

## HIGHLIGHTS OF THE FY 2004 BUDGET

The 46<sup>th</sup> Legislature of the State of Arizona convened in January 2003. By June, it had enacted a new Fiscal Year (FY) 2004 budget for the year beginning July 1, 2003. The state's FY 2004 General Fund budget is \$6.3 billion. After accounting for non-General Fund monies, the state's "all funds" budget is \$19.4 billion. See page BD-7 for information on appropriated fund spending and page BD-13 for all funds spending by agency.

**Resolving the FY 2003 Shortfall** — Prior to addressing the FY 2004 budget, the Legislature had to resolve a shortfall in the FY 2003 budget. Due to the lingering effects of the post – September 11 recession in Arizona, the state's FY 2003 General Fund revenues grew less than anticipated when the budget was originally approved in May 2002. While originally projected to grow by 4.2%, General Fund revenues appeared to be declining by (1.8)% during mid-FY 2003. As a result, the state had a projected General Fund budget shortfall of \$531 million.

The 45<sup>th</sup> Legislature met in its 6<sup>th</sup> Special Session in November 2002 and began to address this problem by approving \$215 million in budget revisions. The 46<sup>th</sup> Legislature continued work on the FY 2003 revisions when it convened in its 1<sup>st</sup> Special Session in March 2003. The Legislature enacted another \$339 million in budget changes. Between the two special sessions, the Legislature either raised revenue or reduced spending by a total of \$554 million. The two largest proposals were a 1) one-time shift of \$230 million in balances in dedicated funds to the General Fund and 2) \$112 million in spending reductions, mostly in the form of non-specified "lump sum" cuts. See page 394 for further details on these FY 2003 mid-year changes.

**Preliminary FY 2003 Final Results** — At the adjournment of the 1<sup>st</sup> Regular Session, the FY 2003 projected ending balance was \$17 million. Since that time, the estimate of the FY 2003 ending balance has increased. General Fund revenues are estimated to be approximately \$100 million higher than anticipated. In addition, the state anticipated receiving \$308 million in federal assistance to balance the FY 2004 budget. Of this amount, approximately \$110 million arrived in FY 2003. The higher revenues and early federal assistance have increased the estimated FY 2003 ending balance to \$227 million. As of this writing, however, this ending balance estimate is not yet final and is subject to further changes.

**The FY 2004 Statutory and Funding Formula Shortfall** — Before beginning work on the FY 2004 budget, the JLBC Staff calculated the growth in the state's anticipated FY 2004 General Fund spending based on existing statutory funding formulas and other technical requirements. Given the projected decline in FY 2003 General Fund revenues, this calculation used a flat revenue

growth rate for FY 2004. Based on these parameters, state spending was projected to reach \$7 billion while revenues were forecast at \$5.5 billion. These assumptions resulted in a projected FY 2004 shortfall of \$1.47 billion.

The final budget eliminated this shortfall with a mix of revenue and spending adjustments. Revenue adjustments equaled \$795 million and included the following items:

|  | <u>\$ in Millions</u> |
|--|-----------------------|
| • 4.5% rather than 0% revenue growth       | \$303                 |
| • New Medicaid Premium Tax                 | 70                    |
| • Greater Tax Enforcement                  | 83                    |
| • Federal Cash Assistance                  | 174                   |
| • New Federal Disproportionate Share Funds | 19                    |
| • Use of Lawsuit Settlement Reserves       | 75                    |
| • Dedicated Fund Transfers                 | 50                    |
| • Other Miscellaneous Revenues             | <u>21</u>             |
| Total                                      | \$795                 |

The budget included another \$654 million in spending changes from the original statutory funding formula level. The main components of these adjustments included:

|  | <u>\$ in Millions</u> |
|--|-----------------------|
| • Use of Bonding for School Repairs      | \$247                 |
| • Higher Federal share of Medicaid costs | 119                   |
| • Efficiency and Federal Savings         | 105                   |
| • Shift to Dedicated and County Funds    | 43                    |
| • Budget Reductions                      | 72                    |
| • Foregone Spending Adjustments          | 74                    |
| • Fee Increases                          | 19                    |
| • Budget Increases                       | (32)                  |
| • Other                                  | <u>7</u>              |
| Total                                    | \$654                 |

**Comparison to the FY 2003 Budget** — As originally budgeted, General Fund revenues, including one-time financing sources were projected to grow from \$6.03 billion in FY 2003 to \$6.32 billion in FY 2004, which is an increase of \$290 million.

In comparison, spending is expected to grow from \$6.01 million to \$6.30 million, which is again an increase of \$290 million. The single largest increase is \$345 million for the Department of Education. Of this amount, \$191 million reflects a school payment that was deferred from FY 2003 to FY 2004. The second largest increase is \$68 million for AHCCCS due to higher caseloads. These increases were offset by \$80 million in unspecified efficiency savings and \$25 million in federal savings and a \$30 million estimated reduction in deferred billings from the prior fiscal year. Laws 2003, Chapter 263 included a provision that the \$80 million efficiency savings would be

reduced dollar for dollar for any FY 2003 revenues in excess of the budget forecast. Given the preliminary final FY 2003 revenue estimate, these assumed savings may be eliminated.

**Structural Shortfall** — There was considerable discussion during the 1<sup>st</sup> Regular Session concerning the General Fund’s structural shortfall, which is defined as the difference between on-going General Fund revenues and on-going spending. Since beginning to incur budget shortfalls in FY 2002, the state has used numerous one-time funding sources to close these gaps.

At the conclusion of the 1<sup>st</sup> Regular Session, the FY 2003 structural shortfall was estimated to be \$(574) million. This calculation appears on the following page in the Modified Statement of Revenue and Expenditures which separates out one-time financing sources from the on-going budget. The actual FY 2003 shortfall is currently projected to be \$(397) million as final revenues are higher than anticipated. The structural shortfall of the enacted FY 2004 budget is estimated to be \$(432) million, with the state having on-going revenues of \$5.98 billion and on-going spending of \$6.41 billion. (These FY 2004 estimates do not match the numbers earlier in the narrative due to the one-time financing adjustments). The elimination of the \$80 million in efficiency savings would increase the FY 2004 structural shortfall to \$(512) million.

**Veto**s — The Governor vetoed certain elements of the budget legislation. See page BD-5. There are questions concerning the legality of some of the vetoes and litigation has been filed to address those issues. Pending resolution of this litigation, the JLBC Staff has incorporated the vetoes into the budget estimates within the Appropriations Report consistent with the Governor’s intent. We have done so, however, without making an assessment of the legality of the vetoes.

Based on material released by the Governor’s office, the vetoes increased General Fund costs by \$63 million. This estimate includes small technical adjustments in the Governor’s estimates. The Governor financed this cost by vetoing the \$75 million Ladewig lawsuit settlement reserve. The Appropriations Report does not attempt to estimate potential dollar impacts of the vetoes beyond those listed in the Governor’s summary materials.

**FY 2004 Ending Balance** — At the end of the 1<sup>st</sup> Regular Session, the anticipated FY 2004 ending balance was \$24 million. The increase of the prior year’s (FY 2003) balance by \$100 million will improve the FY 2004 balance by a corresponding amount, assuming no changes in the originally budgeted level of FY 2004 revenues. The loss of the efficiency savings, however, has an offsetting \$(80) million impact. As a result, the FY 2004 ending balance is currently projected at \$45 million. The traditional Statement of Revenues and Expenditures appears at the bottom of this page.

**Other Budget Impacts** — During the session, the Legislature also approved \$1.2 billion in new debt financing for several different projects. This amount includes a \$250 million lease-purchase for new K-12 school construction in FY 2004 and a \$247 million revenue bond to complete the repairs of existing K-12 schools, as required by the Students FIRST legislation.

In Laws 2003, Chapter 267, the state also agreed to begin lease-purchase payments of \$35 million in FY 2008 to pay for approximately \$400 million in new university research infrastructure construction. In Laws 2003, Chapter 266, the state also pledged \$300 million to pay half of the cost of an expansion of the Phoenix Civic Plaza convention center.

The Legislature also approved FY 2005 budgets for small General Fund agencies and most Other Fund agencies.

STATEMENT OF REVENUES AND EXPENDITURES

|                             | FY 2003<br>6/03 Estimate | FY 2003<br>8/03 Estimate | FY 2004<br>Budget Sent<br>to Governor | FY 2004<br>Budget with<br>Veto | FY 2004<br>Budget<br>8/03 Status |
|-----------------------------|--------------------------|--------------------------|---------------------------------------|--------------------------------|----------------------------------|
| <b>REVENUES</b>             |                          |                          |                                       |                                |                                  |
| Balance Forward             | \$1,000,000              | \$1,000,000              | \$17,762,400                          | \$17,762,400                   | \$227,580,800                    |
| Base Revenues               | 6,030,245,800            | 6,218,081,200            | 6,259,874,100                         | 6,305,767,100                  | 6,218,533,000                    |
| Total Revenues              | \$6,031,245,800          | \$6,219,081,200          | \$6,277,636,500                       | \$6,323,529,500                | \$6,446,113,800                  |
| <b>EXPENDITURES</b>         |                          |                          |                                       |                                |                                  |
| Operating Budget            | 6,015,875,300            | 6,015,875,300            | 6,315,636,300                         | 6,349,770,600                  | 6,349,770,600                    |
| Foregone Efficiency Savings | 0                        | 0                        | 0                                     | 0                              | 80,000,000                       |
| Capital Outlay              | 1,742,900                | 1,742,900                | 0                                     | 0                              | 0                                |
| Administrative Adjustments  | 53,000,000               | 53,000,000               | 23,000,000                            | 23,000,000                     | 23,000,000                       |
| Revertments                 | (57,134,800)             | (79,117,800)             | (73,152,300)                          | (73,152,300)                   | (51,169,300)                     |
| Total Spending              | \$6,013,483,400          | \$5,991,500,400          | \$6,265,484,000                       | \$6,299,618,300                | \$6,401,601,300                  |
| ENDING BALANCE              | \$17,762,400             | \$227,580,800            | \$12,152,500                          | \$23,911,200                   | \$44,512,500                     |