

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 January budget documents of the Joint Legislative Budget Committee and the Governor are to include estimates of the amounts to be appropriated to or transferred from the BSF for the upcoming budget year. The final determination of the amount to be appropriated or transferred is based on calculations from the Arizona Economic Estimates Commission (EEC). This final calculation is not made until June 1 of the budget year. 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 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growth rate, the deficiency when multiplied by the General Fund revenue of the prior year would equal the amount to be withdrawn from the BSF.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% of the current year's General Fund revenues, excluding the beginning balance.
- 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. Between FY 2001 and May of FY 2006, an amount of \$118.8 million was paid from the BSF for alternative fuel costs. It is estimated that total costs will be about \$122 million. For this reason, about \$3.2 million remains in reserve.

Deposits/Withdrawals

In FY 2005, Arizona real adjusted personal income grew by 5.53%, with a trend growth rate of 4.68%. Since annual income growth was 0.85% above the trend, the BSF formula recommended a deposit of \$56.8 million.

Instead, pursuant to Laws 2004, Chapter 275, 3 separate deposits to the BSF were made in FY 2005, for a total of \$156.5 million. These deposits were additional appropriations to the BSF "triggered" when General Fund revenues exceeded certain enacted revenue targets. The FY 2004 General Fund revenue surplus resulted in the first BSF deposit of \$22.8 million in FY 2005. The revenue surplus for the first 4 months of FY 2005 resulted in the second BSF deposit of \$67.6 million, while the revenue surplus for the following 2-month period triggered the third and final FY 2005 BSF deposit of \$66.1 million.

In FY 2006, annual income growth is estimated to be 6.74%, with a trend growth rate of 4.25%. Since annual income growth is expected to exceed the trend by 2.49%, the formula recommended a BSF deposit of \$190.9 million in FY 2006.

Pursuant to Laws 2005, Chapter 286, however, 2 separate deposits to the BSF will be made for FY 2006, for an estimated total of \$474.5 million. Chapter 286 required General Fund revenues above the original enacted

FY 2006 revenue forecast (of May 2005) to be deposited into the BSF. The amount of excess revenue was to be calculated for the first and second half of the year. Excess revenues in the first half of FY 2006 resulted in a BSF deposit of \$333.0 million, whereas excess revenues in the last half of FY 2006 are estimated to trigger an additional appropriation to the BSF of \$141.6 million in July 2006.

Under statute, the fund balance cannot exceed 7% of current year General Fund revenues, which for FY 2006 is expected to be \$640.8 million (7% of \$9.2 billion). Prior to the Chapter 286 deposit, the fund balance was \$166.3 million, including the beginning balance of \$160.8 million plus interest earnings. The combination of the \$166.3 million and the projected Chapter 286 deposit of \$474.5 million will put the fund at the projected cap of \$640.8 million.

Without the 7% cap, another \$775 million would have been deposited into the BSF. These monies will instead remain in the General Fund.

The maximum fund balance for FY 2007 is projected to be \$663.5 million (7% of \$9.5 billion). Given the projected FY 2006 fund balance of \$640.8 million, an additional \$22.7 million can, therefore, be deposited into the BSF in FY 2007. Laws 2006, Chapter 344 appropriated \$9.8 million from the General Fund into the BSF. This amount was based on a mid-session calculation of the dollar amount needed to reach the 7% cap.

With a beginning balance of \$640.8 million, the fund is projected to generate \$25.6 million in interest earnings. Since \$9.8 million of the \$22.7 million in projected growth will be generated by the Chapter 344 appropriation, only

Table 1

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

	Actual FY 2004	Actual FY 2005	Estimate FY 2006	Estimate FY 2007
General Fund Revenues				
Adjusted Revenues	\$6,882,328.3	\$7,950,117.6	\$9,153,726.5	\$9,477,906.8
Statutory Limit of Revenues	7.00%	7.00%	7.00%	7.00%
Maximum Balance	481,763.0	556,508.2	640,760.9	663,453.5
Arizona Personal Income in Prior CY ^{1/}				
Real Adjusted Annual Income Growth	1.98%	5.53%	6.74%	6.16%
7-Year Average Income Growth	4.70%	4.68%	4.25%	4.41%
Annual Difference	(2.72)%	0.85%	2.49%	1.75%
BSF Transactions				
Beginning BSF Balance	13,765.7	13,524.8	160,834.5	640,760.9
BSF Formula Recommendation	(169,505.0)	56,813.9	190,912.8	165,863.4
Actual Transfer In				
Conditional Appropriation - L'04, Ch. 275, Part 2 ^{1/}	0.0	156,490.5	0.0	0.0
Conditional Appropriation - L'05, Ch. 286, Part 1 ^{2/}	0.0	0.0	332,957.6	0.0
Conditional Appropriation - L'05, Ch. 286, Part 2 ^{3/}	0.0	0.0	141,575.7 ^{4/}	0.0
Actual Appropriation - L'06, Ch. 344	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>9,808.6</u>
SUBTOTAL	0.0	156,490.5	474,533.3	9,808.6
Actual Transfer Out				
Payment of Alternative Fuel Credits ^{5/}	(643.2)	(1,485.6)	(3,200.0) ^{6/}	0.0
BSF Transfer to GF - L'04, Ch. 275 ^{7/}	0.0	(8,000.0)	0.0	0.0
BSF Transfer to GF - Due to Excess Interest Earnings	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>(12,746.4)</u>
SUBTOTAL	(643.2)	(9,485.6)	(3,200.0)	(12,746.4)
Balance	13,122.5	160,529.7	632,167.8	637,447.9
Interest Earnings & Equity Gains/Losses	402.3	304.8	8,593.1	25,630.4
Ending BSF	\$13,524.8	\$160,834.5	\$640,760.9	\$663,453.5
Percent of Revenues	0.2%	2.0%	7.0%	7.0%

^{1/} Actual FY 2004 and FY 2005 revenues were above budget forecasts and for this reason triggered 3 separate FY 2005 appropriations to the BSF that totaled \$156.5 million.

^{2/} Actual revenues exceeded the budget forecast for the first 6 months of FY 2006, which triggered an appropriation of \$333.0 million to the BSF.

^{3/} Actual revenues exceeded the budget forecast for the last 6 months of FY 2006, which triggered an appropriation of \$141.6 million to the BSF.

^{4/} This amount would not be deposited until a final determination of FY 2006 revenues is made in July 2006 (FY 2007).

^{5/} The Alternate Fuels payout of BSF money was \$(118.8) million between FY 2001 and FY 2006. It is estimated that the ultimate total could be \$(122) million. \$3.2 million remains in reserve.

^{6/} This amount represents the \$3.2 million held in reserve, however, \$76,300 has been withdrawn for alternative fuel credits during FY 2006 through May.

^{7/} The alternative fuel credit payout was originally estimated to be \$130 million. This estimate was later reduced to \$122 million. As a result, \$8 million was transferred from the BSF to the General Fund in FY 2005.

\$12.9 million of the interest earnings will remain in the BSF. The remaining interest earnings of \$12.7 million would be deposited into the General Fund.

In FY 2007, annual personal income growth is projected to be 1.75% above trend. At this level, the formula deposit from the General Fund would be \$165.9 million. The 7% cap, however, will prevent a deposit of this size. As noted above, Chapter 344 instead appropriates \$9.8 million from the General Fund into the BSF.