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**ARIZONA TAX RESEARCH ASSOCIATION**

**NEWSLETTER**

**VOLUME 68  
NUMBER 9**

**DECEMBER 2008**

## **New Leadership Addresses ATRA Outlook Conference**

Attendees at ATRA's 2008 Outlook Conference were provided an early glimpse of how the newly elected leadership in the House and Senate plan to address Arizona's state budget crisis. Senate President-elect Bob Burns, Speaker-elect of the House Kirk Adams, and Senator Ken Chevront each provided a sobering review of the state's fiscal picture along with their strategies to begin closing the growing state budget deficit.

Speaker-elect Adams stressed that all state expenditures would be on the table for potential budget reductions including employee layoffs, furloughs, and salaries and benefits. Adams pointed out that tough decisions are being made by families and businesses and that they should expect nothing less from state policymakers. He further noted that while this is clearly an opportunity to make government more efficient and smaller, state leaders need to pursue reductions in spending in a manner that doesn't appear gleeful.

Adams also noted that the appropriations process in the House will be changed significantly from that of recent years. In fact, he has appointed a committee that he feels is representative of the entire House, and those members will be empowered to make the tough decisions to balance the budget. Finally, the Speaker-elect said that he is interested in pursuing policies that promote economic growth and attract new business and industry to Arizona.



President-elect Bob Burns also said that the State Senate will undergo major changes in the appropriations process and even indicated that he will withhold all bill activity until the budget is completed. Further, each of the standing committees will also be called

upon to review state agency budgets and forward recommendations to the appropriations committee. Burns also noted that the private sector was responding to the weakened economy and budgetary restraints in a variety of different ways and state policymakers could learn from those decisions.

For those hoping for a return to 100-day sessions, Burns suggested that was not a reasonable expectation considering the severity of the budget crisis and predicted the length of the session could rival those of recent years.

Senator Ken Chevront, one of the Legislature's most knowledgeable members on tax policy, directed his remarks at potential changes in that area. Chevront predicted that efforts to jump start the economy through stimulus packages would inevitably include targeted tax breaks to certain industries. He also took the opportunity to encourage the Republican majority to join him in his efforts to curb the cities use of their tax exempt status to provide property tax breaks to selected companies. He announced his plans to again try to reform the Government Property Lease Excise Tax (GPLET) which applies to private development on land that is owned by a city.



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# Rounds Provides Grim Economic Outlook

Kicking off ATRA’s 2008 Outlook Conference, economist Jim Rounds of Elliot D. Pollack & Company provided expert analysis on the condition of the economy. As the length and the severity of the current budget crisis will depend significantly on the fate of the economy, Rounds’s analysis provided the important context within which the issues of the upcoming legislative session will be discussed.

Rounds began with convincing evidence of the bleakness of the current situation by showing a history of the year-over-year percentage change in Dow Jones stock prices. The recent plummet to a 40% decline represented the largest percentage drop in all of the 28 years included in the chart.

Rounds continued with a discussion on the general causes of recessions as well as the specific challenges the

economy has dealt with this time including the credit crisis and the real estate market.

Additional graphs described the declines in four of the five leading recession indicators. Quarter-over-quarter losses have occurred in real GDP, in retail sales, in employment, and in industrial production. Real personal income was the only recession indicator to still show quarter-over-quarter growth—although it too will likely soon flat line. This data led Rounds to conclude that the economy is certainly in a recession.

Rounds summarized: “The economy will be very weak for the remainder of 2008; not so great in 2009; still below average in 2010.”

After describing the grim realities of the current economic situation, Rounds did not leave the attendees without some



words of wisdom in the way of long-term solutions for policymakers: “Quit spending like drunken sailors. A 67% increase in the budget over three years is unacceptable.”

Rounds also recommended increasing the budget stabilization fund to at least the original 15% of the budget, improving the state’s economic development toolbox, and paying more attention to economists when they say that 15% revenue growth is unsustainable.

# Stavneak Outlines Budget Challenges

Richard Stavneak, Director of the Joint Legislative Budget Committee (JLBC), delivered a gloomy update of the state’s current fiscal crisis to attendees at the 2008 ATRA Outlook Conference.

### General Fund Shortfall

Based on current data, JLBC estimates a \$2.6 billion structural deficit in FY 2009, \$1.2 billion if one-time revenues and expenditures are considered. The problem only gets worse in FY 2010, in which the deficit is estimated to be as large as \$3 billion, depending on adjustments to the FY 2009 budget and other factors.

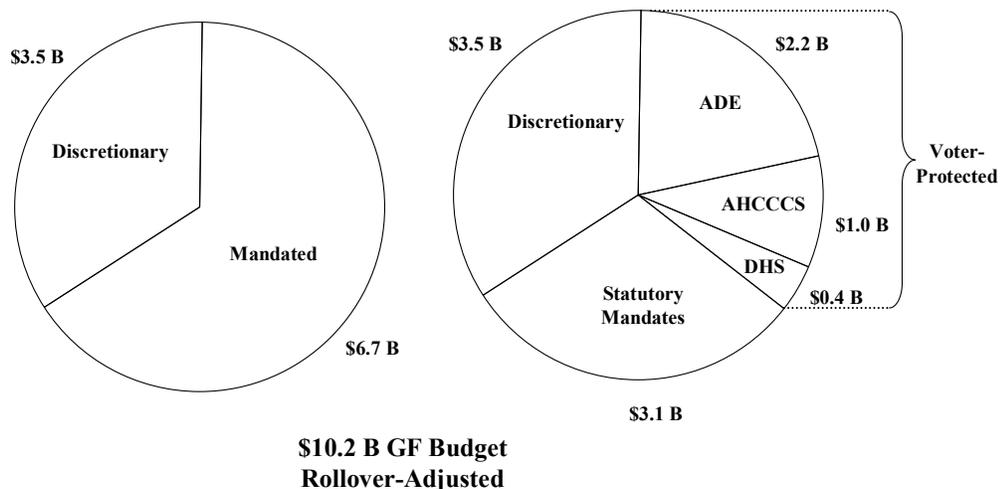
### Revenue Overview

At the close of FY 2008, actual general fund base revenues dropped to a negative 4.6% compared to the previous

See **Budget Challenges**, page 3

## What Is Voter Protected Share of GF Spending?

- No Definitive Answer, But Near \$3.5 B



## Olson, McCarthy Highlight Budget, School Finance Problems

With the looming budget deficit expected to dominate the upcoming legislative session, the state's fiscal woes received similar attention at ATRA's 2008 Outlook Conference. ATRA President Kevin McCarthy began his presentation of current issues in Arizona public finance with an explanation that the structural deficit actually began in June of 2007.

ATRA compares ongoing expenditures and ongoing revenues of each year's state budget to determine whether a structural deficit exists. The relatively small structural deficit of fiscal year (FY) 2007 grew to \$429 million with the adoption of the FY 2008 budget and \$1.4 billion when the Legislature adopted the FY 2009 budget. McCarthy explained that these deficits were intentionally masked through an endless array of budget gimmicks. These deficits between ongoing expenditures and ongoing revenues were closed using carry-forward revenue, rollovers of K-12 school aid payments, borrowing against already purchased school buildings, fund raids, and other one-time revenue sources.

As the economy deteriorated, these planned budget deficits worsened leading to the current fiscal crisis. "A major correction in spending is necessary," McCarthy explained, "if we

are to have any hope of seeing light at the end of the tunnel by FY 2011." As a continued avoidance of tough decisions will undoubtedly increase the severity of the budget crisis down the road, McCarthy warned that banking on a



major economic recovery in the near term would be a mistake.

To solve the budget crisis, McCarthy suggested that every option must be on the table including across the board cuts and elimination of low priority or recently added programs. McCarthy also suggested that this crisis provides an opportunity to improve the state's fiscal management by scrutinizing arcane funding formulas and eliminating redundant funding, ghost funding, and hold harmless formulas.

Following McCarthy's presentation, Justin Olson provided a brief overview of the school finance system

highlighting certain budget limit exemptions that lead to substantial funding inequities (see ATRA's November *Newsletter*). Olson presented ATRA's position that if school districts are going to participate in spending cuts, then the reductions should first be targeted at currently existing inequities and redundancies. Olson provided some examples of these redundancies including funding both current year and prior year student counts, counting one full-time student as up to two if the student is enrolled in more than one district, and funding two years of kindergarten through early learner programs.

Olson concluded his presentation with a brief discussion about school funding statistics, pointing out that there is much more to the school finance picture than is found in the often reported ranking on per-student expenditures. For instance, Arizona ranks 12 in the nation for average salaries of instructional staff and fourth in the nation for the percentage increase in school funding over the last 20 years. Additionally, when the per-student expenditure ranking is adjusted to control for differences in student-to-teacher ratios, Arizona's funding level lies well within the mainstream. Specifically, the average amount Arizona spends per class represents the median funding level among the 50 states.

### BUDGET CHALLENGES, *Continued from page 2*

year, far below the negative 0.9% that was estimated in the adopted budget. As a result of the unanticipated drop in FY 2008 collections, revenues in FY 2009 will have to grow by at least 6.1%, instead of the budgeted 1.9%, in order to meet the \$10 billion adopted budget. Although actual revenue collections in the first quarter of FY 2009 show a decline of 8.9%, the four-sector consensus forecast used by JLBC predicts that revenues will drop just

4.4% for the entire fiscal year. In fact, revenue growth is expected to remain slow at least until FY 2011.

#### *Voter-protected vs. Non-voter-protected*

Stavneak noted that Prop 105 prohibits changes to voter-approved initiatives without a three-fourth's vote of the Legislature. He explained that Prop 105 *limits* but does not *eliminate* the Legislature's ability to modify the education and AHCCCS funding

formulas. According to Stavneak, at least \$2.2 billion of the \$4.4 billion state K-12 general fund budget is not protected by Prop 105. In regard to Prop 204, \$435 million of the \$1.4 billion in general fund spending for AHCCCS also is not voter-protected along with other spending in the state budget. In total, JLBC estimates that approximately \$6.6 billion of the state's general fund budget is not protected by Prop 105.

## Good Government Awards go to Vince Perez and Erik Montague

The Arizona Tax Research Association selected Vince Perez and Erik Montague as the two recipients of the J. Elliott Hibbs ATRA Good Government Award for 2008. The awards were presented during ATRA's Annual Meeting luncheon on Friday, November 21 at The Buttes Resort.

For the last 17 years, ATRA has taken the occasion of the annual meeting luncheon to recognize outstanding individuals whose work in the public sector is characterized by strong, continuing, and consistent efforts to spend taxpayer dollars wisely and to promote government that is efficient, open, and accountable. ATRA solicits nominations from local governments and state agencies, which are then reviewed by ATRA members and staff. As always, there were many worthy nominations, and this year was no different. Due to the large number of nominations this year, ATRA chose two outstanding individuals that stand apart from the others.

Vince Perez, who is the Assistant Director of the Audit Division at the Department of Revenue (DOR), was the first recipient of the Good Government Award. During Vince's twenty years at DOR, he has served in various positions



including the Assistant Director of the Transaction Privilege & Use Tax Audit Division, Legislative Liaison, and Public Information Officer. While he has worn many hats over the years at the Department of Revenue, that service was always distinguished by the expertise and professionalism he demonstrated.

In presenting the award, ATRA President Kevin McCarthy explained that as the Assistant Director of the Audit Division, Vince is often placed in an adversarial position with taxpayers. However, Vince was nominated for the award based on the fairness in which he has treated taxpayers over his many years of service. McCarthy said, "That fairness was grounded in his consistent

effort to be open, honest, and transparent in executing the tax policies and procedures for the Department of Revenue."

The second recipient of this year's Good Government Award went to Erik Montague, who is the Finance Director for the Town of Marana. According to his nominations, Erik's impact on the Town of Marana's financial management has been nothing short of dramatic. In presenting the award, McCarthy noted that in the relatively short tenure with the Town, Erik has created a culture of conservative financial management coupled with transparent budgeting that has touched every aspect of the Town's operation.

Among his many accomplishments, Erik developed a completely new procurement and purchasing system, completely reorganized Marana's budgeting process, and instituted regular budget updates at Town Council meetings to keep elected officials and taxpayer's informed. In the words of Marana Town Manager, Gilbert Davidson, "Erik has the qualities that every taxpayer would want in a public finance professional: accountability, transparency, expertise, and customer service."

## Steve Barela named 2008 Outstanding Member

On behalf of the ATRA Board of Directors, Chairman of the Board Dick Foreman presented Steve Barela with the 2008 Outstanding Member Award at the Outlook Conference Luncheon.

A member of the ATRA Board of Directors, Steve Barela is the state and local tax manager for Arizona Public Service company. Prior to joining APS eight years ago, Steve was a Senior Research Analyst for ATRA. Since joining the APS tax department, Steve has been a constant presence at ATRA, serving on both the legislative policy and tax practitioners committees. Two years ago, he was appointed to his first term on the ATRA Board of Directors. An expert in state and local taxation, Steve also dedicates many hours to the organization through his attendance at ATRA local government budget meetings.

In presenting the award, Dick also recognized Steve for his continuous efforts to increase ATRA's membership. Dick said, "Steve, we appreciate your willingness to spread the word about ATRA and assist the organization in its effort to increase membership. You have truly become our top salesman and the entire organization is grateful for your support."





Richard Stavneak, Director of the Joint Legislative Budget Committee (JLBC), describes the current state of Arizona's budget situation.



Reporters Matt Benson of the *Arizona Republic* (left) and Jim Small of the *Arizona Capitol Times* (right) provide their analysis on how things stack up for the 2009 legislative



Panel of Legislative leaders (from left to right): Larry Lucero of Tucson Electric Power (moderator), Senate President-elect Bob Burns, Speaker-elect of the House Kirk Adams, and Senator Ken Chevront.



Justin Olson, research analyst with ATRA, discusses current issues affecting K-12 school finance and the impact of these issues on the state budget.



Robert Robb (left), columnist with the *Arizona Republic*, providing the keynote address at ATRA's annual awards luncheon. Robb discussed the need for truth in budgeting to eliminate lawmakers' ability to create a false appearance of a balanced budget. Such a presentation of the state budget would include cash borrowed and spent as well as expenditures accrued even if the payment for the expenditures were rolled over to a future fiscal year. Robb also suggested the need to reform voter-mandated spending in order to allow for freezes or participation in across-the-board cuts during poor economic years. Lastly, Robb recommended reducing the state spending limit to prevent any future runaway budget growth similar to the 16% per year Arizona experienced during the upside of this economic cycle.

## Dick Foreman Re-Elected ATRA Chairman

Dick Foreman, Director of Corporate Public Affairs for Southwest Gas Corporation, was re-elected as the Chairman of Arizona Tax Research Association's Board of Directors at its 68<sup>th</sup> Annual Meeting. The other officers of the association for 2008 are as follows: Larry Lucero, *Tucson Electric Power*, first vice-chair; Samantha Omev, *Honeywell*, second vice-chair; Barb Dickerson, *Deloitte Tax LLP*, third vice-chair; and Dave Minard, *individual*, treasurer.

The following members were elected to seats on the ATRA Board of Directors for terms expiring in 2013: Robert Buns, *General Dynamics*; James Busby, *Gallagher & Kennedy*; George Cardon, *Viad Corp.*; Gretchen Kitchel, *Pinnacle West Capital Corp.*; Jim Klinker, *Arizona Farm Bureau*; Michael Galloway, *Bancroft, Susa, & Galloway*; John McNamara, *AT&T*; Munir Malik, *Freeport McMoRan Copper & Gold*; Steve Shiffirin, *Ernst & Young*; Allan Stanton, *Individual*; and Meyer Turken, *Turken Industrial Properties*. For terms expiring in 2011: Edward Munoz, *Raytheon*.

In accepting his nomination to serve a second year as ATRA Chairman, Dick Foreman said, "As the Arizona leading tax



policy organization, ATRA is uniquely positioned to provide the leadership that will be necessary to guide us through the difficult challenges ahead. As ATRA's Chairman, I look forward to working with policymakers to develop sound policy solutions to meet those challenges."