STATE OF ARIZONA

ANNUAL BUDGET

FY 1987

SUMMARY OF RECOMMENDATIONS

AND

ECONOMIC AND REVENUE FORECAST

JLBC

Prepared by The Staff

Of The

JOINT LEGISLATIVE BUDGET COMMITTEE

JOINT LEGISLATIVE BUDGET COMMITTEE

The Joint Legislative Budget Committee was first established on April 25, 1966, pursuant to Laws 1966, Ch. 96. Thereafter, Laws 1979, Ch. 187 expanded and altered the Committee membership. The Committee members are:

Representative John Wettaw Chairman - 1985	Senator S. H. "Hal" Runyan Chairman - 1986
Representative Burton Barr	Senator Pete Corpstein
Representative Carmen Cajero	Senator A. V. "Bill" Hardt
Representative Jim Green	Senator Jeffrey Hill
Representative James Ratliff	Senator John Mawhinney
Representative Betty Rockwell	Senator Ed Sawyer
Representative Polly Rosenbaum	Senator Jack Taylor
Representative Pat Wright	Senator Robert Usdane

The primary powers and duties of the Joint Legislative Budget Committee relate to ascertaining facts and making recommendations to the legislature regarding all facets of the state budget, state revenues and expenditures, future fiscal needs, and the organization and functions of state government.

The Joint Legislative Budget Committee appoints a Staff Director and Chief Executive Officer who is responsible for providing staff support and sound technical analysis to the Committee. The objectives and major products of the staff of the Joint Legislative Budget Committee are:

- **Analysis and Recommendations for the Annual State Budget,** which are presented in January of each year;

- Technical, analytical, and preparatory support in the development of **appropriations bills** considered by the legislature;

- An annual **Appropriations Report,** which is published shortly after the budget is completed and provides detail on the budget along with a further explanation of legislative intent;

- Preparation of **fiscal notes** for those bills considered by the legislature having a fiscal impact on the state or any of its political subdivisions;

- **Management and Fiscal Research Reports** related to state programs and state agency operations;

- Periodic **economic and state revenue forecasts;**

- Periodic **analysis of economic activity, state budget conditions,** and the relationship of one to the other.

Joint Legislative Budget Committee
1716 West Adams
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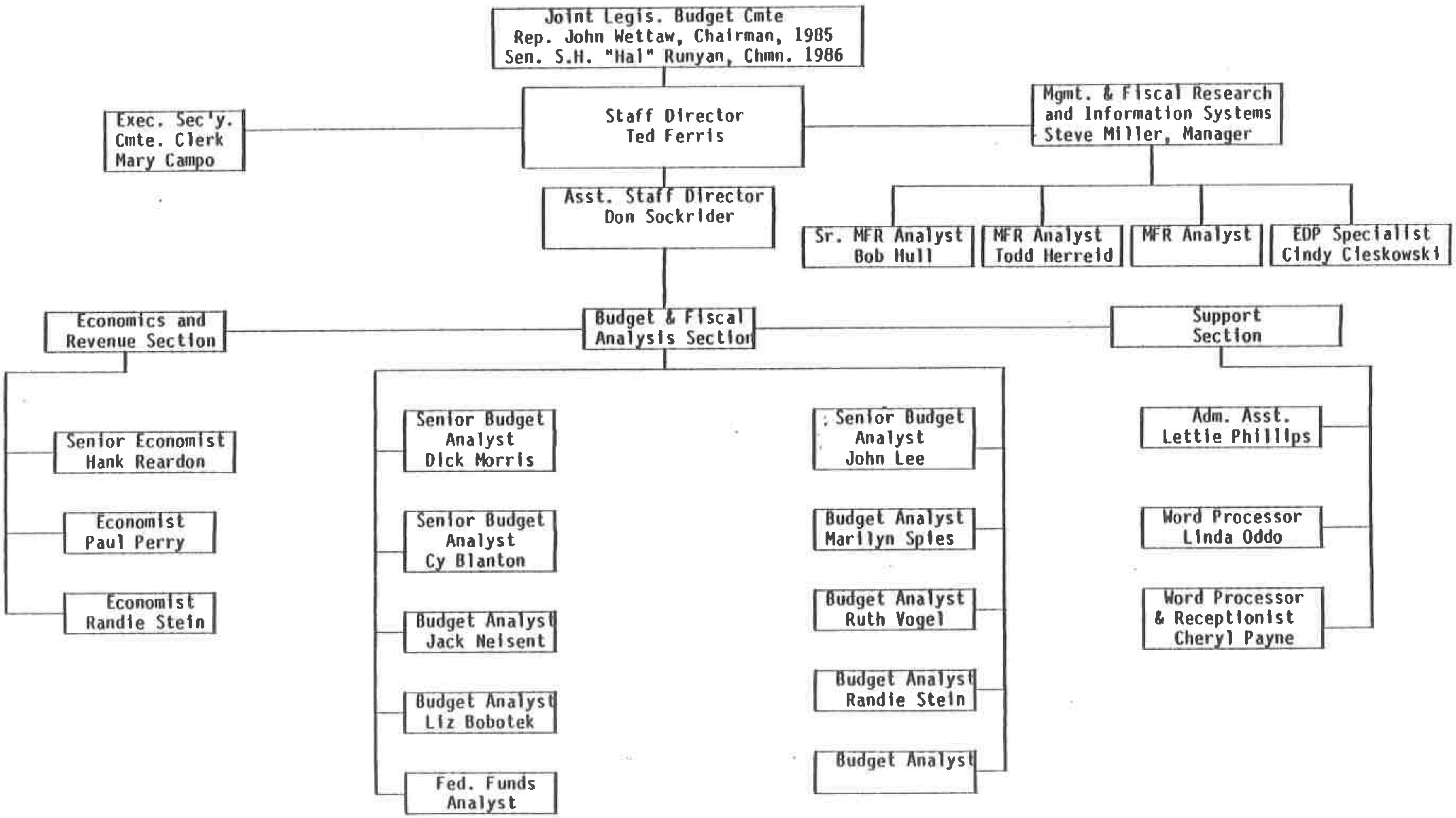
Theodore A. Ferris
Staff Director

JOINT LEGISLATIVE BUDGET COMMITTEE *STAFF ORGANIZATION*



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JLBC

Joint Legislative Budget Committee

1716 WEST ADAMS STREET
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REPRESENTATIVE JOHN WETTAW
CHAIRMAN 1985
SENATOR S. H. "HAL" RUNYAN
CHAIRMAN 1986

THEODORE A. FERRIS
STAFF DIRECTOR

INTRODUCTION

The analysis and recommendations of the Legislative Budget Analyst for FY 1987 are being transmitted in two reports. This, the first, represents a Summary of Recommendations and Economic Revenue Forecast. The second report represents the detail of the recommendation by department, agency, or budget unit, according to funding source, and by major program or organizational activity. The latter report also analyzes and compares the Legislative Staff recommendation to the Executive recommendation.

The Legislative Staff analysis and recommendation was made against the backdrop of a much-improved economy both nationally and in Arizona. Indeed, 1984-85 marked a bell-weather year of real economic expansion in our nation and locally. Although the pace of growth has slowed substantially in FY 1986, we are building from a solid base established in the past three years of recovery following the 1980-82 recession. However, despite our strong showing in Arizona, there are large areas and pockets of substantial unemployment and economic dislocation in our state.

With the improved economy of the past few years have come increased expectations on the part of agencies and individuals dependent upon the myriad programs provided by State Government. State agencies, departments and budget units requested increases totalling 22 percent in their budgets for FY 1987. Yet, with the current economic expansion maturing, the pace of economic growth has slowed, and for reasons spelled-out in length elsewhere in this report, state revenue growth is forecast to grow at a rate only 50-60 percent as fast this fiscal year and next as it did during the previous two fiscal years. Undoubtedly, many interested parties may be disappointed with the size of our recommendations.

Nevertheless, our forecast of state revenues is sufficient to fund the "Current Service Level" of state spending in FY 1987; to provide for recommended improvements in pay and benefits for state employees; to provide for modest program enhancements and to fund anticipated 1986 Session Law changes; to meet the state's critical capital outlay requirements, especially in the area of major maintenance and repair of state facilities; and to provide for a minimum fund balance carry-forward, which we recommend be set aside in a statutorily-established, Budget Stabilization Fund.

INTRODUCTION
(Continued)

These last two points represent a major tenet of the Legislative Staff Analyst's Recommendation for FY 1987. That is, the need and the desirability of continuing to plan now for the future fiscal requirements of the State of Arizona. The state budget need not be like a boat upon the ocean, relentlessly buffeted by waves of economic good fortune and misfortune. Instead, with careful forethought, we can make further progress toward a more stable and productive state fiscal policy. Protecting and preserving the State's assets and investments should be a top priority in each year's budget.

Although our economic forecast calls for continued economic growth at average rates over the next 18 months, history tells us that an economic recession occurs approximately every four years. The current expansion will be four years old at the end of 1986. While we are not forecasting a recession any time before the end of FY 1987, we do believe that prudence dictates that we assume in our planning that a recession will occur either in FY 1988 or FY 1989.

Therefore, regardless of what individual decisions are made by the legislature on the level of state funding for the many programs to be operated in FY 1987, the Legislative Staff Analyst strongly recommends:

1. The establishment of a Budget Stabilization Fund;

2. The utilization of a Building-Renewal Formula for funding major maintenance and repairs of state facilities in both years of plenty and lean years.

Detail on these recommendations, like the detail on all other Legislative Staff recommendations, are contained in the main report, FY 1987 Annual Budget - Analysis and Recommendations.

The Staff of the Joint Legislative Budget Committee looks forward to working on behalf of the Members of the Senate and House Appropriations Committees and the entire Arizona Legislature in developing the Appropriations Acts and related Appropriations Report for FY 1987.

Theodore A. Ferris

Theodore A. Ferris
Staff Director and
Legislative Budget Analyst

FY 1987

SUMMARY OF JLBC STAFF RECOMMENDATION

The exhibit on the following page presents a "balance sheet" perspective on JLBC recommended general fund revenues and expenditures for FY 1986 and FY 1987. We are projecting a carry-forward balance of $25.4 million at the end of FY 1987, and we are recommending that balance be set aside in a statutorily-established Budget Stabilization Fund, to be used to bolster revenues in the next economic downturn. Also, our recommendations allow for $40 million of additional appropriations to meet legislative priorities and Session Law changes.

Tables 1 through 3 summarize the JLBC recommendation for FY 1987 appropriations, while Chart 1 provides a graphic illustration of where general fund revenues are derived and how they are disbursed.

Table 1 provides the recommended dollar increase and percent increase for all agencies/department/budget areas. Both General Fund and Other Fund appropriations are shown. There is a marked difference in the rate of growth of General Fund appropriations (5.0%) and Other Fund appropriations (13.6%).

Table 2 shows the statewide dollar change and percent increase by line item and lump sum for FY 1987 as compared to FY 1986 and FY 1985 (actual).

Table 3 provides a summary of the recommended full-time equated (FTE) positions for FY 1987 as compared to FY 1986. Although the overall increase of 1,980.5 FTE's (6.57%) is relatively large, the increase for all areas other than Corrections, Transportation and Universities is just 336 FTE's (2.90%).

EXHIBIT 1

GENERAL FUND SUMMARY
JLBC RECOMMENDED
REVENUES AND EXPENDITURES
FISCAL YEARS 1986 and 1987
(000's)

	FY 1986	FY 1987
REVENUES:		
- Beginning Balance	$ 14,499.3	$ 8,847.4
- New Revenues	2,299,013.0	2,510,784.1
TOTAL RESOURCES.	$ 2,313,512.3	$ 2,519,631.5
APPROPRIATIONS:		
- Actual Appropriations	$ 2,329,520.7	$ ------
- Est. Supplementals	1,500.0	------
- JLBC Staff Recomm.		
-Operating Budgets	------	2,427,986.8
-Land, Bldgs. & Impr.	------	23,636.9
- State Empl. Pay Package	------	26,517.9
- Legislative Priorities and Session Law Changes	------	40,000.0
- Administrative Adj., Emergencies, Transfers	11,644.2	13,145.3
- Revertments	(38,000.0)	(37,000.0)
TOTAL APPROPRIATIONS	$ 2,304,664.9	$ 2,494,286.9
	==============	==============
CARRY-FORWARD.	$ 8,847.4	$ 25,344.6

BUDGET STABILIZATION FUND

Like the national economy, the Arizona economy experiences expansions and contractions of varying magnitudes. During the recessionary phase of the business cycle, there is an increased need for state-provided services, particularly in the area of social services. However, the slow economic activity associated with a recession leaves the state with insufficient revenues to adequately fund such programs.

Recessions are an inherent part of our economic system. The need exists to plan for recessions and their ramifications upon state budgeting. In response to fluctuations in revenues and corresponding funding problems, twenty-eight states have enacted a variety of counter-cyclical fiscal policies, referred to as Budget Stabilization Funds.

Although there are several different types of Budget Stabilization Funds (generically referred to as "Rainy Day Funds"), all share a common theme: to set aside revenues during times of strong economic growth, and to draw upon these revenues during periods of weak or negative growth. Their common purpose is to provide a built-in revenue stabilizer in order to reduce the state's vulnerability to economic fluctuations.

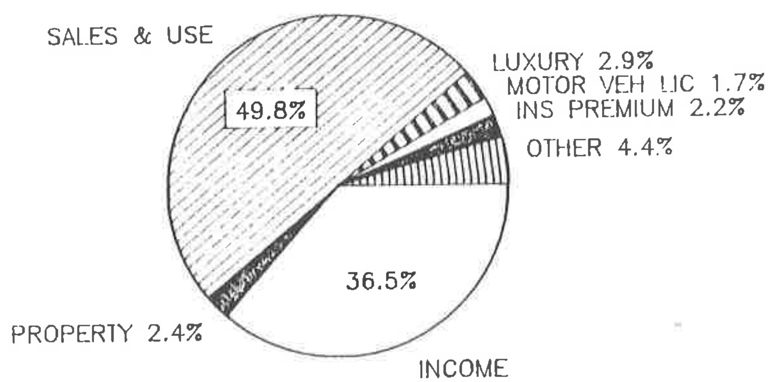
JLBC Staff recommends the establishment of a Budget Stabilization Fund by law. There are several means of structuring such a Fund. The central design issues are: (a) how do revenues flow into the Fund, and (b) how does money flow out of the Fund. JLBC Staff recommends a Fund design in which inflows and outflows are formula-driven. A formula based upon Arizona real personal income growth is preferred.

The optimal size of a Budget Stabilization Fund is largely a function of the state's economic volatility. Inflows should accumulate sufficiently to fund outflows (as mandated by the formula) but not such that large reserve balances remain after funding the outflows. JLBC Staff has analyzed the effectiveness of several different formula options. Interested readers should contact the JLBC Staff for details.

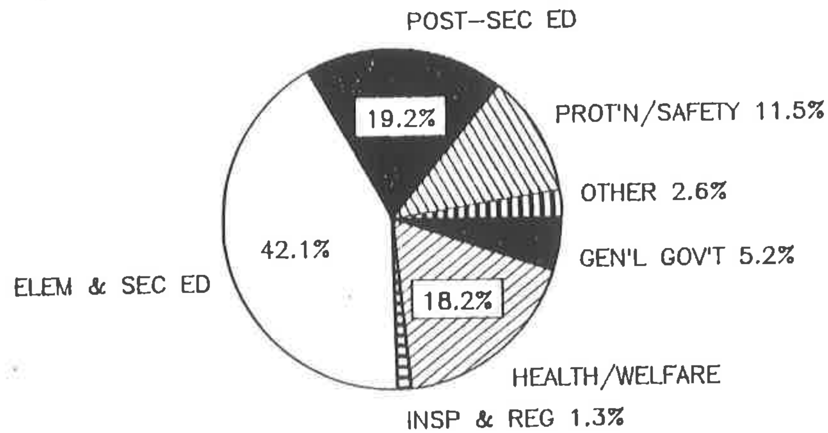
In contemplation of the enactment of such a Fund, JLBC Staff recommends that the $25 million projected carry-forward from FY 1987 be appropriated to a Budget Stabilization Fund, and that a formula be established by law to govern payments into and out of the Fund, which will first become operative in FY 1988.

CHART 1

SOURCES AND DISPOSITION OF GENERAL FUNDS
FY 87 JLBC RECOMMENDATION



SOURCES OF GENERAL FUNDS



DISPOSITION OF GENERAL FUNDS

TABLE 1

JOINT LEGISLATIVE BUDGET COMMITTEE
FUND SOURCE PERCENT OF CHANGE
BY DEPARTMENT
S T A T E   W I D E

DEPARTMENT	FUND	FY 86 ESTIMATE	FY 87 RECOMMENDED	DIFFERENCE	PERCENT OF CHANGE
DEPT. OF ADMINISTRATION	GENERAL	24,594,400	24,757,600	163,200	0.66 %
PERSONNEL BOARD	GENERAL	229,800	206,800	23,000-	10.01- %
ATTY GENERAL-DEPT OF LAW	GENERAL	14,372,800	15,086,800	714,000	4.97 %
COLISEUM & EXPO. CENTER	OTHER	7,402,900	8,189,500	786,600	10.63 %
ARIZONA JUDICIARY	GENERAL	19,188,880	23,313,400	4,124,520	21.49 %
GOVERNOR-OFC OF GOVERNOR	GENERAL	1,589,300	2,172,600	583,300	36.70 %
GOV-OFC OF AFFIRM ACTION	GENERAL	160,100	193,900	33,800	21.11 %
DEPARTMENT OF COMMERCE	GENERAL	3,090,000	2,406,000	684,000-	22.14- %
OFFICE OF TOURISM	GENERAL	2,737,100	2,905,400	168,300	6.15 %
LAW ENF. MERIT SYST. CNL	GENERAL	38,600	42,900	4,300	11.14 %
LEGISLATURE-SENATE	GENERAL	3,648,200	3,655,000	6,800	0.19 %
LEGISLATURE-HOUSE OF REP	GENERAL	4,684,200	4,805,750	121,550	2.59 %
LEGISLATURE-LEG. COUNCIL	GENERAL	1,334,300	1,298,000	36,300-	2.72- %
LEGISLATURE - JLBC	GENERAL	1,271,900	1,291,600	19,700	1.55 %
LEGIS. - AUDITOR GENERAL	GENERAL	5,679,200	5,876,100	196,900	3.47 %
LEGIS-LIBRARY & ARCHIVES	GENERAL	3,794,600	4,234,300	439,700	11.59 %
STATE RETIREMENT SYSTEM	OTHER	7,646,000	8,376,300	730,300	9.55 %
DEPARTMENT OF REVENUE	GENERAL	28,059,300	30,296,800	2,237,500	7.97 %
SECY OF STATE-DEPT OF ST	GENERAL	1,156,500	2,097,300	940,800	81.35 %
STATE BRD OF TAX APPEALS	GENERAL	389,500	407,600	18,100	4.65 %
STATE TREASURER	GENERAL	2,889,000	2,854,100	34,900-	1.21- %
COMM. ON UNIF. ST. LAWS	GENERAL	13,600	14,600	1,000	7.35 %
GOV-AZ. RANGERS PENSION	GENERAL	14,400	14,400	0	0.00 %
COUNCIL/HEARING IMPAIRED	GENERAL	115,600	124,300	8,700	7.53 %
DEP OF ECONOMIC SECURITY	GENERAL	203,144,800	221,771,800	18,627,000	9.17 %
	OTHER	246,800	395,300	148,500	60.17 %
	TOTAL	203,391,600	222,167,100	18,775,500	9.23 %

JOINT LEGISLATIVE BUDGET COMMITTEE
FUND SOURCE PERCENT OF CHANGE
BY DEPARTMENT
S T A T E   W I D E

DEPARTMENT	FUND	FY 86 ESTIMATE	FY 87 RECOMMENDED	DIFFERENCE	PERCENT OF CHANGE
DEPT. OF HEALTH SERVICES	GENERAL	87,965,100	95,827,000	7,861,900	8.94 %
	OTHER	1,300,000	1,300,000	0	0.00 %
	TOTAL	89,265,100	97,127,000	7,861,900	8.81 %
AHCCCS ADMINISTRATION	GENERAL	141,553,496	129,217,900	12,335,596-	8.71- %
	OTHER	134,479,352	151,152,000	16,672,648	12.40 %
	TOTAL	276,032,848	280,369,900	4,337,052	1.57 %
COMM. ON INDIAN AFFAIRS	GENERAL	153,000	160,200	7,200	4.71 %
PIONEERS' HOME	GENERAL	2,403,300	2,540,500	137,200	5.71 %
VETERANS' SERVICES COMM	GENERAL	820,300	855,700	35,400	4.32 %
	OTHER	257,300	295,900	38,600	15.00 %
	TOTAL	1,077,600	1,151,600	74,000	6.87 %
BOARD OF ACCOUNTANCY	OTHER	399,900	407,300	7,400	1.85 %
AGRIC EMPLOYMENT REL BD	GENERAL	210,000	192,500	17,500-	8.33- %
COMM. OF AGRIC & HORTIC	GENERAL	5,220,900	5,462,100	241,200	4.62 %
	OTHER	1,040,300	1,098,900	58,600	5.63 %
	TOTAL	6,261,200	6,561,000	299,800	4.79 %
BOXING COMMISSION	GENERAL	34,600	49,100	14,500	41.91 %
	OTHER	5,500	11,300	5,800	105.45 %
	TOTAL	40,100	60,400	20,300	50.62 %
RADIATION REG. AGENCY	GENERAL	894,900	969,000	74,100	8.28 %
	OTHER	222,700	261,800	39,100	17.56 %
	TOTAL	1,117,600	1,230,800	113,200	10.13 %
BANKING DEPARTMENT	GENERAL	1,712,100	1,827,500	115,400	6.74 %
BARBER EXAMINERS BOARD	OTHER	112,700	117,000	4,300	3.82 %
CHIROPRACTIC EXAM. BOARD	OTHER	141,200	151,500	10,300	7.29 %
REGISTRAR OF CONTRACTORS	GENERAL	2,387,400	2,474,300	86,900	3.64 %
CORPORATION COMMISSION	GENERAL	4,860,200	5,112,400	252,200	5.19 %
	OTHER	4,147,300	4,811,700	664,400	16.02 %
	TOTAL	9,007,500	9,924,100	916,600	10.18 %
RES. UTIL. CONSUMER OFC.	OTHER	736,400	809,600	73,200	9.94 %
BOARD OF COSMETOLOGY	OTHER	356,100	401,100	45,000	12.64 %
DAIRY COMMISSION	GENERAL	403,700	432,300	28,600	7.08 %

JOINT LEGISLATIVE BUDGET COMMITTEE
FUND SOURCE PERCENT OF CHANGE
BY DEPARTMENT
S T A T E   W I D E

DEPARTMENT	FUND	FY 86 ESTIMATE	FY 87 RECOMMENDED	DIFFERENCE	PERCENT OF CHANGE
BOARD OF DENTAL EXAM.	OTHER	328,800	329,200	400	0.12 %
DISPENSING OPTIC. BD.	OTHER	40,100	49,500	9,400	23.44 %
EGG INSPECTION BOARD	OTHER	160,300	169,100	8,800	5.49 %
FUNERAL DIR. & EMB. BD.	OTHER	124,500	126,500	2,000	1.61 %
INDUSTRIAL COMMISSION	OTHER	7,415,900	8,186,400	770,500	10.39 %
OCCUP SFTY & HLTH RVW BD	GENERAL	5,100	16,700	11,600	227.45 %
NURSING CARE INST ADM BD	OTHER	32,000	35,700	3,700	11.56 %
DEPARTMENT OF INSURANCE	GENERAL	2,016,600	2,191,600	175,000	8.68 %
LIQUOR LICENSE & CONTROL	GENERAL	1,786,100	1,865,500	79,400	4.45 %
LIVESTOCK BOARD	GENERAL	3,517,900	3,752,700	234,800	6.67 %
BD. OF MEDICAL EXAMINERS	OTHER	1,208,300	1,241,200	32,900	2.72 %
HOMEOPATHIC MED. EX. BD.	OTHER	2,000	2,600	600	30.00 %
STATE MINE INSPECTOR	GENERAL	618,300	732,700	114,400	18.50 %
OFC. OF MANUFACTURED HSG	GENERAL	1,440,300	1,586,800	146,500	10.17 %
NATUROPATHIC PHYS EXM BD	OTHER	21,900	30,900	9,000	41.10 %
BOARD OF NURSING	OTHER	564,100	674,600	110,500	19.59 %
BOARD OF OPTOMETRY	GENERAL	24,600	0	24,600-	100.00- %
	OTHER	60,100	88,200	28,100	46.76 %
	TOTAL	84,700	88,200	3,500	4.13 %
OSTEOPATHIC EXAMINERS BD	OTHER	171,900	169,100	2,800-	1.63- %
BOARD OF PHARMACY	OTHER	463,400	497,900	34,500	7.44 %
PHYSICAL THERAPY EXAM BD	OTHER	53,500	71,900	18,400	34.39 %
PODIATRY EXAMINERS BOARD	OTHER	34,400	36,500	2,100	6.10 %
PSYCHOLOGIST EXAMINER BD	OTHER	67,100	86,200	19,100	28.46 %
BD. OF PRIV. POSTSEC.ED.	OTHER	80,100	91,800	11,700	14.61 %
DEPARTMENT OF RACING	GENERAL	2,353,300	2,645,100	291,800	12.40 %
	OTHER	232,700	291,500	58,800	25.27 %
	TOTAL	2,586,000	2,936,600	350,600	13.56 %

JOINT LEGISLATIVE BUDGET COMMITTEE
FUND SOURCE PERCENT OF CHANGE
BY DEPARTMENT
S T A T E W I D E

DEPARTMENT	FUND	FY 86 ESTIMATE	FY 87 RECOMMENDED	DIFFERENCE	PERCENT OF CHANGE
REAL ESTATE DEPARTMENT	GENERAL	2,115,700	2,326,600	210,900	9.97 %
STRUCTURAL PEST CTRL BD.	OTHER	215,600	288,500	72,900	33.81 %
BD. OF TECHNICAL REGIS	OTHER	478,400	496,700	18,300	3.83 %
VETERINARY MED. EXAM BD	OTHER	94,200	98,500	4,300	4.56 %
BOARD OF REGENTS	GENERAL	3,644,400	4,050,400	406,000	11.14 %
U OF A - MAIN CAMPUS	GENERAL	152,848,900	163,391,300	10,542,400	6.90 %
	OTHER	35,739,500	36,899,100	1,159,600	3.24 %
	TOTAL	188,588,400	200,290,400	11,702,000	6.21 %
UA-COLLEGE OF MEDICINE	GENERAL	33,977,000	36,982,500	3,005,500	8.85 %
	OTHER	1,858,600	1,885,300	26,700	1.44 %
	TOTAL	35,835,600	38,867,800	3,032,200	8.46 %
ARIZONA STATE UNIVERSITY	GENERAL	132,748,900	142,992,300	10,243,400	7.72 %
	OTHER	37,510,600	37,704,300	193,700	0.52 %
	TOTAL	170,259,500	180,696,600	10,437,100	6.13 %
ASU WEST	GENERAL	4,321,700	4,787,100	465,400	10.77 %
	OTHER	1,018,700	1,184,600	165,900	16.29 %
	TOTAL	5,340,400	5,971,700	631,300	11.82 %
NORTHERN ARIZONA UNIV.	GENERAL	48,208,800	50,157,400	1,948,600	4.04 %
	OTHER	8,682,300	10,026,800	1,344,500	15.49 %
	TOTAL	56,891,100	60,184,200	3,293,100	5.79 %
MEDICAL STUDENT LOANS BD	GENERAL	18,000	96,000	78,000	433.33 %
BD DIR-COMMUNITY COLLEGE	GENERAL	57,409,600	67,950,100	10,540,500	18.36 %
DEPARTMENT OF EDUCATION	GENERAL	998,234,900	1,029,820,600	31,585,700	3.16 %
SCHOOL FOR DEAF & BLIND	GENERAL	8,867,700	9,317,800	450,100	5.08 %
	OTHER	2,701,300	3,401,600	700,300	25.92 %
	TOTAL	11,569,000	12,719,400	1,150,400	9.94 %
COMMISSION ON THE ARTS	GENERAL	1,010,200	1,046,000	35,800	3.54 %
AZ. HISTORICAL SOCIETY	GENERAL	1,630,600	1,703,100	72,500	4.45 %
PRESCOTT HIST. SOCIETY	GENERAL	402,000	400,600	1,400-	0.35- %
DEPT. OF CORRECTIONS	GENERAL	170,392,400	202,316,200	31,923,800	18.74 %
	OTHER	0	7,484,200	7,484,200	100.00 %
	TOTAL	170,392,400	209,800,400	39,408,000	23.13 %

JOINT LEGISLATIVE BUDGET COMMITTEE
FUND SOURCE PERCENT OF CHANGE
BY DEPARTMENT
S T A T E   W I D E

DEPARTMENT	FUND	FY 86 ESTIMATE	FY 87 RECOMMENDED	DIFFERENCE	PERCENT OF CHANGE
EMERG SERV/MILIT AFFAIRS	GENERAL	4,107,700	4,335,400	227,700	5.54 %
BD. OF PARDONS & PAROLES	GENERAL	1,433,800	1,565,700	131,900	9.20 %
DEPT. OF PUBLIC SAFETY	GENERAL	66,419,900	75,141,300	8,721,400	13.13 %
	OTHER	5,400,000	400,000	5,000,000-	92.59- %
	TOTAL	71,819,900	75,541,300	3,721,400	5.18 %
DEPT. OF TRANSPORTATION	GENERAL	84,500	88,000	3,500	4.14 %
	OTHER	136,216,800	150,163,300	13,946,500	10.24 %
	TOTAL	136,301,300	150,251,300	13,950,000	10.23 %
GAME & FISH DEPARTMENT	OTHER	12,866,700	12,995,800	129,100	1.00 %
GOVERNORS' COMM. AZ.ENVR	OTHER	0	117,200	117,200	100.00 %
STATE LAND DEPARTMENT	GENERAL	5,740,900	6,598,800	857,900	14.94 %
MINERAL RESOURCES	GENERAL	411,700	440,000	28,300	6.87 %
OIL & GAS CONSERV. COMM.	GENERAL	161,000	175,900	14,900	9.25 %
STATE PARKS BOARD	GENERAL	4,519,100	4,820,700	301,600	6.67 %
	OTHER	2,947,400	3,286,900	339,500	11.52 %
	TOTAL	7,466,500	8,107,600	641,100	8.59 %
SOLAR ENERGY COMMISSION	GENERAL	308,000	305,100	2,900-	0.94- %
DEPT. OF WATER RESOURCES	GENERAL	28,394,200	9,439,200	18,955,000-	66.76- %
LAND,BLDGS. & IMPS.	GENERAL	25,224,700	23,636,900	1,587,800-	6.29- %
	OTHER	14,413,900	31,645,100	17,231,200	119.55 %
	TOTAL	39,638,600	55,282,000	15,643,400	39.47 %
STATEWIDE TOTAL	GENERAL	2,335,213,576	2,451,623,650	116,410,074	4.98 %
	OTHER	429,699,552	488,035,900	58,336,348	13.58 %
	TOTAL	2,764,913,128	2,939,659,550	174,746,422	6.32 %

TABLE 2
JOINT LEGISLATIVE BUDGET COMMITTEE
PERCENT OF CHANGE ANALYSIS
STATEWIDE
BY LINE ITEM AND LUMP SUM

	FY 1985 Actual	FY 1986 Estimate	FY 1987 Recommend	Total Increase	Percent Increase
F.T.E. Positions	28,046.79	30,124.43	32,104.98	1,980.55	6.57%
Personal Services	605,848,665	700,572,627	754,867,900	54,295,273	7.75
Employee Related Exp.	123,157,528	145,209,816	159,540,500	14,330,684	9.87
Prof. & Outside Services	34,117,817	37,285,515	44,164,400	6,878,885	18.45
Travel - State	6,593,996	8,896,293	11,507,000	2,610,707	29.35
Travel - Out of State	2,372,996	2,538,542	3,040,600	502,058	19.78
Other Operating Exp.	132,503,111	165,753,517	186,884,000	21,130,483	12.75
Food	10,563,572	11,979,900	13,346,900	1,367,000	11.41
Equipment	33,864,235	38,410,958	43,910,600	5,499,642	14.32
Lump Sum Appropriations					
° Comm. on A & T Ct. Appts.	2,642	4,000	4,000	-0-	0.00
° Comm. on Jud. Qual.	47,480	50,000	60,000	10,000	20.00
° Gov. - AZ. Rangers' Pensions	12,000	14,400	14,400	-0-	0.00
° Office of the Governor	1,197,100	1,589,300	1,777,800	188,500	11.86
° Medical Student Loans Bd.	108,000	18,000	96,000	78,000	433.33
° Legislature - Senate	3,163,600	3,648,200	3,655,000	6,800	0.19
° Legislature - House of Rep.	4,270,600	4,684,200	4,805,750	121,550	2.59
° Legislative Council	1,228,600	1,334,300	1,298,000	(36,300)	(2.72)
° Jnt. Legis. Budget Comm.	999,400	1,271,900	1,291,600	19,700	1.55
Special Line Items	1,444,875,461	1,641,651,660	1,709,395,100	67,743,440	4.13
Funding Source					
General Fund	2,023,477,530	2,335,213,576	2,451,623,650	116,410,074	4.98
Other Funds	381,449,273	429,699,552	488,035,900	58,336,348	13.58
TOTAL	2,404,926,803	2,764,913,128	2,939,659,550	174,746,422	6.32%

TABLE 3

JOINT LEGISLATIVE BUDGET COMMITTEE
FULL TIME EQUIVALENT POSITIONS
ANALYSIS OF CHANGE
S T A T E W I D E

DEPARTMENT	FY 86 ESTIMATE	FY 87 RECOMMENDED	DIFFERENCE
DEPT. OF ADMINISTRATION	507.50	537.75	30.25
PERSONNEL BOARD	4.00	3.00	1.00-
ATTY GENERAL-DEPT OF LAW	294.00	303.00	9.00
COLISEUM & EXPO. CENTER	222.00	222.00	0.00
ARIZONA JUDICIARY	291.30	299.80	8.50
GOVERNOR-OFC OF GOVERNOR	0.00	8.00	8.00
GOV-OFC OF AFFIRM ACTION	4.00	5.00	1.00
DEPARTMENT OF COMMERCE	47.00	40.00	7.00-
OFFICE OF TOURISM	15.00	15.00	0.00
LAW ENF. MERIT SYST. CNL	1.00	1.00	0.00
LEGISLATURE - JLBC	26.00	26.00	0.00
LEGIS. - AUDITOR GENERAL	132.00	132.00	0.00
LEGIS-LIBRARY & ARCHIVES	106.00	105.00	1.00-
STATE RETIREMENT SYSTEM	50.00	52.00	2.00
DEPARTMENT OF REVENUE	824.50	865.50	41.00
SECY OF STATE-DEPT OF ST	27.00	27.00	0.00
STATE BRD OF TAX APPEALS	7.50	7.50	0.00
STATE TREASURER	32.00	28.00	4.00-
COUNCIL/HEARING IMPAIRED	3.00	3.50	0.50
DEP OF ECONOMIC SECURITY	2,617.50	2,652.40	34.90
DEPT. OF HEALTH SERVICES	1,520.50	1,632.25	111.75
AHCCCS ADMINISTRATION	325.00	337.00	12.00
COMM. ON INDIAN AFFAIRS	4.00	4.00	0.00
PIONEERS' HOME	110.00	110.00	0.00
VETERANS' SERVICES COMM	37.00	38.00	1.00

JOINT LEGISLATIVE BUDGET COMMITTEE
FULL TIME EQUIVALENT POSITIONS
ANALYSIS OF CHANGE
S T A T E W I D E

DEPARTMENT	FY 86 ESTIMATE	FY 87 RECOMMENDED	DIFFERENCE
BOARD OF ACCOUNTANCY	7.00	7.00	0.00
AGRIC EMPLOYMENT REL BD	4.00	3.00	1.00-
COMM. OF AGRIC & HORTIC	188.50	188.50	0.00
BOXING COMMISSION	1.00	1.50	0.50
RADIATION REG. AGENCY	26.00	26.00	0.00
BANKING DEPARTMENT	52.00	54.00	2.00
BARBER EXAMINERS BOARD	3.00	3.00	0.00
CHIROPRACTIC EXAM. BOARD	2.50	3.00	0.50
REGISTRAR OF CONTRACTORS	73.50	73.50	0.00
CORPORATION COMMISSION	194.00	209.00	15.00
RES. UTIL. CONSUMER OFC.	9.00	10.00	1.00
BOARD OF COSMETOLOGY	12.00	13.00	1.00
DAIRY COMMISSION	8.00	8.00	0.00
BOARD OF DENTAL EXAM.	6.50	6.50	0.00
DISPENSING OPTIC. BD.	0.80	0.80	0.00
EGG INSPECTION BOARD	5.00	5.00	0.00
FUNERAL DIR. & EMB. BD.	1.50	1.50	0.00
INDUSTRIAL COMMISSION	184.00	205.00	21.00
NURSING CARE INST ADM BD	0.50	0.50	0.00
DEPARTMENT OF INSURANCE	61.00	61.00	0.00
LIQUOR LICENSE & CONTROL	57.00	57.00	0.00
LIVESTOCK BOARD	109.20	109.20	0.00
BD. OF MEDICAL EXAMINERS	25.00	27.00	2.00
STATE MINE INSPECTOR	16.00	16.00	0.00
OFC. OF MANUFACTURED HSG	45.00	45.00	0.00

JOINT LEGISLATIVE BUDGET COMMITTEE
FULL TIME EQUIVALENT POSITIONS
ANALYSIS OF CHANGE
S T A T E W I D E

DEPARTMENT	FY 86 ESTIMATE	FY 87 RECOMMENDED	DIFFERENCE
BOARD OF NURSING	13.20	16.20	3.00
BOARD OF OPTOMETRY	1.50	1.50	0.00
OSTEOPATHIC EXAMINERS BD	3.50	4.00	0.50
BOARD OF PHARMACY	10.00	10.00	0.00
PHYSICAL THERAPY EXAM BD	0.50	1.00	0.50
PSYCHOLOGIST EXAMINER BD	0.50	1.00	0.50
BD. OF PRIV. POSTSEC.ED.	2.50	2.50	0.00
DEPARTMENT OF RACING	65.00	67.90	2.90
REAL ESTATE DEPARTMENT	63.00	68.00	5.00
STRUCTURAL PEST CTRL BD.	6.50	9.00	2.50
BD. OF TECHNICAL REGIS	10.00	11.00	1.00
VETERINARY MED. EXAM BD	1.50	1.50	0.00
BOARD OF REGENTS	34.75	34.75	0.00
U OF A - MAIN CAMPUS	4,672.00	4,789.20	117.20
UA-COLLEGE OF MEDICINE	562.20	568.70	6.50
ARIZONA STATE UNIVERSITY	4,171.08	4,330.68	159.60
ASU WEST	124.90	146.90	22.00
NORTHERN ARIZONA UNIV.	1,415.25	1,479.00	63.75
BD DIR-COMMUNITY COLLEGE	8.00	8.00	0.00
DEPARTMENT OF EDUCATION	175.30	179.80	4.50
SCHOOL FOR DEAF & BLIND	391.50	416.50	25.00
COMMISSION ON THE ARTS	9.50	10.50	1.00
AZ. HISTORICAL SOCIETY	46.30	10.50	35.80-
PRESCOTT HIST. SOCIETY	14.50	14.50	0.00
DEPT. OF CORRECTIONS	4,659.70	5,759.10	1,099.40

JOINT LEGISLATIVE BUDGET COMMITTEE
FULL TIME EQUIVALENT POSITIONS
ANALYSIS OF CHANGE
S T A T E W I D E

DEPARTMENT	FY 86 ESTIMATE	FY 87 RECOMMENDED	DIFFERENCE
EMERG SERV/MILIT AFFAIRS	76.00	76.00	0.00
BD. OF PARDONS & PAROLES	43.00	43.00	0.00
DEPT. OF PUBLIC SAFETY	1,579.00	1,593.00	14.00
DEPT. OF TRANSPORTATION	2,915.00	3,091.00	176.00
GAME & FISH DEPARTMENT	260.50	264.00	3.50
GOVERNORS' COMM. AZ.ENVR	0.00	3.00	3.00
STATE LAND DEPARTMENT	132.00	137.50	5.50
MINERAL RESOURCES	11.50	11.50	0.00
OIL & GAS CONSERV. COMM.	4.00	4.00	0.00
STATE PARKS BOARD	138.25	142.85	4.60
SOLAR ENERGY COMMISSION	4.00	4.00	0.00
DEPT. OF WATER RESOURCES	198.70	204.70	6.00
STATEWIDE TOTAL	30,124.43	32,104.98	1,980.55

NOTE: The FTE positions shown are for the Personal Services line item with the exception of the Department of Transportation which includes positions for the Highway Maintenance program. Thus any positions for special line items are not shown above.

FY 1987
Summary Analysis
and Comparison of Governor's Recommended
General Fund Budget to JLBC Staff Recommendation

The exhibit on the following page provides a summary of estimated General Fund revenues and expenditures and year-end balances for FY 1986 and FY 1987. The differences in estimated revenues and projected expenditures are neglible for FY 1986. Consequently, the Governor's projected FY 1986 year-end balance and JLBC staff estimate are quite close at $10.6 million and $8.8 million, respectively.

The projections and recommendations for FY 1987 are different in many respects, although in the aggregate, the economic and revenue estimates of the Governor and JLBC are strikingly close. The difference of $25 million in our General Fund revenue estimate for FY 1987 is just one percent, and when adjusted for the Governor's proposed new $15 million income tax credit, amounts to a net difference of $10 million, or a mere 4/10 of one percent.

On the spending side, however, there are significant differences. Whereas, the Governor has recommended a $2,460.3 million operating budget (General Fund), the JLBC recommendation calls for a $2,428.0 million operating budget, or $32.3 million (1.3%) less in operating funds.

The difference in the recommendations for Land, Buildings and Improvements (L,B,& I) are substantial. The Governor recommended a total for L,B,& I approaching $10.2 million, as contrasted to a JLBC recommendation of $23.6 million, for a difference of $13.4 million.

Other changes recommended by the Governor, not included above, totalled $10.3 million, with new AHCCCS programs comprising $8.5 million of the total. The JLBC recommendation leaves $40 million for additional appropriations reflecting legislative priorities, including session law changes in areas such as AHCCCS, water quality, services for the chronically mentally ill, and educational program enhancements.

After allowing for administrative adjustments, emergencies, and revertments, the Governor recommends a carry-forward balance into FY 1988 of $5.3 million according to JLBC calculations. The JLBC recommendation provides for a carry-forward into FY 1988 of $25.4 million, representing what we feel is a minimum, prudent carry-forward equal to 1% of the state's General Fund budget. The Legislative Staff recommends this amount be set aside in a statutorily - established Budget Stabilization Fund.

EXHIBIT 2

GENERAL FUND SUMMARY
GOVERNOR'S AND JLBC RECOMMENDED
REVENUES AND EXPENDITURES
FISCAL YEAR 1987
(000's)

	Governor's Recommended		JLBC Recommended
REVENUES:			
- Beginning Balance	$ 10,611.4	A)	$ 8,847.4
- New Revenues	2,485,761.7		2,510,784.1
TOTAL RESOURCES	2,496,373.1		$2,519,631.5
APPROPRIATIONS:			
- Recommended Appropriations			
-Operating Budgets	$2,460,289.0		$2,427,986.8
-Land, Bldgs. & Impr.	10,159.2	B)	23,636.9
- State Empl. Pay Package	26,454.2		26,517.9
- Legislative Priorities and Session Law Changes	10,268.2	C)	40,000.0
- Administrative Adj., Emergencies, Transfers	11,913.5		13,145.3
- Revertments	(28,000.0)		(37,000.0)
TOTAL APPROPRIATIONS.	$2,491,084.1		$2,494,286.9
	=============		=============
CARRY-FORWARD	$ 5,289.0		$ 25,344.6

A) Reflects loss of $15.0 million due to Governor's proposed income tax credit for child care and dependent care expenses.

B) Includes $2.2 million previously appropriated for the construction of a new DPS Headquarters and $1.0 million for State Parks acquisition.

C) Includes $8.5 million for new A.H.C.C.C.S. programs and $1.3 million for D.E.S. developmentally disabled facilities closure costs.

SUMMARY COMPARISON OF
GOVERNOR'S RECOMMENDATION AND JLBC RECOMMENDATION
GENERAL FUND APPROPRIATIONS

Contained in the following several pages are tables which attempt to compare and contrast the Governor's recommended general fund appropriations to that recommended by the JLBC staff. Before reviewing these tables, it should be noted that the Governor's recommendations are adjusted to reflect the allocation of rent, inequity adjustments, and risk management charges to the appropriate agency. This is consistent with both the treatment in the JLBC recommendation and the appropriations for the current fiscal year. The Governor, however, has recommended a lump sum appropriation be made for each of these purposes.

Table 4 summarizes the major differences in total general fund appropriations by department/agency. The JLBC judicial and legislative recommendations are $6.8 million below the Governor's recommendation, because the Governor submits these amounts as requested without review, whereas the JLBC is able to make an independent appraisal. The JLBC Community Colleges recommendation is $7.3 million higher, because the Governor did not fully fund the state aid formula. The JLBC recommendation for the Department of Public Safety is $10 million higher than it would be if we followed the Governor's lead and presumed that the legislature will enact legislation to dedicate $10 million of Highway User Revenue Fund monies to finance the DPS budget. When adjusted for the proposed funding shift, the JLBC recommendation for DPS is actually over $700,000 less than the Governor.

Table 5 provides the same information as Table 4 for every state agency and department, irrespective of the size of the difference.

Table 6 summarizes the major differences in the individual recommendations for each agency/department/budget area, which in the aggregate, account for most of the difference between the JLBC and Executive recommendations.

TABLE 4

FY 1987
SUMMARY OF MAJOR DIFFERENCES
GOVERNOR'S RECOMMENDED AND JLBC RECOMMENDED
OPERATING APPROPRIATIONS
GENERAL FUND

	JLBC Over (Below) Gov's. Recommed.
Below the Governor:	
° Judicial	$ (2,125,416)
° Legislative	(4,698,477)
° Revenue (Dept.)	(2,159,829)
° AHCCCS	(10,880,862)
° Economic Security (Dept.)	(8,976,793)
° Deaf & Blind School	(3,888,038)
° Education (Dept.)	(5,184,882)
° Corrections (Dept.)	(2,662,853)
° Water Resources (Dept.)	(3,320,120)
° Public Safety (Dept.)	(738,397)
° Other Agencies Below	(7,656,762)
Above the Governor:	
° Community Colleges	7,265,682 A)
° Other Agencies Above	2,739,645
Net Below Governor	$(42,287,102)
Add: DPS Funding Shift	10,000,000 B)
Adj. Net Below Governor	$(32,287,102)

A) The Governor did not recommend funding the capital outlay portion of the community colleges formula as required by law.
B) The Governor has proposed a statutory change to provide $10 million of HURF Funding.

TABLE 5

GENERAL FUND COMPARISON

AGENCY	GOVERNOR'S RECOMMENDATION	RENT	INEQUITY ADJUSTMENT	RISK MANAGEMENT	GOVERNOR'S ADJ'D RECOMM.	JLBC RECOMMENDATION	DIFFERENCE
GENERAL GOVERNMENT							
DEPT. OF ADMINISTRATION	$23,064,300	$1,025,800	$117,000	$204,389	$24,411,489	$24,757,600	$346,111
ATTORNEY GENERAL	$13,034,700	$1,405,769	$34,900	$21,876	$14,497,245	$15,086,800	$589,555
DEPT. OF COMMERCE	$2,681,900	$109,367	$2,900	$466	$2,794,633	$2,406,000	($388,633)
OFFICE OF THE GOVERNOR	$1,658,400	$141,826		$223	$1,800,449	$2,172,600	$372,151
AFFIRMATIVE ACTION	$181,300			$249	$181,549	$193,900	$12,351
GOVERNOR'S OFFICE FOR CHILDREN	$150,000				$150,000	$0	($150,000)
PLANNING AND POLICY DEVELOPMENT	$403,100				$403,100	$0	($403,100)
JUDICIAL SYSTEM	$24,870,400	$560,176		$8,240	$25,438,816	$23,313,400	($2,125,416)
LAW ENFORCEMENT MERIT SYSTEM	$50,300			$69	$50,369	$42,900	($7,469)
THE LEGISLATURE	$25,827,300		$66,600	$16,802	$25,910,702	$21,160,750	($4,749,952)
STATE PERSONNEL BOARD	$193,800	$12,863		$212	$206,875	$206,800	($75)
DEPT. OF REVENUE	$31,696,300	$688,082	$159,100	$72,247	$32,615,729	$30,296,800	($2,318,929)
DEPT. OF STATE	$2,126,800	$77,925	$10,300	$2,813	$2,217,838	$2,097,300	($120,538)
STATE BOARD OF TAX APPEALS	$373,400	$37,647	$500	$455	$412,002	$407,600	($4,402)
OFFICE OF TOURISM	$2,842,800			$1,563	$2,844,363	$2,905,400	$61,037
STATE TREASURER	$2,716,200	$67,500	$1,200	$824	$2,785,724	$2,854,100	$68,376
COMM. ON UNIFORM STATE LAWS	$14,600			$63	$14,663	$14,600	($63)
WOMEN'S COMMISSION	$56,800				$56,800	$0	($56,800)
SUBTOTAL GENERAL GOVERNMENT	$131,942,400	$4,126,955	$392,500	$330,491	$136,792,346	$127,916,550	($8,875,796)
HEALTH AND WELFARE							
AHCCCS	$139,578,700	$420,262	$5,100	$99,800	$140,103,862	$129,217,900	($10,885,962)
PIONEERS' HOME	$2,540,400		$700		$2,541,100	$2,540,500	($600)
RANGERS' PENSION	$14,400				$14,400	$14,400	$0
DEPT. OF ECONOMIC SECURITY	$229,184,700	$283,180	$185,300	$1,280,713	$230,933,893	$221,771,800	($9,162,093)
DEPT. OF HEALTH SERVICES	$94,642,900	$999,000	$171,600	$547,319	$96,360,819	$95,827,000	($533,819)
COUNCIL FOR HEARING IMPAIRED	$123,700		$100	$606	$124,406	$124,300	($106)
COMM. ON INDIAN AFFAIRS	$151,200	$8,793	$400	$814	$161,207	$160,200	($1,007)

GENERAL FUND COMPARISON

AGENCY	GOVERNOR'S RECOMMENDATION	RENT	INEQUITY ADJUSTMENT	RISK MANAGEMENT	GOVERNOR'S ADJ'D RECOMM.	JLBC RECOMMENDATION	DIFFERENCE
VETERANS' SERVICE COMM.	$879,400	$5,725		$6,343	$891,468	$855,700	($35,768)
SUBTOTAL HEALTH AND WELFARE	$467,115,400	$1,716,960	$363,200	$1,935,595	$471,131,155	$450,511,800	($20,619,355)
INSPECTION AND REGULATION							
AGRIC. EMPLOY. RELATIONS BD.	$179,600	$11,875		$1,448	$192,923	$192,500	($423)
AGRIC. AND HORT. COMM.	$5,403,800	$120,138	$700	$46,331	$5,570,969	$5,462,100	($108,869)
STATE BANKING DEPT.	$2,115,300	$2,250	$700	$12,852	$2,131,102	$1,827,500	($303,602)
REGISTRAR OF CONTRACTORS	$2,509,200	$162,500	$16,500	$2,422	$2,690,622	$2,474,300	($216,322)
CORP. COMMISSION	$4,858,100	$448,800	$36,700	$38,711	$5,382,311	$5,112,400	($269,911)
DAIRY COMMISSIONER	$422,200		$400	$3,796	$426,396	$432,300	$5,904
DEPT. OF INSURANCE	$2,071,400	$202,291	$15,000	$16,409	$2,305,100	$2,191,600	($113,500)
DEPT. OF LIQUOR, LICENSES AND CONTRO	$2,103,600	$112,371	$2,900	$6,279	$2,225,150	$1,865,500	($359,650)
LIVESTOCK BOARD	$3,601,500	$80,988	$6,500	$32,533	$3,721,521	$3,752,700	$31,179
OFFICE OF MANUF. HOUSING	$1,478,900	$86,156	$9,200	$9,594	$1,583,850	$1,586,800	$2,950
MINE INSPECTOR	$687,100	$33,450		$21,337	$741,887	$732,700	($9,187)
OSHA REVIEW BD.	$16,700				$16,700	$16,700	$0
DEPT. OF RACING	$2,597,400	$58,300	$3,800	$13,904	$2,673,404	$2,645,100	($28,304)
RADIATION REG. AGENCY	$1,299,700		$1,500	$8,746	$1,309,946	$969,000	($340,946)
REAL ESTATE DEPT.	$2,414,100		$13,600	$13,724	$2,441,424	$2,326,600	($114,824)
BOXING COMM.	$34,900	$5,000			$39,900	$49,100	$9,200
SUBTOTAL INSPECTION AND REGULATION	$31,793,500	$1,324,119	$107,500	$228,086	$33,453,205	$31,636,900	($1,816,305)
EDUCATION							
COMM. ON ARTS	$1,518,700		$600	$548	$1,519,848	$1,046,000	($473,848)
HISTORICAL SOCIETY	$1,699,900		$4,300	$24,505	$1,728,705	$1,703,100	($25,605)
STATE BD. OF DIR.S FOR COMM. COLLEGE	$60,683,900		$200	$518	$60,684,618	$67,950,100	$7,265,482
SCHOOL FOR DEAF AND BLIND	$13,124,500		$24,400	$81,338	$13,230,238	$9,317,800	($3,912,438)

GENERAL FUND COMPARISON

AGENCY	GOVERNOR'S RECOMMENDATION	RENT	INEQUITY ADJUSTMENT	RISK MANAGEMENT	GOVERNOR'S ADJ'D RECOMM.	JLBC RECOMMENDATION	DIFFERENCE
DEPT. OF EDUCATION	$1,034,615,200	$372,903		$17,379	$1,035,005,482	$1,029,820,600	($5,184,882)
BD. OF MEDICAL STUDENT LOANS	$120,000				$120,000	$96,000	($24,000)
REGENTS COMM. FOR POST-SECONDARY ED.	$370,000	$12,433		$151	$382,584	$406,000	$23,416
PRESCOTT HISTORICAL SOCIETY	$404,700			$3,203	$407,903	$400,600	($7,303)
BD. OF REGENTS	$3,784,200	$46,421		$1,009	$3,831,630	$3,644,400	($187,230)
A.S.U. MAIN	$142,102,300			$1,232,797	$143,335,097	$142,992,300	($342,797)
A.S.U. WEST	$4,850,100				$4,850,100	$4,787,100	($63,000)
N.A.U.	$50,092,800			$481,239	$50,574,039	$50,157,400	($416,639)
U. OF A. MAIN	$160,598,600			$1,447,400	$162,046,000	$163,391,300	$1,345,300
U. OF A. MEDICAL	$35,800,300			$1,653,438	$37,453,738	$36,982,500	($471,238)
SUBTOTAL EDUCATION	$1,509,765,200	$431,757	$29,500	$4,943,525	$1,515,169,982	$1,512,695,200	($2,474,782)
PROTECTION AND SAFETY							
DEPT. OF CORRECTIONS	$201,335,300	$768,993	$148,400	$2,874,760	$205,127,453	$202,316,200	($2,811,253)
MILITARY AFFAIRS	$4,654,900		$3,400	$78,631	$4,736,931	$4,335,400	($401,531)
PARDONS AND PAROLE	$1,481,100	$87,860	$500	$52,474	$1,621,934	$1,565,700	($56,234)
DEPT. OF PUBLIC SAFETY	$64,070,000			$1,809,697	$65,879,697	$75,141,300	$9,261,603
SUBTOTAL PROTECTION AND SAFETY	$271,541,300	$856,853	$152,300	$4,815,562	$277,366,015	$283,358,600	$5,992,585
TRANSPORTATION							
DEPT. OF TRANSPORTATION	$145,400	$0	$600	$410	$146,410	$88,000	($58,410)
NATURAL RESOURCES							
COMM. ON AZ ENVIRONMENT	$110,400			$432	$110,832	$0	($110,832)
STATE LAND DEPT.	$6,533,900	$442,775	$13,200	$186,638	$7,176,513	$6,598,800	($577,713)
DEPT. OF MINES	$437,700	$8,375	$1,200	$3,386	$450,661	$440,000	($10,661)

GENERAL FUND COMPARISON

AGENCY	GOVERNOR'S RECOMMENDATION	RENT	INEQUITY ADJUSTMENT	RISK MANAGEMENT	GOVERNOR'S ADJ'D RECOMM.	JLBC RECOMMENDATION	DIFFERENCE
OIL AND GAS COMM.	$160,300	$13,088	$600	$384	$174,372	$175,900	$1,528
STATE PARKS BD.	$5,079,500	$92,172	$1,000	$45,100	$5,217,772	$4,820,700	($397,072)
SOLAR ENERGY COMM.	$288,600	$16,250	$19,900	$519	$325,269	$305,100	($20,169)
WATER RESOURCES	$12,751,300			$8,020	$12,759,320	$9,439,200	($3,320,120)
SUBTOTAL NATURAL RESOURCES	$25,361,700	$572,660	$35,900	$244,479	$26,214,739	$21,779,700	($4,435,039)
TOTAL OPERATING APPROPRIATIONS	$2,437,664,900	$9,029,304	$1,081,500	$12,498,148	$2,460,273,852	$2,427,986,750	($32,287,102)

TABLE 6

FY 1987
SUMMARY OF MAJOR DIFFERENCES
EXECUTIVE RECOMMENDATION VS. JLBC RECOMMENDATION

Description of Program Change	Executive Recommendation	JLBC Recommendation
ATTORNEY GENERAL		
°AHCCCS Litigation	-0-	378,400
°Expansion of Consumer Fraud Activities	-0-	138,300
°Transfer Legal Cost From Department of Corrections	-0-	120,000
DEPARTMENT OF CORRECTIONS		
°Additional Facilities 1/	22,032,100	16,814,000
°Kitchen & Laundry Equipment & Telephone Service Additional Facilities	-0-	1,039,000
°Security & Protection of Staff & Inmates	-0-	720,800
°Facilities Maintenance	-0-	450,000
°Maintenance of Prisoners in County Jails	-0-	195,200
°Expansion of ARCOR Activities	380,500	70,200
°Legal Costs Transferred to Attorney General	-0-	(120,000)
°Fire Protection for Safford	-0-	98,000
STATE LAND DEPARTMENT		
°State Funding for Forestry Management Staff	212,900	-0-
°Expansion of Urban & Commercial Development Services	251,700	-0-

1/ This difference is considerably less when the Corrections Fund is included.

TABLE 6

FY 1987
SUMMARY OF MAJOR DIFFERENCES
EXECUTIVE RECOMMENDATION VS. JLBC RECOMMENDATION

Description of Program Change	Executive Recommendation	JLBC Recommendation
DEPARTMENT OF ADMINISTRATION		
°Fund Maintenance FTES with Capital Outlay Stabilization Account	(665,400)	-0-
°Decrease D/P Outside Services	-0-	(181,700)
AGRICULTURE & HORTICULTURE		
°Additional Inspectors for Board of Pesticide Control	246,700	-0-
°Replacement Equipment Not Recommended by EBO	-0-	172,100
LIQUOR, LICENSES & CONTROL		
°Phoenix Enforcement Squad	140,100	-0-
°Six Other Issues Not Recommended by JLBC	205,000	-0-
SCHOOL FOR THE DEAF & BLIND		
°Replace Voucher Funds with General Funds	3,414,000	-0-
°Preschool Program Expansion	138,300	-0-
°Ten Other Issues Not Recommended by JLBC	315,100	-0-
DEPARTMENT OF PUBLIC SAFETY		
°Replace General Fund Approp. with HURF Monies	(10,000,000)	-0-
°Liquor/Narcotics Squad	160,000	-0-
°Purchase Radio Mobile Extenders	207,000	-0-
°Computer Software Purchase	100,000	-0-
°Five Other Issues Not Recommended by JLBC	211,500	-0-

TABLE 6

FY 1987
SUMMARY OF MAJOR DIFFERENCES
EXECUTIVE RECOMMENDATION VS. JLBC RECOMMENDATION

Description of Program Change	Executive Recommendation	JLBC Recommendation
DEPARTMENT OF ECONOMIC SECURITY		
°Data Processing Upgrade	139,000	(Overall increase over JLBC)
°Emergency/Transition Shelter	400,000	-0-
°Waiting List - D.D.	407,100	-0-
°Adult Community Services	2,000,000	-0-
°Child Welfare Services	1,330,900	860,600
°Day Care Workload Increase	519,700	-0-
°Adult Protection Services	413,100	-0-
°SSI Supervisory Care Home	159,000	-0-
°Emergency Relief	130,000	-0-
°Work Incentive Demonstration Program Enhancement	1,265,700	-0-
°Provider Increase (In Base)	3,514,700	2,674,400
°Phase-In (In Base)	9,026,000	8,036,200
°Respite Sitter Service	220,700	-0-
°Adult Day Care for Persons Leaving School - D.D.	177,000	-0-
°Child Support Enforcement Administrative Resources	700,000	-0-

TABLE 6

FY 1987
SUMMARY OF MAJOR DIFFERENCES
EXECUTIVE RECOMMENDATION VS. JLBC RECOMMENDATION

Description of Program Change	Executive Recommendation	JLBC Recommendation
ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM		
°Child Care Services	8,087,400	-0-
°Home Health Care	1,833,300	-0-
DEPARTMENT OF HEALTH SERVICES		
°Arizona State Hospital Staffing	-0-	2,336,500
°Perinatal Health Care	1,930,800	1,000,000
°Residential Treatment Emotionally Handicapped Children	150,000	-0-
°Pace System	310,000	-0-
°Administration Division Support	117,100	-0-
°Infectious Disease Control	154,800	-0-
°Day Care Centers	146,500	-0-

TABLE 6

FY 1987
SUMMARY OF MAJOR DIFFERENCES
EXECUTIVE RECOMMENDATION VS. JLBC RECOMMENDATION

Description of Program Change	Executive Recommendation	JLBC Recommendation
BOARD OF REGENTS		
°Mathematics & Science Teacher Project	150,000	-0-
ASU - MAIN CAMPUS		
°Equipment Base Adjustments	-0-	(844,100)
°Vacancy Savings Factor	(556,800)	-0-
°Student Enrollment Decrease	-0-	(745,300)
°Utilities	(1,043,100)	401,400
°Infrastructure	2,503,000	1,427,300
°Gerontology	341,500	259,800
°Instructional Computers	1,082,100	650,100
°Inflation Adjustment for Equipment	(260,900)	-0-
°Collections & Other Receipts	(1,189,500)	(193,700)
NORTHERN ARIZONA UNIVERSITY		
°Equipment Base Adjustments	-0-	(383,100)
°Vacancy Savings Factor	(181,300)	-0-
°Student Enrollment Decrease	-0-	244,500

TABLE 6

FY 1987
SUMMARY OF MAJOR DIFFERENCES
EXECUTIVE RECOMMENDATION VS. JLBC RECOMMENDATION

Description of Program Change	Executive Recommendation	JLBC Recommendation
NORTHERN ARIZONA UNIVERSITY (Cont'd)		
°Repair & Maintenance Transfer	-0-	(200,000)
°Utilities	(141,100)	85,000
°Base Program Adjustments	948,500	347,200
°Center for Excellence in Education	466,900	351,000
°Center for American Indian Economic Development	241,800	-0-
°Collections & Other Receipts	(1,601,000)	(1,344,500)
UNIVERSITY OF ARIZONA - MAIN CAMPUS		
°Equipment Base Adjustments	-0-	(1,886,900)
°Vacancy Savings Factor	(635,400)	-0-
°Student Enrollment Increase	-0-	866,900
°Repair & Maintenance Transfer	-0-	(488,500)
°Utilities	(1,128,200)	(65,100)
°Quality of Undergraduate Teaching	1,396,200	725,700
°Integrated Information System	807,700	1,837,300
°Biotechnology	514,100	1,170,200
°Faciliites Support	385,800	-0-

TABLE 6

FY 1987
SUMMARY OF MAJOR DIFFERENCES
EXECUTIVE RECOMMENDATION VS. JLBC RECOMMENDATION

Description of Program Change	Executive Recommendation	JLBC Recommendation
UNIVERSITY OF ARIZONA - MAIN CAMPUS (Cont'd)		
°Plant/Animal Protection	330,600	444,600
°Community & Public Service	236,200	100,100
°Fluid Mechanics	172,600	420,300
°Reflection Seismology	136,400	254,600
°Agriculture Support Staff	515,500	-0-
°Southwest Studies	921,400	-0-
°Inflation Adjustment for Equipment	(295,900)	-0-
°Collections & Other Receipts	(2,050,200)	(1,159,600)
UNIVERSITY OF ARIZONA - COLLEGE OF MEDICINE		
°Vacancy Savings Factor	(97,800)	-0-
°New Building Maintenance	645,900	396,100
°Immunobiology Research	885,200	-0-
°Vertebrate Development	365,800	-0-
°Clinical Teaching Support	-0-	290,000
°Inflationary & Base Adjustments	(818,300)	(41,000)
°Collections & Other Receipts	108,800	(26,700)

TABLE 6

FY 1987
SUMMARY OF MAJOR DIFFERENCES
EXECUTIVE RECOMMENDATION VS. JLBC RECOMMENDATION

Description of Program Change	Executive Recommendation	JLBC Recommendation
COMMUNITY COLLEGES		
°Capital Outlay Formula	-0-	7,364,800
EDUCATION		
°Institutional Vouchers	191,300	3,600,000
°K-3 School Improvement	2,000,000	-0-
°Dropout Prevention	2,000,000	-0-
°Preschool Handicapped	1,500,000	-0-
°Student Outcome Based Pilot	880,000	-0-
°Magnet Preschool	1,000,000	-0-
°Latch-Key Children	165,000	-0-
°Arizona Teacher Residency Program	525,000	440,000
°ASSET (Arizona School Services Through Educational Technology)	234,000	-0-
°Basic State Aid	898,663,900	898,200,000
STATE PARKS BOARD		
°Additional Personnel for Seven Day Operation, Operational Stability & New Development; & Additional Operating & Equipment Funding	544,600	116,600

TABLE 6

FY 1987
SUMMARY OF MAJOR DIFFERENCES
EXECUTIVE RECOMMENDATION VS. JLBC RECOMMENDATION

Description of Program Change	Executive Recommendation	JLBC Recommendation
DEPARTMENT OF COMMERCE		
°Executive Recommendation Includes Reallocation of Positions Transferred to the Governor's Office	-0-	(373,300)
DEPARTMENT OF BANKING		
°Executive Recommendation Includes Ten Examiner Positions	270,000	-0-
CORPORATION COMMISSION		
°Executive Recommendation Includes Six Positions Which Legislative Staff Does Not Recommend	231,900	-0-
COMMISSION ON THE ARTS		
°Executive Recommendation Includes Community Service Projects	439,700	-0-
ENVIRONMENTAL COMMISSION		
°Legislative Staff Recommends Highways User Revenue Funds as the Funding Source	110,400	-0-

TABLE 6

FY 1987
SUMMARY OF MAJOR DIFFERENCES
EXECUTIVE RECOMMENDATION VS. JLBC RECOMMENDATION

Description of Program Change	Executive Recommendation	JLBC Recommendation
WATER RESOURCES		
°Data Processing Support	317,300	84,700
°Land Acquisition, Habitat Protection Enhancement	2,000,000	-0-
°Water Management Planning	162,900	60,900
°Adjudication Support	376,300	-0-
°USGS Programs - Additional	100,000	-0-
°Flood Plain Delineation Studies	100,000	-0-
DEPARTMENT OF REVENUE		
°Business Master File Programming	219,000	(369,000)
°Construction Cost System	490,000	-0-
°Training	125,300	-0-
°Business Master File Phone Crew	106,000	-0-
°Sales Ratio System	339,000	-0-
°Sales Tax Auditors (8 FTEs)	-0-	247,000
°Equipment & Positions - Quality Control & Estate Tax	135,400	-0-
°Full Fund Positions Authorized in FY 86	-0-	280,000

TABLE 6

FY 1987
SUMMARY OF MAJOR DIFFERENCES
EXECUTIVE RECOMMENDATION VS. JLBC RECOMMENDATION

Description of Program Change	Executive Recommendation	JLBC Recommendation
EMERGENCY SERVICES		
°State to Pick Up 8 Federally Funded Positions	247,400	-0-

THE U.S. ECONOMY

I. 1985 in Review

The United States economy has been on a path of slow, erratic growth since mid-1984. As measured by real Gross National Product, the inflation-adjusted measure of total goods and services produced, the economy has showed little vigor. What does the future behold for our economy? To forecast where the economy is going, it is necessary to first analyze where it has been. Factors currently acting on the state of the economy set the initial conditions which shape the short run outlook.

1985

At the time of this writing, available data runs through the third quarter of 1985. The discussion below will look at the year in terms of three quarters of actual data and a forecast of the fourth quarter. An analysis of the composition of 1985 real GNP reveals which components were responsible for the economy's lackluster performance.

1985 GNP

Table 1 - (Billions of 1972 dollars)

	Actual			Forecast 1/
	Q_1	Q_2	Q_3	Q_4
Real GNP	1,663.5	1,671.3	1,688.9	1,697.7
Consumption:	1,089.1	1,102.1	1,116.5	1,114.3
Nonresidential Fixed Investment:	213.0	220.3	218.2	220.3
Residential Investment:	60.0	60.9	62.6	62.1
Inventory Investment:	19.1	8.3	2.5	10.8
Net Exports:	(28.4)	(33.9)	(38.4)	(32.9)
Government:	310.7	313.5	327.5	323.2

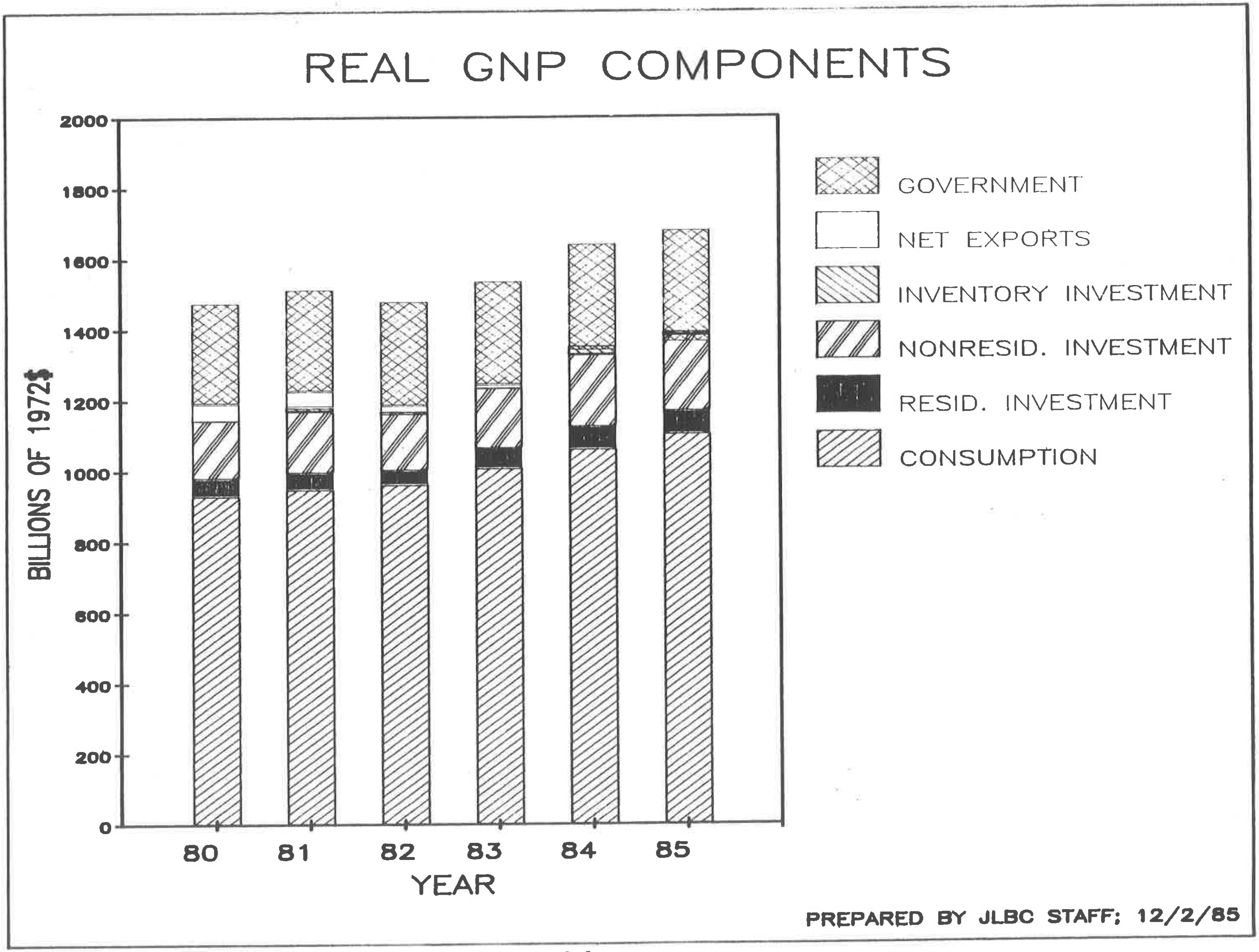
1/ D.R.I., 12/85

Table 2 - Composition of Real GNP in 1985 - Annual Rates of Change

	Actual			Forecast 1/
	Q_1	Q_2	Q_3	Q_4
Real GNP	0.3%	1.9%	4.3%	2.1%
Consumption:	5.2	4.8	5.3	(0.8)
Nonresidential Investment:	(1.5)	14.4	(3.8)	3.8
Residential Investment:	5.5	6.1	11.7	(3.0)
Exports:	(8.9)	(15.2)	0.3	10.1
Imports:	32.2	(0.7)	11.1	(4.8)
Government (Fed.)	0.6	(0.3)	40.9	(14.0)
Government (State/Local)	0.0	6.8	5.1	2.0

1/ D.R.I., 12/85

Assuming that the Data Resources, Inc. forecast materializes, the average of the four quarters would yield the following graphic representation of the real GNP components for 1985 as compared to the prior five years.


REAL GNP COMPONENTS
2000
1800
1600
1400
1200
1000
800
600
400
200
0
BILLIONS OF 1972$
80
81
82
83
84
85
YEAR
GOVERNMENT
NET EXPORTS
INVENTORY INVESTMENT
NONRESID. INVESTMENT
RESID. INVESTMENT
CONSUMPTION
PREPARED BY JLBC STAFF; 12/2/85

To get a better historical perspective of the data represented in the prior chart, it is often helpful to look at economic changes on an annual percentage change basis. The table below represents the annual percent changes in real GNP components for 1980-1985.

Table 3 - Annual Percent Change, Real GNP

	1980	1981	1982	1983	1984	1985 1/
Consumption:	0.5%	2.0%	1.4%	4.8%	5.3%	4.0%
Residential Investment:	(20.3)	(5.5)	(15.0)	41.7	12.2	1.8
Nonresidential Investment:	(2.4)	5.5	(4.7)	2.5	19.8	5.7
Net Exports:	35.2	(12.5)	(38.9)	(53.5)	(220.8)	(114.6)
Government:	2.2	1.0	2.0	(0.3)	3.5	5.2
Real GNP:	(0.3)	2.5	(2.1)	3.7	6.8	2.4

1/ Using D.R.I. 11/85 forecast for 1985 fourth quarter.

As Tables 1-3 indicate, the components of GNP have registered mixed results in 1985. On the positive side, consumption spending has been the most consistent and significant driving force in the current economic expansion. Strong employment and personal income gains following the trough of the recession in late 1982 put consumers in position to lead a recovery.

The tables below evidence the recent strength of consumer spending.

Billions of 1972 dollars
(Seasonally adjusted at annual rates)

	1980	1981	1982	1983	1984	1985 1/
Consumption	931.8	950.4	963.3	1,009.2	1,062.4	1,104.8
% Change	0.5%	2.0%	1.4%	4.8%	5.3%	4.0%

1/ D.R.I., 11/85

I. 1985 in Review
(Continued)

Quarterly Data - Annual Rate of Change

	1984 Q_3	1984 Q_4	1985 Q_1	1985 Q_2	1985 Q_3	1985 Q_4 1/
Consumption	0.7%	3.6%	5.2%	4.8%	5.4%	(0.8)%

1/ D.R.I., 11/85

Consumption spending clearly has been a bright spot for the economy in 1985. However, a substantial portion of the spending by consumers has leaked from the domestic economy in the form of imports. Due to the high value of the U.S. dollar, consumers have purchased relatively cheaper goods from abroad. This has caused a significant deterioration in the net export component of GNP. The foreign trade issue is dealt with in detail in a subsequent section of this report.

Residential investment spending has been modest in 1985. Given the significant decline in mortgage rates relative to levels over the past five years this is somewhat puzzling. In 1984, there were 1,766,000 housing starts. For 1985, the total will probably decline slightly to about 1,754,000 starts.

What has caused the lackluster response in housing activity to the falling mortgage rates? One explanation is that the pent-up demand for housing following the recession ending in 1982 has run its course. Another factor is the fall-off in real disposable personal income growth (from 6.7% in 1984 to 2.2% in 1985).

Nonresidential fixed investment consists of business purchases of durable equipment and nonresidential structure construction. In 1984, nonresidential fixed investment soared nearly 20% over the 1983 level. During 1985, growth has fallen to about 5-6%. Growth in the durable equipment category has been quite weak due to the foreign trade imbalance. As domestic manufacturers lose sales to foreign producers, there is too much unused capacity to support spending on new equipment. The same is true for industrial construction spending.

Spending on nonresidential structures (industrial, commercial, and other) has fallen from a 15.6% growth rate in 1984 to 7.6% growth in 1985. This is in response to weak overall economic growth, and an already overbuilt commercial office space market in most regions of the country.

The final component of GNP, government spending, has provided a short run stimulus to the economy in 1985. As will be shown in a subsequent section, the long-run negative consequences of federal deficit spending will dominate the short-run stimulus.

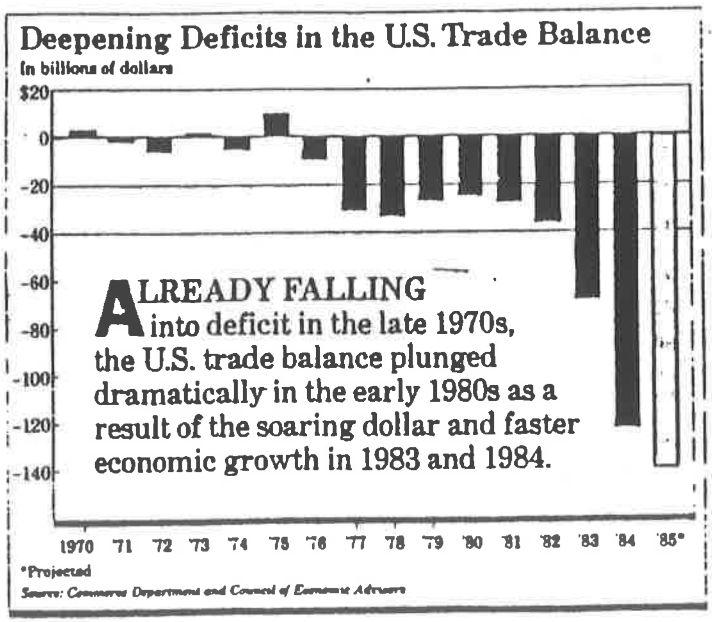
When the federal fiscal year ended on September 30, 1985, the budget deficit totaled $202.8 billion. This is $27.5 billion more than the fiscal 1984 deficit. Although receipts rose 10.2%, outlays more than offset the additional receipts with an 11.3% increase. The consequences of the budget deficit are analyzed in detail in the next section.

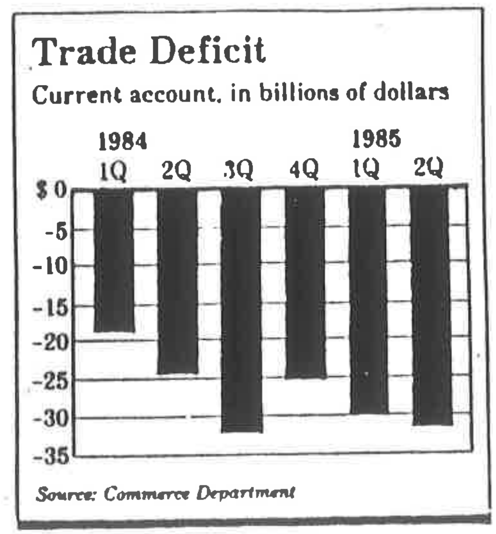
Summary: The economy registered mixed results in 1985. While some components contributed to growth (consumption and government spending) others were a drag on the economy (net exports). This combination of stimulative and contractionary GNP components resulted in slow and erratic economic growth. The next section looks at the two major factors which constrained growth in 1985.

II. Major Impediments to Growth in 1985

The U.S. economy has been sluggish since mid-1984. Real GNP slowed to a 3.6% annual rate in the second half of 1984. The slowdown continued during the first half of 1985 as real GNP registered a mere 1.1% annual rate of gain. The second half of 1985, based on preliminary data, showed a slight pickup. Third quarter growth was 4.2%. The Fourth quarter will show slower growth, probably in the 2.0-3.0% range. What factors have caused the economy to slow? Will these factors constrain future growth in 1986 and 1987?

(1) TRADE DEFICIT: The U.S economy has undergone a major transformation in the foreign trade sector over the past decade.

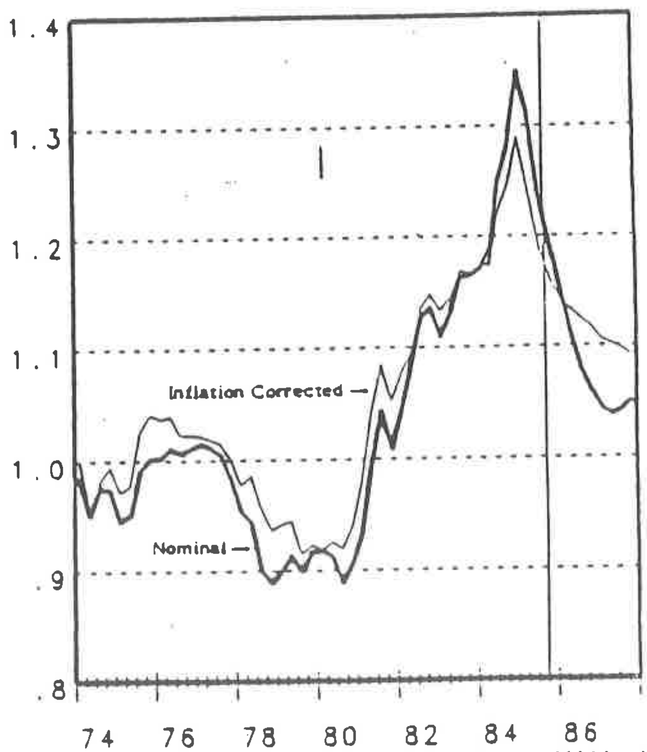




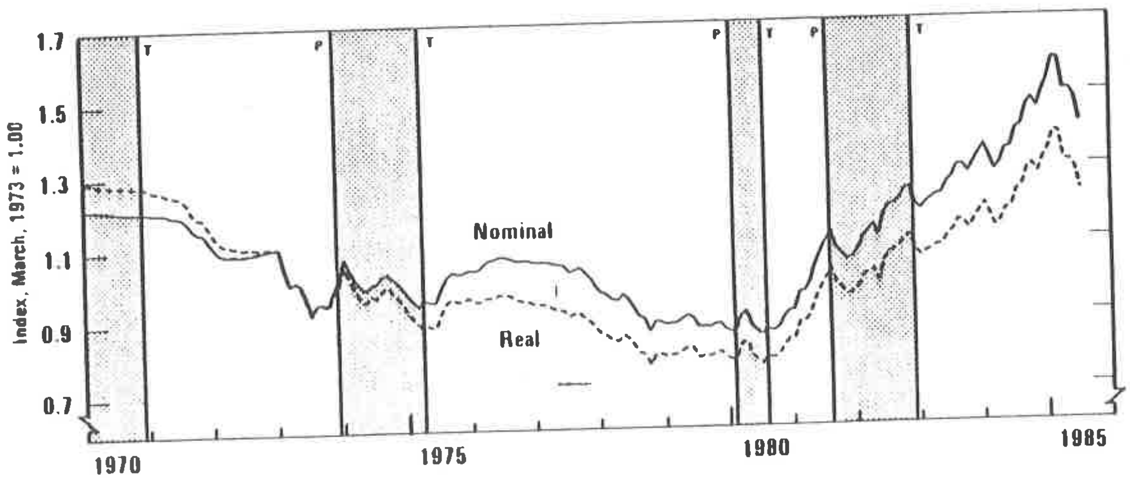
As late as 1975, the United States enjoyed a positive net trade balance. Throughout the late 1970's and early 1980's, the net trade balance was negative, but not a serious impediment to growth. Starting in 1983 and continuing to the present, however, the net trade position has deteriorated significantly. The deterioration can be attributed to the surge in the value of the U.S. dollar relative to foreign currencies, coupled with strong economic growth in 1983 and 1984.

(a) Strong U.S. dollar: As the graphs below illustrate, the U.S. dollar surged tremendously from 1983 through mid 1985. The reasons for this will be discussed later. The consequence of a rising currency is evident; foreign goods become relatively cheaper than domestically-produced goods.

(Trade weighted index, June 1970=1)



Exchange Rate



SOURCES: Federal Reserve Board; International Monetary Fund; Congressional Budget Office.
NOTE: The nominal index is a trade weighted average of bilateral dollar exchange rates. The real index adjusts the nominal index for relative movements in CPIs, and is a measure of the relative prices of domestic and foreign goods and services.

(b) Strong economic growth: With the economic expansion in 1983 and 1984, consumers registered strong income gains. U.S. personal income rose 6.2 percent and 9.8 percent in 1983 and 1984, respectively. Coming off the recession that ended in late 1982, there was "pent up" demand for goods and services.

Thus, both consumers and businesses were ready and able to spend. However, because of the surging U.S. dollar during this time period, consumers bought the relatively cheaper goods produced abroad. Despite heavy consumer spending, the output and sales of U.S. manufacturers producing tradable goods suffered. Industrial production in the manufacturing sector has risen at a mere 2.4 percent annual rate during the first three quarters of 1985. This compares poorly against the 10.5 percent increase in 1984. Moreover, payroll employment data indicate that employment in goods-producing industries has declined by 91,000 people in 1985, while employment in service-producing industries (not significantly threatened by foreign competition) has risen by 1.4 million.

The slowdown in the domestic manufacturing sector has, in turn, left industrial capacity utilization levels too low to justify much investment spending on equipment and industrial construction. The capacity utilization rate has hovered around 80 percent while a more normal rate for this stage of the business cycle is 86-87 percent. The table below shows non-residential fixed investment in 1985:

1985 Non-Residential Fixed Investment

	Q_1	Q_2	Q_3	Q_4
In billions:	213.0	220.3	217.7	215.3
Annual rate of change:	(1.5)	14.4	(4.6)	(4.3)

(2) FEDERAL DEFICIT: Another factor contributing to slow growth in 1985 has been the huge federal deficit. While deficit spending is a stimulative fiscal policy per se, other consequences of deficit financing impact negatively on the economy.

First, deficit financing imposes a direct cost in the form of required interest payments to creditors. The Congressional Budget Office estimates that net interest on the debt will total $129 billion in fiscal year 1985. This represents 3.4 percent of total GNP, and is over 50 percent of all National Defense spending. To the extent that interest payments are financed by taxes, the increased tax burden acts to depress economic growth.

Second, while not easily quantified, the federal deficit has created upward pressure on interest rates. As the public sector enters the credit market, it must compete for loanable funds with the private sector. This competition results in the bidding up of credit costs (i.e. interest rates). It also "crowds out" private sector borrowing which might otherwise have occurred. The table below shows the strong growth in public sector credit market debt during 1984 and early 1985.

II. Major Impediments to Growth in 1985
(Continued)

(Seasonally adjusted, annual rates of change)

	1984 I	1984 II	1984 III	1984 IV	1985 I
Total Debt	11.8	13.6	10.7	14.9	10.6
Private	10.6	13.7	9.7	13.7	10.1
Corporations	15.8	15.8	10.2	16.5	10.8
Households	11.0	14.2	10.8	13.1	11.9
Foreign	(4.3)	20.1	(14.4)	0.4	(7.6)
Other	10.7	14.0	11.2	10.4	6.8
Public	13.0	10.0	14.8	20.0	13.0
Federal government	16.2	13.3	14.7	19.3	12.2
State and local governments	2.6	(1.0)	15.0	22.1	15.9

Interest rates have not been rising in 1985, however. Some economists point to this as evidence that deficit financing does not cause interest rates to rise. This argument neglects to consider what interest rates would have been in the absence of public sector borrowing.

With an expansive monetary policy, and a low inflationary environment, economic theory suggests that interests rates should decrease. As the table below indicates, this has occurred.

	1984 Q_3	1984 Q_4	1985 Q_1	1985 Q_2	1985 Q_3	Q_4
3 Month T-Bill	10.32	8.80	8.18	7.46	7.11	7.25
Prime Rate	12.99	11.80	10.54	10.20	9.50	9.50

II. Major Impediments to Growth in 1985
(Continued)

However, real interest rates (nominal interest rates less inflation) remain high by historical standards. The table below compares real interest rates against the federal deficit.

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Real Prime Rate	1.64	1.02	1.66	3.97	6.07	9.27	8.86	6.99	8.24	6.23
Federal Deficit (in billions)	(53.1)	(45.9)	(29.5)	(16.1)	(61.3)	(64.3)	(148.2)	(178.6)	(175.8)	(195.4)

As the above table indicates, the rise in real interest rates in this decade is highly corollated to the build-up in the federal deficit. To the extent that the federal deficit has increased the cost of borrowing, private sector investment spending necessary for future economic growth has been hindered.

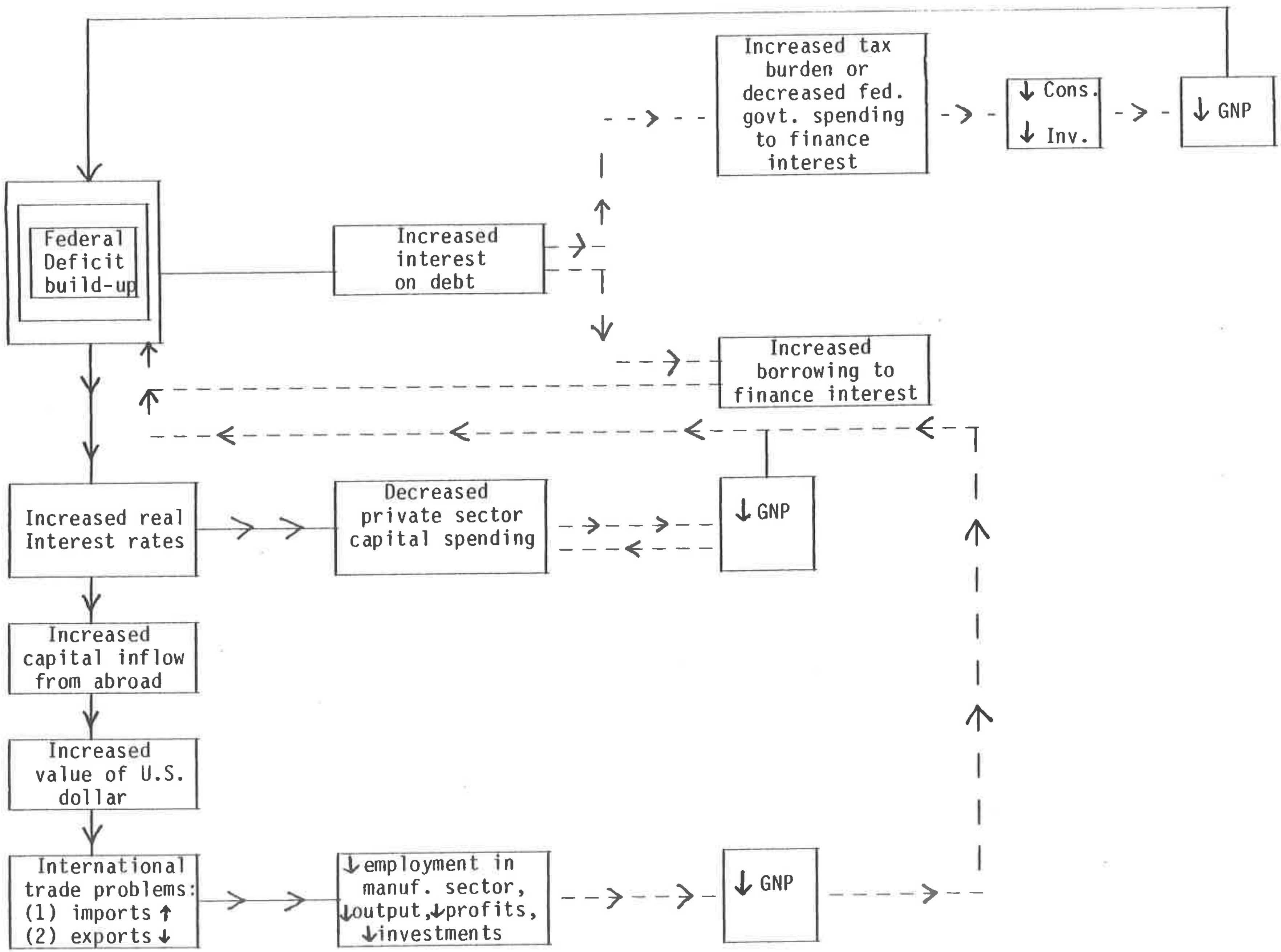
Third, high real interest rates have attracted foreign capital inflows. In 1984, net capital flows doubled the total from 1983. (See: table below for specific data).

Net Capital Inflows on a Reported Basis
(in billions of dollars, seasonally adjusted)

1983	1984	1984 Q_1	1984 Q_2	1984 Q_3	1984 Q_4	1985 Q_1 (Prelim)
32.2	76.9	14.3	22.6	21.5	18.5	13.3

To a large degree, the rise in the federal deficit has been financed by foreign creditors. The capital inflows have contributed significantly to the rise in the U.S. dollar. The U.S. dollar appreciated as foreigners sought dollars to purchase our dollar-based assets. As discussed previously, the high value of the U.S. dollar relative to foreign currencies has damaged domestic goods-producing industries.

Thus, there is a direct linkage between the federal deficit, the U.S. trade problem, and the slow growth of real GNP in 1985. The flow chart below illustrates the causal linkage described above.


Increased tax burden or decreased fed. govt. spending to finance interest
↓ Cons.
↓ Inv.
↓ GNP
Federal Deficit build-up
Increased interest on debt
Increased borrowing to finance interest
Increased real Interest rates
Decreased private sector capital spending
↓ GNP
Increased capital inflow from abroad
Increased value of U.S. dollar
International trade problems: (1) imports ↑ (2) exports ↓
↓ employment in manuf. sector, ↓ output, ↓ profits, ↓ investments
↓ GNP

III. Monetary Policy - 1985 Recap

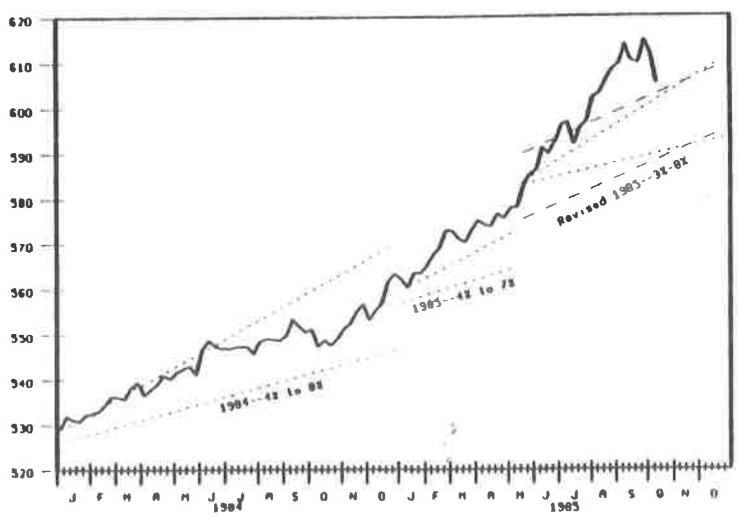
The Federal Reserve Board attempts to promote steady, non-inflationary economic growth via manipulation of the money supply. Due to sluggishness in the economy's performance since mid-1984, the Fed has pursued stimulative ("easy money") policies in 1985. Successful control over inflation in recent years has made this policy feasible.

Economic theory suggests that increases in the supply of money will stimulate economic activity. As the supply of money rises, interest rates should fall. Falling interest rates stimulate investment spending, which boosts overall economic activity.

As stated previously, in 1985 the Fed has sought to spur economic growth by increasing the money supply. Through late November, M_1, which measures cash in circulation, deposits in checking accounts, and non-bank traveler's checks, has risen well above the Fed's target range. The Fed has established a target range of 3-8% annual growth for M_1. This target is designed to facilitate economic growth without creating inflationary pressures.

The chart below shows where M_1 actually is in comparison to the Fed target range.

The Money Supply (M1) and its Target Range
(Billions of dollars)



target range implied by annual target growth rates

Why has the Fed allowed the money supply to rise so far above the 1985 target range? Will this trigger inflationary pressures in 1986 and 1987?

There are several reasons for the Fed's stimulative monetary policies in 1985. First, because the economy has been mired in a "growth recession" (defined as real growth, but, insufficient to reduce unemployment) since mid-1984, the Fed has tried to stimulate interest rate-sensitive sectors by increasing the money supply. The Fed has succeeded in bringing nominal interest rates down. The table below shows various interest rates for the past six quarters.

	1984		1985			
	Q_3	Q_4	Q_1	Q_2	Q_3	Q_4 1/
Prime Rate	12.99	11.80	10.54	10.20	9.50	9.50
3 Mo. T-Bill	10.32	8.80	8.18	7.46	7.11	7.24
Federal Funds	11.39	9.27	8.48	7.92	7.90	8.01
30 year T-Bill Rate	12.68	11.69	11.58	10.99	10.56	10.53

1/ D.R.I. 11/85

The lower nominal rates have helped spur consumer and business spending somewhat. For instance, the fall in interest rates allowed automakers to offer low interest financing. Consumers responded heavily to the financing programs in the third quarter of 1985. The business response has not been tremendous, but, this is largely due to other factors such as the high level of real interest rates and the large amount of excess capacity in U.S. factories. Nonetheless, the Fed's efforts have helped to keep the current economic expansion alive.

Another reason for the expansive monetary policies has been the attempt to reduce the exchange rate through lower interest rates. As discussed in Section 2, the strong value of the U.S. dollar has contributed to the deterioration in our foreign trade position. High interest rates are an important cause of the rise in the dollar. High interest rates attract capital inflows from abroad, which causes the dollar to rise as foreigners seek dollars to purchase dollar-based assets. Therefore, the Fed. has tried to mitigate the problems associated with an overvalued dollar by lowering interest rates. The U.S. dollar has come down 25% since its peak in February. The exchange rate is expected to continue its decline, and this will help alleviate trade problems by late 1986.

III. Monetary Policy - 1985 Recap (Continued)

The impact of the Fed's easy money policies on the rate of inflation is open to debate. One school of thought advocated by "Monetarists" suggests that the strong rise in the supply of money will cause serious inflation during the remainder of this decade. Monetarists believe that increases in the money supply beyond the economy's basic capacity to grow inevitably lead to increases in inflation. While this view has some support historically, most economists believe that the money supply is one of several factors impacting on inflation.

Other inflation factors include people's expectations regarding future prices, price "shocks" (e.g. the oil embargo in the 1970's), monopolistic market power on the supply side, and the degree of "demand-pull" pressure (the bidding up of prices by excessive demand). Most of these factors do not currently suggest that inflation will reignite.

For instance, unemployment is still high enough that wage gains will be modest and will not trigger a wage-price spiral. Other resource prices, such as energy and farm prices, are low and are not expected to take-off in the near future. Increased world competition has been strong enough within most industries that "administered" pricing has not been a significant factor.

Most analysts are expecting small increases in inflation over the next two years, but, the extent to which the Fed's policies will contribute to the increase is uncertain.

A look at recent price levels and a forecast of future prices is presented in the table below.

	1981	1982	1983	1984	1985 1/	1986 1/	1987 1/
C.P.I.-U.	10.4%	6.2	3.2	4.3	3.4	3.2	3.8
GNP Deflator	9.6%	6.0	3.8	3.8	3.7	3.1	3.5

1/ D.R.I., 11/85

IV. U.S. Outlook - 1986 and 1987

The outlook for 1986 and 1987 will be analyzed in two parts; a near term forecast (present to mid-1986) and an intermediate term forecast (mid-1986 through 1987).

A. NEAR TERM OUTLOOK

The U.S. economy improved substantially in the third quarter of 1985 (See: Tables 1 and 2). However, it is unlikely that the third quarter pickup reflects a fundamental strengthening in the economy. Most analysts are expecting the economy to continue its pattern of modest, erratic growth at least through the first half of 1986.

The table below compares various forecasts, by quarter, for the first half of 1986.

Percent Change at Annual Rates

	CHASE 1/		DRI 2/		UCLA 3/	
	Q_1	Q_2	Q_1	Q_2	Q_1	Q_2
Real GNP	1.4	2.8	(0.3)	1.7	1.7	2.6
Consumption	3.4	2.9	1.6	1.1	1.7	2.1
Nonresidential Investment	2.5	2.2	(4.0)	(3.8)	(1.2)	(1.2)
Residential Investment	7.6	4.1	7.2	5.2	9.0	8.2
Government Spending	(2.8)	0.9				
Federal			(15.4)	(1.6)	(13.0)	(1.3)
State and Local			1.1	0.7	2.4	2.1
Net Exports						
Exports			9.0	10.2	9.7	11.3
Imports			(1.3)	(2.4)	0.7	1.3

1/ Chase Econometrics, 11/85
2/ Data Resources, Inc., 12/85
3/ U.C.L.A. Business Forecasting Project, 12/85

What are the major reasons behind these forecasts calling for weak growth during the first half of 1986?

First, as discussed in Section 2, the federal deficit and the foreign trade problems are expected to continue to hinder economic growth.

Second, with a continuation in the foreign trade gap, domestic manufacturing will be weak. This is responsible for the pessimism in the nonresidential fixed investment component. Stagnation of the industrial sector will prohibit substantial growth in business investment.

Third, and most importantly, consumption spending must retrench over the next few quarters. A close look at consumer spending reveals some interesting insights into the economy's outlook for early 1986. For the following reasons, consumer spending will not provide the stimulus over the near term that it had provided previously.

(a) Personal income growth is slowing and this will restrain consumption spending.

Personal Income - Seasonally Adjusted at Annual Rates

1984				1985			
Q_1	Q_2	Q_3	Q_4	Q_1	Q_2	Q_3	Q_4
12.6%	9.2	9.1	7.2	6.1	3.9	3.1	6.4

1/ D.R.I., 11/85

(b) Slower personal income growth has forced consumers to finance expenditures through reductions in savings and/or increases in debt. Consumers have reduced their rate of savings significantly. (See: table below). The average savings rate as a percent of income for the past nine years is 6.1%. For 1985, the rate will be around 4.0%. Consumers will have to cut back expenditures in the near term to get savings back to a more reasonable level.

IV. U.S. Outlook - 1986 and 1987
(Continued)

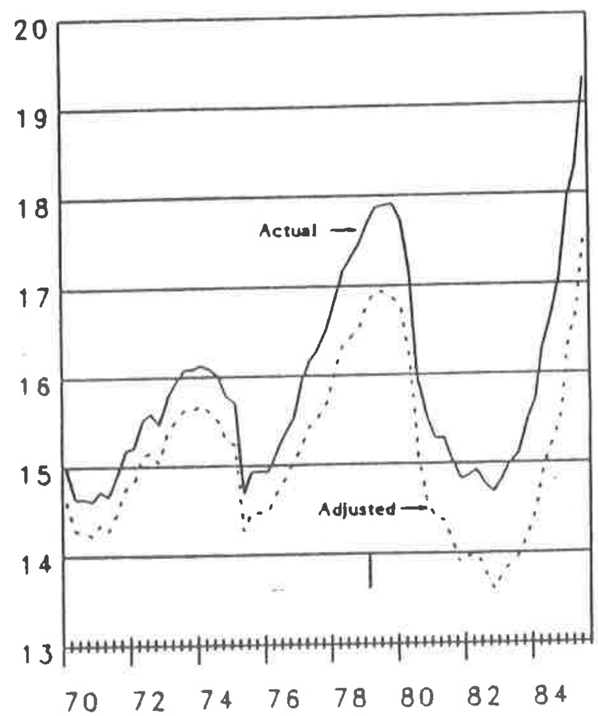
Savings Rate (%)

1984		1985 1/			
Q_3	Q_4	Q_1	Q_2	Q_3	Q_4
6.3	6.2	4.5	5.1	2.7	3.0

1/ per D.R.I., 12/85

Consumers have also accumulated record levels of debt. The following graph illustrates the explosive growth in outstanding credit as a share of disposable income.

Consumer Credit Outstanding
As a Share of Disposable Income



IV. U.S. Outlook - 1986 and 1987
(Continued)

Household Consumer Credit Outstanding (in billions)

1984				1985			
Q_1	Q_2	Q_3	Q_4	Q_1	Q_2	Q_3	Q_4 1/
506.5	538.1	560.5	587.2	615.0	646.3	668.0	687.8

1/ D.R.I., 11/85

If the 1985 fourth quarter forecast proves accurate, household consumer credit outstanding will have increased 19.4% over 1984. While most analysts believe that consumers are overloaded with debt, there are factors which may mitigate the potential impact of the record debt level. For instance, in 1970, households in the top income quintile held only 22% of the consumer debt. Today, the highest quintile hold 50% of the debt. The high income households are best able to deal with debt. Also, increasingly lengthy maturities for automobile installment loans tends to distort consumer debt figures. Despite these mitigating factors, slow employment and income growth, coupled with burdensome debt levels and a low savings rates, will necessitate a curtailment in consumer spending over the next six months.

Summary: The economy is likely to continue its current pattern of sluggish growth through mid-1986. Consumption spending, the mainstay of the recovery in 1983-85 will taper off. Because consumer spending constitutes two-thirds of total GNP, a slowdown in consumer expenditures will prohibit any substantial, sustained growth over the near term. Furthermore, despite a 25% drop in the foreign exchange rate since early 1985, the foreign trade deficit has not yet turned around and probably will not until late 1986 due to time lags. This will result in continued weakness in the industrial manufacturing sector. However, due to factors to be discussed in the next section, there is a strong possibility that the economy will gain strength after mid-1986.

B. INTERMEDIATE TERM OUTLOOK

The U.S. economy should strengthen somewhat during fiscal year 1986-87. Subdued inflation, stimulative monetary policies, declining long term interest rates, and a declining U.S. dollar will provide an economic environment conducive to stronger growth. The upturn will not be of the magnitude achieved during 1984, however. This forecast is consistent with that of most private forecasting services, as evidenced in the table below.

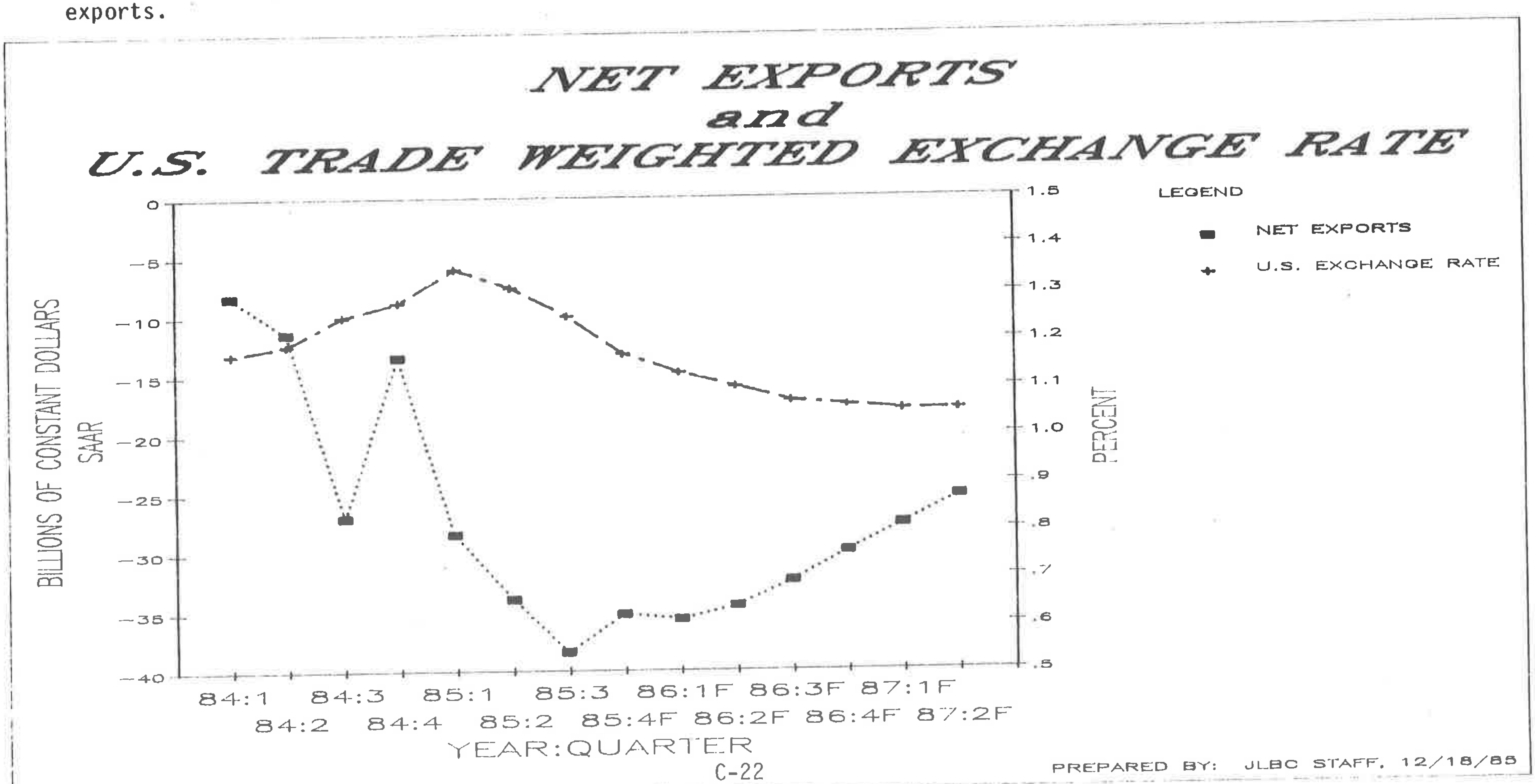
Key U.S. Economic Indicators - Annual Rates of Change

VARIABLE	Actual Fiscal 1984-85	Forecast Calendar 1985	Fiscal 1985-86	Calendar 1986	Fiscal 1986-87
Real GNP	4.2%				
Data Resources, Inc. (DRI)		2.5	2.0	1.8	3.8
Chase Econometrics			2.6	2.5	3.2
Blue Chip Economic Indicators		2.5		3.1	
JLBC		2.5	3.0	3.0	3.5
GNP Deflator	3.8				
DRI		3.6	3.4	3.4	3.6
Chase		3.7	4.1	4.1	4.4
Blue Chip		3.6		3.6	
JLBC		3.6	3.5	3.6	4.1
U.S. Personal Income	8.3				
DRI		5.9		5.4	
Chase					
JLBC		5.9	5.3	6.6	7.7
Personal Savings Rate	5.5				
DRI		3.8	3.1	3.4	3.8
Chase		4.1	3.4	3.5	3.8
JLBC		3.8	3.2	3.4	3.8
3 Month T-Bills (Annual Ave.)	8.7				
DRI		7.5	7.0	6.9	7.1
Chase		7.5	7.1	7.0	7.2
Blue Chip		7.5		7.4	
JLBC		7.5	7.0	6.9	7.0
Aaa Corporate Bonds (Annual Ave.)	12.3				
Blue Chip		11.4		10.8	
JLBC		11.2	10.8	10.7	10.5
Unemployment Rate	7.2				
DRI		7.2	7.2	7.4	7.5
Chase		7.2	7.1	7.0	6.7
Blue Chip		7.2		7.1	
JLBC		7.2	7.2	7.2	7.0
Money Supply (M_1) % Chg. vs. Year Ago (Q4/Q4)	5.2				
DRI		10.9	9.8	5.4	5.4
JLBC		10.9	9.1	6.0	
Net Exports (in billions of current dollars)					
Chase		(92.5)	(98.1)	(94.0)	(96.6)
JLBC		(92.0)	(98.4)	(95.2)	(94.0)
Exchange Rate	11.4%				
DRI		3.9	(16.4)	(14.4)	(4.6)
JLBC		3.9	(16.4)	(14.4)	

FACTORS SUPPORTING STRONGER GROWTH IN FY 86-87

First, the U.S. trade deficit should see some improvement during FY 86-87. The U.S. dollar has already fallen about 25% from its February, 1985 peak. Further declines are anticipated for 1986. As the dollar falls, imports will lose their attractiveness to U.S. consumers and domestic manufacturers will recoup lost sales.

During 1985, a coordinated program designed to lower the value of the dollar was launched. The United States, together with Japan, West Germany, Britain, and France committed themselves to lower the dollar via market intervention (central bank sales of dollars in foreign exchange markets in return for foreign currencies). The graph below graphically represents our forecast of the falling dollar and the corresponding rebound in net exports.



Second, the federal government's passage of the Gramm-Rudman Amendment confirms its commitment to deficit reduction. In the short run, Gramm-Rudman may be contractionary as federal spending is curtailed. It may also lead to a tax increase which would further contract the economy. The financial markets are responding favorably to the legislation, however. Long term interest rates are expected to trend downward.

UCLA Forecast (12/85)	1985	1986	1987
20 year U.S. Bonds	10.98%	9.32	9.17
Mortgage Rate (existing homes)	11.78%	10.88	10.72

Lower long term interest rates should stimulate housing construction and other interest-sensitive sectors.

UCLA Forecast (12/85)	1985	1986	1987
Housing starts (in millions)	1.756	1.909	1.996

Falling interest rates should also aid the decline of the U.S. dollar, thereby lowering the foreign trade gap.

Third, the Federal Reserve Board has "primed the pump" by increasing the money supply by approximately 9% in 1985. Due to time lags, the stimulative monetary policies of 1984 and 1985 should positively impact economic activity in 1986 and 1987.

The Fed is likely to maintain flexible, accommodative policies in 1986. As long as inflation remains subdued, the Fed has no reason not to prolong the expansion via "easy money" policies. Energy (particularly oil) prices and farm prices are low and wage gains are modest. Capacity utilization rates are low enough that bottleneck pressures should not occur. While the growth in the money supply is likely to push prices slightly upward, inflation will not reignite to such a degree as to force the Fed to tighten.

Therefore, despite the fact that the economic expansion is already longer than average, a recession in FY 86 or FY 87 is unlikely. The expected combination of rigid fiscal policy under Gramm-Rudman and a flexible, accommodative monetary policy is likely to result in:

(a) continued weak growth through the remainder of FY 86, and

(b) stronger growth in FY 87 as:

(1) the depreciating dollar improves the trade imbalance,
(2) long term interest rate reductions stimulate investment spending and housing activity, and
(3) the Fed accommodates growth through easy money policies so long as inflation remains subdued.

C. RISKS TO THE FORECAST

Economic forecasts are based upon both economic and political assumptions. In a dynamic economic system such as ours, the assumptions are many. When key assumptions change, the forecast also changes. As such, there are always risks to the forecast. This section briefly summarizes the major risks to our U.S. economic forecast.

Probably the biggest risk to the forecast is the possibility of a resurgence in inflation. The rapid monetary expansion in 1985 could fuel inflationary pressures in 1986 and 1987. If inflation were to rekindle, the Fed would not be able to counter the fiscal contraction and/or tax increase expected from Gramm-Rudman. A recession could materialize under this scenario.

Another risk is the possibility of consumer retrenchment greater than that currently expected. Declining consumer confidence, low savings and high levels of debt could weaken spending. This would seriously impair housing activity, auto sales, and sales of other big-ticket items. Under this scenario, the economy would weaken in the near term.

Also, it is possible that efforts to lower the dollar will weaken, and the dollar will plateau at this level. This would hinder the rebound expected in our net trading position, keeping the economy on its current slow-growth path.

V. Deficit Reduction Under Gramm-Rudman

As discussed in Section 2, the federal budget deficit has been a significant impediment to economic growth. The federal government recently enacted the Balanced Budget and Emergency Deficit Control Act of 1985 (the "Gramm-Rudman" Amendment) This section will summarize the mechanics of Gramm-Rudman and analyze its potential impact on the economy.

Gramm-Rudman is unique legislation in that is provides a mechanism for automatic deficit reduction. In each of the next six years, a maximum deficit target is specified. The deficit targets are:

FY 1986 - - $180 billion
FY 1987 - - $144 billion
FY 1988 - - $108 billion
FY 1989 - - $ 72 billion
FY 1990 - - $ 36 billion
FY 1991 - - $ 0

The President is required each year to submit a budget which falls within these targets. Likewise, Congress may not enact a budget which would exceed the target levels. If congressional actions lead to a projected deficit in excess of the target level, the President is empowered to "sequester" controllable entitlement and discretionary spending in an across the board manner so as to achieve the deficit target. Sequestration means the permanent cancellation of budget authority. Specifically excluded from the sequestration process are Social Security, interest on the debt, and uncontrollable expenditures as mandated by federal law (e.g. Medicare eligibility) or prior contract. The sequestering provisions can be waived if either the Congressional Budget Office or the Office of Management and Budget submit a forecast of negative real economic growth for two consecutive quarters, or, if the Commerce Department reports actual negative real growth.

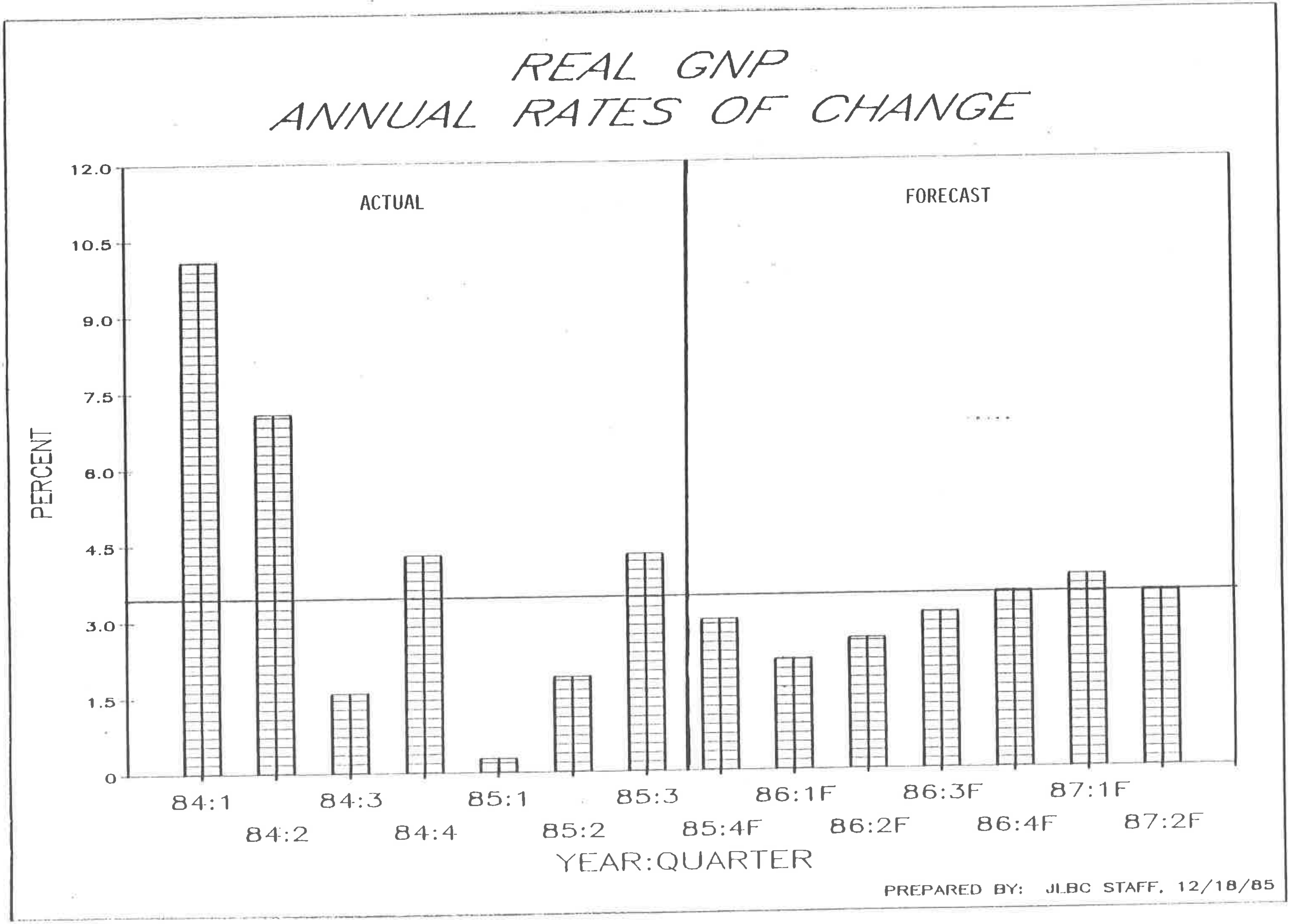
Clearly, a strong federal budget deficit reduction program is needed. Whether Gramm-Rudman is the appropriate vehicle to reduce the deficit is uncertain. The political and economic ramifications of Gramm-Rudman can be extreme.

Politically, if the targets are not met, the legislation strips Congress and the Administration of its role in making political choices in taxation and spending; essential elements of the budget process. A legislated, formula-driven solution to the deficit problem imposes great rigidity on fiscal policy-making.

Economically, a rigid fiscal policy shifts a great burden onto monetary policy-makers at the Fed. If economic conditions render a sharp fiscal contraction under Gramm-Rudman inappropriate, the Fed must stand ready to counter the fiscal drag with flexible, accommodative money policies. The Fed can only do so if inflation does not reignite. An upswing in inflation would pose a dilemma to the Fed - further easing of monetary policies would be inflationary, but, failure to ease could choke off the expansion and lead to a recession.

Another potential political and economic consequence of Gramm-Rudman is the possibility of an income tax increase. Faced with the choice of reducing defense spending or increasing revenues via taxation, the President may back-off his longstanding vow not to raise taxes. A tax increase would further contract the economy and place a greater burden on the Fed to maintain flexibility.

Gramm-Rudman will reshape the federal budget-making process, and, if adhered to it will reduce the budget deficit. As discussed in Section 2 deficit reduction is essential to the economy's future well-being. Only time will tell if this legislation is the appropriate cure for the economic ills caused by our current deficit problem.


REAL GNP
ANNUAL RATES OF CHANGE
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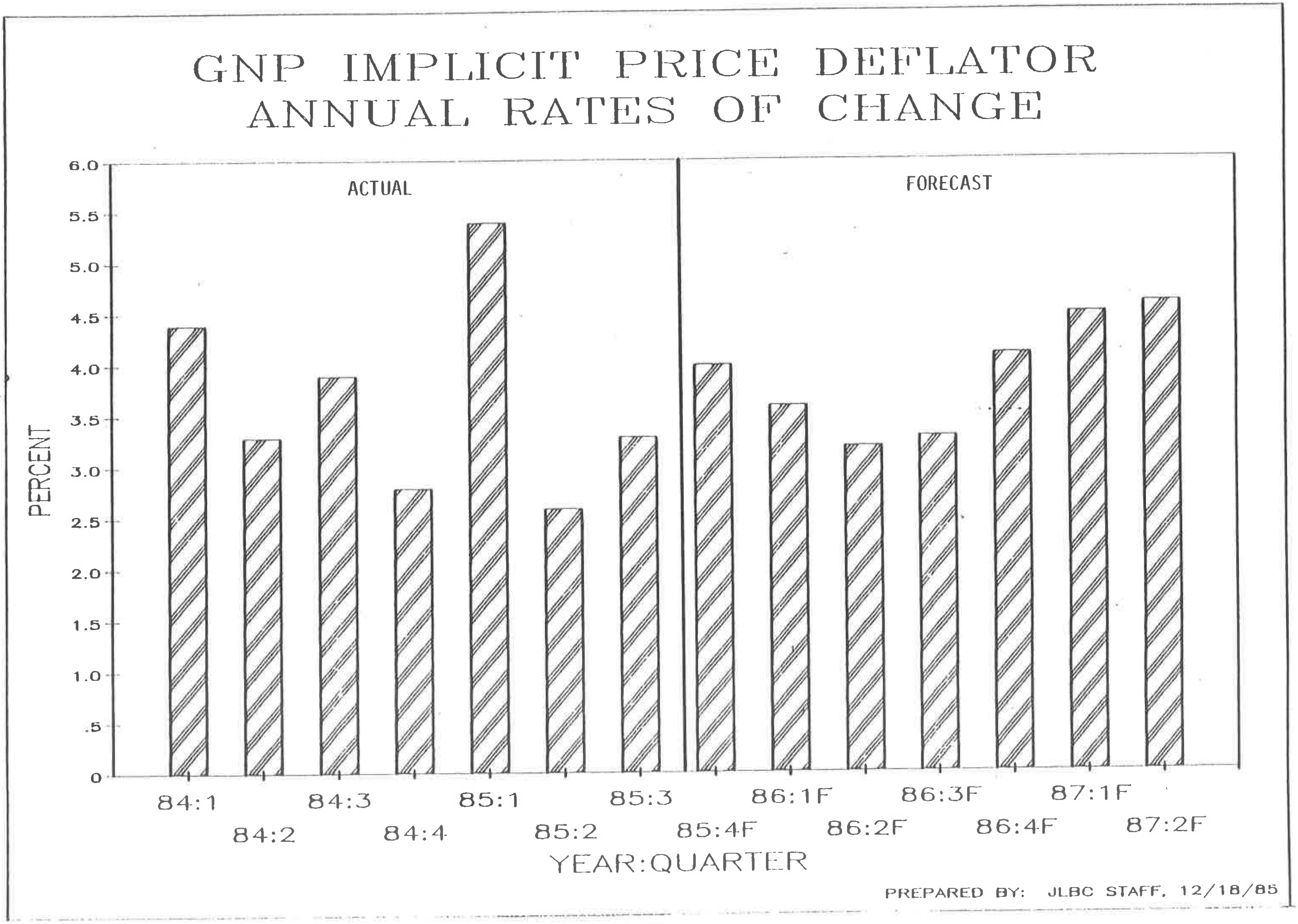
YEAR:QUARTER
PREPARED BY: JLBC STAFF, 12/18/85


GNP IMPLICIT PRICE DEFLATOR
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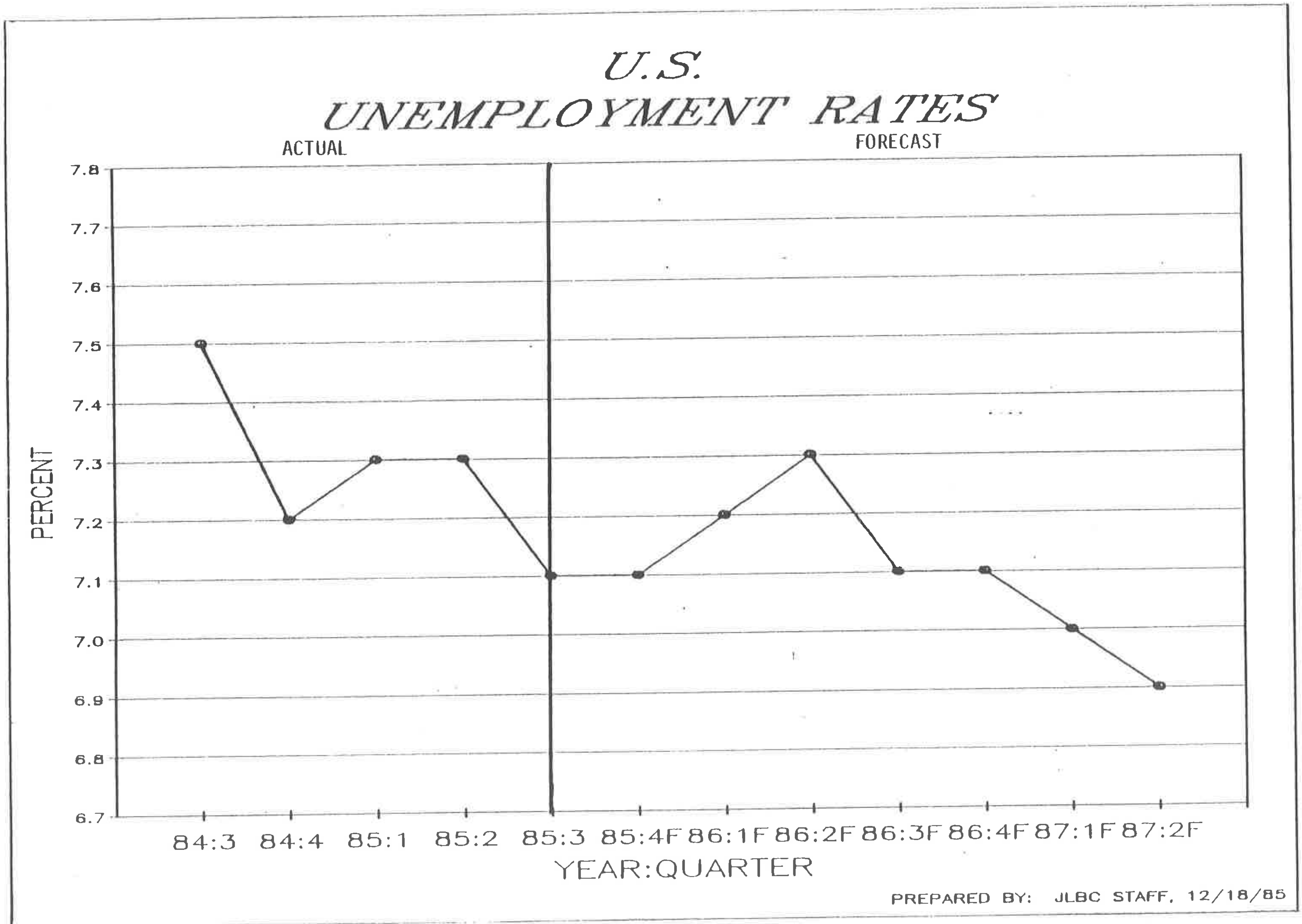
PREPARED BY: JLBC STAFF, 12/18/85


U.S.
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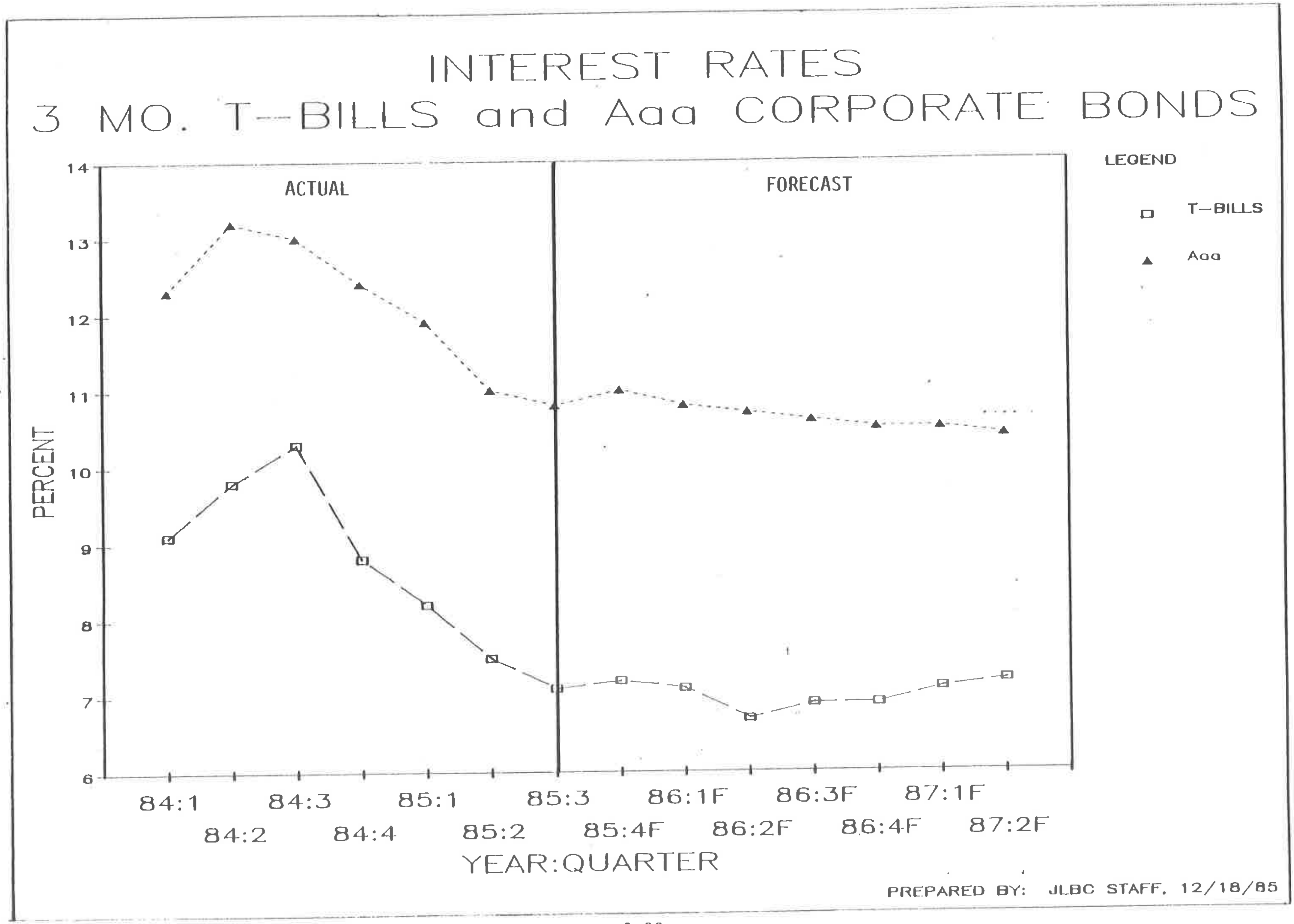
YEAR:QUARTER
PREPARED BY: JLBC STAFF, 12/18/85


INTEREST RATES
3 MO. T-BILLS and Aaa CORPORATE BONDS
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T-BILLS
Aaa
ACTUAL
FORECAST
PERCENT
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85:4F
86:1F
86:2F
86:3F
86:4F
87:1F
87:2F
YEAR:QUARTER
PREPARED BY: JLBC STAFF, 12/18/85

THE ARIZONA ECONOMY

In 1984, the Arizona economy exploded, registering one of the most rapid expansions on record. At the end of 1984, Arizona had one of the lowest unemployment rates in the country, 4.4%. According to the U.S. Department of Labor, we were the fastest growing state in the nation in 1984 and 95,000 jobs were added (December to December) during the year.

In 1985 the picture changed and we entered a period of declining rates of growth. Relative to other states, however, the outlook is good. In October 1985, the most current data available, Arizona was one of two states with over-the-year wage and salary job growth in excess of 5%. The extent of the decline in growth can be seen on Exhibit I, ARIZONA WAGE AND SALARY EMPLOYMENT. This exhibit compares January 1985 with recently announced figures for November 1985. In January 1985, total wage and salary employment was 8.8% above January one year before. By November, this growth was down to 4.4% above November one year ago. This change is even more pronounced in the important goods producing sectors of Manufacturing, Mining and Construction.

Manufacturing employment started 1985 9.2% higher than January the year before. By November 1985, this growth was down to 2.2%. Employment (not seasonally adjusted) has declined in three of the five most recent months.

Construction employment began 1985 at a level 20.1% above the same month one year ago. This increase is down to 5.2% in November, a decline of 14.9 percentage points. Using non-seasonally adjusted numbers, construction employment peaked at the historic high of 111,100 jobs in June 1985 and has since shown decreases for four of the five subsequent months.

The Mining sector started in January 1985 12.0% below January of 1985 and by November had declined further to a negative 14.1%.

A dichotomy has developed in the U.S. economy. Domestic demand (spending by consumers, business investment in plant and equipment, and government spending) has been stronger but this demand has been met, in large part, by foreign producers. This is the result of the price advantage of foreign goods caused by the strong U.S. dollar. As a result, the goods-producing sectors (Manufacturing, Mining and Construction) have experienced a deterioration in their markets while the service producing sectors have enjoyed strong, although slower, growth.

This has been reflected in Arizona where the goods-producing sectors have plunged from a growth rate of 11.6% in January to 2.5% in November. The service-producing sectors, although declining somewhat from 7.9% in January to 5.0% in November have so far maintained a more stable and stronger growth.

Exhibit I

ARIZONA WAGE AND SALARY EMPLOYMENT

	January 1985		November 1985 1/	
	Employment	% Change 2/	Employment	% Change 2/
Manufacturing	178,500	9.2%	182,500	2.2%
Mining	12,500	(12.0)	11,000	(14.1)
Construction	103,500	20.1	109,000	5.2
Transp., Communications, etc.	62,200	5.8	64,000	3.1
Trade	301,300	9.2	314,700	4.4
Finance, Insurance, etc.	73,700	7.4	79,500	8.6
Services	284,800	10.4	300,100	5.9
Government	209,100	3.6	227,800	4.0
TOTAL	1,225,600	8.8%	1,288,600	4.4%

1/ Preliminary

2/ Percentage change column shows change from corresponding month in prior year.

The Manufacturing sector has been hurt by a slump in computer sales and by heightened foreign competition, which impacts on a large number of high technology jobs in Arizona. In general, Arizona manufacturing has been adversely affected by the strong U.S. dollar. Defense and aerospace have been doing well and are offsetting some of the sluggishness in other areas of Manufacturing. We believe that the computer industry slump has bottomed out and this, together with the continuing decline of the dollar are positive factors for FY 1987. An offsetting factor in FY 1987 may be in defense-related employment. Growth in this area may be slow and, beyond our forecast period, will decline if the Gramm-Rudman approach to federal deficit reduction is effective. In general, we believe that the period of reduced growth will end in FY 1986 and that employment growth in FY 1987 will be at the 4.2% level.

Employment in Mining has dropped from a high of 27,600 in July of 1974 to 11,000 jobs in November of 1985, less than 40% of the high employment. Our forecast assumes minor increases in production and prices, however, no significant upturn in mining is expected.

As was noted earlier, Construction employment peaked in June at 111,100 jobs and since then four of the five months have shown decreases. Office space is overbuilt as is multi-family housing. Construction in these areas will be stagnant until occupancy rates improve. While Construction employment will still be at a high level, we expect further declines in FY 1986. FY 1987 will be relatively flat with an increase of 1.9%.

Trade employment, although currently slowing in growth, is one of our largest sectors, providing 314,700 jobs in November 1985. We expect Trade to grow by 4.9% in FY 1986, with a 4.6% increase in FY 1987.

The Services sector is still relatively strong, with a 5.9% increase in November 1985, although its growth is also slowing. Our forecast is for an average of 6.0% growth in FY 1986 and 4.7% in FY 1987.

Exhibits II and III summarize the staff view of the significant positive and negative factors for fiscal years 1986 and 1987. An important aspect of the Arizona economy, in the last half of FY 1986, should be the end of the decline in the computer and semi-conductor industries. Although FY 1986 will see an end to the decline, activity will be at a low level. In FY 1987, we anticipate a resumption of growth in these industries. In both years, tourism will be strong due to (1) the impact of new destination resorts and (2) more foreign and American tourists as a result of the declining value of the dollar. It is likely that this latter effect will be more pronounced in FY 1987.

Exhibit II

ARIZONA OUTLOOK - FY 1986

FY 1986 Summary: No significant deviation from the current pattern of relatively sluggish growth in major sectors of the Arizona economy.

FY 1986 :

Positive Factors	Negative Factors
1) End of decline in computer and semi-conductor industries	1) Construction industry will not contribute much to growth
2) Strong growth during year in Missiles and Aerospace	2) Overbuilt condition in multi-family housing and in office building
3) Expected strong retail sales	3) Low level of activity in computer and semi-conductor industries
4) Continued high level of activity in Construction sector	4) Arizona mirrors the sluggishness of the U.S. economy
5) Strong Services sector	
6) Strong tourism aided by impact of new destination resorts	
7) Wealth effects of strong stock market	

Exhibit III

ARIZONA OUTLOOK - FY 1987

FY 1987 Summary: The Arizona economy should reflect anticipated improvements in the national economy including declining long term interest rates and a declining U.S. dollar.

FY 1987 :

Positive Factors	Negative Factors
1) Resumption of growth in computer and semi-conductor industries	1) Reduction of growth in U.S. defense expenditures and possible decline due to the Gramm-Rudman approach to deficit reduction
2) Reduced long term interest rates should have a positive effect on housing	2) Possible resumption of growth in inflation
3) Increased competitiveness of Arizona industries due to declining value of the U.S. dollar	
4) Declining value of dollar should bring in more foreign and American tourists. New destination resorts will also aid tourism	
5) Strong Services sector	

THE ARIZONA ECONOMY
(Continued)

Exhibit IV, shows the staff forecast for four key Arizona economic variables. We expect growth in Arizona personal income to decline somewhat from the 11.9% increase in 1985 to an increase of approximately 9% in both FY 1986 and FY 1987.

Retail sales are expected to be strong in both years, reflecting growth comparable to that in Arizona personal income.

Population growth is forecast to continue at a high level, although down from the 4.3% increase in FY 1985.

A decline in the unemployment rate is expected in FY 1987 as a result of improvements in the Arizona economy.

Exhibit V, ARIZONA WAGE AND SALARY EMPLOYMENT, PERCENT GROWTH OVER PRIOR YEAR, shows anticipated employment growth in each sector for FY 1986 and FY 1987 together with actual growth for FY 1985.

Chart I is a bar chart which compares growth rates for current and constant dollar Arizona personal income for 1976 through 1987.

Chart II is a bar chart which compares growth rates for U.S. and Arizona personal income for 1975 through 1987.

Chart III is a line graph which compares U.S. and Arizona unemployment rates for 1974 through 1987.

Exhibit IV

FORECAST OF KEY ARIZONA ECONOMIC INDICATORS

	FY 1985 Actual	FY 1986 Forecast	FY 1987 Forecast
Personal Income 1/	11.9	9.0	8.6
Retail Sales 1/	8.9	9.9	9.3
Population 1/ 2/	4.3	3.5	3.2
Unemployment Rate	5.2	6.7	6.0

1/ Rates of Change
2/ Population as of July 1, the start of the fiscal year.

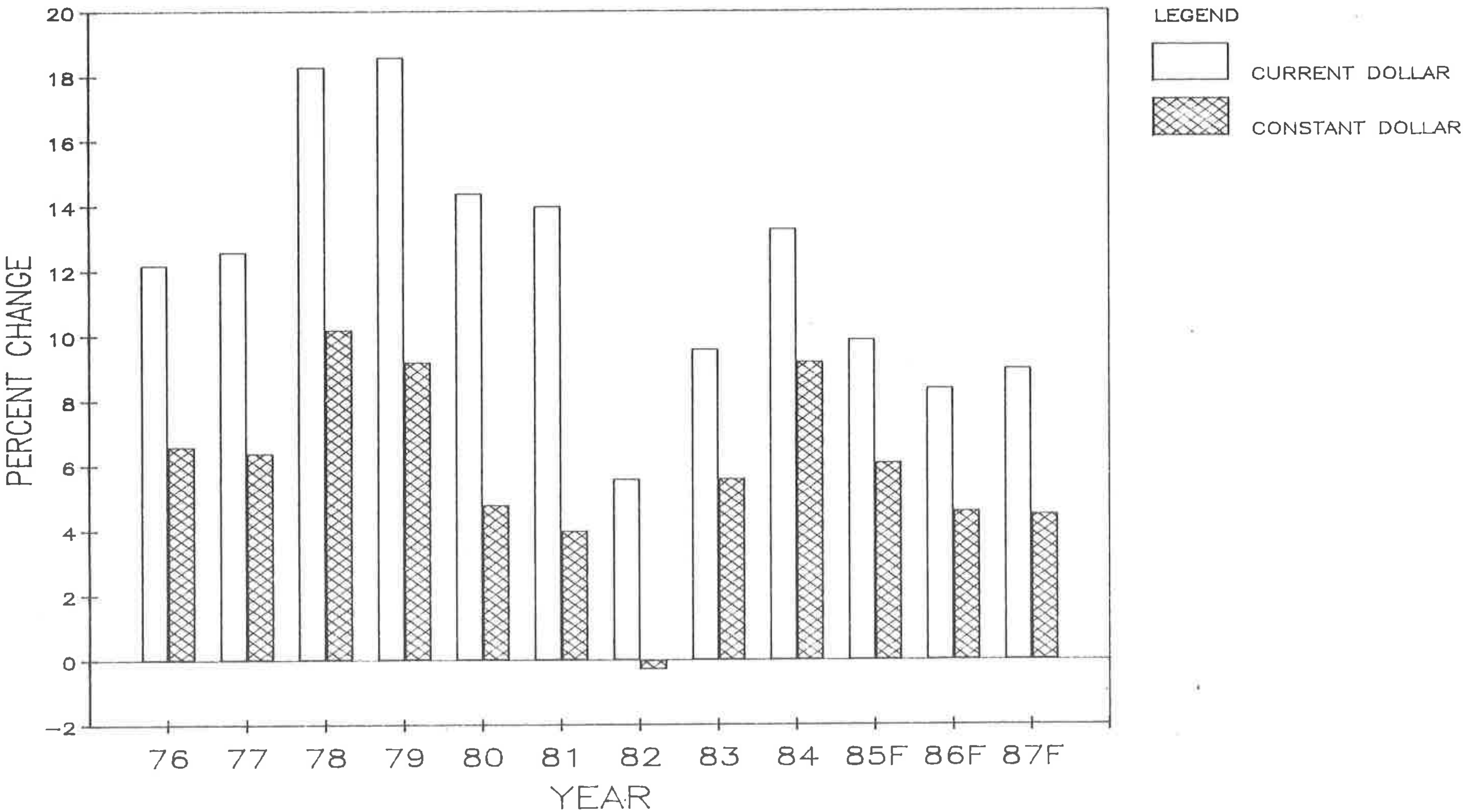
Exhibit V

ARIZONA WAGE AND SALARY EMPLOYMENT
PERCENT GROWTH OVER PRIOR YEAR
BASED ON AVERAGE EMPLOYMENT

	FY 1985 Actual	FY 1986 Forecast	FY 1987 Forecast
Manufacturing	9.0%	3.9%	4.2%
Mining	(10.7)	(11.2)	2.0
Construction	17.9	4.3	1.9
Trans., Communications, etc.	6.0	4.1	4.3
Trade	8.8	4.9	4.6
Finance, Insurance, etc.	7.6	9.5	8.5
Services	10.3	6.0	4.7
Government	2.7	3.6	2.5
TOTAL	8.3	4.8	4.2

CHART I

ARIZONA PERSONAL INCOME CURRENT and CONSTANT DOLLAR GROWTH RATES



PREPARED BY: JLBC STAFF, 1/3/86

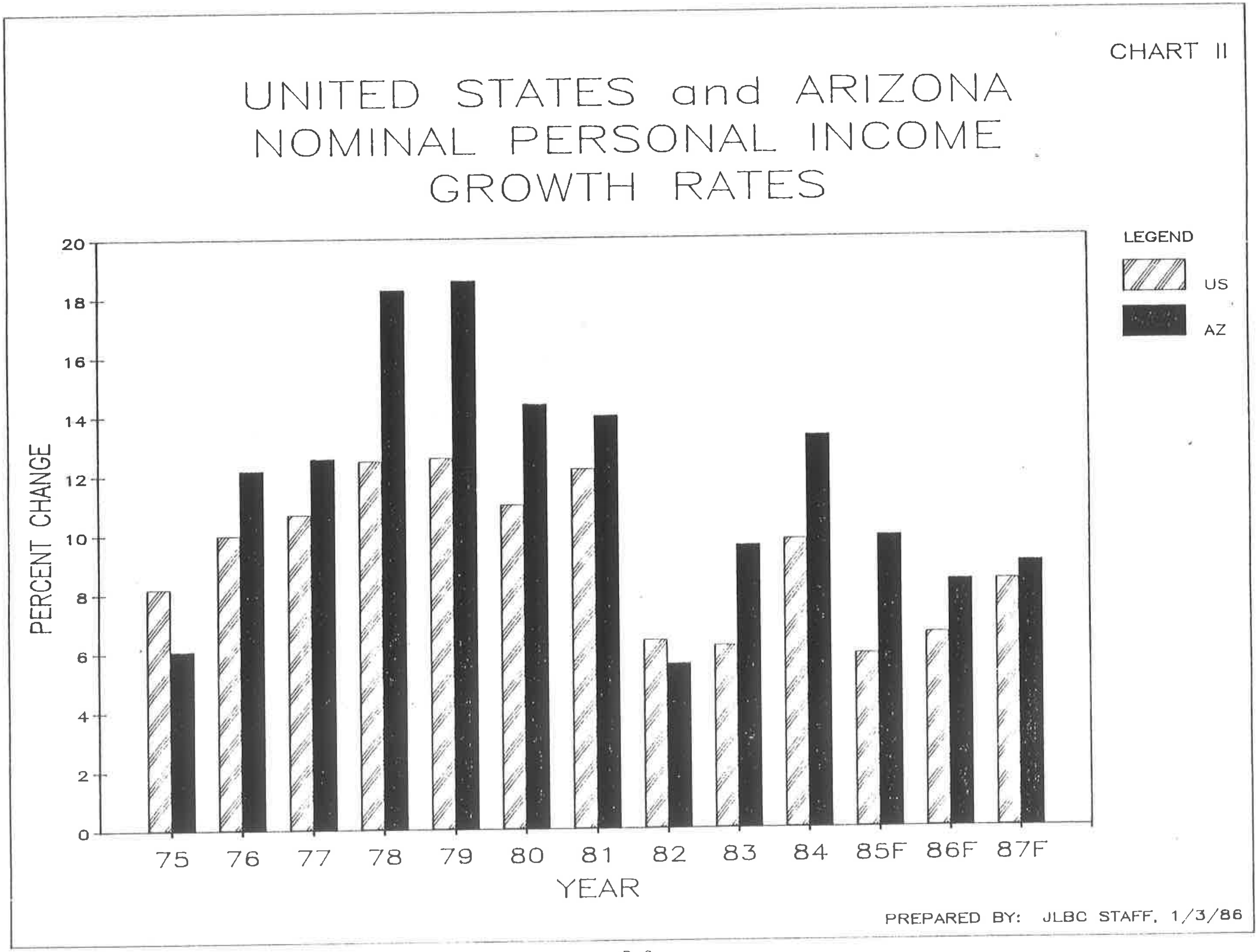


CHART II
UNITED STATES and ARIZONA
NOMINAL PERSONAL INCOME
GROWTH RATES
LEGEND
US
AZ
PERCENT CHANGE
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6
8
10
12
14
16
18
20
75
76
77
78
79
80
81
82
83
84
85F
86F
87F
YEAR
PREPARED BY: JLBC STAFF, 1/3/86

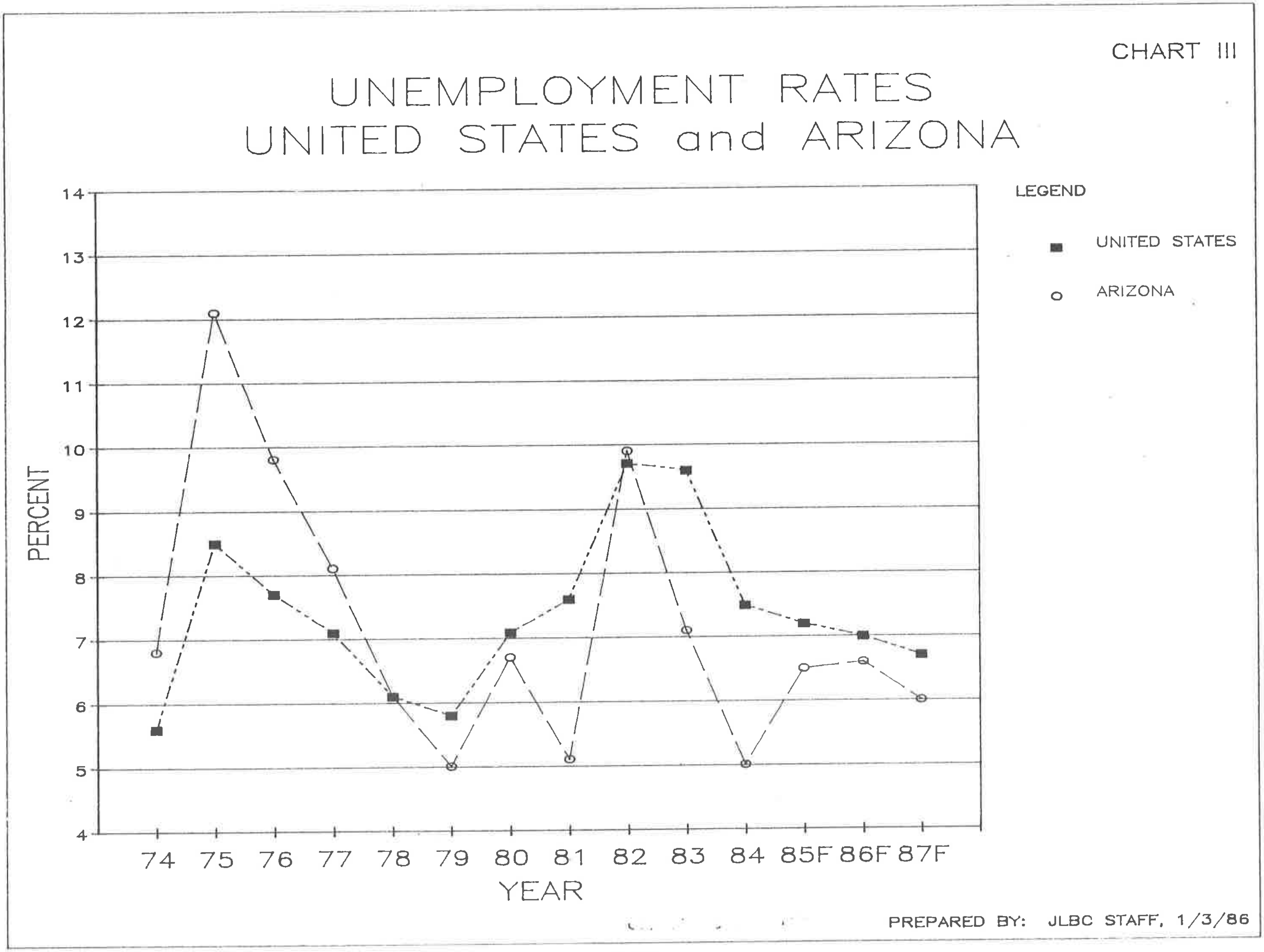

CHART III
UNEMPLOYMENT RATES
UNITED STATES and ARIZONA
LEGEND
UNITED STATES
ARIZONA
PERCENT
14
13
12
11
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8
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5
4
74 75 76 77 78 79 80 81 82 83 84 85F 86F 87F
YEAR
PREPARED BY: JLBC STAFF, 1/3/86

GENERAL FUND REVENUE

The comments on General Fund revenue refer to Exhibit I, STATEMENT OF PROJECTED NEW REVENUE, LEGISLATIVE STAFF ESTIMATE. In FY 1985, General Fund new revenue increased by 16.1%. After adjusting for (1) the fact that the Business Transaction Tax was not fully effective in FY 1984 and (2) a nonrecurring FY 1984 transfer of $25.0 million to the counties from the State's share of the Sales Tax and (3) a nonrecurring transfer in excess of $25 million from the Tax Protest Fund to the General Fund, the increase was 11.9%. Our forecast reflects the slower growth of the Arizona economy in FY 1986, showing an increase in Total New Revenue of 8.0%, down from 11.9% the year before. We anticipate an increase to 9.2% in FY 1987.

The Sales and Use Tax category showed an increase of 25.3% in FY 1985, but after adjustments, the increase becomes 13.0%. This category also reflects the slower growth of the Arizona economy with an increase of 8.3% in FY 1986 and 7.8% in FY 1987.

Income Tax collections will show an increase of 10.4% in FY 1986, down from the 15.4% increase in FY 1985. The decrease in growth is due to a decline in Corporate Income Tax collections as well as slower growth in the individual income tax. As the Corporate Income Tax Collections become stronger, we expect the Income Tax to show stronger growth in FY 1987 at 13.4%.

Property Taxes show a negative growth in FY 1985 of 31.5% due to reduction of the Property Tax rate from $.75 to $.40 per hundred dollars of assessed valuation. There is zero growth in FY 1986 due primarily to (1) a decline in assessment ratios for mines, utilities and railroads, (2) significant declines in mine valuations and (3) the rate reduction not becoming fully effective on unsecured property until FY 1986. In FY 1987, the Property Tax resumes a more normal growth of 10%.

Growth in Insurance Tax collections is expected to be slow over the forecast period due to the reduced growth in the Arizona economy and to the large increases in the Guaranty Funds assessments, which are deductible for tax purposes.

Collections for Motor Vehicle License Taxes deposited in the General Fund are expected to decline in FY 1986 and FY 1987 because of the diversion of money to the Highway Fund. Although there is some question, we are assuming that the intended effective date of January 1, 1986 for the start of diversion of funds to the Highway Fund will hold.

Interest collections are reduced in FY 1985 due to declining interest rates. A modest increase in collections is expected in FY 1986.

GENERAL FUND REVENUE
(Continued)

In fiscal 1985, Transfers and Reimbursements show a 74.1% decrease from FY 1984 due to a nonrecurring transfer of over $25 million from the Tax Protest Fund to the General Fund.

The following exhibits and charts follow this narrative:

Exhibit I, STATEMENT OF PROJECTED NEW REVENUE, LEGISLATIVE STAFF ESTIMATE has been discussed previously in some detail. Essentially, the exhibit compares each of the three years shown with the preceding year.

Exhibit II, STATEMENT OF PROJECTED NEW REVENUE, COMPARISON OF EXECUTIVE AND LEGISLATIVE STAFF ESTIMATES shows that, although there are individual differences (the major ones being FY 1987 Sales and Use Taxes and Income Taxes), the forecasts of the Legislative Staff and the Executive are remarkably similar in total. The Legislative Staff forecast exceeds that of the Executive by $2.88 million in FY 1986 and by $10.02 million in FY 1987. Amounts shown for the Executive are without reduction for their proposed income tax credit for child and dependent care expenses. They estimate that this credit would aggregate $15.0 million. Inclusion of this credit would increase the amount by which the Legislative Staff forecast exceeds that of the Executive for FY 1987 to $25.02 million.

Chart I, shows in graphic form, the percent growth in FY 1987 over FY 1986 for significant categories of General Fund revenue based on the Legislative Staff estimates.

Chart II shows, for FY 1987, major categories of General Fund revenue as a percent of total New Revenue.

Chart III shows, for 12 years, dollars of General Fund revenue as a bar chart and percent change as a line graph. In terms of percent change Arizona has had strong years and years which exhibited very low or negative growth. Fortunately, years of the latter category are rare in Arizona. It should be noted that the Fiscal Years 1979 through 1982 were years when the CPI showed at or near double digit inflation. The Legislative Staff estimate shows "mid-stream" growth in FY 1986 and FY 1987 and is consistent with our current and forecasted low inflation economic environment.

Exhibit I

STATE OF ARIZONA
GENERAL FUND
STATEMENT OF PROJECTED NEW REVENUE
LEGISLATIVE STAFF ESTIMATE
(Thousands)

	Actual FY 1985		Forecast FY 1986		Forecast FY 1987	
	Amount	% Change	Amount	% Change	Amount	% Change
Taxes						
Sales and Use	$1,070,244.7	25.3%	$1,159,245.0	8.3%	$1,250,233.0	7.8%
Income	730,875.0	15.4	807,000.0	10.4	915,209.0	13.4
Property	54,989.2	(31.5)	55,000.0	0.0	60,500.0	10.0
Luxury	68,234.9	1.9	70,500.0	3.3	73,300.0	4.0
Insurance Premium	49,566.0	13.9	53,500.0	7.9	56,000.0	4.7
Motor Vehicle License	50,155.4	18.1	48,500.0	(3.3)	43,900.0	(9.5)
Pari Mutuel	7,722.1	7.8	8,300.0	7.5	9,047.0	9.0
Estate	14,758.0	17.7	13,800.0	(6.5)	15,000.0	8.7
Other Taxes	3,461.3	0.5	5,163.0	1.5	5,398.1	4.6
Sub-Total - Taxes	2,050,006.6	17.6	2,221,008.0	8.3	2,428,587.1	9.3
Other Revenues and Transfers						
Licenses, Fees, Permits, Sales, Services	27,242.3	10.4	31,300.0	14.9	34,250.0	9.4
Interest	27,217.7	26.6	23,680.0	(13.0)	24,440.0	3.2
Other Miscellaneous	15,233.9	22.8	16,025.0	5.2	17,507.0	9.2
Transfers and Reimbursements	7,802.1	(74.1)	7,000.0	(0.1)	6,000.0	2.0
Sub-Total - Other Revenues	77,496.0	(12.7)	78,005.0	0.7	82,197.0	5.4
Total New Revenue	$2,127,502.6	16.1%	$2,299,013.0	8.0%	$2,510,784.1	9.2%

Prepared by: JLBC Staff
Date: January 3, 1986

Exhibit II

STATE OF ARIZONA
GENERAL FUND
STATEMENT OF PROJECTED NEW REVENUE
COMPARISON OF EXECUTIVE AND LEGISLATIVE STAFF ESTIMATES
(Thousands)

	FY 1986			FY 1987		
	Executive Estimate	Leg. Staff Estimate	Difference	Executive Estimate	Leg. Staff Estimate	Difference
Taxes						
Sales and Use	$1,155,000.0	$1,159,245.0	$ 4,245.0	$1,262,900.0	$1,250,233.0	$(12,667.0)
Income	810,880.0	807,000.0	(3,880.0)	887,900.0	915,209.0	27,309.0
Property	54,200.0	55,000.0	800.0	64,500.0	60,500.0	(4,000.0)
Luxury	70,500.0	70,500.0	-0-	73,200.0	73,300.0	100.0
Insurance Premium	56,500.0	53,500.0	(3,000.0)	57,000.0	56,000.0	(1,000.0)
Motor Vehicle License	46,300.0	48,500.0	2,200.0	45,600.0	43,900.0	(1,700.0)
Pari Mutuel	8,339.9	8,300.0	(39.9)	9,467.1	9,047.0	(420.1)
Estate	15,000.0	13,800.0	(1,200.0)	16,000.0	15,000.0	(1,000.0)
Other Taxes	4,900.0	5,163.0	263.0	5,000.0	5,398.1	398.1
Sub-Total - Taxes	2,221,619.9	2,221,008.0	(611.9)	2,421,567.1	2,428,587.1	7,020.0
Other Revenues and Transfers						
Licenses, Fees, Permits, Sales and Services	30,813.7	31,300.0	486.3	34,585.6	34,250.0	(335.6)
Interest	22,000.0	23,680.0	1,680.0	22,000.0	24,440.0	2,440.0
Other Miscellaneous	16,699.2	16,025.0	(674.2)	17,609.0	17,507.0	(102.0)
Transfers and Reimbursements	5,000.0	7,000.0	2,000.0	5,000.0	6,000.0	1,000.0
Sub-Total - Other Revenues and Transfers	74,512.9	78,005.0	3,492.1	79,194.6	82,197.0	3,002.4
Total New Revenue	$2,296,132.8	$2,299,013.0	$ 2,880.2	$2,500,761.7	$2,510,784.1	$ 10,022.4

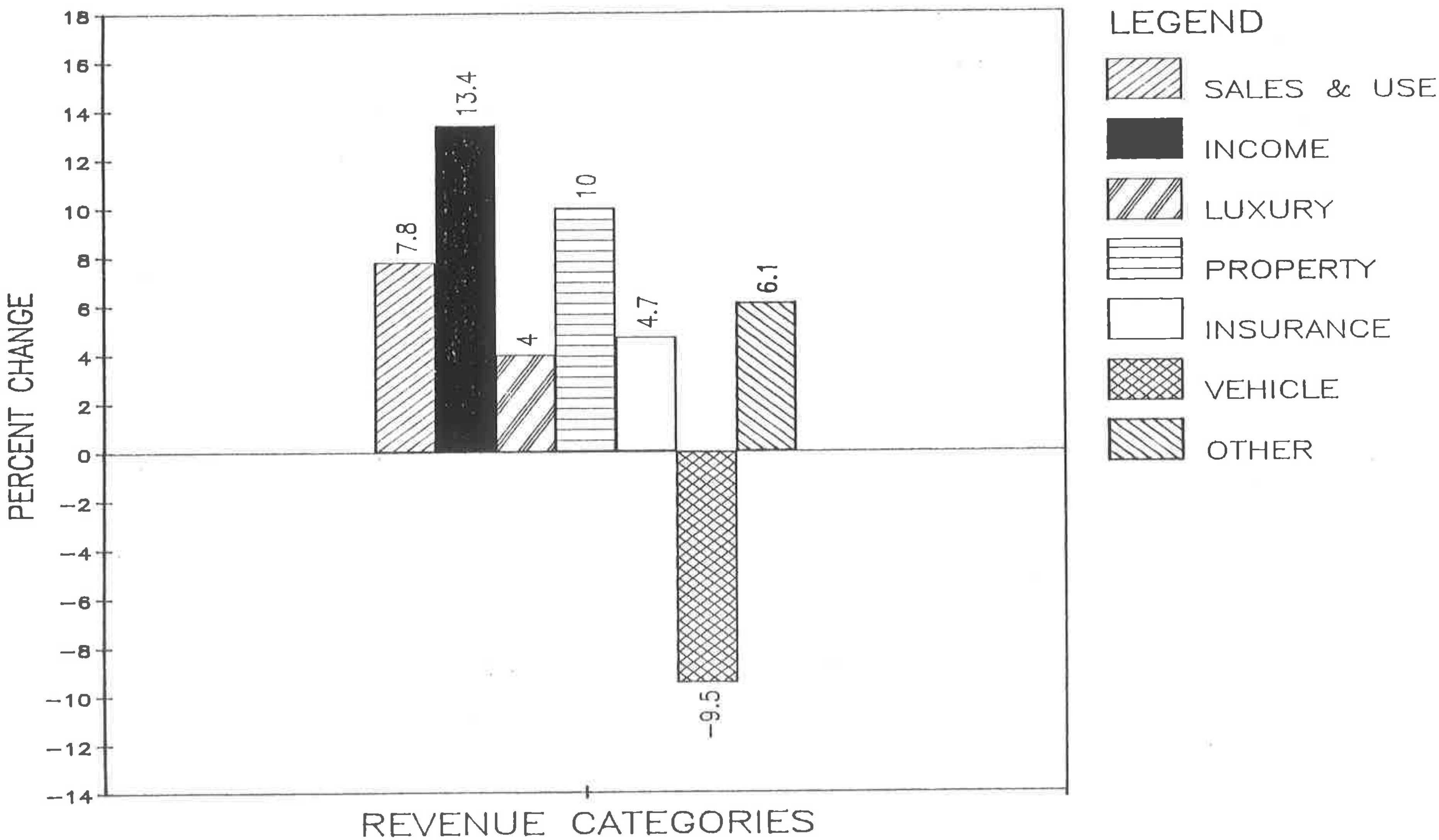
Prepared by: JLBC Staff
Date: January 7, 1986

CHART I

FY 1987 GENERAL FUND NEW REVENUE

PERCENT CHANGE FROM PRIOR YEAR

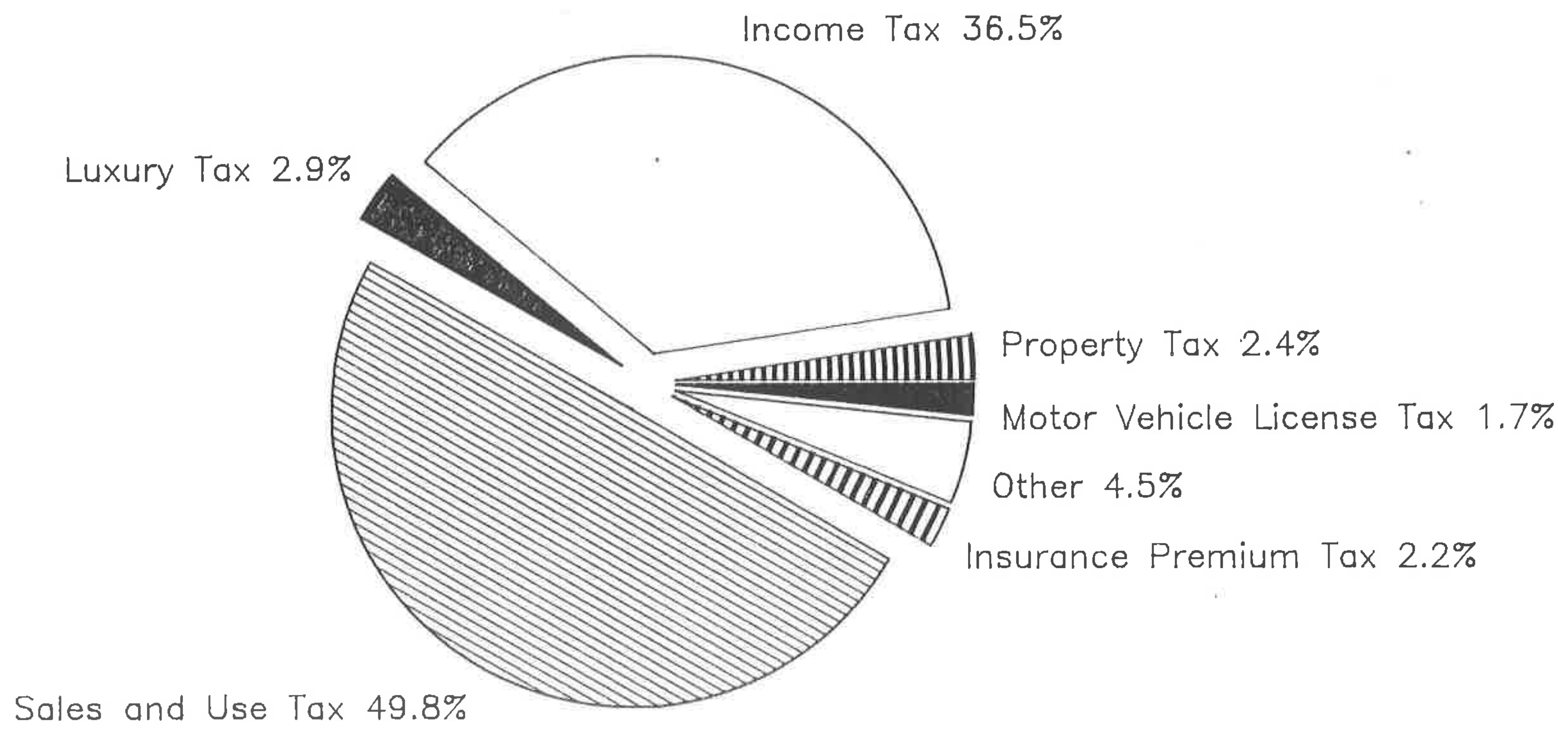
Legislative Staff Estimate



PREPARED BY: JLBC STAFF, 1/8/86

CHART II

General Fund New Revenue Sources as a Percent of Total Legislative Staff Estimate

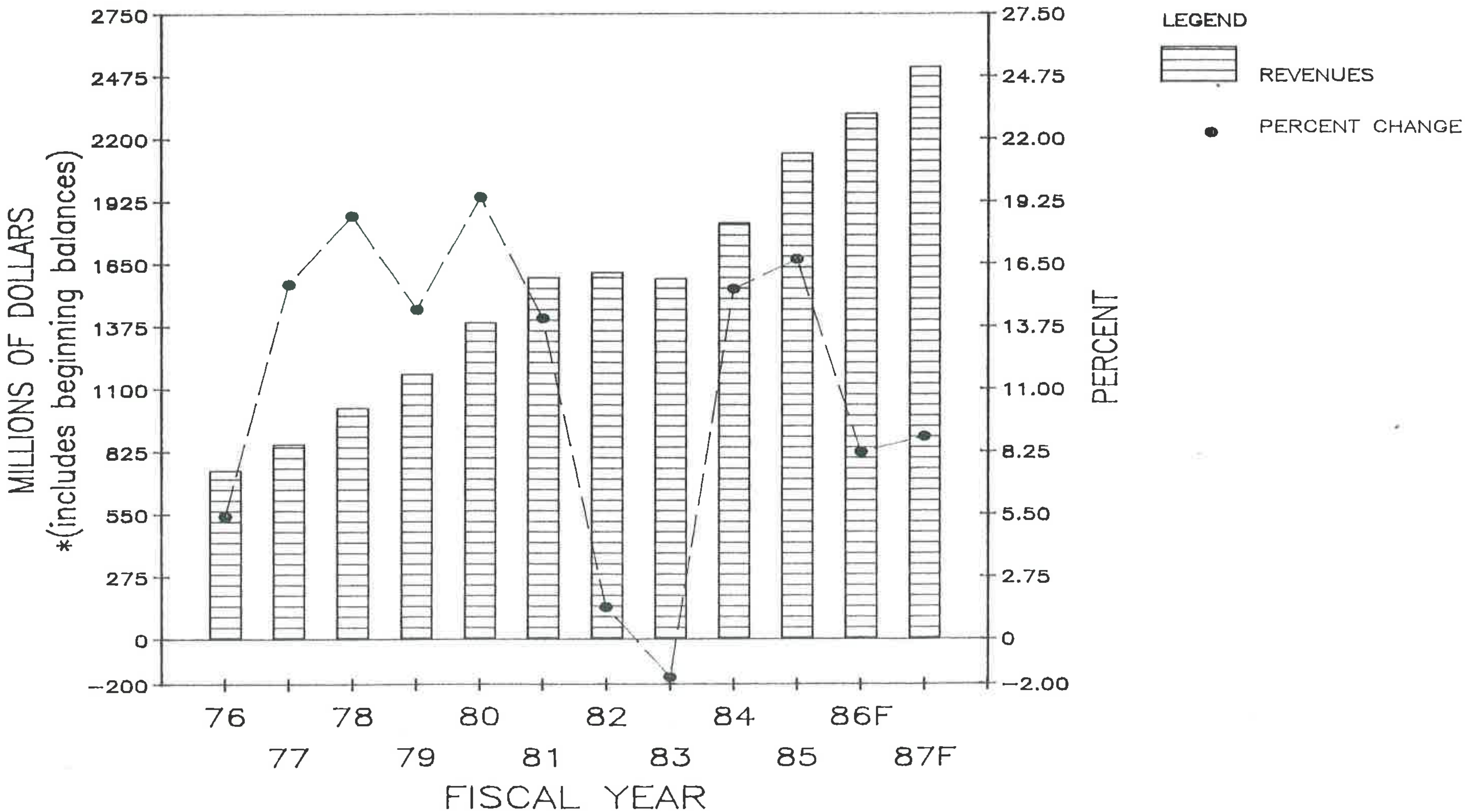


FY 1987

PREPARED BY: JLBC STAFF, 1/8/86

CHART III

GENERAL FUND
REVENUE AVAILABLE*
Legislative Staff Estimate



PREPARED BY: JLBC STAFF, 1/8/86