

# ARIZONA BUDGET STABILIZATION FUNDS

Arizona has two 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 and Recent Developments

The Budget Stabilization Fund (BSF) for Arizona was enacted in 1990 (A.R.S. § 35-144). The fund is administered by the State Treasurer, who is responsible for transferring General Fund money 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 annual budget recommendations of the JLBC and the Governor include estimates of the amounts to be appropriated to or transferred from the BSF. The final determination of the amount to be appropriated or transferred is made based on calculations from the Arizona Economic Estimates Commission (EEC). The EEC determines the annual growth rate of inflation-adjusted total state personal income, the trend growth rate over the past seven years, and the calculated appropriation to or transfer from the BSF. The EEC reports this calculation for the prior calendar year by June 1. The EEC calculations however, do not result in any automatic deposits or withdrawals, as they must be authorized by legislative action.

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

- The deposit into 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 both less than 2% and less than the trend growth rate, 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's total balance cannot be larger than 7.0% of the prior year's General Fund revenues.

## Alternative Uses

Laws 2000, Chapter 1 provided for the financing of construction of a new Arizona State Hospital (ASH) 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 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. This was subsequently modified by Laws 2000, Chapter 1, 7<sup>th</sup> Special Session to provide that the payments would be made from the BSF rather than interest earnings from the BSF.

Based on the passage of Proposition 204 and an Attorney General opinion, the reimbursement to the BSF for Arizona State Hospital construction costs is the last priority in the use of funds from the master tobacco settlement agreement. It is estimated that the reimbursement will occur in FY 2002, but not in FY 2003.

Recently, Laws 2000, 7th Special Session, Chapter 1, required that the refund payments for alternative fuel vehicle tax credits and Consumer Loss Recovery Fund liabilities would be funded by the Budget Stabilization Fund up to \$200 million. This amount is to be reimbursed to the BSF by the General Fund at the rate of up to \$16 million annually.

Figure 4

**ESTIMATED CHANGES TO THE BUDGET STABILIZATION FUND  
FY 1999 THROUGH FY 2003  
(\$ in Thousands)**

	Actual <sup>1/</sup> FY 1999	Actual FY 2000	Estimate FY 2001	Estimate FY 2002	Estimate FY 2003
<u>General Fund Revenues</u>					
Adjusted Revenues	5,635,341.2	5,960,280.0	6,275,147.1	7,049,837.1	7,507,522.6
Statutory Limit of Revenues	6.333%	7.000%	7.000%	7.000%	7.000%
Maximum Balance	356,886.2	417,219.6	439,260.3	493,488.6	525,526.6
<u>Arizona Personal Income in Prior CY</u>					
Real Adjusted Annual Income Growth	8.00%	5.94%	7.31%	3.88%	4.40%
7-Year Average Income Growth	6.00%	6.52%	6.84%	6.30%	6.02%
Annual Difference	2.00%	-0.58%	0.47%	-2.42%	-1.62%
<u>BSF Transactions</u>					
Beginning BSF Balance	291,670.0	383,560.4	405,960.5	235,278.1	266,354.8
BSF Formula Recommendation	104,588.0	0.0	28,013.3	0.0	0.0
Actual / Recommended Deposit	75,115.0	0.0	0.0	0.0	0.0
ASH Construction Fund Payments	--	(20,000.0)	(20,000.0)	(20,000.0)	(20,000.0)
ASH Reimbursement from Settlement Fund	--	20,000.0	20,000.0	20,000.0	0.0
Payment of Alternative Fuel Credits	--	--	(200,000.0)	0.0	0.0
Alternative Fuel Repayment to BSF	--	--	16,000.0	16,000.0	16,000.0
Balance	365,078.8	383,560.4	221,960.5	251,278.1	262,354.8
Effective Interest Rate	5.1%	5.8%	6.0%	6.0%	6.0%
Interest Earnings	18,481.6	22,400.1	13,317.6	15,076.7	15,741.3
<b>Ending BSF Balance</b>	<b>383,560.4</b>	<b>405,960.5</b>	<b>235,278.1</b>	<b>266,354.8</b>	<b>278,096.1</b>
<b>Percent of Revenues</b>	<b>6.8%</b>	<b>6.8%</b>	<b>3.7%</b>	<b>3.8%</b>	<b>3.7%</b>

<sup>1/</sup> In FY 1999, the Legislature removed the maximum allowed in the BSF for that fiscal year.

<sup>2/</sup> Includes Proposition 301 revenues.

<sup>3/</sup> Based on the passage of Proposition 204 and an Attorney General opinion, the reimbursement to the Budget Stabilization Fund for Arizona State Hospital construction costs is the last priority in the use of Tobacco Settlement Funds. This reimbursement is currently projected to be made in FY 2002, but not in FY 2003.

<sup>4/</sup> Represents the maximum payment of Alternative Fuel credits of \$(200.0) million. Some of the payment may actually occur in FY 2002, and the total cost may be less than \$200 million.

Alternative fuel tax credits will be paid out in the form of individual income tax refunds at the end of FY 2001 and the beginning of FY 2002. The Department of Revenue will determine by the middle of each month the amount of General Fund refunds from the prior month that are to be reimbursed by the BSF. Therefore, there is a 1 month lag between when the state sends out the refunds and when the General Fund receives reimbursement. June refunds will be reimbursed in July. However, a 13th month adjustment should allocate the July reimbursement to FY 2001.

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.

**Projected Deposits/Withdrawals**

Based on the projections of a gradually slowing economy, *Figure 4* shows that the difference between real adjusted annual personal income growth and the seven-year average will be (2.42)% in FY 2002 and (1.62)% in FY 2003. However, since the adjusted annual income growth rates for these years are greater than 2.0%, no withdrawal from the BSF is anticipated.

The unpaid balance of the withdrawn amount will bear interest at the annual average interest rate earned on operating funds on deposit at the Treasurer's Office.

**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). The Treasurer has stated that it intends to annually increase the proportion of equities in

## BSF Balances

At the end of FY 2001, balances in the BSF, including accrued interest, are expected to be \$435.3 million prior to alternative fuel adjustments. If \$200 million is withdrawn for alternative fuel tax credit payments, balances would fall to about \$235.3 million by the end of FY 2001.

*Figure 4* shows the actual deposits and balances in the BSF for FY 2000, as well as estimates of balances for FY 2001 through FY 2003.

## 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 other than interest earnings. 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 2000, the fund balance was \$75,717,200.

The two stabilization funds are summarized over the period FY 2000 through FY 2003 in *Figure 5*.

At its May 31, 2001 meeting, the JLBC approved a transfer of \$52,339,900 from the Medical Services Stabilization Fund to address FY 2001 Title XIX shortfalls in AHCCCS, the Department of Health Services, and the Department of Economic Security. The Committee also authorized a FY 2001 "contingency" amount of 5%, or \$2,617,000, to provide for unanticipated costs. After the transfer, the fund balance at the close of FY 2001 is projected to be \$24,546,200. Laws 2001, Chapter 273 also appropriated \$2,500,000 from the Medical Services Stabilization Fund in both FY 2002 and FY 2003 to DHS for the establishment of the Arizona Mental Health Research Institute. Laws 2001, Chapter 344 appropriates \$13,405,600 from the General Fund to the Medical Services Stabilization Fund in FY 2002 to repay it for a portion of the AHCCCS's FY 2001 Supplemental. Laws 2001, Chapter 385 transfers all monies remaining in the Medical Services Stabilization Fund after December 31, 2003 to the Medically Needy Account of the Tobacco Tax and Health Care Fund, which is estimated to total approximately \$37,634,800. Thus, the FY 2004 ending balance will be \$0.

**Figure 5**

### Total Stabilization Funds (\$ in Millions)

	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>
BSF	\$405,960.5	\$235,278.1	\$266,354.8	\$278,096.1
AHCCCS Fund	<u>75,717.2</u>	<u>24,546.2</u>	<u>37,349.4</u>	<u>36,716.9</u>
<b>Total</b>	<b>\$481,677.7</b>	<b>\$259,824.3</b>	<b>\$303,704.2</b>	<b>\$314,813.0</b>