Long-Term Budget Projections

The JLBC Staff has updated its long-term General Fund budget projections through FY 2014. The starting point of the analysis is the enacted FY 2011 budget adjusted for the latest 4-sector consensus revenue forecast. Numerous factors affect these estimates. Depending on the particular assumptions, the projected FY 2014 ending balance ranges from a $700 million surplus to a $(1) billion shortfall.

FY 2010 and FY 2011

The updated forecast results in a projected $(150) million shortfall at the end of FY 2010. This analysis assumes this shortfall is rolled forward into FY 2011. This carry-forward shortfall plus the revised revenue estimates creates a projected FY 2011 shortfall of $(368) million. To avoid creating a long-term rolling shortfall, the $(368) million shortfall is presumed to be resolved by the end of FY 2011 and is not carried into FY 2012. These estimates assume the passage of the budget-related ballot propositions *(see discussion below)*.

FY 2012 - FY 2014

Any long-term projection is speculative by its nature and the possible revenue forecast error could exceed $1 billion by FY 2014. The methodology parallels the approach used in the long-term January Baseline estimates. In particular, the spending adjustments are essentially limited to statutorily-required caseload growth and debt and lease-purchase obligations. As outlined below, it may prove difficult to sustain that policy through the next 4 years.

The uncertainty of the long-term estimates is compounded by several factors, including whether the voters approve certain ballot measures and the state's ultimate ability to eliminate Proposition 204 funding.

The FY 2011 budget referred a three-year 1 cent sales tax increase to the voters as well as the redirection of First Things First and Growing Smarter monies to the General Fund. If the voters do not approve the sales tax increase, $862 million of conditional spending reductions would be enacted. The approved budget also ended General Fund support of Prop 204 on January 1, 2011.

The recently enacted federal health care legislation appears to require Arizona to retain the Prop 204 program or lose its federal Medicaid funding. This retention would not affect the FY 2011 budget as long as Congress extends the current enhanced federal Medicaid match rate through the end of FY 2011. The enhanced match rate savings essentially offset the cost of retaining Prop 204 through FY 2011. Relative to the enacted budget, however, Prop 204 would create a state cost in FY 2012 when the enhanced match rate ends.

The JLBC Staff has developed 2 different scenarios to estimate FY 2012 - FY 2014 budget balances. In the first scenario, the Prop 204 program is retained *(see Table 1 and Attachment A)*. General Fund balance estimates were then developed for passage and failure of the ballot propositions.

If the ballot propositions are approved by the voters, projected FY 2012 revenues are $8.8 billion compared to $9.6 billion in spending, for a shortfall of $(863) million. If the ballot propositions fail, the predicted shortfall is $(1.0) billion. The FY 2012 shortfall is lower with approved ballot propositions because they generate revenue of $1.05 billion in that year ($968 million from the sales tax and a net $80 million from redirected First Things First tobacco revenue). In comparison, $862 million in conditional spending reductions would be enacted in FY 2011 if the sales tax increase fails. Assuming these reductions remain in place through FY 2012, they do not provide as much deficit relief in FY 2012 as the ballot propositions.

By FY 2014, however, the long-term impact of the ballot propositions changes. Since the 1 cent sales tax increase is scheduled to end at the end of FY 2013, the state would lose $1 billion in revenue and the projected FY 2014 shortfall is $(982) million. In comparison, the "ballot props fail" scenario produces a lower shortfall of $(200) million. If the voters do not enact the sales tax in May, the $862 million in conditional reductions would be enacted and are presumed to continue throughout the forecast period. Unlike the sales tax increase, there is no time limit on the deficit relief from the conditional spending reductions. (As described below, however, the magnitude of the conditional spending reduction may be in conflict with federal stimulus requirements.)

If Prop 204 funding is not restored, there is $895 million to $923 million in additional deficit relief each year *(see Scenario 2 in Table 1)*. As a result, most of the FY 2013 - FY 2014 scenarios generate a positive ending balance. *(See Attachment B)*

Table 1

Projected General Fund Ending Balance
($ in millions)

Scenario 1: Prop 204 Funded	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
A: Ballot Props Pass	(150)	(368)	(863)	(379)	(982)
B: Ballot Props Fail	(150)	(892)	(1,048)	(654)	(200)

Scenario 2: Prop 204 Unfunded	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
A: Ballot Props Pass	(150)	(368)	32	544	(86)
B: Ballot Props Fail	(150)	(892)	(153)	269	696

Other Long-Term Caveats

Beyond the issues already discussed, there are other assumptions in this analysis that increase the uncertainty of these estimates:

- Revenue forecast: The projections are based on the recent update of the 4-sector consensus forecast at the Finance Advisory Committee (FAC) meetings. That forecast includes revenue growth of between 7.5% and 9.6% growth in FY 2012 - FY 2014, which is substantially higher than the growth rate of the last few years. *(See JLBC Staff's FAC - Revenue Update, April 2010 for more information).* While most economists forecast some future growth, the precise magnitude is difficult to predict with any certainty. If the economy grew at a 5% annual rate during FY 2012 - 2014, General Fund revenues would be $1 billion less than the 4-sector consensus by FY 2014. This alternative forecast would increase the shortfall in the "Prop 204 funded" scenarios to between $(1.2) billion and $(2.0) billion.

- Inflation funding: The projected balances continue the current policy of fully funding caseload growth for statutory programs, but fund little or no inflation increases in K-12 and state employee costs. The analysis assumes that the current 5% salary reduction (in the form of the 2.75% performance pay cut and the 6 days of annual furlough) remain in place through the end of FY 2014. The long-run sustainability of this inflation policy is uncertain.

- Medicaid growth: This analysis assumes 3% annual growth in Medicaid base expenditures and then further adjusts the estimates for the new federal health care requirements. This 3% growth factor would include any combination of enrollment and inflation adjustments. This rate, however, is significantly below the long-term trend in Medicaid costs. The low growth factor reflects the high current AHCCCS enrollment due to the recession and expected flattening of caseload as the economy recovers. In contrast, AHCCCS assumes its baseline costs would increase by 6% to 9%. *(See JLBC Staff's Analysis of the Cost of Federal Health Care Legislation, March 2010 for more information.)*

- Capital outlay expenses: Other than payment of existing lease-purchase obligations, this forecast does not fund any new state building or School Facilities Board construction beyond the FY 2011 budget commitments. As with inflation, this assumption is uncertain. If school enrollment resumes its historical 3% growth through FY 2014, future school construction costs are estimated to be $700 million during that time period.

- Federal stimulus education requirements: The state has already received most of its $1.0 billion allocation of State Fiscal Stabilization Funds under the 2009 federal stimulus legislation. As a requirement of receiving those funds, the state agreed to keep its K-12 and higher education funding at or above FY 2006 spending levels. While a state may request a waiver of the maintenance of effort (MOE) provision, federal law requires that a state's education budget as a percent of total spending must not decline in any circumstance. If the sales tax ballot proposition does not pass, educational spending would fall by $551 million and would cause education's share of the overall budget to decline. To keep education's share of spending constant, its level of reductions could be no greater than $418 million. The federal response to a decline in the education percentage is not known, but could potentially involve them trying to recoup the stabilization funding.

After FY 2011, the long-term calculations do not carry forward any shortfalls or surpluses into the following year. The balance calculations also reflect the projected cash balance and not the structural balance. The latter includes only ongoing revenue and expenditures. By FY 2014, the projections include few one-time resources so the cash and structural estimates are very similar.

Attachment A

STATEMENT OF GENERAL FUND REVENUES AND EXPENDITURES

SCENARIO I: PROP 204 FUNDED

	FY 2010 Revised	FY 2011 Revised	FY 2012 Forecast	FY 2013 Forecast	FY 2014 Forecast
REVENUES					
Ongoing Revenues	$6,771,226,800	$7,020,888,400	$8,024,988,500	$8,765,325,000	$9,412,533,500
Enacted Revenue Changes		10,607,600	(6,100,000)	(5,000,000)	(500,000)
Budget Legislation Changes	18,800,700	63,583,600	(2,144,000)	(12,852,000)	
Sales Tax Increase -May Ballot		918,000,000	967,829,800	1,056,875,100	
First Things First Redirect - Nov. Ballot		60,000,000	120,000,000	120,000,000	120,000,000
Urban Revenue Sharing	(628,649,100)	(473,986,800)	(428,199,400)	(447,697,800)	(497,001,800)
Net On-going Revenues	$6,161,378,400	$7,599,092,800	$8,676,374,900	$9,476,650,300	$9,035,031,700
One-time Financing Sources					
Balance Forward	($480,713,000)	($150,185,000)			
Other Revenue Changes	113,420,000	34,600,000			
State Asset Leaseback/Other Financing	1,485,419,300				
Fund Transfers - November Ballot		448,538,600			
Fund Transfers	386,505,800	180,292,300	102,389,500	102,389,500	102,389,500
Subtotal One-time Revenues	$1,504,632,100	$513,245,900	$102,389,500	$102,389,500	$102,389,500
Total Revenues	$7,666,010,500	$8,112,338,700	$8,778,764,400	$9,579,039,800	$9,137,421,200
EXPENDITURES					
Operating Budget Appropriations	$9,588,250,900	$9,508,835,500	$9,643,043,900	$9,961,868,600	$10,122,764,700
FY 2010 Supplementals	132,583,200	0			
First Things First/DES Redirect - Nov. Ballot		40,000,000	40,000,000	40,000,000	40,000,000
Administrative Adjustments	72,731,600	73,607,000	73,388,300	74,853,500	77,086,600
Revertments	(113,241,600)	(112,905,100)	(115,159,200)	(118,594,800)	(120,525,600)
Subtotal Ongoing Expenditures	$9,680,324,100	$9,509,537,400	$9,641,273,000	$9,958,127,300	$10,119,325,700
One-time Expenditures					
Capital Outlay	$10,400,000	$4,000,000			
Capital Outlay Prior Year Reversions	(450,000)				
Temporary Federal Assistance	(1,289,189,500)	(973,385,200)			
SFB Debt Refinance		(60,000,000)			
Payment Deferrals	(584,889,100)				
Subtotal One-time Expenditures	($1,864,128,600)	($1,029,385,200)	$0	$0	$0
Total Expenditures	$7,816,195,500	$8,480,152,200	$9,641,273,000	$9,958,127,300	$10,119,325,700
Ending Balance w/ Ballot Props 1/	($150,185,000)	($367,813,500)	($862,508,600)	($379,087,500)	($981,904,500)
Structural Balance (On-going Rev/Expend)	($3,518,945,700)	($1,910,444,600)	($964,898,100)	($481,477,000)	($1,084,294,000)
Impact of Ballot Proposition Failures					
Sales Tax Failure		(918,000,000)	(967,829,800)	(1,056,875,100)	
Other Ballot Failures		(468,538,600)	(80,000,000)	(80,000,000)	(80,000,000)
Conditional Reductions		862,366,000	862,366,000	862,366,000	862,366,000
Revised Ending Balance w/out Ballot Props 2/	(150,185,000)	(891,986,100)	(1,047,972,400)	(653,596,600)	(199,538,500)

1/ Assumes passage of budget-related ballot propositions

2/ Assumes failure of budget-related ballot propositions

STATEMENT OF GENERAL FUND REVENUES AND EXPENDITURES

SCENARIO 2: PROP 204 UNFUNDED

	FY 2010 Revised	FY 2011 Revised	FY 2012 Forecast	FY 2013 Forecast	FY 2014 Forecast
REVENUES					
Ongoing Revenues	$6,771,226,800	$7,020,888,400	$8,024,988,500	$8,765,325,000	$9,412,533,500
Enacted Revenue Changes		10,607,600	(6,100,000)	(5,000,000)	(500,000)
Budget Legislation Changes	18,800,700	63,583,600	(2,144,000)	(12,852,000)	
Sales Tax Increase -May Ballot		918,000,000	967,829,800	1,056,875,100	
First Things First Redirect - Nov. Ballot		60,000,000	120,000,000	120,000,000	120,000,000
Urban Revenue Sharing	(628,649,100)	(473,986,800)	(428,199,400)	(447,697,800)	(497,001,800)
Net On-going Revenues	$6,161,378,400	$7,599,092,800	$8,676,374,900	$9,476,650,300	$9,035,031,700
One-time Financing Sources					
Balance Forward	($480,713,000)	($150,185,000)			
Other Revenue Changes	113,420,000	34,600,000			
State Asset Leaseback/Other Financing	1,485,419,300				
Fund Transfers - November Ballot		448,538,600			
Fund Transfers	386,505,800	180,292,300	102,389,500	102,389,500	102,389,500
Subtotal One-time Revenues	$1,504,632,100	$513,245,900	$102,389,500	$102,389,500	$102,389,500
Total Revenues	$7,666,010,500	$8,112,338,700	$8,778,764,400	$9,579,039,800	$9,137,421,200
EXPENDITURES					
Operating Budget Appropriations	$9,588,250,900	$9,114,757,100	$8,748,225,900	$9,039,031,500	$9,227,196,100
FY 2010 Supplementals	132,583,200	0			
First Things First/DES Redirect - Nov. Ballot		40,000,000	40,000,000	40,000,000	40,000,000
Administrative Adjustments	72,731,600	73,607,000	73,388,300	74,853,500	77,086,600
Revertments	(113,241,600)	(112,905,100)	(115,159,200)	(118,594,800)	(120,525,600)
Subtotal Ongoing Expenditures	$9,680,324,100	$9,115,459,000	$8,746,455,000	$9,035,290,200	$9,223,757,100
One-time Expenditures					
Capital Outlay	$10,400,000	$4,000,000			
Capital Outlay Prior Year Reversions	(450,000)				
Temporary Federal Assistance	(1,289,189,500)	(579,306,800)			
SFB Debt Refinance		(60,000,000)			
Payment Deferrals	(584,889,100)				
Subtotal One-time Expenditures	($1,864,128,600)	($635,306,800)	$0	$0	$0
Total Expenditures	$7,816,195,500	$8,480,152,200	$8,746,455,000	$9,035,290,200	$9,223,757,100
Ending Balance w/ Ballot Props 1/	($150,185,000)	($367,813,500)	$32,309,400	$543,749,600	($86,335,900)
Structural Balance (On-going Rev/Expend)	($3,518,945,700)	($1,516,366,200)	($70,080,100)	$441,360,100	($188,725,400)
Impact of Ballot Proposition Failures					
Sales Tax Failure		(918,000,000)	(967,829,800)	(1,056,875,100)	
Other Ballot Failures		(468,538,600)	(80,000,000)	(80,000,000)	(80,000,000)
Conditional Reductions		862,366,000	862,366,000	862,366,000	862,366,000
Revised Ending Balance w/out Ballot Props 2/	(150,185,000)	(891,986,100)	(153,154,400)	269,240,500	696,030,100

1/ Assumes passage of budget-related ballot propositions

2/ Assumes failure of budget-related ballot propositions