Report of the
95TH ARIZONA TOWN HALL

"RIDING THE FISCAL ROLLER COASTER: GOVERNMENT REVENUE IN ARIZONA"

Grand Canyon, Arizona
November 1 - 4, 2009

INTRODUCTION

The 95th Arizona Town Hall acknowledges the critical nature of the current fiscal crisis, believes an immediate, temporary revenue-raising response by the state legislature is imperative, and believes the inherent structural imbalance in state revenue and expenditures must be addressed now to assure a more stable and predictable quality of life for all Arizonans into the future.

Government revenues in Arizona are on a roller coaster ride with no end in sight. The state's economy is highly volatile, and its system for government tax and fee collections has amplified that volatility, leading to extreme highs and lows in government revenue streams. Government responded to recent periods of soaring revenues with tax cuts and new, recurring spending commitments, leading to structural deficits that have left Arizona governments chronically underfunded. Money set aside from surplus years for the state's budget stabilization fund, or "rainy day fund" — intended to mitigate shortfalls in leaner years — has been wholly inadequate for the task. The precipitous decline in revenues for the current fiscal year has led to dramatic cuts in government spending and services.

Arizona's revenue systems are also far from ideal when judged against the other guiding principles used to measure their performance. Yet efforts to change the state's tax code have generally been piecemeal, often driven by narrow special interests, and efforts at broader, system-wide reforms have failed.

Various structural impediments pose significant barriers to enacting systemic reforms. Most notable is the 1992 state constitutional amendment requiring that legislation increasing state revenues through taxation or fees must be approved by two-thirds of the members of each house of the Arizona legislature. This supermajority requirement has created a seemingly insurmountable barrier to increasing taxes and fees, regardless of necessity.

Participants in the 95th Arizona Town Hall, a diverse cross-section of Arizona residents from various communities and walks of life, met for three days of facilitated discussions designed to seek consensus on how to best address Arizona's fiscal roller coaster ride. This report captures the consensus that emerged from those discussions. While not every Town Hall participant agrees with every conclusion and recommendation herein, this report reflects the overall consensus achieved by the 95th Arizona Town Hall.

THE EFFECTS OF ARIZONA'S GOVERNMENT REVENUE SYSTEMS ON ARIZONA'S PEOPLE AND BUSINESSES

All of Arizona's businesses and citizens have a direct stake in the taxes they pay. Revenue collection affects Arizonans' amount of disposable income, consumer choices, job creation and retention, and business location decisions. Government revenues directly affect whether a community can implement and support infrastructure development, education, and other desired services. Higher quality and quantities of services typically translate into a better quality of life for residents, which draws top-notch talent and businesses into the state. Indeed, the quality of life ensured by the provision of services can be more important than specific tax breaks in influencing business and individual relocation decisions.

The state's transaction privilege taxes ("sales taxes"), for instance, affect consumers in a variety of ways. Excise taxes on tobacco and alcohol may reduce consumption, and all sales taxes tend to have a disproportionate impact on low-income individuals. While taxes can be politically unpalatable, they are less so when passed on to tourists and winter visitors; however, because sales taxes are a function of consumer spending, dependence on such taxes can cause significant problems during economic downturns when consumer spending decreases, especially in communities that rely heavily on tourism. Sharp drops in sales taxes force some communities to cut back on public services. Moreover, high sales taxes encourage people to make purchases online or in other taxing districts.

User fees and impact fees are more popular than other taxes because taxpayers understand their purpose and benefits. If user and impact fees are too high, however, they discourage utilization of particular services and the expansion of businesses and residential development, leading to declines in both government revenues and a community's quality of life.

Property taxes influence citizens' decisions about whether to purchase and/or invest in real property. They also affect funding for K-12 and community college education. If Arizona fails to adequately fund education, key employers likely will choose to locate elsewhere. Property taxes are more predictable and less volatile than many other taxes.

High property taxes can discourage people and businesses from moving into a community. Indeed, property taxes are typically very unpopular because they are highly visible, payable in a lump sum, and their role in funding government is not well understood. When property values decline and property taxes remain the same, taxpayers feel unfairly burdened. Moreover, property taxes in Arizona disproportionately burden businesses due to differential assessment ratios between residential property and other property taxes on real and personal property for the manufacturing industry. This disproportionate burden on businesses may impede economic growth.

On the other hand, when government lacks revenues to pay for public services such as parks and streets, some of those burdens and costs either go unfunded or are shifted to the private sector, such as through homeowner associations. Similarly, budget shortfalls affect Arizonans because public services such as libraries and schools are reduced, a problem that is exaggerated by the volatility of the state's revenue systems. Nonetheless, higher taxes do not always translate to better quality of life.

THE RELATIONSHIP BETWEEN GOVERNMENT REVENUES AND THE ECONOMY

Government revenues in Arizona are inextricably linked with the state's economic performance. Revenues decline during economic downturns, while demand for government spending remains steady, or increases. The state economy's heavy reliance on cyclical industries, such as tourism and new home construction, renders government revenues highly susceptible to economic forces beyond the state's control.

This cyclical volatility is amplified by heavy reliance on relatively few revenue sources. For example, taxes with a narrow base such as the state's sales tax are more vulnerable to economic cycles than are more broadly distributed funding sources. Declines to the general economy are therefore magnified in their effects on Arizona government revenues.

Economic trends also influence public policy decisions. During economic boom times, the state opted for tax cuts and increased services, rather than setting aside sufficient funds to prepare for the inevitable future downturns. The state's rainy day fund is capped at an inadequately low level, insufficient to bridge significant economic declines. Still, legislators are reluctant to increase taxes during economic downturns and deficits for fear of harming economic recovery. This continual postponing of difficult decisions has led to a political culture of "managing by crisis."

Economic downturns provide an opportunity to eliminate unnecessary programs and government inefficiencies, but constituents disagree over which programs fulfill the "core mission" of government. Cuts to services valued by individual taxpayers may reduce their willingness to support efforts to increase public revenues.

Tax policies also have a substantial impact on the state's economic development. Taxes on corporations in Arizona are high in comparison to the public benefits conferred, and relative to taxes on individuals. Although lower tax rates are widely believed to foster economic growth, the true relationship is likely more nuanced. Economic growth requires both the elimination of barriers to business development and stability of revenues and services. Some businesses choose not to locate in a state where investments in infrastructure and education, or other public services valued by employees, are at risk because of revenue instability. Constitutional and statutory limitations, and revenue instability, also limit the ability of state and local governments to provide incentives for targeted industries to grow within or relocate to Arizona. Severe reductions in revenues also place at risk the state's eligibility for federal matching funds, to the overall detriment of the state economy.

PRINCIPLES UNDERLYING AN OPTIMAL REVENUE SYSTEM

Arizona's tax systems should incorporate the guiding principles that define good tax systems everywhere, including stability, predictability, simplicity, transparency, fairness, responsiveness, efficiency, competitiveness, neutrality, sustainability, horizontal equity, and vertical equity. Additionally, Arizona should have a long-term plan, rather than merely respond to current crises with a quick fix. This plan should discourage reliance only on annual budgeting, especially in light of the countercyclical relationship between government spending and economic growth. Arizona has neither adequately recognized or predicted the costs of its rapid growth, nor provided for the increases in services and infrastructure demands associated with such growth.

Simplicity of the revenue system is critical, especially as it relates to the public's understanding of the relative roles of different levels of government and the costs associated with those roles. The tax code should be understandable and without excessive exemptions. Arizona also needs greater transparency and accountability to voters to ensure that taxes are used efficiently and effectively in accordance with voter preferences and are not raised unnecessarily.

Stability of Arizona's revenue systems also is critical. Disproportionate reliance on income taxes paid by the affluent contributes to revenue volatility due to factors such as significant swings in capital gains. Flatter rates yield more stable revenues but result in higher taxes on the middle class, which are politically unpalatable. Consideration should be given to identifying more stable sources of revenue. Reliance on property taxes might be more difficult in Arizona than in other states because roughly 15% of Arizona's lands are privately owned; however, a statewide property tax would increase revenue stability.

Reducing unhealthy competition between state and local governments for the same tax dollars is another principle that should guide the design of revenue systems. State and local governments must increase communication, possibly through the formation of voluntary, cross-jurisdictional alliances. Certain actions at the state level have significant effects on local government. For example, it is all too easy for the state to take shared revenues from local governments to balance its own budget, which leaves the local governments short of the resources they need. The state frequently considers this option. Similarly, the state has passed down mandates to local governments without the added revenue sources needed to pay the costs of such programs.

Balance between state and local government revenue streams also is needed. Local governments are often best equipped to decide and articulate how revenues should be used, promoting trust between the populace and their leaders. To the extent possible, revenue expenditures should be kept close to their sources. Local governments should have the opportunity to collect revenues to provide local services. As more control is shifted to local governments, restrictions on those local governments must be reduced to afford them flexibility and empower them to better address their changing needs.

Arizona's tax system also should exhibit fairness. The best systems make use of the broadest possible tax base to help keep tax rates low.

EVALUATING THE CURRENT STATE REVENUE SYSTEM

Positive attributes of Arizona's current system of state tax revenue include the relative progressivity and generally low rates of personal income taxes, the ability to capture tax revenues from non-residents through sales taxes, the capacity to set aside some funds to mitigate future deficits through the rainy day fund, and the mechanism to equalize funding for K-12 education. Additionally, the state has avoided undue dependence on personal income taxes, which are an especially volatile funding source. Arizona's income tax is based on the adjusted gross income on the federal income tax return, and preparing tax returns is relatively simple and easy.

Although Arizona's current revenue system has a number of strengths, it also has substantial room for improvement. Recent tax cuts without accompanying reductions in spending have exacerbated structural deficits. The elimination of the state property tax has rendered the system less broad-based, balanced and stable. Additionally, legislative "fund sweeps" from dedicated sources undermine public confidence in the system and provide a disincentive to public sector savings, such as for capital projects. Finally, the state funding system relies heavily on inherently regressive sales taxes. Though exclusion of food mitigates the impact of these taxes on those with lower incomes, Arizona should expand and modernize its sales tax system to broaden its base.

Relatively high corporate income and personal property taxes under the current system may deter businesses from relocating to Arizona. Additionally, high corporate income taxes reduce transparency of taxation, as businesses often pass the costs of increased taxation on to consumers, who therefore ultimately shoulder the burden of the tax. Finally, numerous tax exemptions and credits unnecessarily complicate the tax code and cater to special interests.

Most significant, however, is the fact that Arizona has a structural deficit caused by several factors. Chief among these factors is the constitutional requirement that legislation to increase government revenues must pass by a two-thirds majority of both houses of the legislature. By contrast, passing tax cuts and raiding the state's rainy day fund require only a simple majority vote. As a result, the legislature has become predisposed toward ever-decreasing taxes and an increasing structural deficit, without setting aside sufficient funds to stabilize revenues during economic downturns. Additionally, Arizona's outdated revenue system does not reflect the ever-changing modern economy. Government revenues thus lag behind the state's economic growth. For example, the state sales tax applies principally to sales of goods and not services, but sales of goods represent a declining percentage of economic activity as compared with sales of services.

Other factors are largely political. Term limits undermine long-term perspectives among legislators and increase the influence of unelected legislative staff and lobbyists. Non-competitive or "safe" legislative districts (where one party is all but guaranteed victory) and public campaign financing ("Clean Elections") both reward and encourage candidates representing political extremes. Elected officials on the ideological extremes often are not willing, and have no incentive, to reach bipartisan agreements necessary to address the state's financial challenges. Additionally, tax credits and exemptions are used to reward politically influential constituents at the price of an increasingly narrow and volatile tax base. Voter initiatives and legislative enactments, particularly those without periodic reviews or sunset provisions, have committed the state to increased spending programs while also hindering the government's ability to raise additional funds. This "something for nothing" mentality has become a pervasive feature of the modern political culture. Voters who reward this mentality at the ballot box must share the blame.

The current system is neither sufficient to support, nor directed at supporting, its most important objectives, such as education, transportation, health, human services, and public safety. While Arizona's current revenue collection system is not as burdensome as many other states' as a percentage of income, the system does not sufficiently address that the state's need for government revenue is countercyclical. Building stronger reserves through the rainy day fund would reduce revenue volatility. Adding legally protected triggers as a prerequisite to invading the rainy day fund would ensure that the money is left undisturbed until predetermined economic conditions require its use. While strengthening the rainy day fund is advisable, having a rainy day fund does not eliminate the need to stabilize the state's revenue sources.

ARIZONA'S LOCAL GOVERNMENTS' REVENUE SYSTEMS AND THEIR INTERPLAY WITH THE STATE

In general, Arizona's local government revenue systems have several advantages over the state system. Local governments benefit from the relative stability of property tax revenues. Local governments also have better mechanisms for monitoring and managing revenue systems than the state, and have better long-range and short-range strategic planning than the state. Local governments generally are better at linking revenues to expenditures, and more political ownership exists at the local level, allowing more nonpartisan and bipartisan cooperation. Local governments offer more transparency and cooperation with businesses and individuals than state government, which means local governments are more accountable and responsive to their citizens' needs. Local governments also have the ability to generate revenues through bonding, and local bond issues tend to be successful because the local government is perceived as having more credibility. Municipalities also have more flexibility than state and county governments to address revenue problems quickly. Counties, on the other hand, get their taxing authority from the state and are, therefore, less able to develop and impose new taxes.

Local governments, however, are vulnerable to state and federal actions, such as unfunded mandates that significantly affect their revenues and expenses. The state's ability to influence local governments should be reduced, and local governments should be given more flexibility in generating revenue so they can be less dependent on growth and retail sales taxes. Local governments should consider how to better adjust the various types of fees they charge to be sure the fees accurately reflect the costs of the services they cover, and should be more consistent in determining what specific items are taxed.

Cities typically have focused tax incentives on attracting retail businesses because those businesses generate sales tax revenues. Business incentives instead should be used to attract businesses that offer high-paying jobs. Cities should then cooperate with one another to assure that each jurisdiction has its fair share of tax-generating retail businesses. Indeed, the legislature has not been consistent in its treatment of local jurisdictions, favoring some counties with revenue-raising tools and incentives that are denied to others. Finally, Arizona should be cognizant of the economic development tools that are being used in other states, and should empower local jurisdictions to compete effectively with other states for desired businesses.

In the past, the relationship between state and local government revenue systems in Arizona was more cooperative. The revenue-sharing process generally functioned adequately, and various jurisdictions worked together effectively on common tasks, such as joint audits. The relationships have been strained recently, however, as a result of budget deficits and the state government's decisions that negatively affect local governments. To reduce its budget deficits, the state legislature has resorted to the "raiding" of local funds and state-shared funds such as court fines and fees. The relationship between state and local governments has been further strained by the legislature's efforts to balance the state's budget on the backs of local jurisdictions.

The legislature also has taken revenues from school districts and has failed to pursue best practices for funding education. Additionally, the state has placed a burden of unfunded mandates on school districts resulting in a deterioration of the spirit of local governance. Thus, rather than working together to address revenue shortfalls at all levels, the local and state governments have become increasingly adversarial. Indeed, litigation has replaced dialogue to resolve these jurisdictions' conflicting view of appropriate revenue sharing solutions.

State, local, and tribal governments and school districts should develop partnerships in pursuit of a common vision for the state's economic future. This relationship requires a mutual respect for the distinct roles played by the various levels of government, recognition of the revenue requirements to fulfill these distinct roles, and increased communication and collaboration. Local governments must take a more active role in fostering this relationship, which at present is too heavily dominated by state-level mandates. Increased cooperation helps to identify and develop appropriate new funding sources, including user fees, impact fees, and federal matching funds, borrowing from best practices developed in other states.

CHALLENGES TO REFORMING ARIZONA'S REVENUE SYSTEMS

Creating effective government revenue systems for Arizona will not be easy. Numerous impediments currently exist. The supermajority requirement for raising revenues is one of the biggest roadblocks to effective revenue policies. Legislation by initiative, which is how the supermajority requirement came about, has in some cases limited the legislature's ability to act, although it also can be used to overcome legislative inaction. Constitutional barriers include the one-percent cap on residential property tax, inflexible revenue commitments under Proposition 105[1], and limits on state government bonding obligations. Term limits and two-year terms for legislative office foster shortsighted thinking rather than long-term vision, and impede the development of expertise and institutional memory. Lack of public trust in the legislature is a further barrier to change.

Use of current revenue management tools has proven inadequate to resolve Arizona's structural deficit problem. Better forecasting and mechanisms for more rapid-response fiscal adjustments could provide a partial solution, but only if legislators also are willing to adopt a long-term perspective on the state's economic well being. Arizona needs a long-term strategic plan for growth and development, which should include the means for achieving, policing, and enforcing a balanced budget, with a specific implementation schedule. The dire need for a long-term plan does not, however, obviate the need for a short-term plan to deal with the current revenue shortfall and concomitant economic crisis.

[1] Proposition 105, adopted by voters at the 1992 general election, amended Article 9 of the Arizona Constitution to require a "supermajority" or 2/3 vote of the members of each house of the Legislature for any net increases in state revenues.

Although some private sector entities have a clear vision for Arizona's future, and could make excellent partners in planning and providing for Arizona's economic growth, the legislature has not taken advantage of opportunities to work with such partners. In fact, the private sector is reluctant to become involved in partnerships with government because the possibility exists for the legislature to abrogate its commitments, as it did when it terminated committed funding for the Science Foundation of Arizona.

The polarized atmosphere of Arizona's politics impedes reformation of Arizona's revenue systems. The budgeting process should be bipartisan, but often it is not. Legislators should be encouraged to consider the best interests of Arizona as a whole. The resolution or moderation of political differences presents what appears to be an intractable problem. Unfortunately, those with extreme views on both sides of the political spectrum often are not receptive to efforts to moderate their views or to compromise their positions for the common good. Arizona's Clean Elections system exacerbates this extremism, which increases voter apathy and distrust of government. Unless voters insist that legislators work in a bipartisan fashion, the current lack of political will, cooperation, and leadership is unlikely to change. Moreover, many proposed changes to the revenue system, and especially new taxes, are likely to be viewed with suspicion by voters.

In addition to these constitutional and political challenges, statutory challenges also exist. Such challenges include homeowner rebates, which subsidize homeowner property taxes; the reliance on the referendum process for tax increases, which delays the enactment of tax legislation; and requirements of automatic increases in expenditures. The structural deficit exists in large part because Arizona's system historically and currently has not adequately tied revenue to expenditures.

Challenges also exist at the local level. County revenue systems are statutorily fixed and are not tailored to individual counties, creating challenges for some counties that do not fit the typical mold, including rural counties that have grown away from their traditional economic structures. School districts have a similar problem. Tribal governments also experience challenges which should not be overlooked, as tribal governments contribute significant revenues to the state, and 30% of the state's land base is tribal.

OVERCOMING THE CHALLENGES

To create the most effective government revenue systems for Arizona, the state must implement both substantive and procedural changes. Spending cuts alone cannot solve the current problem. Additionally, although long-term reform is necessary, the state must also take immediate actions to resolve the current fiscal crisis. Because taxes are widely unpopular, effectively tackling the state's structural deficit will entail substantial political risks. Simply "passing the buck" to voters to resolve the state's fiscal crisis may reduce those risks but is unlikely to succeed without extensive voter education and outreach efforts.

The state also should enact reforms to address the political dysfunction that prevents state lawmakers from working together effectively to resolve the current fiscal crisis. Eliminating term limits, lengthening terms of office, and creating more competitive legislative districts would foster a more long-term perspective and reduce the influence of ideological extremes among the state's elected representatives. Revisions also should be considered to the state's system for public campaign financing. Although the Clean Elections system may be popular, it should be reformed to ensure that elected officials remain sufficiently responsive to the needs of their constituents.

Additionally, to overcome the current political stalemate, the legislature and the governor should appoint a non-partisan expert commission made up of civic and business leaders, former lawmakers, and others with the necessary expertise. Based in part on best practices developed by other states, the commission would prepare a recommended long-term comprehensive plan as well as specific immediate action items to reform the state's revenue systems. The commission's recommendations would be presented to the legislature for an up-or-down vote, without amendment. If not approved by the legislature, the commission's recommendations would be presented to voters through initiative or referendum.

Finally, in any overhaul of the state's revenue systems, the following changes should be considered: 1) increasing revenue stability by broadening the tax base, including by expanding the sales tax to include services; 2) making taxes for businesses competitive; 3) reviewing existing tax credits, exemptions and deductions based on data-driven analysis; 4) requiring sunset or periodic review provisions for voter initiatives so that these measures must be specifically authorized to remain in place; 5) increasing the cap on funds placed into the state's rainy day fund to at least 20 percent of the general fund, from the current 7 percent, and adding restrictions on withdrawal that are linked to measurable decreases in economic activity; 6) eliminating the supermajority requirement to pass laws that increase taxes or fees; 7) increasing transparency and accountability, so voters know how their taxes will be used and are assured that the funds are used for the stated purposes; 8) revising Proposition 105 to allow the legislature more flexibility to determine how identified revenue streams are collected; 9) authorizing issuance of state general obligation bonds, but only for capital improvements; and 10) evaluating and implementing reforms that have worked in other jurisdictions.

ASSURING REVENUE SYSTEMS RESPOND TO ECONOMIC CHANGE

Numerous individuals and institutions share responsibility for assuring that the state's revenue systems respond effectively to changing economic conditions. The governor, legislature, and other state entities and officials (such as the State Treasurer, Corporation Commission, and Department of Revenue) all play a role in assuring that state revenue systems are responsive to economic changes. Within the legislative branch, the Joint Legislative Budget Committee (JLBC) is responsible for providing data and analysis to allow the state to effectively forecast economic conditions. Within the executive branch, the Office of Strategic Planning and Budgeting (OSPB) has this responsibility. The JLBC and OSPB have expert professional staffs and consult with academic and private-sector parties and make recommendations. The resulting forecasts and projections are based partly in economics, partly in politics.

This shared responsibility results in a diffusion of accountability. Although voters are ultimately responsible for insisting that elected officials perform their duties, voter ignorance and apathy reduce this accountability. Additionally, although the state Constitution mandates that the legislature levy sufficient taxes to fund education and balance the budget, no feasible mechanism exists to correct failures to fulfill this duty.

The unreliability of economic forecasting, combined with a lack of technical economic expertise among elected officials, contribute to delayed responses to economic conditions. Other factors impeding the necessary change and accountability include the two-thirds vote requirement to increase state revenues, differences of political philosophy and partisanship, term limits, public financing of election campaigns, complexity of the tax system, lack of transparency that hides some taxes from those who ultimately shoulder the burden, and the influence of special interests on the political process.

Both state and local officials are responsible for assuring that local government revenue systems effectively respond to a changing economy. Although local governing boards, in collaboration with professional staff, set and implement their own fiscal policy, the state legislature is responsible for providing the necessary tools for local governments to collect and manage revenues. The state government also has a significant impact on local jurisdictions through unfunded mandates, fund sweeps, constitutional and statutory restrictions on local funding mechanisms, and the shifting of state/local responsibilities. All local governments operate in the shadow of the state government, which controls allocation of shared revenue funds. To foster cooperation between state and local governments, clear roles and responsibilities should be defined and respected.

Local governments are generally more politically agile and better able to adapt quickly to a changing economy than their state counterparts. Factors affecting the ability of local governments to change their revenue systems include nonpartisan elections, influences of special interests, transparency, accountability to local voters, cross-jurisdictional competition and/or cooperation, limits on information and expertise, limited flexibility for the use of bond funding sources, and reliance on property taxes.

CAPITALIZING ON PAST EFFORTS

Past efforts to study and change Arizona's revenue systems have identified many of the same problems and solutions discussed during this Town Hall. The problem with many of these studies, however, is that they are often ignored and forgotten by state government. This result occurs because the studies are too broad, state government views the studies as partisan or biased, and/or state government does not agree with the studies' conclusions. Often the overarching belief about such studies is that they represent an agenda or were based on predetermined outcomes. Studies are more credible when they are narrowly defined, focused on what is best for Arizona as a whole, and produced with the inclusion of diverse stakeholders, including representatives from the private sector. Such studies also should include action plans to implement their recommendations. A well-executed, unbiased study would provide legislators a reasonable basis for supporting what may be unpopular solutions. Proposals also must be summarized clearly to garner public understanding and support.

Successful, influential studies as suggested here are possible—for example, one such study resulted in implementing a merit-based selection system for judges in Arizona. This effort was successful largely because it was narrowly focused, backed by a detailed plan, and had strong leadership that built a broad-based coalition and was willing to compromise to achieve the overall objective. The Town Hall Background Report prepared for this Town Hall accurately summarizes lessons learned from past efforts.

In 2003-04, the Citizens Finance Review Commission (CFRC), a nonpartisan panel of business and community leaders, met weekly for a year, carefully studied Arizona's revenue systems, and made recommendations. The substantive issues examined by the CFRC were documented, written from a citizen's perspective and based on input from experts, lobbyists, and others. Although the CFRC's recommendations were well-supported, few or none have been implemented, as they were made at a time when state revenues were soaring and the momentum for change was lost to the pressure for tax reduction. Timing is everything: The state should take advantage of the external pressures arising from its current fiscal crisis to build momentum for change. The citizenry must be energized for change, and today's budget crisis can be the catalyst to build support for reform.

Political will is necessary to implement recommendations; however, political will does not begin and end with elected officials. Leadership and support from the governor, the legislature, and business and community leaders also is necessary for reform. Past efforts at reform have been successful when leaders educated the public and built consensus around specific reforms. In contrast, when communication efforts have been weak, reform efforts generally have failed.

TAKING ACTION

Reform of Arizona's revenue systems should be aimed at clearly delineated objectives, including elimination of structural deficits and keeping Arizona competitive. The state's revenue systems should provide sufficient revenues for the services that the public needs and is willing to pay for, while providing adequate reserves to protect against future deficits. In addition, the revenue systems should maximize the diversification of revenue sources and avoid disproportionate burdens on specific groups and economic sectors. Taxes and fees should be transparent, understandable, fair, sustainable and balanced. A revenue system must be flexible and able to respond quickly to changing economic conditions, and should include mechanisms to monitor, measure, and adjust collections and expenditures as necessary. Revenue policies should minimize distortions of business activity, promote economic growth, emphasize stability, predictability, efficiency, and simplicity, and promote intergovernmental cooperation and inclusion. Finally, although the focus of this report is on revenue and not spending, reform of revenue systems likely will not be politically viable unless it also eliminates unnecessary and wasteful government spending.

IMMEDIATE ACTION

The state of Arizona must take immediate action to resolve its current fiscal crisis. The governor should call the legislature into special session to (1) meet its constitutional duty to balance the state's budget, (2) approve a temporary sales tax increase with a definite sunset provision, and (3) consider spending cuts as soon as possible, without referring the issue to voters. To avoid further cuts in critical services and programs, the legislature should also continue to search for other short-term revenue sources, such as increases to income and property taxes, expansion of the sales tax base, expansion of the application of user fees, reduction of tax credits, and increased revenues from gaming.

LONG-TERM ACTIONS

The need for these immediate stop-gap measures should not deter or distract the state from also undertaking a more thorough overhaul and update of its revenue systems to better address the realities of the state's present and future economic condition. A long-term vision for state services and the state's revenue system, supported by a comprehensive, long-term strategic plan, is imperative. The Town Hall identified the following specific action items for implementation of an effective long-term revenue system in Arizona.

(1) The Town Hall recommends implementation of secure, stable, flexible, sustainable revenue sources sufficient to provide the services for which the public is willing to pay, while also promoting economic growth, reducing the effects of cyclicality, and increasing stability. Recommended items for consideration include:

- Broaden the sales tax base while lowering the tax rate.
- Reinstate the state property tax.
- Expand the application of user and impact fees.
- Evaluate tax credits and sunset or eliminate tax exemptions.
- Increase efforts to obtain a larger share of federal funds.
- Increase the cap on the rainy day fund to at least 20% of state general fund expenditures of the prior year, and add restrictions on withdrawal tied to measureable reductions in economic activity.
- Increase excise taxes on gasoline for transportation uses.
- Critically evaluate expenditures and tie expenditures to revenues.
- Consider general obligation bonding, severance taxes, exit taxes, visa taxes, and inheritance taxes.

(2) The Town Hall recommends identifying and removing barriers, including structural barriers, to political cooperation and change. Recommended items for consideration include:

- Eliminate the supermajority requirement.
- Require sunset or reaffirmation provisions for initiative measures.
- Remove term limits and/or lengthen legislative terms.
- Repeal or amend Arizona's public campaign finance Clean Elections law.
- Amend the state Constitution to add an effective balanced budget requirement, to include provisions for accountability.

- Create more competitive legislative districts.
- Amend Proposition 105 to provide for greater spending flexibility.
- In order that the Town Hall's proposed changes to the state constitution be considered in a coherent manner, the Town Hall recommends that the legislature study the feasibility of calling a limited constitutional convention to address the need for an Arizona Constitution that contains a fiscal policy structure adequate to meet contemporary needs.

(3) The Town Hall recommends improving efficiency of the revenue system. Recommended items for consideration include:

- Reevaluate revenue projection tools to improve accuracy.
- Reward individuals who identify fraud and waste or who otherwise improve fiscal efficiency.
- Define and respect the different roles of local and state governments.

(4) The Town Hall recommends establishing performance measures to track the effectiveness of the revenue system and mechanisms to make adjustments as needed. Recommended items for consideration include:

- Develop a long-term strategic plan that includes accountability, defined timetables, and assignment of responsibilities.
- Evaluate expenditures and tie expenditures to revenues.
- Incorporate a mechanism for spending evaluation and adjustment in the event that revenues fall short of projections.
- Create an independent agency, equivalent to the federal Congressional Budget Office, that monitors revenues and expenses and makes economic projections on which fiscal adjustments can be based.
- Replace annual budgets with a two-year budget process.

(5) The Town Hall recommends establishing a timetable for change that includes measures to increase revenues immediately.

While it is the legislature's job to implement change, business and community leaders must be involved. Changing Arizona's tax system will occur only as a result of bipartisan effort. All Arizonans are in this crisis together and a coalition of stakeholders supporting reform is needed. Although desirable, it is unrealistic to think that elected officials will be able to take the necessary action alone.

A commission or similar "blue ribbon" panel comprised of a diverse group of Arizona citizens, business leaders, community leaders and experts in the field should be established jointly by the legislative and executive branches to conduct a public process to evaluate the recommendations in this Town Hall report. The commission should also build a statewide coalition of key stakeholders to assist the commission in publicizing its findings and recommendations so that it can garner the widespread understanding of the issues and support needed for change to occur. The commission should be empowered and funded to hire professionals to develop and implement a public outreach plan, taking into account the recommendations in Chapter 19 of the Town Hall Background Report. The commission's recommendations should then be presented to the legislature for an up-or-down vote, without amendment. If not approved by the legislature, the commission's recommendations should be presented to voters through initiative or referendum.

A well-planned, highly visible, and well-funded public relations and education campaign and development of a statewide coalition of key stakeholders is necessary to overcome the natural resistance to change, as well as opponents of reform. Such an effort must garner the support of key stakeholders and target citizens at the grassroots level, through service clubs, chambers of commerce, and other organizations to create a groundswell of community support for the proposed recommendations. In addition, Town Hall participants should become actively involved in this process and should commit to educating their communities about the need for reform and for supporting the recommendations of the Town Hall. Participants in this Town Hall are a diverse group of people representing a broad spectrum of the public, and this diversity lends credibility to efforts to publicize the recommendations of this report. Participants should attend follow-up meetings, take the report and recommendations back to their employers and groups of which they are members, ask them to endorse and support the recommendations, and generate grassroots support for the reform of Arizona's revenue systems.