

The Quality of Arizona’s Budget Process

Highlights

- *According to a May 2015 study by Federal Funds Information for States (FFIS), Arizona’s budget process ranked 30th among all states. Arizona’s greatest budget process strengths were its stabilization fund and the understandability of the budget, and its greatest weaknesses were in balanced budget requirements and the governor’s ability to reduce spending*
- *Arizona lost the majority of its points for not having a constitutional requirement for a balanced budget. However, certain constitutional and statutory provisions limit Arizona’s ability to incur budget deficits, and Arizona’s long term debt remains lower than most other states*
- *If the report had taken into account Arizona’s constitutional and statutory restrictions on budget deficits, Arizona’s ranking could have jumped to as high as 7th overall*

Federal Funds Information for States (FFIS) published a report in May 2015 that ranked the quality of Arizona’s budget process 30th among all states. Arizona’s budget process strengths were in stabilization funds and understandable finances. Arizona received a perfect score in the stabilization funds category, and received the 5th highest score of all states in the understandable budgets and finances category. Arizona’s budget process weaknesses were in balanced budget requirements and ability to reduce spending. Arizona was 1 of 4 states to receive no points in the balanced budget requirements category, and its score in the ability to reduce spending category was slightly below average.

FFIS is a program sponsored jointly by the National Conference of State Legislatures (NCSL) and the National Governors Association (NGA). FFIS obtained data for this analysis from a survey conducted by the National Association of State Budget Officers (NASBO) in spring 2015 called *Budget Processes in the State*.

Category	FFIS Budget Process Quality Rankings			
	Maximum Score	U.S. Average	Arizona Score	Arizona Ranking
Balanced budget requirements	20	14	0	T-47th
Ability to reduce spending	25	16	15	T-16th
Stabilization funds	20	19.9	20	T-1st
Understandable Finances	<u>35</u>	<u>19</u>	<u>30</u>	<u>5th</u>
Total	100	68.8	65	30th

Balanced Budget Requirements

Arizona received 0 out of 20 possible points in the balanced budget requirements category. Points were allocated to states that maintain a constitutional requirement to submit, enact, and sign a balanced budget.

Nearly all states maintain requirements for a balanced budget in their constitutions or in statute. Balanced budget provisions are designed to limit the extent to which states can incur debt. According to NCSL, Vermont is the only state that does not have any constitutional or statutory requirements for a balanced budget. NASBO reports that other states, including Arizona, do not have balanced budget requirements. Whether states are considered to have a balanced budget requirement depends on the specific criteria that each source uses to define a balanced budget, but there is no consensus among experts about how a balanced budget requirement should be legally defined.

The Arizona Legislative Council states that “The Arizona Constitution does not contain a specific requirement that the Legislature adopt a balanced budget each year,” but that “the Constitution makes it difficult or impossible to finance a long-term deficit.” The Constitution requires that the Legislature submit a budget that is sufficient to meet the state’s necessary expenses, but if the Legislature unintentionally spends more than it generates in revenue, the state is allowed to carry over the deficit.

According to NASBO, Arizona is one of 11 states in which the Constitution allows the deficit to be carried over to the next year. In the FFIS report, states did not lose points in the balanced budget category if their constitution allows deficits to be carried over. There were 6 of those 11 states that received perfect scores in the balanced budget requirements category.

Arizona’s Constitution requires that any deficit must be paid in the following fiscal year. The Constitution permits the Legislature to issue no more than \$350,000 in general obligation bonds to finance a deficit, limiting the state’s capacity to run long-term budget deficits. According to NASBO, only 2 states have lower constitutional limits on general obligation debt. Although the Arizona Constitution does not provide an enforcement mechanism to balance the budget, the Legislative Council reports that it found “no case from any state that addresses the remedy for [violating balanced budget requirements].”

Arizona also maintains certain balanced budget requirements in statute. § A.R.S. 35-111 states that “the Governor shall submit to the legislature a budget containing...all monies and revenues estimated to be available therefor, together with an explanation of the basis of the estimates and recommendations as to proposed legislation, if any, which the governor deems necessary to provide revenues sufficient to meet the proposed expenditures.” The Governor must therefore submit a budget to the Legislature that is balanced.

In states with explicit constitutional balanced budget requirements, these requirements typically only apply to General Fund monies. Borrowing to finance capital expenditures is usually exempted from the legal requirement for a balanced budget, meaning that even states with explicit constitutional balanced budget requirements can still accumulate significant debt. Using data from the Pew Charitable Trusts June 2015 report called *Fiscal 50: State Trends and Analysis*, we estimate that in FY 2012, the average state had \$2,250 in state debt per capita excluding unfunded pension liabilities. In FY 2012, Arizona’s state debt per capita of \$1,625 was lower than the national average.

The lack of explicit constitutional requirement for a balanced budget likely precludes a full score of 20. However, If Arizona had been granted 15 out of 20 points in this category to take account of Arizona’s constitutional and statutory restrictions on budget deficits, Arizona’s overall budget process ranking would have jumped from 30th to 7th. If Arizona had received only half of the points in this category, Arizona’s ranking would have been 13th instead of 30th.

Ability to Reduce Spending

In the FFIS report, Arizona received 15 out of 25 points for the ability of the Governor to reduce spending. The average score for this category was 16 points. Arizona received points for the Governor's line item veto power and the frequency of fund allotments, but lost points for not granting the Governor the power to make mid-year reductions to the budget without legislative approval.

Many states provide the executive branch with powers to reduce spending. These powers include the line item veto, and the ability to reduce spending on the enacted budget (sometimes called "impoundment" or "unallotment"). According to NASBO, the Governor retains the line item veto power in 41 states. There are 33 states that allow the Governor to withhold funds from executive branch agencies.

The line item veto allows the governor to veto one or more items in an appropriations bill while still approving of the rest of the bill. The Arizona Constitution permits the Governor to use the line item veto on any bill that "contains several items of appropriations of money." The Governor may veto an appropriation, but may not replace it with a different amount.

Many states also grant governors the power to reduce the enacted budget to help the governor balance the budget without legislative approval in the event of unanticipated revenue shortfalls. Arizona is one of 15 states in which the governor does not retain this power. The Governor may provide guidance to agencies that they prepare for mid-year reductions, but any changes to the enacted budget must eventually be ratified by the Legislature.

Only 13 states give governors unlimited power to reduce spending without legislative approval, and 22 states impose restrictions on that power. These restrictions include exempting certain agencies from gubernatorial budget cuts, requiring the governor to impose across-the board cuts instead of deciding cuts on an agency-by-agency basis, or imposing a percentage limit on the amount of funds that can be reduced. There is no consensus on the appropriate scope of gubernatorial power in reducing the enacted budget. Other mechanisms, including budget stabilization funds, provide an alternative means to address budget shortfalls.

Stabilization Funds

In the FFIS report, Arizona received 20 out of 20 points in the category of stabilization funds. Arizona is one of many states that maintains a rainy day fund in which revenues are put aside during periods of strong economic growth to be used to help close budget shortfalls caused by a recession. The FFIS report awarded points to states that had a rainy day fund, and maintained a balance in the fund equal to at least 5% of general fund revenues. There were 31 states that received a perfect score in this category.

Arizona's Budget Stabilization Fund (BSF) receives deposits or withdrawals based on a formula that accounts for the growth rate in Arizona personal income. The Arizona Legislature must authorize any deposits or withdrawals, so the actual changes in the fund balance may not correspond with the formula. The Legislature has suspended the formula for many years. Currently, Arizona's BSF balance equals 5.3% of General Fund revenues. The total balance of the fund may not exceed 7% of the current year's General Fund revenues.

NASBO recommends that states maintain budget stabilization funds equal to at least 5% of revenues, but the appropriate percentage to save for each state may vary depending on the volatility of each

state's revenue sources. States with more volatile revenue sources will, on average, have larger budget shortfalls during recessions, and may therefore require larger withdrawals from the budget stabilization fund. According to a 2014 Report by the Pew Charitable Trusts, Arizona had the 7th most volatile revenue collections of any state. While budget experts generally agree that states should not save less than 5% of General Fund revenues, there is no consensus about how much additional revenue should be set aside by states with relatively volatile revenues.

Understandable Finances

In the FFIS Report, Arizona received 30 out of 35 points for the understandability of its budget. Points were awarded to states that published budget documents that demonstrated the long term impact of the current year budget, and that were transparent about programs receiving state monies. Arizona's score was the 5th highest of all states.

Because state budgets in the current year can affect future spending levels, states typically illustrate the long-term impacts of the current year budget in their budget documents. For example, according to NASBO, 36 states (including Arizona) publish multi-year forecasts of the budget. Arizona publishes spending forecasts for 2 years beyond the budgeted fiscal year. Additionally, 17 states (including Arizona) published the state's annual required contribution (ARC) to the state pension plan, which shows whether states are meeting actuarial recommendations for funding their pensions for state employees. Publishing the ARC helps illustrate to the public and policymakers how the current year budget is impacting pension costs in future budgets.

Budget documents may also improve public understanding of the budget by providing information about the programs that state monies are funding. For example, NASBO tracks whether states publish program descriptions, caseloads, the number of state employees working for each program, and program performance measures. The Office of Strategic Planning and Budgeting (OSP) and JLBC budget documents provide some combination of all four of these categories of information.

Arizona lost points for not appropriating federal funds and certain other funds. While Arizona does not appropriate federal funds, it does establish expenditure authority limits for agencies that receive federal monies that cap the amount of federal monies that each agency may spend.