

# Arizona

## At a Glance

	Change in revenue	Size of budget gap	Change in unemployment rate	Foreclosure rate	Needs supermajority?	GPP "Money" grade	Score
<b>Arizona</b>	-16.5%	41.1%	3.0	2.42%	Yes	C+	<b>28</b>
California	-16.2%	49.3%	4.6	2.02%	Yes	D+	30
United States	-11.7%	17.7%	4.4	1.37%	17 yes, 33 no	B-	17

SOURCE: Pew Center on the States 2009, reflecting best available and most current data as of July 31, 2009.

If it was not already apparent to Arizonans that the housing bubble they had so roundly enjoyed had burst, the message hit home on August 16, 2007. That is the day one of the largest private mortgage companies in the country, headquartered in Tucson, suddenly shut its doors, turned off the phones and stopped lending. First Magnus Financial Corp. became one of the first victims of the housing market collapse, but the entire state would soon feel the pain.

The Great Recession officially started just a few months later, and Arizona was in the cross hairs. Its economy was based on sunshine and all of the benefits that good weather brought to the Grand Canyon State. Clear skies attracted aerospace companies, solar power producers and, during the spring, Major League Baseball teams. And that drew droves of people who wanted to live and work there, as well as the “snow birds”—retirees from colder climates who came for vacations and second homes. There was reason for optimism. In 2007, Arizona was the second-fastest-growing state. Since 2000, the population jumped by more than 25 percent, with similar growth in housing units.<sup>29</sup>

But since the recession hit and money dried up for housing and travel, the state in September 2009 became the first to lose 10 percent of its workforce, even surpassing Michigan.<sup>30</sup> As of the

first quarter 2009, Arizona’s foreclosure rate was the third-highest in the country, behind only Nevada’s and Florida’s (Exhibit 3).<sup>31</sup> Meanwhile, collections from Arizona’s top three revenue-generating taxes—corporate income, personal income and sales—dropped more than 21 percent in fiscal year 2009.<sup>32</sup>

Early on, as the economy grew bleaker and state revenues sank, Arizona’s lawmakers reacted slowly, looking to solutions they had used to deal with other, less serious recessions. In fiscal year 2008, they drained the state’s rainy day fund, a sort of savings account set up to deal with any sudden revenue drop-offs, and delayed last-quarter payments to school districts to wipe those bills off the balance sheets of one fiscal year and push them onto the next.<sup>33</sup> “These are the type of gimmicks that are done every time we have a slowdown. They’ve just never been done to this magnitude before... [The state] never before had skipped the last quarter of school payments,” said state Treasurer Dean Martin (R).<sup>34</sup>

When drafting the fiscal year 2010 budget, Arizona had \$7 billion in revenue to pay for \$11 billion in spending.<sup>35</sup> Martin said he thinks the biggest mistake the legislature made in handling this recession was failing to make drastic spending cuts. “The budget situation... is as bad as it is in California. That’s a self-inflicted

phenomenon,” Martin said. “It’s basically because of what happened in the first two years of the recession. Rather than taking their foot off the accelerator, [legislators] basically floored it. They kept spending as if there was no recession.”<sup>36</sup>

Eileen Klein, deputy chief of staff for finance for Governor Jan Brewer (R), traced the origins of the crisis to when Janet Napolitano, a Democrat, was governor, dealing with a GOP-controlled legislature. Napolitano left office in January to serve in President Obama’s Cabinet. “You had a divide politically between the legislative branch and the executive branch. The Republican Party was in search of tax cuts when times were good, and the Democrats were in search of program expansion when times were good. The political compromise was a little bit of both,” Klein said. “All of this came together at the time when the economy began to slide.”<sup>37</sup>

services to balance the books. But lawmakers have been hamstrung by voter-imposed spending constraints. In 2000, for example, voters raised the sales tax to pay for schools. They also greatly expanded eligibility for the state’s Medicaid program. In fiscal year 2009, the restrictions meant legislators had discretion over only 30 percent of state Medicaid spending and 37 percent of funding for elementary and secondary education.<sup>38</sup>

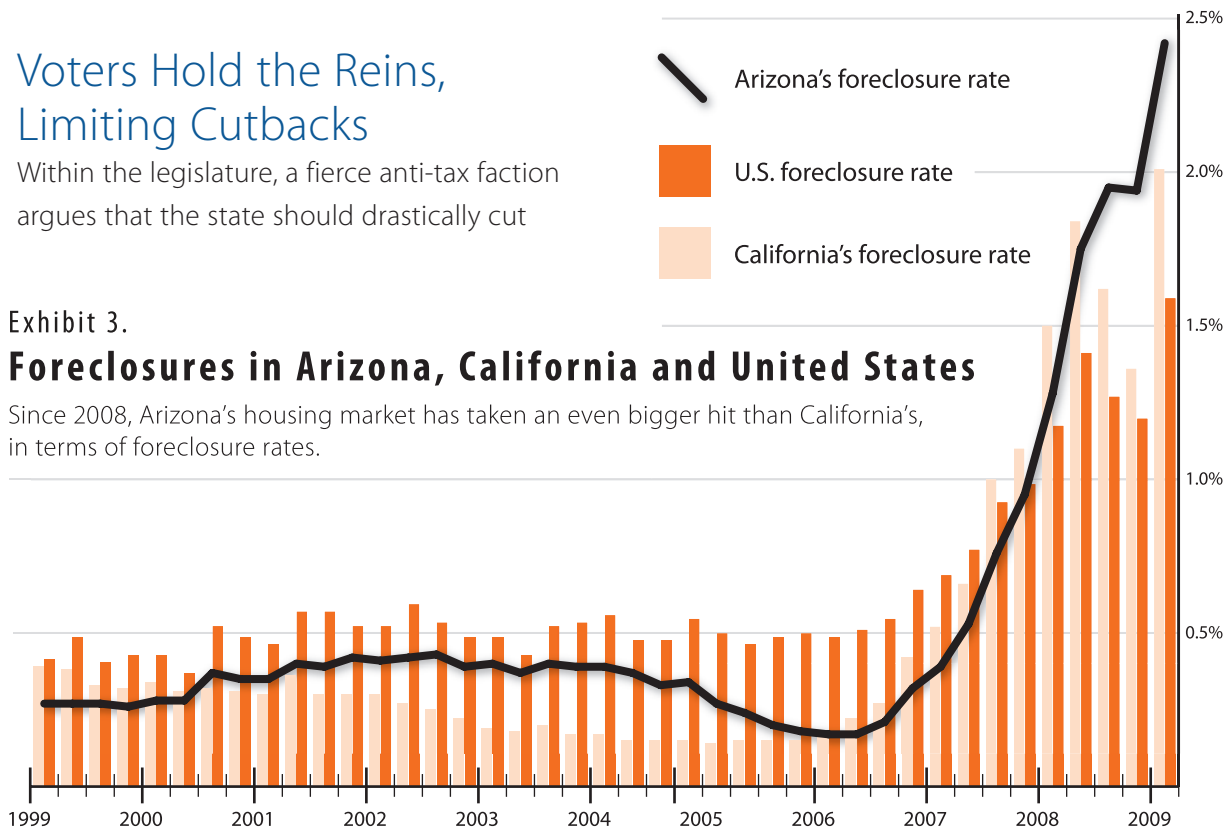
Since 2000, Medicaid rolls have more than doubled. Arizona began 2001 with more than 552,000 people on Medicaid.<sup>39</sup> By August 2009, that number exceeded 1.3 million.<sup>40</sup> Increased Medicaid enrollment led to higher state spending, even though the federal government picks up most of the tab.<sup>41</sup> Arizona’s Medicaid expenses have been growing at a rate of more

## Voters Hold the Reins, Limiting Cutbacks

Within the legislature, a fierce anti-tax faction argues that the state should drastically cut

**Exhibit 3. Foreclosures in Arizona, California and United States**

Since 2008, Arizona’s housing market has taken an even bigger hit than California’s, in terms of foreclosure rates.



SOURCE: Pew Center on the States 2009, based on data from the Mortgage Bankers Association: National Delinquency Survey; Moody's Economy.com.

than double the national average,<sup>42</sup> putting even more pressure on the state budget. “We have pre-programmed expenditures that accelerate at about 7 percent each year. So the expenditure rate already presumes a pretty healthy or robust revenue [increase],” said Klein.<sup>43</sup>

Reversing voter mandates to make it easier for lawmakers to cut their way to a balanced budget is virtually impossible because of another proposition passed by voters in 1998 that requires changes in voter-approved spending to be approved by 75 percent majorities in the legislature. Any changes must “further the

### SCORECARD INDICATOR: FORECLOSURE RATE

The change in foreclosure rates in a state is an indicator of how severely it has suffered since the nation’s housing market bubble burst. The market’s demise hit Sun Belt states particularly hard. Arizona, like California, Nevada and Florida, depended on new construction to fuel its economy. One estimate by University of Arizona economist Marshall Vest concluded that in 2007, construction, lending and related industries accounted for 20 percent of Arizona’s jobs.<sup>44</sup>

A change in foreclosure rates also can indicate how the economy is doing in general, because other factors, such as job losses or salary reductions, can cause people to fall behind on their mortgage payments. Also, when people stop buying houses—or borrowing against them—they also cut back spending on cars, appliances and construction materials, spurring declines in state sales tax collections.

purpose,” in the words of the law, of the original ballot initiative.

## Raising Taxes No Easier Option

The revenue side of the ledger offers no easier answers. With Arizona’s tax structure heavily weighted toward sales and income taxes, the state’s coffers have taken a significant hit during the recession. One issue is volatility. The state now depends on the sales tax for 48.4 percent of its general revenues, while the individual income tax generates about 16 percent. The income tax is particularly volatile in this economy because it depends heavily on capital gains. In fiscal year 2009, receipts from personal income tax fell 32 percent in Arizona and 14 percent from the sales tax.<sup>45</sup> The inability of Arizona’s tax structure to cover spending levels in economic downturns led, in part, to a grade of C+ in 2008 from the Pew Center on the States’ Government Performance Project, which assessed states on how well they managed their fiscal affairs.<sup>46</sup>

The prospect of raising taxes to generate additional revenue has faced stiff opposition. Since taking office in January 2009, Brewer has clashed with lawmakers over her support of a temporary sales tax increase, which, at this writing, she has yet to land. During a nine-month struggle, Brewer sued legislative leaders to force them to deliver a budget, which she later vetoed because it did not come with a ballot referral for her sales tax hike. As the standoff continued, the state nearly ran out of cash in late summer. In September, after signing the majority of bills for a spending plan, Brewer told the state, “We cannot cut our way out of this problem. We cannot tax our way out of this problem. Both solutions will be necessary to resolve this crisis and doing both will take incredible political courage and compromise.”<sup>47</sup>

## ARIZONA

In the new budget, state universities are bracing for layoffs, about 10,000 parents who had been covered by a state-backed health insurance plan that covers their children will be dropped, and the Arizona Capitol itself may be sold to a private investor and leased back to the state to help make ends meet.<sup>48</sup> But that still leaves Arizona's government in a \$1 billion hole this fiscal year.<sup>49</sup> Even Brewer's proposed sales tax increase would come too late to fill that gap. "We've basically used up all the gimmicks or tricks," said state Senate President Robert Burns (R). "Now we've come to the cliff."<sup>50</sup>

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—ARIZONA GOVERNOR JAN BREWER

The home state of conservative icon Barry Goldwater has one of the highest percentages of state legislators who have signed a national pledge not to raise taxes.<sup>51</sup> Brewer once signed the pledge, but that was before she became governor.<sup>52</sup> When her plan to put the sales tax on the ballot was finally brokered by Republican leaders, it failed by two votes in the Senate. Brewer blamed "extremists" in both parties for its demise.<sup>53</sup>

Meanwhile, past actions by elected officials also place hurdles on revenue generation. In the 1990s, then-Governor Fife Symington (R) led

successful efforts to lower the state income tax. Other tax cuts followed, too. Income tax rates fell nearly 40 percent during the 1990s, and vehicle license tax rates were reduced. (Lawmakers recently eliminated the statewide property tax for three years, only to see it restored as a result of this year's budget battle.)<sup>54</sup>

Some see a treasure trove in reversing the earlier cuts. "If you would reasonably reverse [those tax cuts] ... you'd pick up in the vicinity of \$2 billion to \$2.5 billion," said Dennis Hoffman, an economics professor at Arizona State University (ASU) who projects revenue income for the state.<sup>55</sup> That would be nearly enough to plug the state's budget gap.

For now, the immediate prospects of raising taxes seem limited to Brewer's push for the sales tax hike. Her administration predicts the change would boost state revenues by \$1 billion a year for three years, when it would expire, and it would take about four months for the state to see new revenues after legislative approval.<sup>56</sup> Polls indicate the public supports the sales tax increase, but that support is soft, said David Berman, a senior research fellow at ASU's Morrison Institute for Public Policy. "The only way you're going to sell it is by wrapping it up in education spending. It'll be a tough campaign."<sup>57</sup>

Meanwhile, Brewer has asked state agencies to prepare for cuts of 15 percent to 20 percent starting in January 2010 when the legislature returns and begins plugging more budget holes.<sup>58</sup> Such cuts will come on top of reductions already made as part of the battle over this year's budget.