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ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER

**VOLUME 63
NUMBER 2**

FEB/MARCH 2003

Budget deficit provides opportunities for better financial management

Arizona's budget crisis is severe and will not be resolved without real leadership from state policymakers. The standard practice in recent years of supporting higher government spending-while at the same time opposing tax increases-has collided with the realities of the economic cycle and that is not necessarily a bad thing.

Growing government is considerably easier than cutting it. Downturns in the economy, followed by declines in the growth rates of tax revenue, are the only times government programs are scrutinized and spending re-prioritized.

Protected Spending

Complicating policymakers efforts to cut spending is the prevailing attitude that the power they exercise over the budget has been greatly diminished. It is true that a series of recent initiatives has created some "voter protected" spending. However, in an effort to protect budgets, as well as shift responsibility for the problem to the voters, some state policymakers have adopted an expanded interpretation of programs that are voter protected.

Another tool used by those trying to limit the options for restraining spending increases is to argue that most of the budget (63%) is "**statutorily mandated**." Although true, this argument demonstrates much of what is wrong with the process of determining the state budget each year. While "**statutorily mandated**" spending does create a minimum funding expectation on the part of the recipient, characterizing these budget guidelines as mandates ignores that most are subject to annual legislative review and change.

Simple Math

Seventy-eight percent of Arizona's state general fund budget is directed to education, low-income health programs, and prisons.

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While many have criticized the Joint Legislative Budget Committee Chairman's budget for including all the budgets in the overall resolution to the crisis, the simple truth is that this huge deficit cannot be balanced responsibly by focusing all the reductions on twenty-eight percent of the budget.

Arizona's funding formulas allow for students to be double and sometimes triple counted on the one hand and provide funding for students that don't exist on the other.

After taking education, health care, and prison spending "off the table," there is \$1.3 billion left in the current Fiscal Year (FY) 2002-03 budget. The FY 2003-04 deficit is estimated as high as \$1.5 billion. More importantly, excluding education, health and welfare, and prisons simply because they are high priorities ignores the fact that each of these areas could be made more efficient and effective.

The Formulas

Last fall, the Arizona Fiscal Accountability Committee examined the funding formulas that drive the "statutorily mandated" spending and found many to be flawed.

For example, Arizona, despite having one of the fastest growing student populations in the United States, is extremely sloppy in the manner in which it counts students for funding purposes. Arizona's funding formulas allow for students to be double and sometimes triple counted on the one hand and provide funding for students that don't exist on the other. The Legislature has been aware of these problems for years. Opposition from the spending lobby, however, continues to throw obstacles in front of efforts to at least make sense out of the myriad of formulas and statutes that drive state spending.

The sad truth is that it takes a budget crisis to fix glaring flaws in government funding programs. To her credit, Governor Napolitano's FY 2003-04 budget recommendations call for the elimination of redundant funding for dual enrollment, in which high school classes — taught by high school faculty during the high school day — simultaneously qualify for both high school and community college credit. A student taking such a course is counted for state aid purposes by both the high school and the community college for the exact same seat time — as if there were two students in two separate locations. The Legislature's budget recommendations also include eliminating the double funding. In fact, the last three budget

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Update on key public finance bills

Although fewer bills than usual were introduced in this regular legislative session, numerous important bills affecting public finance and taxation have made their way into legislative committees this year. The following is a selected list of the most important proposed legislation on which ATRA has been engaged so far.

ATRA SUPPORTS

HB2357 & HB2358 schools; desegregation expenses (Huffman) Caps budgeted levies for desegregation and OCR at FY 2001-02 levels until FY 2005-06. Eliminates the 35% homeowner rebate for deseg/OCR levies. Also eliminates the ability to budget deseg/OCR monies for capital or transportation purposes. Creates more accountability reforms. *Awaiting Senate Education.*

SB1331 Truth in taxation (Martin) Prohibits a county, community college, city or town from levying primary property taxes in excess of the previous year levy, excluding new construction, if the jurisdiction fails to comply with TNT requirements (i.e., TNT hearing, publication of notice, etc.). *Awaiting House Ways & Means.*

SB1066 Sales tax increase; preexisting contracts (Martin) Provides that prime contractors that enter into contracts or written bids on or before the effective date or the date of the election of a tax rate increase are not affected by the increase. *Chapter 3.*

HB2094 Community colleges; declining enrollment (Gray L.) Changes the college state aid formula to include declines in enrollment as well as growth. *Held in House Education.*

HB2323 schools; excess utilities; phasedown (Graf) Legislation introduced on ATRA's behalf to phase excess utilities property taxes down until the elimination

of this budget category after FY 2008-09 pursuant to Prop. 301. *Held in House Rules.*

HB2356 Corporate income tax; sales factor (Huffman) Provides multistate businesses with the option of using a 100% weighted sales factor, phased in over five years, when calculating business income taxes as opposed to the double weighted sales factor currently in place. *Held in House Rules.*

SB1272 Bond election pamphlets; disclosure (Martin) Attempts to clarify the tax impact of proposed bond elections by including an example for each property type in the bond information pamphlets. *Awaiting House Ways & Means.*

HB2276 Schools; financial and compliance audits (Gray L.) Requires school districts not subject to the Single Audit Act of 1996 and that meet certain criteria to contract for a financial statement audit. Additionally, beginning in FY 2003-04, all audit contracts must include a systematic review of average daily membership. *Awaiting Senate COW.*

HB2248 Appropriation of federal monies (Pearce) Gives the legislature authority to appropriate noncustodial federal monies. *Vetoed.*

ATRA OPPOSES

HB2355 Hospital districts; funding (Carruthers) Same as SB 1207 Allows a hospital district with boundaries coterminous with a county's boundaries with a population of less than 45,000 to levy a transaction privilege tax by either unanimous approval of the board of directors or by resolution of the board to bring the question to a public vote, requiring majority approval of the voters. The rate cannot exceed 10% of the state rate (0.5%) and can only be levied for a maximum of four years. Requires the board to go back to the voters every four years for approval to continue levying the tax. *Held in House*

Rules.

HB2225 New construction; valuation (Jayne) Changes the date from September 30 to December 31 in which the assessor can make changes to the tax roll based on new construction, additions, deletions, etc. *Discussed and held in House Ways & Means.*

HB2383 county islands; annexation (Hanson) Changes the annexation laws for annexation of county land that has 80 acres or less and is surrounded by a city or town on at least three sides. Reverses the current process by requiring property owners affected by the annexation to opt-out of the annexation as opposed to opting-in through their approval. *Failed House 3rd Read.*

SB1026 K-3 overrides; governing board approval (Mead) Removes the voter approval requirement for K-3 overrides. *Held in Senate Finance.*

HB2435 local community development authority (Arnold) Allows governing bodies of one or more cities or towns, community college districts and county boards of supervisors to establish a Community Development Authority for the purpose of the development, construction and operation of historical, scientific, cultural, economic and open space facilities.

The Authority is considered a corporate body with the powers and immunities of a municipal corporation and shall be considered a public improvement district. The Authority may issue negotiable community development authority bonds, which will not constitute a legal debt of the governing bodies and are only considered obligations of the Authority. However, upon termination of the Authority, the participating cities, towns, community college and county boards assume all outstanding liabilities and obligations and acquire all assets of the

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Published 10 times annually by the Arizona Tax Research Association, a nonprofit organization whose purpose is to promote efficiency and economy in Arizona government and reductions at all levels. Permission to reprint is granted to all publications giving appropriate credit to the Arizona Tax Research Association.

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Arizona's average instructional staff pay rank leads nation as a percentage of per capita personal income

Rank	State	2000-2001 avg. salary inst. staff (NEA)	Rank	State	% of per capita personal income
1	Massachusetts	\$61,899	1	ARIZONA	187.8%
2	New Jersey	\$56,691	2	Rhode Island	184.4%
3	Connecticut	\$54,808	3	Michigan	171.8%
4	Rhode Island	\$53,962	4	Pennsylvania	171.0%
5	New York	\$53,296	5	West Virginia	170.1%
6	California	\$52,631	6	Alabama	166.8%
7	Pennsylvania	\$50,821	7	Alaska	165.2%
8	Michigan	\$50,694	8	South Carolina	164.0%
9	District of Columbia	\$50,053	9	Indiana	163.8%
10	Illinois	\$49,889	10	Arkansas	163.7%
11	Alaska	\$49,426	11	Massachusetts	163.1%
12	Delaware	\$49,080	12	California	162.8%
13	Maryland	\$48,230	13	Utah	160.7%
14	ARIZONA	\$47,626	14	Wisconsin	158.8%
15	New Hampshire	\$46,855	15	New Mexico	158.5%
16	Wisconsin	\$45,221	16	Mississippi	158.2%
17	Indiana	\$44,595	17	Idaho	158.1%
18	Georgia	\$44,328	18	North Carolina	157.6%
19	Ohio	\$44,319	19	Ohio	157.1%
20	Washington	\$44,263	20	Georgia	157.1%
21	Minnesota	\$43,878	21	Kentucky	156.3%
22	Nevada	\$42,702	22	Delaware	155.8%
23	North Carolina	\$42,638	23	Illinois	154.7%
24	Oregon	\$42,513	24	Maine	154.4%
25	Hawaii	\$41,401	25	Oregon	152.8%
26	Virginia	\$41,194	26	New York	152.2%
27	Texas	\$40,626	27	Louisiana	151.8%
28	Colorado	\$40,604	28	Oklahoma	151.0%
29	South Carolina	\$39,819	29	New Jersey	150.6%
30	Maine	\$39,659	30	Tennessee	147.7%
31	Alabama	\$39,648	31	Hawaii	146.3%
32	Florida	\$39,460	32	Montana	145.2%
33	Tennessee	\$38,943	33	Texas	144.9%
34	Missouri	\$38,650	34	Nevada	143.8%
35	Vermont	\$38,393	35	Iowa	142.3%
36	Nebraska	\$38,359	36	Maryland	142.0%
37	Idaho	\$38,093	37	Missouri	140.8%
38	Kentucky	\$37,894	38	Vermont	140.2%
39	Iowa	\$37,811	39	Washington	140.0%
40	Utah	\$37,737	40	New Hampshire	139.5%
41	West Virginia	\$37,181	41	Florida	139.5%
42	Kansas	\$36,894	42	Nebraska	138.2%
43	Oklahoma	\$36,314	43	Minnesota	136.2%
44	Arkansas	\$36,181	44	Kansas	134.0%
45	Wyoming	\$35,949	45	Connecticut	132.4%
46	Louisiana	\$35,267	46	Virginia	131.5%
47	New Mexico	\$34,614	47	Wyoming	129.5%
48	Montana	\$33,249	48	District of Columbia	129.0%
49	Mississippi	\$33,244	49	North Dakota	124.7%
50	North Dakota	\$31,194	50	Colorado	123.0%
51	South Dakota	\$31,142	51	South Dakota	120.6%
	United States	\$45,334		United States	152.3%

Arizona's news media and some policy makers and analysts continue to characterize public school salaries as low, often lumping a variety of funding statistics to describe Arizona's public school system as "the worst in the nation" or "bottom of the heap."

One of the most egregious examples of this tendency was found in an *Arizona Republic* editorial in support of the sales tax increase in Proposition 301, stating that "this measure indisputably is anchored in a single fact: that until it is passed, Arizona teachers are paid worse than any other public school teachers in America" (September 26, 2000). The same editorial concluded that "raising [Arizona] from the bottom of the salary ladder is a vital first step."

While it is widely accepted and quoted that Arizona's per-pupil expenditures rank low nationally, it does not follow that instructional staff or teacher pay is last in the nation.

The National Education Association, (NEA), the largest teacher's union in the nation, ranks Arizona 14th for school year 2000-2001 in average salaries for "instructional staff."

The NEA defines instructional staff as including "consultants or supervisors of instruction, principles, teachers, guidance personnel, librarians, psychological personnel, and other instructional staff."

The instructional staff category does *not* include such positions such as "administrative staff, attendance personnel, health service personnel, or clerical personnel."

Calculating these average salaries as a percentage of per capita personal income is a common method that accounts for differences in the underlying wealth between states.

Arizona's average instructional staff salary is nearly double the per capita personal income figure, placing this state at the top of the national ranking.

See *AZ average teacher pay*, page 4

AZ average teacher pay ranks 25th as a percentage of per capita personal income

Arizona faces many of the same challenges that confront other rapidly growing states. Financing a public school system with a rapidly growing student population is always going to be a top concern demanding policy makers' attention.

Such rapid growth is reflected in many national statistics. For example, national data have shown that Arizona teachers have, on average, less teaching experience than their counterparts in other states.

Arizona teachers also have full classrooms. With an estimated 18 students to every teacher, the NEA ranks Arizona 4th compared to other states, putting us in the company of other fast-growing states, such as Utah, California, Florida, Washington, and Nevada.

Arizona has also had to commit enormous sums of taxpayers dollars to the construction and renovation of school buildings. In fact, Arizona has outpaced every other state in per-pupil expenditures for capital (*see ATRA Newsletter, January 2003*).

However, are Arizona teachers at "the bottom of the salary ladder" as the Arizona Republic has asserted? With an average salary of \$37,167, according to the NEA, Arizona ranks 33rd (between Tennessee and Missouri) for school year 2000-2001.

Adjusting for differences between states in per capita personal income, Arizona climbs to 25th in the national ranking.

The most important budgetary decisions school officials make are: 1) how many teachers are needed given the number of students? and 2) how much are they going to be paid?

National rankings do not show—nor should they be mistakenly or misleadingly used to claim—that "Arizona teachers are paid worse than any other public school teachers in America."

Rank	State	2000-2001 avg. teacher salary (NEA)	Rank	State	% of per capita personal income
1	Connecticut	\$52,693	1	Michigan	171.8%
2	California	\$52,480	2	Pennsylvania	166.7%
3	New York	\$52,040	3	Rhode Island	165.7%
4	Michigan	\$50,694	4	West Virginia	164.2%
5	New Jersey	\$50,177	5	Arkansas	163.7%
6	Pennsylvania	\$49,528	6	California	162.3%
7	District of Columbia	\$48,704	7	Oregon	161.7%
8	Rhode Island	\$48,474	8	Alaska	160.9%
9	Alaska	\$48,123	9	Alabama	159.6%
10	Illinois	\$47,847	10	Indiana	159.1%
11	Massachusetts	\$47,789	11	South Carolina	156.3%
12	Delaware	\$47,047	12	Utah	155.2%
13	Maryland	\$45,963	13	New Mexico	154.7%
14	Oregon	\$44,989	14	North Carolina	153.4%
15	Nevada	\$44,386	15	Mississippi	152.0%
16	Indiana	\$43,311	16	Ohio	151.6%
17	Ohio	\$42,764	17	Idaho	150.9%
18	Georgia	\$42,216	18	Kentucky	150.9%
19	Minnesota	\$42,212	19	Georgia	149.6%
20	Washington	\$42,137	20	Nevada	149.5%
21	Wisconsin	\$42,122	21	Delaware	149.4%
22	North Carolina	\$41,496	22	New York	148.6%
23	Virginia	\$40,197	23	Illinois	148.4%
24	Hawaii	\$40,052	24	Wisconsin	147.9%
25	Colorado	\$39,184	25	ARIZONA	146.6%
26	Texas	\$38,361	26	Montana	145.2%
27	New Hampshire	\$38,301	27	Louisiana	144.7%
28	Vermont	\$38,253	28	Oklahoma	143.5%
29	Florida	\$38,230	29	Tennessee	142.0%
30	Alabama	\$37,956	30	Maine	141.6%
31	South Carolina	\$37,938	31	Hawaii	141.5%
32	Tennessee	\$37,431	32	Vermont	139.7%
33	ARIZONA	\$37,167	33	Iowa	137.3%
34	Missouri	\$36,715	34	Texas	136.8%
35	Kentucky	\$36,589	35	Maryland	135.3%
36	Iowa	\$36,479	36	Florida	135.2%
37	Utah	\$36,441	37	Missouri	133.7%
38	Idaho	\$36,375	38	New Jersey	133.3%
39	Maine	\$36,373	39	Washington	133.2%
40	Arkansas	\$36,182	40	Minnesota	131.1%
41	Kansas	\$35,901	41	Kansas	130.4%
42	West Virginia	\$35,888	42	Virginia	128.3%
43	Wyoming	\$34,678	43	Connecticut	127.3%
44	Oklahoma	\$34,499	44	Massachusetts	125.9%
45	Nebraska	\$34,175	45	District of Columbia	125.5%
46	New Mexico	\$33,785	46	Wyoming	124.9%
47	Louisiana	\$33,615	47	North Dakota	123.5%
48	Montana	\$33,249	48	Nebraska	123.1%
49	Mississippi	\$31,954	49	Colorado	118.7%
50	North Dakota	\$30,891	50	South Dakota	117.2%
51	South Dakota	\$30,265	51	New Hampshire	114.1%
	United States	\$43,339		United States	145.6%

Financial management *Continued from page 1*

recommendations from Governor Hull's administration contained similar provisions.

In addition to cutting into the "statutorily mandated" spending, lawmakers should improve the state's financial management by familiarizing themselves with the laws that drive budget increases and reform those that are flawed. ATRA recommends the following as formulas worth reviewing:

Prior year versus current year: School district funding is based on the prior-year's 100th day student count plus current year growth. The system therefore holds districts harmless for reductions in enrollment from the prior year, even though it may be funding those students at another district or charter school.

Students not properly withdrawn: Cases have emerged where students are being counted in two districts because one of the districts failed to complete withdrawal paperwork.

Rapid decline: School districts that experience declining enrollment for more than one year (they are held harmless automatically for the first year) may be eligible for additional "rapid decline" funding.

Open enrollment versus "refusal by students to attend classes": Open enrollment laws include an exception for deseg/OCR districts who can continue to claim students that have left a district school to attend school in another district or charter.

TRCL versus TSL: State law provides two K-12 formulas for transportation — the **transportation support level** (TSL) and the **transportation revenue control limit** (TRCL). The TSL formula involves the average daily route miles per eligible student transported. Additional factors in the formula reflect academic, vocational, and athletic trips, as well as students with disabilities. The formula can result in changes as variables in the transportation calculation of the district change.

The TRCL calculation can change in only one direction — up. To calculate the TRCL, the previous year's TRCL is adjusted by growth, if any, in the TSL. In other words, if

the TSL formula results in more funding, the TRCL grows by the same amount. If there was no growth in the TSL, or even if it declined, the TRCL is held harmless.

In 1980, the year the current system was adopted, the TSL and the TRCL were approximately equal. Over the last two decades, as the actual transportation needs of districts have changed, this "hold harmless" funding mechanism has resulted in the TRCL outpacing the TSL by \$48.5 million in FY 2002-03, 7.2% more than the previous year's difference. That's \$48.5 million in transportation funding for students who are not there.

The state's equalization formula (with only a handful of exceptions) recognizes only the TSL. School district budgets, however, use the TRCL. What this means is that the \$48.5 million to transport ghosts is falling to local property taxpayers.

This discrepancy in transportation formulas explains why Hayden-Winkelman Unified's primary property tax rate is nearly double the qualifying tax rate, contributing to the district's notoriously high taxes (\$44.81 per \$100 combined property taxes in the Town of Hayden). The cost to the state general fund is approximately \$13 million through additional state aid in recognition of the homeowner rebate and the one-percent cap.

Career ladder: Under current law, 28 school districts have the legal authority to participate in a "career ladder" program. The number of participating districts was capped as of FY 1993-94 because of concerns raised about the cost and effectiveness of the program. The general fund cost of career ladder is approximately \$35 million.

JTEDs: Student counts between school districts and joint technological education districts (JTEDs) can, by law, add up to a total of 1.25 ADM if the JTED class is being conducted on the high school campus (the so-called satellite model). The blending of the centralized campus model and the satellite model, such as is occurring at the East Valley Institute for Technology (EVIT), raises concerns about how these student

counts are conducted and monitored by the state. Add the fact that many of these courses also qualify for community college credit through dual enrollment, and you have the recipe for potential triple counting of students.

Community college hold harmless: Operating state aid for colleges increases through student growth, but never decreases for declining student counts.

Equalization assistance: Four, sometimes five, of Arizona's eight "rural" community college districts qualify for equalization assistance from the state general fund. The key driver in this formula is the average net assessed value (NAV) for the eight districts. The further a district is from the average, the more money it gets from the state. Valuation growth in Coconino and Yavapai counties has been driving a wedge into the formula resulting in greater exposure for the state general fund. The formula for FY 2003-04 resulted in an estimated \$13.6 million cost to the general fund.

Retirement Benefits/Programs: A major factor in the annual increases taxpayers face with funding the state budget each year is the cost of funding the various retirement programs for state and local government employees. The FY 2003-04 budget is facing over a \$30 million increase in funding the defined benefit programs of state employees. The taxpayers commitment to fund the contribution rate more than doubled from 2.49% to 5.70% of payroll primarily as a result of a steady stream of benefit increases in recent years. While there is little the legislature can do about the costs for the FY 2003-04 budget, they should explore every option available to try to limit their future exposure including creating a new benefit structure for future employees.

Clearly, Arizona's budget deficit will not be closed by simply fixing flawed funding formulae. To avoid tax increases or larger structural deficits in FY 2004-05, the legislature must look to reductions in all general fund budgets. However, there is little

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Financial management

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excuse for leaving many of these redundancies and inefficiencies in place, while at the same time making across-the-board reductions to all programs.

Balancing the FY 2003-04 budget will be a difficult task but that exercise will be made more worthwhile if the legislature acts to make structural changes that improve the efficiencies of future state budgets.

Legislative update

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Authority. *Held in House Ways & Means.*

SB1335 School construction funding reform (Weiers) Returns the primary responsibility of school construction back to local property taxes. Contains scaled subsidies for districts below the median assessed value per pupil. Statutory debt caps (5 and 10%) are removed. *Discussed and held in Senate Finance and Senate Education.*

HB2315 Now: expenditure limitation; Greenlee County (Konopnicki) Limits the penalty imposed on Greenlee County in Fiscal year's 2002-03 and 2003-04 to \$100 for exceeding their expenditure limit. *Awaiting Senate Finance.*

HB2425 fire district assistance tax (Jackson Jr) Specifies that the fire district assistance tax (FDAT) also be distributed to municipal and volunteer fire departments as well as county fire districts and that the distribution be based on 20% of their adopted budgets. Requires that the board of

supervisors establish a process for reviewing and approving municipal and volunteer fire departments for participation in the distribution of monies from FDAT. Amended in PIC to exclude municipalities. *Failed in House Utilities and Municipalities.*

FAVORABLY AMENDED

SB1211 community college districts; override elections (Hellon) As introduced, would have allowed community college override elections to occur in March, May, or September, in addition to November. Currently colleges can hold such elections only on general election dates. Amended in the House and Senate to allow districts one election date per year in November. *Transmitted to Governor.*

HB2059 2003 tax corrections act (Huffman) Annual bill regarding technical changes to Arizona's tax code was favorably amended in the House Ways & Means Committee to remove all substantive changes. *Awaiting Senate 3rd Read.*