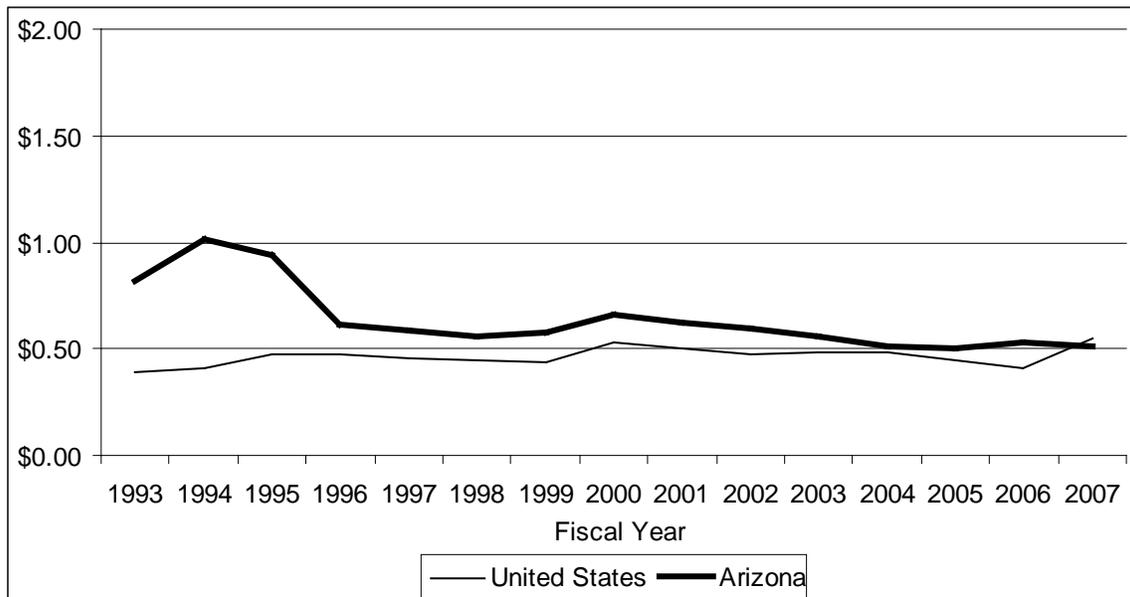
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	-13%	Per Capita	-10
Per \$1,000 of Personal Income	-37%	Per \$1,000 of Personal Income	-11
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-95	Per Capita	-2
Per \$1,000 of Personal Income	-104	Per \$1,000 of Personal Income	-4

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** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

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STATE AND LOCAL GOVERNMENT NATURAL RESOURCES CAPITAL OUTLAYS PER \$1,000 OF PERSONAL INCOME



PARKS AND RECREATION CAPITAL OUTLAYS

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$441,566	1.12%	0.45%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$70.34	209.3%	4	1
Per \$1,000 of Personal Income	2.07	237.7	2	1

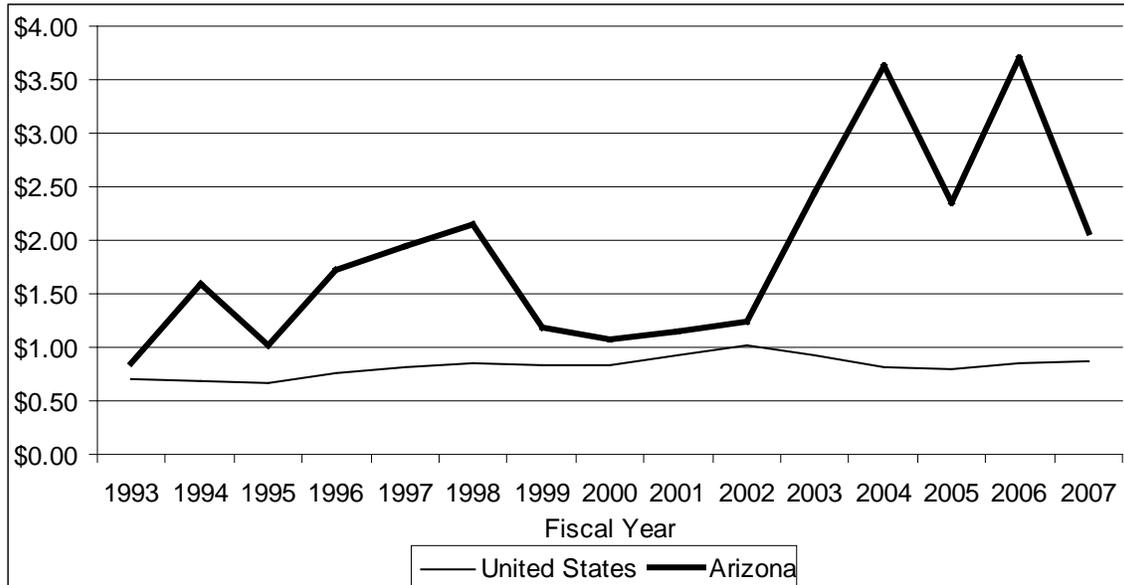
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	237%	Per Capita	11
Per \$1,000 of Personal Income	142%	Per \$1,000 of Personal Income	11
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	106	Per Capita	4
Per \$1,000 of Personal Income	117	Per \$1,000 of Personal Income	5

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STATE AND LOCAL GOVERNMENT PARKS AND RECREATION CAPITAL OUTLAYS PER \$1,000 OF PERSONAL INCOME



SEWERAGE CAPITAL OUTLAYS

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$753,424	1.91%	0.78%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$120.03	205.4%	3	1
Per \$1,000 of Personal Income	3.53	233.3	2	1

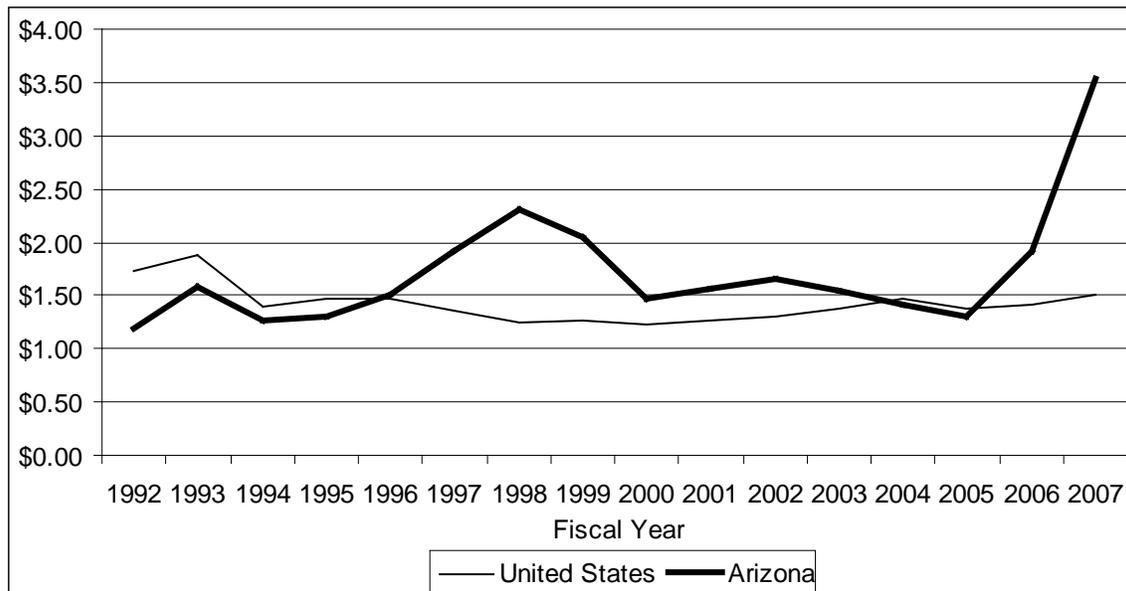
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	319%	Per Capita	31
Per \$1,000 of Personal Income	198%	Per \$1,000 of Personal Income	32
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	146	Per Capita	6
Per \$1,000 of Personal Income	165	Per \$1,000 of Personal Income	6

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STATE AND LOCAL GOVERNMENT SEWERAGE CAPITAL OUTLAYS PER \$1,000 OF PERSONAL INCOME



SOLID WASTE CAPITAL OUTLAYS

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$39,691	0.10%	0.11%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$6.32	77.9%	21	4
Per \$1,000 of Personal Income	0.19	88.5	22	4

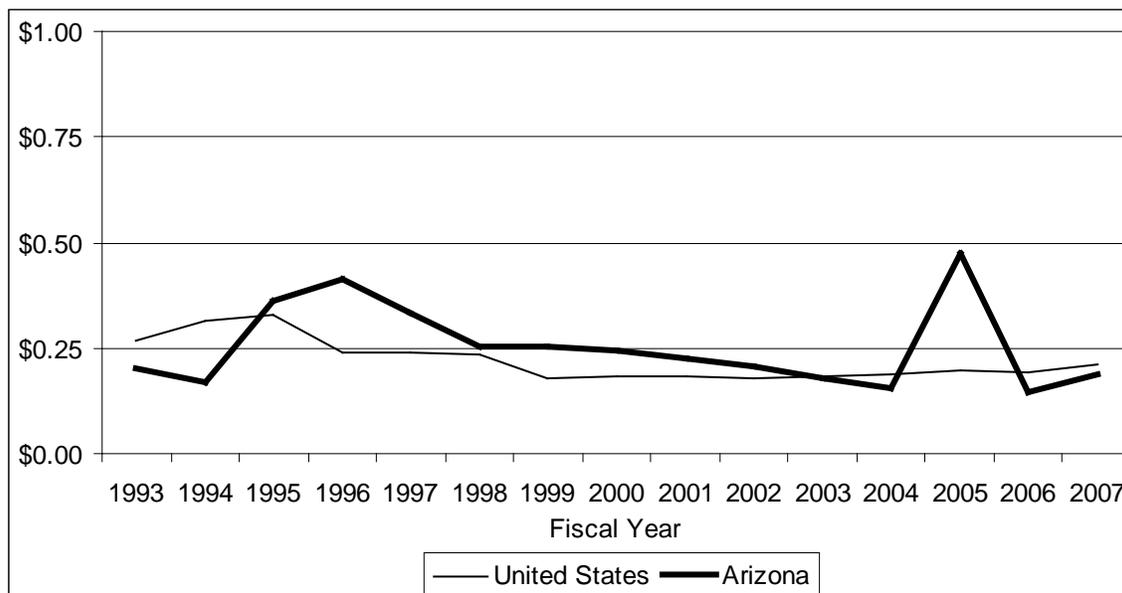
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	28%	Per Capita	2
Per \$1,000 of Personal Income	-8%	Per \$1,000 of Personal Income	-1
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	13	Per Capita	0
Per \$1,000 of Personal Income	13	Per \$1,000 of Personal Income	0

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STATE AND LOCAL GOVERNMENT SOLID WASTE CAPITAL OUTLAYS PER \$1,000 OF PERSONAL INCOME



OTHER CAPITAL OUTLAYS

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,386,127	3.52%	2.87%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$220.82	102.1%	19	5
Per \$1,000 of Personal Income	6.50	116.0	14	5

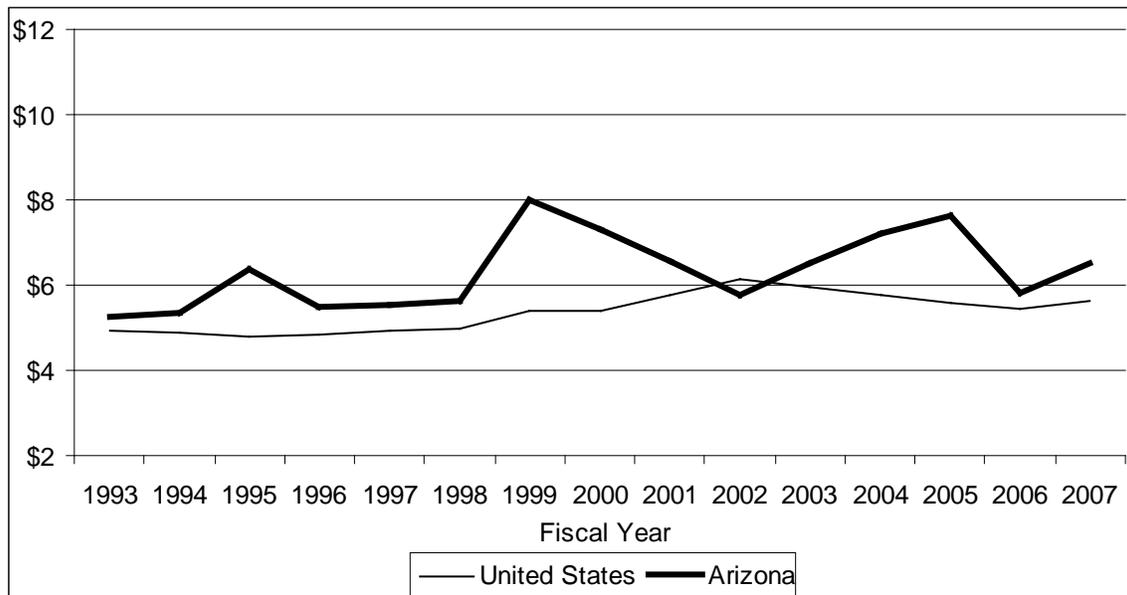
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	72%	Per Capita	
Per \$1,000 of Personal Income	24%	Per \$1,000 of Personal Income	
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	11	Per Capita	
Per \$1,000 of Personal Income	9	Per \$1,000 of Personal Income	

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

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STATE AND LOCAL GOVERNMENT OTHER CAPITAL OUTLAYS PER \$1,000 OF PERSONAL INCOME



TOTAL NONCAPITAL EXPENDITURES

Expenditures for current operations (compensation of employees, purchases of supplies and materials, lease payments, payments for contractual services, etc), interest on debt, and assistance and subsidies (such as grants for scholarships).

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$33,117,701	84.02%	87.31%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$5,275.90	80.2%	48	9
Per \$1,000 of Personal Income	155.29	91.1	41	6

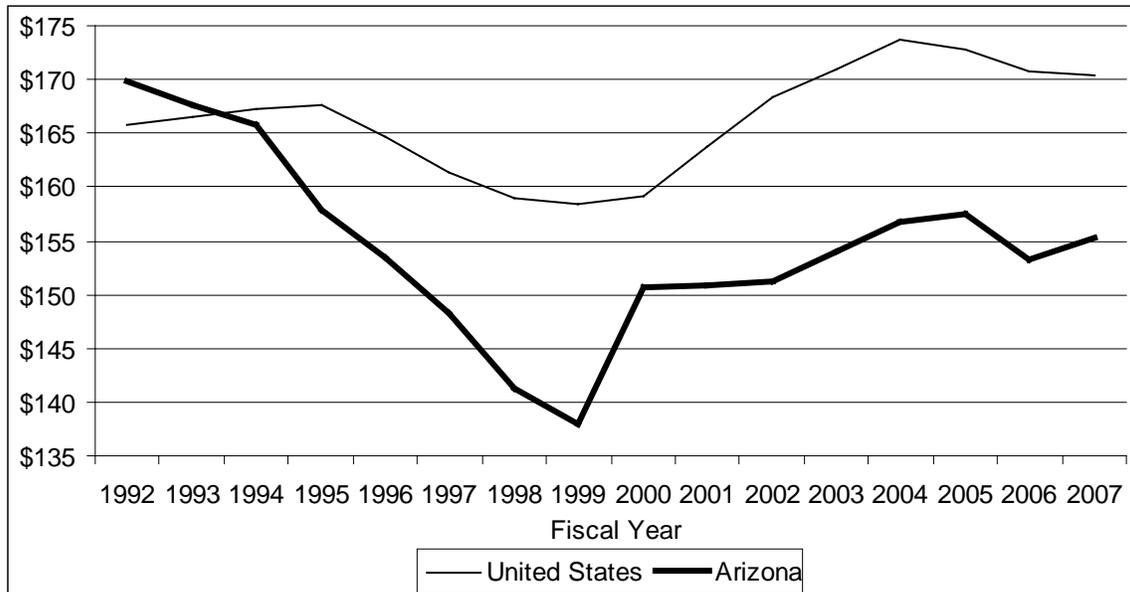
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	29%	Per Capita	-15
Per \$1,000 of Personal Income	-9%	Per \$1,000 of Personal Income	-19
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-8	Per Capita	-2
Per \$1,000 of Personal Income	-11	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

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STATE AND LOCAL GOVERNMENT TOTAL NONCAPITAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



EDUCATION NONCAPITAL EXPENDITURES

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$10,996,576	27.90%	30.31%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$1,751.84	76.7%	50	9
Per \$1,000 of Personal Income	51.56	87.1	44	7

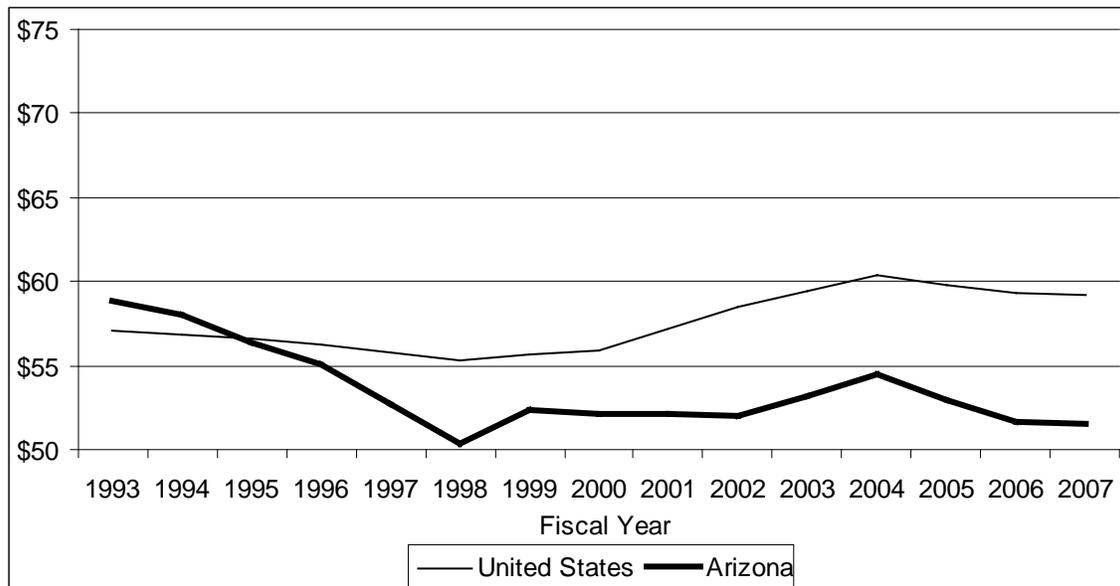
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	22%	Per Capita	-9
Per \$1,000 of Personal Income	-12%	Per \$1,000 of Personal Income	-13
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-11	Per Capita	-1
Per \$1,000 of Personal Income	-16	Per \$1,000 of Personal Income	-1

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STATE AND LOCAL GOVERNMENT EDUCATION NONCAPITAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



HIGHER EDUCATION NONCAPITAL EXPENDITURES

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$3,394,308	8.61%	7.92%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$540.74	90.6%	36	8
Per \$1,000 of Personal Income	15.92	103.0	30	6

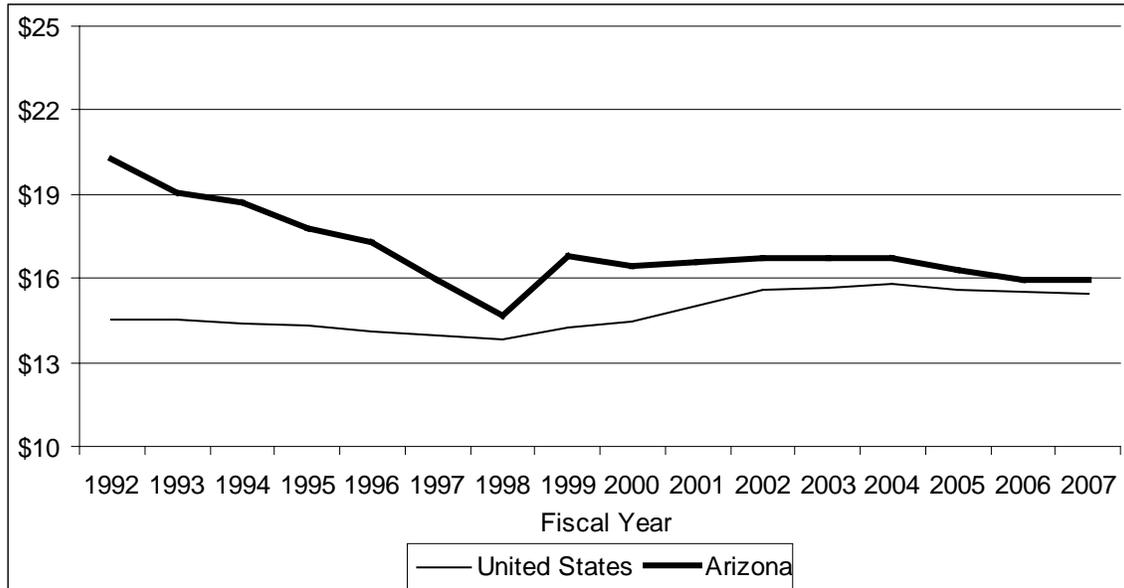
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	11%	Per Capita	-20
Per \$1,000 of Personal Income	-21%	Per \$1,000 of Personal Income	-19
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-29	Per Capita	-3
Per \$1,000 of Personal Income	-36	Per \$1,000 of Personal Income	-3

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STATE AND LOCAL GOVERNMENT HIGHER EDUCATION NONCAPITAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



ELEMENTARY AND SECONDARY EDUCATION NONCAPITAL EXPENDITURES

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$7,072,193	17.94%	20.77%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$1,126.65	72.0%	50	8
Per \$1,000 of Personal Income	33.16	81.8	48	7

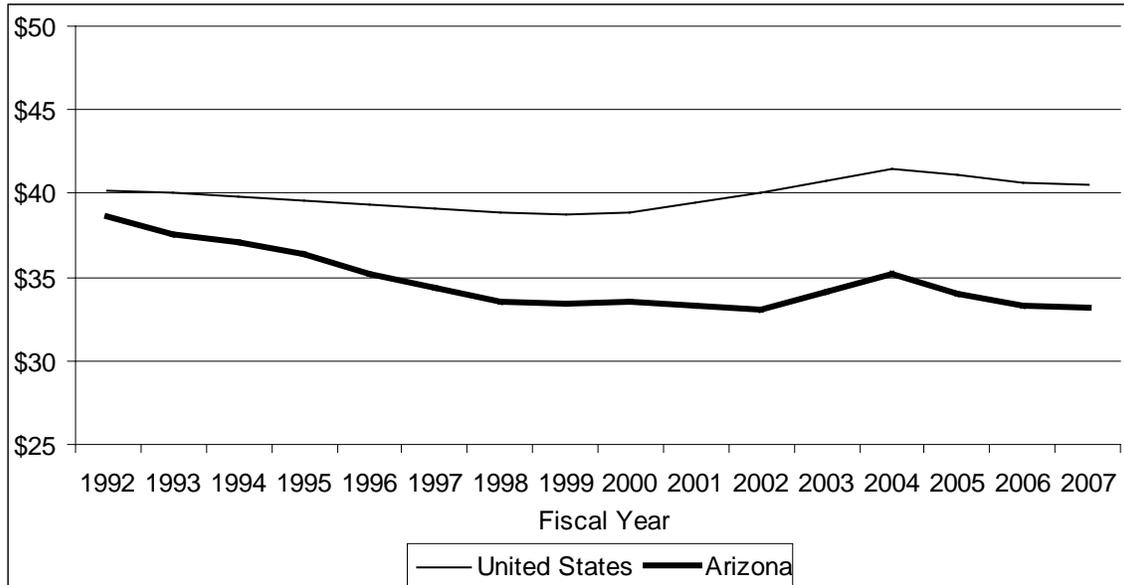
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	21%	Per Capita	-5
Per \$1,000 of Personal Income	-14%	Per \$1,000 of Personal Income	-13
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-11	Per Capita	1
Per \$1,000 of Personal Income	-14	Per \$1,000 of Personal Income	0

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STATE AND LOCAL GOVERNMENT ELEMENTARY AND SECONDARY EDUCATION NONCAPITAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



HOSPITALS NONCAPITAL EXPENDITURES

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,108,523	2.81%	4.91%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$176.60	47.7%	41	9
Per \$1,000 of Personal Income	5.20	54.2	37	9

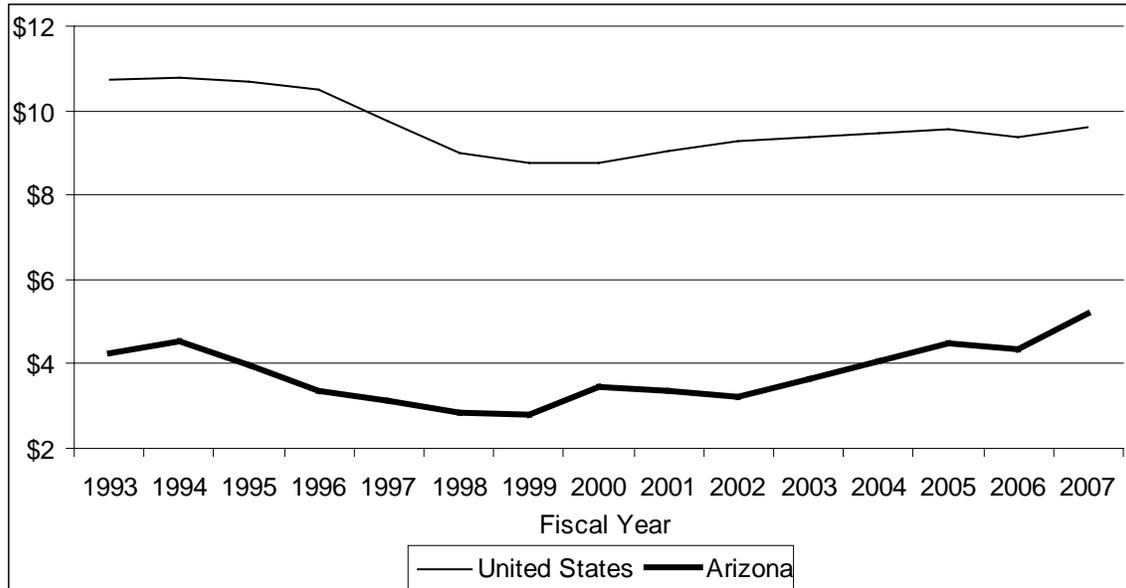
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	69%	Per Capita	5
Per \$1,000 of Personal Income	22%	Per \$1,000 of Personal Income	9
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	14	Per Capita	0
Per \$1,000 of Personal Income	15	Per \$1,000 of Personal Income	0

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STATE AND LOCAL GOVERNMENT HOSPITALS NONCAPITAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



HIGHWAYS NONCAPITAL EXPENDITURES

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,180,286	2.99%	2.72%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$188.03	91.9%	36	6
Per \$1,000 of Personal Income	5.53	104.3	32	6

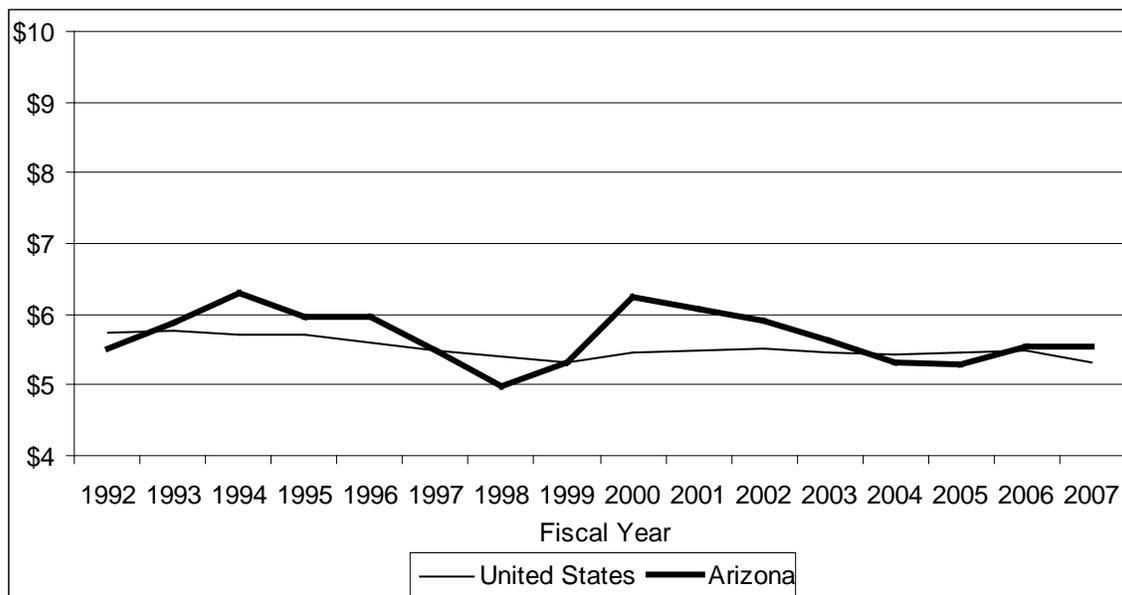
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	41%	Per Capita	8
Per \$1,000 of Personal Income	0%	Per \$1,000 of Personal Income	2
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	9	Per Capita	2
Per \$1,000 of Personal Income	8	Per \$1,000 of Personal Income	0

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STATE AND LOCAL GOVERNMENT HIGHWAYS NONCAPITAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



CORRECTIONS NONCAPITAL EXPENDITURES

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$1,515,956	3.85%	2.87%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$241.50	111.7%	10	3
Per \$1,000 of Personal Income	7.11	126.9	5	3

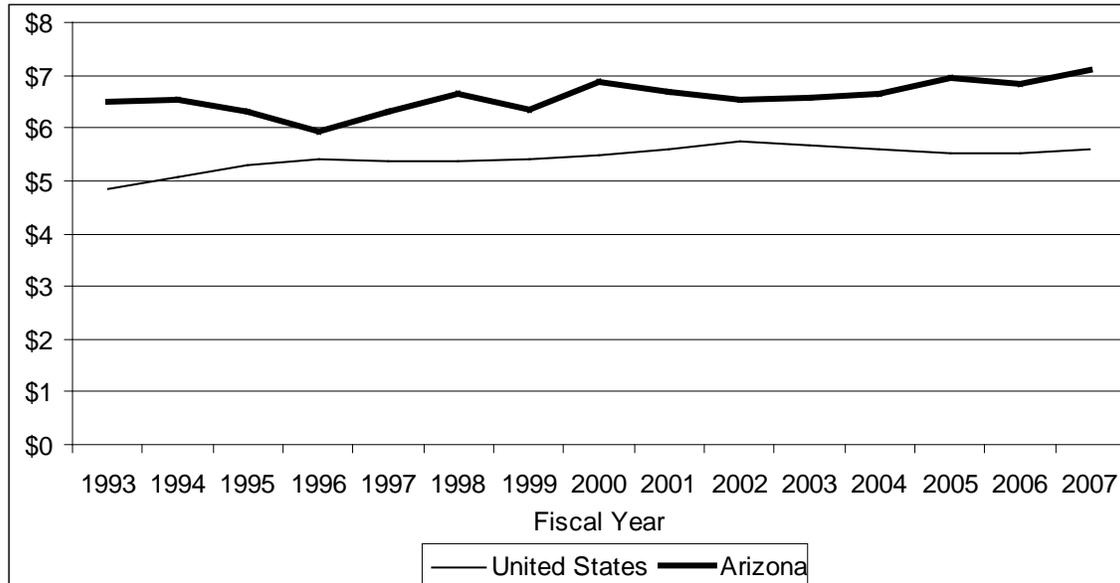
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	52%	Per Capita	-2
Per \$1,000 of Personal Income	9%	Per \$1,000 of Personal Income	1
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-3	Per Capita	0
Per \$1,000 of Personal Income	-7	Per \$1,000 of Personal Income	0

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STATE AND LOCAL GOVERNMENT CORRECTIONS NONCAPITAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



NATURAL RESOURCES NONCAPITAL EXPENDITURES

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$516,494	1.31%	1.00%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$82.28	109.8%	26	5
Per \$1,000 of Personal Income	2.42	124.7	25	5

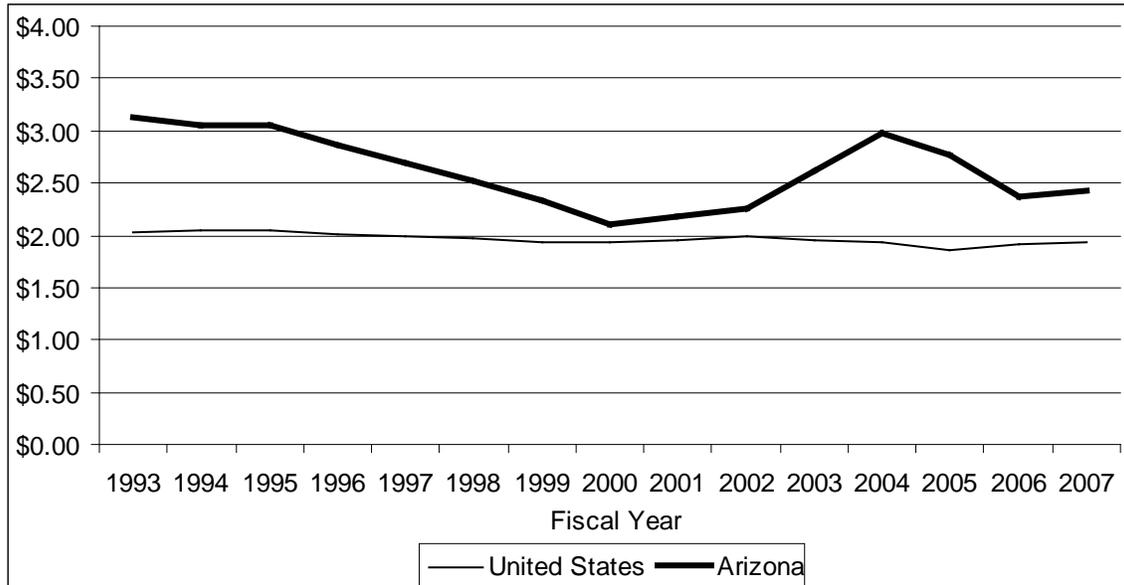
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	8%	Per Capita	-4
Per \$1,000 of Personal Income	-23%	Per \$1,000 of Personal Income	-7
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-22	Per Capita	-1
Per \$1,000 of Personal Income	-29	Per \$1,000 of Personal Income	-1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

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STATE AND LOCAL GOVERNMENT NATURAL RESOURCES NONCAPITAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



PARKS AND RECREATION NONCAPITAL EXPENDITURES

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$588,912	1.49%	1.21%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$93.82	102.5%	21	8
Per \$1,000 of Personal Income	2.76	116.5	15	7

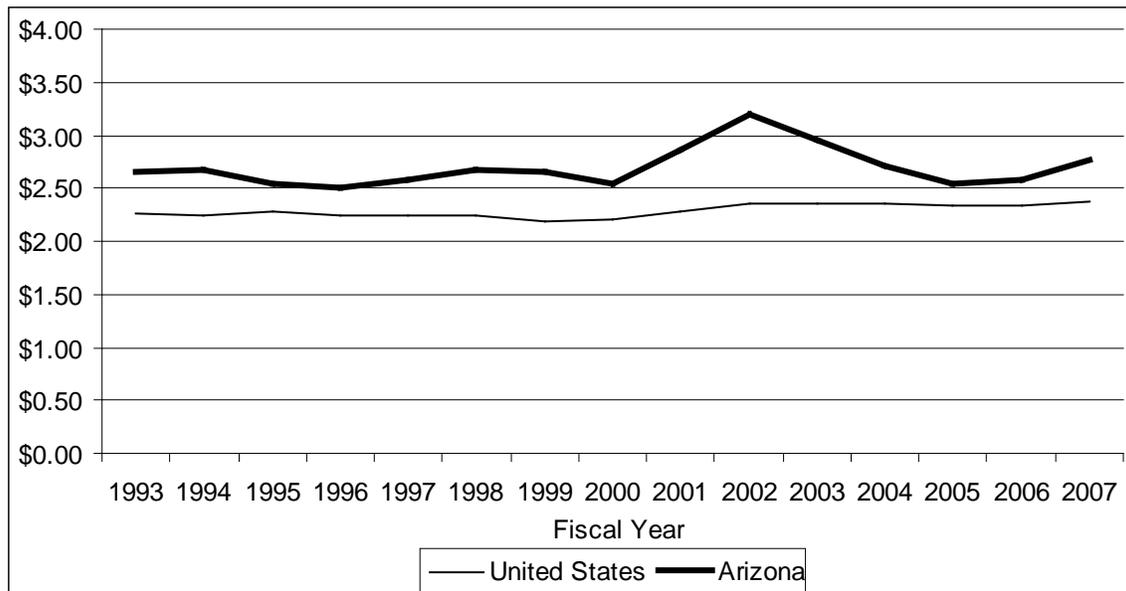
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	44%	Per Capita	-2
Per \$1,000 of Personal Income	4%	Per \$1,000 of Personal Income	0
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	2	Per Capita	0
Per \$1,000 of Personal Income	-1	Per \$1,000 of Personal Income	1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

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STATE AND LOCAL GOVERNMENT PARKS AND RECREATION NONCAPITAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



SEWERAGE NONCAPITAL EXPENDITURES

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$450,515	1.14%	1.17%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$71.77	81.3%	34	7
Per \$1,000 of Personal Income	2.11	92.4	27	6

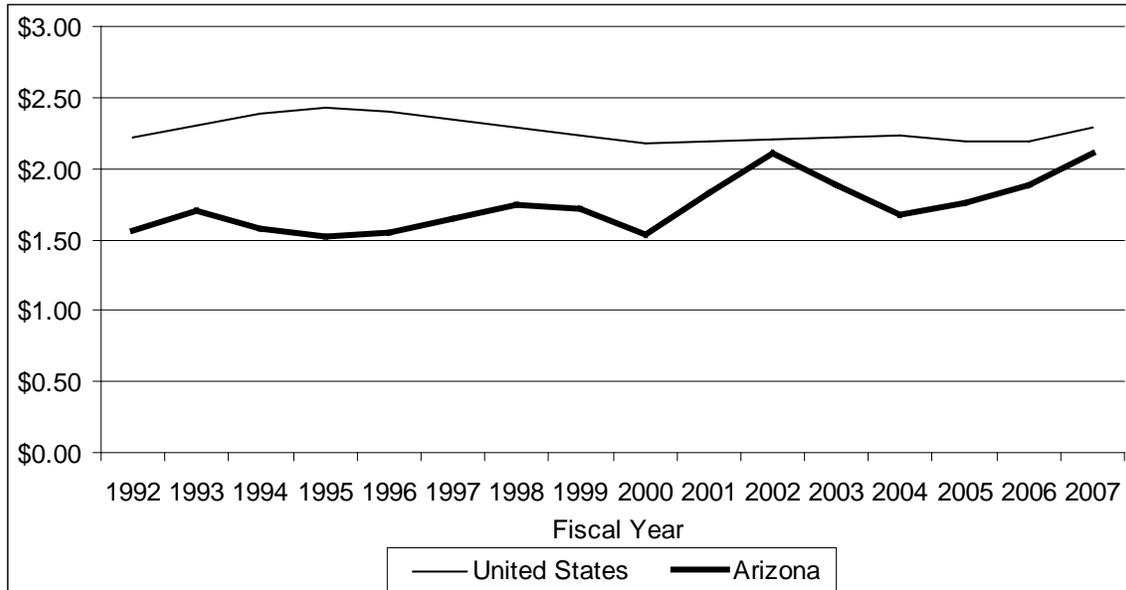
Change Between 1992 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	90%	Per Capita	8
Per \$1,000 of Personal Income	35%	Per \$1,000 of Personal Income	14
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	20	Per Capita	2
Per \$1,000 of Personal Income	22	Per \$1,000 of Personal Income	3

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STATE AND LOCAL GOVERNMENT SEWERAGE NONCAPITAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



SOLID WASTE NONCAPITAL EXPENDITURES

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$320,978	0.81%	0.91%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$51.13	74.8%	34	4
Per \$1,000 of Personal Income	1.51	85.0	32	4

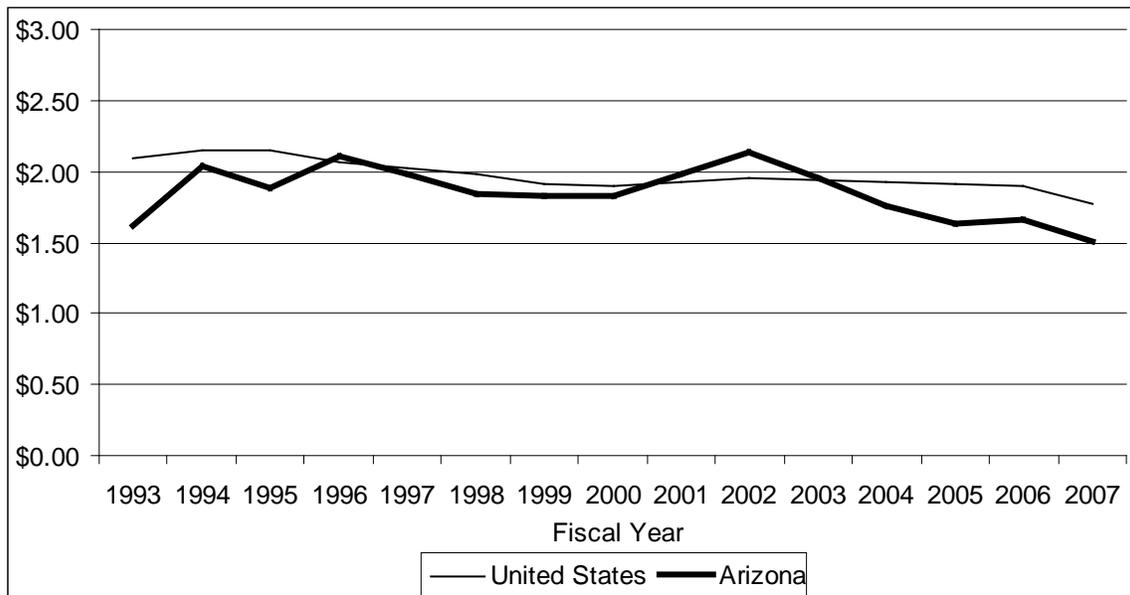
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	29%	Per Capita	1
Per \$1,000 of Personal Income	-7%	Per \$1,000 of Personal Income	1
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	9	Per Capita	1
Per \$1,000 of Personal Income	8	Per \$1,000 of Personal Income	1

* 50 states plus District of Columbia; a rank of 1 represents the highest expenditure

** Arizona plus eight western states (California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington); a rank of 1 represents the highest expenditure

*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT SOLID WASTE NONCAPITAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



OTHER NONCAPITAL EXPENDITURES

ARIZONA STATE AND LOCAL GOVERNMENTS

	Arizona	Share of Total Expenditures	
	\$ in 000	Arizona	United States
2007	\$16,439,461	41.71%	42.22%

2007	Dollars	Percentage of U.S. Average	Rank Among States	
			All*	Western**
Per Capita	\$2,618.93	82.4%	37	7
Per \$1,000 of Personal Income	77.09	93.5	30	4

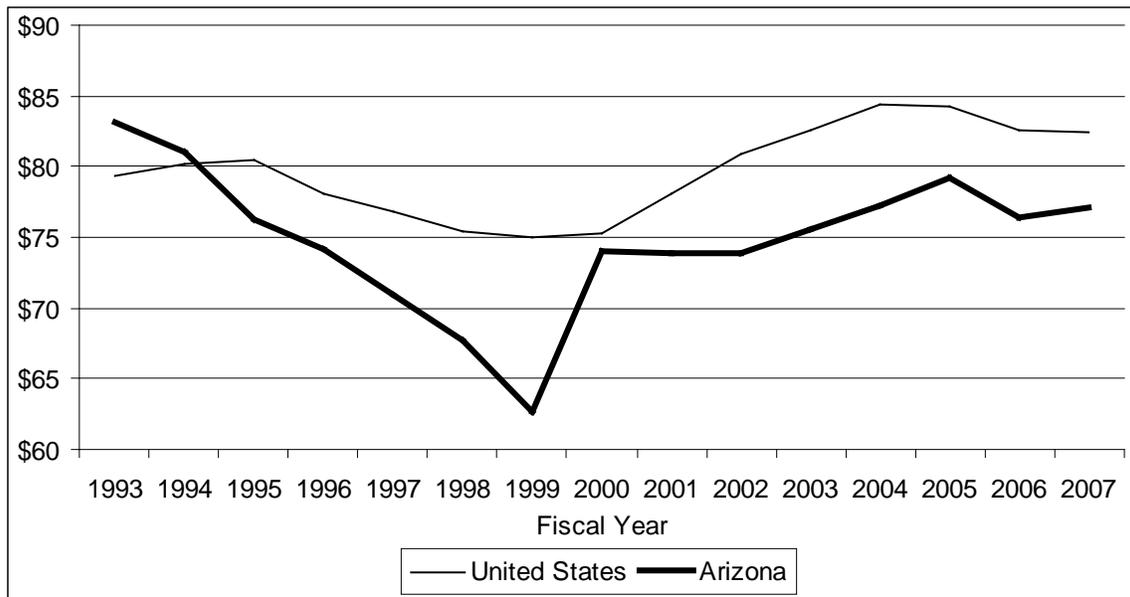
Change Between 1993 and 2007			
Percent Change of Dollar Value:		In U.S. Rank***:	
Per Capita (inflation adjusted)	29%	Per Capita	-9
Per \$1,000 of Personal Income	-7%	Per \$1,000 of Personal Income	-15
In Ratio to U.S. Average:		In Western Rank***:	
Per Capita	-7	Per Capita	-2
Per \$1,000 of Personal Income	-11	Per \$1,000 of Personal Income	-1

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*** A negative change in rank means that expenditures fell relative to other states

STATE AND LOCAL GOVERNMENT OTHER NONCAPITAL EXPENDITURES PER \$1,000 OF PERSONAL INCOME



APPENDIX C REVENUE PROJECTIONS

State government general fund revenue per \$1,000 of personal income under each of the three scenarios discussed in Chapter 15 is compared to a projection of revenue under the existing revenue system and under the systems that were in place in 1988 and in 1992 in the following table. Projected revenue of the existing system is based on the permanent sales tax rate; it does not reflect the additional revenue that will be realized during fiscal years 2011 through 2013 due to the temporary increase in the sales tax rate.

PROJECTED REVENUE PER \$1,000 OF PERSONAL INCOME, ARIZONA STATE GOVERNMENT GENERAL FUND, FISCAL YEARS 2010 THROUGH 2015

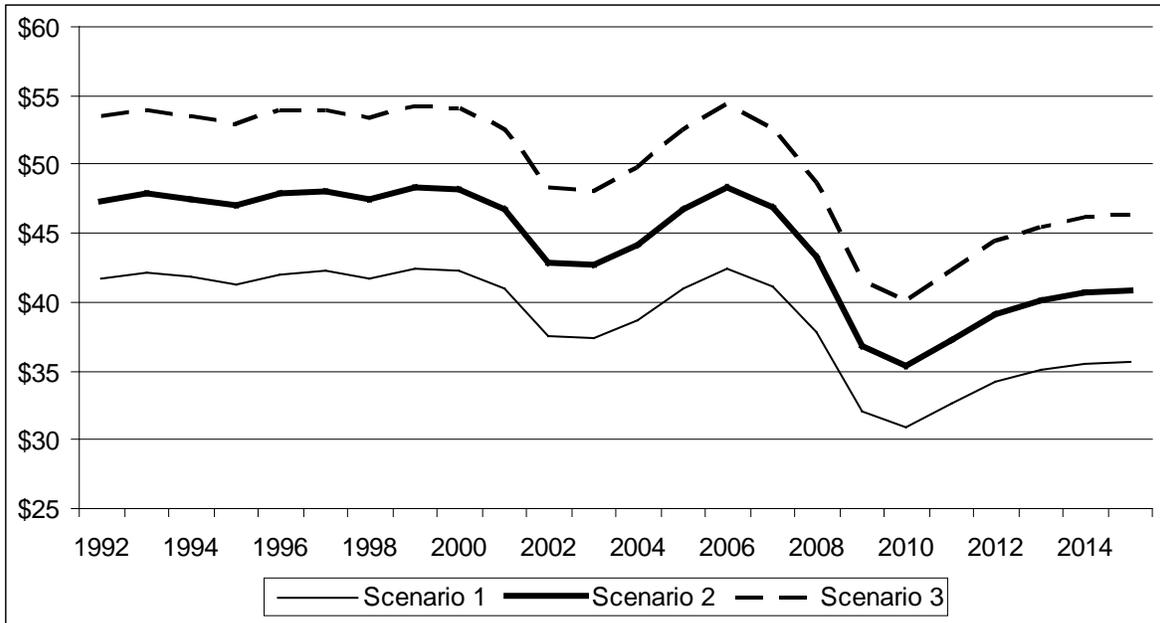
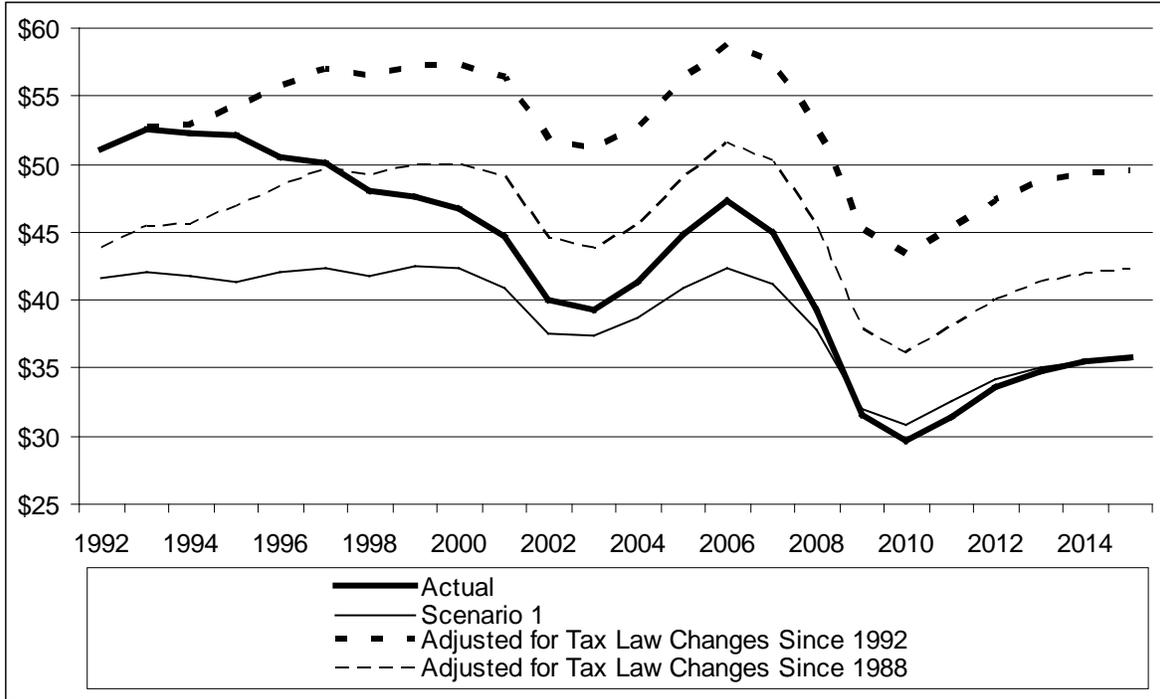
Fiscal Year	Existing	Without Tax Law Changes		Scenario 1	Scenario 2	Scenario 3
		Since 1988	Since 1992			
2010	\$29.63	\$36.14	\$43.43	\$30.85	\$35.34	\$40.11
2011	31.47	37.98	45.28	32.58	37.31	42.33
2012	33.56	40.07	47.37	34.16	39.12	44.37
2013	34.79	41.30	48.60	35.04	40.12	45.51
2014	35.47	41.98	49.28	35.49	40.65	46.12
2015	35.76	42.27	49.57	35.64	40.84	46.35
Percent Change: 2010-15	20.7%	17.0%	14.1%	15.5%	15.6%	15.6%

Revenue from the existing system in 2010 is 18 percent less than if the tax law changes that have been passed since 1988 had not occurred. The differential still would be 15 percent in 2015. Compared to the revenues that would have been realized if the tax increases from 1989 through 1992 had been implemented but none of the subsequent tax changes had occurred, revenue from the existing system in 2010 is 32 percent less; the differential still would be 28 percent in 2015.

In Scenario 1, the revenue neutral scenario, revenue in 2010 is 4 percent higher than in the existing system, with the differential disappearing over time. Compared to Scenario 1, the revenue in Scenario 2 is about 14.5 percent higher in each year. The revenue in Scenario 3 is about 13.5 percent higher in each year than in Scenario 2.

As seen in the percentage change between the 2010 economic trough and the assumed cyclical peak in 2015, the existing revenue system is the most volatile. In the graphs that follow, it can be seen that the projected revenue in the upcoming economic expansion is less than that of the prior expansions in all cases. Thus, the revenue projections are conservative.

ONGOING REVENUE PER \$1,000 OF PERSONAL INCOME, ARIZONA STATE GOVERNMENT GENERAL FUND, FISCAL YEARS 1992 THROUGH 2015



Source: Calculated by authors, based on data from the Arizona Joint Legislative Budget Committee.