PUBLIC FINANCE IN ARIZONA
VOLUME I: FACTS

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PREFACE

This is the first of a series of three reports that discuss government finance in Arizona. The reports are available at www.wpcarey.asu.edu/seid/ccpr.

An objective review of government finance in Arizona is presented in this first volume. Included in the report are analyses of Arizona state government finance, using data of the Arizona Joint Legislative Budget Committee, and of the combined finances of all state and local governments within Arizona, using data of the U.S. Census Bureau. A historical perspective is provided for both datasets. For combined state and local government finance, comparisons are made to other states and to the national average. In addition, other measures of the tax burden by state are examined.

The second volume goes beyond the factual material included in the first volume. It particularly addresses the conceptual and empirical relationships between taxes, government revenue, and economic growth. It also discusses current issues specific to Arizona state government finance. The second volume is a revised version of the report "Tax Reductions, the Economy, and the Deficit in the Arizona State Government General Fund," incorporating new and updated material.

The third volume presents options and offers recommendations for managing the Arizona state government general fund. The near-term budget deficit is addressed as well as ways to prevent budget deficits from recurring every time economic growth slows. The third volume is an update to the report "Options for Managing the Arizona State Government General Fund: Closing the Structural Deficit and Preventing Large Deficits in the Future," but few changes were made.

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SUMMARY

The Arizona state government general fund is projected to have a deficit of more than $1 billion in the current fiscal year, following a deficit in the previous fiscal year. Another, larger, deficit is projected for the next fiscal year. While some have tried to blame the deficit on high spending, state government general fund expenditures have not been out of line with the historical record. Instead, revenue is at a historic low as a result of two factors: tax cuts over the past 15 years that were larger than spending reductions, and a cyclical downturn in revenue linked to the weak economy.

An examination of broader public finance data verifies the conclusion that government spending is not the cause of the current budget deficits affecting many state and local governments in Arizona. Over time, government revenue and expenditures in Arizona have dropped, with a cyclical decrease in revenue the primary problem for most local governments.

If state and local governments had implemented adequate rainy-day funds, current budget dilemmas would be much more manageable. State government did create a budget stabilization fund in 1990, designed to set aside revenue during times of strong economic growth to be spent during periods of weak economic growth or recession. However, the state government's rainy-day fund was weakened in 1995 before it had a chance to demonstrate its value. As a result, the amount of monies put into the fund during periods of budget surpluses has been highly inadequate to offset the lowered revenue during economic downturns. Instead, temporary surpluses were used to grant permanent tax reductions.

Arizona State Government General Fund

Arizona state government general fund revenue per $1,000 of personal income was at a record low in fiscal year 2008 and will be even lower in the current fiscal year. Revenue has been below the historic norm in most years since 2000.

The net effects of tax law changes passed by the Arizona Legislature since 1992 have cumulated to $1.6 billion per year in lost revenue on a nominal basis. Considering inflation and population growth, revenue in the current fiscal year is nearly $2.6 billion less than it would have been had the long series of tax cuts not taken place.

The tax cuts were passed in years in which state government general fund revenue was greater than expected, causing a surplus with which tax cuts could be implemented while still balancing the budget in the near term. However, revenue always has been cyclical, going up and down with the economic cycle. Over the last decade, cyclicality has been greater than in the past due to two factors: (1) the tax law changes have narrowed the tax base of state government, making revenue flows more cyclical, and (2) capital gains have become much more volatile (a national phenomenon).

Capital gains surged during the late 1990s due to the stock market boom. Many of the tax cuts were implemented during this period. Following a sharp decline, capital gains again soared temporarily due to the real estate boom, and again were accompanied by a large tax reduction.

Arizona state government general fund expenditures per $1,000 of personal income have fallen since the early 1990s. In fiscal year 2008, expenditures per $1,000 of personal income were 17th highest of the last 30 years, including being lower than in 15 of the 16 years between 1981 and 1996. While the 2008 figure was up considerably from the 2003 figure, expenditures in 2003 were at a record low due to the spending cuts implemented at that time in order to balance the general fund during the last economic downturn.

An appropriation limitation exists in the Arizona Constitution. Not only has spending been well below the limit since the early 1980s, spending has fallen over time relative to the limit.

Arizona State and Local Government Finance

To compare government spending in Arizona to other states, state and local government finance must be combined, since the level of government levying taxes and fees and having responsibility for funding programs varies from state to state. This cross-country comparison reveals that not only has government revenue and expenditures in Arizona declined over time, they have decreased relative to the national average. Arizona's revenue and expenditure ranks among all states and among a smaller group of fast-growing and/or western states also have fallen.

Arizona state and local government revenue per $1,000 of personal income has been at historic lows since the early 1990s — far below the figures of the 1960s and below the norm of the period from the 1970s into early 1990s. Arizona's figure has been less than the national average since the mid-1990s. The state's revenue rank in 2006 was 39th in the nation and ninth among 13 comparison states. If not for revenue received from the federal government, Arizona would rank even lower: 45th nationally and next-to-last in the comparison group on own-source revenue (tax and nontax revenue combined). Per $1,000 of personal income, own-source revenue was 12 percent less than the national average in 2006; prior to 1995, it had been average or above average in each year.

Four measures of the tax burden in Arizona each put the state's burden in 2006 at between 8 and 18 percent less than the national average, with each measure down 6-to-14 percentage points since 1992. Among all states, Arizona ranked between 37th and 40th on each measure. It placed ninth or 10th among the 13 comparison states. The latest data from the Tax Foundation for 2008 ranks Arizona 41st, the lowest on record.

Expenditures by state and local governments in Arizona have fallen significantly since the early 1990s per $1,000 of personal income. The 2006 figure was 7 percent less than the national average and the lowest on record. However, the state's rapid population growth causes above-average needs for capital spending (building roads, schools, and other physical infrastructure). Though capital outlays are down considerably from the historic norm, the state's capital spending still is above the national average. This leaves spending on current operations far below the national average and below the historical norm. Arizona's current operations spending per $1,000 of personal income in 2006 ranked 42nd in the nation and 10th among the 13 comparison states. On a per capita basis, current operations spending was second lowest in the country.

ARIZONA STATE GOVERNMENT

The focus of this section is the Arizona state government general fund, the fund currently receiving attention because of its large deficit in the last fiscal year and projected large deficits in the current and succeeding fiscal years. The general fund is the largest of numerous funds maintained by the state government. In comparison to some public accounting systems, the general fund is narrowly defined; for example, transportation revenue and funding for the Arizona Department of Transportation are not part of the general fund.

State government finance data come from the Arizona Joint Legislative Budget Committee (JLBC), which reports state government finance data on a fiscal year basis. The current fiscal year (2009) runs from July 1, 2008 through June 30, 2009. Unless otherwise noted, years in this report refer to fiscal years.

In order to compare state government finance data over time, nominal revenue and expenditures reported by the JLBC need to be adjusted for inflation, population growth, and real per capita economic growth. All of these adjustments can be accomplished simply by dividing revenue and expenditure data by personal income, as reported by the U.S. Department of Commerce. (To match to the fiscal year of the state government, quarterly personal income from the third quarter of one calendar year through the second quarter of the next year was averaged.)

General Fund Revenue

State government general fund revenue per $1,000 of personal income since 1971 is displayed in Chart 1. The bulk of the revenue comes from tax collections. The lines plotted in Chart 1, particularly the tax line, illustrate considerable cyclicality in revenue corresponding to the economic cycle. In addition, revenue has declined from the peak levels of the mid-to-late 1970s, with most of the decrease occurring since the early 1990s.

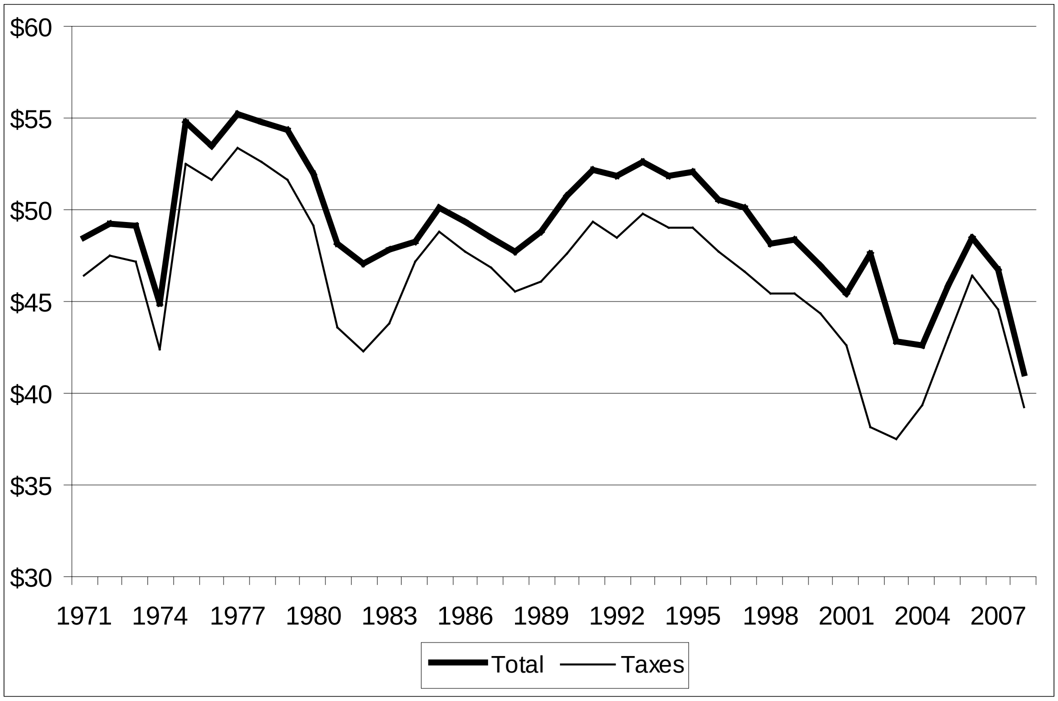
The decrease in revenue from the early 1990s through 2001 occurred during a long period of strong economic growth and resulted from a series of tax decreases passed by the Arizona Legislature, as detailed in the following subsection. In contrast, the further decline in 2003 and 2004 was due to a weak economy. The sharp increase in revenue in 2005 and 2006 reflects a strong economy that was boosted by the real estate boom. The large downturn in revenue in 2007 and 2008 (the last year on the chart) is partially due to further tax cuts, and partially results from a substantial weakening of economic growth. With revenue falling further in the current fiscal year due to the economic recession, total revenue per $1,000 of personal income is certain to fall below $40, by far the lowest figure on record.

History of Tax Law Changes

The line in Chart 1 depicting tax collections per $1,000 of personal income reflects both cyclical changes and the effects of tax increases and reductions. Significant changes to the Arizona tax code have been implemented over the last 30 years.

Tax collections were reduced significantly between 1979 and 1981: Decreases in property tax rates caused collections to drop in 1979 and 1980, and the sales tax on food to be consumed at home was eliminated in 1981. At the same time that substantial reductions in revenue resulted from these changes, an economic slump and declines in federal revenue sharing also lowered

CHART 1
REVENUE PER $1,000 OF PERSONAL INCOME, 1971 THROUGH 2008, ARIZONA STATE GOVERNMENT GENERAL FUND



Sources: Arizona Joint Legislative Budget Committee (revenue) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

public-sector revenues. The result was a significant imbalance between revenues and expenditures that was solved by a combination of spending reductions and a temporary increase in the sales tax rate. Even with a strong economic recovery that began in 1983, the budget could not be balanced without maintaining the higher general sales tax rate. Thus, this higher rate was made permanent in 1984. Despite this rate increase, tax collections per $1,000 of personal income remained below that of the late 1970s, as shown in Chart 1.

In the mid-1980s, few changes were made to the tax code. After 1986, the state economy weakened substantially, lowering state government revenue. At the same time, spending for the Arizona Health Care Cost Containment System (AHCCCS, the state's alternative to Medicaid) skyrocketed. (Prior to the mid-1980s, spending on indigent health care was a county, not state, responsibility.)

In order to annually balance the general fund, as required by the Arizona Constitution, tax increases and spending reductions were implemented from 1989 through 1991. Collections were increased from various taxes, most notably the individual income tax. Expressed as a percentage of general fund expenditures, the effects of the tax law changes were large from 1989 through 1991, raising revenues at least 3.6 percent in each of the three years. Despite a weak economy through 1992, tax collections rose. The JLBC estimated that the effect of these tax increases was to raise state government revenue by nearly $450 million per year by 1992 (see Table 1).

TABLE 1
ESTIMATED DOLLAR VALUE OF TAX CHANGES, 1989 THROUGH 2009, ARIZONA STATE GOVERNMENT GENERAL FUND

Fiscal Year	Tax Change in Millions Annual	Cumulative Since 1988	Cumulative Since 1992
1989	$122	$122	
1990	109	231	
1991	208	439	
1992	10	449	
1993	-19	430	$-19
1994	-25	405	-44
1995	-121	284	-165
1996	-285	-1	-450
1997	-175	-176	-625
1998	-172	-348	-797
1999	-142	-490	-939
2000	-105	-595	-1,044
2001	-158	-753	-1,202
2002	-33	-786	-1,235
2003	12	-774	-1,223
2004	57	-717	-1,166
2005	-5	-722	-1,171
2006	-18	-740	-1,189
2007	-194	-934	-1,383
2008	-218	-1,152	-1,601
2009	-35	-1,187	-1,636
2009, Adjusted*		-1,377	-2,579

* Adjusted for inflation and population growth

Sources: Arizona Joint Legislative Budget Committee (tax changes) and U.S. Department of Commerce, Census Bureau (population) and Bureau of Economic Analysis (gross national product implicit price deflator).

After 1992, the Arizona economy began to strengthen, causing a cyclical recovery in revenue to begin. The budget surpluses resulting from the improving economy enabled a series of tax cuts to be passed. The magnitudes of the initial cuts were small and/or the reductions were phased in due to revenue collection still being weak and continued spending increases for AHCCCS. The Arizona economy strengthened further during 1994, with growth rates reaching boom conditions in 1995. The cyclical surge in revenue that resulted allowed subsequent tax reductions to be much larger. Between 1995 and 2001, the decreases in revenues ranged from 1.8 to 6.5 percent of the size of the general fund. The tax increases of 1989 through 1992 were reversed by 1996 on a nominal basis, by 1997 on a real basis, and by 1998 on a real per capita basis.

Tax reductions continued through 2001. Thus, despite the strong economic cycle, revenue per $1,000 of personal income decreased substantially after 1995.

An economic recession followed by a weak and slow recovery held down state revenue for years, precluding new tax reductions of any magnitude to be implemented between 2002 and 2006.

However, strong economic gains eventually returned, boosted by the real estate boom. This provided the surpluses necessary to pass additional tax cuts that largely took effect in 2007 and 2008. In 2007 and 2008, the tax cuts amounted to about 2 percent of the size of the general fund.

The annual estimates of the effects of the tax law changes presented in Table 1 are unadjusted. In nominal terms, tax changes since 1988 cumulated to an estimated reduction in annual revenue of nearly $1.2 billion in 2009. After adjusting for population growth and inflation, the magnitude of the tax changes since 1988 is a decrease in revenue of nearly $1.4 billion. The unadjusted figure is not much different from the adjusted figure since nearly all of the tax increases occurred at the beginning of the period.

Cumulating the tax changes since 1988 implicitly assumes that the tax code and revenue collected at that time represents the "norm" for the state. Alternatively, revenue per $1,000 of personal income in the early 1990s might be considered the norm since these figures were between those of the 1980s and the higher figures of the mid-to-late 1970s. Thus, the cumulation of tax changes since the early 1990s also are shown in Table 1. The unadjusted loss in revenue cumulates to $1.6 billion. If inflation and population growth are considered, the magnitude of the net tax cuts balloons to nearly $2.6 billion per year.

The historical record indicates that most of the tax cuts occurred at times of strong economic growth when surplus funds were available (actual revenue collected exceeded projections and exceeded the amount spent). Further, the sizes of the surpluses were unusually large from the mid-1990s through 2000 due to the boom in the stock market, which caused capital gains to soar, as shown in Chart 2, boosting state tax collections. Surpluses again were very large from 2005 through 2007 and again were due to a surge in capital gains, this time the result primarily of the real estate boom. Capital gains probably dropped substantially in calendar years 2007 and 2008, contributing to the decline in state government revenue in 2008 and 2009.

Revenue Sources

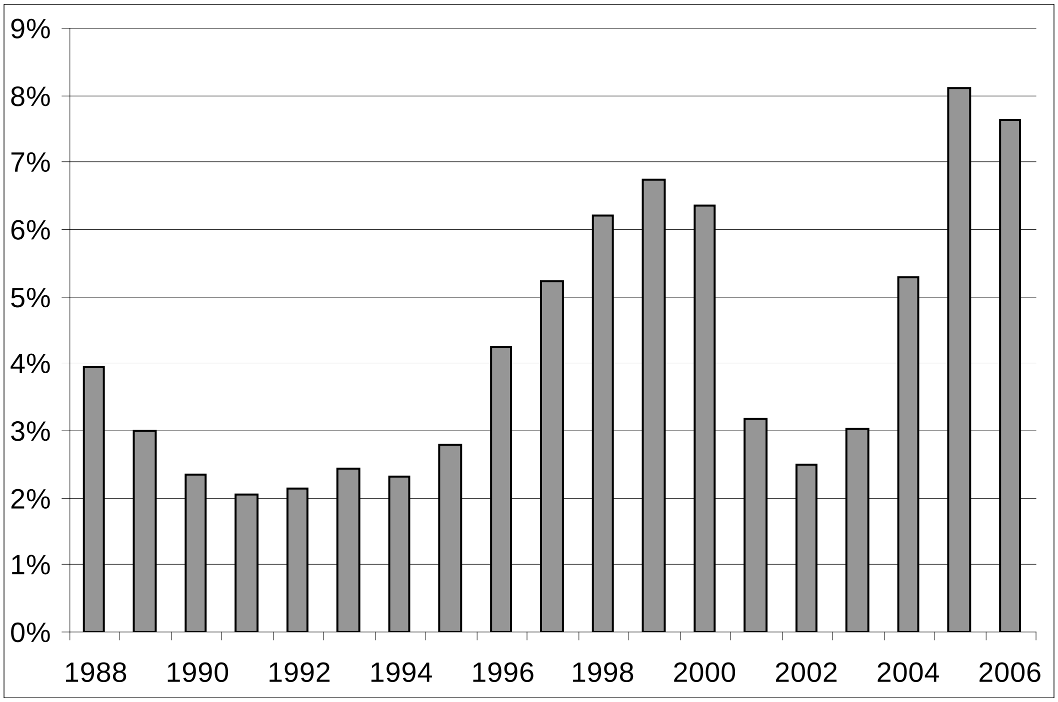
The state government general fund had revenue of $8,742 million in 2008 — $817 million less than in the prior year. This was a decline of nearly 9 percent, before considering inflation or population growth. Revenue from almost all sources declined.

State government collects revenue from a number of tax and nontax sources, as seen in Table 2. However, just two taxes — the sales and use tax and the individual income tax — provided almost 90 percent of the revenue in 2008, compared to 65 percent in 1971 (see Chart 3).

The overall effects of the changes in tax laws displayed in Table 1 are shown by major tax category in Table 3. The individual income tax was disproportionately affected, with revenue declines from this tax accounting for more than 60 percent of the overall decline since 1988 and nearly 60 percent since 1992. A series of individual income tax rate reductions were implemented, with significant declines in revenue in 1995 and 1996, from 1998 through 2001, and again in 2007 and 2008.

The cumulative decreases in collections since 1992 from the sales, property, and corporate income taxes have been similar in magnitude. Property tax cuts occurred primarily in 1997. The

CHART 2
CAPITAL GAINS IN ARIZONA AS A PERCENTAGE OF PERSONAL INCOME, 1988 THROUGH 2006 CALENDAR YEARS



Sources: Internal Revenue Service (capital gains) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

cumulative reduction in sales tax collections was due primarily to a phased-in reduction in the commercial lease rate implemented from 1994 through 1998. A variety of other sales tax exemptions also were added to the tax code. (The voter-approved increase in the sales tax rate in 2000 did not affect the general fund, since the revenue was earmarked for education.)

The first decrease in corporate income taxes did not take effect until 2000. It was not until 2001 that the tax increases of 1989 and 1991 were offset. The net decline in “other” taxes entirely results from the elimination of the general fund portion of the vehicle license tax between 1999 and 2001.

While Table 3 presents the estimated impacts of the tax law changes, actual collections per $1,000 of personal income are shown in Chart 4. The decline over time in overall state government general fund revenue primarily results from significant decreases in revenue per $1,000 of personal income from the property tax and from taxes other than property, income, and sales, though revenue from the sales tax also has dipped. In contrast, relative to personal income, income tax collections (which include personal and corporate) have increased somewhat except for sharply lower figures from 2002 through 2004 and in 2008. That income tax collections in some years were robust despite the multiple decreases in rates is not a result of “supply-side” economics. Instead, as noted earlier, sharp increases in capital gains — due first to the stock market boom and later to the real estate boom — are responsible for the higher income tax

TABLE 2
REVENUE BY SOURCE, 2008,
ARIZONA STATE GOVERNMENT GENERAL FUND

	2008	Share of Total
TOTAL	$8,742,200,000	100.0%
Total Taxes	8,351,600,000	95.5
Sales and Use	4,353,600,000	49.8
Total Income	3,506,500,000	40.1
Individual	3,406,500,000	39.0
Corporation	784,500,000	9.0
Urban Revenue Sharing	-684,500,000	-7.8
Property	20,000,000	0.2
Luxury	61,000,000	0.7
Insurance Premium	407,000,000	4.7
Estate	300,000	0.0
Other Taxes	3,200,000	0.0
Nontax Revenues	390,600,000	4.5
Lottery	48,200,000	0.6
Licenses, Fees and Permits	140,900,000	1.6
Interest	95,200,000	1.1
Other	106,300,000	1.2

Source: Arizona Joint Legislative Budget Committee.

collections. The surge in income tax collections during the 1990s and again recently occurred throughout the country, regardless of whether state income tax rates were increased or decreased.

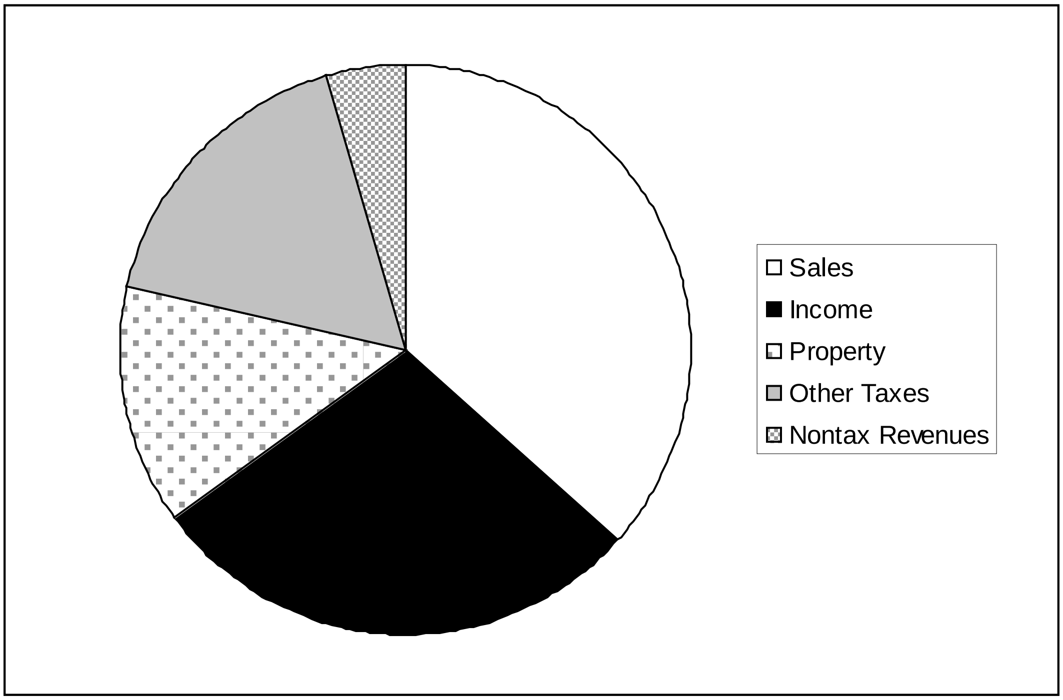
Sales and Use Tax. State government's primary revenue source is sales and use taxes, accounting for half of the general fund revenues. In 2008, sales and use tax collections were $4,354 million, down $104 million from the prior year. A larger decline in collections is occurring in the current fiscal year.

Sales and use tax collections per $1,000 of personal income peaked at more than $25 in 1985, about equal to the 1979 figure, but have since declined to less than $21. Despite this decrease, the sales and use tax share of total revenue collections has increased from less than 37 percent in the early 1970s to about 50 percent. While sales tax collections for the general fund have declined, they have not fallen as much as collections from other revenue sources.

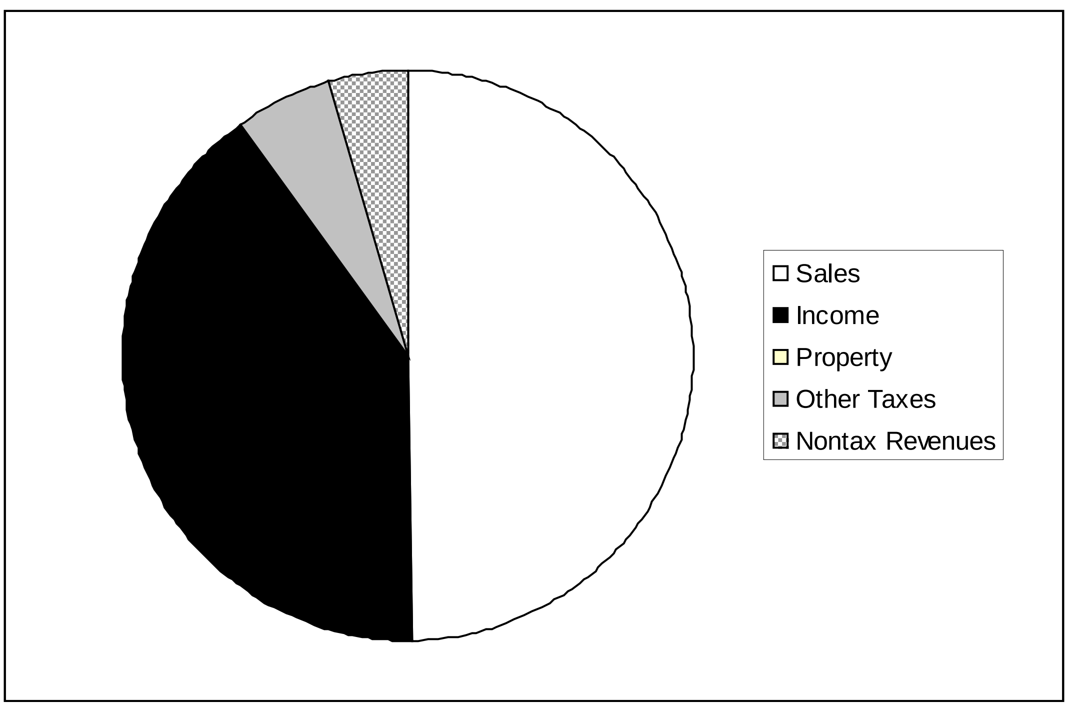
A number of taxes comprise the sales and use category. By far the largest component of the sales and use category is the transaction privilege tax (TPT) — Arizona's version of a general sales tax in which the seller is responsible for remitting the entire amount of the tax due to the state. Nearly $4 billion in revenue to the general fund was collected from the TPT in 2008. The retail portion of the TPT accounted for 46 percent of the collections in 2008, with the contracting tax's share around 22 percent, and the utilities and restaurant and bar subcategories each contributing 8 percent. A variety of other TPT taxes made up the remaining 16 percent of the general sales tax collections.

CHART 3
SHARE OF TOTAL REVENUE BY CATEGORY, 1971 AND 2008,
ARIZONA STATE GOVERNMENT GENERAL FUND

1971



2008



Source: Arizona Joint Legislative Budget Committee.

TABLE 3
ESTIMATED DOLLAR VALUE OF TAX CHANGES BY TYPE OF TAX, 1989 THROUGH 2009, ARIZONA STATE GOVERNMENT GENERAL FUND

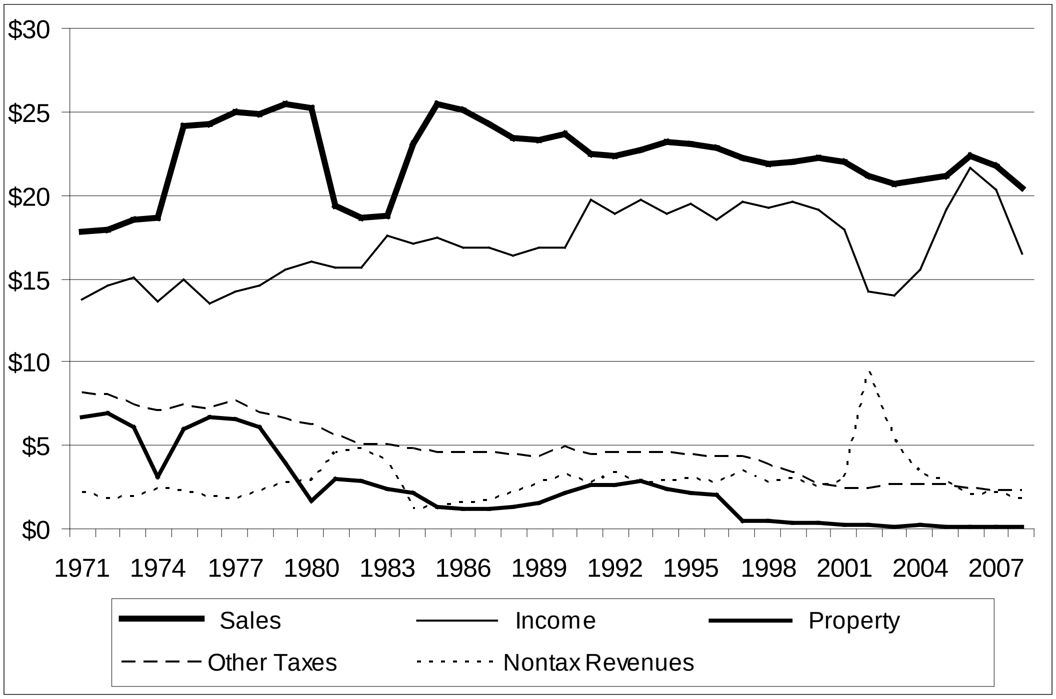
	Tax Change in Millions				
Fiscal Year	Sales	Individual Income	Corporate Income	Property	Other
Annual					
1989	$23	$35	$29	$28	$6
1990	7	64	0	23	16
1991	-4	119	31	50	14
1992	-0	9	0	0	0
1993	-8	-14	0	-1	3
1994	-12	-11	0	-1	-1
1995	-21	-103	4	-1	0
1996	-46	-202	-18	-18	0
1997	-23	-1	-0	-150	0
1998	-60	-115	3	0	-0
1999	-4	-51	-7	0	-80
2000	-8	-27	-14	-0	-55
2001	-4	-83	-46	-0	-25
2002	-0	10	-41	-2	0
2003	-0	11	22	-2	-19
2004	0	0	0	7	50
2005	0	-2	0	-7	4
2006	-1	-14	-3	0	0
2007	-2	-176	-11	0	-5
2008	-0	-186	-32	0	0
2009	0	-4	-30	0	0
Cumulative Through 2009					
Since 1988	-163	-741	-113	-74	-92
Since 1992	-189	-968	-173	-175	-128

Source: Arizona Joint Legislative Budget Committee.

The use tax, which contributed $341 million in general fund revenue in 2008, is applied to retail purchases of personal property by Arizona businesses (and individuals, except that enforcement of this provision is limited) in states that levy a sales tax of less than 5.6 percent. Other sales and use tax sources — severance tax on metalliferous minerals, jet fuel use tax, jet fuel excise tax, severance tax on timber, and rental occupancy tax — provided only $25 million in general fund revenue.

Income Tax. The income tax is the other primary source of general fund revenue, accounting for about 40 percent of the total in 2008. The net collection from the individual and corporate income tax less the amount distributed to local governments through urban revenue sharing was $3,507 million, down $664 million from the prior year. Collections from the individual income tax totaled $3,407 million in 2008 compared to $785 million from the corporate income tax (before the urban revenue sharing distribution). Collections from the individual income tax fell $329 million in 2008 and collections from the corporate income tax were down $202 million.

CHART 4
REVENUE PER $1,000 OF PERSONAL INCOME BY CATEGORY, 1971 THROUGH 2008, ARIZONA STATE GOVERNMENT GENERAL FUND



Sources: Arizona Joint Legislative Budget Committee (revenue) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

Collections from the corporate income tax always have been cyclical, but the volatility in individual income tax collections has increased substantially since the mid-1990s, due to the huge cycles in capital gains. After accounting for less than 30 percent of total general fund revenue through most of the 1970s, the income tax share has fluctuated since then between 30 and 45 percent.

Income tax collections per $1,000 of personal income in recent years have ranged from nearly $20 during the late 1990s to $14 in 2003 (nearly the lowest on record) to nearly $22 in 2006, the highest on record. The 2008 figure was $16.5 and the current year's figure will be lower.

Property Tax. In the 1970s, the property tax was the third largest source of state general fund revenue, with collections amounting to more than $6 per $1,000 of personal income. A large tax cut in 1980 dropped this figure to less than $2, and the elimination of the state portion of the tax in 1997 cut general fund collections to just $0.1 in 2008. Property taxes still are collected by local governments and are a major source of revenue for school districts. The $20 million collected by the state in 2008 came from land parcels not included in a school district.

Other Taxes. A variety of other taxes combined to contribute $472 million in 2008, about 5 percent of the state's general fund revenue. Collections were $3 million higher than in 2007. In the early 1970s, the share was nearly 17 percent.

Per $1,000 of personal income, collections have fallen from more than $8 to a little more than $2. All but the insurance premium tax — which now accounts for most of the collections ($407 million in 2008) — have declined in importance. After collections of around $1.3 per $1,000 of personal income through most of the time series, the insurance premium tax figure increased in 2003 and 2004 to about $1.9.

Per $1,000 of personal income, luxury tax collections were around $4 in the early 1970s but now are only $0.3, estate taxes have dropped from $1.1 to virtually zero, the parimutuel tax dropped from $0.5 to zero, the motor vehicle license tax fell from around $1 to zero, and all other taxes combined declined from $0.5 to less than $0.1.

Nontax Revenue. Various other sources of revenue contributed $391 million, or 4.5 percent of the general fund total in 2008. In 2008, licenses, fees and permits amounted to $141 million and the state lottery added $48 million (to the general fund). Interest earned contributed $95 million, and other sources produced $106 million. These other revenues per $1,000 of personal income have fluctuated over time mostly between $1.8 and $4.7, with the 2008 figure $1.8.

Budget Stabilization Fund

In the private sector, an economic slump reduces demand for goods and services. The drop off in sales leads to a general reduction in business activity, frequently resulting in layoffs of personnel no longer needed.

In the public sector, however, most public functions experience only a small reduction in the *rate of increase* in demand during recessions. Most government functions are tied to the population, which continues to grow (though less rapidly) during an economic slump. For example, the number of students to educate does not decline, nor does the need for police, fire and correctional services. While the demand for a few services falls off, such as inspections of buildings under construction, demand for some public-sector functions is countercyclical. For example, the demand for unemployment insurance benefits rises during recessions, as does the number of people eligible for public welfare. Enrollment in community colleges and universities frequently increases during slumps because of limited employment opportunities.

Thus, unlike the private sector, an economic slump does not lead to a decline in the demand for services in the public sector. However, government revenue collections are highly cyclical, falling sharply during economic downturns. Therefore, it is especially important for the public sector to have funds set aside to offset revenue decreases during an economic decline. In order to minimize the need to enhance revenue and/or reduce spending during an economic downturn, many states have adopted a "rainy-day fund."

Continued public spending during a recession using rainy-day monies helps mitigate the impact of a recession. When the economy is strong, use of a rainy-day fund helps control public expenditures by setting aside, rather than spending, excess revenue.

The Arizona Legislature created a Budget Stabilization Fund (BSF) in 1990 (a year with a substantial general fund deficit). The BSF is designed to set aside revenue during times of strong economic growth to be spent during periods of weak growth or recession. Because of the severe cyclicality of the Arizona economy, revenue collection is more cyclical than in the average state, making the existence of a rainy-day fund of particular importance in Arizona.

According to the original 1990 statute, the annual transfer between the BSF and the general fund was determined by a formula that compares the inflation-adjusted percent change in Arizona personal income minus transfer payments for the latest calendar year to the average growth rate over the last seven years. The transfer is calculated as the difference between the annual and average growth rates multiplied by the general fund revenue of the prior fiscal year. When annual growth is above the seven-year average, monies are transferred from the general fund to the BSF. When annual growth is below the average, the transfer is from the BSF to the general fund.

Under the 1990 statute, the balance in the rainy-day fund could reach 15 percent of the general fund budget before further transfers to the BSF were blocked. The size of the cap had been determined from an analysis of prior economic cycles that showed that a rainy-day balance of this size was necessary to prevent the BSF from dropping to zero before the economy recovered from a recession. However, the Legislature reduced the cap to 5 percent in 1995. Subsequently, the limit gradually was raised from 5 percent in 1997 to 7 percent in 2000.

The operation of the BSF has varied from the original intent in other ways as well. The original BSF statute was changed to block transfers to the general fund in years in which growth in adjusted personal income exceeds 2 percent. The Legislature rarely has authorized the formula-calculated transfer to or from the rainy-day fund. Funds from the BSF have been used to make expenditures unrelated to cyclical fluctuations in revenue, particularly for the alternative fuels tax credit.

The first payment into the BSF was made in 1994. In the next fiscal year (the one in which the limit was dropped to 5 percent), the cap already was reached. In the next two years (1996 and 1997), the formula called for a transfer to the BSF, but no deposit was made to the fund because of the 5 percent limit. While the dollar limit of the BSF rose gradually each year because of the increasing size of the general fund (before adjustment for inflation or population growth), the fund's interest earnings kept the balance at the limit. In 1998 and 1999, the gradual increase in the percentage limit from 5-to-7 percent allowed some deposits to be made to the fund, though less than those indicated by the formula. With a weakening economy, withdrawals from the BSF began in 2001. The total transferred to the general fund from 2001 through 2003 was $455 million, some $339 million less than called for by the formula. The BSF balance essentially dropped to zero.

Large deposits to the BSF during the economic expansion from 2005 through 2007 again pushed the reserve to the 7 percent maximum allowed. Most of this was used in 2008, leaving little to balance the current year's budget and nothing to assist with next year's projected deficit.

General Fund Expenditures

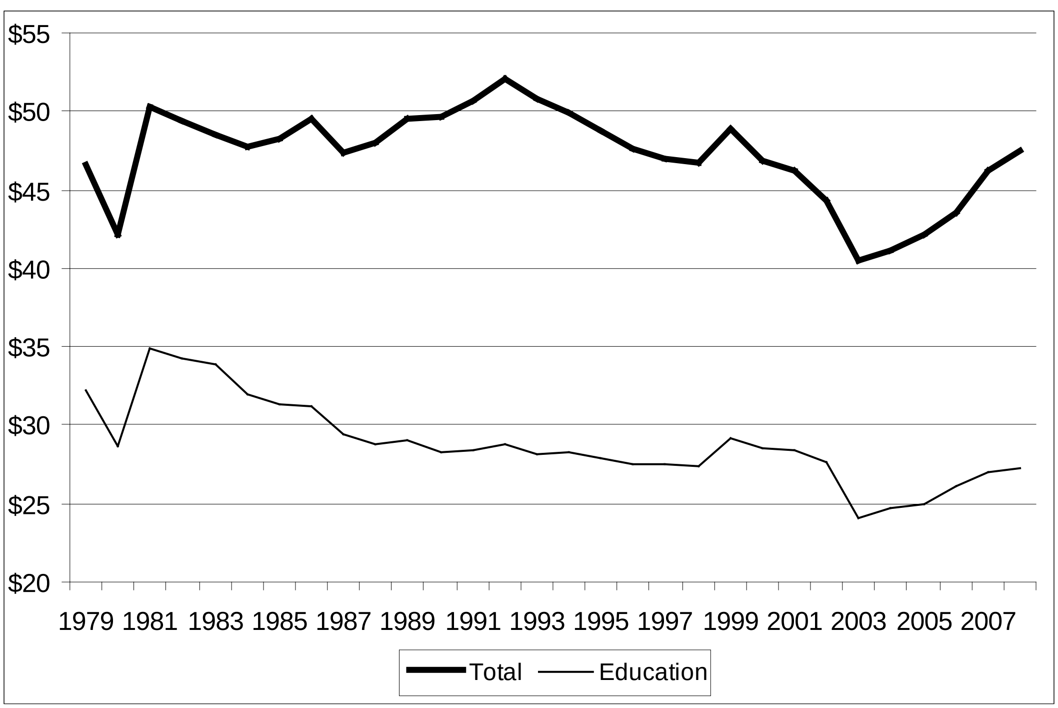
State government general fund expenditures per $1,000 of personal income since 1979 are displayed in Chart 5. (The JLBC revenue data go back to 1971 but the earliest expenditure data are for 1979.) A large share of total expenditures always has gone to education. The lines plotted in Chart 5 illustrate some cyclicality in expenditures as well as a decline over time, particularly for education.

The large decrease in expenditures per $1,000 in personal income in 2003 reflects actions taken to resolve a significant budget deficit. That deficit was partially due to a weak economy but also was a result of the tax decreases passed by the Arizona Legislature in the preceding decade. The revenue lost had not been matched by equivalent declines in spending.

The subsequent increase in expenditures after 2003 reflects a recovery from the record low spending figure, enabled by a surge in revenue resulting from the strong economy that was enhanced by the real estate boom. Despite the large increase in expenditures per $1,000 in personal income between 2003 and 2008, the 2008 level was lower than in most years prior to 1997, including 15 of 16 years between 1981 and 1996.

The surge in revenue after 2003 hid the structural deficit for a few years, but the downturn in the economy and the real estate bust made the structural deficit apparent again in 2008. A variety of

CHART 5
EXPENDITURES PER $1,000 OF PERSONAL INCOME, 1979 THROUGH 2008, ARIZONA STATE GOVERNMENT GENERAL FUND



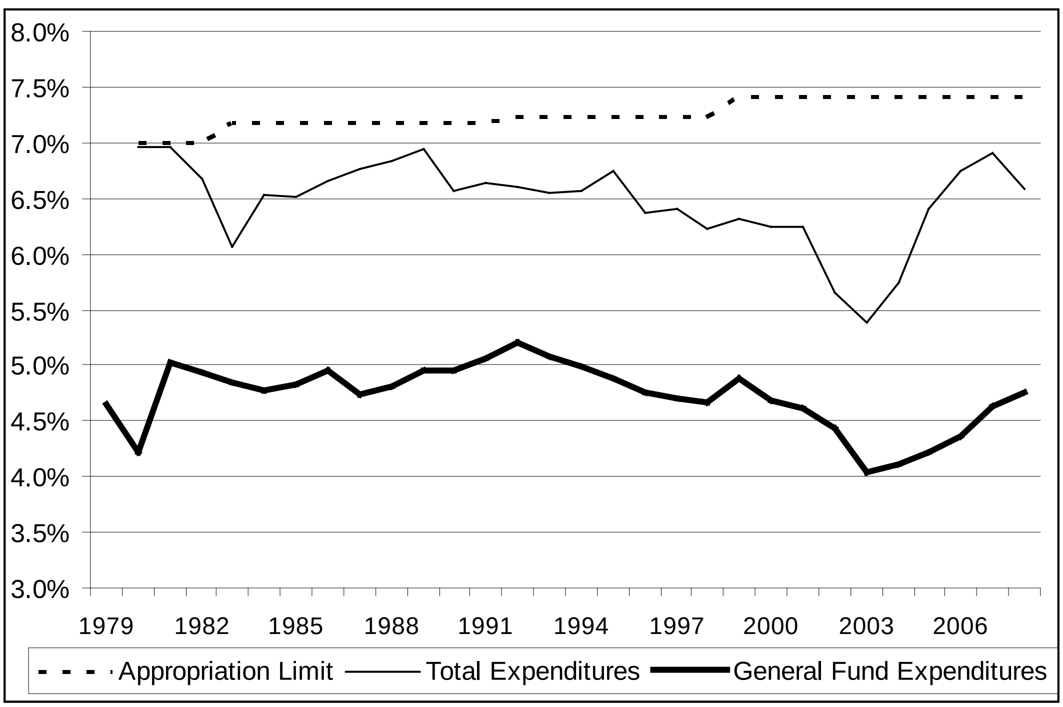
Sources: Arizona Joint Legislative Budget Committee (expenditures) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

actions were used to balance the 2008 budget. The expenditures appropriated for the current fiscal year are less than in 2008, before considering inflation and population growth. Even with this lower spending, a very large budget deficit again is present in the current fiscal year. With sizable further spending cuts likely in the near term, spending per $1,000 of personal income will be down significantly in 2009 from the 2008 cyclical high shown in the chart, and likely will drop further in 2010, since an additional budget deficit is projected for that year.

The state constitution has limited appropriations since 1979. The definition of appropriation used in the constitution is broader than the general fund. Originally the limit was 7 percent of personal income, but the limit varies with changes in government spending responsibilities, between the federal government and the state government, and also between state government and local governments. As seen in Chart 6, appropriations have been less than the limit by at least 0.5 percentage points in every year since 1990.

General fund spending peaked at 5.2 percent of personal income in 1992. In 2008, spending was 4.75 percent of personal income, less than in most years. The 2009 and 2010 figures almost certainly will be much lower.

CHART 6
EXPENDITURES AND CONSTITUTIONAL APPROPRIATION LIMIT AS A PERCENTAGE OF PERSONAL INCOME, 1979 THROUGH 2008, ARIZONA STATE GOVERNMENT GENERAL FUND



Sources: Arizona Joint Legislative Budget Committee (expenditures and limit) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

Expenditures by Category
Total general fund expenditures in 2008 totaled $10,113 million (see Table 4). The JLBC classifies state government expenditures into several categories. Education spending was 57 percent of the total, with elementary and secondary education (listed in the table as the Department of Education) alone accounted for 40 percent. Health and welfare is the other large category of expenditures, with 27 percent of the total. Protection and safety accounted for 11 percent of the spending, with most of this for corrections.

Education funding has fallen since 1981 per $1,000 of personal income, as seen in Chart 5. However, health and welfare spending per $1,000 of personal income has climbed substantially, though erratically, since the early 1980s (see Chart 7). Per $1,000 of personal income, protection and safety spending also has increased, while spending in the other categories has decreased.

As large as education's share was in 2008, it was smaller than in the past (see Chart 8), dropping from 69 percent in 1979 to 57 percent in 2008. Offsetting this decline in share was a large gain in the share of expenditures for health and welfare, rising from 16 percent to more than 26 percent. The protection and safety share rose from 6 percent to 11 percent, while the share of all other spending fell from more than 8 percent to 5 percent.

Education. The decline in education spending per $1,000 of personal income since 1981 shown in Chart 5 totals 22 percent. Initially, decreases occurred primarily in the K-12 subcategory, as seen in Chart 9. The decline between the 1981 peak and 1989 was 23 percent. Since the late 1980s, spending per $1,000 of personal income has hardly changed in K-12, but the figures for universities have decreased, by 38 percent between 1989 and 2008.

In 2008, education expenditures totaled $5,801 million, 57 percent of the general fund total. Elementary and secondary (K-12) spending was $4,027 million — 40 percent of total general fund spending — and another $479 million went to the School Facilities Board to build and maintain the physical infrastructure of schools. Before 1999, this capital spending was not part of the general fund, financed instead through long-term debt of school districts.

Expenditures for the Board of Regents and the universities was $1,092 million in 2008 — 11 percent of the total general fund. State general fund spending for community colleges was much lower at $168 million in 2008. Community colleges also are funded by local governments.

Health and Welfare. Health and welfare spending was $2,690 million in 2008, close to 27 percent of the general fund total. The Arizona Health Care Cost Containment System (AHCCCS: Arizona's alternative to Medicaid) received nearly half of the spending in this category ($1,132 million) in 2008, or close to 13 percent of the entire general fund budget. State spending for AHCCCS accounts for most of the volatility in health and welfare spending over time that is seen in Chart 7. Per $1,000 of personal income, AHCCCS funding has gone from zero in 1982 to a peak of $6.54 in 1993, down to $3.54 in 2002, then back up to $5.99 in 2008.

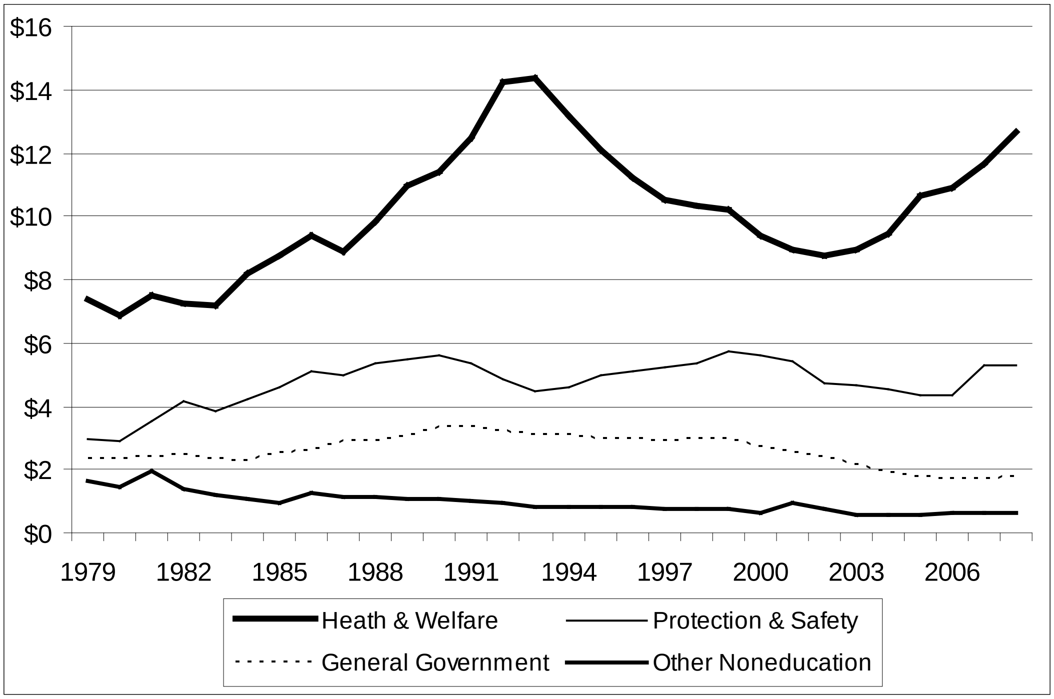
The Departments of Economic Security (DES: $797 million) and Health Services (DHS: $578 million) accounted for nearly all of the remainder of the health and welfare category. In the last decade, funding per $1,000 of personal income has been less than $4 for DES, lower than the $4

TABLE 4
EXPENDITURES BY CATEGORY AND SUBCATEGORY, 2008, ARIZONA STATE GOVERNMENT GENERAL FUND

	2008	**Share of Total**
TOTAL GENERAL FUND	$10,112,751,400	100.0%
Total Education	5,801,312,000	57.4
Community Colleges, Arizona	167,744,800	1.7
Deaf and the Blind, School for the	21,946,600	0.2
Education, Department of	4,027,156,200	39.8
School Facilities Board	479,101,400	4.7
Universities/Regents	1,091,780,400	10.8
Other	13,582,600	0.1
Total Health and Welfare	2,689,823,700	26.6
Arizona Health Care Cost Containment System	1,273,797,000	12.6
Economic Security, Department of	796,587,200	7.9
Environmental Quality, Department of	30,326,900	0.3
Health Services, Department of	578,383,100	5.7
Other	10,729,500	0.1
Total Protection and Safety	1,123,282,700	11.1
Corrections, Department of	890,813,900	8.8
Emergency and Military Affairs, Dept of	14,561,800	0.1
Juvenile Corrections, Department of	80,353,700	0.8
Public Safety, Department of	134,533,100	1.3
Other	3,020,200	0.0
Total Inspection and Regulation	48,701,200	0.5
Agriculture, Department of	11,915,800	0.1
Corporation Commission	5,697,900	0.1
Insurance, Department of	7,368,000	0.1
Other	23,719,500	0.2
Total Natural Resources	79,418,600	0.8
Land Department	26,093,000	0.3
Parks Board	27,866,700	0.3
Water Resources, Department of	23,013,100	0.3
Other	2,445,800	0.0
Total Transportation	84,600	0.0
General Government	369,961,300	3.7
Administration, Department of	31,981,500	0.3
Attorney General	24,271,600	0.2
Commerce, Department of	14,078,400	0.1
Courts	126,867,600	1.3
Governor, Office of the	7,274,500	0.1
Legislature	57,213,100	0.6
Revenue, Department of	74,498,500	0.7
Secretary of State	7,094,500	0.1
Tourism, Office of	14,639,300	0.1
Treasurer	5,448,700	0.1
Other	6,593,600	0.1

Source: Arizona Joint Legislative Budget Committee.

CHART 7
EXPENDITURES PER $1,000 OF PERSONAL INCOME BY CATEGORY, 1979 THROUGH 2008, ARIZONA STATE GOVERNMENT GENERAL FUND



Sources: Arizona Joint Legislative Budget Committee (expenditures) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

to $5 of the preceding two decades. Since many of the agency's programs are countercyclical, DES funding is higher during recessions. The Department of Health Services has received funding of around $2 per $1,000 of personal income throughout the time series, fluctuating countercyclically.

Protection and Safety. Expenditures in this category amounted to $1,123 million in 2008, about 11 percent of the general fund total. Per $1,000 of personal income, expenditures have climbed from less than $3 around 1980 to more than $5.

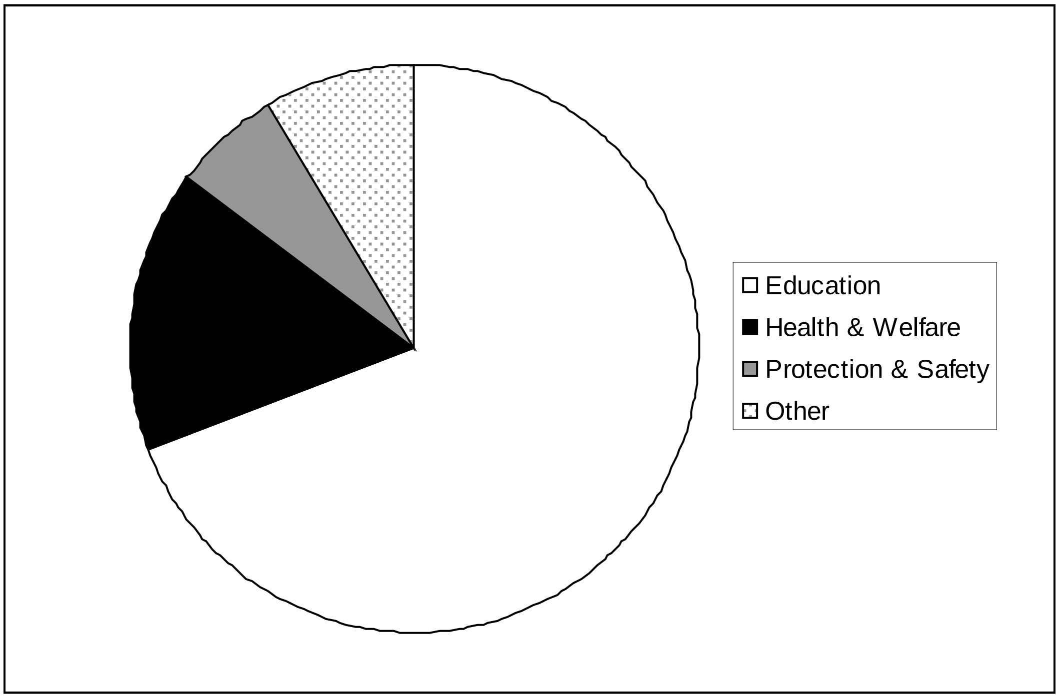
The Department of Corrections and the Department of Juvenile Corrections received $971 million in 2008: 86 percent of this category's funding and close to 10 percent of the general fund total. The correctional system is responsible for the increase over time in the category's funding.

The Department of Public Safety has received variable amounts of funding from the general fund over the years. Its funding per $1,000 of personal income in 2008 was similar to the historical median.

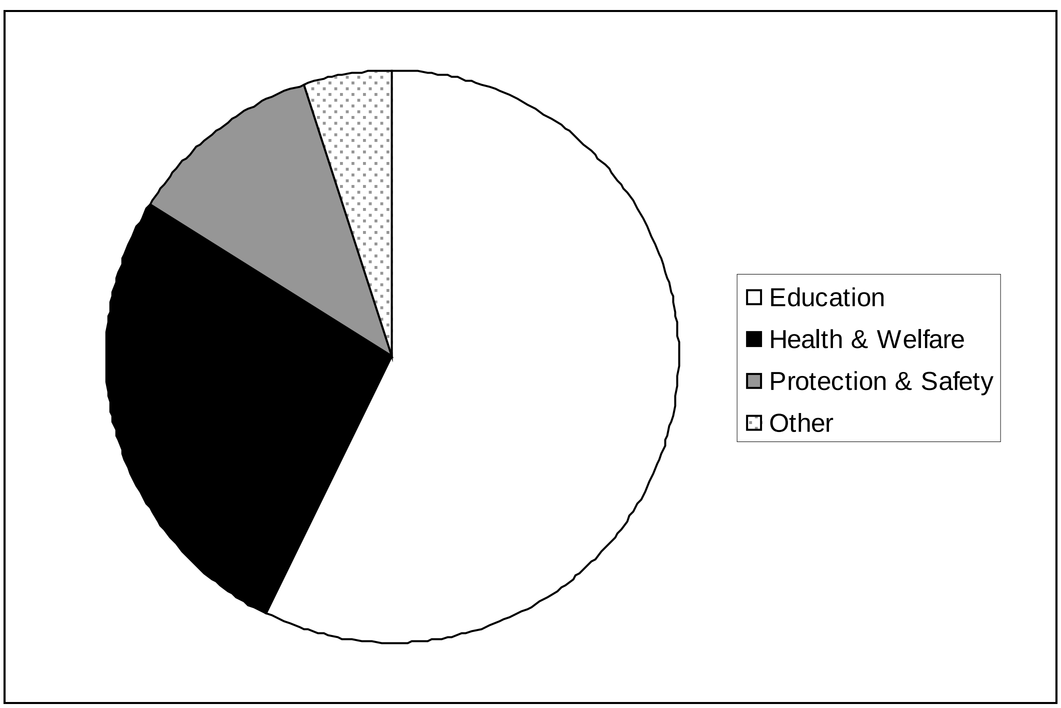
Other. Other than education, health and welfare, and protection and safety, the rest of state government received just under $500 million in 2008, less than 5 percent of the overall general fund expenditures. The court system was the only subcategory receiving more than 1 percent of

CHART 8
SHARE OF TOTAL EXPENDITURES BY CATEGORY, 1979 AND 2008,
ARIZONA STATE GOVERNMENT GENERAL FUND

1979



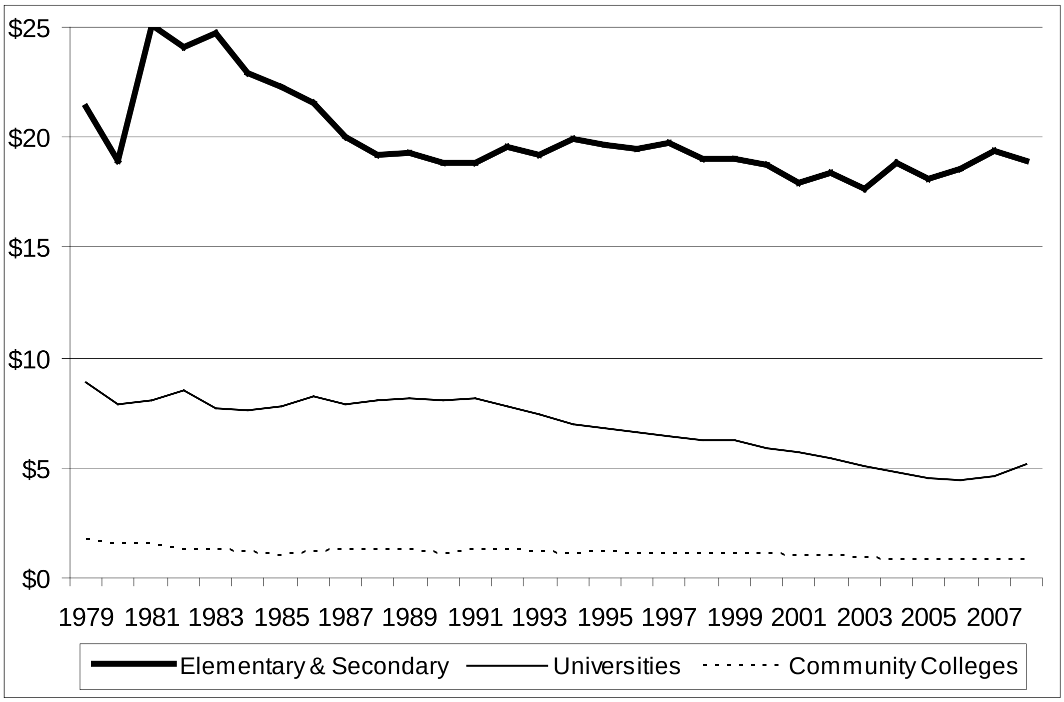
2008



Source: Arizona Joint Legislative Budget Committee.

the general fund total in 2008. Spending per $1,000 of personal income has fallen over time for the "other" category as a whole, and in most of the subcategories.

CHART 9
EDUCATION EXPENDITURES PER $1,000 OF PERSONAL INCOME BY SUBCATEGORY, 1979 THROUGH 2008, ARIZONA STATE GOVERNMENT GENERAL FUND



Sources: Arizona Joint Legislative Budget Committee (expenditures) and U.S. Department of Commerce, Bureau of Economic Analysis (personal income).

COMBINED STATE AND LOCAL GOVERNMENT FINANCE: INTRODUCTION

The level of government levying taxes and fees and having responsibility for funding programs varies from state to state. Over time, within any state, the responsibility for some revenues and expenditures may shift between state and local governments. Thus, state government finance data cannot be meaningfully compared across states. Instead, state government finance data must be combined with local government finance data of counties, cities and towns, school districts, and special districts (such as those created for fire prevention).

The primary source of data on public-sector finance across the United States is the state and local government finance series compiled by the U.S. Department of Commerce, Census Bureau. The annual Census Bureau tabulations present revenue and expenditure figures by state, using a consistent accounting system for all states. The Census Bureau aggregates the data across all state and local governments in the nation to create a national total.

The Census Bureau's state and local government finance data run from fiscal year 1963-64 through fiscal year 2005-06, though data for 2001 and 2003 are limited to national totals. Every five years (in years ending in '2' and '7'), the Census Bureau data come from a census of all governments. In the other years, the Census Bureau collects data from each state government and from a sample of local governments in each state in order to produce estimates of the government finance figures. Most of the detail reported by the Census Bureau is for "general" revenue and expenditures, but information also is provided for utility, liquor store, and insurance trust finances. For state government, the Census Bureau's definition of "general" is much broader than the general fund of the JLBC.

Revenue consists of state and local government tax collections, nontax revenue of state and local governments, and intergovernmental transfers from the federal government. Overall expenditures are subdivided into capital outlays and current operations. A capital outlay is defined as a public expenditure for construction, the purchase of land and existing structures, and the purchase of equipment. All other expenditures are classified as current operations. For most expenditure categories, the Census Bureau does not split the spending into current operations and capital outlays, though over time the number of categories for which capital outlays are separately reported has increased.

Comparing Government Finances Over Time and Across States

In the analysis of combined state and local government data for Arizona presented in the next section, Arizona is compared to the national average and is ranked among the 51 "states" (including the District of Columbia). In addition, Arizona is compared to a subset of western or fast-growing states (California, Colorado, Florida, Georgia, Idaho, Nevada, New Mexico, North Carolina, Oregon, Texas, Utah and Washington).

In order to compare the government finance data of states of widely varying sizes, and to compare data in one state over time as the population changes, the government finance data must be adjusted. Two measures typically are employed to adjust for size differences: revenue or expenditures per resident ("per capita") and revenue or expenditures relative to a gauge of income.

A weakness of both measures as applied to the government finance data collected by the Census Bureau is that revenue paid by businesses cannot be separated from that paid by individuals (except that the corporate and individual income taxes have been separated in recent years). Similarly, taxes and fees paid by tourists, business travelers, and seasonal residents cannot be isolated from those paid by residents. Thus, both measures substantially overstate the direct state and local government taxes paid by the average resident to his/her home state.

A very different measure, specifically used to assess tax burden, is to calculate the amount of taxes that would be paid by a hypothetical household or business. It is of particular value to individuals and businesses making migration decisions. While the results can provide high-quality information for the hypothetical household or business, the findings should not be generalized to other households or businesses. Since this method is very labor intensive, few studies employ this approach and those that do limit their analyses to a small number of hypothetical businesses or households.

Per Capita

The per capita measure — government revenue or expenditures divided by population — is simple and straightforward. Better measures could be constructed for some categories — for example, elementary and secondary school expenditures could be adjusted by the number of students — but developing such measures becomes a major project when comparing a number of states and when comparing government finances over time.

The per capita measure is criticized for not considering the concept of ability to pay. For example, the same amount of per capita taxes in a poor state will be more of a burden to taxpayers than in a state in which residents have higher incomes. From one perspective, acknowledging differences in income levels (the ability to pay) across states is important. From another perspective, however, a highly progressive tax system can collect average per capita revenue in a state with low incomes without unduly burdening those with low incomes.

Moreover, states with low incomes have greater demands for their public services. Limiting tax collections (and therefore expenditures) to the average ability to pay could compromise the capacity of the state to address income and related issues, helping to perpetuate those problems. Similarly, limiting the amount of spending in a poor state will equate to a lower quality and/or lesser quantity of infrastructure and other government services in that state relative to other states. In turn, subpar infrastructure and government services will limit the poor state’s economic development, perpetuating its status as a poor state.

A drawback to comparing per capita measures across states is that the cost of living varies by state. Research has shown that a meld of unadjusted and cost-of-living-adjusted data provides the best comparison across states. However, a state-level index of living costs is not regularly produced. Various efforts to produce cost-of-living indexes have shown Arizona’s living costs to be quite close to the national average. Thus, adjusting for the cost of living has little impact on Arizona’s comparison to the national average, but the ranking among states can be different after adjusting for living costs.

While the per capita measure has limitations, so do the alternative methods of comparing government finance data over time and across states. The per capita measure as well as the income measure is presented in this report to compare the Census Bureau's government revenue and expenditure figures *for a given year*.

If the per capita analysis is performed over time, the finance data must be inflation adjusted; the gross domestic product implicit price deflator is used for this purpose. However, per capita analyses *over time* are *not* recommended. Inflation-adjusted per capita incomes in the United States rise over time due to productivity gains. In an increasingly affluent society, government tax collections per capita can increase without the tax burden increasing. Thus, over time it is important to consider changes in income when analyzing government finance data.

Moreover, a growing and changing economy creates additional costs and additional demand for public services, requiring the growth of public revenue to keep pace with economic growth. For example, schools have expended substantial monies to acquire computer hardware and software to keep pace with the technological changes.

Relative to Personal Income

The most common way to account for income differences across states and across time is to divide the government revenue or expenditure figure by personal income, usually expressing the result per $1,000 of personal income. Personal income is used in Arizona statutes and in the Constitution for purposes such as the calculation of the appropriation limitation and the operation of the budget stabilization fund.

Personal income by state is calculated quarterly and annually by the U.S. Department of Commerce, Bureau of Economic Analysis (BEA). For the analysis in the following section, the annual average of personal income for the four quarters that align with the state government fiscal year were used.

While personal income is a reasonable measure of economic growth, it is a poor indicator of ability to pay. Applied to the Census Bureau data, this method has the same shortcomings as the per capita method in not being able to differentiate taxes paid by businesses from those paid by individuals or by residents from nonresidents.

Further, personal income is defined broadly and includes nonmonetary income, such as pensions paid by an employer, contributions paid by both the employer and the employee for government social insurance, and the imputed rent received by homeowners. Income received by entities other than individuals, such as businesses, also is included. Since these sources of income are not available to households to apply to tax payments, personal income produces a distorted indicator of ability to pay.

In contrast, a measure such as household income includes only the money income actually received. Conceptually, money income would be much better as an adjustment to reflect ability to pay, but reliable money income estimates are not available annually by state. The best source of household and per capita money income has been the decennial census.

In Arizona, the difference between the personal income and decennial census income measures has been substantial. In 1999, per capita income from the decennial census was 6 percent less than the national average, while per capita personal income was 15 percent less than the national average. The difference between these two measures was greater in Arizona than in any other state.

This large difference between the two income measures relative to the national average suggests either that the BEA is underestimating nonmoney income in Arizona in those components for which state-specific data do not exist, or that income other than household money income is very low in Arizona. In either case, including nonmoney income results in the understatement of the ability of Arizonans to pay taxes. Thus, personal income is an unsuitable measure of the ability to pay in Arizona.

Despite these limitations, the personal income measure is used in this report along with the per capita measure to compare the Census Bureau's government revenue and expenditure figures *for a given year*. When comparing government revenue and expenditures *over time*, it is important to consider gains in real per person income. In an increasingly affluent population, government tax collections per capita can increase without the tax burden increasing. Thus, despite its shortcomings, the personal income measure is preferred to the per capita measure when comparing data over time.

Tax Burden as Measured by the Tax Foundation

The Tax Foundation produces an alternative measure of tax burden, but does not look at nontax revenue, federal funds, or expenditures. Its measure is designed to answer the question "How much are the residents of a state paying to state and local governments, regardless of the state in which the government is located?" In order to answer this question, tax burdens are shifted as necessary from the state of collection to the state of residence of the taxpayer. For example, residents of Alaska do not pay the high severance taxes levied in that state. Instead, consumers around the country ultimately pay those taxes.

The Tax Foundation's measure of tax burden estimates the effective tax rate as a percentage, calculated as per capita total state and local government taxes divided by per capita income. The data for the latest fiscal year are projections (the Tax Foundation refers to these as "advance estimates") and the estimates for the prior year are "preliminary." The Tax Foundation typically releases the annual data in April — for example, projections for 2007 were released in April 2007. However, due to a major revision in methodology, the 2008 figures were not released until August 2008.

In addition to the geographic shifting of the tax burden, the Tax Foundation measure is different from other measures in the way in which both taxes and income are defined. Instead of using the Census Bureau data for taxes, the release of which lags behind by a couple of years, the overall state and local tax estimate of the BEA is used. The BEA estimate is conceptually equivalent to the Census Bureau's definition of a tax plus special assessments.

The income measure calculated by the Tax Foundation starts with personal income as measured by the BEA, but adds to and subtracts from personal income in order to end up with a proxy for money income. The Tax Foundation methodology requires certain assumptions, as in the distribution of national data to the states. Thus, the conceptual advantage of the Tax Foundation's income measure is counterweighted by the rough-estimate nature of various components of income.

Like the per capita and personal income measures, the Tax Foundation's measure of tax burden should not be defined as the ability of a state's residents to pay taxes. While it adjusts for taxes paid by nonresidents, the estimate of taxes includes taxes paid by businesses as well as personal taxes. The income measure is similarly broad, including all sources of money income to all businesses and individuals.

Tax Burden of Hypothetical Household

Another approach to comparing tax burdens across geographic areas is to select a hypothetical household based on household composition, income, and other factors. The tax burden for this household is calculated using the actual tax code in every state. These studies typically limit the analysis to major taxes paid directly by households and often select just one hypothetical household, typically of upper-middle income. Because the property tax varies by place within a state, these studies usually pick one city in each state to compare. Since these studies actually work through the tax code of each state, they potentially result in an accurate portrayal of geographic variations in tax burden for the selected household (or business), but should not be generalized to other households (or businesses).

A study conducted annually by the District of Columbia is an example of the hypothetical household approach to comparing tax burden. It calculates the tax bill for a family of four with two school-age children at five widely different income levels ranging from $25,000 to $150,000. Among the specific assumptions is that the household owns its home except at the lowest income and that wage and salary income is split 70-30 percent between two adults in the household, with the rest of the income divided 50-50.

The District of Columbia study uses the tax code of each state in each year for four tax categories: individual income tax, residential property tax, general sales and use tax, and automobile taxes (including gasoline tax, registration fees, excise tax, and personal property tax). Taxes are calculated for the largest city in each state and for the District of Columbia. Results are available for each year from 1997 through 2007, with the 2007 study released in August 2008.

Though 11 years of data are available from the District of Columbia study, it is not recommended that this study be used as a time series. Changes in methodology, particularly in recent years, have caused inconsistencies in the results over time. Further, a time series analysis reveals that the accuracy of some of the data is in doubt, particularly for some years in the calculation of the property tax.

Summary

Conceptually, the Tax Foundation measure of tax burden is superior to the per capita or standard personal income measures. However, like the BEA personal income data, the accuracy of the Tax Foundation income data by state is unclear. Further, the Tax Foundation data are limited to overall tax burden.

The District of Columbia study is a useful complement to the other methods for measuring tax burden, particularly since it estimates the burden at five different incomes. It is of special value to individuals considering relocation. However, it does not provide a clear picture of how the tax burden has changed over time.

The Census Bureau's government finance series is a rich source of data regarding revenues and expenditures. Its major shortcoming is the lag in publishing the figures. In addition, each of the means of adjusting the raw data in order to compare government finances across states and over time has significant shortcomings. For the comparison across states in a given year, the use of both the per capita and personal income measures is recommended. For the comparison over time, however, the personal income measure alone is recommended.

COMBINED STATE AND LOCAL GOVERNMENT FINANCE: ANALYSIS

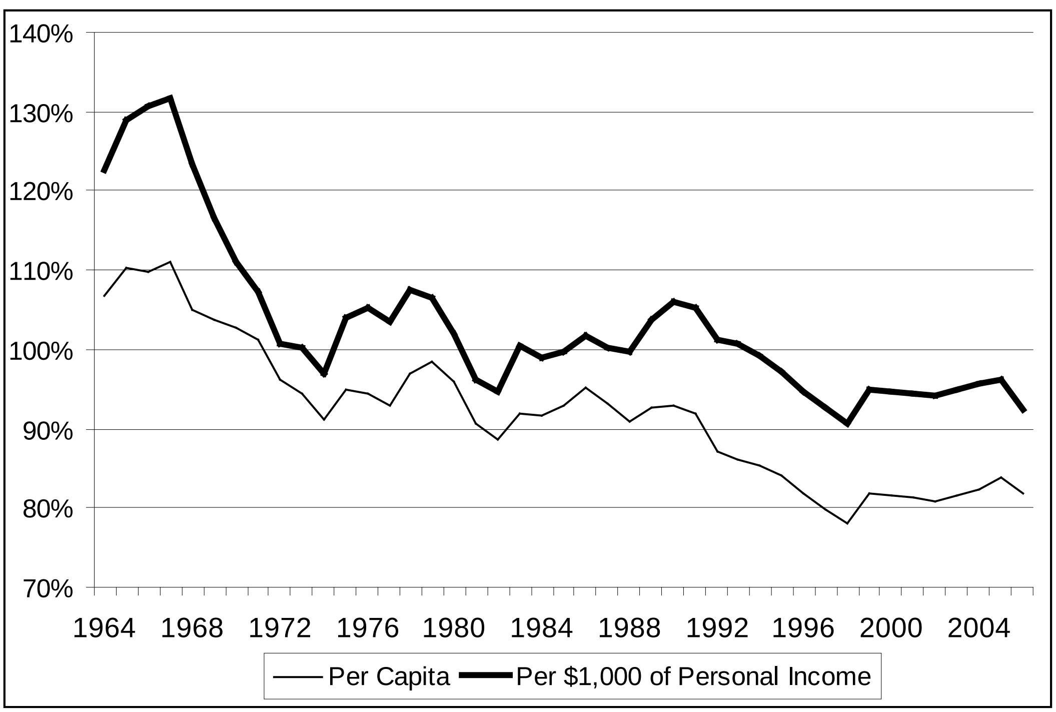
The latest Census Bureau public finance data are for fiscal year 2006. While data are presented back to 1964, changes since 1992 are particularly examined in this section. That year was selected as a comparison year since it is a census year and since it represents the beginning of the period of ongoing tax reductions by the Arizona Legislature. Further, for several years before 1992, spending for capital outlays was unusually high. The analysis that follows is for combined state and local government general revenue and expenditures, as defined by the Census Bureau.

Census Bureau Revenue

Total state and local government general revenue in Arizona was $36.5 billion in 2006: $6,021 per Arizona resident and $190.41 per $1,000 of personal income. Total revenue was less than the national average, by 18.1 percent per capita and by 7.5 percent per $1,000 of personal income. Arizona's per capita figure was second lowest in the nation. The state ranked 39th among the 51 "states" on the personal income measure and ninth among 13 western and/or fast-growing states.

Per capita and relative to personal income, Arizona revenue as a ratio to the national average was much higher during the 1960s than in subsequent years, as seen in Chart 10. From the 1970s into

CHART 10
GENERAL REVENUE AS A PERCENTAGE OF THE NATIONAL AVERAGE, 1964 THROUGH 2006, ARIZONA STATE AND LOCAL GOVERNMENTS



Note: Data for 2001 and 2003 are estimated.

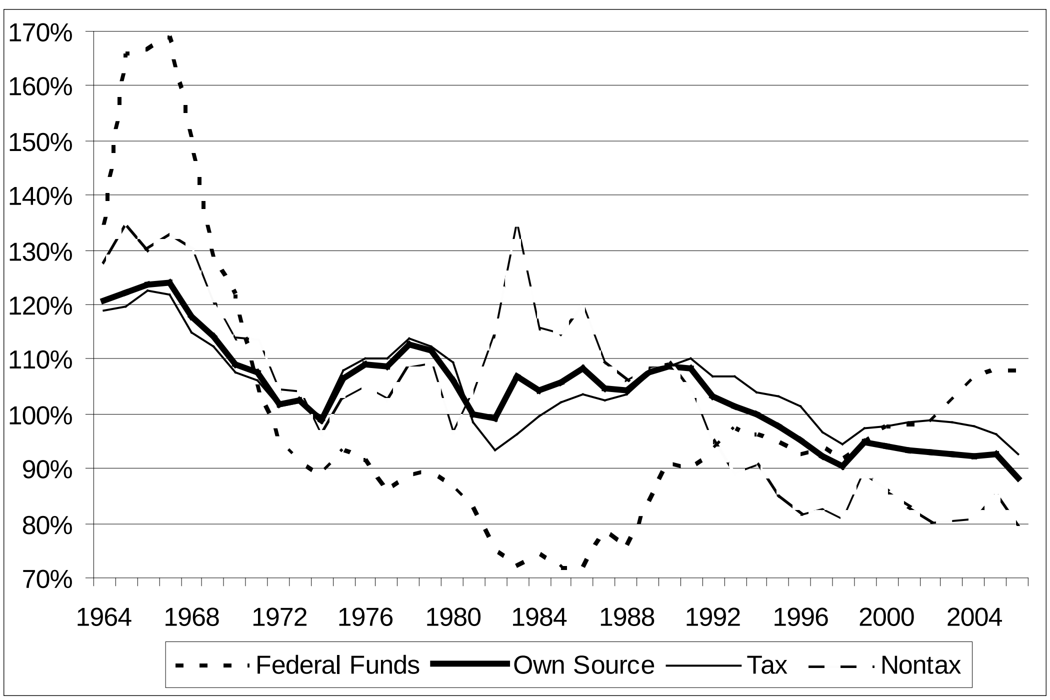
Sources: U.S. Department of Commerce, Census Bureau (revenue and population) and Bureau of Economic Analysis (personal income).

the early 1990s, state and local government revenue in Arizona per $1,000 of personal income fluctuated near the national average; the per capita figure usually was 5-to-10 percent less than the U.S. average. Since the mid-1990s, both measures have been considerably below the historical norm. Arizona's rank among the states also has declined; in 1992, Arizona had ranked 26th overall and sixth among the comparison states on the personal income measure.

State and local government revenue is divided into that received from the federal government and that collected directly by state and local governments. The "own source" revenue is further split into tax and nontax categories. The revenue from each of these categories per $1,000 of personal income is shown in Chart 11 as a ratio to the national average. Collections in each of the own-source categories in Arizona was considerably below the national average in 2006 after falling substantially over time, but federal funding was above average in 2006 after rising since the mid-1980s.

Intergovernmental transfers from the federal government amounted to $8.8 billion in 2006, nearly one-fourth of state and local government revenue. Per capita receipts from the federal government were 4 percent below the national average, with Arizona ranking 31st among all

CHART 11
GENERAL REVENUE BY MAJOR SOURCE PER $1,000 OF PERSONAL INCOME AS A PERCENTAGE OF THE NATIONAL AVERAGE, 1964 THROUGH 2006, ARIZONA STATE AND LOCAL GOVERNMENTS



Note: Data for 2001 and 2003 are estimated.

Sources: U.S. Department of Commerce, Census Bureau (revenue) and Bureau of Economic Analysis (personal income).

states and fifth in the comparison group. Receipts per $1,000 of personal income were 8 percent above average, after having been 7 percent below average in 1992. Arizona's national rank on federal funds rose from 38th to 26th, and the rank among the comparison states went from eighth to fifth.

Own-source tax revenue was $19.9 billion in 2006, accounting for 55 percent of all revenue. On a per capita basis, this amounted to $3,291 — 18 percent less than the U.S. average, ranking 37th in the nation and 10th among the comparison states. Per $1,000 of personal income, Arizona was 8 percent below the national average, a considerable change from having been 7 percent above average in 1992. In 2006, Arizona ranked 40th among all states, down from 10th in 1992, and placed 10th among the comparison states, down from the highest in 1992.

Nontax sources of revenue brought in $7.7 billion in 2006, accounting for 21 percent of the total. Arizona's use of nontax revenue was far below the national norm. In contrast, relative to personal income, Arizona's figure had been above the national average in most years prior to 1992, by substantial amounts in some years. Per capita, the state ranked last in 2006 at 30 percent below the national average. Per $1,000 of personal income, Arizona's collections in 2006 were 20 percent below average, 47th in the nation and last among the comparison states. In 1992, Arizona was not as far below the personal income norm, just 5 percent below average and ranked 37th (12th among the comparison states).

Sales and Gross Receipts Tax

The sales and gross receipts category includes the general sales tax and selective sales taxes. Other than federal funds, the general sales tax is the largest single source of revenue in Arizona, with collections of $7.5 billion in 2006 accounting for more than 20 percent of total revenue. The state's use of this tax is far above the norm. Per capita, collections were 30 percent above average, 10th in the nation and fourth among the comparison states. Relative to personal income, collections were 47 percent above average, about the same as in 1992. Arizona ranked eighth in the nation and third in the comparison group.

Arizona collected $1.9 billion from selective sales taxes. Per capita, this was 29 percent below average, ranking 43rd (ninth among the comparison states). Relative to personal income, it was 20 percent below average, further below average than in the early 1990s. Arizona ranked 40th among all states and eighth in the comparison group in 2006.

The various selective sales taxes are shown in Table 5. On both measures, Arizona was far below the norm on collections from alcoholic beverages, public utilities, and miscellaneous other selective sales taxes. Per $1,000 of personal income, the ratio to the national average has fallen significantly since the early 1990s in the public utilities and alcoholic beverages categories. In contrast, due to the voter-approved initiative raising tobacco taxes, Arizona went from below to above the national average on tobacco tax collections per $1,000 of personal income.

Property Tax

Though the state portion of the property tax was eliminated in 1997, the property tax remains a major source of revenue to local governments. A total of $5.5 billion was collected in 2006, some 15 percent of all state and local government revenue. On a per capita basis, Arizona's

TABLE 5
GENERAL REVENUE BY SOURCE, 2006,
ARIZONA STATE AND LOCAL GOVERNMENTS

	Dollars in Thousands	Share of Total	Per Capita Dollars	Per Capita Ratio to US	Per $1,000 of Personal Income Dollars	Per $1,000 of Personal Income Ratio to US
TOTAL REVENUE	$36,482,885	100.0%	$6,021	81.9%	$190.41	92.5%
From Federal Government	8,818,173	24.2	1,455	95.7	46.02	108.1
Total Own Source	27,664,712	75.8	4,566	78.3	144.39	88.4
Taxes	19,940,354	54.7	3,291	81.9	104.07	92.4
Property	5,524,045	15.1	912	75.5	28.83	85.2
Sales and Gross Receipts	9,347,395	25.6	1,543	111.3	48.79	125.7
General Sales	7,463,355	20.5	1,232	129.8	38.95	146.6
Selective Sales	1,884,040	5.2	311	71.2	9.83	80.3
Motor Fuels	772,849	2.1	128	102.6	4.03	115.8
Alcoholic Beverages	61,147	0.2	10	55.9	0.32	63.1
Tobacco Products	298,001	0.8	49	97.7	1.56	110.3
Public Utilities	183,726	0.5	30	38.1	0.96	43.0
Other	568,317	1.6	94	57.0	2.97	64.3
Individual Income	3,253,279	8.9	537	59.4	16.98	67.1
Corporate Income	890,004	2.4	147	82.5	4.65	93.2
Motor Vehicle License	192,171	0.5	32	46.0	1.00	51.9
Other	733,460	2.0	121	43.9	3.83	49.6
Nontax Sources	7,724,358	21.2	1,275	70.4	40.32	79.5
Current Charges	4,418,044	12.1	729	64.7	23.06	73.1
Education	1,682,879	4.6	278	85.2	8.78	96.2
Higher Education	1,437,224	3.9	237	85.9	7.50	97.0
School Lunch Sales	111,501	0.3	18	81.1	0.58	91.6
Other	515,185	1.4	85	30.2	2.69	34.1
Hospitals	19,689	0.1	3	5.9	0.10	6.7
Highways	334,184	0.9	55	106.0	1.74	119.7
Airports	8,037	0.0	1	23.6	0.04	26.6
Parking Facilities	0	0.0	0	0.0	0.00	0.0
Natural Resources	121,192	0.3	20	167.6	0.63	189.3
Parks and Recreation	119,993	0.3	20	68.0	0.63	76.8
Housing and Community Development	33,004	0.1	5	31.9	0.17	36.0
Sewerage	533,040	1.5	88	77.4	2.78	87.4
Solid Waste Management	363,922	1.0	60	131.0	1.90	147.9
Other	686,919	1.9	113	64.3	3.59	72.6
Miscellaneous Revenue	3,306,314	9.1	546	79.7	17.26	89.9
Interest Earned	1,169,245	3.2	193	80.3	6.10	90.6
Special Assessments	75,854	0.2	13	52.5	0.40	59.2
Sale of Property	324,506	0.9	54	404.0	1.69	456.2
Other	1,736,709	4.8	287	70.3	9.06	79.4

Source: U.S. Department of Commerce, Census Bureau (revenue and population) and Bureau of Economic Analysis (personal income).

collections were 24 percent less than the national average, ranking 36th overall and ninth in the comparison group. Relative to personal income, collections were 15 percent below average; they had been 11 percent above average in 1992. Arizona's rank fell from 19th to 33rd overall and from third to eighth among the comparison states.

Income Tax

The individual income tax provided revenue of $3.3 billion in 2006, or $537 per resident. This was 41 percent below the per capita average, ranking 40th overall and ninth in the comparison group. Relative to personal income, Arizona's collections were 33 percent less than average in 2006, down from 15 percent below average in 1993 (the first year the Census Bureau separated the individual and corporate income taxes). Arizona ranked 40th (36th in 1993) overall and ninth in the comparison group. With nine states not using the income tax, collections in Arizona were among the lowest of those states levying the tax.

The corporate income tax raised $890 million in 2006. Collections from this source are erratic from year to year, with the 2006 figure unusually high due to the strong economy at that time. On a per capita basis, Arizona's collections were 17 percent below average, but ranked 17th overall and fourth in the comparison group. Relative to personal income, collections were 7 percent below average; over time Arizona has ranged from above to considerably below the U.S. average. In 2006, Arizona ranked 24th overall and sixth in the comparison group.

Other Taxes

Collections from the motor vehicle license tax plunged in Arizona with the elimination of the state portion of the tax between 1999 and 2001. In 2006, less than $200 million was collected from this source. The per capita figure was less than half the national average after having been a little above average in the early-to-mid-1990s. Per $1,000 of personal income, the 2006 collection was 48 percent less than the national average; it had been more than 30 percent above average. Arizona's 2006 personal income rank was 49th, down from 10th in 1996. One of the comparison states had a lower figure.

Collections from miscellaneous other taxes amounted to $733 million in 2006. Arizona's collections were far less than the national average: 56 percent below average per capita (ranked 45th) and 50 percent below average relative to personal income (ranked 43rd and next to last in the comparison group). The ratio to the national average changed little over time.

Nontax Sources

Current charges (user fees) accounted for more than half of the nontax revenue in Arizona in 2006. Per capita collections were 35 percent below the national average, fourth lowest in the nation, and collections per $1,000 of personal income were 27 percent below average, 43rd in the nation and last among the comparison states. Arizona has fallen somewhat further behind the national norm over time.

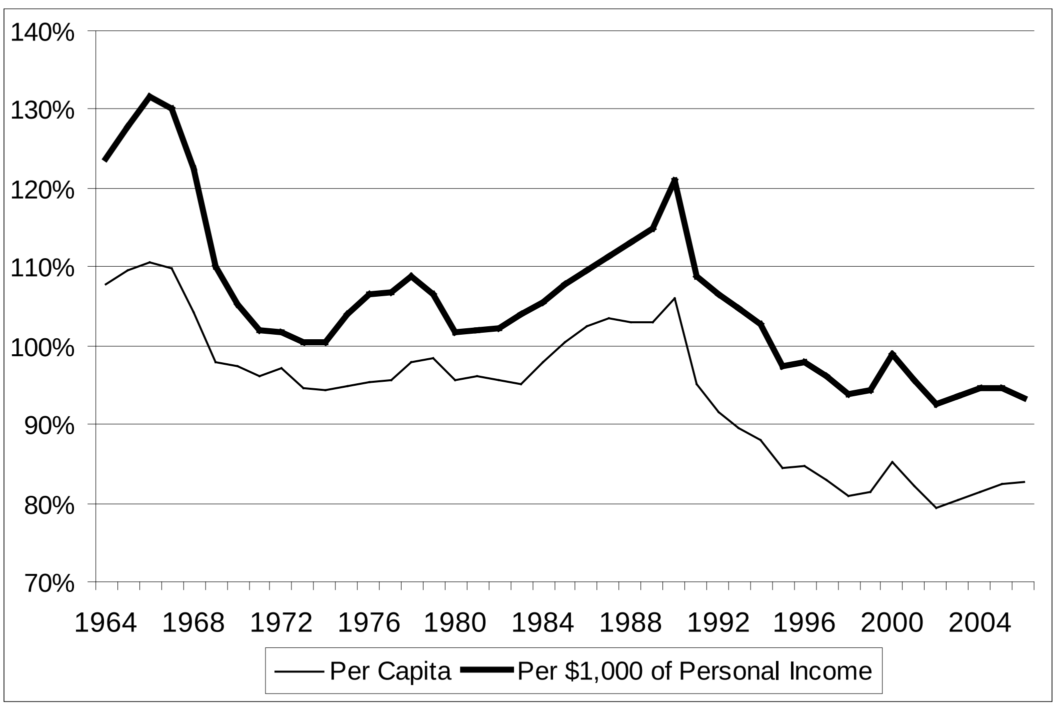
Of the many types of current charges shown in Table 5, Arizona's use was less than average on most. The decline in current charges per $1,000 of personal income as a percentage of the U.S. average, from 85 percent in 1992 to 73 percent in 2006, mostly was due to a decrease in the higher education subcategory.

Census Bureau Expenditures

Total state and local government general expenditures in Arizona totaled $35.7 billion in 2006: $5,900 per Arizona resident and $186.57 per $1,000 of personal income. Total expenditures were less than the national average, by 17.3 percent per capita and by 6.6 percent per $1,000 of personal income. Arizona's per capita figure was fifth lowest in the nation and third lowest among 13 western and/or fast-growing states. In 2006, the state ranked 36th among the 51 states on the personal income measure and ninth among the comparison states, down from 21st and fifth, respectively, in 1992.

As a percentage of the national average, total expenditures per capita and per $1,000 of personal income have fallen since the early 1990s in Arizona, as seen in Chart 12. The ratios since the late 1990s have been the lowest on record. Per $1,000 of personal income, Arizona's figure has been around 95 percent of the national average since the late 1990s; prior to 1995, the Arizona figure always had been higher than average. Similarly, Arizona's per capita spending figure has been at least 15 percent less than average since the late 1990s, but historically ranged from 5 percent below to above the national average.

CHART 12
GENERAL EXPENDITURES AS A PERCENTAGE OF THE NATIONAL AVERAGE, 1964 THROUGH 2006, ARIZONA STATE AND LOCAL GOVERNMENTS



Note: Data for 2001 and 2003 are estimated.

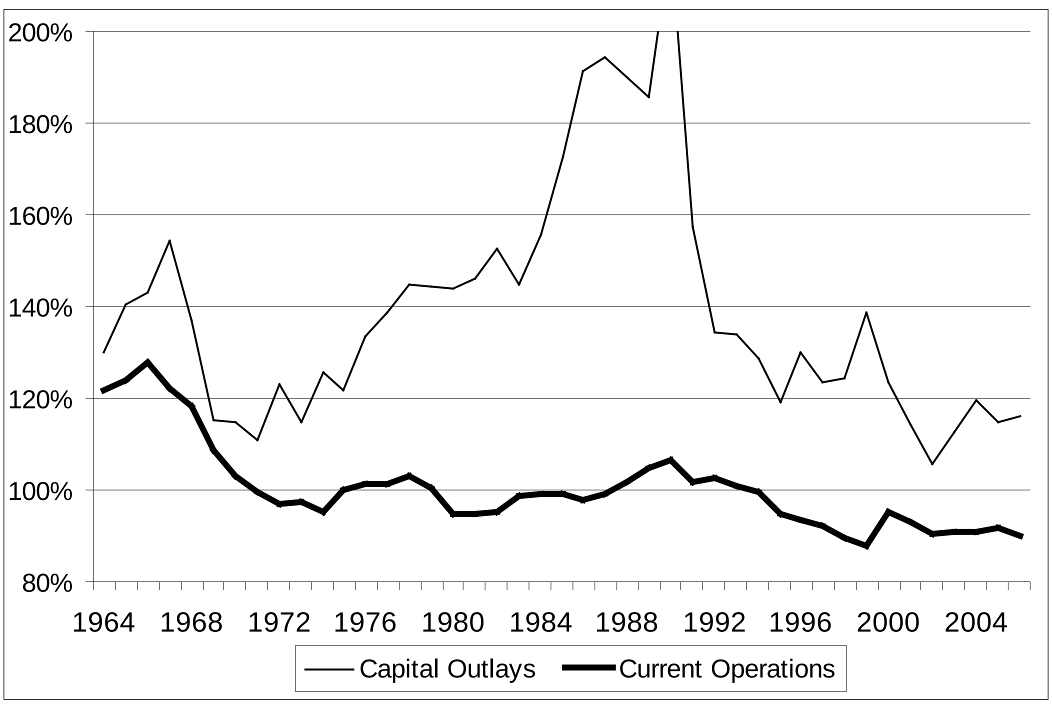
Source: U.S. Department of Commerce, Census Bureau (expenditures and population) and Bureau of Economic Analysis (personal income).

The spike in expenditures in 1990 resulted from unusually high capital outlays — spending on infrastructure, such as new schools, new roads, equipment, and land. Spending on current operations — compensation, supplies, materials, operating leases, and contractual services — was only slightly higher tat that time.

Spending on capital outlays by Arizona governments was $5.4 billion in 2006, or $895 per person, only 3 percent more than the national average (17th in the nation and sixth in the comparison group). Per $1,000 of personal income, capital outlays were 16 percent higher than the national average. These above-average figures are due to the demands placed on infrastructure building from Arizona's rapid growth. Historically, Arizona's capital outlays have been much further above the national average. As seen in Chart 13, spending on capital outlays has been erratic by year, but expenditures per $1,000 of personal income have been lower since 2002 than at any time except during the late 1960s and early 1970s. Capital spending was very high during the 1980s. Arizona ranked 17th in 2006, down from the top 10 in the early 1990s.

Expenditures for current operations totaled $30.3 billion in 2006, just more than $5,000 per resident. This was 20 percent less than the national average and the second lowest in the nation.

CHART 13
GENERAL CURRENT OPERATIONS SPENDING AND CAPITAL OUTLAYS PER $1,000 OF PERSONAL INCOME AS A PERCENTAGE OF THE NATIONAL AVERAGE, 1964 THROUGH 2006, ARIZONA STATE AND LOCAL GOVERNMENTS



Note: Data for 2001 and 2003 are estimated.

Source: U.S. Department of Commerce, Census Bureau (expenditures) and Bureau of Economic Analysis (personal income).

Per $1,000 of personal income, spending on current operations was 10 percent below average; it had been 3 percent above average in 1992 and had fluctuated from slightly below to slightly above average from the 1970s into the early 1990s. The national rank fell from 22nd in 1992 to 42nd in 2006 and the rank among the comparison states dropped from fifth to 10th.

The Census Bureau data on state and local government finances provide expenditures for a number of categories and subcategories. In some of the latter, capital outlays are provided.

Education

Arizona governments expended nearly $12 billion for educational services in 2006. Per capita expenditures were $1,974 in 2006 — 20 percent less than the national average and second lowest in the country. In 1992, Arizona's spending had been only 2 percent less than the U.S. average. Spending per $1,000 of personal income fell from 14 percent above average in 1992 to 10 percent below average in 2006, with the rank dropping from 19th to 42nd overall and from fifth to 10th among the comparison states.

Nearly all of the spending was in the education category. Its share of total expenditures was not as high on a combined state and local government basis as for state government alone, but still accounted for one-third of total expenditures in Arizona in 2006 (see Table 6).

Expenditures for elementary and secondary education were more than twice as much as for higher education. K-12 spending was 24 percent less than the per capita U.S. average and 14 percent less per $1,000 of personal income — the third lowest in the nation on a per capita basis and fifth lowest relative to personal income, with the latter rank down from 22nd highest in 1992. Only one of the comparison states spent less relative to personal income in 2006.

Elementary and secondary school spending for current operations was even further below the national average at 26 percent lower per capita and 17 percent less per $1,000 of personal income (see Table 7). Capital outlay spending was below the national per capita average but above the average relative to personal income. In the early 1990s, capital outlays relative to personal income had been more than twice as high as the U.S. average.

Spending for higher education was not as far below the national norm as for K-12 on either a per capita or personal income basis. Still, at 8 percent below average, Arizona ranked only 35th on a per capita basis in 2006. Its rank relative to personal income fell from 12th in 1992 to 30th in 2006, with a figure a little above the national average. The higher education ratios to the national average were similar for current operations and capital outlays.

It would be more meaningful to compare education expenditures per student rather than per capita. This was not done because of the data collection effort needed to reflect the number of K-12 and higher education students per state per year. However, enrollment data were collected for Arizona and the nation for 2006. The demand for education is higher in Arizona than the national average for both K-12 and higher education, measured both by enrollment per capita and enrollment relative to personal income. Thus, Arizona education expenditures are further below the national average per student than either per capita or relative to personal income. Education

TABLE 6
GENERAL EXPENDITURES BY CATEGORY, 2006, ARIZONA STATE AND LOCAL GOVERNMENTS

	Dollars in Thousands	Share of Total	Per Capita Dollars	Per Capita Ratio to US	Per $1,000 of Personal Income Dollars	Per $1,000 of Personal Income Ratio to US
TOTAL EXPENDITURES	$35,747,327	100.0%	$5,900	82.7%	$186.57	93.4%
Education Services	11,957,872	33.5	1,974	79.5	62.41	89.7
Education	11,800,497	33.0	1,948	79.5	61.59	89.8
Higher Education	3,574,947	10.0	590	91.5	18.66	103.3
Elementary and Secondary	7,737,742	21.6	1,277	75.9	40.38	85.7
Other	487,808	1.4	81	67.1	2.55	75.8
Libraries	157,375	0.4	26	73.6	0.82	83.1
Social Services	8,506,063	23.8	1,404	74.9	44.39	84.5
Public Welfare	6,059,588	17.0	1,000	80.3	31.63	90.7
Cash Assistance Payments	173,629	0.5	29	38.9	0.91	44.0
Vendor Payments	4,679,405	13.1	772	83.6	24.42	94.3
Other Public Welfare	1,206,554	3.4	199	80.4	6.30	90.8
Hospitals	882,105	2.5	146	39.2	4.60	44.3
Health	1,510,920	4.2	249	104.3	7.89	117.7
Social Insurance Administration	49,788	0.1	8	53.0	0.26	59.8
Veterans' Services	3,662	0.0	1	18.1	0.02	20.5
Transportation	2,873,279	8.0	474	88.4	15.00	99.8
Highways	2,466,482	6.9	407	89.4	12.87	100.9
Air	404,323	1.1	67	107.9	2.11	121.8
Other	2,474	0.0	0	2.2	0.01	2.4
Public Safety	4,151,549	11.6	685	107.5	21.67	121.4
Police	1,692,482	4.7	279	105.0	8.83	118.6
Fire	809,753	2.3	134	116.3	4.23	131.3
Correction	1,428,310	4.0	236	111.8	7.45	126.3
Inspection and Regulation	221,004	0.6	36	79.4	1.15	89.7
Environment And Housing	3,331,388	9.3	550	99.6	17.39	112.5
Natural Resources	575,514	1.6	95	110.8	3.00	125.2
Parks And Recreation	1,246,282	3.5	206	175.9	6.50	198.6
Housing & Community Development	398,486	1.1	66	46.6	2.08	52.6
Sewerage	752,507	2.1	124	94.2	3.93	106.3
Solid Waste	358,599	1.0	59	77.6	1.87	87.6
Government Administration	2,167,637	6.1	358	95.5	11.31	107.9
Financial	674,960	1.9	111	88.5	3.52	99.9
Judicial and Legal	842,057	2.4	139	112.2	4.39	126.7
General Public Buildings	170,271	0.5	28	69.0	0.89	78.0
Other	480,349	1.3	79	94.4	2.51	106.6
Interest On General Debt	1,308,156	3.7	216	74.9	6.83	84.6
Not Elsewhere Classified	1,451,383	4.1	240	61.5	7.58	69.4

Source: U.S. Department of Commerce, Census Bureau (expenditures and population) and Bureau of Economic Analysis (personal income).

TABLE 7
GENERAL CURRENT OPERATIONS EXPENDITURES AND CAPITAL OUTLAYS BY CATEGORY, 2006, ARIZONA STATE AND LOCAL GOVERNMENTS

	Dollars in Thousands	Share of Total	Per Capita Dollars	Per Capita Ratio to US	Per $1,000 of Personal Income Dollars	Per $1,000 of Personal Income Ratio to US
Current Operations						
TOTAL	$30,327,210	100.0%	$5,005	79.9%	$158.28	90.2%
Education	10,238,522	33.8	1,690	77.8	53.44	87.9
Higher education	3,160,982	10.4	522	91.8	16.50	103.7
Elementary & secondary	6,594,062	21.7	1,088	73.3	34.42	82.8
Hospitals	861,603	2.8	142	40.7	4.50	46.0
Highways	1,099,957	3.6	182	91.4	5.74	103.2
Correction	1,355,147	4.5	224	110.5	7.07	124.7
Natural resources	470,123	1.6	78	109.8	2.45	124.0
Parks and recreation	511,167	1.7	84	98.4	2.67	111.1
Sewerage	374,543	1.2	62	77.0	1.95	86.9
Solid waste management	330,201	1.1	54	78.7	1.72	88.9
Other	15,085,947	49.7	2,490	81.9	78.74	92.5
Capital Outlays						
TOTAL	5,420,117	100.0	895	102.9	28.29	116.2
Education	1,561,975	28.8	258	92.9	8.15	104.9
Higher education	413,965	7.6	68	89.1	2.16	100.6
Elementary & secondary	1,143,680	21.1	189	94.7	5.97	107.0
Hospitals	20,502	0.4	3	15.1	0.11	17.0
Highways	1,366,525	25.2	226	87.8	7.13	99.2
Correction	73,163	1.3	12	145.4	0.38	164.2
Natural resources	105,391	1.9	17	115.6	0.55	130.6
Parks and recreation	735,115	13.6	121	389.3	3.84	439.6
Sewerage	377,964	7.0	62	120.9	1.97	136.6
Solid waste management	28,398	0.5	5	66.3	0.15	74.9
Other	1,151,084	21.2	190	95.2	6.01	107.5

Source: U.S. Department of Commerce, Census Bureau (expenditures and population) and Bureau of Economic Analysis (personal income).

expenditures per student in 2006 in Arizona were 31 percent below the national average for K-12 and 24 percent below average for higher education.

Social Services

The next largest category of government spending is for social services, accounting for nearly 24 percent of the Arizona total in 2006. At 25 percent below the national per capita average and 15 percent less relative to personal income, Arizona's spending on social services was even further below average than education. Arizona's per capita spending ranked 44th nationally and ninth among the comparison states in 2006. Unlike education, the rank for social services did not deteriorate much over time, with the personal income measure's rank going from 35th in 1992 to 38th in 2006 and from seventh to ninth in the comparison states.

Public welfare accounts for more than 70 percent of the social services spending. Per capita welfare spending in Arizona in 2006 was 20 percent less than the national per capita average, ranking 42nd nationally and eighth among the comparison states. Per $1,000 of personal income, welfare spending was 9 percent below average, ranking 34th nationally, down from 25th in 1992, and seventh in the comparison group, down from third.

More than three-fourths of the public welfare spending was in the category of “vendor payments,” which consists almost entirely of AHCCCS/Medicaid. Vendor payments in Arizona in 2006 were 16 percent below the national per capita average and 6 percent less relative to personal income. The per capita rank was 39th (fifth in the comparison group) and the rank relative to personal income was 30th (fourth in the comparison group). Relative to the national Medicaid average, AHCCCS spending has fluctuated over time.

Spending on hospitals in Arizona in 2006 was 61 percent below the per capita average, 41st in the nation. However, other health expenditures were a little above the per capita average and further above average relative to personal income.

Public Safety
Public safety was the next largest category of general fund expenditures, accounting for almost 12 percent of total spending by Arizona governments in 2006. Arizona’s spending was 8 percent above the national per capita average, the 12th highest figure in the nation, and fourth highest among the comparison states. Relative to personal income, spending was 21 percent above average, ranking seventh among all states and fourth in the comparison group. The ratio to the national average was nearly as high in 2006 as in 1992.

Arizona’s public safety spending in 2006 was above average and ranked among the top 10 states relative to personal income in three of the category’s components: police protection, fire protection, and correction. The per capita ranks and per capita spending relative to the national average were not quite as high.

Environment and Housing
The environment and housing category accounted for 9 percent of all spending by state and local governments in Arizona in 2006. Arizona’s spending was equal to the national per capita average and 13 percent more than the average relative to personal income. Arizona ranked 20th nationally on a per capita basis and 15th relative to personal income, up from 25th in 1992. Arizona ranked sixth among the comparison states on both measures in 2006.

Arizona’s relatively high spending in this category in 2006 largely resulted from a huge increase in capital outlays for parks and recreation between 2002 and 2004. Arizona’s 2006 capital outlay in this subcategory was second highest in the nation. Overall spending on parks and recreation was far above average, ranking near the highest in the nation.

Spending in Arizona in 2006 also was above average in the natural resources subcategory. The rank relative to personal income in 2006 was 20th, down from 10th in 1992. In contrast, spending in 2006 was near average for sewerage, below average for solid waste management, and far below average for housing and community development. Relative to personal income, Arizona ranked

47th in housing and community development, down from 34th in 1992, and 31st in solid waste, about the same as in 1992. The sewerage rank was 17th, up from 41st. Half of the expenditures in the sewerage subcategory are for capital outlays; Arizona ranked eighth nationally.

Transportation
Expenditures for transportation accounted for 8 percent of the Arizona total in 2006. Per capita spending was 12 percent below average, ranking 38th overall and 11th in the comparison group. Spending per $1,000 of personal income was at the U.S. average but ranked 32nd and ninth in the comparison group. In 1992, transportation spending had been 19 percent above average relative to personal income and had ranked 23rd nationally and fifth in the comparison group.

Most (86 percent) of the transportation spending is for highways, and more than half of the highway spending is for capital outlays. Despite Arizona's rapid growth and traffic congestion, capital spending on highways in Arizona was below the national per capita average in 2006 and only equal to the national average relative to personal income. Arizona placed 30th among all states and ninth in the comparison group on capital outlays relative to personal income. Current operations spending for transportation was below the national per capita average but slightly higher than average per $1,000 of personal income.

Spending for air transportation was above average in Arizona in 2006. The state ranked 13th relative to personal income, about the same as in 1992.

Government Administration and Other Expenditures
Spending on government administration — which includes the judicial and legal systems, financial administration, public buildings, and various other programs — accounted for 6 percent of state and local government expenditures in Arizona in 2006. Expenditures were a little below the per capita average but a little above the average relative to personal income. The only subcategory above average on a per capita basis was judicial and legal; the only subcategory below average on a personal income basis was miscellaneous other.

Though still above average per $1,000 of personal income, expenditures dropped significantly between 1992 and 2006; the figure had been 34 percent above average in 1992. The national rank dropped from ninth to 21st; the rank in the comparison group went from fourth to eighth. The ratio and rank declined in all four subcategories.

Interest payments and expenditures not elsewhere classified each amounted to 4 percent of the total expenditures in Arizona in 2006. Spending in both categories was well below the national average on per capita and personal income bases. The expenditure per $1,000 of personal income as a ratio to the U.S. average for the miscellaneous category was unchanged between 1992 and 2006, but the ratio for interest payments fell sharply, from 39 percent above to 15 percent below average. The interest payments rank dropped from 10th to 35th (second to eighth in the comparison group). The rank for the not elsewhere classified category hardly changed; it was 37th nationally and eighth in the comparison group in 2006.

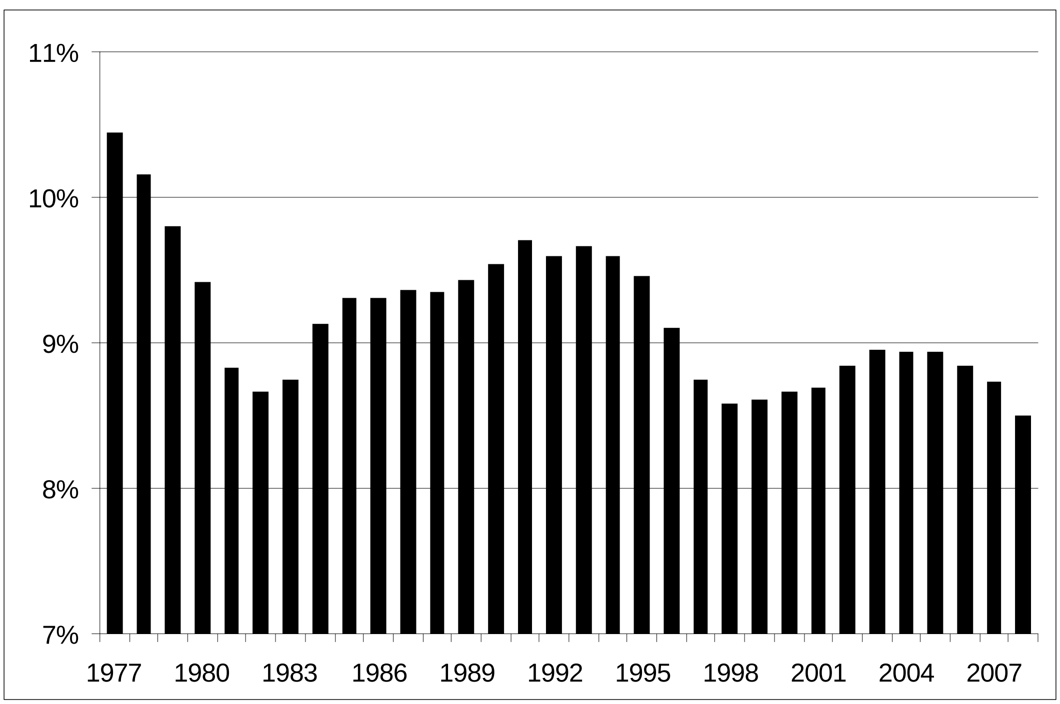
Tax Foundation Tax Burden

As calculated by the Tax Foundation, the state and local government tax burden in Arizona — defined as per capita taxes as a share of per capita income — from 1977 (the first year available) through 1980 was about equal to the national average at around 10 percent of income, though Arizona ranked above the median state (between 17th and 21st). State government tax reductions from 1979 through 1981 sent the burden down, to below the national average. Since 1981, Arizona's tax burden has always been lower than the U.S. average. An inability to balance the budget led to a subsequent tax increase in 1983, but the burden during the rest of the 1980s remained less than in the late 1970s.

When the economy slowed in the late 1980s, state government revenue was insufficient to meet the needs, causing spending reductions and further tax increases. The tax burden approached the national average in 1991 when Arizona ranked 25th among the states. However, even after the increases, the tax burden remained below the historical pre-1980 level as well as below the national average (see Charts 14 and 15).

A series of state government tax cuts began in the early 1990s, lowering the tax burden to below the level of the early 1980s. Since 1991, Arizona's tax burden has declined from 9.7 percent of per capita income to 8.5 percent in 2008. The national average tax burden barely dropped during this period and was 9.7 percent in 2008. The burden in Arizona in 2008 was 1.2 percentage points less

CHART 14
TAX FOUNDATION TAX BURDEN IN ARIZONA, 1977 THROUGH 2008, STATE AND LOCAL GOVERNMENT TAXES



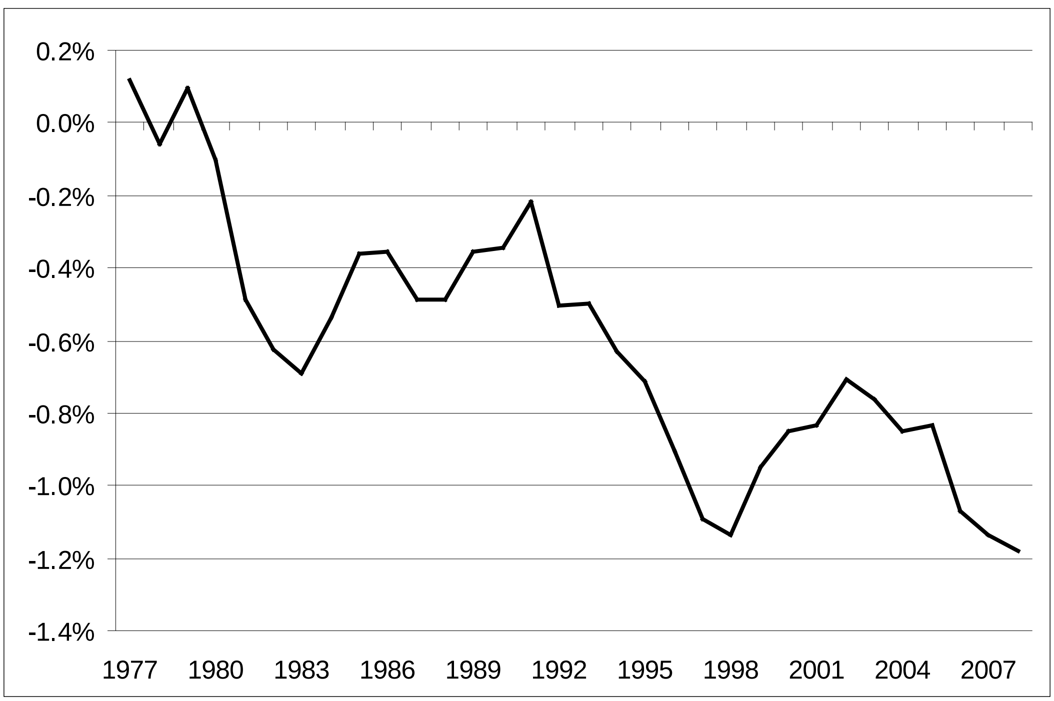
Source: Tax Foundation.

than the national average, the largest differential on record. Arizona ranked 41st among the 50 states, its lowest rank on record, down from a rank of 17th in 1977.

Among the subset of 13 comparison states, Arizona's tax burden ranked 10th in 2008. It had ranked as high as fifth in 1979. In 2008, the tax burden in Florida and Nevada was well below that of Arizona, while the burden in Texas was marginally less than in Arizona (see Chart 16).

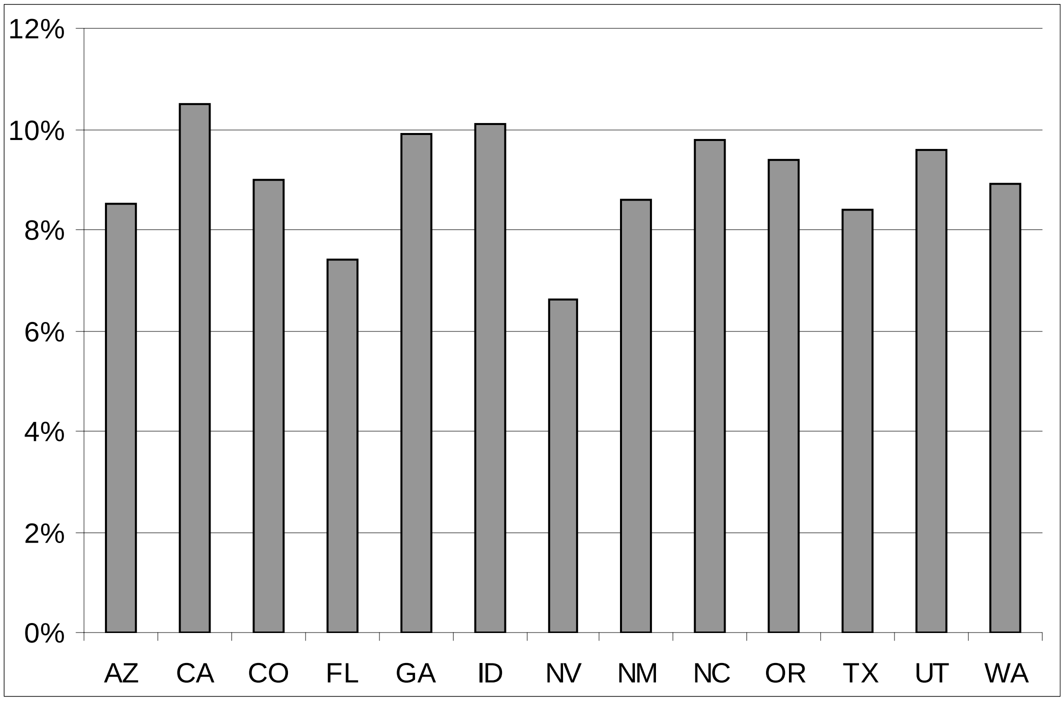
Thus, the Tax Foundation results are consistent with the Census Bureau data in showing that the tax burden in Arizona is among the lowest in the country and has fallen significantly over time, particularly since the early 1990s. This consistency is significant given that the Tax Foundation's method of estimating taxes is very different from that of the Census Bureau. Further, the Tax Foundation's measure of income is different from the personal income measure used to adjust the Census Bureau data.

CHART 15
TAX FOUNDATION TAX BURDEN IN ARIZONA RELATIVE TO NATIONAL AVERAGE, 1977 THROUGH 2008, STATE AND LOCAL GOVERNMENT TAXES



Source: Tax Foundation.

CHART 16
2008 TAX FOUNDATION TAX BURDEN IN COMPARISON STATES, STATE AND LOCAL GOVERNMENT TAXES



Source: Tax Foundation.

District of Columbia Tax Burden

The results of the 2007 District of Columbia study are summarized in Table 8. The overall tax burden in Phoenix was substantially below the norm except in the lowest income category. The income tax and property tax burdens were quite low, the sales tax burden was very high, and the automobile taxes were close to the norm except at the highest income.

Compared to the largest city in each of the comparison states, the overall tax burden in Phoenix ranked ninth or 10th highest among the 13 cities at each of the four highest incomes. The tax burden in Florida, Nevada and Washington was lower than in Arizona at each of these four incomes. At the lowest income, Arizona ranked third highest, with only Georgia and North Carolina having higher tax burdens.

Thus, the results of the District of Columbia study are consistent with the other measures, indicating that the tax burden in Arizona is among the lowest in the country.

TABLE 8
2007 DISTRICT OF COLUMBIA TAX BURDEN STUDY, STATE AND LOCAL GOVERNMENT TAXES IN PHOENIX, ARIZONA

	Household Income				
	$25,000	**$50,000**	**$75,000**	**$100,000**	**$150,000**
Rank Among 51 'States'					
Income Tax	25	38	39	41	41
Property Tax	*	43	42	42	42
Sales Tax	2	2	2	1	2
Automobile Taxes	27t	24t	17	17	13
Total Taxes	17	42	44	42	41
Total Taxes as a Percentage of Income					
Total	12.6%	6.8%	6.8%	7.2%	6.9%
Difference from Average State	0.7	-2.0	-1.9	-1.7	-2.1
Difference from Median State	1.2	-2.0	-1.7	-1.7	-2.4

* Tax assumed to be equal in all states.
t: tie.

Source: Government of the District of Columbia, *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison*.

Summary

For the broad categories of revenue and expenditures, Arizona's comparison to the national average, to all states, and to the comparison states is summarized in Table 9 for each measure for 2006. The change between 1992 and 2006 also is compared.

In 2006, total Arizona state and local government revenue was substantially less than the national average per capita and per $1,000 of personal income. The percentages of the national average for taxes were similar, while Arizona was further below average on total own-source revenue (due to very low collections of user fees and other revenues). As a ratio to the national average, Arizona's tax burden figures as measured by the Tax Foundation and by the District of Columbia were between the per capita and personal income measures. Arizona's rank in 2006, both among all states

TABLE 9
COMPARISON OF MEASURES OF GENERAL REVENUE AND EXPENDITURES, 2006, ARIZONA STATE AND LOCAL GOVERNMENTS

	Percentage of the U.S. Average		**Rank Among 51 States**		**Rank Among 13 States**	
	2006	**Change from 1992**	**2006**	**Change from 1992**	**2006**	**Change from 1992**
TOTAL REVENUE						
Per Capita	81.9%	-5.1	50	-14	13	-5
Per $ of Personal Income	92.5	-8.8	39	-13	9	-3
Own Source Revenue						
Per Capita	78.3	-10.4	47	-14	13	-5
Per $ of Personal Income	88.4	-14.9	45	-27	12	-8
Taxes						
Per Capita	81.9	-9.9	37	-10	10	-4
Per $ of Personal Income	92.4	-14.4	40	-30	10	-9
Tax Foundation	89.2	-5.8	40	-12	10	-1
District of Columbia*	83.5	na	37	na	9	na
TOTAL EXPENDITURES						
Per Capita	82.7	-8.8	47	-17	11	-3
Per $ of Personal Income	93.4	-13.1	36	-21	9	-4
Current Operations						
Per Capita	79.9	-8.3	50	-17	13	-5
Per $ of Personal Income:	90.2	-12.5	42	-20	10	-5
Capital Outlays						
Per Capita	102.9	-12.4	17	-3	6	-2
Per $ of Personal Income	116.2	-18.0	17	-9	5	-2

* Average of the five income levels
na: not available

Sources: U.S. Department of Commerce, Bureaus of the Census and Economic Analysis, Government of the District of Columbia, and Tax Foundation.

and in the comparison group, ranged by measure from well below the median state to near the bottom.

All measures show that the revenue of Arizona's state and local governments declined relative to the national average between 1992 and 2006, by between 5 and 15 percentage points. The state's rank fell in each case, by between 10 and 30 places relative to all states and by one to nine places relative to the comparison group.

Total Arizona state and local government expenditures also were substantially less than the national average per capita and per $1,000 of personal income in 2006, with the state ranking quite low relative to all states and to the comparison states. Capital outlays were somewhat above the national average, due to Arizona's rapid growth, with ranks above the median state. In contrast, expenditures for current operations were quite low. Relative to all states, Arizona's spending on current operations ranked second-to-last on the per capita measure and among the bottom 10 relative to personal income.

All measures show that Arizona's expenditures declined relative to the national average between 1992 and 2006, by at least 8 percentage points. The state's rank fell in each case, relative to all states and to the comparison group, with the declines particularly large for current operations.