

The Other Grand Canyon

Arizona's yawning budget chasm has tempers flaring over a proposed tax hike. It's also spreading the fiscal pain all over the state.

BY MARY JO PITZL

When the housing bubble popped nationally, it exploded in Arizona.

The damage is widespread: Home foreclosures rank Arizona third-highest in the nation, a prominent homebuilder declared bankruptcy and scores of businesses went under.

At the state Capitol, the toll is measured in negative numbers—a deficit as deep as \$3 billion on a budget that barely cracks \$10 billion.

That toll is now taking on another, more human, face with hundreds of state workers laid off, fewer services for everyone from disabled newborns to shut-in seniors, and shuttered state parks.

Arizona lawmakers, who just three years ago were scrapping over how to spend a \$1 billion surplus, are now grappling with deficits. In late January, they closed a \$1.6 billion deficit for FY 2009. And as they turned their attention to the FY 2010 budget and a deficit that could hit \$3 billion, they learned they may have to cut even

more in the current year spending plan.

The situation approaches an emergency-room scenario, where doctors are struggling to stop the bleeding so they can perform a life-saving procedure, only to have a new wave of casualties flood in.

Now, state policymakers are at odds over how to wrestle the budget back into balance. Governor Jan Brewer, just six weeks into her tenure, inflamed the debate with her call for a temporary tax increase. Although the GOP governor is building her budget plan on cuts as well as federal stimulus money, the mere mention of a tax hike has overshadowed all else.

The Republicans, who control the Legislature, say they're not convinced a tax increase is needed. They're willing to sell state assets, such as various buildings, or look at getting an advance, in effect, on future state lottery money, before looking at a tax increase.

"The 'b' word is better than the 't' word," says House Appropriations Chairman John Kavanagh, setting out a game plan that would agree to borrowing ahead of taxation.

Meanwhile, lawmakers are intent on eliminating a state property tax—suspended since 2006—that brings in about \$250 million a year, even as their governor is talking about

This is one in a series of in-depth state fiscal profiles as legislatures grapple with the recession, deep budget shortfalls and painful decisions on how to cut spending and increase revenue.

tax increases. Brewer has been silent on the tax elimination, which adds up to one quarter of the amount of money that she suggests would have to be cut from state programs.

HOW IT GOT THIS BAD

It wasn't all that long ago that Arizona's fiscal situation was as sunny as the state's chamber-of-commerce weather. Money was pouring into state coffers, fueled by the boom in housing and the consumer spending that goes along with it.

The state's average revenue growth of



REPRESENTATIVE
JOHN KAVANAGH
ARIZONA

Mary Jo Pitzl covers the Arizona Legislature for the Arizona Republic.

7 percent a year nearly tripled in 2006, and state officials were happy to put the largesse to work. They cut state income taxes, worked a deal with then-Governor Janet Napolitano to suspend a property tax for three years, filled the rainy-day fund to the brim, and still had money to expand all-day kindergarten classes and launch a public-private partnership to boost investment in medicine, technology and bioscience.

“The first half is going to be ugly like you can’t believe. The second half will only be homely.”

—Economist Elliott Pollock
describing the 2009 fiscal outlook

Spending increased 9.3 percent over the last five years, according to Arizona’s Joint Legislative Budget Committee. That contrasted with a slower growth in population and inflation, which hovered just under 6 percent a year. But soaring tax collections masked the disconnect—until the housing market tanked.

In a two-year span, the growth in state tax collections plummeted 25 points, from a high of 20.1 percent in 2006 to a low of -4.6 percent in 2008. The bad news continues in 2009, and the normal growth rate of 7 percent a year is not expected to return until 2012, if then.

“The first half is going to be ugly like you can’t believe,” said economist Elliott Pollock as he briefed grim-faced lawmakers on the fiscal outlook for 2009. “The second half will only be homely.”

The prediction is proving true, from balance sheets to the political realm to the Capitol grounds.

Republicans blamed Democrat Napolitano for the budget woes, saying she led the state on a spending spree that will take years to rectify. Indeed, despite GOP control, Napolitano led the budget show, uniting the minority Democrats and picking up enough Republicans to get the needed votes.

Napolitano, who resigned her seat in mid-January to become secretary of the U.S. Department of Homeland Security, rejected accusations that she drove the state into a budget ditch.

“I took the governorship with a deficit,” she said in early January. “I was hoping to hand it over without a deficit. But the national economy just overtook us.”

Arizona, she argued, is not an economic island divorced from the rest of the country. “The national economy went down. The state is not immune.”

But if the nation got the fiscal flu, Arizona got the most virulent strain. The state ranks second, after Nevada, in the size of its projected budget deficit for FY 2010: 28 percent, according to the National Conference of State Legislatures. For the current fiscal year, it ranked tops in the nation, although lawmakers resolved the \$1.6 billion deficit a day after the latest NCSL calculation.

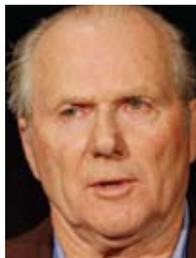
“From my perspective, it can all be laid at the feet of overspending,” says Senate President Bob Burns, a Republican and veteran of 18 years in the Legislature. He’s been running a slide show charting the budget’s ups and downs in Senate chambers to drive home the seriousness of the state’s fiscal crisis.

Add the bad economy to the recent spending, Burns says, and Arizona has been hit with a “double whammy.”

Democrats counter that Burns and his GOP colleagues are leaving out another factor: A 10-percent cut to the state income tax pushed by Republicans that took effect over two years. An analysis by the budget agency shows that the state would have collected enough in revenue to cover its expenses for the last two fiscal years if the tax weren’t cut. It does not look at the current-year budget.

CLIMBING OUT

While debate rages over the cause of the deficit, the numbers are indisputable, even as they inch upward with new revenue reports.



SENATE PRESIDENT
BOB BURNS
ARIZONA



HOUSE SPEAKER
KIRK ADAMS
ARIZONA

Lawmakers have already been warned they may need to cut another \$400 million from the current-year budget, as tax collections wane.

Brewer, in an address to a joint session of the Legislature, pegged the deficit for FY 2010 at \$3 billion. “We cannot expect state revenues to improve until 2012 at the very earliest,” she says.

So far, Arizona lawmakers have erased the deficit with budget cuts, federal stimulus money and a raid on unspent money in various state accounts, which has triggered lawsuits.

But then Brewer raised the prospect of a tax increase.

“We must be willing to consider the passage of a temporary tax increase ... of roughly \$1 billion per year,” she said in her legislative address. There was scattered applause, but none from lawmakers, and two Republican senators walked out at the mention of a tax hike.

Brewer did not specify which tax to increase, nor for how long it would run, inviting lawmakers to work with her on a plan. But it is widely believed that a 1 cent increase in the state’s 5.6 percent sales tax, for three years, is the starting proposition. It would be the first state tax hike in eight years.

Lawmakers were cool to the proposal, if not outright opposed.

“I’m not in favor of a tax increase, and I’m not prepared to vote for one,” Senate President Burns says.

House Speaker Kirk Adams, also a Republican, said a three-year tax increase wouldn’t solve a budget dilemma that the governor describes as a long-term problem. He called the proposal a “hope and a prayer” and said Brewer would be better advised to push her call for tax reform to the front burner, instead of waiting for 2012, as her plan anticipates.

Getting the Legislature to enact a tax increase is a tough sell: It takes a two-thirds

THE CUTS

Arizona lawmakers cut nearly \$600 million from the FY 2009 budget. They issued lump-sum cuts to most state agencies, and left the details to agency directors. Some of the cuts include:

- ◆ Hundreds of layoffs and thousands more furloughed, generally one day a pay period through the end of the fiscal year.
- ◆ A total of 159 Child Protective Service staffers fired, with the cuts coming overwhelmingly from case managers and investigators.
- ◆ Services for developmentally disabled children from birth to age 3 ended.
- ◆ Three state parks closed; others being contemplated for closure.
- ◆ The state archives building closed, just weeks after its grand opening.
- ◆ Child-care subsidies that help provide care for 18,000 children was cut. However, lawmakers used federal stimulus dollars to restore the funding.
- ◆ Inmates are being considered to supply janitorial services to state office buildings.
- ◆ A program that provided financial assistance to grandparents who find themselves raising their grandchildren was ended.

vote, and more than half the lawmakers, all Republicans, have signed no-tax hike pledges.

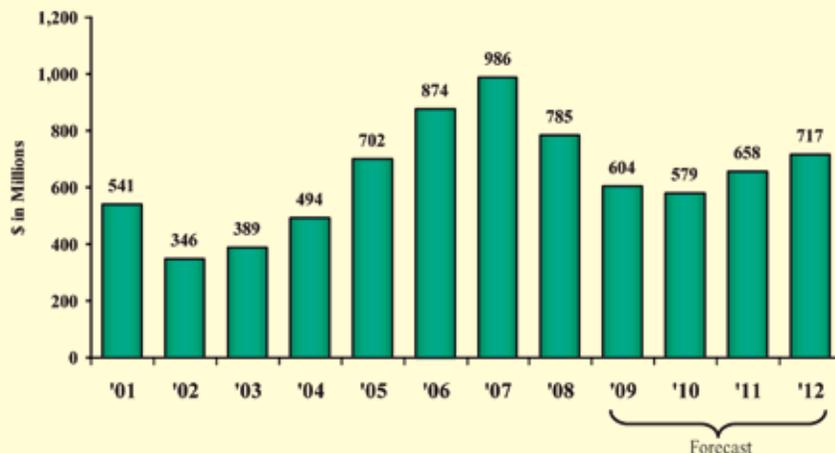
Even the idea of referring a tax increase to the voters, which would take a simple majority vote in the Legislature, didn't immediately get traction. Brewer's lieutenants have their work cut out for them, trying to find a moderate middle that will work for a budget plan that includes painful cuts, a politically painful tax hike and perhaps a few budget gimmicks.

The minority Democrats in the House have criticized Brewer's plan for pushing both tax increases and tax cuts without laying out a specific plan to balance the 2010 budget. They've been holding public statewide budget hearings of their own, and have recently released their own budget proposal.

Federal stimulus money will play a major role in whatever budget fix emerges. Arizona stands to reap \$4.2 billion from the American Recovery and Reinvestment Act, and lawmakers already counted \$500 million of that

TAX COLLECTIONS

This graphic shows the actual and forecasted revenue for Arizona from sales, corporate and personal income taxes from FY 1999 through FY 2012. It includes enacted tax law changes.



Sources: Arizona Legislature's Joint Legislative Budget Committee, Finance Advisory Committee, University of Arizona, 2009.

toward their current-year efforts to close the budget gap. They are considering pouring in another \$500 million to plug a new hole in the FY 2009 budget.

Brewer said that not all of the \$4 billion can go toward a budget fix, but it is welcome help.

"It will reduce our state deficit by about \$1 billion a year for three years, and we are going to use it," she says.

CUTS STILL A CERTAINTY

Driving the governor's unusual call for a tax hike is what she says is the realization that cuts alone can't solve the problem. Since Brewer signed the bills that closed the \$1.6 billion deficit, the state Capitol has been the stage for near-daily protests as the cuts to state agencies are translated into people's lives.

Teachers, students, therapists, advocates for the elderly and the disabled, university presidents, child-care providers and others have brought their stories to the lawmakers' workplace, pleading for a break.

"No one is more acutely aware than I of the depth and the pain of these budget cuts," Brewer says. It is an outrage, she adds, that past budgets have created false hope.

"We end up victimizing the people we should be caring for the most," she says.

Lawmakers say they, too, feel the pain, and are counting on stimulus money and



SENATOR
REBECCA RIOS
ARIZONA

maneuvers other than tax hikes to avoid draconian cuts.

"This will be a staged withdrawal, if you will, from the spending levels that we've had over the last six years," Adams says.

Others say that there's little left to withdraw from, without making drastic changes, such as deep cuts in course offerings in the state's higher-education system or leaving child-abuse complaints unchecked.

Senator Rebecca Rios, the assistant minority leader, is only half joking when she says the glass-is-half-full analogy no longer works. It would be better, she said, to describe it as a tin cup.

CHECK OUT NCSL's State Budget Update report to see where all the states stand in terms of budget shortfalls for FY 2009 and FY 2010 at www.ncsl.org/magazine.