

FINANCING ARIZONA'S FUTURE

Key Facts

GOVERNMENT FINANCE IN ARIZONA

- More than one-third of the revenue received by Arizona state government comes from the federal government. Similarly, more than one-third of the revenue realized by local governments in Arizona derives from either the federal government or the state government — primarily the latter.
- The general fund is by far the largest of the more than 200 funds used by Arizona state government. Its revenue comes from multiple sources, though primarily from the state sales tax and the state income tax.
- In contrast, most of the other funds receive revenue from just one or a few specific sources, and that revenue must be used for specific purposes.
- The Arizona State Legislature appropriates (decides how to spend) less than 40 percent of the total authorized spending of the Arizona state government. The monies that are not appropriated mostly come from user fees and the federal government and must be used for specific purposes.
- The general fund is the primary catch-all fund for Arizona State Government. It is largely dependent on sales and income taxes which fluctuate significantly with the economic cycle.
- General fund revenue has fallen by one-third since the early 1990s after adjusting for the state's growth. The decline in revenue largely results from a series of state tax law changes that have reduced tax rates and added tax credits and tax exemptions. The primary rationale provided for these tax law changes has been that tax reductions would boost economic growth.
- There has been no discernible improvement in economic growth and therefore no boost in tax collections to offset the initial loss of revenue resulting from these tax law changes.

REVENUE SYSTEM GUIDING PRINCIPLES

1. **Stability:** The revenue system should minimize year-to-year fluctuations in revenues over the economic cycle.
2. **Responsiveness:** The revenue system should keep pace with long-term growth in the economy.
3. **Predictability:** A stable and responsive revenue system produces a predictable stream of revenues, benefitting taxpayers and policymakers.
4. **Efficiency:** Revenue sources should be broad based with low marginal tax rates.
5. **Competitiveness:** Revenue policies should promote economic vitality and prosperity.
6. **Exportability:** The system should tax nonresidents (such as tourists) as well as residents.
7. **Neutrality:** The use of tax credits and exemptions should be limited.
8. **Horizontal Equity:** Revenue policies should treat people of equal means similarly.
9. **Vertical Equity:** Overall tax payments as a proportion of income should not be higher for those with lower incomes.
10. **Simplicity:** The system should be designed to minimize costs of compliance and administration.

REVENUES AND EXPENDITURES

- Nearly three-fourths of the appropriations in the current fiscal year go to only three of the more than 100 state agencies: Department of Education, Arizona Health Care Cost Containment System, and Department of Corrections.
- Disproportionately large decreases in appropriations have been made to higher education and to an aggregate of relatively small state agencies
- The general fund has experienced a structural deficit over much of the last four decades. It was caused mostly by reducing revenues without reducing spending by an equal amount, though certain expenditures were increased without boosting revenues.
- Sizable decreases in total authorized spending have occurred in many agencies, particularly the Department of Transportation.

LOCAL GOVERNMENT REVENUE

- Local governments consist of counties, municipalities (incorporated cities and towns), school districts, and special districts (such as for fire protection).
- State government shares revenue with some local governments. A portion of the income tax collected by the state is shared with municipalities through the urban revenue sharing program.
- State-shared revenues are a significant portion of the total revenue of local governments.
- State shared revenue and other total general revenue available to the aggregate of all local governments declined 19 percent between fiscal years 1993 and 2013 after adjusting for the state's growth, with most of the drop occurring after fiscal year 2007.
- The largest categories of expenditures by counties in Arizona are related to crime: corrections, police protection, and judicial and legal administration.

REVENUE AND EXPENDITURE COMPARISONS TO OTHER STATES

- The total state and local government tax burden in Arizona of individuals and businesses combined is considerably below the national average.
- The individual tax burden in Arizona is substantially below average for those with high incomes, but is a little above average for those with low incomes. Arizona has one of the most regressive tax systems in the nation.
- Businesses in Arizona pay comparatively high amounts in property taxes and sales taxes. Other business tax burdens, including the corporate income tax, are quite low.
- Per student spending on K-12 education in Arizona in FY 2014 was the third lowest in the nation at 30 percent below average. Per student spending on K-12 education is below average in every expenditure category; Arizona ranks near the bottom on administrative costs. In FY 2015 per student support for higher education was the 10th lowest in the nation.