

ARIZONA BUDGET STABILIZATION FUNDS

Arizona has 2 funds which can be used for budget contingencies. These are the Budget Stabilization Fund and the AHCCCS Medical Services Stabilization Fund.

Budget Stabilization Fund — Background

The Budget Stabilization Fund (BSF) for Arizona was created in 1990 (A.R.S. § 35-144). The fund is administered by the State Treasurer, who is responsible for transferring General Fund monies into and out of the BSF as required by law. The BSF is designed to set revenue aside during times of above-trend economic growth and to utilize this revenue during times of below-trend growth. It is designed to provide revenue stabilization across a typical business cycle. Under the economic formula which drives the BSF, the first payment into the fund was required in FY 1994.

The Formula

The determination of the amount to be appropriated to (deposit) or transferred out (withdrawal) of the BSF is made using a formula based upon total annual Arizona personal income (excluding transfer payments) and adjusted for inflation.

The Arizona Economic Estimates Commission (EEC) determines the annual growth rate of inflation-adjusted total state personal income, the trend growth rate over the past seven years, and an estimate of the appropriation to or transfer from the BSF. The EEC reports this calculation for the prior calendar year in the April-May timeframe.

Key features of the Arizona BSF can be summarized as follows:

- The deposit into the BSF (or withdrawal from the BSF) for a given fiscal year is determined by comparing the annual growth rate of inflation adjusted Arizona Personal Income (AZPI) for the calendar year ending in the fiscal year to the trend growth rate of inflation adjusted AZPI for the most recent seven years.
- Adjusted personal income in the BSF formula is defined as total Arizona personal income less transfer payments, adjusted by the gross domestic product price deflator index.
- If the annual growth rate exceeds the trend growth rate, the excess multiplied by General Fund revenue of the prior fiscal year would equal the amount to be deposited into the BSF.

- If the annual growth rate is less than the trend growth rate by 2.0% or more, the deficiency when multiplied by the General Fund revenue of the prior year would equal the amount to be withdrawn from the BSF. This 2% floor avoids withdrawing monies from the BSF when economic conditions are slowing but there is not a recession.
- By a two-thirds majority, the Legislature, with the concurrence of the Governor, can decrease a deposit or increase a withdrawal.
- The BSF is limited in size, although the limit was temporarily suspended by the Legislature for FY 1999. Thereafter, the BSF cannot be larger than 7.0% of the prior year's General Fund revenues.

State Hospital Financing Mechanism

Laws 2000, Chapter 1 provided for the financing of construction of a new Arizona State Hospital by appropriating interest earnings from the BSF of \$20,000,000 per year over 4 years, \$80,000,000 total, from FY 2000 through FY 2003. These payments will be made by the Treasurer on an equal monthly basis, \$1,660,000 million per month, to a construction account at the Treasurer's Office. Chapter 1 provides for the reimbursement of this diversion of BSF interest earnings from \$20,000,000 in annual receipts from the Arizona share of the master tobacco settlement agreement.

Investments of BSF Funds

In addition to the fixed income investments available to the Treasurer, the 1998 Legislature allowed the Treasurer to invest up to 25% of the BSF in equity securities (Laws 1998, Chapter 266). As of April 2000, the Treasurer had invested \$27,200,000 in the Standard & Poor's 500 index or about 7.7% of the \$388,700,000 total BSF balance. The total market value of equities was \$29,900,000, which represented a \$2,700,000 unrealized gain at that time. The Treasurer has stated that it intends to annually increase the proportion of equities in the BSF by 5% to reach the 25% limit over 5 years. It is expected that a "buy and hold" strategy will be used for the equity funds until BSF monies are eventually withdrawn.

Appropriations (Deposits) to BSF

At the end of FY 2000, the BSF balance is projected to be \$409,300,000, or approximately 6.9% of General Fund revenue. Laws 1997, Chapter 199 capped the BSF balance at 7.0% of revenue in FY 2000 and thereafter.

ESTIMATED CHANGES TO THE BUDGET STABILIZATION FUND
FY 1997 THROUGH FY 2001
(\$ in Millions)

	<u>Actual</u> <u>FY 1997</u>	<u>Actual</u> <u>FY 1998</u>	<u>Actual</u> <u>FY 1999</u>	<u>Estimate</u> <u>FY 2000</u>	<u>Estimate</u> <u>FY 2001</u>
General Fund Revenues ^{1/}	5,039,857,800	5,229,384,500	5,635,341,216	5,942,112,500	6,271,190,200
Maximum Balance	251,992,890	294,623,523	356,717,099	415,947,875	438,983,314
Maximum % of Revenues	5.000%	5.634%	6.330%	7.000%	7.000%
Adjusted Annual Income Growth	6.5%	5.7%	7.1%	5.9%	5.8%
Adjusted 7-Year Income Growth	3.8%	4.5%	5.6%	6.5%	6.8%
Annual Difference	2.7%	1.2%	1.5%	(0.6)%	(1.0)%
BSF Formula Recommendation ^{2/3/}	127,766,000	60,478,000	0.0	0.0	0.0
Beginning Balance	233,130,000	245,810,900	291,670,000	386,838,000	409,296,200
Actual Deposit/Withdrawal	0.0	30,000,000	75,115,000	0.0	0.0
ASH Construction Fund Payments	0.0	0.0	0.0	(20,000,000)	(20,000,000)
ASH Reimbursement from Settlement Fund	0.0	0.0	0.0	20,000,000	20,000,000
Balance	<u>233,130,000</u>	<u>275,810,900</u>	<u>366,785,000</u>	<u>386,838,000</u>	<u>409,296,200</u>
Effective Interest Rate	5.4%	5.7%	5.5%	5.9%	5.0%
Interest Earnings	<u>12,680,900</u>	<u>15,859,100</u>	<u>20,053,000</u>	<u>22,458,200</u>	<u>24,685,200</u>
Ending Balance	<u>245,810,900</u>	<u>291,670,000</u>	<u>386,838,000</u>	<u>409,296,200</u>	<u>433,981,400</u>
Ending Balance As A % of GF Revenue	<u>4.9%</u>	<u>5.6%</u>	<u>6.9%</u>	<u>6.9%</u>	<u>6.9%</u>

^{1/} Total revenues less beginning balance forward.

^{2/} The Economic Estimates Commission determines this by multiplying prior year revenues times the annual difference from trend growth.

N/A - Not Applicable.

^{3/} Starting in FY 1999, the BSF formula will not recommend a withdrawal unless the difference from the 7-year average is greater than (2.0)%.

Table 3 shows the actual deposits to the BSF for FY 1997 through FY 1999 as well as estimates of BSF balances for FY 2000 through FY 2001. (For a further history of the BSF, please see the JLBC Staff's Summary of Recommendations and Economic and Revenue Forecast published in January 2000.)

**Medical Services Stabilization Fund —
Background**

The AHCCCS Medical Services Stabilization Fund is authorized in A.R.S. § 36-2922. It is to be used if the appropriation for AHCCCS in a fiscal year is insufficient to cover the cost of AHCCCS medical services. AHCCCS must notify the Chairperson of the Joint Legislative Budget Committee and the Director of the Governor's Office of Strategic Planning and Budgeting that the appropriation is insufficient, and the JLBC Staff may recommend that AHCCCS withdraw an amount from the Medical Services Stabilization Fund to cover the shortfall.

The fund currently has no ongoing source of funding. The fund previously received \$15,000,000 per year from the Medically Needy Account of the Tobacco Tax and Health Care Fund to the Medical Services Stabilization Fund. This monthly transfer was discontinued after July 1, 1998. Interest earnings are retained in the fund. At the end of FY 1999, the fund balance was \$76,528,700. The 2 stabilization funds are summarized over the period FY 1999 through FY 2001 in Table 4.

Table 4

	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>
BSF	\$386,838	\$409,296	\$433,981
AHCCCS Fund	<u>76,529</u>	<u>72,355</u>	<u>75,973</u>
	<u>\$463,367</u>	<u>\$481,651</u>	<u>\$509,954</u>