

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

There is a statutory formula to calculate the amount to be appropriated to (deposit) or transferred out (withdrawal) of the BSF. The formula is based on total annual Arizona personal income (excluding transfer payments) adjusted for inflation.

The January Budget documents of the JLBC 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. In practice, the formula has only served as a general guideline and has infrequently been used to determine the actual deposit or withdrawal.

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Fund revenue of the prior year would equal the amount to be withdrawn from the BSF.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 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 2007, an amount of \$118.9 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 \$3.1 million remains in reserve.

Deposits/Withdrawals

In CY 2005, Arizona real adjusted personal income grew by 6.74%, with a trend growth rate of 4.25%. Since annual income growth was 2.49% above the trend, the BSF formula recommended a deposit of \$190.9 million in FY 2006. However, the Legislature did not appropriate such monies from the General Fund since the formula recommendation was effectively superseded by Laws 2005, Chapter 286.

Laws 2005, Chapter 286 required General Fund revenues above the original enacted FY 2006 revenue forecast to be deposited into the BSF. Prior to Chapter 286, the fund balance was \$168.6 million. The excess revenues, which were calculated for the first and second half of FY 2006, resulted in 2 separate BSF deposits of \$333.0 million and \$148.0 million, respectively, for a total of \$481.0 million. These deposits brought the total fund balance to \$649.6 million.

The fund balance prior to the second Chapter 286 deposit was \$501.6 million. This amount included the beginning balance (\$160.8 million), the first Chapter 286 deposit (\$333.0 million), interest earnings (\$7.9 million), and alternative fuel tax credit payments (\$0.1 million). The

magnitude of the second Chapter 286 deposit was limited by the statutory cap on the BSF balance. The fund balance cannot exceed 7% of current year General Fund revenue. At the time of the calculation of the second deposit in August 2006, 7% of General Fund revenue was \$649.6 million (if it were calculated now, the cap would have been \$650.5 million). Without the cap, the second deposit would have been \$1.05 billion rather than \$148 million. The difference of \$907 million was retained in the General Fund in FY 2006.

Laws 2006, Chapter 344 provided a FY 2007 appropriation of \$9.8 million to the BSF. This appropriation was based on a 2006 mid-session estimate of the dollar amount required to bring the FY 2007 fund balance up to the cap.

In CY 2006, Arizona real adjusted personal income grew by 5.96%, with a trend growth rate of 3.98%. Since annual

income growth exceeded the trend by 1.98%, the formula recommended a BSF deposit of \$173.9 million in FY 2007. However, such a deposit was disallowed under the 7% cap.

The FY 2007 maximum fund balance is estimated to be \$689.6 million (7% of \$9.85 billion in General Fund revenue). The expected ending balance is \$687.0 million, which includes an estimated beginning balance of \$649.6 million, the Chapter 344 deposit of \$9.8 million, and interest earnings of \$27.5 million. This amount is \$2.6 million below the maximum allowable fund balance.

The maximum fund balance for FY 2008 is projected to be \$705.3 million (7% of \$10.1 billion). With an estimated beginning balance of \$687.0 million and expected interest earnings of \$30.9 million, the FY 2008 ending balance is projected to be \$12.6 million above the cap. This amount will therefore be transferred to the General Fund as excess

Table 1

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

	Actual FY 2005	Actual FY 2006	Estimate FY 2007	Estimate FY 2008
<u>General Fund Revenues</u>				
Adjusted Revenues	\$7,950,117.6	\$9,284,689.5	\$9,850,991.3	\$10,076,032.0
Statutory Limit of Revenues	7.0%	7.0%	7.0%	7.0%
Maximum Balance	556,508.2	649,928.3	689,569.4	705,322.2
<u>Arizona Personal Income in Prior CY</u>				
Real Adjusted Annual Income Growth	5.53%	6.74%	5.96%	3.71%
7-Year Average Income Growth	4.68%	4.25%	3.98%	3.48%
Annual Difference	0.85%	2.49%	1.98%	0.23%
<u>BSF Transactions</u>				
Beginning BSF Balance	13,524.8	160,834.5	649,613.1	686,962.9
BSF Formula Recommendation	56,813.9	190,912.8	173,913.0	22,657.3
<u>Actual Transfer In</u>				
Conditional Appropriations - L'04, Ch. 275 ^{1/}	156,490.5	0.0	0.0	0.0
Conditional Appropriation - L'05, Ch. 286, Part 1 ^{2/}	0.0	332,957.6	0.0	0.0
Conditional Appropriation - L'05, Ch. 286, Part 2 ^{3/}	0.0	148,000.3	0.0	0.0
Actual Appropriation - L'06, Ch. 344	<u>0.0</u>	<u>0.0</u>	<u>9,808.6</u>	<u>0.0</u>
SUBTOTAL	156,490.5	480,957.9	9,808.6	0.0
<u>Actual Transfer Out</u>				
Payment of Alternative Fuel Credits ^{4/}	(1,485.6)	(80.9)	(6.9)	0.0
BSF Transfer to GF - L'04, Ch. 275 ^{5/}	(8,000.0)	0.0	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>(12,554.0)</u>
SUBTOTAL	(9,485.6)	(80.9)	(6.9)	(12,645.4)
Balance	160,529.7	641,711.5	659,414.8	674,317.5
Interest Earnings & Equity Gains/Losses ^{6/}	304.8	7,901.7	27,548.1	30,913.3
Ending BSF Balance	\$160,834.5	\$649,613.1	\$686,962.9	\$705,322.2
Percent of Revenues	2.0%	7.0%	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 \$148.0 million to the BSF.
^{4/} The alternative fuel credit payout of BSF money was \$(118.9) million between FY 2001 and May of FY 2007. It is estimated that the ultimate total could be \$(122) million. For this reason, the BSF balance includes \$3.1 million in reserve monies.
^{5/} 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.
^{6/} Assumes a rate of return of 4.5% in FY 2008.

interest earnings.

Arizona real adjusted personal income is projected to grow by 3.71% in CY 2007 compared to a 7-year average annual growth rate of 3.48%. Since the annual growth rate is expected to exceed the trend by 0.23%, the BSF formula would result in a recommended fund deposit of \$22.7 million in FY 2008. However, due to the 7% cap, this formula recommendation cannot be implemented.