

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. 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 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 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.
- 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).

Alternative Uses

Laws 2000, Chapter 1 as amended by Laws 2000, 7th Special Session, Chapter 1 and Laws 2001, 2^d Special Session, Chapter 3, provided for the financing of construction of a new Arizona State Hospital (ASH) by appropriating a total of \$77.5 million from the BSF over 4 years, FY 2000 through FY 2003. Chapter 1 also provides for the reimbursement of the BSF from annual receipts from the Arizona share of the master tobacco settlement agreement.

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 not occur in FY 2002 or FY 2003.

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 was to be reimbursed to the BSF by the General Fund at the rate of up to \$16 million annually. After FY 2001, however, this reimbursement provision was repealed.

Table 1

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

| | Actual FY 1999 | Actual FY 2000 | Actual FY 2001 | Estimate FY 2002 | Estimate FY 2003 |
|---|-------------------|-------------------|-------------------|--------------------------------|-------------------------------|
| General Fund Revenues | | | | | |
| Adjusted Revenues | 5,635,341.2 | 5,960,280.0 | 6,180,843.1 | 6,763,019.4 | 6,604,658.5 |
| Statutory Limit of Revenues | 6.333% | 7.000% | 7.000% | 7.000% | 7.000% |
| Maximum Balance | 356,886.2 | 417,219.6 | 432,659.0 | 473,411.4 | 462,326.1 |
| Arizona Personal Income in Prior CY | | | | | |
| Real Adjusted Annual Income Growth | 8.00% | 5.94% | 7.31% | 2.10% | 3.30% |
| 7-Year Average Income Growth | 6.00% | 6.52% | 6.84% | 5.78% | 5.61% |
| Annual Difference | 2.00% | -0.58% | 0.47% | -3.68% | -2.31% |
| BSF Transactions | | | | | |
| Beginning BSF Balance | 291,670.0 | 383,560.4 | 407,666.3 | 391,523.8 | 129,782.1 |
| BSF Formula Recommendation | 104,588.0 | 0.0 | 28,013.2 | 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) | (17,500.0) |
| ASH Reimbursement - Settlement Fund ^{1/} | -- | 20,000.0 | 20,000.0 | 0.0 | 0.0 |
| Payment of Alternative Fuel Credits ^{2/} | -- | -- | (49,425.3) | (80,574.7) | 0.0 |
| Alternative Fuel Repayment to BSF | -- | -- | 16,000.0 | 0.0 | 0.0 |
| BSF Transfer to GF - 45 th Leg - 2 nd SS ^{3/} | -- | -- | -- | (119,000.0) | 0.0 |
| BSF Transfer to GF - 45 th Leg - 3 rd SS ^{3/} | -- | -- | -- | (47,150.0) | 0.0 |
| BSF Transfer to GF - 45 th Leg - 3 rd SS ^{3/ 4/} | -- | -- | -- | (7,361.1) | 0.0 |
| BSF Transfer to GF - 45 th Leg - 2 nd RS ^{3/} | -- | -- | -- | 0.0 | (50,000.0) |
| Balance | 365,078.8 | 383,560.4 | 374,241.0 | 117,438.0 | 62,282.1 |
| Effective Interest Rate | 5.1% | 5.8% | 4.6% | 10.5% | 5.0% |
| Interest Earnings | 18,481.6 | 22,400.1 | 17,282.8 | 12,344.1 | 3,123.1 |
| Ending BSF Balance | 383,560.4 | 405,960.5 | 391,523.8 | 129,782.1 ^{4/} | 65,405.2 ^{4/} |
| Percent of Revenues | 6.8% | 6.8% | 6.3% | 1.9% | 1.0% |

^{1/} 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 Tobacco Settlement Funds. This reimbursement is currently projected to not be made in either FY 2002 or FY 2003.

^{2/} Currently, the alternative fuels payout from the BSF equals \$(108) million combined between FY 2001 and FY 2002. The Executive currently estimates that the total will be \$(130) million..

^{3/} These Laws notwithstanding existing provisions of law so that the statutory formula was not used to determine the withdrawal amounts.

^{4/} If revenues fall below the budgeted total in FY 2002, a transfer from the BSF will be made to make up the difference. At sine die, it was estimated that \$(7.4) million would be withdrawn from the BSF at the end of FY 2002. As of May 2002, the anticipated FY 2002 shortfall had grown by \$(59.2) million. If this shortfall holds through June 2002, the FY 2002 and FY 2003 balances would be reduced by a corresponding amount.

Alternative fuel tax credits were paid out in the form of individual and corporate income tax refunds at the end of FY 2001, and have continued during FY 2002. The Department of Revenue determines 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 allocates the July reimbursement to the previous June.

Projected Deposits/Withdrawals

Based on the projections of a gradually slowing economy, Table 1 shows that the difference between real adjusted annual personal income growth and the seven-year average will be (3.68)% in FY 2002 and (2.31)% in FY 2003. However, 2nd and 3rd Special Session legislation notwithstanding the existing provisions of law, and specified the transfer amounts.

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.

**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 2001, the fund balance was \$25,345,500. Laws 2001, Chapter 344 appropriated \$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 In

addition, Laws 2001, 2nd Special Session, Chapter 7, transferred \$15,000,000 from the Health Education Account of the Tobacco Tax and Health Care Fund to the Medical Services Stabilization Fund.

Laws 2001, 1st Special Session, Chapter 1, as amended by Laws 2001, 2nd Special Session, chapter 8, as amended by Laws 2002, 3rd Special Session, Chapter 1 appropriated \$7,777,600 from the Medical Services Stabilization Fund for the state emergency services program. Laws 2001, 2nd Special Session, Chapter 5 appropriated \$45,339,800 from the Medical Services Stabilization Fund to address FY 2002 Title XIX shortfalls in AHCCCS and the Department of Health Services. Laws 2001, Chapter 273, as amended by Laws 2002, Chapter 329 also appropriated \$2,500,000 from the Medical Services Stabilization Fund in FY 2002 to DHS for the establishment of the Arizona Mental Health Research Institute. 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 \$71,300. Thus, the FY 2004 ending balance will be \$0.

The two stabilization funds are summarized over the period FY 2000 through FY 2003 in [Figure 1](#).

| Figure 1 | | | | |
|----------------------------------|--------------------|--------------------|--------------------|-------------------|
| Total Stabilization Funds | | | | |
| (\$ in Thousands) | | | | |
| | <u>FY 2000</u> | <u>FY 2001</u> | <u>FY 2002</u> | <u>FY 2003</u> |
| BSF | \$405,960.5 | \$391,523.8 | \$129,782.1 | \$65,405.2 |
| AHCCCS Fund | <u>72,876.0</u> | <u>25,345.5</u> | <u>71.3</u> | <u>71.3</u> |
| Total | \$481,677.7 | \$416,869.3 | \$129,853.4 | \$65,476.5 |