ANNUAL BUDGET

FY 1995

SUMMARY OF RECOMMENDATIONS

AND

ECONOMIC AND REVENUE FORECAST

Prepared By

JOINT LEGISLATIVE BUDGET COMMITTEE

SENATOR CAROL SPRINGER
Chairman 1994

REPRESENTATIVE ROBERT "BOB" BURNS
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JLBC

JOINT LEGISLATIVE BUDGET COMMITTEE

The Joint Legislative Budget Committee was established in 1966, pursuant to Laws 1966, Chapter 96. In 1979, a bill was passed to expand and alter the committee membership, which now consists of the following 16 members:

Representative Robert "Bob" Burns Chairman 1993	Senator Carol Springer Chairman 1994
Representative Brenda Burns	Senator Lela Alston
Representative Carmen Cajero	Senator Gus Arzberger
Representative Lisa Graham	Senator A. V. "Bill" Hardt
Representative Leslie W. Johnson	Senator Bev Hermon
Representative Bob McLendon	Senator Matt Salmon
Representative Greg Patterson	Senator John Wettaw
Representative Polly Rosenbaum	Senator Pat Wright

The primary powers and duties of the JLBC relate to ascertaining facts and making recommendations to the Legislature regarding all facets of the state budget, state revenues and expenditures, future fiscal needs, and the organization and functions of state government.

JLBC appoints a Director who is responsible for providing staff support and sound technical analysis to the Committee. The objectives and major products of the staff of the JLBC are:

- **Analysis and recommendations for the annual state budget**, which are presented in January of each year;
- Technical, analytical, and preparatory support in the development of **appropriations bills** considered by the Legislature;
- Periodic **economic and state revenue forecasts**;
- Periodic **analysis of economic activity, state budget conditions,** and the relationship of one to the other;
- Preparation of **fiscal notes** or the bills considered by the Legislature that have a fiscal impact on the state or any of its political subdivisions;
- An annual **Appropriations Report**, which is published shortly after the budget is completed and provides detail on the budget along with an explanation of legislative intent;
- **Management and fiscal research reports** related to state programs and state agency operations.
- **Support to the JLBC** with respect to recommendations **on business items** placed on the committee's agenda such as transfers of appropriations pursuant to A.R.S. § 35-173;
- **Support to the Joint Committee on Capital Review** (JCCR) with respect to all capital outlay issues including land acquisition, new construction, and building renewal projects
- **Support to the Joint Legislative Tax Committee** (JLTC) as directed in fulfilling the requirements of A.R.S. § 41-1322(D).

STATE OF ARIZONA
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TED FERRIS
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RICHARD STAVNEAK
DEPUTY DIRECTOR

January 12, 1994

The Honorable John Greene
President of the Senate
and
The Honorable Mark Killian
Speaker of the House
State Capitol
State of Arizona

Dear President Greene and Speaker Killian:

On behalf of Senator Carol Springer, Representative Bob Burns, and the Staff of the Joint Legislative Budget Committee, it is my pleasure to transmit to you and the entire 41st Legislature of the State of Arizona, our Budget Analysis and Recommendations for Fiscal Year 1995.

The combination of an $86 million carry-forward from FY 1993, a $191 million upward revision in the FY 1994 revenue forecast, and a further increase of $265 million in the FY 1995 revenue forecast provides the Legislature with a considerable degree of freedom to pursue a number of different policy options. The JLBC Staff recommends that the 41st Legislature take several steps that would (1) make payment on past financial obligations, and (2) help ensure the future health of the state budget. The two most significant recommendations are the immediate elimination of the K-12 Rollover, at a cost of $142.5 million in FY 1994, and full funding of the required deposits to the Budget Stabilization Fund in both FY 1994 and FY 1995, at a combined cost of $152 million. While these policies will absorb most of the surplus, once implemented, they will ensure that we have the resources to address critical state spending issues in FY 1996 and beyond in a way that is more sustainable.

Our recommendations are contained in three volumes:

(1) This Summary of Recommendations and Economic and Revenue Forecast;
(2) An Analysis and Recommendations book, which contains recommendations, by agency, and by program;
(3) A Non-Appropriated Funds book, which provides an explanation of those funds not subject to legislative appropriation.

The Staff of the Joint Legislative Budget Committee looks forward to working with you, the Senate and House Appropriations Committees, and the entire 41st Arizona Legislature in developing the state budget for FY 1995.

Sincerely,

Ted Ferris

Ted Ferris
Director
TF:lm

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FISCAL YEAR 1995 - GENERAL FUND
JLBC STAFF RECOMMENDATION

The combination of an $86 million carry-forward from FY 1993, a $191 million upward revision in the FY 1994 revenue forecast, and a further increase of $265 million in the FY 1995 revenue forecast provides the Legislature with a considerable degree of freedom to pursue a number of different policy options. The JLBC Staff recommends that the 41st Legislature take several steps that would (1) make payment on past financial obligations, and (2) help ensure the future health of the state budget. In light of the state's sharply improved financial position, the JLBC Staff recommends the following "sound fiscal practices":

- An appropriately cautious revenue forecast;
- Elimination of the "K-12 Rollover" in FY 1994;
- Full funding of the Budget Stabilization Fund as required by law;
- A return to the practice of "pay-as-you-go" financing of capital projects, in lieu of further lease-purchase;
- A substantial increase in funding for Building Renewal (major maintenance and repair of state-owned buildings);
- Legislation to establish a process for reducing the number of state funds and increasing legislative oversight of non-appropriated funds.

While these policies will absorb most of the surplus, once implemented, they will ensure that we have the resources to address critical state spending issues in FY 1996 and beyond in a way that is more sustainable.

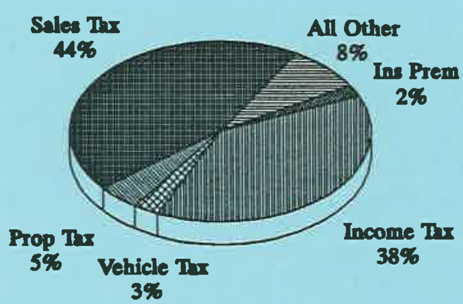
OPERATING APPROPRIATIONS

Agency/Activity	$ Change From FY 94	JLBC Staff FY 95 Rec.
	($ Millions)	
• Dept. of Education (K-12)	$136.5	$1,580.6
• Universities	6.9	547.2
• AHCCCS	37.5	514.7
• Dept of Economic Security	12.1	368.8
• Dept of Corrections	41.5	324.8
• Dept of Health Services	12.3	206.5
• Courts	6.6	90.9
• Community Colleges	3.9	90.6
• Dept of Revenue	0.2	47.7
• Dept of Public Safety	0.7	34.9
• All Other	6.4	240.7
TOTAL	264.5	4,047.2

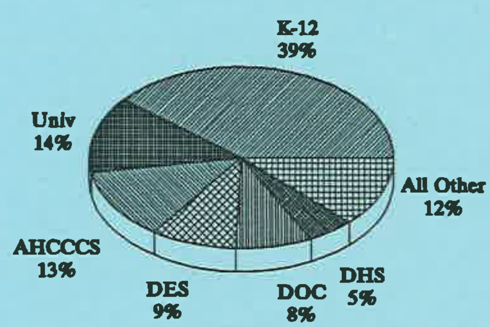
REVENUES AND YEAR-END BALANCES

	Executive	JLBC	Difference
REVENUES:		($ Millions)	
•Beginning Balance	$191.5	$35.6	$(155.9)
•Base Revenues	4,169.0	4,169.0	0.0
•Federal Retirees' Refunds	(34.2)	(34.2)	0.0
•Disproportionate Share Revenue	58.2	70.0	11.7
•Governor's Tax Reduction Proposals	(120.0)	0.0	120.0
SUBTOTAL-REVENUES	$4,264.6	$4,240.4	$(24.2)
EXPENDITURES:			
APPROPRIATIONS			
•Operating Subtotal	$4,082.5	$4,047.2	$(35.2)
•Capital Outlay Subtotal	25.0	31.6	6.6
•Supplemental Appropriations:			
-Reverse K-12 Rollover	71.3	N/A	(71.3)
-Required Payment to BSF	0.0	123.6	123.6
•Other Bills	26.0	20.0	(6.0)
•Pay/Health Insurance Increase	64.3	30.0	(34.3)
•Risk Management Savings	(10.0)	(10.0)	0.0
•Administrative Adj. & Emergencies	21.0	21.0	0.0
•Revertments	(45.0)	(45.0)	0.0
SUBTOTAL-EXPENDITURES	$4,235.0	$4,218.4	$(16.6)
PROJECTED ENDING BALANCE:	$29.6	$22.0	$(7.6)

Where It Comes From



Where It Goes



Prepared for Members of the Arizona State Legislature by the Joint Legislative Budget Committee Staff

MAJOR FACTORS BEHIND CHANGE IN GENERAL FUND OPERATING BUDGETS DIFFERENCE FROM ORIGINAL FY 1994 ESTIMATES

Department of Education **$136.5 Million**
- New Students - 16,858 New K-8 Students (3.5% Growth); 5,633 New 9-12 Students (3.3%); 470 New Preschool Disabled (35%) $79.8
- 1.5% Deflator Adjustment 36.6
- Eliminate Use of District's Cash Balances to Offset Basic State Aid (Statutory Authority for Offset Expires in FY 1994) 18.0
- Restore $15 per Student Capital Levy Reduction 9.4
- Fund 100% of Sudden Growth, up from 75% 4.0
- Interest Savings From Rollover Elimination (0.7)
- Increase Local Support of Career Ladders from 1/3 to 2/3, as Required by Statute (9.3)
- Other Technical Changes, Including 1% Assessed Value Growth, Statutory Reduction in Homeowner's Rebate and Retirement and Other Adjustments (1.3)

Department of Corrections **$41.5 Million**
- Open 1,050 New Prison Beds $15.9
- 1,020 New Prisoners - 5.9% Growth 3.1
- Annualization of FY 1994 Prison Openings 3.8
- Special Pay Package - Correctional Officers 1.5
- Fund Shift - Corrections Fund No Longer Available for Operating, Will be Used for Lease-Purchase Payments and New Construction 18.6
- One-time Equipment Costs (1.4)

AHCCCS **$37.5 Million**
- 25,800 New Member Years–(7.4% Growth) and Other Demographics $8.1
- 3% Cap Rate/5% Medical Inflation Increase 12.7
- State Match for $17.4 Million in New Federal Disproportionate Share Funds 8.5
- Statutory Phase Down of Quick Pay Discount 5.6
- End of Federal SLIAG Funding 3.0
- State Match for $5 Million in New Federal Title 19 Funds for Non-SMI Mental Health 2.5
- Add 91 New Eligibility Workers 1.6
- Increase County Acute Contribution Based on 29.5% of Non-Federal Costs (2.1)
- Other Acute Care and Administrative Changes (2.4)

Department of Health Services **$12.3 Million**
- New Seriously Mentally Ill Services $7.5
- Children's Behavioral Health, Including $2M for "State-Only" 7.1
- Replace "Off-Budget" Pure Research Program with Applied Public Health Projects, Including $300,000 for Poison Center 2.1
- Transfer General Mental Health to AHCCCS (5.1)
- All Other 0.7

Department of Economic Security **$12.2 Million**
- AFDC-10,613 New Recipients (5% Growth), Less Savings from FY 1994 Surplus/Higher Child Support $(3.0)
- 98 New AFDC Eligibility/Fraud Staff 1.8
- DD–Fund 4% Caseload Growth and 473 Children from Waiting List 3.7
- Foster Care/Adoption Services–9% Growth 4.3
- Add 70 CPS and 14 Adult Protective Staff 4.0
- 3,444 New Child Care Placements 2.5
- Other (1.1)

Universities **$6.9 Million**
- Student Enrollment Growth of 1,424 (1.7%) $3.6
- ERE & Risk Management 3.0
- AHEC and Other 0.3

Courts **$6.6 Million**
- 2,120 Adult/480 Juvenile New Probation Slots $5.3
- 6% Juvenile Support Services Growth/Other 1.3

Community Colleges **$3.9 Million**
- Increase Operating Aid–80 New Students (0.1% Growth), 1.5% Inflation $1.1
- 23% Increase in Capital Outlay Aid 2.4
- Increase Equalization Aid and Other 0.4

Department of Youth Treatment and Rehabilitation **$2.5 Million**
- Implementation of Consent Decree $3.1
- Other (0.6)

Secretary of State **$1.7 Million**
- Biennial Cost of Elections $1.7

Department of Environmental Quality **$1.3 Million**
- Increase WQARF Clean-ups $0.5
- Add Safe Drinking Water Staff 0.5
- Create Contingency to Investigate Environmental Hazards 0.3

Schools for the Deaf and Blind **$1.0 Million**
- Replace 21 School Buses/Vehicles $0.5
- New Bus Aides 0.1
- New Students and Other Changes 0.4

Land Department **$0.8 Million**
- Pay CAP Water Obligation $0.7
- Expand Legal Support and Fully Fund Nat. Resource Conservation Districts 0.4
- Other (0.3)

Department of Public Safety **$0.7 Million**
- Reduce Use of HURF and Highway Funds $3.3
- Increased Highway Patrol Fund Offset (2.7)
- Other 0.1

Office of Tourism **$0.6 Million**
- Expand Toll-Free Line to Answer All Calls $0.4
- Operate New Welcome Center/Other 0.2

Arizona Historical Society **$0.3 Million**
- Partial Opening of Papago Park Museum $0.3

FY 1995
COMPARISON OF MAJOR POLICY ISSUES

MAJOR ISSUES	EXECUTIVE RECOMMENDATION	JLBC STAFF RECOMMENDATION
Parameters of General Fund Budget	• $300 M Increase in General Fund Operating Budget • 981 FTE Position Increase; or 352 FTE Increase, Excluding Corrections/DYTR • $29.6 M Surplus	• $265 M Increase in General Fund Operating Budget • 785 FTE Position Increase; or 309 FTE Increase, Excluding Corrections/DYTR • $22.0 M Surplus
K-12 Rollover	• Continues @ $142.5 M in FY 94; Reduces to $71.25 M in FY 95	• Recommend $142.5 M Supplemental to Eliminate Rollover in FY 94
Budget Stabilization Fund (BSF)	• Recommends Legislation to Avoid Required Deposits in Both FY 94 and FY 95	• Recommends Full Funding of Required Deposits of $28.4 M in FY 94 and $123.6 M in FY 95
Tax Cuts	• Recommends $100 M Income Tax Cut • $20 M High County Property Tax Relief	• No Additional Tax Cuts
State Employee Issues	• $60 M for Pay/Health Insurance Increase • $4.3 M for Provider Increase • Retirement Contribution of 3.75%	• $30 M for Pay/Health Insurance Increase • No Provider Increase • Retirement Contribution of 3.75%
Capital Outlay	• $9 M for Construction –Crime and Health Lab Planning –Construct 530 Prison Beds–Lease-Purchase in FY 96 • $16 M for Building Renewal; Fund 67% of DOA and 55% of University Formula	• $15 M for Construction –Crime/Health Lab Plus Flagstaff Office Building Planning –Construct 450 Prison Beds. Pay Cash in FY 95 • Similar Amount for Building Renewal; Fund 58% of DOA/University Formula
Other Bills	• $26 M, Including $21 M for Educ. Reform	• $20 M Unspecified
AGENCIES		
K-12	• Funds 2% of 2.6% Deflator at a Cost of $48 M • Reduces 50% of $142.5 M Rollover in FY 95 • Continues to Fund Sudden Growth at 75% of Requirement • Adds $18 M to Eliminate Use of District's Cash Balances to Offset State Aid and $9 M to Restore $15 Per Student Capital Reduction	• Funds 1.5% of 2.6% Deflator at a Cost of $37 M • Eliminates Full Rollover of $142.5 M in FY 94 • Fully Funds Sudden Growth at a $4 M Cost • Adds $18 M to Eliminate Use of District's Cash Balances to Offset State Aid and $9 M to Restore $15 Per Student Capital Reduction
Community Colleges	• Adds $7.4 M, Including 2% Inflation, $2.5 M for Unfunded FY 94 Operating Aid, and $3.5 M to Fully Fund Capital Formula	• Adds $3.5 M, Including 1.5% Inflation, No FY 94 "Catch-up," and $2.4 M to Fund 92% of the Capital Formula (was 77% in FY 94)
Universities	• Adds $18.2 M for Operating, Including $4.7 M for Enrollment, $2 M for New Campus Development and $5 M for Faculty Salaries	• Adds $6.9 M for Operating, Including $3.6 M for Enrollment Growth
Youth Treatment and Rehabilitation	• Adds $3.4 M and 45 FTE for Consent Decree Implementation • Adds $1.9 M for New Boot Camp • Funds 30 New Beds in FY 95. Funds No New Probation Slots	• Adds Similar Amounts as the Executive for the Consent Decree • Does Not Recommend Added Funding • No New Beds. Courts' Budget Includes 480 New Probation Slots

MAJOR ISSUES	EXECUTIVE RECOMMENDATION	JLBC STAFF RECOMMENDATION
Corrections	• Funds 1,650 New Beds in FY 95. No New Adult Probation Slots • Annualize and Open New Prisons at a Cost of $25.8 M, Including Population Growth • Provides $2.5 M for CSO Pay Plan • Provides $18.6 M from General Fund as a Result of Eliminating Use of Corrections Fund for Operating Costs • Provides $3.4 M to Contract for 600 Private Beds	• Funds 1,050 New Beds in FY 95. Courts' Budget Includes 2,120 New Adult Probation Slots • Annualize and Open New Prisons at a Cost of $22.8 M, Including Population Growth • Provides $1.5 M for CSO Pay Plan • Provides Same Amount from General Fund as a Result of Eliminating Use of Corrections Fund for Operating Costs • Does Not Recommend this Funding
DPS	• Recommends $1.2 M for Expansion of the Gang Unit	• Does Not Recommend this Funding
Attorney General	• Provides an Additional $2.6 M, Including $800,000 for Rent for 43% Space Expansion and $1.6 M Lump Sum	• Provides an Additional $600,000, Including $200,000 for Rent for 17% Space Expansion
AHCCCS	• Recommendation Based on "Current Law," Including Program Changes from Last Session • Net County Impact: $11.5 M Entirely Due to County Share of Long Term Care • Retains all New Dispro Share Funding for State; Uses $22.8 M to Offset General Fund Increase • Net General Fund Increase of $16.4 M; Without Dispro Offset, Increase is $46.4 M	• Recommendation Based on "Current Law," Including Program Changes from Last Session • Net County Impact: $11.4 M Largely Due to County Share of Long Term Care • Allocates Additional Dispro Share Funding to State, Counties and Hospitals Based on Current Formula (All Gain Proportionally) • Net General Fund Increase of $37.5 M
Economic Security	• Provides $7.0 M for D.D. Waiting List and 6% Caseload Growth • Provides $500,000 for Family Service Centers and $1.75 M for Healthy Families • Adds 92 CPS Staff FTE Positions and $4.5 M for a 93% Investigation Rate • Does Not Transfer Children's Behavioral Health Funding	• Provides $4.3 M for D.D. Children's Waiting List and 4% Caseload Growth • Does Not Recommend Funding • Adds 70 FTE Positions and $3.5 M for a 93% Investigation Rate • Transfers $(2.8) M to DHS for Children's Behavioral Health
Health Services	• $7.4 M Increase for SMI • $1.6 M for Children's Behavioral Health • No Offset as a Result of New Title 19 Mental Health Program in AHCCCS • Does Not Address Disease Research Commission • Arizona Poison Control Total Funding of $475,000	• $7.5 M Increase for SMI • $7 M for Children's Behavioral Health • Save $5.1 M as a Result of New Title 19 Mental Health Program in AHCCCS • Redirects Disease Research Funds from Pure Research to Applied Public Health Projects • Arizona Poison Control Total Funding of $750,000
DEQ/WQARF	• Adds $2 M from General Fund for WQARF Clean-ups; "Frees up" $460,000 of WQARF Currently Used to Fund FTE's	• Adds $550,000 from General Fund for the Same Purpose; "Frees up" $460,000 of WQARF Currently Used to Fund FTE's
Veterans' Comm.	• $2 M to Open Nursing Home in June 95	• Defers Nursing Home Opening to FY 96
Arizona Historical Society	• Add $234,500 for Partial Opening of Papago Park Museum	• Add Same Amount for Partial Opening of Papago Park Museum
Agriculture	• Adds 14 FTE's and $435,000 for Africanized Honey Bee Program	• Does Not Recommend Added Funding
State Parks Board	• Eliminates State Lake Improvement Fund Appropriation for Operating Expenses; Restores $1.2 M in General Fund Support • Adds $200,000 for Conservation Corps	• Continues Usage of State Lake Improvement Funds for Operating Expenses • Adds Same Amount for Conservation Corps

GENERAL FUND REVENUES AND EXPENDITURES
FISCAL YEARS 1994 AND 1995

	FY 1994 JLBC STAFF	FY 1995 JLBC STAFF	FY 1995 EXECUTIVE
REVENUES:			
BEGINNING BALANCE	$ 86,014,600	$ 35,642,900	$ 191,549,000
BASE REVENUES	3,916,730,300	4,169,040,300	4,169,040,300
FEDERAL RETIREES' REFUNDS	(51,100,000)	(34,200,000)	(34,200,000)
DISPROPORTIONATE SHARE REVENUE	58,219,700	69,953,800	58,219,700
GOVERNOR'S TAX REDUCTION PROPOSAL	0	0	(100,000,000)
GOVERNOR'S HIGH COUNTY PROPERTY TAX RELIEF		0	(20,000,000)
SUBTOTAL-REVENUES	$4,009,864,600	$4,240,437,000	$4,264,609,000
EXPENDITURES:			
APPROPRIATIONS:			
•Prior Session Appropriations	5,129,700	0	0
•Operating Subtotal	3,788,113,200	4,047,241,100	4,082,454,800
•Capital Outlay Subtotal	11,471,900	31,551,400	25,000,000
•Supplemental Appropriations:			
-Agency Supplemental Appropriations	11,100,000	0	0
-Reverse K-12 Rollover	142,500,000	0	71,250,000
-Required Payment to BSF	28,386,000	123,603,000	0
•Other Bills	0	20,000,000	26,000,000
•FY 1995 Pay Increase/Health Ins. Increase	0	30,000,000	64,300,000
•Risk Management Savings	0	(10,000,000)	(10,000,000)
ADMINISTRATIVE ADJ. & EMERGENCIES	22,564,900	21,000,000	21,000,000
REVERTMENTS	(40,000,000)	(45,000,000)	(45,000,000)
CHG. IN CONTINUING APPROPRIATIONS	4,956,000	0	0
SUBTOTAL-EXPENDITURES	$3,974,221,700	$4,218,395,500	$4,235,004,800
PROJECTED ENDING BALANCE:	$ 35,642,900	$ 22,041,500	$ 29,604,200

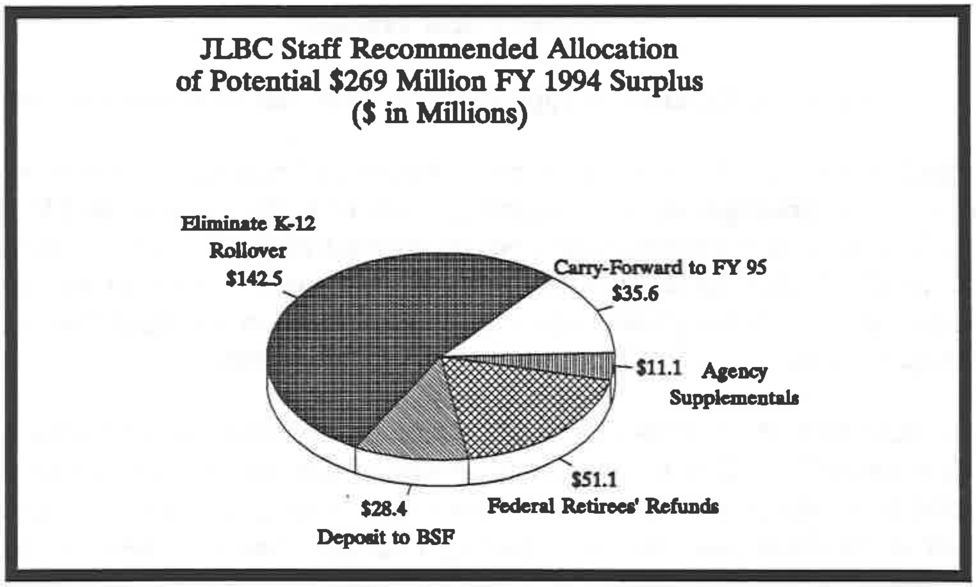
FY 1993 REVIEW AND FY 1994 UPDATE

In June 1993, the JLBC Staff projected that the state would conclude FY 1993 with a $65 million surplus as a result of improving trends in state government finances. As it turned out, the news was even better as the state concluded the year with a $86 million surplus. The unexpectedly large surplus was created by an excess of revenues totalling $103 million as compared to the JLBC Staff forecast prior to enactment of the budget. A more detailed review of that year's revenue forecast is included in the revenue section at the back of this summary book.

A fair portion of the unanticipated revenues were unforeseeable and unrelated to economic events. For example, the collective overage of $34 million in the property tax, insurance premium tax, estate tax, and disproportionate share revenue had little to do with the state of the economy. The $26 million overage in the sales tax appears to have been driven by a surge in optimism that was unique to Arizona and a handful of other states. The $51 million overage in the income tax may have had more to do with the effects of the 1990 Tax Reform Act, which obviously generated more revenue for the state than expected from both the individual and corporate income taxes.

Forecasting was made even more difficult by the fact that tax growth accelerated at year's end, as growth in the final 4 months averaged 13% as compared to the prior year. This extraordinary growth came too late in the fiscal year to be reflected in either the revised FY 1993 or FY 1994 budget forecasts for revenue. Nonetheless, this hypergrowth was not maintained as year-to-date growth in FY 1994 of roughly 7% is actually less than FY 1993's annual increase of 8.5%.

The revised Staff estimate for FY 1994 revenue is $190.5 million higher than the estimate used at time of enactment of the budget in March 1992. The higher revenues, when combined with the $86 million surplus carried forward from FY 1993 and certain other "balance-sheet" adjustments, would lead to a $268.7 million surplus at the end of FY 1994 if not for 4 obligations, including: 1) federal retiree refunds of $51.1 million (already underway); 2) proposed supplemental appropriations of $11.1 million for state agencies; 3) a proposed supplemental appropriation of $28.4 million to make the estimated required deposit into our Budget Stabilization Fund; 4) a proposed supplemental appropriation of $142.5 million in order to eliminate the accounting practice commonly known as the "K-12 Rollover" (which is an exception to Generally-Accepted Accounting Principles). When these obligations are paid, the projected year-end surplus is reduced to $35.6 million (see graph at top of next page).



OVERVIEW OF THE JLBC STAFF RECOMMENDED GENERAL FUND BUDGET FOR FY 1995

The JLBC Staff's FY 1995 budget recommendation is based upon two major themes--paying past financial obligations and implementing sound fiscal remedies that will help ensure our state's future budgetary health. The budgets of the past 6 years were balanced with the use of several fiscal "shortcuts." While our improving economy will produce higher revenues than in the recent past, the JLBC Staff recommends that we take this opportunity to put our fiscal house in order before beginning additional programs. Although this approach limits our ability to immediately apply our growing state General Fund surpluses toward new or expanded programs, it does increase the likelihood that the most critical state spending priorities can be addressed in FY 1996 and beyond in a way that is more sustainable.

In light of the state's sharply improved financial position, **the JLBC Staff recommends the following "sound fiscal practices":**

- An appropriately cautious revenue forecast;
- Elimination of the "K-12 Rollover" in FY 1994;
- Full funding of the Budget Stabilization Fund as required by law;
- A return to the practice of "pay-as-you-go" financing of capital projects, in lieu of further lease-purchase;
- A substantial increase in funding for Building Renewal (major maintenance and repair of state-owned buildings); and
- Legislation to establish a process for reducing the number of state funds and increasing legislative oversight of non-appropriated funds.

Sound Fiscal Practices

Improving Economy--Appropriately Cautious Revenue Forecast

As described in the FY 1993 Review section, Arizona's improving economy was first reflected in the **surprisingly strong revenue growth of 8.5%** achieved **in FY 1993**. This compared favorably with the consensus revenue forecast of 4.7% used for that year's budget. Whereas, the JLBC Staff forecast for income and job growth in Arizona was quite accurate (for example, actual income growth was 7.6% versus 7.2% in the Staff forecast), General Fund revenues exceeded the Staff forecast by over $100 million.

During the **first half of FY 1994** (through December), General Fund **revenue growth has slowed to roughly 7%.** Due to the skewed impact of last year's tax cuts and this year's federal retirees refund program, where the associated revenue losses are concentrated in the second half of the fiscal year, we are expecting a further slowing of revenue growth over the next 6 months on a year-over-year basis. Furthermore, growth during the second half of FY 1993 was especially strong and, therefore, will make the year-over-year comparison look worse during the second half of the year. For FY 1994 as a whole, we are forecasting that total personal income in Arizona will once again grow by 7.6%. However, due to the factors cited above, **we expect annual revenue growth to abate somewhat to 5.0%.** Nonetheless, our base revenue forecast of $3,975 million (prior to the federal retiree refunds) is some $190.5 million higher than the Governor's revenue forecast, which was used last March when this year's budget was adopted (and $132.4 million higher than the JLBC Staff revenue forecast of last March).

The JLBC Staff FY 1995 forecast calls for a modest acceleration in the Arizona personal income growth rate to 8.2%, to be accompanied by a similar increase **in the base revenue growth rate to 6.6%.** Of course, the Staff estimate reflects the legislated tax changes of 1993. Without these effects, the JLBC Staff forecasted increase of base revenue would be 7.3% instead of 6.6%, while the net total revenue increase would be 7.9% instead of the 7.2% shown below.

GENERAL FUND REVENUE
(dollars in millions)

	FY 1993	FY 1994	% CHG.	FY 1995	% CHG.
Sales Tax	$1,631.4	$1,737.1	6.5%	$1,866.5	7.4%
Income Taxes	1,422.6	1,497.8	5.3	1,608.5	7.4
Other Revenue	730.8	740.1	1.3	764.0	3.2
Total Base Revenue	$3,784.8	$3,975.0	5.0%	$4,239.0	6.6%
Fed Retiree Refunds	--	(51.1)		(34.2)	(33.1)
Total Revenue	$3,784.8	$3,923.9	3.7%	$4,204.8	7.2%

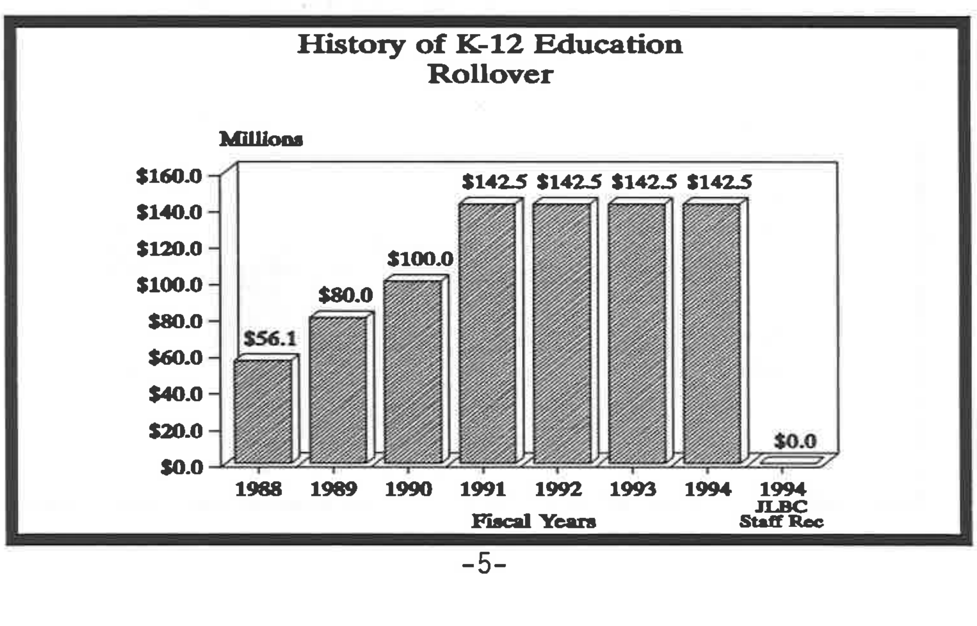
Elimination of the "K-12 Rollover"

The JLBC Staff recommends eliminating the practice of "rolling over" State Aid payments in FY 1994. The "K-12 Rollover" is a finance technique used to help balance the budget that shifts funding requirements from one fiscal year to the next **(which is an exception to Generally-Accepted Accounting Principles)**. As displayed in the chart below, the "rollover" began in FY 1988 at a level of $56.1 million and has grown to its current level of $142.5 million.

The FY 1994 General Appropriation Act provided approximately 11 months of funding for FY 1994 State Aid requirements. The Act funded the remaining State Aid payments, $142.5 million, with an appropriation from FY 1995, with the deferred payment to be made on July 1. In addition, the Act included an FY 1995 appropriation of $696,400 for any costs to school districts which may be associated with the reductions in State Aid apportionments. The Education Omnibus Budget Reconciliation Bill also included language authorizing the "rollover."

To reverse the "rollover" the JLBC Staff recommends:
-- Supplementing the FY 1994 State Aid appropriations by $142.5 million. This would serve to fund the full 12 months of FY 1994 State Aid payments in FY 1994.
-- Repeal the advance FY 1995 appropriation of $142.5 million for the "rollover" and the $696,400 for related costs.
-- Repeal the Education ORB language.

As a result of eliminating the "rollover", the state will save $696,400 in "related costs" and improve our overall cash balances. In addition, there are other costs associated with the "rollover", specifically imputed foregone interest earnings. The fact that the state deferred the payment instead of raising taxes and/or cutting spending to balance the budget has caused State Treasury balances, and thus interest earnings, to be lower than they otherwise would have been. The JLBC Staff estimate of foregone interest since inception of the K-12 Rollover is nearly $35 million. Therefore, **eliminating the "rollover" will improve the state's operating cash balances and interest earnings in the future**, under the assumption that the $142.5 million would otherwise be used to increase spending or reduce taxes.



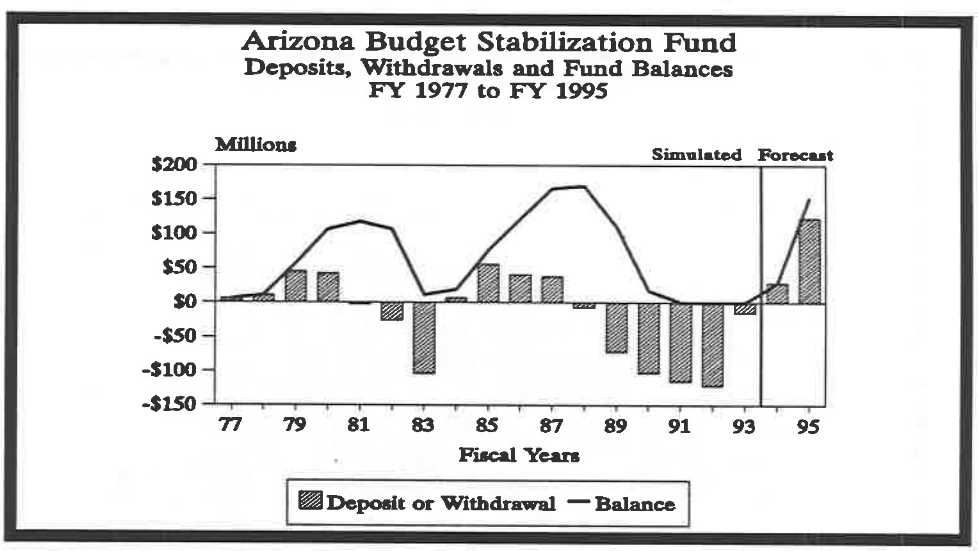
Full Funding of Arizona's Budget Stabilization Fund

The JLBC Staff recommends full funding of Arizona's Budget Stabilization Fund (BSF), consistent with the formula established in Chapter 6, Laws 1990, 3rd Special Session (A.R.S. § 35-144). Essentially, **the BSF is designed to set revenue aside during times of above-trend economic growth and to spend this revenue during times of below-trend growth.** A detailed explanation of the philosophy and formula under which the BSF operates can be found at the back of this summary recommendation book.

Since the enactment of the BSF in 1990, the formula properly allowed for withdrawals from the Fund in FY 1991 and FY 1992, as Arizona remained mired in recession. Of course, because there were no monies on deposit in the BSF, the withdrawals did not occur. As it turned out, FY 1993 was a turnaround year, as real (inflation-adjusted) personal income grew by 3% more than in the prior year, but was still slightly below the 7-year trend. Accordingly, the formula called for a small withdrawal.

The Arizona economy is now "gathering steam" and **the JLBC Staff forecasts that 1993 and 1994 will be "above-trend" growth years,** with real growth of 2.6% and 5.0%, respectively. These increases are 0.75% and 3.15% above trend for those years **and will dictate an initial deposit of $28.4 million into the BSF in FY 1994, followed by a deposit of $123.6 million in FY 1995.** The required FY 1994 deposit was not included in the enacted budget last spring. Therefore, a supplemental appropriation will be necessary yet this year.

The graph below includes a JLBC Staff simulation of how the BSF would have operated since 1977, through 2 major recessions, along with the Staff estimates for FY 1994 and FY 1995. Basically, the BSF would have operated as intended, "filling up" during the expansion phase of the economic cycle and "emptying out" during the recessions. Between FY 1987 and FY 1992, the state budget was revised each year with total revisions of $644 million over the 6-year period (See Chart at top of next page). The JLBC Staff believes that if we do not fund the BSF now, we will find ourselves, once again, cutting budgets at mid-year during the next, inevitable recession.



SUMMARY OF MIDYEAR BUDGET REVISIONS FY 1987 TO FY 1992 ($ MILLIONS)								
STEPS TAKEN TO BALANCE	FY87	FY88	FY89	FY90	FY91	FY92	TOTALS	% TOTAL
BUDGET CUTS	$142.6	$25.5	$30.7	$14.1	$89.8	$33.1	$335.8	52.1%
FUND TRANSFERS	6.5	0.0	36.3	0.0	4.1	12.5	59.4	9.2%
REVENUE INCREASES	4.3	13.8	0.0	0.0	0.0	51.8	69.9	10.8%
TAX ACCELERATION	0.0	0.0	0.0	81.0	0.0	0.0	81.0	12.6%
PAYMENT DEFERRALS	0.0	56.1	0.0	0.0	0.0	0.0	56.1	8.7%
ACCOUNTING CHANGES	0.0	42.2	0.0	0.0	0.0	0.0	42.2	6.5%
TOTALS	$153.4	$137.6	$67.0	$95.1	$93.9	$97.4	$644.4	100.0%

Pay-As-You-Go Cash Financing of New State Facilities

JLBC Staff recommends the use of pay-as-you-go financing, rather than lease-purchase, for constructing new facilities. With the improved state budget outlook, the Staff recommends a return to cash financing of new facilities, which is the least expensive financing method. Beginning in the mid-1980's, the legislature approved the issuance of Certificates-of-Participation (COP's) to finance the acquisition or construction of general state office buildings, ASU-West, a new Supreme Court building, the ENSCO property, facilities at ASDB, the Tonto Natural Bridge, and more recently, RTC and other distressed properties along with additional state prisons. All told, as of December 31, 1993, there were outstanding issuances of $496 million with an annual lease-purchase requirement of $57 million.

COP financing made sense in the late 1980's and early 1990's, due to our poor budgetary climate, record low interest rates, and the opportunity to take advantage of severely depressed building values and construction costs. Now, these factors are all receding, making pay-as-you-go the more attractive financing option.

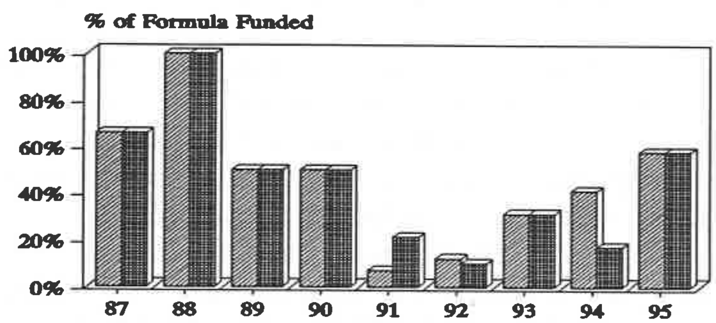
Accordingly, the JLBC Staff recommends a combination of $8.5 million of General Fund and $5 million of Corrections Fund monies to construct 450 new prison beds. The Staff also recommends a total of $2.2 million in planning money for 3 new facilities: a health laboratory for DHS, a crime laboratory for DPS and a Flagstaff state office building to serve DES and other state agencies with offices in Flagstaff. The current laboratories are unsafe, inefficient, and too small. The new facilities will ensure that the growing workloads, which affect public health and safety, are met in a safe and efficient work environment. The new Flagstaff office building would enable the state to terminate several high-cost private leases and lead to greater coordination in service delivery. These facilities would have a total estimated construction cost of $24 million in FY 1996.

Major Maintenance and Repair of State Buildings

Major maintenance and repair would be funded at 58% of the Building Renewal Formula under the JLBC Staff recommendation. The formula was created in 1986 as part of a major reform of the capital budgeting process. By considering factors such as the current replacement value and expected useful life of each facility, the formula is intended to ensure that necessary monies are appropriated for the upkeep and renewal of state buildings.

As demonstrated by the following chart, **the state has not funded more than 50% of the Building Renewal Formula since FY 1988.** The Auditor General reported in October 1993 that numerous problems, "including overloaded electrical systems, structurally unsafe cooling systems, leaking roofs, and insufficient fire-safety systems . . . stem from the deferral of building renewal projects."

Building Renewal Formula
History of General Fund Support



	87	88	89	90	91	92	93	94	95
DOA	66%	100%	50%	50%	7%	12%	31%	41%	58%
Regents	66%	100%	50%	50%	21%	10%	31%	17%	58%

Fiscal Years

Enhanced Oversight of Non-Appropriated Funds

The JLBC Staff recommends the introduction of legislation that would control the growth in the number of state funds and the dollar level of "off-budget" spending, otherwise known as non-appropriated funds. Non-appropriated funds constitute 52% of the overall state spending. In addition, this off-budget spending is growing much more quickly than appropriated expenditures. From FY 1993 to FY 1995, non-appropriated spending is expected to grow 22%, almost twice the growth in the appropriated budget. Furthermore, each additional fund that is created imposes new accounting and administrative responsibilities on the General Accounting Office, the State Treasurer, and the affected state agency, while usually lessening legislative oversight. We need a mechanism for reducing the number of state funds, which number nearly 500, and exercising greater legislative oversight of non-appropriated funds.

Under the proposed legislation, the JLBC Staff would develop an annual recommendation to the Legislature for reducing the number of all funds and the dollar level of non-appropriated funds. The Staff would be required to propose a 10% reduction in the number of funds and a 5% reduction in non-appropriated spending. Upon review by the Joint Legislative Budget Committee, legislation would be introduced to implement the reduction proposal.

Other Budget Issues

State Employees

The state work force of appropriated FTE positions would grow by 785, or 2.2%, under the JLBC Staff recommendation. This growth is largely centered in the criminal justice agencies. Of the new positions, 62% will staff new prisons or help implement the Department of Youth Treatment and Rehabilitation judicial consent decree.

JLBC Staff recommendation sets aside $30 million for state employee pay and health benefit changes. Individual agency budgets already include sufficient dollars to fund the retirement rate at 3.75%, up from 3.14% last year. Details of the general pay adjustment would be determined during the appropriations process. Among numerous options, this set aside could fund: an across-the-board increase, a flat dollar amount per FTE position, or some combination of the two. University pay adjustments will be calculated on the prorated General Fund share of Personal Services, which is approximately 80%.

ANNUAL INCREASES IN STATE EMPLOYEES' SALARIES AS COMPARED TO ANNUAL RATES OF INFLATION 10-YEAR REVIEW

FY	GEN'L	MERIT	CMR	TOTAL INCREASE	CPI-U	INCREASE AFTER INFL.
1985	5.0%	2.5%	0.0%	7.5%	3.9%	3.6%
1986	4.0	1.3	0.7	6.0	2.8	3.2
1987	3.0	3.0	0.2	6.2	2.2	4.0
1988	1.5	0.0	0.0	1.5	4.1	(2.6)
1989	3.5	0.0	0.1	3.6	4.7	(1.1)
1990	0.0	1.3	0.3	1.5	4.7	(3.2)
1991	4.5	0.0	0.3	4.8	5.5	(0.8)
1992	0.0	0.0	0.0	0.0	3.5	(3.5)
1993	4.4*	0.0	0.0	4.4	2.6	1.8
1994	0.0	0.0	0.0	0.0	3.3	(3.3)

* Actual increase of $1,000 per employee, effective 4-1-93, represented a 4.4% increase in the base salary for the average employee
Gen'l=General Pay Adjustment; Merit=Performance Pay;
CMR=Classification Maintenance Review; CPI-U Consumer Price Index

Education

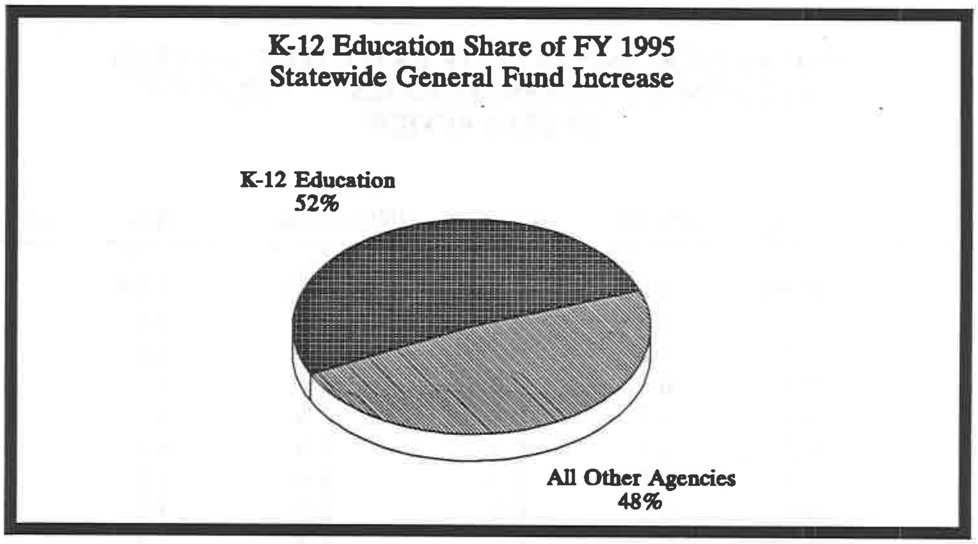
The JLBC Staff recommends $136.5 million in new K-12 funding--a 9.4% increase. The increase is associated with these key factors:

-- $79.8 million for 3.5% student growth
-- $36.6 million to fund a 1.5% GDP inflation adjustment and,
-- $4 million increase to fully fund Sudden Growth.

Also, as part of our policy of instituting sound fiscal practices, the JLBC Staff recommendation:

-- eliminates the $142.5 million K-12 "rollover" in FY 1994,
-- adds $18 million to eliminate the use of District's Cash Balance to offset State Aid, and
-- adds $9.4 million to restore the one-time reduction in capital funding

K-12 expenditures represent a rising share of the state's General Fund expenditures. After many years in which the K-12 share of General Funding spending declined, K-12's share of the budget is on the rise from a low of 37.1% in FY 1991. Under the JLBC Staff recommendation, that trend will continue, as K-12 will account for 39.1% of total General Fund spending in FY 1995. This occurs because K-12 accounts for 52% of all new spending in the Staff recommendation.



As part of sound fiscal practices, the recommendation includes a $2.4 million, or 23.3%, increase in capital funding for community colleges. This recommendation will help ensure that critical building and equipment needs can be addressed on an annual basis. The budget also includes $70,000 for 0.1% student growth and $1 million for a 1.5% inflation adjustment. Student growth has slowed significantly in the last year. The 0.1% growth rate compares to a prior 5-year average of 8.2%.

Under the JLBC Staff recommendation, the universities would receive a total increase of $26-27.5 million. This amount includes $6.9 million in their operating budgets, $10.4 million in capital outlay, and $9-10 million in the Staff recommended general pay adjustment, depending on the specific design of the pay plan.

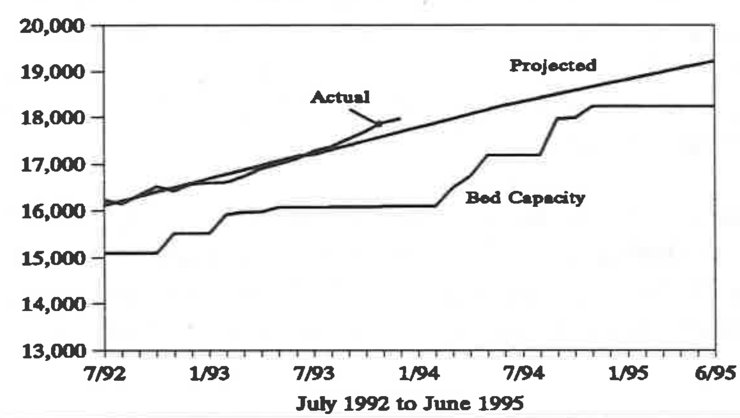
Criminal Justice

The JLBC Staff recommends a total General Fund increase of $41.5 million, or 14.6% for the Department of Corrections budget. The recommendation includes $22.8 million to annualize the cost of 650 prison beds opened in FY 1994 and to open 1,050 new prison beds in FY 1995. The recommendation also includes $18.6 million from the General Fund to offset the loss of the Corrections Fund as a financing source for operating costs. The Corrections Fund will be used to make lease-purchase payments on the FY 1993 and FY 1994 prison construction projects as well as a lease payment to Apache County for the Apache Prison and to help construct 450 new beds in Globe and Yuma.

The JLBC Staff recommendation would reduce the current 1,879 bed shortfall to 989 by the end of FY 1995. In addition to the 650 new state-run prison beds to be opened in FY 1994, an additional 450 private treatment beds will be activated near Marana. In combination with the 1,050 new beds in FY 1995, this expansion will bring the designated bed capacity of the prison system to 18,239, which reduces the bed shortfall to approximately 1,000 beds.

No other beds will be available until construction of the 768-bed Special Management Unit is completed in December of 1995. For FY 1996, the JLBC Staff is recommending opening an additional 450 beds to be constructed at existing sites in Globe (100) and Yuma (350), on a pay-as-you-go basis, at a projected cost of $13.5 million in FY 1995. (General Fund, $8.5 million; Corrections Fund, $5.0 million)

Department of Corrections
Prison Population Growth



The Recommendation would also fund a $1.5 million special pay adjustment for Correctional Service Officers (CSO) over and above any general pay adjustment. In FY 1994, the Legislature also appropriated $1.5 million to the department to increase CSO salaries. The increase amounted to a $296 annual increase (roughly 1.5%) for each of the 4,480 CSO series employees. Salaries paid by the Arizona state government are below the amounts paid to similar employees of the federal government, surrounding states, and Maricopa and Pima counties. As a result, the department has experienced excessive turnover rates, which in turn impact training and overtime costs. The new $1.5 million in FY 1995 could provide an additional $265 (roughly 1.3%) annual increase.

The JLBC Staff recommends $3.3 million in total funds in FY 1995 to implement the Department of Youth Treatment and Rehabilitation judicial consent decree, plus FY 1994 supplementals of $3.4 million. The FY 1995 amount includes $1.1 million for 43 new staff and higher salaries and $1.8 million for institutional and community treatment programs.

The JLBC Staff supplements its criminal justice institutional resources by adding $5.3 million for 2,600 new probation slots. Any analysis of proposed criminal justice resources should encompass both the prison beds and community placements of the Department of Corrections and Youth Treatment and Rehabilitation as well as the probation slots funded through the Courts budget.

In addition to opening 1,050 new adult prison beds, the JLBC Staff recommends funding for 2,120 new adult probation slots. The Staff also recommends 480 new juvenile probation slots.

Health and Welfare

The AHCCCS recommendation is based on current law and represents the second year of a 2-year plan. The recommendation continues reforms enacted during the prior year, including the provision of only emergency services to undocumented aliens, establishing county contributions at 29.5% of total non-federal AHCCCS costs, and reducing private hospital reimbursement on state-only bills by $10 million. The Staff recommendation also includes new funding for the statutorily accelerated phase-down of the 10% quick pay discount on categorical bills and for the implementation of Title 19 mental health services for non-Seriously Mentally Ill adults.

The Staff's recommended General Fund increase for AHCCCS, $37.5 million, reflects a level of growth well below that of recent years. Increases in the AHCCCS budget from FY 1990 through FY 1993 averaged $67.7 million per year, while enrollment over that same time period increased 16.1% on average per year. For FY 1995, we estimate an enrollment increase of 7.4%.

The JLBC Staff recommendation would continue to share increases in Disproportionate Share Hospital revenue with the counties and private hospitals. Under the Staff's proposal, counties would receive $6.4 million in additional net payments, private hospitals would receive $4.6 million more and the state would gain $15.6 million. These amounts reflect increases over the original FY 1994 appropriated amounts.

The JLBC Staff recommends an additional $12 million for the Department of Economic Security. Two particular recommendations focus on improved financial practices -- $1.8 million for 98 additional welfare eligibility workers to keep our error rate in check and $1.5 million to offset a potential loss of federal funds for Developmental Disabilities.

Other key Staff recommendations include: no inflation funding for AFDC benefits, an additional 70 Child Protective Services staff and funding for 473 Developmental Disabilities children currently on the waiting list.

Behavioral health programs in the Department of Health Services would receive a net increase of $9.5 million under the JLBC Staff recommendation. The increases include $7.5 million for the Seriously Mentally Ill, $7 million for Children's Behavioral Health and a reduction of $5 million to reflect the transfer of some Adult General Mental Health clients to AHCCCS.

The JLBC Staff recommendation for DHS would also refocus disease prevention funding from pure research to public health projects. Each year, $2.9 million of state tax revenues are diverted for disease control research outside of the legislative appropriations process. The recommendation redirects these funds to vital public health efforts, including: the Arizona Poison Control Center (APCC), tuberculosis treatment, emergency environmental hazard abatement (such as the Hanta Virus, or the Maryvale Cancer Cluster), on-going disease research, and the cancer and birth defects registry.

Natural Resources

The JLBC Staff recommends the continued use of State Lake Improvement Funds -- watercraft motor fuel taxes -- for the operation of water-based state parks. Under state law, all SLIF revenues in FY 1995 are scheduled to again be used only for capital projects and local grants. Since FY 1992, one-fourth of SLIF revenues, approximately $1.2 million, have offset General Fund appropriations. The continued use of SLIF for operating expenses is consistent with the use of parks visitor revenue for operating expenses, in that parks users help to fund a portion of the cost of operating state parks. Using a portion of SLIF for operating expenses instead of parks development also instills an awareness that parks cannot be built or expanded without funding to operate the park.

Other Issues

As part of sound fiscal practices, the JLBC Staff recommends improvements to the state's accounting system. This recommendation includes an additional 10 FTE positions and $737,300 for the Department of Administration to conduct statewide training programs on use of the state's automated financial systems, develop an automated fixed asset tracking system, and establish an automated systems security team in order to assure the integrity and confidentiality of information.

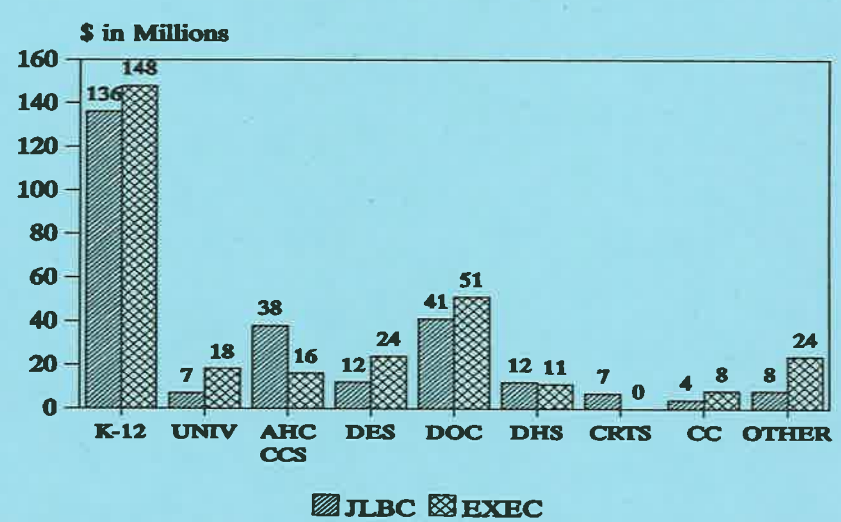
The JLBC Staff is recommending privatization of state services where appropriate. For example, the Staff recommends that the Southern Arizona Mental Health Center (SAMHC) be privatized by no later than the beginning of FY 1996. With a budget of $3.7 million and 81 FTE positions, SAMHC currently competes with private nonprofit organizations in Pima County for the provision of mental health services. In addition, the JLBC Staff also recommends reduced funding for the Department of Weights and Measures to reflect the closing of its petroleum laboratory and the contracting for that service with the private sector. This closing will save the Department approximately $170,000 and 12 FTE positions.

TABLES AND GRAPHS

TEN LARGEST GENERAL FUND AGENCIES
FY 1995 JLBC STAFF RECOMMENDATION
COMPARISON WITH EXECUTIVE RECOMMENDATION AND FY 1994 APPROPRIATIONS

AGENCY	FY 1994 Appropriation	FY 1995 Executive Recommendation	FY 1995 JLBC Staff Recommendation	$ Difference JLBC - Executive	$ Difference JLBC - FY 1994
K-12	1,444,175,200	1,591,966,200	1,580,638,400	(11,327,800)	136,463,200
UNIVERSITIES	540,320,400	558,474,100	547,207,600	(11,266,500)	6,887,200
AHCCCS	477,191,800	493,606,000	514,688,400	21,082,400	37,496,600
DEPT OF ECONOMIC SECURITY	356,653,900	380,827,600	368,800,200	(12,027,400)	12,146,300
DEPT OF CORRECTIONS	283,298,200	334,698,400	324,787,500	(9,910,900)	41,489,300
DEPT OF HEALTH SERVICES	194,178,200	205,674,500	206,453,600	779,100	12,275,400
COURTS	84,228,500	84,228,500	90,865,700	6,637,200	6,637,200
COMMUNITY COLLEGES	86,727,100	94,533,000	90,578,500	(3,954,500)	3,851,400
DEPT OF REVENUE	47,488,300	47,673,800	47,670,400	(3,400)	182,100
DEPT OF PUBLIC SAFETY	34,148,200	36,159,000	34,894,000	(1,265,000)	745,800
ALL OTHER	234,306,000	254,613,700	240,656,800	(13,956,900)	6,350,800
TOTAL	3,782,715,800	4,082,454,800	4,047,241,100	(35,213,700)	264,525,300

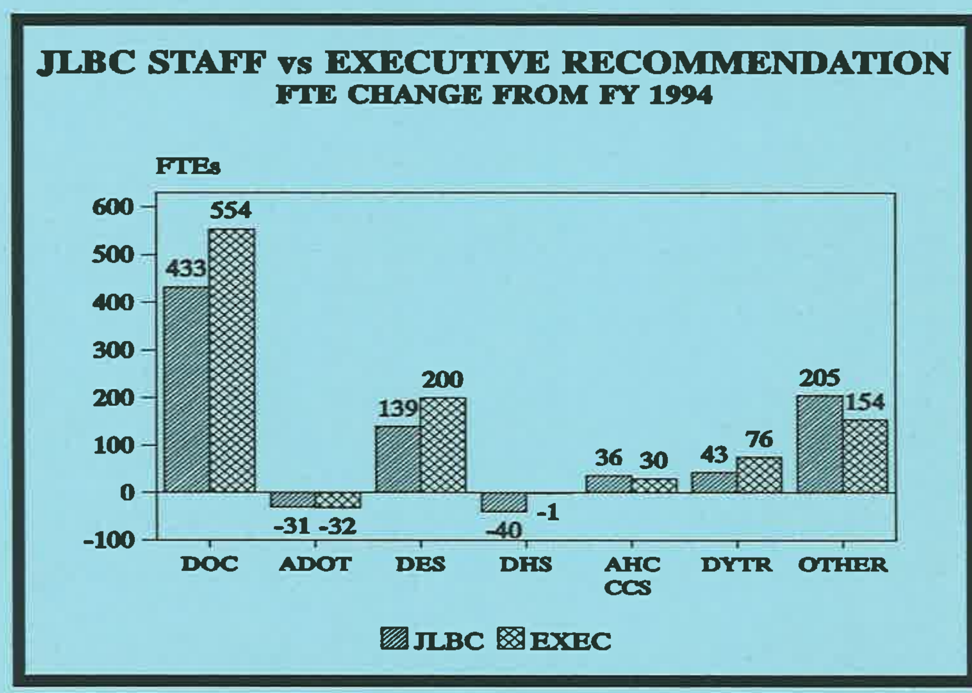
JLBC STAFF vs EXECUTIVE RECOMMENDATION
DOLLAR CHANGE FROM FY 1994



FULL-TIME EQUIVALENT POSITIONS - TOTAL APPROPRIATED FUNDS
TEN LARGEST AGENCIES
FY 1995 JLBC STAFF RECOMMENDATION
COMPARISON WITH EXECUTIVE RECOMMENDATION AND FY 1994 FTE POSITIONS

AGENCY	FY 1994 Estimate	FY 1995 Executive Recommend. 1/	FY 1995 JLBC Staff Recommend.	# Difference JLBC - Executive	# Difference JLBC - FY 1994
UNIVERSITIES	10,805.2	10,691.6	10,879.1	187.5	73.9
DEPT OF CORRECTIONS	6,812.4	7,365.9	7,245.7	(120.2)	433.3
DEPT OF TRANSPORTATION	3,184.5	3,153.0	3,154.0	1.0	(30.5)
DEPT OF ECONOMIC SECURITY	2,528.0	2,727.8	2,666.5	(61.3)	138.5
DEPT OF HEALTH SERVICES	1,692.3	1,691.3	1,652.5	(38.8)	(39.8)
DEPARTMENT OF PUBLIC SAFETY	1,515.0	1,537.0	1,517.0	(20.0)	2.0
DEPT OF REVENUE	1,236.0	1,232.0	1,232.0	0.0	(4.0)
AHCCCS	1,003.3	1,032.9	1,039.4	6.5	36.1
DEPT OF ADMINISTRATION	897.0	889.9	885.0	(4.9)	(12.0)
DEPT OF YOUTH TRTMENT & REHAB	658.0	733.5	701.0	(32.5)	43.0
ALL OTHER	5,336.2	5,593.7	5,480.4	(113.3)	144.2
TOTAL	35,667.9	36,648.6	36,452.6	(196.0)	784.7

1/ Executive recommendation has been adjusted for comparability with the JLBC Staff recommendation, with the exception of the Universities.



GENERAL FUND SUMMARY
By Function of Government

	FY 1994 ESTIMATE	FY 1995 EXEC REC.	FY 1995 JLBC REC.	JLBC REC.- FY 1994	EXEC REC.- JLBC REC.
GENERAL GOVERNMENT					
ADMINISTRATION, DEPARTMENT OF	24,825,600	25,926,800	23,897,700	(927,900)	2,029,100
ATTORNEY GENERAL	18,860,000	21,481,600	19,472,600	612,600	2,009,000
COMMERCE, DEPARTMENT OF	6,990,800	7,882,400	6,999,000	8,200	883,400
COURTS					
Court of Appeals	8,218,100	8,218,100	8,274,400	56,300	(56,300)
Comm on Appellate and Trial Court Appts	10,000	10,000	10,000	0	0
Commission on Judicial Conduct	150,800	150,800	179,500	28,700	(28,700)
Superior Court	64,908,300	64,908,300	71,420,400	6,512,100	(6,512,100)
Supreme Court	10,941,300	10,941,300	10,981,400	40,100	(40,100)
TOTAL	84,228,500	84,228,500	90,865,700	6,637,200	(6,637,200)
EQUAL OPPORTUNITY, GOVERNOR'S OFFICE	229,000	229,600	229,200	200	400
GOVERNOR, OFFICE OF THE	5,948,600	5,498,500	5,498,500	(450,100)	0
GOVERNOR - OSPB	1,372,600	1,420,600	1,420,600	48,000	0
LAW ENFORCEMENT MERIT SYS COUNCIL	41,300	41,000	40,800	(500)	200
LEGISLATURE					
Auditor General	7,232,300	8,032,300	8,269,000	1,036,700	(236,700)
House of Representatives	7,131,000	7,481,000	7,481,000	350,000	0
Joint Legislative Budget Committee	1,857,500	1,915,000	1,956,000	98,500	(41,000)
Legislative Council	2,506,000	2,506,000	2,486,700	(19,300)	19,300
Library, Archives & Public Records	4,664,400	4,718,500	4,945,800	281,400	(227,300)
Senate	5,735,200	5,735,200	5,735,200	0	0
TOTAL	29,126,400	30,388,000	30,873,700	1,747,300	(485,700)
PERSONNEL BOARD	229,800	292,400	292,400	62,600	0
REVENUE, DEPARTMENT OF	47,488,300	47,673,800	47,670,400	182,100	3,400
SECRETARY OF STATE	1,751,300	3,473,200	3,421,200	1,669,900	52,000
TAX APPEALS, BOARD OF	684,000	707,800	733,000	49,000	(25,200)
TOURISM, OFFICE OF	5,403,300	7,403,300	5,955,200	551,900	1,448,100
TREASURER, STATE	3,455,400	3,560,200	3,585,900	130,500	(25,700)
UNIFORM STATE LAWS, COMMISSION ON	23,300	23,600	24,400	1,100	(800)
TOTAL - GENERAL GOVERNMENT	**230,658,200**	**240,231,300**	**240,980,300**	**10,322,100**	**(749,000)**
HEALTH AND WELFARE					
AHCCCS	477,191,800	493,606,000	514,688,400	37,496,600	(21,082,400)
ECONOMIC SECURITY, DEPARTMENT OF	356,653,900	380,827,600	368,800,200	12,146,300	12,027,400
ENVIRONMENTAL QUALITY, DEPT OF	9,695,500	12,888,900	11,039,800	1,344,300	1,849,100
HEALTH SERVICES, DEPARTMENT OF	194,178,200	205,674,500	206,453,600	12,275,400	(779,100)
HEARING IMPAIRED, COUNCIL FOR THE	207,300	221,700	207,500	200	14,200
INDIAN AFFAIRS, COMMISSION OF	161,200	163,200	163,200	2,000	0
PIONEERS' HOME	1,769,600	1,785,100	1,885,100	115,500	(100,000)
RANGERS' PENSIONS	9,800	10,100	10,100	300	0
VETERANS' SERVICE COMMISSION	797,400	2,818,100	819,100	21,700	1,999,000
TOTAL - HEALTH AND WELFARE	**1,040,664,700**	**1,097,995,200**	**1,104,067,000**	**63,402,300**	**(6,071,800)**
INSPECTION AND REGULATION					
AGRIC. EMPLOYMENT RELATIONS BD.	63,600	56,300	57,600	(6,000)	(1,300)
AGRICULTURE, DEPT. OF	9,627,400	10,068,600	9,628,300	900	440,300
BANKING DEPARTMENT	2,125,100	2,441,300	2,433,100	308,000	8,200
BOXING COMMISSION	59,000	71,900	61,600	2,600	10,300
BUILDING AND FIRE SAFETY, DEPT. OF	2,807,900	2,927,900	2,909,700	101,800	18,200
CONTRACTORS, REGISTRAR OF	4,173,700	0	0	(4,173,700)	0
CORPORATION COMMISSION	5,045,000	5,034,600	4,837,900	(207,100)	196,700
INSURANCE, DEPARTMENT OF	3,022,500	3,578,200	3,590,900	568,400	(12,700)

GENERAL FUND SUMMARY
By Function of Government

	FY 1994 ESTIMATE	FY 1995 EXEC REC.	FY 1995 JLBC REC.	JLBC REC.- FY 1994	EXEC REC.- JLBC REC.
LIQUOR LICENSES AND CONTROL, DEPT.	1,900,300	2,052,700	1,976,300	76,000	76,400
MINE INSPECTOR	541,500	709,400	575,300	33,800	134,100
OSHA REVIEW BOARD	9,000	9,000	9,000	0	0
RACING, DEPARTMENT OF	2,441,100	2,475,700	2,468,800	27,700	6,900
RADIATION REGULATORY AGENCY	969,000	978,900	991,800	22,800	(12,900)
REAL ESTATE DEPARTMENT	2,547,400	2,856,000	2,859,700	312,300	(3,700)
WEIGHTS AND MEASURES, DEPT. OF	1,879,800	1,445,300	1,396,000	(483,800)	49,300
TOTAL - INSPECTION & REGULATION	**37,212,300**	**34,705,800**	**33,796,000**	**(3,416,300)**	**909,800**
EDUCATION					
ARTS, COMMISSION ON THE	1,258,900	1,480,200	1,272,200	13,300	208,000
COMMUNITY COLLEGES	86,727,100	94,533,000	90,578,500	3,851,400	3,954,500
DEAF AND THE BLIND, SCHOOL FOR THE	15,263,700	15,633,600	16,189,800	926,100	(556,200)
EDUCATION, DEPARTMENT OF	1,444,175,200	1,591,966,200	1,580,638,400	136,463,200	11,327,800
HISTORICAL SOCIETY, ARIZONA	3,282,200	3,563,100	3,595,700	313,500	(32,600)
HISTORICAL SOCIETY, PRESCOTT	543,700	551,100	552,900	9,200	(1,800)
MEDICAL STUDENT LOANS BOARD	1,000	105,700	114,600	113,600	(8,900)
UNIVERSITIES					
Arizona State University - Main	184,324,800	191,991,100	186,770,800	2,446,000	5,220,300
Arizona State University - West	29,602,800	29,748,900	29,822,200	219,400	(73,300)
Northern Arizona University	75,531,200	77,508,500	75,906,800	375,600	1,601,700
Board of Regents	7,155,400	7,924,100	7,417,700	262,300	506,400
University of Arizona - Main	198,968,000	207,725,600	201,791,300	2,823,300	5,934,300
University of Arizona - Health Science Center	44,738,200	43,575,900	45,498,800	760,600	(1,922,900)
TOTAL	540,320,400	558,474,100	547,207,600	6,887,200	11,266,500
TOTAL - EDUCATION	**2,091,572,200**	**2,266,307,000**	**2,240,149,700**	**148,577,500**	**26,157,300**
PROTECTION AND SAFETY					
CORRECTIONS, DEPARTMENT OF	283,298,200	334,698,400	324,787,500	41,489,300	9,910,900
CRIMINAL JUSTICE COMMISSION, ARIZONA	1,000,000	1,591,300	1,000,000	0	591,300
EMRG. & MILITARY AFFAIRS, DEPT. OF	4,354,400	4,454,600	4,461,500	107,100	(6,900)
EXECUTIVE CLEMENCY, BOARD OF	1,890,600	1,724,800	1,717,900	(172,700)	6,900
PUBLIC SAFETY, DEPARTMENT OF	34,148,200	36,159,000	34,894,000	745,800	1,265,000
YOUTH TREATMENT REHAB., DEPT OF	31,147,900	35,398,700	33,612,200	2,464,300	1,786,500
TOTAL - PROTECTION AND SAFETY	**355,839,300**	**414,026,800**	**400,473,100**	**44,633,800**	**13,553,700**
TRANSPORTATION					
TRANSPORTATION, DEPARTMENT OF	69,600	70,200	73,800	4,200	(3,600)
NATURAL RESOURCES					
ENVIRONMENT, COMMISSION ON THE AZ	89,900	104,900	84,100	(5,800)	20,800
GEOLOGICAL SURVEY, ARIZONA	613,200	610,600	610,700	(2,500)	(100)
LAND DEPARTMENT	9,083,800	10,049,800	9,861,700	777,900	188,100
MINES & MINERAL RESOURCES, DEPT.OF	607,600	612,000	650,600	43,000	(38,600)
PARKS BOARD	4,642,500	6,112,100	4,835,400	192,900	1,276,700
WATER RESOURCES, DEPARTMENT OF	11,662,500	11,629,100	11,658,700	(3,800)	(29,600)
TOTAL - NATURAL RESOURCES	**26,699,500**	**29,118,500**	**27,701,200**	**1,001,700**	**1,417,300**
OPERATING BUDGET TOTAL*	**3,782,715,800**	**4,082,454,800**	**4,047,241,100**	**264,525,300**	**35,213,700**

* FY 1994 does not include one-time appropriations of $1.8 million for Irrigation District Relief, $3.5 million for Flood Relief and $97,400 for unallocated risk management charges.

OTHER APPROPRIATED FUNDS SUMMARY
By Function of Government

	FY 1994 ESTIMATE	FY 1995 EXEC REC.	FY 1995 JLBC REC.	JLBC REC.- FY 1994	EXEC REC.- JLBC REC.
GENERAL GOVERNMENT					
ADMINISTRATION, DEPARTMENT OF	110,081,400	87,235,700	86,526,300	(23,555,100)	709,400
ATTORNEY GENERAL	3,697,400	3,702,300	3,697,400	0	4,900
COLISEUM AND EXPOSITION CENTER	13,784,600	14,484,000	0	(13,784,600)	14,484,000
COMMERCE, DEPARTMENT OF	1,966,400	1,969,700	1,966,300	(100)	3,400
SUPERIOR COURT	750,000	750,000	0	(750,000)	750,000
SUPREME COURT	50,000	50,000	886,900	836,900	(836,900)
LOTTERY, ARIZONA	40,637,700	50,575,200	49,003,500	8,365,800	1,571,700
RETIREMENT SYSTEM	3,241,300	3,355,100	3,362,900	121,600	(7,800)
TOTAL - GENERAL GOVERNMENT	174,208,800	162,122,000	145,443,300	(28,765,500)	16,678,700
HEALTH AND WELFARE					
AHCCCS	0	29,974,300	0	0	29,974,300
ECONOMIC SECURITY, DEPARTMENT OF	643,100	648,800	683,600	40,500	(34,800)
ENVIRONMENTAL QUALITY, DEPT	5,339,900	10,835,800	10,907,500	5,567,600	(71,700)
HEALTH SERVICES, DEPARTMENT OF	16,352,500	15,922,700	16,763,200	410,700	(840,500)
PIONEERS' HOME, ARIZONA	1,195,900	1,204,500	1,204,500	8,600	0
VETERANS' SERVICE COMMISSION	453,400	451,600	456,900	3,500	(5,300)
TOTAL - HEALTH AND WELFARE	23,984,800	59,037,700	30,015,700	6,030,900	29,022,000
INSPECTION AND REGULATION					
AGRICULTURE, DEPT. OF	1,924,800	1,709,500	1,708,500	(216,300)	1,000
CONTRACTORS, REGISTRAR OF	0	4,773,300	4,434,600	4,434,600	338,700
CORPORATION COMMISSION	5,520,400	5,595,900	5,792,500	272,100	(196,600)
INDUSTRIAL COMMISSION	12,481,600	13,084,200	14,370,700	1,889,100	(1,286,500)
RACING, DEPARTMENT OF	1,009,600	1,591,500	1,566,500	556,900	25,000
RADIATION REGULATORY AGENCY	93,000	99,300	100,300	7,300	(1,000)
RESIDENTIAL UTILITY CONSUMER OFFICE	1,005,700	977,500	958,600	(47,100)	18,900
WEIGHTS AND MEASURES, DEPT. OF	1,024,200	746,800	777,400	(246,800)	(30,600)
ACCOUNTANCY, BOARD OF	941,100	944,400	935,400	(5,700)	9,000
APPRAISAL, BOARD OF	229,800	236,300	232,200	2,400	4,100
BARBERS, BOARD OF	141,800	141,400	141,400	(400)	0
BEHAVIORAL HEALTH EXAMINERS, BD OF	296,700	319,900	319,600	22,900	300
CHIROPRACTIC EXAMINERS, BOARD OF	236,600	234,500	234,000	(2,600)	500
COSMETOLOGY, BOARD OF	623,300	624,700	624,100	800	600
DENTAL EXAMINERS, BOARD OF	528,000	556,200	496,400	(31,600)	59,800
FUNERAL DIRECTORS & EMBALMERS, BD	175,300	176,400	175,200	(100)	1,200
HOMEOPATHIC EXAMINERS, BOARD OF	22,300	23,500	24,300	2,000	(800)
MEDICAL EXAMINERS, BOARD OF	2,687,500	2,703,800	2,727,700	40,200	(23,900)
NATUROPATHIC PHYSICIANS BOARD	41,900	44,700	43,700	1,800	1,000
NURSING, BOARD OF	1,093,100	1,100,200	1,103,500	10,400	(3,300)
NURSING CARE INSTITUTIONAL ADMIN. BD.	63,600	64,200	64,200	600	0
OCCUPATIONAL THERAPY EXAM., BOARD O	90,900	91,000	86,600	(4,300)	4,400
OPTICIANS, BOARD OF DISPENSING	68,900	60,000	59,600	(9,300)	400
OPTOMETRY, BOARD OF	95,600	97,800	97,300	1,700	500
OSTEOPATHIC EXAMINERS, BOARD OF	289,200	290,400	289,500	300	900
PHARMACY, BOARD OF	641,000	633,100	633,400	(7,600)	(300)
PHYSICAL THERAPY EXAMINERS, BOARD	72,300	73,600	73,100	800	500
PODIATRY EXAMINERS, BOARD OF	50,400	51,800	51,800	1,400	0
PRIVATE POSTSECONDARY EDUCATION	130,600	129,700	154,800	24,200	(25,100)
PSYCHOLOGIST EXAMINERS, BOARD OF	197,800	198,900	198,300	500	600
RESPIRATORY CARE EXAMINERS BOARD	134,100	135,200	135,200	1,100	0
STRUCTURAL PEST CONTROL COMM	1,020,000	1,026,400	1,029,300	9,300	(2,900)
TECHNICAL REGISTRATION, BOARD OF	856,200	857,900	857,900	1,700	0

OTHER APPROPRIATED FUNDS SUMMARY
By Function of Government

	FY 1994 ESTIMATE	FY 1995 EXEC REC.	FY 1995 JLBC REC.	JLBC REC.- FY 1994	EXEC REC.- JLBC REC.
VETERINARY MED EXAMINING BOARD	170,400	171,800	170,700	300	1,100
TOTAL - INSPECTION & REGULATION	**33,957,700**	**39,565,800**	**40,668,300**	**6,710,600**	**(1,102,500)**
EDUCATION					
DEAF AND THE BLIND, SCHOOL FOR THE	4,768,300	5,289,300	5,192,000	423,700	97,300
TOTAL - EDUCATION	**4,768,300**	**5,289,300**	**5,192,000**	**423,700**	**97,300**
PROTECTION AND SAFETY					
CORRECTIONS, DEPARTMENT OF	20,392,500	14,651,300	14,549,700	(5,842,800)	101,600
CRIMINAL JUSTICE COMMISSION, ARIZONA	545,200	548,900	529,900	(15,300)	19,000
EMRG. & MILITARY AFFAIRS, DEPT. OF	131,000	63,900	63,900	(67,100)	0
PUBLIC SAFETY, DEPARTMENT OF	50,165,200	48,800,000	49,000,000	(1,165,200)	(200,000)
YOUTH TREATMENT REHAB., DEPT OF	2,736,300	3,614,900	2,952,300	216,000	662,600
TOTAL - PROTECTION AND SAFETY	**73,970,200**	**67,679,000**	**67,095,800**	**(6,874,400)**	**583,200**
TRANSPORTATION					
TRANSPORTATION, DEPARTMENT OF	193,500,400	195,023,800	194,883,000	1,382,600	140,800
NATURAL RESOURCES					
GAME AND FISH DEPARTMENT	16,718,800	17,057,600	17,070,800	352,000	(13,200)
PARKS BOARD	3,506,200	2,343,700	3,583,100	76,900	(1,239,400)
WATER RESOURCES, DEPARTMENT OF	0	0	0	0	0
TOTAL - NATURAL RESOURCES	**20,225,000**	**19,401,300**	**20,653,900**	**428,900**	**(1,252,600)**
OPERATING BUDGET TOTAL*	**524,615,200**	**548,118,900**	**503,952,000**	**(20,663,200)**	**44,166,900**

* FY 1994 does not include unallocated AFIS charges of $287,600 and risk management charges of $476,700.

ECONOMIC AND REVENUE FORECAST

THE U. S. ECONOMY

The Outlook for FY 1994—Modest But Improving Growth

Many people in the media continue to talk about the "current economic recession." In part, this is because certain key states, or regions such as California, remain in recessions. However, the national economic recovery is more than two and a half years old, and all the latest indicators suggest that the overall economy is now picking up steam. The unemployment rate fell in November from 6.8% of the labor force to 6.4%, its largest monthly drop in a decade, and down from 7.7% in June 1992. Industrial production grew by an annual rate of 4.4% in October, 1993, while retail sales jumped by 4.7%. Since the end of Calendar Year (CY) 1991, real Gross Domestic Product (GDP) has risen by an annual rate of 3.0%. Most economists expect it to grow by 4.0% to 5.0% in the last quarter of CY 1993.

CY 1994 also looks promising. The indexes of leading indicators, which forecast business conditions six to nine months in advance, have risen strongly over the past three months. The University of Michigan's Index of Consumer Confidence saw one of the largest jumps in its 25-year history in November. Auto sales are expected to be up 12.0% in CY 1994, and new housing is rebounding sharply because of low interest rates and rising consumer confidence. Both of these important sectors are now at comparative boom levels when viewed against the previous five years. Consumers paid down debt considerably during and after the recession because of job security fears. They have now started to add a little more debt to their balance sheets each month.

Some analysts are anxious that the federal tax increase, which will take effect January 1, will stall the economy in the first half of 1994. Growth in real inflation adjusted GDP is, in fact, likely to slow in early 1994. But it will be due largely to comparison with the strong growth in the last quarter of CY 1993. The last quarter of CY 1993 will reflect a pick-up after the floods in the midwestern states in the summer of 1993 and a very strong surge in car output.

JLBC Staff expects growth of real GDP of 3.0% in the state fiscal year ending June 30, 1994. Inflation will remain subdued due to continued excess industrial capacity, a slightly above normal level of unemployment, and fierce competition among sellers. The GDP Deflator is expected to increase only 2.5% and the Consumer Price Index only 2.6%. Increasing fears that stronger growth will start the inflation engine again can be expected in the second half of FY 1994. However, evidence suggests that higher inflation is at least two or more years away. Productivity, the output of products compared to the costs of inputs (mainly labor), has been rising sharply in the last two years. This has lowered inflation pressures. The price of oil has also recently fallen from $19 to $15 per barrel and may stay at that price. If it were to stay at this level or fall further, inflation pressures will be reduced more.

Passage of the intensely debated North American Free Trade Agreement (NAFTA) in November, to take effect on January 1, 1994, will probably not have much of an effect on the U.S. or Arizona economies for the remainder of Arizona's FY 1994. This phase-down of tariffs will take up to 15 years for some products. However, for some key industries like textiles, auto parts, machinery and other manufactured goods, the effects may start to be felt nationally and in Arizona by FY 1995 in the form of higher exports and job growth.

Interest rates have come down over the past several year, and most people think they have stabilized at the current low levels for the remainder of FY 1994. While wage and salary employment has started to rebound (1.9% in FY 1994), manufacturing employment will continue to decline an expected 1.6%, mainly due to the continued movement of manufacturing to other countries and more efficient production methods.

The Outlook for FY 1995

The outlook for FY 1995 is for continuing growth. The conditions are in place for growth to accelerate. The positive effects expected from the NAFTA agreement will start to show up in the national economy; and the recently signed General Agreement on Tariffs and Trade (GATT) treaty will also be having a positive effect on U.S. foreign trade by then.

The Clinton Administration introduced its Health Security Act to Congress on October 27, 1993. It is likely to be modified substantially by the House of Representatives and the Senate. The debate over the future of the health care sector will create a great deal of uncertainty, which may otherwise slow investment and employment growth until the true costs are clarified. Small businesses, which currently provide no health insurance, will be cautious about hiring new workers because of fears of the mandated health coverage in the Clinton plan until these costs are clarified. Nonetheless, this should be settled by mid-FY 1995 and will allow employers to make more definite plans. The Clinton plan proposes health cost subsidies for small businesses.

Corporate restructuring, which has caused millions of job losses, and turnovers in recent years will continue in FY 1995 but the worst will be over. Total employment growth is expected to increase to 2.3% in FY 1995. The decline in manufacturing employment is expected to slow to the lowest rate in five years.

It appears as though the Federal Reserve will be able to remain somewhat accommodating in FY 1995. However, there is already talk that the Federal Reserve may tighten short-term interest rates upward by up to 0.5% in anticipation of inflationary fears in the next year. Sharp increases in short or long-term interest rates are not expected in FY 1995 and rates are expected to stay in their current range.

Table 1 shows the sectors of the economy that are expected to contribute to growth in FY 1995. Table 2, at the end of this section, shows the percentage increases expected for FY 1994 and FY 1995, as well as historical results starting with FY 1989.

TABLE 1

SOURCES OF REAL GROSS DOMESTIC PRODUCT GROWTH [1/]

(Billions of 1987 $)

		FY 1991	FY 1992	FY 1993	FY 1994	FY 1995
Consumption	- Services	$29.2	$20.2	$49.3	$46.7	$47.1
	- Nondurables	(2.5)	(5.4)	25.9	27.5	25.6
	- Durable Goods	(16.5)	10.1	32.6	33.7	28.9
Nonresidential Fixed Investment		(10.6)	(18.1)	41.5	59.5	51.3
Residential Fixed Investment		(34.7)	9.6	23.1	11.0	15.9
Change in Business Inventories		(30.9)	15.9	11.7	0.1	2.7
Federal Government Purchases		6.4	(13.4)	(8.1)	(17.5)	(13.1)
State/Local Government Purchases		15.8	12.1	8.5	13.5	11.5
Net Exports		32.7	9.8	(30.5)	(36.7)	(13.6)
Change in GDP (1987 $)		$(11.0)	$40.9	$154.0	$137.9	$156.2

1/ Totals may not add due to rounding.

During FY 1995, there will be a strong chance of continued gains in personal income, consumption and consumer confidence (see Charts 1-8). As mentioned, consumer and business balance sheets have been improving steadily and the pent-up demand for housing and autos is showing in the market now. The cost of debt has declined, improving cash flow in the economy.

Inflation is expected to stay in the 3.0% range despite the expected increases in demand. The stable inflation rate will continue to promote growth in several ways. It makes planning easier in a more predictable environment compared to the greater uncertainty of prices in times of high inflation. If inflation is rising at a rapid rate, people don't know how to allocate resources. Second, continued low expected inflation may allow real interest rates (the difference between nominal interest rates and expected inflation) to decline. This lowers the real cost of capital for all borrowers. Third, low inflation often improves business cash flow and permits businesses to take a longer planning horizon. During periods of high inflation and higher interest rates, businesses must invest in projects that bring a fast short-term return, since these returns are compared to the cost of putting the same investments into interest bearing deposits. Lower interest rates reduce cash outflow for borrowing and increase the number of ventures which appear viable.

However, the outlook for U.S. economic growth is constrained by international economic conditions. Europe and Japan will be recovering, but U.S. exports are not expected to boom. Price competition is so severe in almost all areas of the economy that cost control will continue to be the way to make profits. Costs control translates into lower (than otherwise) business spending. Table 1 shows that the expansion is expected to be consumer led. Quarterly growth rates between 2.5% and 3.0% appear more likely during FY 1995. An overall growth rate of 3.0% is predicted for the year.

Commercial banks will start to add to loans in FY 1995, but at a slow rate. Despite encouragement by the Federal Reserve Board, bank credit has barely grown for several years. Banks have taken advantage of lower interest rates to earn a large spread between the cost of their funds and rates available on investments in U.S. Treasury and mortgage bonds. The improved economy may increase business loan demand.

It will also remain to be seen whether employment will continue to increase sharply. Incomes will improve in the economy though. Manufacturing employment, typically one of the highest paying sectors, is expected to slow its decline in FY 1995. Most large U.S. corporations will continue to reduce middle management though. It is often difficult for these employees, now numbering in the millions, to find comparable jobs. Many workers are now at smaller firms earning lower salaries.

Overall, FY 1995 should see a steady rate of growth in a low inflation environment, which should set the foundation for continued expansion. However, at the time of this writing, if the trends of the last few months of calendar 1993 continue, the "alternative scenario" favors even faster improvement for the U.S. economy.

Risks to the Forecast

Positive Alternative-Stronger Growth Than Anticipated

Looking at FY 1995, the higher growth alternative would depend on a continued strong rebound in hiring caused by continued increases in housing and a sooner than anticipated turnaround in Europe and Japan, which would help U.S. exporters. There could be a sharp reduction in unemployment as employers see that the recovery is stronger than anticipated. Fixed business investments would be higher than anticipated and manufacturing would also rebound.

Negative Alternative-New Hiring Delayed and Continued Weak Growth

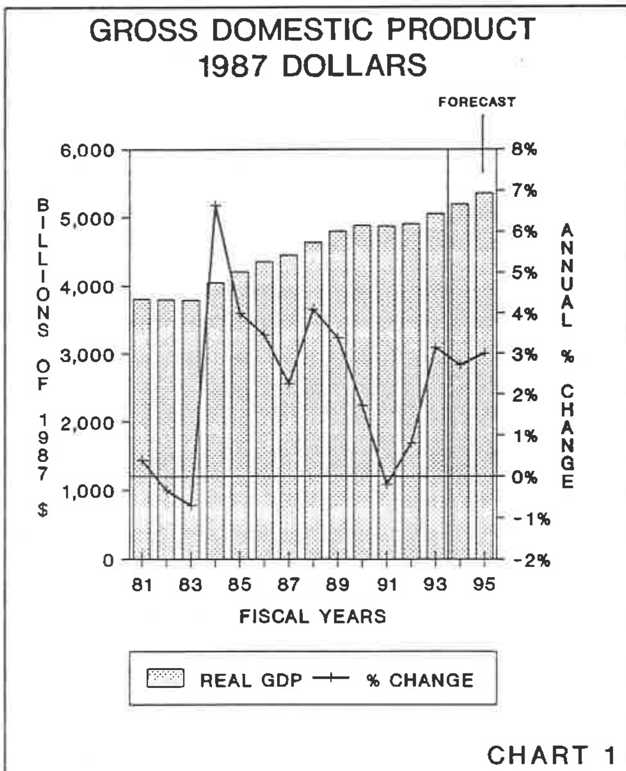
The Clinton Administration loses credibility in some way, which cannot be foreseen at this time, such as a foreign crisis or the debate on the health care program becomes too politically divisive and time consuming for politicians and business alike. This is more than a remote possibility and could reduce confidence. Inventory restocking and business fixed investment would not increase as expected because of lower sales forecasts.

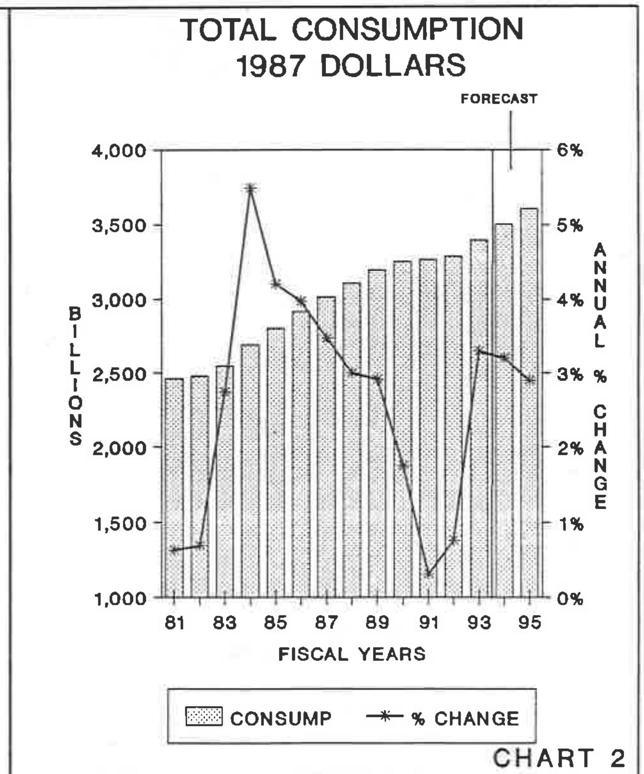
TABLE 2

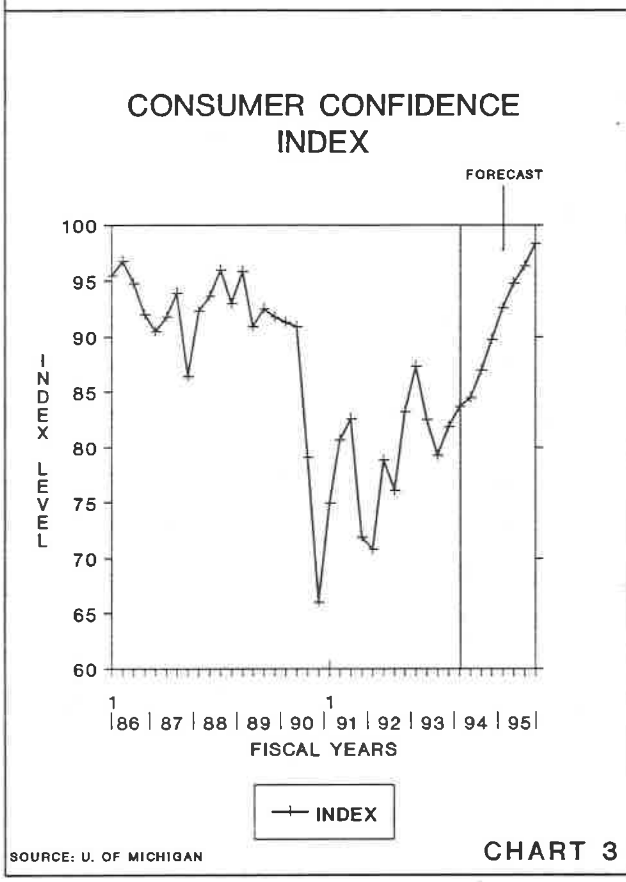
KEY U.S. ECONOMIC INDICATORS

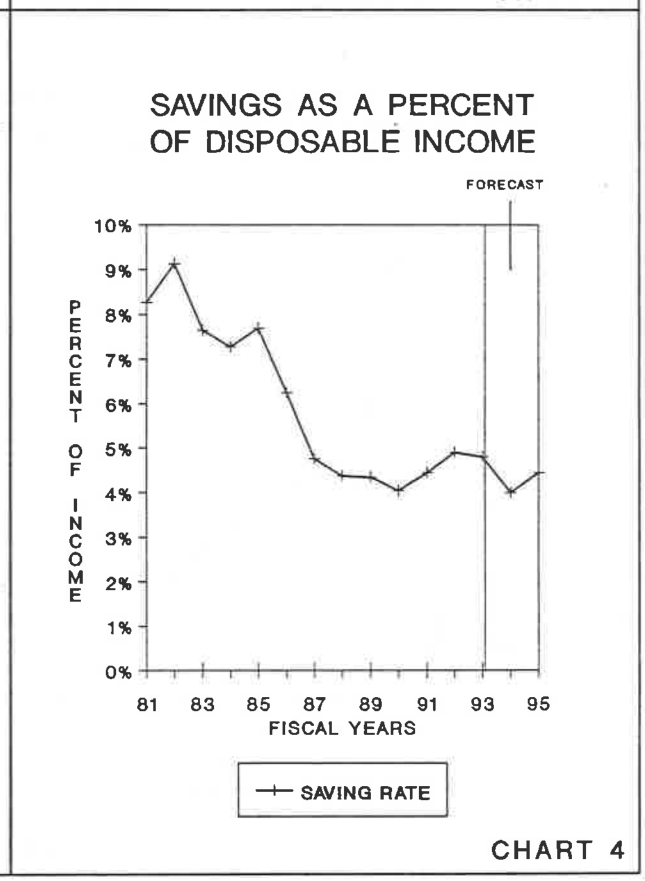
	Actual FY 1989	Actual FY 1990	Actual FY 1991	Actual FY 1992	Actual FY 1993	Forecast FY 1994	Forecast FY 1995
Real Gross Domestic Product 1/	3.4%	1.7%	(0.2)%	0.8%	3.1%	3.0%	3.0%
GDP Deflator 1/	4.5	4.2	4.3	3.4	2.7	2.5	3.1
Consumer Price Index 1/	4.6	4.8	5.4	3.2	3.1	2.6	3.3
Industrial Production 1/	3.2	(0.1)	(1.1)	0.6	3.2	3.1	3.8
Three Month T-Bill 2/	7.9	7.8	6.5	4.4	3.0	3.0	3.6
Aaa Corporate Bonds 2/	9.7	9.1	9.1	8.4	7.8	6.7	6.8
Wage and Salary Employment 1/	3.0	2.0	(0.0)	(0.6)	1.0	1.9	2.3
Manufacturing Employment 1/	1.2	(0.8)	(2.8)	(2.7)	(1.6)	(1.5)	(0.5)
Unemployment Rate 2/	5.3	5.3	6.2	7.1	7.2	6.6	6.4

1/ Annual Percent Change
2/ Average Rate for Year


GROSS DOMESTIC PRODUCT
1987 DOLLARS
FORECAST
BILLIONS OF 1987 $
ANNUAL % CHANGE
6,000
5,000
4,000
3,000
2,000
1,000
0
8%
7%
6%
5%
4%
3%
2%
1%
0%
-1%
-2%
81 83 85 87 89 91 93 95
FISCAL YEARS
REAL GDP
% CHANGE
CHART 1


TOTAL CONSUMPTION
1987 DOLLARS
FORECAST
BILLIONS
ANNUAL % CHANGE
4,000
3,500
3,000
2,500
2,000
1,500
1,000
6%
5%
4%
3%
2%
1%
0%
81 83 85 87 89 91 93 95
FISCAL YEARS
CONSUMP
% CHANGE
CHART 2


CONSUMER CONFIDENCE
INDEX
FORECAST
INDEX LEVEL
100
95
90
85
80
75
70
65
60
1 86 87 88 89 90 1 91 92 93 94 95
FISCAL YEARS
INDEX
SOURCE: U. OF MICHIGAN
CHART 3


SAVINGS AS A PERCENT
OF DISPOSABLE INCOME
FORECAST
PERCENT OF INCOME
10%
9%
8%
7%
6%
5%
4%
3%
2%
1%
0%
81 83 85 87 89 91 93 95
FISCAL YEARS
SAVING RATE
CHART 4

CONSUMER & PRODUCER PRICE INDEX CHANGES

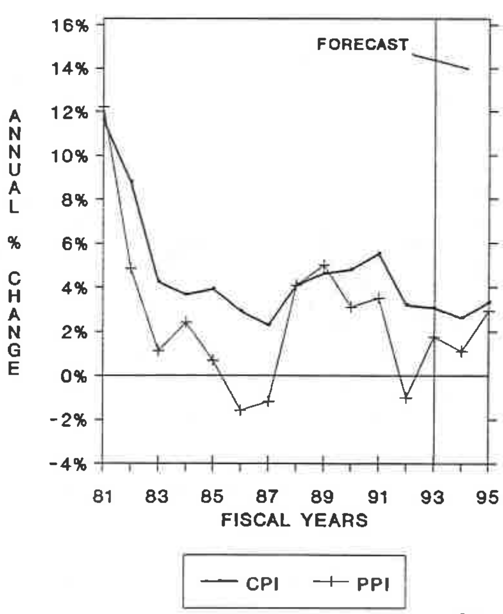


CHART 5

KEY INTEREST RATES

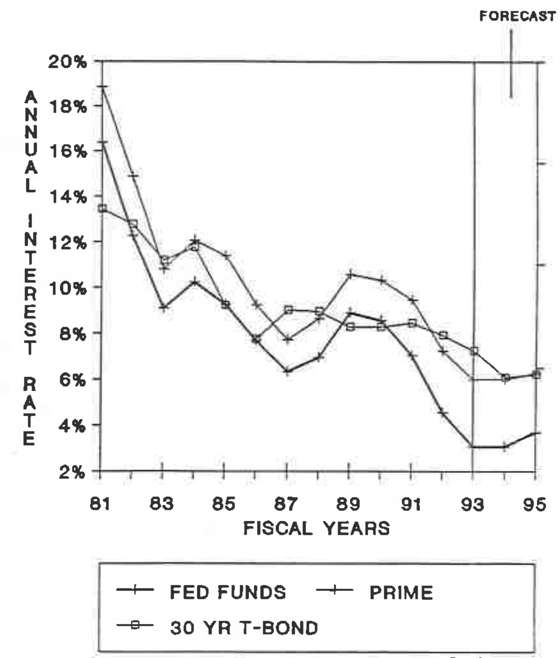


CHART 6

CHANGE IN TOTAL HOUSING STARTS SINGLE FAMILY AND MULTI-UNIT

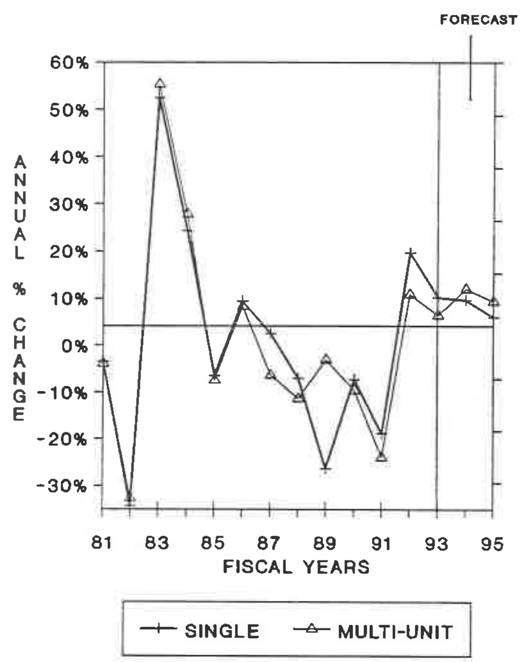


CHART 7

ANNUAL PERCENT CHANGE IN CAR SALES

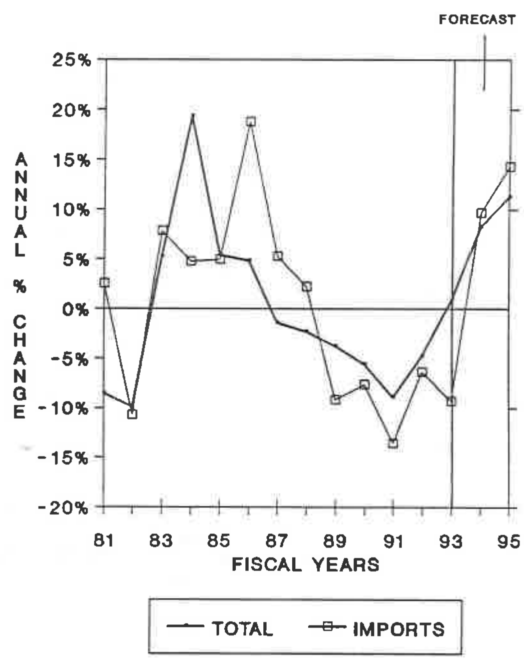


CHART 8

THE ARIZONA ECONOMY

The Arizona economic outlook for FY 1994 and FY 1995 has brightened considerably. Last January, we aptly described the economy as suffering from a "creeping recovery." But since then, the economy has exceeded the expectations of most state forecasters on the Arizona Blue Chip Panel. Now, the economy seems poised for accelerating growth during our forecast period.

Vital Statistics From FY 1993

FY 1993 key Arizona economic indicators show the economy is gathering momentum and reversing two negative trends that started in the eighties (see Table 5):

- Job growth rose 2.7%. This is the highest wage & salary employment increase in five years and a nice rebound from the near zero growth in FY 1992. Moreover, the goods producing sector, driven by a 7.4% growth in construction, gained 1.4%—the first gain since FY 1986, weathering six consecutive years of job losses (see Table 3).

- Personal income in current dollars grew a strong 7.5% and 4.7% in real or inflation adjusted dollars. This reverses a trend of declining income growth since FY 1984 (see Chart 11). But, the exciting story is the real per capita income growth of 2.3%—the first positive outcome in five years (see Chart 12).

- Population grew at 2.4%, the same rate as in FY 1992. This was 91,500 new Arizonans. Although slower than its average 3% annual growth of the 1980s, Arizona is still far above the 1.0% national rate and ranked in the top ten states for population growth.

- Retail Sales recorded a robust 7.9% gain, led by auto and building material purchases, which skyrocketed 14.2% and 14.4%, respectively.

- The unemployment rate dropped to 5.9%, a sharp improvement from the 7.0% rate in FY 1992.

The Outlook for FY 1994

The encouraging results from FY 1993 should springboard the Arizona economy to even better health in FY 1994. We forecast jobs to increase by 3.0% and personal income to accelerate by 7.6%. In fact, employment in both the goods producing and service sectors is expected to expand faster in FY 1994 than in FY 1993. FY 1994 may turn in the best performance since FY 1986, a year when Arizona experienced a double digit personal income increase and over 6% job growth.

TABLE 3

ARIZONA WAGE AND SALARY EMPLOYMENT
PERCENT GROWTH OVER PRIOR YEAR
RECENT HISTORY
(Based on Average Employment)

	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991	FY 1992	FY 1993
Goods Producing								
Manufacturing	2.1%	2.2%	1.0%	(0.1)%	(0.7)%	(2.9)%	(4.8)%	(1.0)
Mining	(7.9)	(2.7)	5.9	3.1	1.7	6.5	0.8	(3.1)
Construction	8.9	(5.9)	(9.1)	(8.6)	(6.6)	(4.4)	(2.7)	7.4
Total Goods Producing	4.1	(1.0)	(2.4)	(2.7)	(2.4)	(2.9)	(4.0)	1.4
Service Producing								
Transportation/Communication & Public Utilities	4.6	7.3	6.7	2.4	6.1	2.6	(1.3)	2.1
Trade	6.0	4.7	3.8	3.7	2.1	0.8	0.9	2.0
Finance/Insurance/Real Estate	12.4	7.5	3.7	(2.7)	1.0	(0.3)	(0.4)	2.2
Services	9.8	6.1	7.3	5.9	4.6	2.4	2.6	3.8
Government	4.1	3.0	3.1	2.7	4.3	5.4	3.3	3.4
Total Services Producing	7.2	5.2	4.9	3.6	3.6	2.4	1.7	2.9
Total Wage/Salary Employment	6.4%	3.7%	3.3%	2.2%	2.4%	1.3%	0.7%	2.7%

A closer examination of our employment forecast, as shown on Table 4, reveals a continuing improvement in the Goods Producing [1/] sector, which is predicted to grow 2.8%. This is due mainly to our expectations that manufacturing will post a gain for the first time in six years, albeit a meager 1.0%. Also, mining employment should stabilize as falling copper prices moderate. Meanwhile, construction should continue its strong expansion in residential housing as jobs rise 7.0%, which is slightly slower than the 7.4% growth in FY 1992. Interest rates, which recently have turned higher, may restrain rising demand for housing temporarily.

The Service Producing [2/] sector is expected to show greater job growth in all industries except for a) Government and b) Transportation, Communication and Public Utilities. A 3.0% increase in service jobs may seem small compared to the 8.0% growth during the mid-eighties, but it would still be the best in four years.

1/ Manufacturing, Construction, and Mining

2/ Transportation, Communications, Public Utilities (TCPU); Trade; Finance, Insurance, Real Estate (FIRE); Services; and Government

Recent evidence as of November, 1993 shows that Arizona employment is 2.3% higher than the same period a year ago. The current job leaders are lumber and wood products at 11.9%, construction at 7.9%, general merchandise and apparel at 7.6%, and business services at 7.5%. Defense related jobs are still declining, but at the slower rate of 3.4 % instead of the double digit losses in FY 1993. Also, mining and food stores continue to register job losses of 3.2% and 3.8%, respectively.

In addition, Arizona personal income is forecast to accelerate 7.6% in current dollars and 4.9% in real dollars. So far, we are right on track as the second quarter of 1993 showed a 7.5 % increase over the prior year. Meanwhile, real per capita income should gain 2.3%, which is higher than the projected national growth rate. This is significant because until FY 1993 Arizona had not beaten the U.S. rate since FY 1986 (see Chart 12). Now in FY 1994, we will have beaten the U.S. rate for two consecutive years.

TABLE 4

ARIZONA WAGE AND SALARY EMPLOYMENT
PERCENT GROWTH OVER PRIOR YEAR
FORECAST
(Based on Average Employment)

	FY 1993	Forecast FY 1994	Forecast FY 1995
Goods Producing			
Manufacturing	(1.0)%	1.0%	3.0%
Mining	(3.1)	0.0	1.0
Construction	7.4	7.0	8.0
Total Goods Producing	1.4	2.8	4.5
Service Producing			
Transportation, Communication and Public Utilities	2.1	2.0	4.0
Trade	2.0	2.5	4.0
Finance, Insurance, Real Estate	2.2	2.5	3.6
Services	3.8	4.0	5.0
Government	3.4	3.0	3.5
Total Services Producing	2.9	3.1	4.2
Total Wage and Salary Employment	2.7%	3.0%	4.3%

Finally, retail sales in the state will benefit from the low interest rates and strong population inflows. Lower interest rates usually encourage consumers to borrow for big ticket items such as autos, computers, and appliances. Also, low mortgage rates spur home buying or refinancing, which leads to home related purchases or extra disposable income for spending.

The Outlook for FY 1995

As mentioned earlier, the national economy has given ample recent signs of accelerating as we head into the new year. If the national economy continues to expand as predicted by most economists, this will set the stage for Arizona to perform significantly better in FY 1995 than in FY 1994.

TABLE 5

KEY ARIZONA ECONOMIC INDICATORS

	Actual FY 1989	Actual FY 1990	Actual FY 1991	Actual FY 1992	Actual FY 1993	Forecast FY 1994	Forecast FY 1995
Personal Income - Current Dollars [1]	6.5%	5.7%	5.5%	4.6%	7.5%	7.6%	8.2%
- Constant Dollars [1]	1.9	1.4	1.2	1.2	4.7	4.9	5.0
- Per Capita Constant Dollars [1]	(0.4)	(0.5)	(0.9)	(1.1)	2.3	2.3	2.2
Retail Sales [1][2]	5.7	4.2	2.6	5.0	7.9	7.0	7.3
Population [1]	2.2	2.0	2.1	2.4	2.4	2.5	2.7
Wage and Salary Employment [1]	2.2	2.4	1.3	0.7	2.7	3.0	4.3
Manufacturing Employment [1]	(0.1)	(0.7)	(2.9)	(4.8)	(1.0)	1.0	3.0
Construction Employment [1]	(8.6)	(6.6)	(4.4)	(2.7)	7.4	7.0	8.0
Unemployment Rate [3]	5.9	5.2	5.1	7.0	5.9	5.7	5.4

[1] Annual Percent Change
[2] Based on Department of Revenue definition of Retail Sales
[3] Average Rate for Year

As such, personal income will rise 8.2%. In real terms, this is 5.0% and on a real per capita basis this is 2.2%. All sectors of the job market in FY 1995 are expected to grow significantly higher than in FY 1994. Also, population will increase faster than FY 1994 at 2.7%. In turn, retail sales will escalate 7.3% and unemployment will dip to 5.4% (see Table 5).

Besides a moderately expanding U.S. economy, these are the major assumptions underlying our ebullient Arizona outlook for FY 1995:

- Interest rates will continue to be relatively low as U.S. inflation remains stable. This should stimulate what is beginning to look like a construction led expansion in its initial stages. To this point, a real estate expert speaking at the recent ASU & Bank One Economic Forecast Luncheon proclaimed that Arizona's single family housing market has fully corrected from the depressed conditions of the late 1980s, with residential permits up 20% in 1993; apartment permits should double to 4,700 units in 1994 as vacancy rates fall to 5%; while the office, retail and industrial markets will return to normal as vacancy rates at these properties drop to around 10% or lower by the end of 1995 or soon thereafter.

- The passage of the North American Free Trade Agreement (NAFTA) will benefit Arizona more than most states due to our proximity to Mexico's border. As a result, the export trade boom will broaden, encouraging business investments and more hiring.

- Population flows into Arizona will be strong as our better than the national average job market attract new residents. Also, Arizona will be the recipient of significant numbers of businesses and people migrating out of California due to an eroding business climate and the current recession in the Golden State, which is projected by many California economists to continue in 1994.

- Economic development efforts of the past few years begin to bear fruition. In particular, Hughes Missile Systems, which relocated to Tucson from California in 1993, has only brought in about 800 jobs as of September. This means that the remaining 3,200 jobs announced by Hughes will have a big impact when they are finally transferred, hopefully by the end of 1994.

<u>Risks to the Forecasts</u>

The recent spate of upbeat economic news on the state and national level suggests there is more upside than downside risk to our Arizona outlook for both FY 1994 and FY 1995. However, a few cautionary winds are looming on the near horizon. Whether these winds turn into storms is difficult for anyone to predict, but they are important in providing balance to the forecasts. They are listed below for the reader's awareness:

- Health care reform is casting a large cloud of uncertainty over many businesses, especially small businesses. Since Arizona is distinctly a small business state, with 95% of all business establishments having fewer than 50 employees, a substantial rise in health care costs will constrain job growth.

- Higher federal taxes in 1994, resulting in lower disposable income than otherwise possible, could dampen consumer spending. However, a study by the WEFA group, a national forecasting firm, estimates that taxes will have only a small drag on the economy due to offsetting lower interest rates from deficit reduction.

- Further defense cuts announced by the Clinton Administration in September may affect Arizona more than expected. Even though we believe Arizona will receive a larger share of federal monies than other states to help in the post-Cold War transition, Arizona is still vulnerable to Department of Defense spending cuts.

- California's plight is benefiting Arizona in the short term through a structural shift of businesses and people, but Arizona employment would have been even higher if not for California's woes. So continued decay of Arizona's largest trading partner will restrain Arizona's upbeat job prospects.

- Continued weakness in Japan and Europe may halt the fragile but growing U.S. economy. Not only are countries becoming more globally connected, but so are states with large trade sectors. Arizona's export sector alone accounts for about 10% of the state's economy.

In summary, the Arizona economy, by most economic measures, is ready to accelerate its current economic expansion. We foresee solid and expanding growth during the forecast period. However, since the present recovery has been mild compared to previous business cycles, the Arizona economy is vulnerable to the risks which we have identified above.

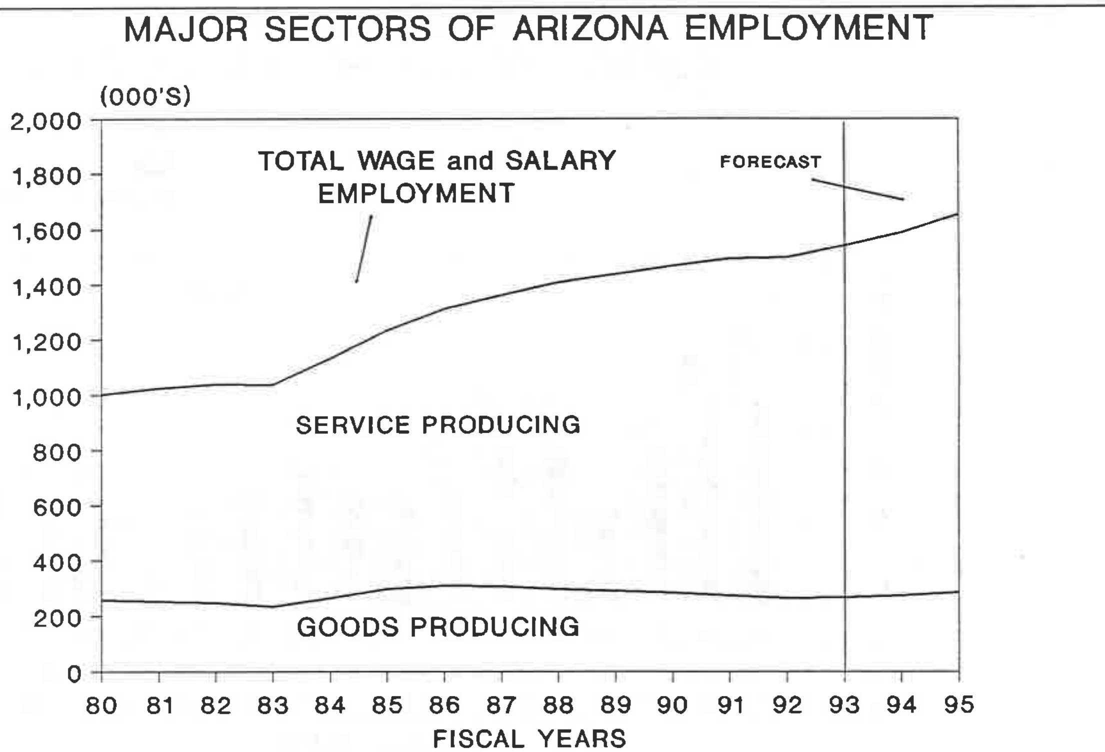


CHART 9

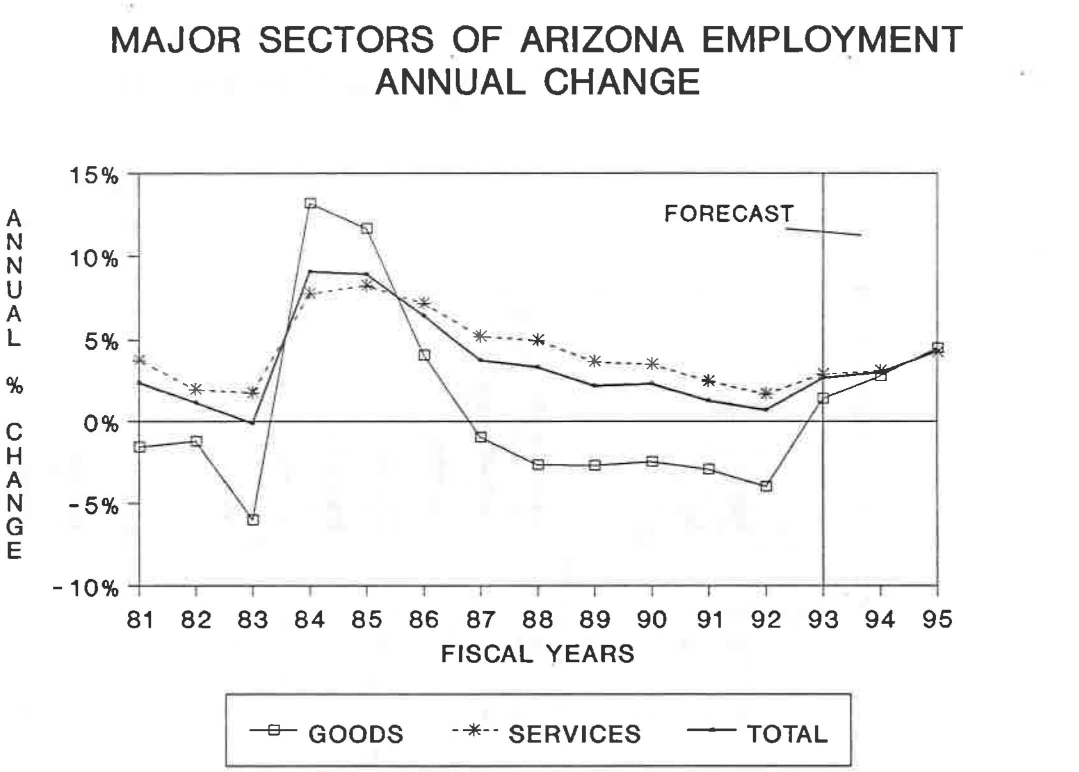
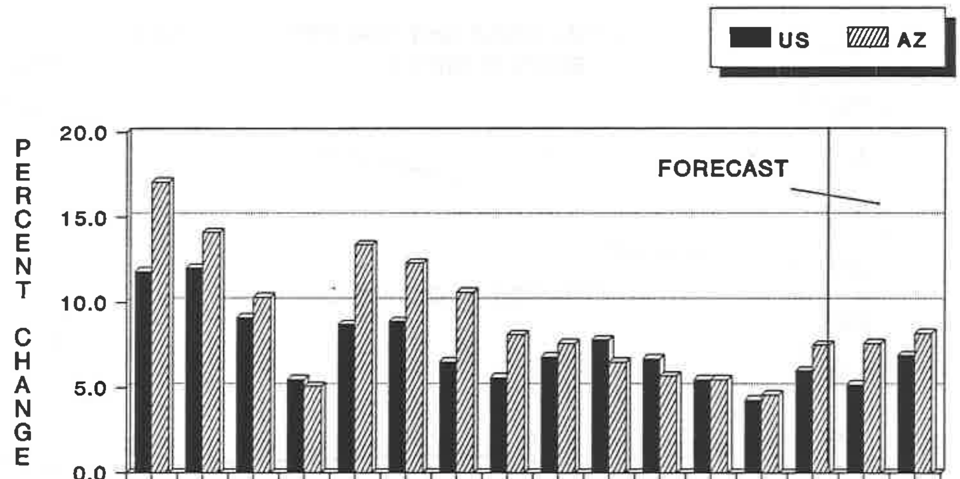


CHART 10

U.S. and ARIZONA
CURRENT DOLLAR PERSONAL INCOME

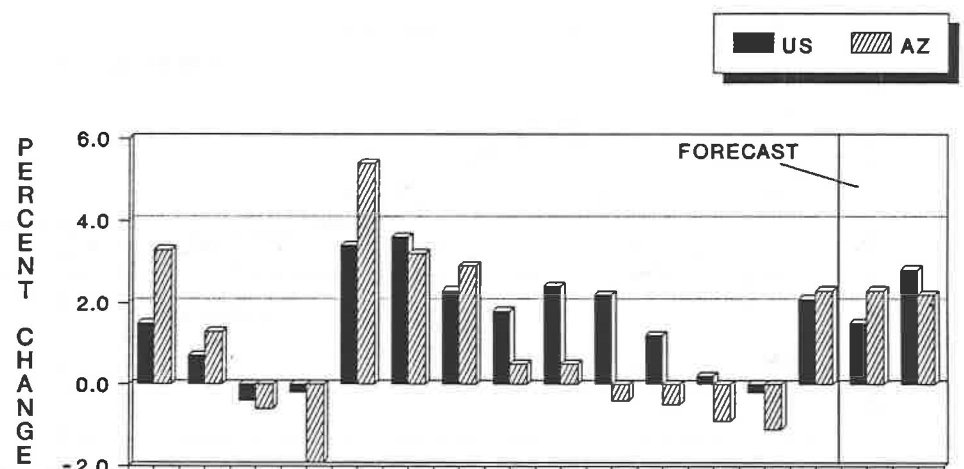


	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95
US	11.8	12.0	9.1	5.5	8.7	8.9	6.5	5.6	6.8	7.8	6.7	5.5	4.3	6.0	5.2	6.9
AZ	17.1	14.1	10.3	5.1	13.4	12.3	10.6	8.1	7.6	6.5	5.7	5.5	4.6	7.5	7.6	8.2

FISCAL YEARS

CHART 11

U.S. and ARIZONA
REAL PER CAPITA INCOME



	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95
US	1.5	0.7	-0.4	-0.2	3.4	3.6	2.3	1.8	2.4	2.2	1.2	0.2	-0.2	2.1	1.5	2.8
AZ	3.3	1.3	-0.6	-1.9	5.4	3.2	2.9	0.5	0.5	-0.4	-0.5	-0.9	-1.1	2.3	2.3	2.2

FISCAL YEARS

CHART 12

GENERAL FUND REVENUE

The JLBC Staff revenue forecast is shown on Table 8. In order to preserve the continuity of the revenue series, we have elected to show the Federal Retiree Refunds for both FY 1994 and FY 1995 as a separate deduction from Total Base Revenue. Our forecasts for both fiscal years are appropriately cautious. To put it another way, the risk of actual collections coming in below the forecast for either fiscal year is relatively small. Table 6 compares (1) the initial forecast as shown in the FY 1993 Budget Book and (2) the forecast for FY 1993 made prior to the enactment of the FY 1994 budget, with actual FY 1993 revenue collections. Table 7 compares two earlier FY 1994 revenue forecasts with the new JLBC FY 1994 revenue forecast. Table 9 compares the Governor's and the JLBC Staff revenue forecasts for FY 1994 and FY 1995.

FY 1993 Revisited

Forecasting economic activity for a year in which an economic turning point may (or may not) occur is one of the most difficult aspects of forecasting encountered by economists. Using Arizona Personal Income (AZPI) as a measure of the economy, AZPI increased by 4.6% in FY 1992, and we now know that AZPI increased by 7.5% in FY 1993. It might be considered that FY 1993 was a turnaround year. Our initial forecast for FY 1993, which was included in the FY 1993 Budget Book, successfully forecast this with an increase of 7.6% in AZPI for FY 1993. Our forecast prior to the enactment of the FY 1994 budget showed an increase in FY 1993 AZPI of 7.2%. Yet, in spite of our accurate economic forecast, we substantially underestimated FY 1993 revenues.

Unlike several prior years, when the breaks (unanticipated developments) all seemed to fall against us, in FY 1993 all the breaks were favorable. From an economic standpoint, revenue collections were on the high side of the feasible range. In addition, we received a number of non-economic revenue effects, all positive and unpredictable.

Examples of receipts on the high side of the feasible range are:

1. Unitary (1.0) elasticity (the percent change in a revenue source as compared to the percent change in income) might be considered eminently satisfactory for Retail Sales relative to AZPI. For the six years prior to FY 1993, it averaged a mere 0.67. However, the elasticity turned out to be 1.05 in FY 1993.

2. Another factor in collections on the high side of the feasible range is our lack of experience with the Individual Income Tax, as established in the Arizona Tax Reform Act (ATRA) of 1990, with the result that our forecast was conservative. The increase in state revenues was more than expected and that it appears that ATRA resulted in a higher than anticipated overall income tax elasticity.

The major unpredictable effects on FY 1993 revenue include the following:

	Amount [1/]
1. Unanticipated collection of delinquent property taxes from El Paso Electric Company, due in FY 1992.	$8.0
2. Unpredictable surge in Estate Tax.	10.0
3. Excess in Disproportionate Share Revenue, allocated for high county property tax relief, but paid by another means.	5.0
4. Insurance Tax - Required proof of insurance to register vehicle.	5.0
5. Insurance Tax - Surge of commercial reinsurance from other states to Arizona.	3.9
6. Insurance Tax credit adjustment in state's favor.	2.4
TOTAL	$34.3

1/ Millions

FY 1994 Forecast

The revenue forecast used for the FY 1994 budget session was essentially equal to the actual FY 1993 collections. Our new FY 1994 forecast exceeds that forecast by $190.5 million before the deduction of Federal Retiree Refunds and $139.0 million after the deduction. This provides the potential for an even larger ending balance in FY 1994 than the $86.0 million surplus at the end of FY 1993. In fact, if not for four specific obligations, the year-end surplus would grow from $86.0 million in FY 1993 to $268.7 million on June 30, 1994. The four obligations we are satisfying are: 1) $51.1 million of federal retiree refunds; 2) $11.1 million for supplemental appropriations; 3) $28.4 million for this year's required payment to our Budget Stabilization Fund; and 4) $142.5 million to immediately and completely reverse the budget-balancing gimmick known as the "K-12 Rollover." After paying these obligations, the projected year-end surplus drops to $35.6 million.

Sales Tax collections for the five months year-to-date are up a strong 7.6% over the same period last year, led by the Retail and Construction sectors. Our forecast for FY 1994 is for an increase of 6.5%. In FY 1994, payments aggregating $10.0 million for County Property Tax Relief will be paid from the Sales Tax. Last year, this payment was made from another fund source. Adjusting for these payments, we would be at 8.4% for the five months year-to-date, with our forecast for the year at 7.1%.

Chart 13 shows the improved level of Retail Sales collected by the Department of Revenue in recent quarters. For the five months year-to-date of FY 1994, the Retail Sales category is 9.0% ahead of the same period last year.

Chart 14 shows Restaurants and Bars Sales growth as collected by the Department of Revenue. Restaurants and Bars Sales are also doing reasonably well with an increase of 8.6% for the five months year-to-date in FY 1994.

Chart 15 shows Hotel/Motel Sales collected by the Department of Revenue. For the five months year-to-date in FY 1994, they are up 8.4% and with the severely cold weather in the rest of the U.S., it would be surprising if this did not improve.

Chart 16 shows the improved level of Contracting Sales collected by the Department of Revenue. For the five months year-to-date of FY 1994, Contracting Sales are above the same period last year by 15.6%, and we expect contracting sales will continue to be strong.

Individual Income Tax collections are forecasted to increase 5.0% in FY 1994. Because of the new federal tax package, many companies disbursed bonuses, normally paid in January 1993, in December 1992. This brought a unanticipated $14.0 million into FY 1993 collections, but it also brought a comparable reduction in FY 1994 collections. Another negative in FY 1994 is the loss of $4.4 million in enforcement collections brought about by the need to use enforcement personnel in the Federal Retiree Project. For the five months year-to-date, Individual Income Taxes are up 8.3%—excluding the effect of Federal Retiree Refunds.

Corporation Income Tax collections are forecasted to increase by 3.7%. For the five months year-to-date, they are ahead of last year by 39.7%, but we believe that this rate is not sustainable, based on the level of corporate profits and the initial effect of credits from the defense restructuring program.

Property Tax collections are expected to decline by 4.5%. Most of this decline is due to collection in FY 1993 of $8.0 million due in FY 1992, with the balance of the decline due to sluggish assessed valuation, estimated to decrease by 0.7% in CY 1993.

Insurance Premium Tax collections are forecast to decline by 10.2% in FY 1994. Recent legislation, which adjusted the deductibility of tax credits by lowering the deductibility percents in early years and raising the deductibility percents in later years, saved revenue in FY 1992; but we will now start paying a higher and higher price for this "bailout."

Interest collections are expected to increase by 28.1%, largely because of higher levels of Operating Fund cash balances.

FY 1995 Forecast

Sales and Use Taxes are expected to increase by 7.4% in FY 1995. Again, there are complications. Our forecast assumes no Property Tax Relief and no payments to the Disease Control Research Fund. Adjusting for this shows an increase in FY 1995 of 6.7%. Another complication is the loss of $30.0 million of revenue as the result of legislation passed in the last regular session, primarily due to the phase-out of the Commercial Lease Tax. Adjusting for all these changes, our forecast is consistent with an increase of 7.7%.

Individual Income Tax collections are expected to increase by 9.4% in FY 1995, reflecting Arizona's growing economy and reflecting the JLBC forecast of an increase of 8.2% in Arizona personal income.

Corporation Income Tax collections are expected to decrease by 1.6%, reflecting flat corporation profits growth and a higher level of tax credits from the defense restructuring program.

Property Tax collections will increase by 1.6%, reflecting a very modest increase of 1.0% in assessed valuation in CY 1994 compared to the three previous consecutive years of decline.

Insurance Premium Tax collections call for a reduction of 3.9%, the result of raising deductibility of tax credits in later years, described previously.

Chart 17 shows, for the 10 years, starting in FY 1986, dollars of General Fund revenue as a bar chart and percent change as a line graph. Also shown are "underlying growth rates" (after elimination of legislative changes) for FY 1989 through FY 1994. Amounts shown for FY 1994 and FY 1995 are before deduction for the Federal Retiree Refunds.

Chart 18 shows, as a line chart, Sales and Use Tax collections for the period FY 1986 through FY 1995.

Chart 19 shows, as a line chart, Individual Income Tax collections for the period FY 1986 through FY 1995. The effect of Federal Retiree Refunds is excluded from FY 1994 and FY 1995.

Chart 20 shows, as a line chart, Corporation Income Tax collections for the period FY 1986 through FY 1995.

Chart 21 shows, as a line chart, Total General Fund Revenue collections for the period FY 1986 through FY 1995.

Chart 22 shows, in graphic form, the percent and dollar growth in FY 1995 over FY 1994 for significant categories of General Fund revenue based on JLBC Staff estimates. The Individual Income Tax excludes the effect of Federal Retiree Refunds.

Chart 23 shows major General Fund tax sources as a percent of total General Fund base revenue, based on the JLBC Staff FY 1995 forecast, but excluding Federal Retiree Refunds.

Table 6

STATE OF ARIZONA
GENERAL FUND REVENUE
SELECTED FORECASTS - FY 1993
COMPARED WITH ACTUAL FY 1993
(Thousands)

	A Initial Forecast FY 1993 1/ Budget Book	B Prior to Enactment FY 1994 Budget	C FY 1993 Revenue Actual	Differences C - A	 C - B
Taxes					
Sales and Use	$1,597,399.9	$1,605,399.9	$1,631,354.4	$33,954.5	$25,954.5
Income - Individual	1,376,300.0	1,347,900.0	1,367,097.1	(9,202.9)	19,197.1
- Corporation	207,000.0	207,000.0	239,208.0	32,208.0	32,208.0
- Urban Revenue Sharing	(183,700.0)	(183,700.0)	(183,667.2)	32.8	32.8
Property	192,867.0	193,257.0	203,240.4	10,383.4	9,983.4
Luxury	71,100.0	69,800.0	73,069.9	1,969.9	3,269.9
Insurance	89,600.0	90,300.0	103,002.5	13,402.5	12,702.5
Motor Vehicle License	107,100.0	107,100.0	103,103.8	(3,996.2)	(3,996.2)
Pari-Mutual	4,900.0	5,100.0	4,929.0	29.0	(171.0)
Estate	25,000.0	28,000.0	39,714.3	14,714.3	11,714.3
Other Taxes	1,850.0	1,904.5	1,832.8	(17.2)	(71.7)
Subtotal - Taxes	3,489,416.9	3,472,061.4	3,582,885.0	93,478.1	110,823.6
Other Non-Tax Revenue					
Lottery	35,182.0	37,502.0	34,498.7	(683.3)	(3,003.3)
Licenses, Fees, Permits/Sales & Service	45,117.0	41,122.5	44,977.1	(139.9)	3,854.6
Interest	17,500.0	16,300.0	11,393.8	(6,106.2)	(4,906.2)
Other Miscellaneous	32,421.0	35,800.0	39,723.3	7,302.3	3,923.3
Subtotal - Other Non-Tax Revenue	130,220.0	130,724.5	130,592.9	372.9	(131.6)
Total Base Revenue Before Other Revenue Sources	3,619,636.9	3,602,785.9	3,713,477.9	93,851.0	110,692.00
Other Revenue Sources					
Transfers and Reimbursements	20,200.0	20,211.0	7,658.9	(12,541.1)	(12,552.1)
Disproportionate Share	58,685.2	58,685.2	63,685.2	5,000.0	5,000.0
Subtotal - Other Revenue Source	78,885.2	78,896.2	71,344.1	(7,541.1)	(7,552.1)
TOTAL BASE REVENUE	$3,698,522.1	$3,681,682.1	$3,784,822.0	$86,309.9	$103,139.9

1/ Adjusted for bills passed with revenue impact.

Table 7

STATE OF ARIZONA
GENERAL FUND REVENUE SELECTED FORECASTS - FY 1994
COMPARED WITH NEW JLBC FORECAST
(Thousands)

	A OSPB Forecast [1/2/] January 1993	B JLBC Forecast [1/] March 1993 Revision	C New JLBC Forecast [3/] January 1994	Differences C - A	 C - B
Taxes					
Sales and Use	$1,687,536.5	$1,709,136.5	$1,737,100.0	$49,563.5	$27,963.5
Income - Individual	1,389,694.0	1,399,694.0	1,435,240.3	45,546.3	35,546.3
- Corporation	206,850.0	222,250.0	247,950.0	41,100.0	25,700.0
- Urban Revenue Sharing	(185,400.0)	(185,400.0)	(185,400.0)	0.0	0.0
Property	192,910.0	194,400.0	194,100.0	1,190.0	(300.0)
Luxury	70,000.0	73,000.0	73,300.0	3,300.0	300.0
Insurance	78,000.0	81,200.0	92,500.0	14,500.0	11,300.0
Motor Vehicle License	104,000.0	107,000.0	111,000.0	7,000.0	4,000.0
Pari-Mutual	5,200.0	5,500.0	5,100.0	(100.0)	(400.0)
Estate	25,000.0	27,000.0	35,000.0	10,000.0	8,000.0
Other Taxes	1,800.0	1,960.0	1,940.0	140.0	(20.0)
Subtotal - Taxes	3,575,590.5	3,635,740.5	3,747,830.3	172,239.8	112,089.8
Other Non-Tax Revenue					
Lottery	40,000.0	38,082.0	42,500.0	2,500.0	4,418.0
Licenses, Fees, Permits/Sales & Service	44,494.3	42,094.3	46,400.0	1,905.7	4,305.7
Interest	12,600.0	13,500.0	14,600.0	2,000.0	1,100.0
Other Miscellaneous	35,000.0	35,900.0	40,400.0	5,400.0	4,500.0
Subtotal - Other Non-Tax Revenue	132,094.3	129,576.3	143,900.0	11,805.7	14,323.7
Total Base Revenue Before Other Revenue Sources	3,707,684.8	3,765,316.8	3,891,730.3	184,045.5	126,413.5
Other Revenue Sources					
Transfers and Reimbursements	18,500.0	19,000.0	25,000.0	6,500.0	6,000.0
Disproportionate Share	58,219.7	58,219.7	58,219.7	0.0	0.0
Subtotal - Other Revenue Source	76,719.7	77,219.7	83,219.7	6,500.0	6,000.0
TOTAL BASE REVENUE	$3,784,404.5	$3,842,536.5	$3,974,950.0	$190,545.5	$132,413.5

1/ Adjusted for bills passed with revenue impact.
2/ Used by Legislature throughout the 1993 Session.
3/ For comparative purposes, the effect of Federal Retiree Refunds is not included.

Table 8

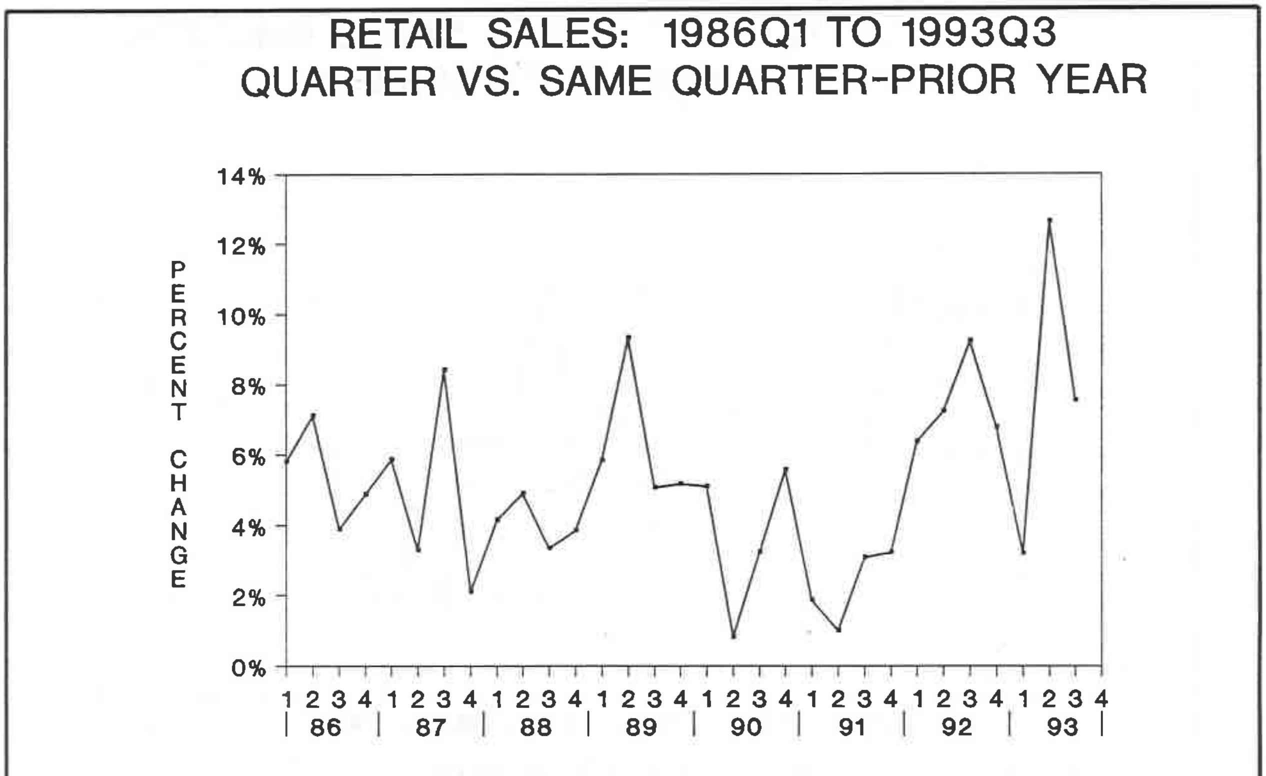
STATE OF ARIZONA
GENERAL FUND
STATEMENT OF PROJECTED BASE REVENUE
JLBC STAFF ESTIMATE
(Thousands)

	Actual FY 1993		Forecast FY 1994		Forecast FY 1995	
	Amount	% Change	Amount	% Change	Amount	% Change
Taxes						
Sales and Use	$1,631,354.4	8.5%	$1,737,100.0	6.5%	$1,866,500.0	7.4%
Income - Individual	1,367,097.1	10.5	1,435,240.3	5.0	1,570,000.0	9.4
- Corporation	239,208.0	13.1	247,950.0	3.7	244,100.0	(1.6)
- Urban Revenue Sharing	(183,667.2)	4.3	(185,400.0)	0.9	(205,600.0)	10.9
Property	203,240.4	13.0	194,100.0	(4.5)	197,300.0	1.6
Luxury	73,069.9	1.1	73,300.0	0.3	74,000.0	1.0
Insurance Premium	103,002.5	2.4	92,500.0	(10.2)	88,900.0	(3.9)
Motor Vehicle License	103,103.8	3.3	111,000.0	7.7	120,000.0	8.1
Pari-Mutuel	4,929.0	(0.1)	5,100.0	3.5	5,200.0	2.0
Estate	39,714.3	54.8	35,000.0	(11.9)	35,000.0	0.0
Other Taxes	1,832.8	2.6	1,940.0	5.8	2,040.0	5.2
Subtotal - Taxes	3,582,885.0	9.9	3,747,830.3	4.6	3,997,440.0	6.7
Other Non-Tax Revenues						
Lottery	34,498.7	(2.0)	42,500.0	23.2	45,000.0	5.9
License, Fees & Permits/Sales & Service	44,977.1	11.8	46,400.0	3.2	47,800.0	3.0
Interest	11,393.8	(27.4)	14,600.0	28.1	15,600.0	6.8
Other Miscellaneous	39,723.3	(5.6)	40,400.0	1.7	37,900.0	(6.2)
Subtotal - Other Non-Tax Revenues	130,592.9	(2.0)	143,900.0	10.2	146,300.0	1.7
Total Base Revenue before Other Revenue Sources	3,713,477.9	9.4	3,891,730.3	4.8	4,143,740.0	6.5
Other Revenue Sources						
Transfers and Reimbursements	7,658.9	(85.7)	25,000.0	226.4	25,300.3	1.2
Disproportionate Share	63,685.2	54.8	58,219.7	(8.6)	69,953.8	20.2
Subtotal - Other Revenue Sources	71,344.1	(24.6)	83,219.7	16.6	95,254.1	14.5
TOTAL BASE REVENUE	3,784,822.0	8.5	3,974,950.0	5.0	4,238,994.1	6.6
Federal Retiree Refunds	--		(51,100.0)		(34,200.0)	--
ADJUSTED TOTAL BASE REVENUE	$3,784,822.0	8.5%	$3,923,850.0	3.7%	$4,204,794.1	7.2%

Table 9

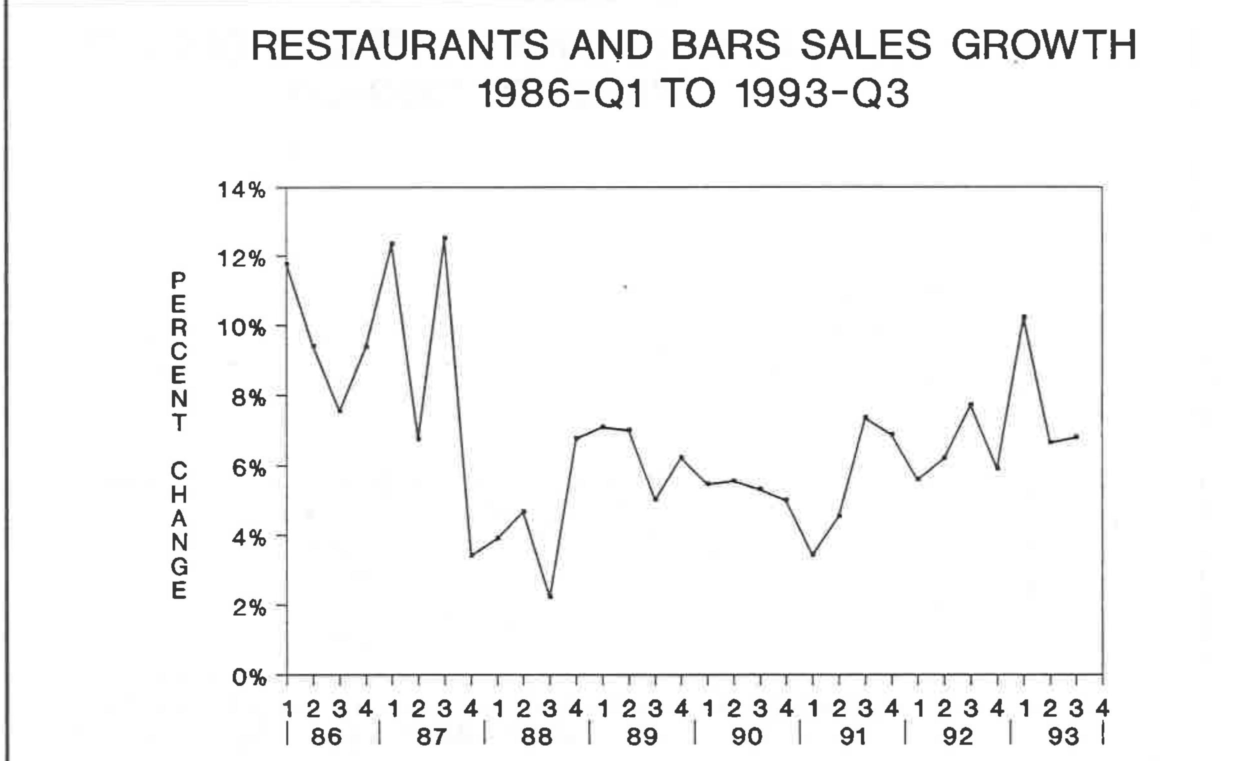
STATE OF ARIZONA
GENERAL FUND
STATEMENT OF PROJECTED BASE REVENUE
COMPARISON OF GOVERNOR'S AND JLBC STAFF ESTIMATES
(Thousands)

	FY 1994 Governor's Estimate	FY 1994 JLBC Staff Estimate	FY 1994 Difference	FY 1995 Governor's Estimate	FY 1995 JLBC Staff Estimate	FY 1995 Difference
Taxes						
Sales and Use	$1,732,900.0	$1,737,100.0	$ 4,200.0	$1,841,400.0	$1,866,500.0	$25,100.0
Income - Individual	1,461,500.0	1,435,240.3	(26,259.7)	1,582,000.0	1,570,000.0	(12,000.0)
- Corporation	259,800.0	247,950.0	(11,850.0)	261,300.0	244,100.0	(17,200.0)
- Urban Revenue Sharing	(185,400.0)	(185,400.0)	0.0	(205,610.0)	(205,600.0)	10.0
Property	188,700.0	194,100.0	5,400.0	189,400.0	197,300.0	7,900.0
Luxury	73,470.0	73,300.0	(170.0)	74,470.0	74,000.0	(470.0)
Insurance Premium	89,200.0	92,500.0	3,300.0	82,400.0	88,900.0	6,500.0
Motor Vehicle Licenses	108,200.0	111,000.0	2,800.0	111,450.0	120,000.0	8,550.0
Pari Mutuel	4,490.0	5,100.0	610.0	4,700.0	5,200.0	500.0
Estate	30,000.0	35,000.0	5,000.0	29,000.0	35,000.0	6,000.0
Other Taxes	1,850.0	1,940.0	90.0	1,900.0	2,040.0	140.0
Subtotal - Taxes	3,764,710.0	3,747,830.3	(16,879.7)	3,972,410.0	3,997,440.0	25,030.0
Other Non-Tax Revenues						
Lottery	42,890.0	42,500.0	(390.0)	45,000.0	45,000.0	(0.0)
Licenses, Fees & Permits/Sales & Service	42,230.0	46,400.0	4,170.0	43,380.0	47,800.0	4,420.0
Interest	11,000.0	14,600.0	3,600.0	12,000.0	15,600.0	3,600.0
Miscellaneous	32,500.0	40,400.0	7,900.0	37,500.0	37,900.0	400.0
Subtotal - Other Non-Tax Revenues	128,620.0	143,900.0	15,280.0	137,880.0	146,300.0	8,420.0
Total Base Revenue Before Other Revenue Sources	3,893,330.0	3,891,730.3	(1,599.7)	4,110,290.0	4,143,740.0	33,450.0
Other Revenue Sources						
Transfers & Reimbursements	23,500.0	25,000.0	1,500.0	22,500.0	25,300.3	2,800.3
Disproportionate Share Revenue	58,220.0	58,219.7	(0.3)	58,220.0	69,953.8	11,733.8
Subtotal - Other Revenue Sources	81,720.0	83,219.7	1,499.7	80,720.0	95,254.1	14,534.1
TOTAL BASE REVENUE	3,975,050.0	3,974,950.0	(100.0)	4,191,010.0	4,238,994.1	47,984.1
Adjustment to Consensus	0.0	0.0	0.0	36,250.0	0.0	(36,250.0)
Federal Retiree Refunds	(51,100.0)	(51,100.0)	0.0	(34,200.0)	(34,200.0)	0.0
ADJUSTED TOTAL BASE REVENUE	$3,923,950.0	$3,923,850.0	$(100.0)	$4,193,060.0	$4,204,794.1	$11,734.1



CHANGE FROM SAME QUARTER IN PRIOR YEAR

CHART 13



CHANGE FROM SAME QUARTER IN PRIOR YEAR

CHART 14

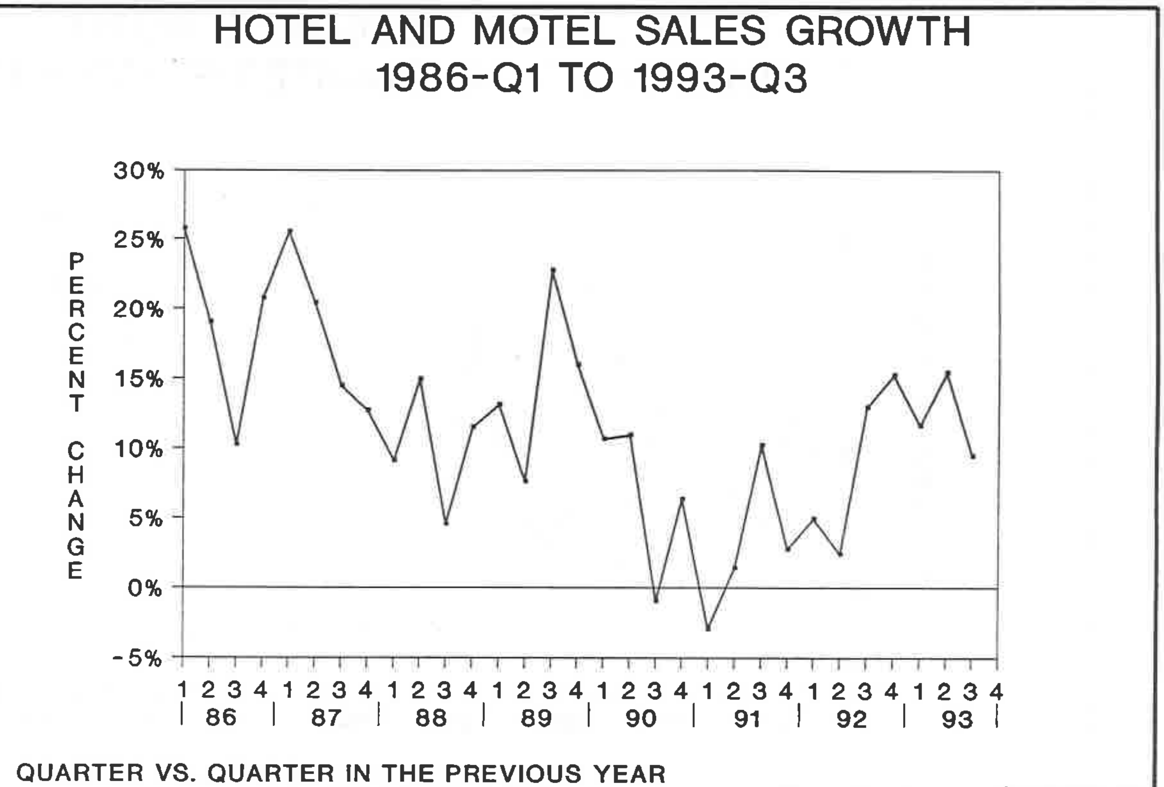


CHART 15

CHART 16

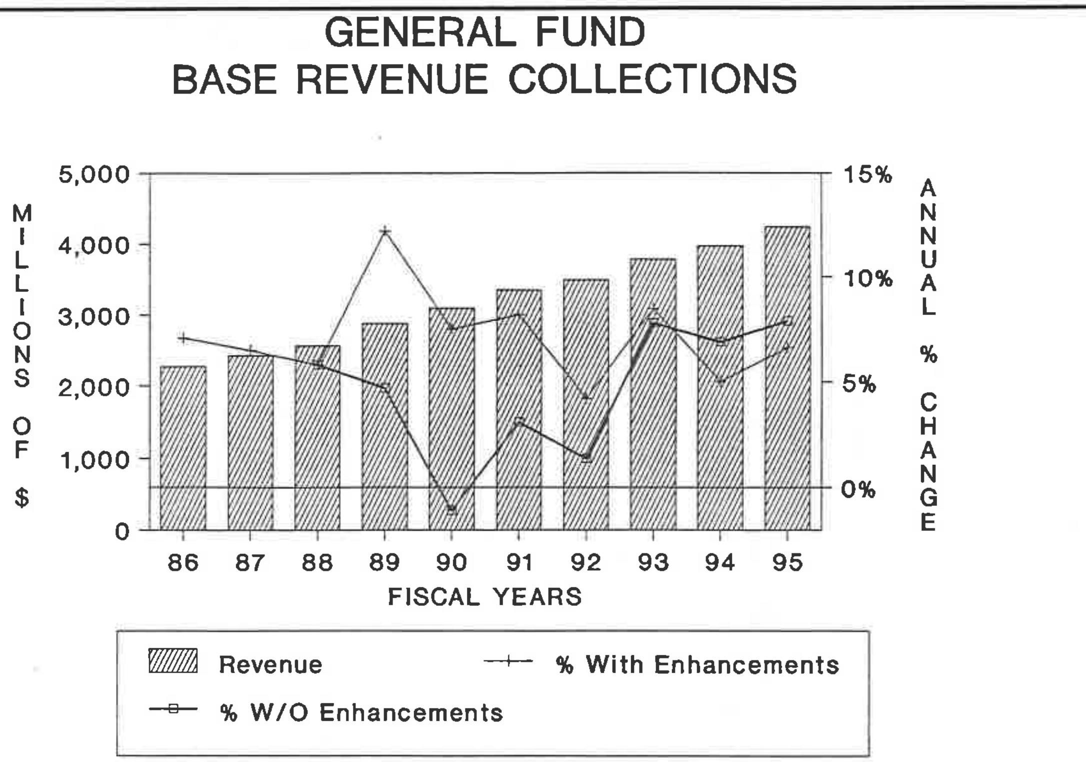
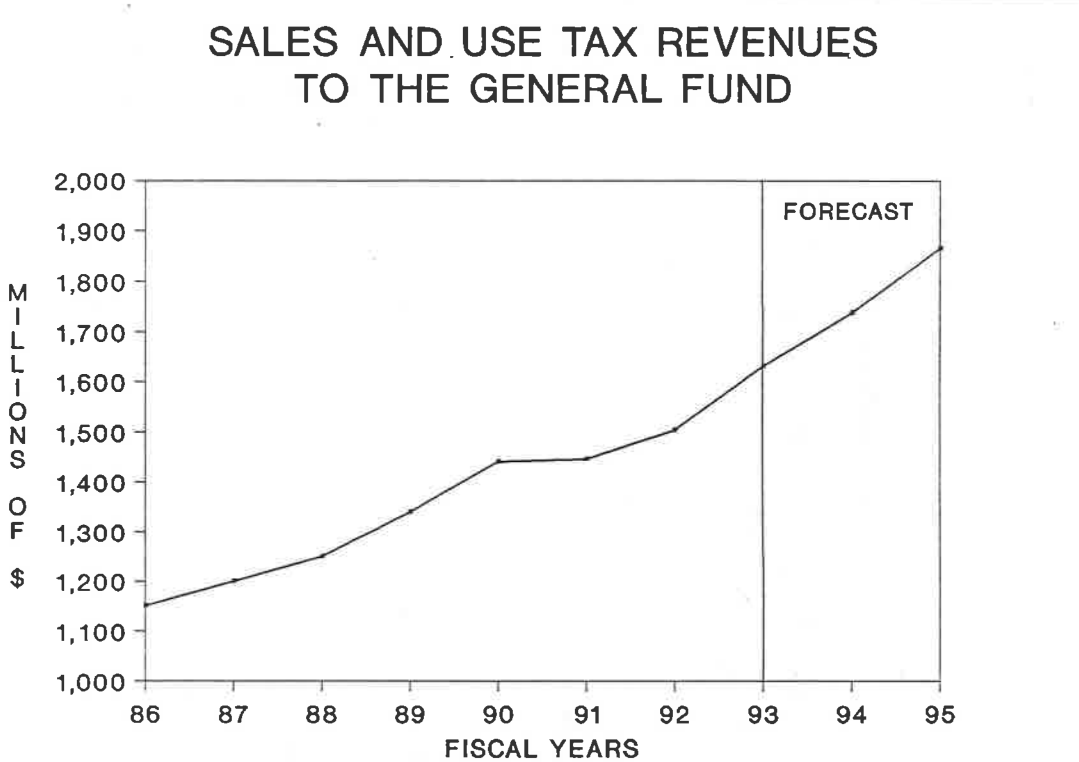


CHART 17



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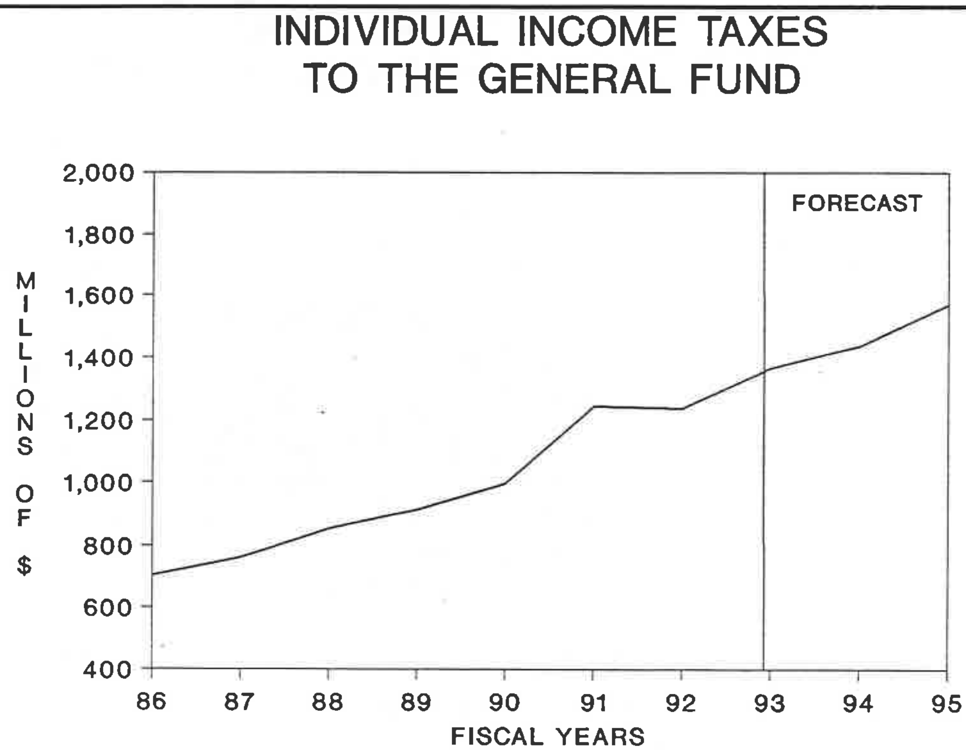

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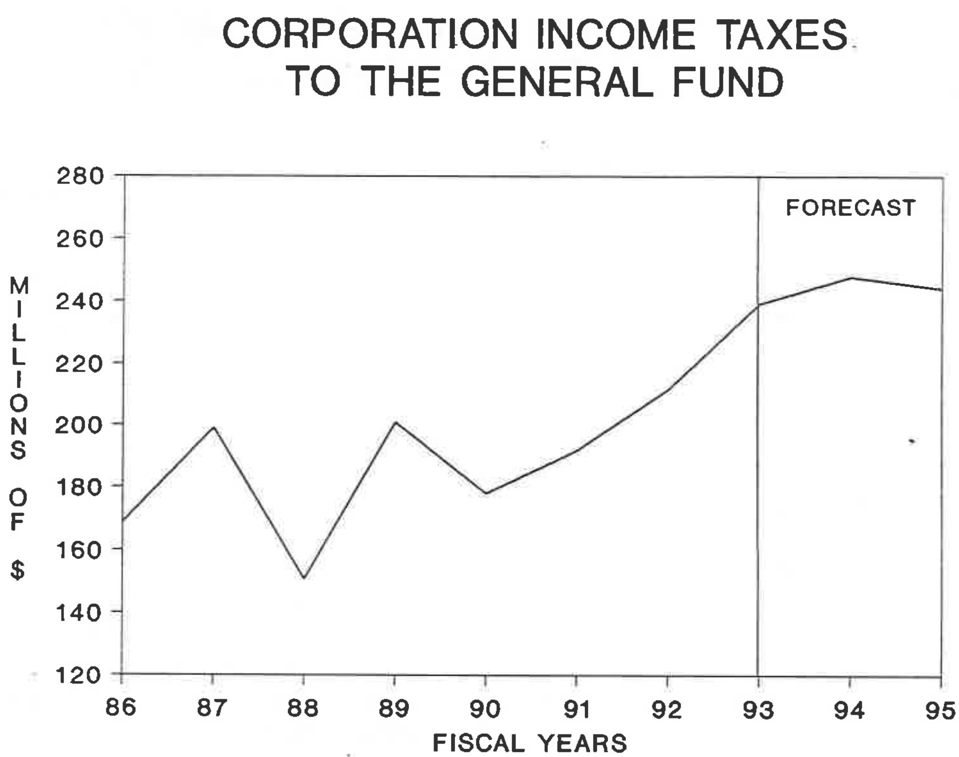
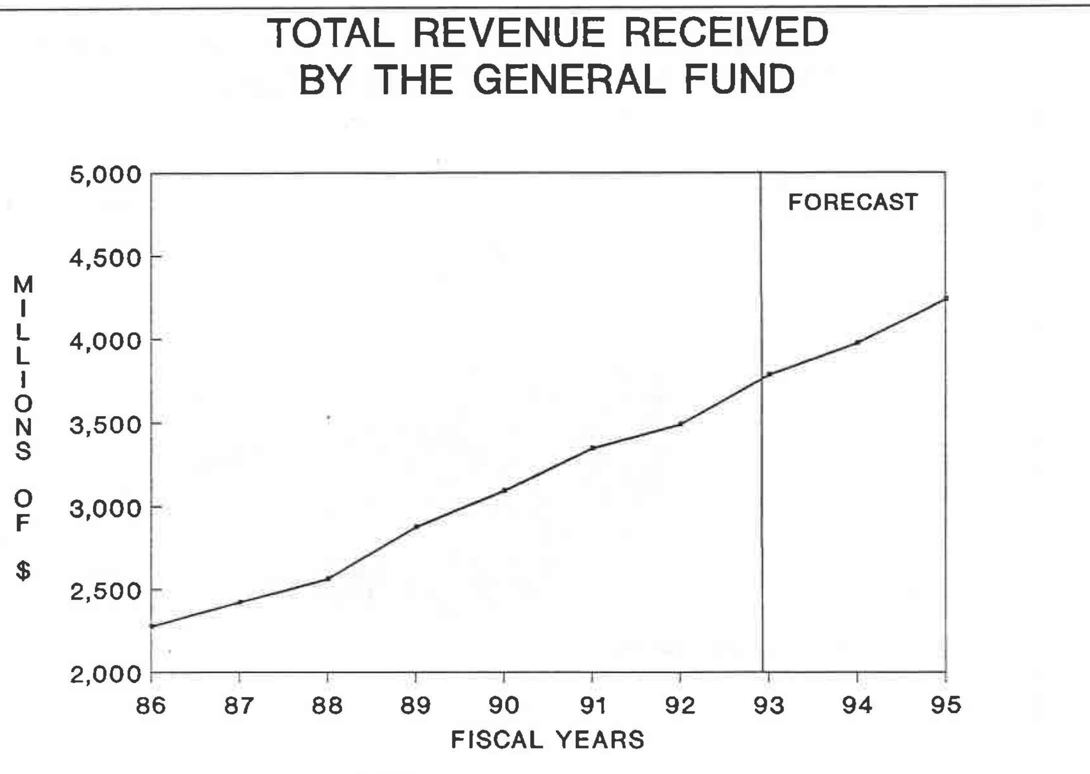


CHART 20



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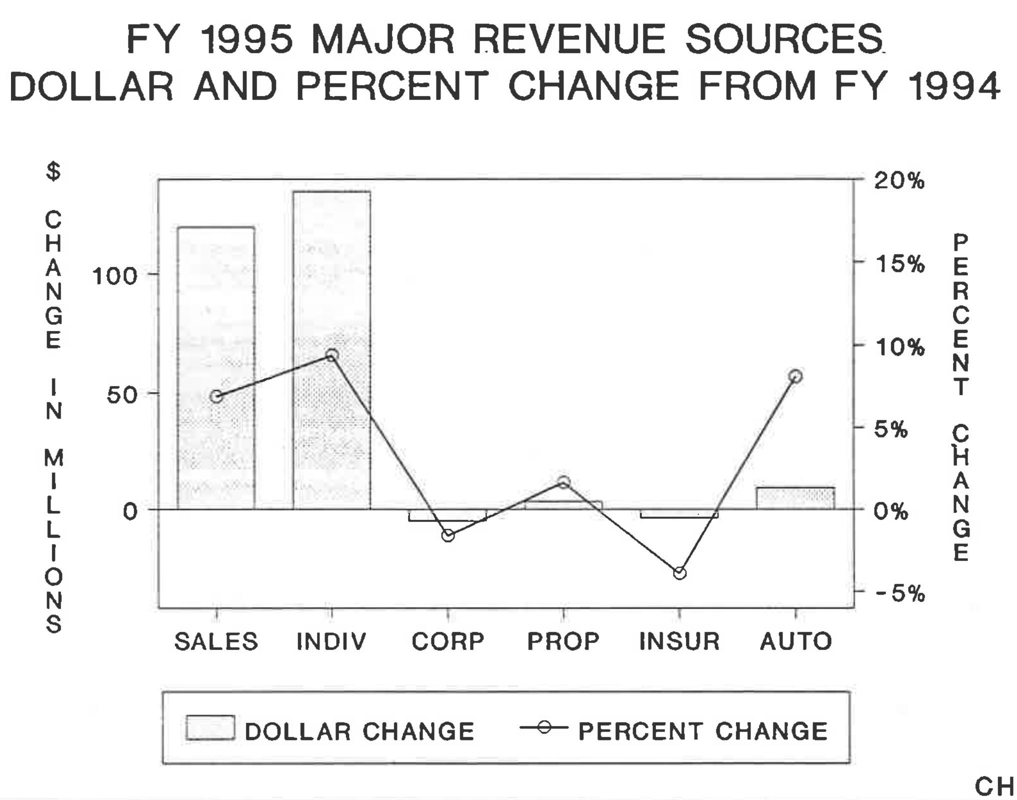
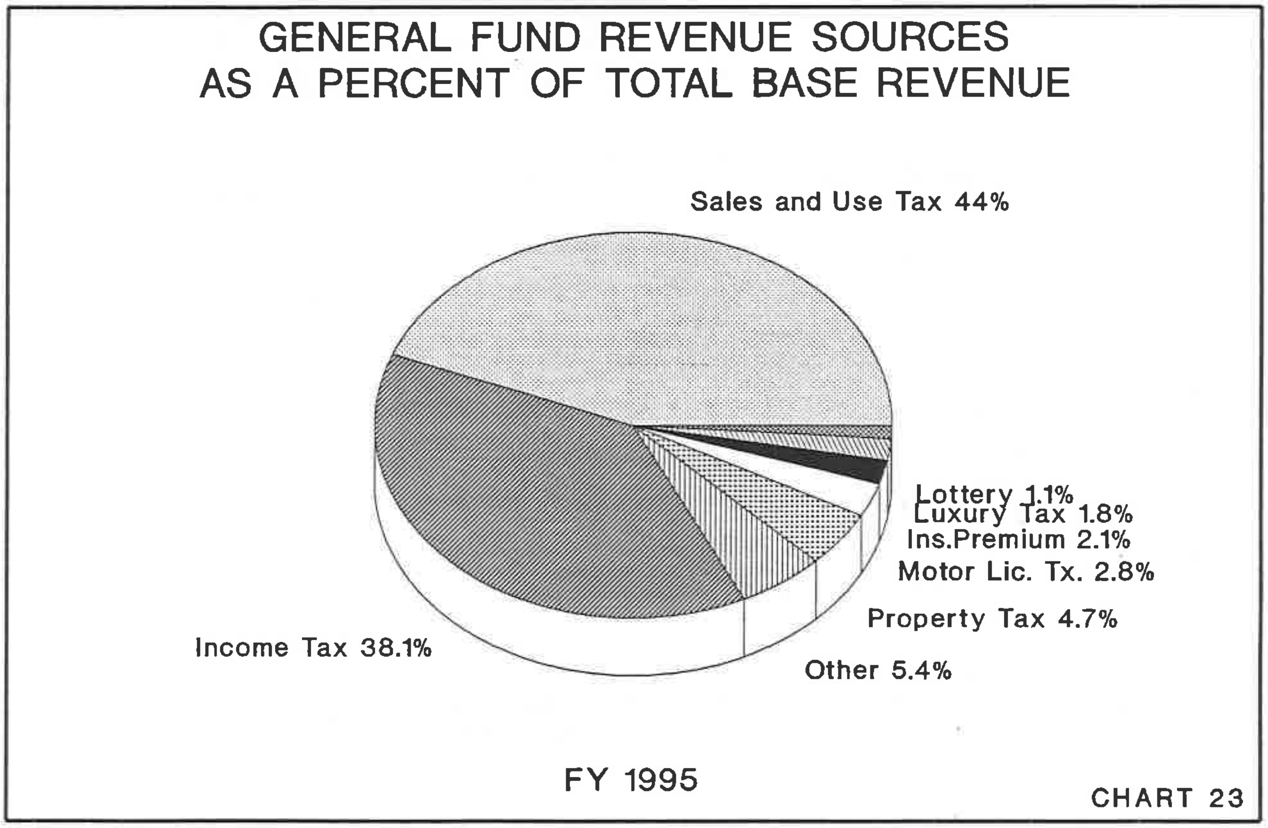


CHART 22


GENERAL FUND REVENUE SOURCES
AS A PERCENT OF TOTAL BASE REVENUE
Sales and Use Tax 44%
Lottery 1.1%
Luxury Tax 1.8%
Ins.Premium 2.1%
Motor Lic. Tx. 2.8%
Property Tax 4.7%
Other 5.4%
Income Tax 38.1%
FY 1995
CHART 23

ARIZONA'S BUDGET STABILIZATION FUND

Background

Arizona is one of the most recent states to join the majority of states (roughly 40) to implement some form of a "Rainy Day Fund." The Budget Stabilization Fund (BSF) for Arizona was passed during the 1990 Third Special Session (A.R.S. § 35-144). The fund is a separate account 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 spend this revenue during times of below-trend growth. It is designed to provide revenue stabilization across a typical business cycle. Under the economic formula which drives the Budget Stabilization Fund, the first payment into the fund is required in the current fiscal year (FY 1994).

The Arizona BSF is not intended to finance the state during a major national recession, but is intended to dampen the "stop-go" or "tax-spend-cut" cycle that has become a recurring phenomena in the Arizona state budget process like many other states. This occurs when a national or regional recession, or even a slowing in the state economy reduces annual revenues below projections or drives expenditures above appropriations. This causes either mid-year budget cuts and/or certain state tax increases in the following legislative session. After the economy improves and state revenue starts growing at a faster rate, new programs are initiated or taxes are cut. This, in turn, exacerbates the budgetary shortfall during the next downturn.

The principle behind Arizona's formula-driven budget stabilization fund is to mirror changes in the growth cycle of the Arizona economy. State economic history has shown that when the Arizona economy has expanded rapidly, the total state personal income was one of the best measures of that growth.

The Formula

The determination of the amount to be appropriated to (deposit) or transferred out (withdrawal) of the Budget Stabilization Fund is made using a formula based upon annual personal income (excluding transfer payments) and adjusted for inflation. Essentially, when annual growth is above trend monies are deposited into the BSF, whereas, when growth is below trend monies are withdrawn from the BSF.

The Arizona Economic Estimates Commission (EEC) determines the annual growth rate of inflation-adjusted total state personal income, the trend growth rate over the past 7 years, and the required appropriation to or transfer from the BSF. The EEC reports this calculation for the prior calendar year in the April-May timeframe.

Key features of the Arizona BSF can be summarized as follows:

- The deposit into the BSF (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 (see Chart 24).

- 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 (see Chart 25).

- If the annual growth rate is less than the trend growth rate, the deficiency when multiplied by the General Fund revenue of the prior fiscal year would equal the amount to be withdrawn from the BSF (see Chart 25).

- By a two-thirds majority, the Legislature, with the concurrence of the Governor, can decrease a deposit or increase a withdrawal.

Simulated Results

Chart 24 shows the growth of real Arizona Personal Income over a 18-year period. The annual changes are compared to the trend-growth using a moving 7-year average. Using actual data for the growth of personal income until CY 1992 and forecasts thereafter, this Budget Stabilization Fund simulation shows what would have occurred and what can be expected.

Deposits to the BSF (would have) occurred when the growth rate was above the 7-year moving average of real personal income growth (the unshaded areas). Withdrawals happen when real annual personal income growth is less than the 7-year average (the shaded areas).

The results of the simulation are shown in the chart below. Not surprisingly, periods of declining personal income growth were also periods when the state revenue growth rate declined and demands for state services soared. The availability of a BSF at these times would have made a positive contribution to state revenue until more normal economic growth resumed. The simulation suggests that the BSF will work as intended if the formula is adhered to by the Legislature and Governor.

Estimated Appropriations (Deposits) to BSF

As of this date, the Arizona economy is "gathering steam" and the JLBC Staff forecasts that CY 1993 and CY 1994 will be "above-trend" growth years, with real growth of 2.45% and 4.89%, respectively. These increases are 0.75% and 3.15% above trend for those years and will dictate an initial deposit into the BSF in FY 1994 of $28.4 million, followed by a deposit of $123.6 million in FY 1995. The required FY 1994 deposit was not included in the enacted budget last spring. Therefore, a supplemental appropriation will be necessary.

TABLE 10

ESTIMATED DEPOSITS TO BSF
FY 1994 AND FY 1995
($ Millions)

Fiscal Year	Real Adjusted AZPI*	Annual Growth	7-Year Average Growth	Excess Growth or Shortfall	Actual Fiscal Revenues**	Deposits/ Withdrawals	Interest Earnings	Balance
1994	$45,740	2.45%	1.70%***	0.75%	$3,784.8	$ 28.4	$-0-	$ 28.4
1995	$47,975	4.89%	1.74%****	3.15%	$3,923.9	$123.6	$1.1	$153.1

* For calendar year ending in fiscal year (e.g. - CY 1993 for FY 1994)
** For prior fiscal year, excluding beginning balance.
*** Average for 1987 through 1993.
**** Average for 1988 through 1994.

ARIZONA REAL PERSONAL INCOME GROWTH
ONE YEAR RATE TO SEVEN YEAR AVERAGE

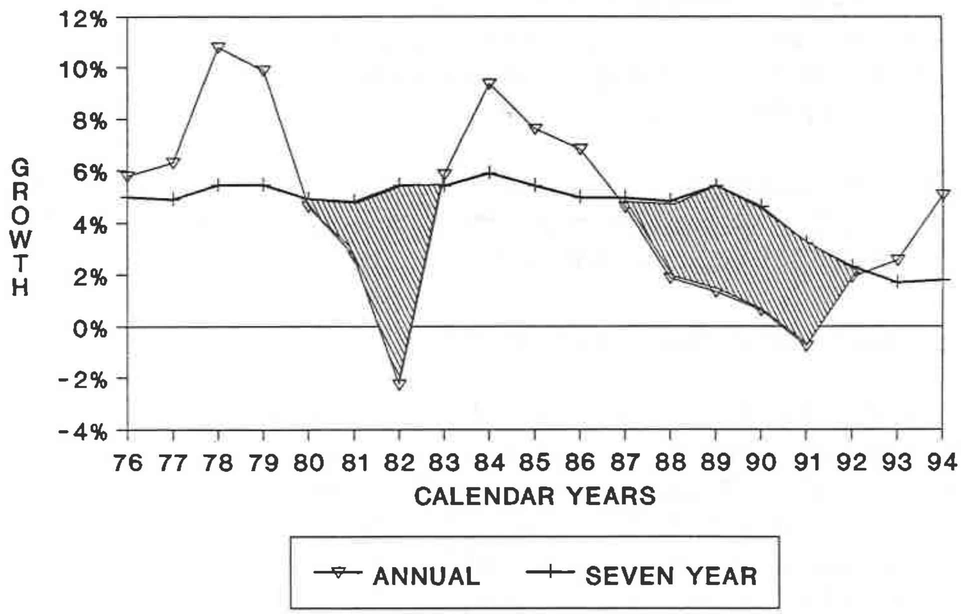
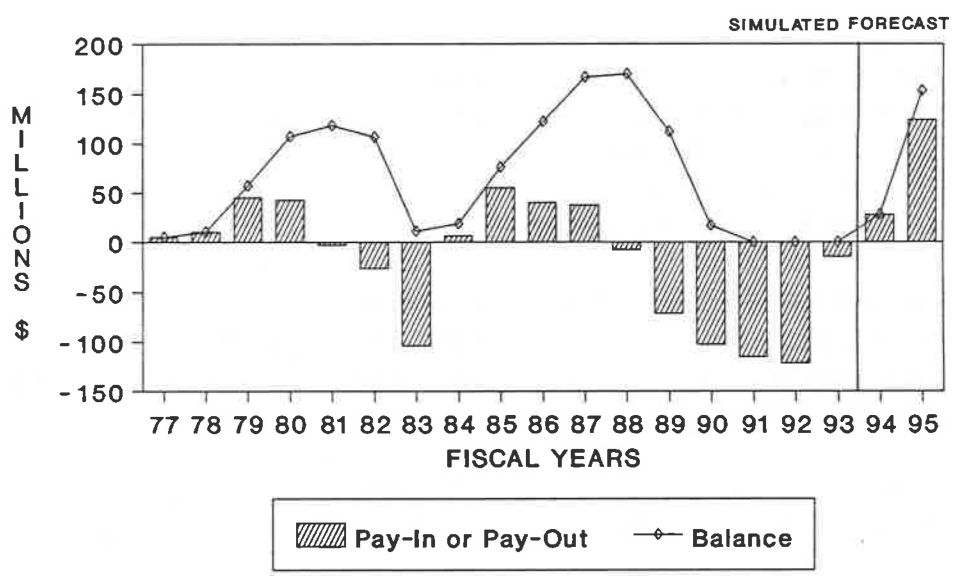


CHART 24

ARIZONA BUDGET STABILIZATION FUND
DEPOSITS, WITHDRAWALS AND FUND BALANCES
FY 1977 TO FY 1995



NOTE: Fund Balance Earns Interest
at 6-Month T-Bill Rate

CHART 25

OPERATING FUND CASH BALANCES

Average balances in the Operating Fund for the first six months of FY 1994, from July through December, were $357 million, compared to $153 million for the same period in FY 1993, an increase of 133% (see Chart 26). This increase has been due to faster than anticipated growth in revenues received by the Treasurer's Office. Sales tax and individual withholding taxes are up more than forecast a year ago. Also, it appears that certain areas of social services spending are rising less than expected, which would also help explain this surge in Operating Fund balances.

The JLBC Staff estimates that average balances for the entire year will be $364 million, as compared to $252 million in FY 1993. We are assuming that balances decline slightly to an average level of $346 million in FY 1995.

Slightly Higher Interest Earnings Expected

Short-term interest rates have stayed at low levels since last year and even fallen a little more for some maturities. Federal funds are still about 3% at this time, the lowest in 20 years. The first quarter (July through September) of FY 1994 saw the Federal Funds interest rate at about 3.06%, compared to 3.26% in the first quarter of FY 1993. Three-month Treasury bills yielded about 3.00% compared to 3.08%, and ten-year U.S. Treasury bonds were 5.62% compared to 6.62% in the first quarter of FY 1993. Mortgage rates have also declined from 7.90% to 7.04% during the same period.

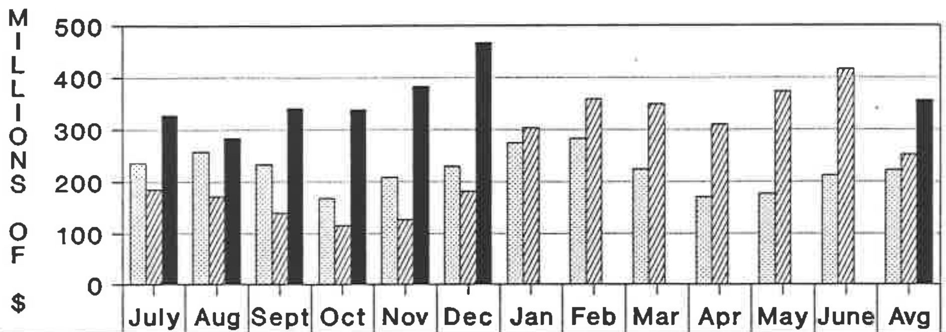
The Treasurer's Office believes that interest rates will stay in their current ranges but may increase slightly as the U.S. economy continues to improve. In the meantime, it will keep Operating Fund investments in short maturity investments to avoid being locked into low yields if interest rates do increase substantially in the future.

When looking at which factor has the larger effect on interest earnings for the General Fund, interest rates or balances, short-term interest rates like the Federal Funds or U.S. T-bill rates are clearly dominant. For example, at an average balance of $300 million, an increase in interest rates from 3% to 4% would increase interest earnings from $9 million to $12 million. At a constant 3% interest rate, balances would have to rise to $400 million to achieve the same $12 million in earnings.

Interest earnings have fallen along with interest rates for the past several years, from $15.7 million in FY 1992 to $11.4 million in FY 1993 (see Chart 27). Nevertheless, while interest rates are not expected to rise much, the higher balances in the Operating Fund are expected to have a positive effect for General Fund earnings in the next two years.

The result of the sharply higher current and expected balances is that interest earnings for the General Fund are expected to increase to $14.56 million in FY 1994 and to $15.57 million in FY 1995.

OPERATING FUND
AVERAGE MONTHLY INVESTED BALANCES
FY 1992 through FY 1994 YTD



	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	Avg
91/92	236	259	234	168	209	230	274	283	225	170	177	213	223
92/93	185	171	139	116	127	182	304	359	350	312	373	416	252
93/94	329	284	341	339	383	467							357

91/92 92/93 93/94

CHART 26

INTEREST EARNINGS AND THE FEDERAL FUNDS RATE

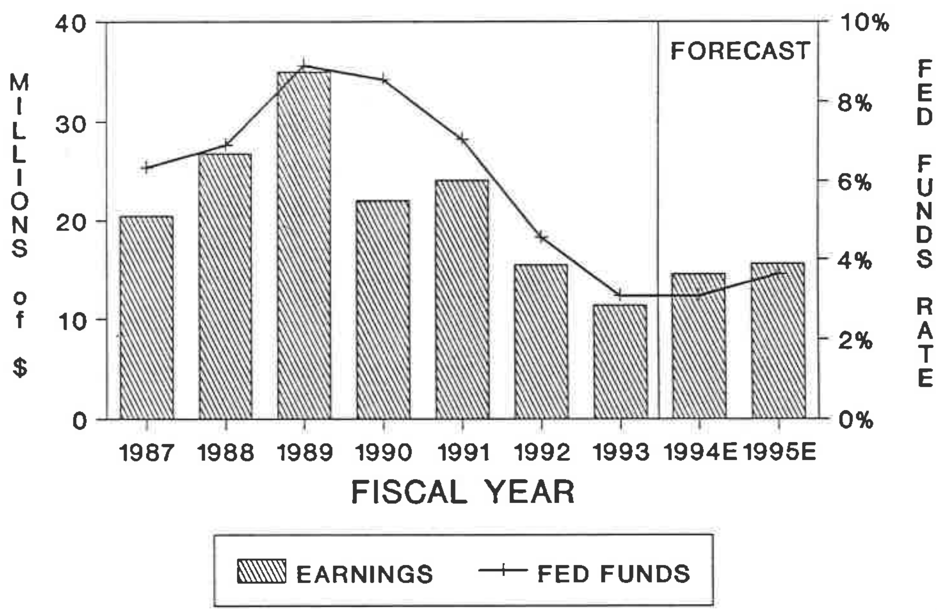


CHART 27