

BUDGET STABILIZATION FUND

Background

The Budget Stabilization Fund (BSF) for Arizona was enacted in 1990 (A.R.S. § 35-144). The fund is administered by the State Treasurer, who is responsible for transferring General Fund money into and out of the BSF as required by law. The BSF is designed to set revenue aside during times of above-trend economic growth and to utilize this revenue during times of below-trend growth.

The Formula

The determination of the amount to be appropriated to (deposit) or transferred out (withdrawal) of the BSF is made using a formula based upon total annual Arizona personal income (excluding transfer payments) and adjusted for inflation.

The budget documents of the JLBC and the Governor are to include estimates of the amounts to be appropriated to or transferred from the BSF. The final determination of the amount to be appropriated or transferred is based on calculations from the Arizona Economic Estimates Commission (EEC). The EEC determines the annual growth rate of inflation-adjusted total state personal income, the trend growth rate over the past 7 years, and the calculated appropriation to or transfer from the BSF. The EEC reports this calculation for the prior calendar year by June 1. The EEC calculations however, do not result in any automatic deposits or withdrawals, as they must be authorized by legislative action.

Key features of the BSF can be summarized as follows:

- The deposit into or withdrawal from the BSF for a given fiscal year is determined by comparing the annual growth rate of inflation adjusted Arizona Personal Income (AZPI) for the calendar year ending in the fiscal year to the trend growth rate of inflation adjusted AZPI for the most recent 7 years.
- Adjusted personal income in the BSF formula is defined as total Arizona personal income less transfer payments, adjusted by the gross domestic product price deflator index.
- If the annual growth rate exceeds the trend growth rate, the excess multiplied by General Fund revenue of the prior fiscal year would equal the amount to be deposited into the BSF.
- If the annual growth rate of Arizona personal income is both less than 2% and less than the trend growth rate, the deficiency when multiplied by the General

Fund revenue of the prior year would equal the amount to be withdrawn from the BSF. This 2% floor avoids withdrawing monies from the BSF when economic conditions are slowing but there is not a recession.

- By a two-thirds majority, the Legislature, with the concurrence of the Governor, can decrease a deposit or increase a withdrawal.
- The BSF's total balance cannot be larger than 7.0% of the prior year's General Fund revenues.
- In addition to the fixed income investments available to the Treasurer, the 1998 Legislature allowed the Treasurer to invest up to 25% of the BSF in equity securities (Laws 1998, Chapter 266).

Alternative Uses

Laws 2000, 7th Special Session, Chapter 1 required that the refund payments for alternative fuel vehicle tax credits and Consumer Loss Recovery Fund liabilities would be funded by the Budget Stabilization Fund up to \$200 million. To date, approximately \$117 million has been paid from the BSF for alternative fuel costs. A total of \$130 million has been set aside for this purpose for the last several years. The Executive now believes that a maximum of \$122 million will be needed for the claims.

Deposits/Withdrawals

The BSF formula recommendation for FY 2002 was zero. While Arizona personal income growth was less than the trend growth rate for the year, it was above the 2% floor, resulting in no recommended transfer. Legislation passed in the 2nd and 3rd Special Sessions of the 45th Legislature, however, notwithstanding the existing provisions of law and specified transfer amounts for FY 2002 as noted in *Table 1*.

In FY 2003, personal income grew by 1.67%, while the 7-year average was 5.26%. Since annual growth was both less than 2% and less than the trend, the BSF formula recommended a withdrawal. The recommended transfer was \$(224.1) million. Funds were not available in the BSF for a transfer of this amount. Instead, the Legislature transferred \$(30.0) million from the BSF to the General Fund.

In FY 2004, Arizona personal income grew by 1.98%, with a trend growth rate of 4.70%. Below trend growth would normally dictate a BSF withdrawal. The BSF formula indicates a transfer of \$(169.5) million. However,

there is not enough money in the fund for a transfer of this size.

In FY 2005, the annual income growth figure is estimated to be 6.82%, with the trend growth rate at 4.63%. Since annual income growth is above the trend, the formula would provide a deposit into the BSF. The deposit amount would be \$143.5 million in FY 2005. In the 2004

legislative session, the Legislature instead authorized a transfer from the BSF to the General Fund of \$8.0 million in FY 2005. In addition, the Legislature approved two conditional appropriations into the BSF. Conditional upon General Fund revenues reaching certain targets, the BSF would first receive a \$6.0 million deposit and, second, a deposit of 50% of revenues over a certain level.

Table 1

**Budget Stabilization Fund
(\$ in Thousands)**

<u>General Fund Revenues</u>	<u>Actual FY 2002</u>	<u>Actual FY 2003</u>	<u>Estimate FY 2004</u>	<u>Estimate FY 2005</u>
Adjusted Revenues	\$6,239,325.1	\$6,217,459.1	\$6,551,569.9	\$7,114,873.8
Statutory Limit of Revenues	7.000%	7.000%	7.000%	7.000%
Maximum Balance	436,752.8	435,222.1	458,609.9	498,041.2
<u>Arizona Personal Income in Prior CY</u>				
Real Adjusted Annual Income Growth	2.10%	1.67%	1.98%	6.82%
7-Year Average Income Growth	5.78%	5.26%	4.70%	4.63%
Annual Difference	-3.68%	-3.59%	-2.72%	2.19%
<u>BSF Transactions</u>				
Beginning BSF Balance	391,523.8	64,719.3	13,765.7	13,522.5
BSF Formula Recommendation	0.0	(224,085.4)	(169,505.0)	143,479.4
<u>Actual Transfer In</u>				
Conditional Appropriation - L'04, Ch. 275, Part 1 ^{1/}	0.0	0.0	0.0	0.0
Conditional Appropriation - L'04, Ch. 275, Part 2 ^{2/}	0.0	0.0	0.0	0.0
<u>Actual Transfer Out</u>				
ASH Construction Fund Payments ^{3/}	(20,000.0)	(17,500.0)	0.0	0.0
Payment of Alternative Fuel Credits ^{4/}	(61,942.9)	(5,528.7)	(643.2)	(4,500.0)
BSF Transfer to GF - L'01, 2SS, Ch. 4	(119,000.0)	0.0	0.0	0.0
BSF Transfer to GF - L'02, 3SS, Ch. 2, Part 1	(47,150.0)	0.0	0.0	0.0
BSF Transfer to GF - L'02, 3SS, Ch. 2, Part 2 ^{5/}	(84,397.9)	0.0	0.0	0.0
BSF Transfer to GF - L'03, Ch. 262 ^{6/}	0.0	(30,000.0)	0.0	0.0
BSF Transfer to GF - L'04, Ch. 275	0.0	0.0	0.0	(8,000.0)
Balance	59,033.0	11,690.6	13,122.5	1,022.5
Interest Earnings & Equity Gains/Losses	5,686.3	2,075.1	400.0	1,000.0
Ending BSF Balance	\$64,719.3	\$13,765.7	\$13,522.5	\$2,022.5
Percent of Revenues	1.0%	0.2%	0.2%	0.0%

Footnotes

- ^{1/} If revenues exceed the forecast by \$102 million, \$6.0 million would be appropriated to the BSF.
- ^{2/} If revenues exceed the forecast by \$102 million, 50% of the additional revenue above \$102 million would be deposited in the BSF.
- ^{3/} Pursuant to Laws 2003, 1st Special Session, Chapter 1, in FY 2003 the amount of \$13.4 million was subsequently transferred from the Arizona State Hospital Capital Construction Fund to the General Fund.
- ^{4/} The Alt. Fuels payout of BSF money was \$(116.9) million between FY 2001 and FY 2003. Through the first 11 months of FY 2004, another \$(0.6) million has been paid out. It is estimated that the ultimate total could be \$(122) million. \$4.5 million remains in reserve.
- ^{5/} Since revenues fell below the budgeted total in FY 2002, the BSF was used to make up the difference. A total of \$84.4 million was withdrawn to balance the FY 2002 budget.
- ^{6/} The FY 2003 transfer to the General Fund was originally supposed to be in the amount of \$(50) million. According to Laws 2002, Chapter 327. This amount was modified to \$(30) million by Laws 2003, Chapter 262.