PROPOSED BUDGET
FY 1996
AND
FY 1997

SUMMARY OF RECOMMENDATIONS

AND

ECONOMIC AND REVENUE FORECAST

Prepared By

JOINT LEGISLATIVE BUDGET COMMITTEE

REPRESENTATIVE ROBERT "BOB" BURNS
Chairman 1995

SENATOR CAROL SPRINGER
Chairman 1996

TED FERRIS
Director

RICHARD STAVNEAK
Deputy Director

1716 West Adams Street
Phoenix, Arizona 85007
Phone (602) 542-5491
FAX (602) 542-1616

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 1995
Representative J. Ernest Baird
Representative Russell "Rusty" Bowers
Representative Carmen Cajero
Representative Jeff Groscost
Representative Herschella Horton
Representative Laura Knaperek
Representative Bob McLendon

Senator Carol Springer
Chairman 1996
Senator Gus Arzberger
Senator A. V. "Bill" Hardt
Senator James Henderson, Jr.
Senator Thomas C. Patterson
Senator Gary Richardson
Senator Marc Spitzer
Senator John Wettaw

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
Joint Legislative Budget Committee

1716 WEST ADAMS
PHOENIX, ARIZONA 85007

PHONE (602) 542-5491

FAX (602) 542-1616

TED A. FERRIS
DIRECTOR

RICHARD STAVNEAK
DEPUTY DIRECTOR

January 11, 1995

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 42nd Legislature of the State of Arizona, our recommended budget for FY 1996. As required by the Budget Reform Act of 1993, our recommendations include a second year appropriation (FY 1997) for 88 budget units.

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 42nd Arizona Legislature in developing the state budget for FY 1996.

Sincerely,

Ted A. Ferris
Director

TAF:lm

TABLE OF CONTENTS

BUDGET IN BRIEF
FISCAL YEAR 1996 - GENERAL FUND
JLBC STAFF RECOMMENDATION

Due to surprisingly strong growth of revenues and rising General Fund surpluses, we are able to concur with the Governor's recommendation to reduce taxes by $200 million. While the Governor would further reduce income taxes, toward his goal of repealing the state income tax, we have not made a specific recommendation given the Legislature's interest in reducing other taxes, most notably the personal property tax.

Additionally, the JLBC Staff recommended budget continues to emphasize "sound fiscal practices" including:

- **An appropriately cautious revenue forecast, based upon waning economic growth;**
- **Full funding of the "Rainy Day Fund," with the fund size limited to 5% of revenues ($217 million);**
- **Increased capital outlays on a "pay-as-you-go" basis, including 90% funding of the building renewal formula;**
- **$39.4 million to repay the Corrections Fund for non-construction expenditures (and pay for FY 1997 prison construction);**
- **$27.4 million to eliminate the "Midnight Reversion" year-end accounting gimmick; and**
- **Statutory revisions to enhance legislative oversight of state programs.**

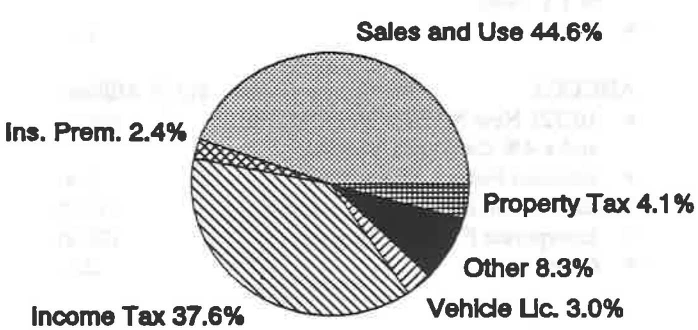
OPERATING APPROPRIATIONS

Agency/Activity	$ Change From FY 95	JLBC Staff FY 96 Rec.
	($ Millions)	
• Dept. of Education (K-12)	$76.1	$1,731.8
• Universities	16.6	597.7
• AHCCCS	(7.7)	479.0
• Dept of Economic Security	6.2	385.5
• Dept of Corrections	35.0	373.8
• Dept of Health Services	(1.4)	216.6
• Judiciary	7.7	103.7
• Community Colleges	(1.8)	96.2
• Dept of Public Safety	6.1	43.8
• Dept of Youth Treatment	7.1	42.3
• All Other	4.1	286.8
TOTAL	147.9	4,357.2

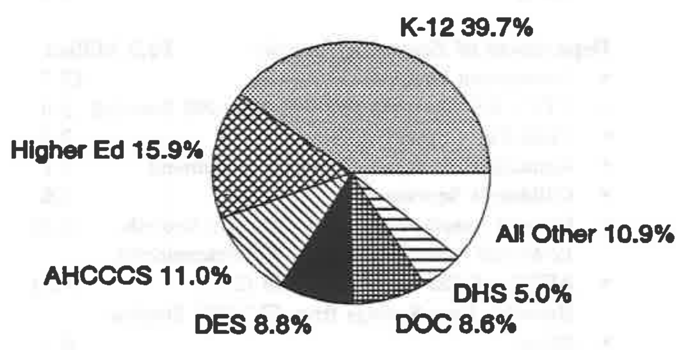
REVENUES AND YEAR-END BALANCES

	Executive	JLBC	Difference
	($ Millions)		
REVENUES:			
•Beginning Balance	$220.5	$139.7	$(80.9)
•Base Revenues	4,506.1	4,524.9	18.8
•Tax Reform/Tax Reduction	(200.0)	(200.0)	0.0
SUBTOTAL-REVENUES	$4,526.6	$4,464.6	$(62.1)
EXPENDITURES:			
APPROPRIATIONS			
•Prior Session Appropriations	$13.3	$13.3	$0.0
•Operating Appropriations	4,393.8	4,357.2	(36.6)
•New FY 96 Employee Pay	35.2	0.0	(35.2)
•Executive Initiatives	19.8	0.0	(19.8)
•Capital Outlay	61.8	77.4	15.6
•Repay Corrections Fund	24.0	39.4	15.4
•Administrative Adj. & Emergencies	22.8	22.0	(0.8)
•Revertments	(54.0)	(54.7)	(0.7)
SUBTOTAL-EXPENDITURES	$4,516.6	$4,454.6	$(62.1)
PROJECTED ENDING BALANCE:	$10.0	$10.0	$0.0

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 1995 ESTIMATES

Department of Education	**$76.1 Million**
• New Students - 17,194 New K-8 Students (3.5% Growth); 8,479 New 9-12 Students (4.8%)	$92.0
• Homeowner's Rebate (State Pays 35% of Primary Property Tax)	19.4
• Fully Fund Sudden Growth	7.7
• Career Ladder Step Increases	3.1
• Base Adjustment from FY 1995 Appropriation	(14.5)
• Assessed Valuation Growth at 3.0%	(27.7)
• Other	(3.9)

Department of Corrections	**$35.0 Million**
• Open 868 New Prison Beds	$17.2
• 1,666 New Prisoners; 6.2% Growth	4.5
• Annualize FY 1995 Prison Openings	3.8
• Annualize 2% April 1995 Pay Adjustment	3.1
• Open 400 Private Beds/Other Related Costs	1.3
• ERE/Risk Management	2.5
• Other	2.6

Universities	**$16.6 Million**
• Annualize 2% April 1995 Pay Adjustment	$8.2
• ERE and Risk Management	5.5
• Student Enrollment Growth of 1,572 (1.9%)	5.5
• Mandates (ADA & Alternative Fuels)	1.4
• Collections Adjustment	(1.6)
• Transfers and One-Time Cost	(1.8)
• Other	(0.6)

Judiciary	**$7.7 Million**
• 1,071 Adult/614 Juvenile New Probation Slots	$4.3
• Pay Annualization, Judges Salary Increase, and New Judges	1.4
• 5.2% Juvenile Support Services Growth	1.3
• Other	0.7

Department of Youth Treatment and Rehabilitation	**$7.1 Million**
• 51 New Community Placements	$2.3
• Annualize Boot Camp Opening (96 Slots)	2.2
• Other	2.6

Department of Economic Security	**$6.2 Million**
• Automation Upgrades	$3.7
• LTC - 4% Caseload Growth, FY 1995 Shortfall	3.0
• Child Care Increased Costs	2.1
• Annualize 2% April 1995 Pay Adjustment	1.1
• Children's Services	1.0
• General Assistance - 3.4% Caseload Growth, 12-Month Rule Savings, SSI Reimbursements	(1.0)
• AFDC - 5,258 New Recipients (2.7% Growth), Less Savings from FY 1995 Surplus	(4.1)
• Other	0.4

Department of Public Safety	**$6.1 Million**
• Transfer of Anti-Gang Funding from ACJC	$4.0
• Higher Risk Management Charges	2.0
• Department Pay Plan Promotional Costs	0.6
• Freeze HURF and Highway Funds Usage at $20 Million Each	0.0
• Other	(0.5)

Veterans' Service Commission	**$2.5 Million**
• Open New 200-Bed Nursing Home	$2.5

Secretary of State	**$1.7 Million**
• March 1996 Presidential Preference Primary Election Expenses/Other	$3.4
• 1994 Primary and General Election Savings	(1.7)

Land Department	**$1.1 Million**
• Risk Management Costs for State Land Hazardous Waste Clean-up	$0.9
• Other	0.2

Department of Commerce	**$(0.5) Million**
• Open New Europe Office/Other Trade Expansions	$0.4
• Reduce Job Training Funds from $3M to $2M	(1.0)
• Other	0.1

Department of Health Services	**$(1.4) Million**
• Substance Abuse Treatment	$1.2
• Computer Improvements	0.9
• Expand Clozapine Treatment	0.8
• Fund 1 Poison Center from EMS Funds	(1.0)
• Eliminate WIC Supplemental Funding	(1.0)
• Moratorium on Disease Control Research	(1.0)
• Title 19 Implementation Refinancing Savings	(1.0)
• Other	(0.3)

Community Colleges	**$(1.8) Million**
• 1,293 Fewer Students, a (1.6)% Enrollment Decline; No Inflation	$(1.2)
• Rollover of FY 1995 Williams AFB Subsidy to FY 1996	(0.7)
• Other	0.1

AHCCCS	**$(7.7) Million**
• 10,321 New Member Years (2.6%) and a 4% Capitation Increase	$30.6
• Reduced Federal Match Rate	3.4
• Elimination of Deferred Liability	(15.7)
• Incorporate FY 1995 Surplus	(28.8)
• Other	2.8

FY 1996
COMPARISON OF MAJOR POLICY ISSUES

MAJOR ISSUES	JLBC STAFF RECOMMENDATION	EXECUTIVE RECOMMENDATION
Parameters of General Fund Budget	• $147.9 M Increase in General Fund Operating Budget • 586 FTE Position Increase/63 Excluding Corrections/YTR • $10 M Surplus	• $184.5 M Increase in General Fund Operating Budget • 908 FTE Position Increase/348 Excluding Corrections/YTR • $10 M Surplus
Budget Stabilization Fund (BSF)	• Funds Scheduled $87 M Deposit in June 1995 • Total Fund Balance: $217 M • Caps at 5% of Revenue	• Does not Fund June 1995 Deposit • Total Fund Balance: $111 M (Plus Interest) • Does Not Address Cap
Tax Cuts	• $200 M Tax Cut/Reform (unspecified)	• $200 M Income Tax Cut
State Employee Issues	• No Pay Proposal • 3.95% Retirement Contribution (up from 3.75%)	• $24 M for 4% Merit Pay, January 1996 $7.6 M for Correctional Service Officers $3.6 M Other Inequity Pay Adjustments • 3.95% Retirement Contribution (up from 3.75%)
Corrections Fund Repayment	• $39.4 M	• $24 M
"Midnight Reversion"	• Eliminates Accounting Procedure at a Cost of $27.4 M	• No Proposal
Capital Outlay	• $51 M for Construction (Pay-As-You-Go) • Combined Crime/Health Lab (FY 96: $16 M/FY 97: $7 M) • 900 New Prison Beds (FY 96: $23 M/ FY 97: $5 M) • $26 M for 90% funding of Building Renewal Formula	• $42 M for Construction (Pay-As-You-Go) • Separate Health/Crime Labs (FY 96: $15 M/FY 97: $8 M) • 1,300 New Prison Beds (FY 96: $21 M/ FY 97: $27 M) • $20 M for 70% Funding of Building Renewal Formula
Executive Initiatives	• No Set Aside	• $19.8 M Set Aside
AGENCIES		
K-12	• Adds $99.7 M for Enrollment Growth, Including Full Funding of Sudden Growth • No Deflator Funding • Homeowner's Rebate Frozen at 35% • 3% Assessed Value Growth for a Savings of $(27.8)M	• Adds $95.3 M for Enrollment Growth, Including Full Funding of Sudden Growth • Same Recommendation • Same Recommendation • 3% Assessed Value Growth for a Savings of $(29.1) M
Universities	• Adds $16.6 M for Operating, Including $8.2 M for Pay Annualization, $5.5 M for Enrollment, $5.5 M for ERE and Risk Management and $(1 M) for Other Adjustments • Collections Fund Adjustment of $(1.6)M	• Adds $14.2 M for Operating, Including $8.5 M for Pay Annualization, $5.6 M for Enrollment, $4.5 M for ERE and Risk Management and $1.7 M for Other Adjustments •Collections Fund Adjustment of $(6.1) M
Community Colleges	• Reduces $(1.8) M for Enrollment Decline and Roll FY 95 Williams AFB Subsidy to '96	• Same Enrollment Decline

MAJOR ISSUES	JLBC STAFF RECOMMENDATION	EXECUTIVE RECOMMENDATION
Youth Treatment and Rehabilitation	• Adds $2.6 M for Purchase of Care: 51 Residential Beds and 83 Support Slots	• Adds $1.5 M for Purchase of Care: 21 Residential Beds and 83 Support Slots
Corrections	• Opens 868 State Prison Beds, $17.2 M • Opens 400 Private Beds, $0.9 M	• Opens Same Number of Beds, $17.1 M • Opens Same Number of Beds, $1.0 M
DPS	• Does Not Fund New Officers • Recommends $1.1 M for Highway Patrol Equipment, Including 50 Vehicles • Recommends Directly Appropriating $4 M Anti-Gang Enforcement Monies to DPS • Continues the Use of $20 M from each of HURF/Highway Funds for Operating Costs	• Recommends $2 M for 30 New Officers • Recommends $3.6 M for Similar Equipment, Including 137 Vehicles • Recommends Continuing to Appropriate Most Anti-Gang Funding through ACJC • Same Recommendation
AHCCCS	• Adds $33.6 M for Demographic Growth, Capitation Increases, and FMAP Changes • Continues $10 M Private Hospital Payments • Freezes Quick Pay Discount at FY 95 Level ($4) M • Would Decouple the County Acute Care Contribution from Long Term Care. This would essentially Freeze the Current County Acute Care Contribution at $74 M.	• Adds $13.4 M for Demographic Growth, Capitation Increases, and FMAP Changes • Same Recommendation • Same Recommendation • Would Continue 29.5% Formula for County Acute Care Costs. Increases General Fund Share of Acute Care by Over $18 M. Lowers County Contribution to $56 M.
Economic Security	• Does Not Fund Foster Care Rate Increases • Recommends $1.0 M and uses Other Available Dollars for Children Services • Does Not Fund New CPS Legal Staff • Does Not Fund New Elderly Home Care • Does Not Recommend New Funding for Domestic Violence	• Adds $2.4 M for this Issue • Adds 8 FTE Positions and $5.1 M for Children Services • Adds 14.5 FTE Positions and $1.0 M • Adds $1.2 M for this Issue • Adds $1 M for this Issue
Health Services	• Does Not Fund New Program Expansions • Funds 1 Poison Control Center • Moratorium on New Disease Control Research	• Adds $4.3 M for Maricopa Behavioral Health Crisis Services and $2.4 M for New Indian Behavioral Health Services • Maintains Support of 2 Centers • Maintains Current Disease Control Research Funding
DEQ	• Maintains Total WQARF Funding at $5 M, Including $1.55 M General Fund	• Adds $0.3 M General Fund for WQARF Priority Site Remediation
ADOT	• Reduces Operating Budget by $(14.0) M • Provides $3.5 M of New Enterprise Funding • Recommends Appropriating the County Auto License Fund starting in FY 97.	• Reduces Operating Budget by $(9.9) M • Provides $7.2 M for Enterprise • Eliminates County Auto License Fund and Appropriates its 251 FTE Positions and over $10 M from State Highway Fund in FY 96
Veterans' Comm.	• Opens Nursing Home in August 1995 at a Combined FY 95 and FY 96 Cost of $3.6 M	• Opens Nursing Home in November 1995 at a FY 96 Cost of $2.5 M
Commerce	• Reduces Job Training Program by $(1) M	• Adds $2 M to Job Training
Tourism	• Does Not Fund January 96 "Signature Bowl Events" Promotion	• Adds $2 M for this Issue.

GENERAL FUND REVENUES AND EXPENDITURES
FISCAL YEARS 1995 AND 1996
(dollars in thousands)

	Executive FY 95	JLBC Staff FY 95	Executive FY 96	JLBC Staff FY 96
REVENUES				
Balance Forward	$229,204.4	$229,204.4	$220,528.7	$139,655.4
Base Revenues	4,336,992.4	4,357,800.0	4,506,107.6	4,524,900.0
Tax Reform/Tax Reduction	0.0	0.0	(200,000.0)	(200,000.0)
TOTAL REVENUES	$4,566,196.8	$4,587,004.4	$4,526,636.3	$4,464,555.4
EXPENDITURES				
Prior Session Appropriations	0.0	0.0	13,255.7	13,255.7
Operating Appropriations	4,268,826.4	4,268,826.4	4,393,756.0	4,357,174.5
Budget Stabilization Fund:				
Trigger 1-FY 94 Surplus	68,504.0	68,504.0	0.0	0.0
Trigger 2-FY 95 Excess Revenues	0.0	87,500.0	0.0	0.0
New FY 96 Employee Pay	0.0	0.0	35,240.0	0.0
Executive Initiatives	0.0	0.0	19,783.6	0.0
FY 95 Supplementals	7,078.7	5,702.1	0.0	0.0
Operating Subtotal	4,344,409.1	4,430,532.5	4,462,035.3	4,370,430.2
Capital Outlay	32,459.0	32,459.0	61,800.0	77,418.2
Repay Corrections Fund	0.0	0.0	24,001.0	39,434.0
Admin Adjustments/Emergencies	22,800.0	21,000.0	22,800.0	22,000.0
Change in Continuing Appropriations	0.0	27,357.5	0.0	0.0
Revertments	(54,000.0)	(64,000.0)	(54,000.0)	(54,727.0)
TOTAL EXPENDITURES	$4,345,668.1	$4,447,349.0	$4,516,636.3	$4,454,555.4
PROJECTED ENDING BALANCE	$220,528.7	$139,655.4	$10,000.0	$10,000.0

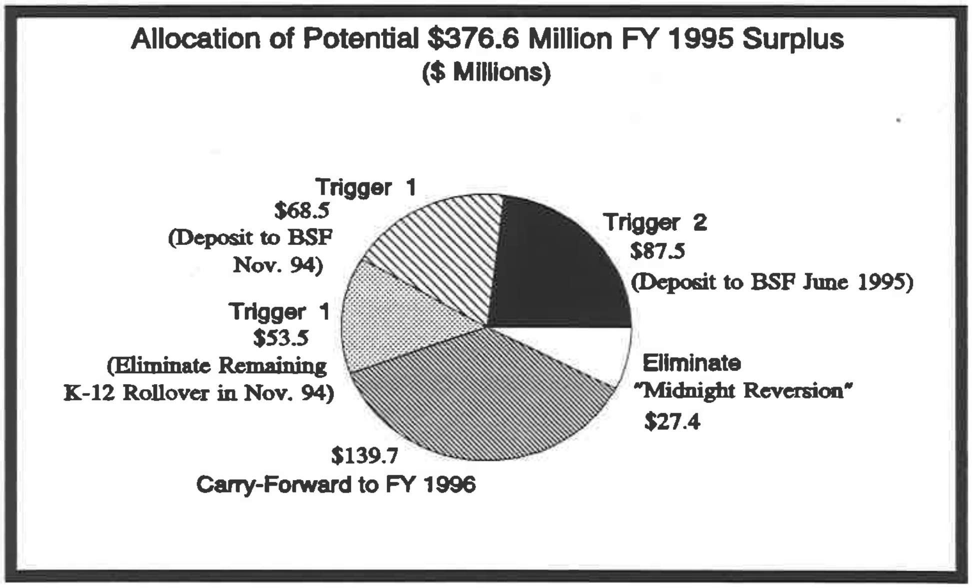
FY 1994 REVIEW AND FY 1995 UPDATE

In March 1994, at the time of enactment of the FY 1995 budget, the officially forecasted ending balance for FY 1994 (General Fund) was $107.2 million and for FY 1995 was just $4.9 million. These projections were based upon the Governor's lower forecast of revenue, and were after setting aside $89 million to reduce the "K-12 Rollover" from $142.5 million to $53.5 million, and appropriating $42 million as the initial deposit into Arizona's Budget Stabilization Fund (BSF).

Because the JLBC Staff had a revenue estimate that was over $93 million higher than the Governor's for these 2 fiscal years, the Legislature passed a FY 1995 budget with so-called **"Triple-Trigger"** provisions: 1) to the extent that the FY 1994 ending balance exceeded $107.2 million, the excess surplus was to be directed first to eliminate the remaining K-12 Rollover and, thereafter, to be deposited into the BSF; 2) to the extent that FY 1995 revenues exceed the budget estimate of $4,237.1 million they are to be deposited into the BSF, except that when combined with any deposit made under "Trigger 1," the total deposited into the BSF cannot exceed the formula-required amount; 3) the 3rd trigger would come into play only if Triggers 1 and 2 failed to eliminate the remaining K-12 Rollover, and would make a FY 1996 General Fund appropriation to eliminate any remaining K-12 Rollover.

On July 20, 1994, the JLBC Staff issued a Budget Status Report (No. 1994-1), which pegged the FY 1994 year-end surplus at $210.2 million. Pursuant to Trigger 1, this would eliminate the remaining K-12 Rollover of $53.5 million and result in a BSF deposit of $49.5 million. **As it turned out, the final ending General Fund balance for FY 1994 was an even more robust $229.2 million,** which triggered a higher BSF deposit of $68.5 million.

Turning to "Trigger 2" and FY 1995's General Fund revenues, the JLBC Staff forecast of $4,357.8 million is well above the trigger level for revenue of $4,237.1 million and, therefore, will trigger a year-end deposit to the BSF of $87.5 million in order to fully fund FY 1995's required deposit of $156 million. It is worthwhile to note that if not for Triggers 1 and 2, and the JLBC Staff's recommendation that we eliminate the year-end bookclosing practice known as the "Midnight Reversion Law" at a cost of $27.4 million, the ending balance would have grown from $229.2 million on June 30, 1994, to $376.6 million on June 30, 1995. As it is, after triggering supplemental appropriations to eliminate the remaining $53.5 million of the K-12 Rollover, fully funding FY 1995's BSF deposit at $156 million, and reserving $27.4 million to reverse the "Midnight Reversion," the JLBC Staff is still projecting a healthy year-end balance of $139.7 million, which will be used in constructing our FY 1996 budget recommendations.



OVERVIEW OF THE JLBC STAFF RECOMMENDED GENERAL FUND BUDGET FOR FY 1996

Tax Relief in Arizona

JLBC Staff Recommended Budget Allows for $200 Million of Tax Reductions

The JLBC Staff recommended budget for FY 1996 incorporates $200 million of unspecified tax relief. Whereas, taxes were increased by over $500 million during three consecutive legislative sessions from 1988 through 1990, our improved economy, strong underlying revenue growth and rising surpluses have provided an opportunity to lower taxes during each of the past two legislative sessions. These tax cuts are intended to reverse the earlier tax increases and to improve the after-tax incomes of individuals and businesses in Arizona. While there is room for debate over whether Arizona is an "average" or "high" tax state, there is no broad-based data that would support the assertion that we are a "low" tax state.

The level and structure of taxes in Arizona (and how efficiently and effectively we spend them) is important when you consider the fact that Arizona per capita personal income has remained 5-15% below the national average over the past 20 years. While some of the gap is explained by demographic and societal factors (choice) that state government cannot and, perhaps, should not attempt to influence, a significant portion of the gap is related to our mix of jobs and industries, with Arizona being characterized by lower paying jobs. Some portion of this difference is certainly attributable to the "sunshine factor" and our willingness to work for lower wages than elsewhere due to our favorable climate. Nonetheless, we may be able to alter our taxing and spending policies in a manner that encourages and attracts higher-paying jobs.

Although Arizona's strong economy and revenue growth are providing opportunities for tax reduction/reform, any tax relief should be developed in the context of careful long-range budget planning. Whereas, tax cuts may be enacted by a simple majority vote, the Arizona Constitution now requires a two-thirds majority for any bill that entails a net tax increase. Of course, the Legislature's commitment to build the "rainy day fund" to a level equal to 5% of revenues, makes it less risky to be aggressive in tax-cutting.

Given that this year's budget recommendations are predicated upon a relatively large, $200 million tax cut, it should be noted that there is a precedent for including a major tax change as part of the JLBC Staff's budget recommendations. In FY 1991, the deep and lengthy recession in Arizona had reduced the estimated revenue growth rate to less than 3%, while social service caseloads were skyrocketing. The JLBC Staff recommended budget assumed tax increases totalling $298.9 million. As it turned out, legislation was enacted which raised FY 1991 revenues by $252.1 million.

Governor Would Reduce Income Taxes, Others Propose Property Tax Cuts

The Governor is recommending that state income taxes be reduced an additional $200 million as a further step toward his goal of eliminating the state income tax (estimated yield of $1,656 million, or 37% of our total estimate of $4,525 million of General Fund revenue). Over the past two legislative sessions, the state income tax has been reduced by $111 million. These reductions had the effect of reversing the effects of the 1990 tax increase which raised the income tax by some $110 million as part of the aforementioned $252 million tax increase. Further decreases in the income tax are sought by those who feel it will place Arizona in a better position to compete for higher paying jobs with neighbors such as Texas and Nevada that have no income tax, and will generate higher incomes through the lowering of taxes.

However, there is legislative interest in other tax cuts, particularly in cutting property taxes. There is an emerging national trend toward the elimination of the property tax as a primary funding source for local schools (Michigan being the most noteworthy). In a relative sense, recent data suggests that property taxes are more burdensome than income taxes in Arizona. For example, in FY 1992, total property taxes in Arizona were 4.15% of personal income as compared to the U.S. total of 3.72%, ranking Arizona 15th. Our income tax, on the other hand, was 2.00% of Arizona personal income versus 2.40% nationally, which ranked Arizona 35th; and, this relatively low ranking was prior to the income tax cuts of the past two years.

Sound Fiscal Practices

The JLBC Staff's FY 1996 budget recommendation continues to stress the 2 major themes contained in last year's recommendations--paying past financial obligations and implementing sound fiscal practices that will ensure our state's future budgetary health.

While our General Fund revenue growth remains excellent and our surplus is rising (when deposits to the BSF are included), we are forecasting that economic growth will subside somewhat in 1995 and early 1996 as a transition to a federal reserve-induced recession beginning in mid-1996 (the start of FY 1997). Therefore, we feel it is important to view FY 1996 as a transition year, where we are careful to not overcommit our surplus revenues in support of continuing operations, but rather target these one-time revenues for one-time spending.

As a result, the JLBC Staff recommends the following:

- An appropriately cautious revenue forecast; based upon waning economic growth;
- Full funding of the Budget Stabilization Fund with deposits capped at 5% of revenue (approximately $217 million);
- Continued use of pay-as-you-go financing of capital projects and 90% funding of major maintenance and repair of state buildings;
- a General Fund transfer of $39.4 million to the Corrections Fund to repay prior non-construction expenditures;
- elimination of the "Midnight Reversion" accounting technique at a cost of $27.4 million;
- statutory revisions to enhance legislative-executive oversight of state programs. These revisions include: 1) eliminating or consolidating 87 funds and converting $336 million of non-appropriated funds to appropriated status; 2) creating both a new agency for information technology planning and a new legislative/executive/private sector authorization committee; and 3) establishing a schedule to conduct program authorization reviews on 75 state programs, as envisioned by the 1993 Budget Reform Act.

Waning Economic Growth--Appropriately Cautious Revenue Estimate

After 6 consecutive years where actual general fund revenues fell short of estimates, the opposite has occurred for fiscal years 1993, 1994 and 1995. There is a tendency to overestimate revenue on the downswing of the business cycle, and, thereafter, to underestimate revenue on the upside. However, because there were so many years where revenues fell short of expectations, the JLBC Staff has become even more cautious in our revenue forecasting, to the point where there is a small chance of there being a revenue shortfall.

Our forecast for the next 2 years maintains this cautious approach. As explained in detail later in the "Economic and Revenue Forecast" section of this report, we are forecasting that the U.S. economy will exhibit slower growth later this year and on into 1996 as a transition to a mild national recession beginning in mid-1996 (around the start of FY 1997). Likewise, the Arizona economy begins to slow, although there is so much momentum in the Arizona economy that this slowdown is really not felt until 1997.

The combination of a slowing economy and already scheduled tax cuts results in a substantial deceleration in the General Fund revenue growth rate. Whereas, revenues grew by 8.5% in FY 1993 and 7.6% in FY 1994, we are forecasting growth of 7.0% this year (FY 1995), followed by increases of 3.8% and 3.5% in FY 1996 and FY 1997, respectively.

Even though our revenue estimate for FY 1995 is nearly $230 million higher than the estimate used when the budget was enacted in March 1994, revenue growth is running well ahead of our revised estimate. For example, **it appears that General Fund revenue collections for the first half of the fiscal year are 16% greater than a year earlier.** However, the tax relief enacted last session will largely occur in the second half of this year, and will lower the revenue growth rate by roughly 4% from what would otherwise occur. When combined with the impact of a slowing economy, **we are anticipating a rather precipitous slowing of the revenue growth rate during the second half of FY 1995.** Nonetheless, there is a good chance that we will exceed this year's revenue estimate.

GENERAL FUND REVENUE
(dollars in millions)

	Actual FY 1994	Estimated FY 1995	Estimated FY 1996	Estimated FY 1997
Sales Tax	$1,793.0	$1,957.0	$2,035.7	$2,117.2
Income Taxes	1,577.2	1,621.5	1,722.5	1,827.9
Other Revenue	758.3	801.3	785.0	797.2
Subtotal	$4,128.5	$4,379.8	$4,543.2	$4,742.3
Fed Retiree Refunds	(55.2)	(22.0)	(18.3)	(57.7)
Total Revenue	$4,073.3	$4,357.8	$4,524.9	$4,684.6

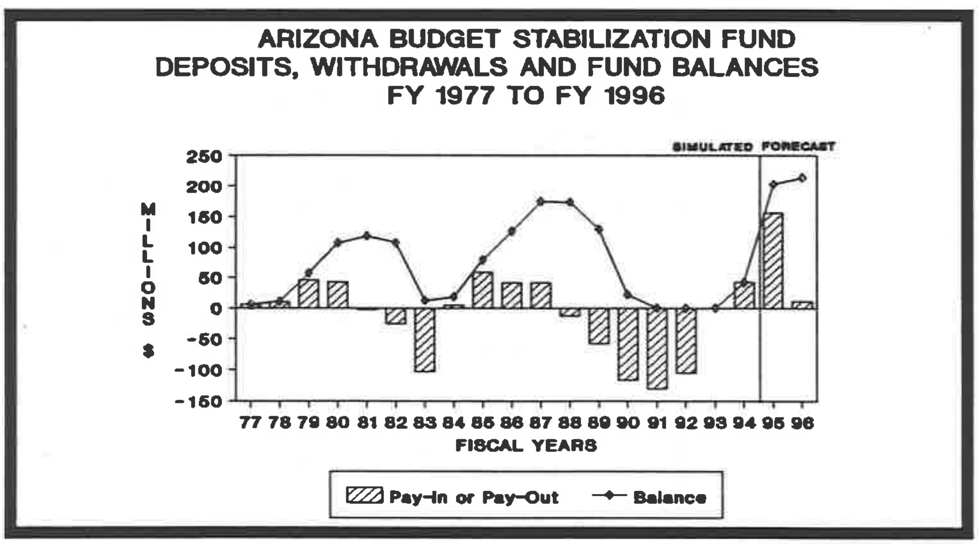
Full Funding of Arizona's Budget Stabilization Fund with Recommended Lower Cap (5% of General Fund Revenue)

The Arizona Budget Stabilization Fund (BSF) is designed to set revenue aside during times of above-trend economic growth and to utilize this revenue during times of below-trend growth. A detailed explanation of the philosophy and formula under which the BSF operates can be found at the back of this summary recommendation book.

In FY 1995, 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). This will require a deposit of $156 million, which will be accomplished under the "Triple Trigger" provisions of the current year budget (see Discussion earlier in this section). The Governor is recommending that "Trigger 2" be repealed, and that the BSF be limited to its current balance of approximately $111 million plus interest earnings.

For FY 1996, a deposit will not be required if the JLBC Staff recommendation for a lower cap on the maximum BSF balance is enacted (without the lower cap, a further deposit of nearly $100 million would be required). Currently, the BSF is limited to 15% of General Fund revenue, whereas, the JLBC Staff is recommending that this cap be lowered to 5%.

The graph below includes a JLBC Staff simulation of how the BSF would have operated since 1977, through two major recessions, along with the Staff estimates for FY 1994 through FY 1996. 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. The JLBC Staff believes that a BSF equal to 5% of the budget will provide the Legislature with a reasonable measure of budgetary flexibility going into the next recession.



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 continuing 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, 1994, there were outstanding issuances of $486 million with an annual lease-purchase requirement of $57 million.

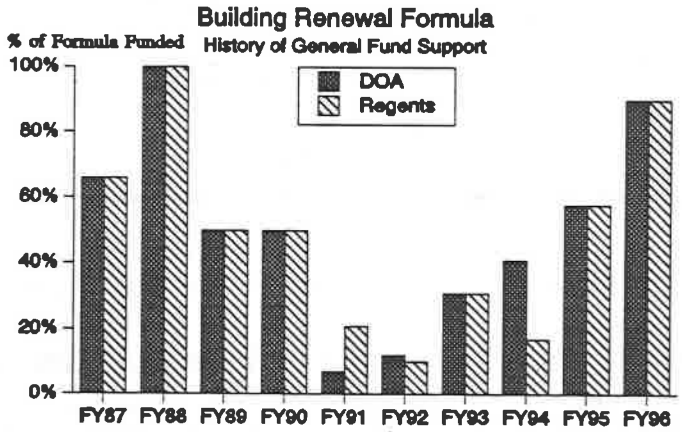
COP financing made sense in the late 1980's and early 1990's, due to our poor budgetary climate, record low interest rates, and the opportunity to take advantage of severely depressed building values and construction costs. Now, these factors are all receding, making pay-as-you-go the more attractive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

Accordingly, the JLBC Staff recommends $23 million of General Fund monies for prison projects including the construction of 900 new beds and a master plan for a new Phoenix-area complex. The JLBC Staff also recommends $16 million for the construction of a new State Laboratory and $2 million for the planning and design of a new State Hospital. The State Laboratory would combine the functions of the DHS and DPS laboratories.

Major Maintenance and Repair of State Buildings

Major maintenance and repair would be funded at 90% 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 100% 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."



DOA	66%	100	50%	50%	7%	12%	31%	41%	58%	90%
Reg	66%	100	50%	50%	21%	10%	31%	17%	58%	90%

Repayment of the Corrections Fund

The JLBC Staff recommendation includes a General Fund transfer of $39.4 million to the Corrections Fund to repay fund monies that have been used in the past for non-construction related expenditures. Without a General Fund transfer, the Corrections Fund would be in deficit by the end of FY 1996, and unable to meet continuing lease-purchase obligations in FY 1997 while providing necessary funds to build the next round of prison beds at a new prison complex. The following table details the use of Corrections Fund monies for non-construction expenditures.

Non-Construction Expenditures	
Operating Budgets FY 1985-92	$5,127,000
FY 1988 & FY 1989 General Appropriation Acts	
Drug Enforcement Activities	10,411,500
FY 1993 General Appropriation Act	
Operating Budget	15,581,700
FY 1994 General Appropriation Act	
Operating Budget	18,600,000
Subtotal	$49,720,200
General Fund Deposits to Corrections Fund	
Laws 1989, Chapter 5, 1st Special Session	
Construction and Operating	$(3,845,000)
Laws 1994, Chapter 2, 8th Special Session	
Construction Related	(6,440,800)
Subtotal	$(10,285,800)
Difference	$39,434,400

When this transfer is added to the anticipated Corrections Fund of revenue of $22 million for FY 1997, a total of $61 million will be available for lease-purchase payments and new construction projects in FY 1997. JLBC Staff estimates that required lease-purchase payments and other obligations will be $31 million, leaving some $30 million for new construction.

Eliminate the Use of the "Midnight Reversions" Accounting Technique

The JLBC Staff recommends ending the use of the "Midnight Reversion" accounting technique effective immediately (in FY 1995). At the end of each fiscal year, certain unobligated General Fund appropriations ("continuing appropriations," including any unspent amounts appropriated to the Legislature and legislative agencies) do not lapse and are available in the next fiscal year. In FY 1983, pursuant to statute, the state began to count these nonlapsing appropriations at the end of the fiscal year as part of the General Fund ending balance in spite of the fact that the monies continue to be appropriated and available for expenditure as of the first day of the new fiscal year. (They revert at midnight on June 30 and become available again the next day) This technique is not in accordance with Generally Accepted Accounting Principles (GAAP). Ending this practice would have a cost to the General Fund of $27.4 million.

Enhanced Oversight of Non-Appropriated Funds

In 1995, legislation will be introduced to control the number of state funds as well as the dollar level of "off-budget" spending, otherwise known as non-appropriated funds. The legislation is an outgrowth of the Legislature's belief that it should exercise greater oversight of non-appropriated funds. As required by Laws 1994, Chapter 366, the JLBC Staff has made its first annual recommendation to eliminate or consolidate at least 10% of the total number of funds, and convert at least 5% of non-appropriated fund expenditures to appropriated status.

For FY 1995, we have determined that there are 606 separate funds, and that non-appropriated resources constitute $4.18 billion, or 48%, of the state's overall spending authority. To reduce the number of funds and increase legislative oversight, the JLBC Staff is recommending to eliminate or consolidate 87, or 14%, of all state funds and to convert $336 million, or 8%, of fund expenditures to appropriated status.

Improved Legislative Oversight of Information Technology Purchases

The JLBC Staff recommends the introduction of legislation to create 1) a separate state agency responsible for statewide information technology planning, coordinating, and consulting and 2) a new, more powerful information technology authorization committee. The planning and consulting functions would be removed from the Department of Administration, which would retain responsibility for a centralized Data Center and telephone services to state agencies. The Information Technology Authorization Committee would consist of legislative, executive, and private sector representatives, and would approve centralized information technology standards and approve individual agency expenditures of over $100,000.

Currently, information technology management decisions in Arizona state government are made on an individual or shared agency basis with insufficient communication with executive and legislative leadership. There is a lack of effective coordination or central authority. The recommended changes are intended to improve oversight and statewide coordination for over $130 million spent annually on information technology for state government. Please refer to the January 1995 JLBC Staff report on information technology for more information.

Continuing Implementation of Budget Reform

State government will continue to implement the Arizona Budget Reform Act (Laws 1993, Chapter 252), which requires a number of major changes affecting the allocation of state government resources. Pursuant to this Act, all but 14 budget units will receive appropriations biennially with each year amount being itemized. This biennial budgeting provision will take affect statewide during the upcoming year. The JLBC Staff is recommending both FY 1996 and FY 1997 funding for 88 budget units.

As also required by this Act, the Governor's Office of Strategic Planning and Budgeting (OSPB) presents to the Joint Legislative Budget Committee (JLBC) a listing of the programs and subprograms that are performed or overseen by state government. This list and updates are subject to review and modification by the JLBC. The first list, which included over 1,200 programs and subprograms, was presented to the Legislature in February 1994.

In addition, agencies are required to develop strategic plans and evaluation criteria to evaluate the success or failure of each program in achieving its goals and objectives. Under the direction of OSPB, the Strategic Planning Advisory Committee, comprised of members representing all 3 branches of state government, developed the Managing for Results: Strategic Planning and Performance Measurement Handbook to aid agencies in developing their plans and performance measures. OSPB, in conjunction with the Governor's Office of Excellence in Government (OEG), provided strategic planning training to over 200 state employees from 85 agencies this past summer.

To ensure the continual evolution of budget reform, a Joint Subcommittee on Budget Reform and Program Authorization Review was formed to review and revise the Act where appropriate, such as formally defining the "program authorization review" (PAR) process. The PAR is a 4-year pilot project intended to link budgeting with program performance evaluation. **The subcommittee will be introducing legislation to establish the program authorization review of 75 programs over the next 4 years: 10 in FY 1995, 15 in FY 1996, 30 in FY 1997, and 20 in FY 1998.** Agencies, in conjunction with JLBC Staff, OSPB, and OEG, are developing performance measures that focus on program results and accountability. The strategic plans and performance measures that are currently being developed will provide key information in the decision-making process to either continue, modify or eliminate the programs being reviewed.

Other Budget Issues

State Employees

The state work force of appropriated FTE positions would grow by 586, or 1.5%, under the JLBC Staff recommendation. This growth is largely centered in the criminal justice agencies. Of the new positions, 523 will staff new prisons or help implement the Department of Youth Treatment and Rehabilitation judicial consent decree. When these FTE positions are excluded, statewide growth is 63 positions, or 0.2%.

Education

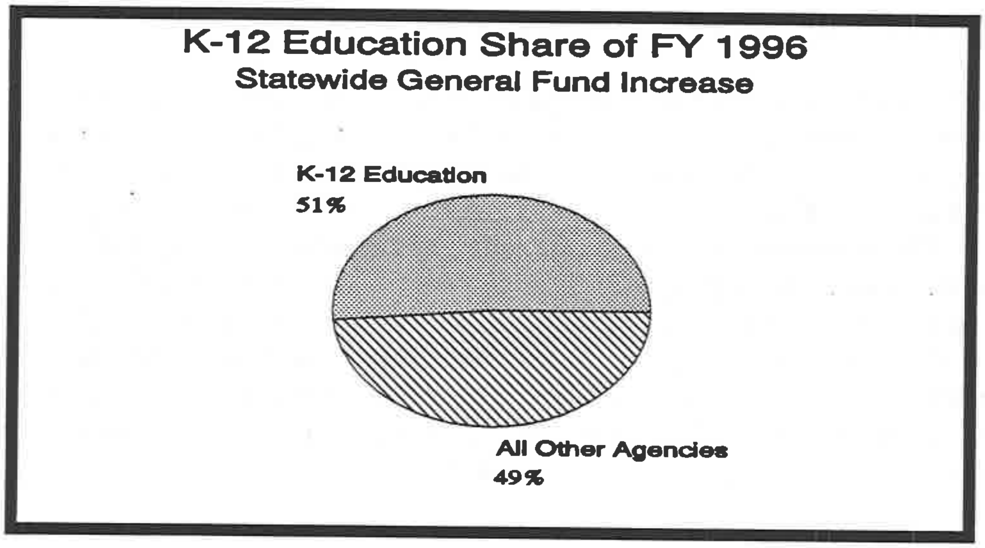
The JLBC Staff recommends $76.1 million in new K-12 funding—a 4.6% increase. The increase is associated with these key factors:

— $92.0 million for 3.5% elementary student growth and 4.8% high school growth,
— $19.4 million for the homeowner's rebate, and
— $7.7 million for Sudden Growth.

These factors are offset by:

— a $(27.7) million decrease resulting from 3.0% assessed valuation growth, and
— a $(14.5) million base adjustment from the FY 1995 appropriation, reflecting an anticipated surplus in the current fiscal year.

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 Fund spending declined, K-12's share of the budget is on the rise from a low of 37% in FY 1991. Under the JLBC Staff recommendation, that trend will continue, as K-12 will account for 40% of total General Fund spending in FY 1996. This occurs because K-12 accounts for 51% of all net new spending in the Staff recommendation.



The JLBC Staff recommends $16.6 million in new University funding, a 2.9% increase. The recommendation includes $8.2 million to annualize the April 2% pay adjustment, $5.5 million for student enrollment growth and $5.5 million for employee benefit and Risk Management charges.

In addition, the JLBC Staff recommends $23.2 million for university capital outlay, which includes $19.2 million for university building renewal and $4 million for construction of a joint use facility at NAU-Yuma/Arizona Western College (an additional $2 million would be appropriated in FY 1997).

The JLBC Staff recommends a $(1.8) million, or (1.9)% reduction in Community Colleges funding, mostly reflecting a decline in student enrollment. For FY 1996 formula computations, system-wide FTSE declined (1.6)%, as compared with an average FTSE increase of more than 6% over the most recent 5-year period.

Criminal Justice

The JLBC Staff recommends a total General Fund increase of $35 million, or 10.3% for the Department of Corrections budget. The recommendation includes $26.4 million to annualize the cost of 650 state-operated and 600 private prison beds opened in FY 1995, to open 868 state-operated and 400 private prison beds in FY 1996, and to cover costs associated with the increase in the prison population.

The JLBC Staff recommendation would reduce the current 1,368 bed shortfall to 976 by the end of FY 1996. The projected bed deficit at the end of FY 1995 is 1,044. The inmate population is projected to increase by 100 inmates per month in FY 1996. As noted above, a total of 868 new state-run and 400 privately-operated beds are recommended for opening in FY 1996. Given the projected increase in the prison population, bed deficits would range from a high of 1,744 to a low of 876 in FY 1996.

The JLBC Staff's capital recommendation includes funding to construct 900 new state-run prison beds. Of the 900 beds, 400 beds could be opened in FY 1997. The remaining 500 would not open until FY 1998. A total of 500 previously authorized beds are also anticipated to open in FY 1997.

The JLBC Staff recommends $7.1 million to add to DYTR's secure-care, residential, and support capacity, and a FY 1995 supplemental of $2.2 million. The FY 1996 amount includes $2.2 million to annualize the expenses of a new boot camp (24 secure beds and 72 aftercare slots), $2.3 million for 51 additional residential treatment beds, and $300,000 for 83 non-residential community support slots.

The JLBC Staff supplements its criminal justice institutional resources by adding $4.3 million for 1,685 state-funded new probation slots. Another 955 county-funded slots are also recommended, for a total of 2,640 slots. Any analysis of proposed criminal justice resources should encompass both the prison beds and community placement of the Department of Corrections and Youth Treatment and Rehabilitation as well as the probation slots funded through the Judiciary budget.

The 2,640 new slots include 1,465 for adults and 1,175 for juveniles.

Transportation/Public Safety

The JLBC Staff recommends reductions in the ADOT operating and capital budgets to generate additional highway construction resources. The JLBC Staff recommendation provides $107 million from the State Highway Fund for statewide highway construction, which is $30 million more than the FY 1995 estimate. The JLBC Staff has recommended an operating budget reduction of $14 million and 160 FTE positions. In addition, non-highway capital construction is being reduced from $8 million to $4 million.

The JLBC Staff recommends freezing the mandated decline in HURF/Highway Funds for the Department of Public Safety. Under A.R.S. § 28-1598, the amount available for department use from each of these funds is scheduled to decrease in FY 1996 by $2.5 million, to a level of $17.5 million per fund. This would result in a total General Fund increase of $5 million. However, the JLBC Staff recommends enacting permissive legislation to maintain funding at the current FY 1995 level of $20 million for each fund. The use of these funds to offset department operating costs is constitutionally permissible as one of the functions of HURF/Highway Fund monies is to provide for expenses associated with state enforcement of traffic laws. Use of these funds by the department will also not decrease overall funding for state construction of highways. As noted above, reductions in the Arizona Department of Transportation's (ADOT) operating and capital outlay budgets should increase funds available for highway construction to an amount $30 million above FY 1995 spending levels.

Health and Welfare

The JLBC Staff recommends a cautious approach to caseload growth to avoid FY 1996 supplementals. Although there are several client population areas which have shown growth below the expected trend, the JLBC Staff has studied each very carefully before recommending reductions in funding. This approach, combined with a cautious revenue forecast should continue to mitigate or eliminate any supplementals for FY 1996.

For the Department of Economic Security, this approach includes 2.7% caseload growth for AFDC, 3.4% caseload growth for General Assistance, and 4% Long Term Care caseload growth for FY 1996.

While growth in the AFDC population has grown at less than 0.5% in FY 1995, the JLBC Staff recommends funding 2.7% caseload growth, which is equal to projected overall population growth in FY 1996.

For the Department of Health Services, the JLBC Staff maintains current funding for Title 19 Seriously Mentally Ill and Children's Behavioral Health Services, even though the Executive has included a $3.4 million demographic reduction in these areas. Due to the fact that there are new capitation rates, the JLBC Staff believes it is more prudent to go with level funding.

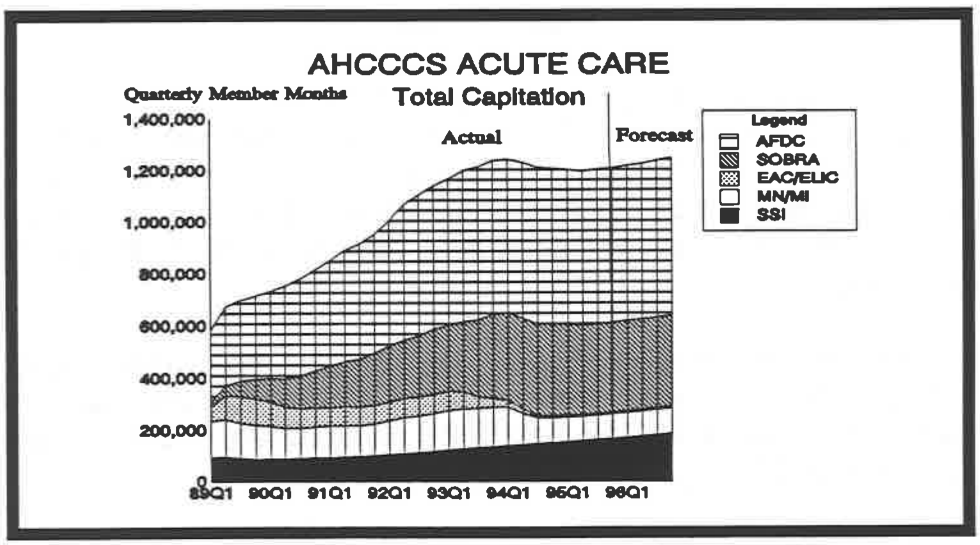
For the Arizona Health Care Cost Containment System (AHCCCS), the JLBC Staff has included an increase of 10,300 new member years, or 2.6% growth over the revised FY 1995 base. While, for the first time since AHCCCS began, there has been a slight decline in total clients in the current year, there are still many factors which will reverse this temporary trend. Again our forecast is a more cautious approach to forecasting the growth in population and costs of the various AHCCCS programs.

The JLBC Staff recommends an overall $7.7 million reduction in the original FY 1995 AHCCCS budget. For the first time since the creation of AHCCCS, the staff recommends a decrease in the General Fund portion of its budget. The JLBC Staff currently estimates that AHCCCS will revert $28.8 million at the end of FY 1995. This is due primarily to 3 factors: 1) greater than expected savings from providing only emergency services to undocumented aliens; 2) lower than expected population growth; and 3) substantially lower than expected capitation rates due to a significant increase in health plan bid competition.

After adjusting the FY 1995 appropriation down to the projection of actual expenditures, the JLBC Staff recommendation is actually an increase of $21.1 million over the revised base level. A further major factor in reducing the cost of AHCCCS is the elimination of Deferred Liability at savings over the FY 1995 appropriation of $19 million. Deferred liability was a separate program to make supplemental payments to health plans for extraordinary costs not included in the capitation rates (typically for members that are hospitalized on the effective date of enrollment). Deferred Liability was eliminated as a simplification measure due to the effective negotiation of AHCCCS and the increased health plan competition.

The JLBC Staff recommends freezing all Acute Care discounts and non-General Fund state match contributions at the current FY 1995 level. The recommendation would:

- continue the hospital reimbursement reduction on state-only program bills of $10 million;
- freeze the Quick Pay discount at the current discount levels rather that continuing the phase-out of this discount;
- maintain the county acute care contribution at a fixed level of $74.1 million; for the past 2 years the county acute care contribution was set at 29.5% of the state portion of both Acute Care and Arizona Long-Term Care System (ALTCS) less the county contribution for the ALTCS program. The JLBC Staff recommendation decouples the ALTCS and Acute Care programs so that any increases or decreases in one no longer affects the other unrelated program. The county acute care contribution would be maintained at the current year level of $74 million.
- continue to deduct $5 million from the AHCCCS budget from the recovery of third party liability funding.



The JLBC Staff recommends a $1.4 million reduction in the Department of Health Services budget. The recommendation maintains current level funding for seriously mentally ill and children's behavioral health programs, while providing a $1.3 million increase for substance abuse services. Savings of $1 million result from refinancing existing state-only mental health clients through implementation of the federal Title 19 program for adults between 21 and 65 years of age. The Staff also recommends a moratorium on new disease control research grants for first year savings of $1 million, and financing 1 Poison Control Center through the EMS Operating Fund for General Fund savings of nearly $1 million.

The JLBC Staff recommends several changes which would help the Arizona State Hospital (ASH) reduce its census and place patients in more suitable community settings. A growing consensus exists that many of the patients currently at ASH would benefit from more appropriate community settings which may be less costly to the state. The Staff recommendation addresses the problems which have prevented ASH from effectively placing these individuals in the community. The recommendation includes an increase in Clozapine funding of $770,000, funding for the development of community providers, the ability for resources to follow the client to the community, and greater direct control by ASH of community placement resources.

The JLBC Staff recommends an additional $6.1 million for the Department of Economic Security. One key JLBC Staff recommendation provides $3.7 million for improved quality of services and accountability through automation upgrades and new system development.

The remaining recommendation focuses on services for caseload growth for Long-Term Care and additional money for Children's Services, Child Care subsidies, and Vocational Rehabilitation and Employment Support Services. The JLBC Staff recommendation provides no inflation funding for AFDC benefits, and incorporates the FY 1995 surplus in the AFDC and General Assistance programs.

Other Issues

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 during FY 1996. This recommendation was first approved for FY 1995 but has not yet been implemented. With a budget of $3.8 million and 82 FTE positions, SAMHC currently competes with private nonprofit organizations in Pima County for the provision of mental health services.

For the Department of Transportation, the JLBC Staff recommends a 10% reduction in the number of FTE positions in the right-of-way, roadway engineering, and bridge groups, and the use of 90% of the dollar reduction to privatize these functions. This recommendation will result in savings of 25 FTE positions and $107,800.

OVERVIEW OF JLBC STAFF RECOMMENDED FY 1997 BUDGETS FOR 88 BUDGET UNITS

First-Ever Biennial Budgets Proposed Pursuant to Budget Reform Act of 1993

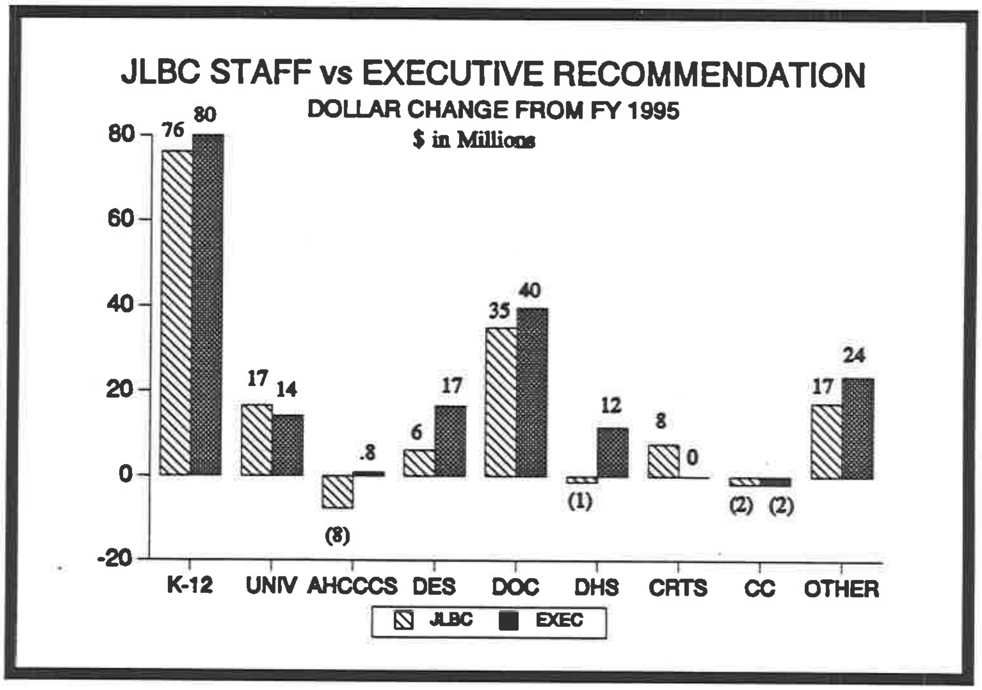
Chapter 252, Laws of 1993, the "Budget Reform Act of 1993" provided that effective with the 42nd Legislature, all but 14 "major budget units" (MBU's) would receive two years of appropriations, with each year appropriated separately. Accordingly, both the Executive and JLBC Staff proposed budgets include a recommended appropriation for FY 1997. The 14 MBU's that continue to receive annual appropriations, one year at a time, account for some 94% of the General Fund total. Therefore, the JLBC Staff does not have to present a comprehensive and balanced budget for FY 1997.

As is typical in the 18 states that use biennial budgeting, the second year appropriation typically does not contain funding for new programs nor program expansions (policy issues). Such is the case with our recommendations. The JLBC Staff recommended General Fund appropriations for FY 1997 total $247.3 million for 55 budget units that receive a General Fund appropriation. This represents a $(71,400) decrease from FY 1996. The remaining 33 budget units receive non-General Fund appropriations ("Other Funds") where the recommended total of $97.4 million represents a $(328,900) decrease from FY 1996.

TABLES AND GRAPHS

TEN LARGEST GENERAL FUND AGENCIES
FY 1996 JLBC STAFF RECOMMENDATION
COMPARISON WITH EXECUTIVE RECOMMENDATION AND FY 1995 APPROPRIATIONS

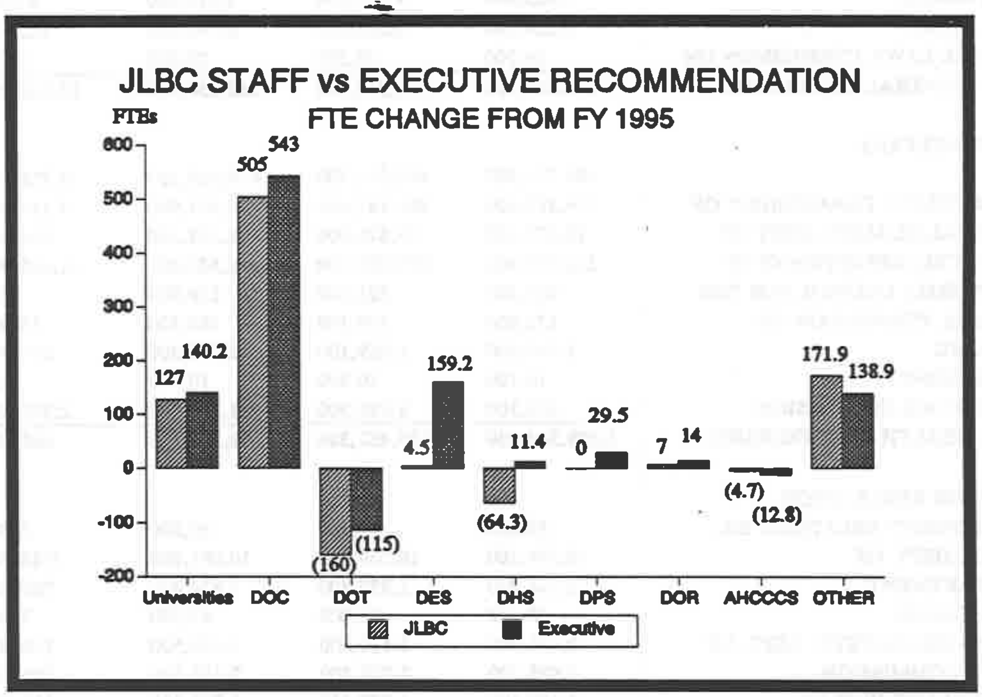
AGENCY	FY 1995 Appropriation	FY 1996 Executive Recommendation	FY 1996 JLBC Staff Recommendation	$ Difference JLBC - Executive	$ Difference JLBC - FY 1995
K-12	1,655,753,900	1,735,627,800	1,731,828,000	(3,799,800)	76,074,100
UNIVERSITIES	581,065,600	595,227,400	597,654,400	2,427,000	16,588,800
AHCCCS	486,731,300	487,510,700	479,006,200	(8,504,500)	(7,725,100)
DEPT OF ECONOMIC SECURITY	379,312,600	395,847,400	385,471,900	(10,375,500)	6,159,300
DEPT OF CORRECTIONS	338,779,800	378,515,800	373,825,500	(4,690,300)	35,045,700
DEPT OF HEALTH SERVICES	218,018,800	229,593,100	216,583,000	(13,010,100)	(1,435,800)
JUDICIARY	95,986,300	95,986,300	103,688,000	7,701,700	7,701,700
COMMUNITY COLLEGES	98,045,700	96,235,300	96,216,500	(18,800)	(1,829,200)
DEPT OF PUBLIC SAFETY	37,653,500	43,347,700	43,776,600	428,900	6,123,100
DEPT OF YOUTH TREATMENT	35,195,800	39,609,700	42,315,900	2,706,200	7,120,100
ALL OTHER	282,755,000	296,254,800	286,808,500	(9,446,300)	4,053,500
TOTAL	4,209,298,300	4,393,756,000	4,357,174,500	(36,581,500)	147,876,200



FULL-TIME EQUIVALENT POSITIONS - TOTAL APPROPRIATED FUNDS
TEN LARGEST AGENCIES
FY 1996 JLBC STAFF RECOMMENDATION
COMPARISON WITH EXECUTIVE RECOMMENDATION AND FY 1995 FTE POSITIONS

AGENCY	FY 1995 Estimate	FY 1996 Executive Recommend. 1/	FY 1996 JLBC Staff Recommend.	# Difference JLBC - Executive	# Difference JLBC - FY 1995
UNIVERSITIES	13,871.6	14,011.8	13,998.6	(13.2)	127.0
DEPT OF CORRECTIONS	7,313.4	7,856.4	7,818.4	(38.0)	505.0
DEPT OF TRANSPORTATION	3,153.0	3,038.0	2,993.0	(45.0)	(160.0)
DEPT OF ECONOMIC SECURITY	2,682.6	2,841.8	2,687.1	(154.7)	4.5
DEPT OF HEALTH SERVICES	1,678.5	1,689.9	1,614.2	(75.7)	(64.3)
DEPARTMENT OF PUBLIC SAFETY	1,582.0	1,611.5	1,582.0	(29.5)	0.0
DEPT OF REVENUE	1,232.0	1,246.0	1,239.0	(7.0)	7.0
AHCCCS	1,065.1	1,052.3	1,060.4	8.1	(4.7)
DEPT OF ADMINISTRATION	917.0	918.1	927.0	8.9	10.0
DEPT OF YOUTH TRTMENT & REHAB	706.0	723.0	724.0	1.0	18.0
ALL OTHER	5,859.5	5,980.3	6,003.4	23.1	143.9
TOTAL	40,060.7	40,969.1	40,647.1	(322.0)	586.4

1/ Executive recommendation has been adjusted for comparability with the JLBC Staff recommendation.



FY 1996 GENERAL FUND SUMMARY
By Function of Government

	FY 1995 ESTIMATE	FY 1996 EXEC REC.	FY 1996 JLBC REC.	JLBC REC.- FY 1995	JLBC REC. - EXEC REC.
GENERAL GOVERNMENT					
ADMINISTRATION, DEPARTMENT OF	25,426,400	26,274,900	26,040,500	614,100	(234,400)
ATTORNEY GENERAL	21,558,600	21,577,200	22,008,100	449,500	430,900
COMMERCE, DEPARTMENT OF	7,181,700	10,448,800	6,689,500	(492,200)	(3,759,300)
CONSTITUTIONAL DEFENSE COUNCIL	1,000,000	0	500,000	(500,000)	500,000
EQUAL OPPORTUNITY, GOVERNOR'S OFC OF	235,400	238,200	238,100	2,700	(100)
EQUALIZATION, STATE BOARD OF	0	51,200	0	0	(51,200)
GOVERNOR, OFFICE OF THE	5,897,200	6,058,600	6,059,200	162,000	600
GOVERNOR - OSPB	1,460,000	1,699,500	1,699,500	239,500	0
JUDICIARY					
Court of Appeals	8,491,700	8,491,700	8,900,400	408,700	408,700
Comm on Appellate and Trial Court Appts	10,000	10,000	10,000	0	0
Commission on Judicial Conduct	208,700	208,700	210,200	1,500	1,500
Superior Court	76,006,300	76,006,300	82,781,400	6,775,100	6,775,100
Supreme Court	11,269,600	11,269,600	11,786,000	516,400	516,400
TOTAL	95,986,300	95,986,300	103,688,000	7,701,700	7,701,700
LAW ENFORCEMENT MERIT SYS COUNCIL	41,800	47,200	46,400	4,600	(800)
LEGISLATURE					
Auditor General	8,588,300	8,880,000	9,343,300	755,000	463,300
House of Representatives	7,668,400	7,668,400	7,763,100	94,700	94,700
Joint Legislative Budget Committee	3,009,600	1,999,900	1,999,900	(1,009,700)	0
Legislative Council	3,078,700	3,855,000	3,797,200	718,500	(57,800)
Library, Archives & Public Records	5,047,900	5,047,900	5,113,600	65,700	65,700
Senate	5,865,600	5,923,200	5,969,600	104,000	46,400
TOTAL	33,258,500	33,374,400	33,986,700	728,200	612,300
PERSONNEL BOARD	295,100	316,100	306,000	10,900	(10,100)
REVENUE, DEPARTMENT OF	48,717,000	50,570,800	50,072,800	1,355,800	(498,000)
SECRETARY OF STATE	3,741,900	5,570,000	5,453,100	1,711,200	(116,900)
TAX APPEALS, BOARD OF	745,300	829,900	764,000	18,700	(65,900)
TOURISM, OFFICE OF	7,425,800	9,476,100	7,513,000	87,200	(1,963,100)
TREASURER, STATE	3,624,200	3,682,600	3,746,500	122,300	63,900
UNIFORM STATE LAWS, COMMISSION ON	24,300	28,200	27,000	2,700	(1,200)
TOTAL - GENERAL GOVERNMENT	**256,619,500**	**266,230,000**	**268,838,400**	**12,218,900**	**2,608,400**
HEALTH AND WELFARE					
AHCCCS	486,731,300	487,510,700	479,006,200	(7,725,100)	(8,504,500)
ECONOMIC SECURITY, DEPARTMENT OF	379,312,600	395,847,400	385,471,900	6,159,300	(10,375,500)
ENVIRONMENTAL QUALITY, DEPT OF	12,377,400	13,876,000	13,352,300	974,900	(523,700)
HEALTH SERVICES, DEPARTMENT OF	218,018,800	229,593,100	216,583,000	(1,435,800)	(13,010,100)
HEARING IMPAIRED, COUNCIL FOR THE	219,700	223,100	219,500	(200)	(3,600)
INDIAN AFFAIRS, COMMISSION OF	171,800	179,100	184,800	13,000	5,700
PIONEERS' HOME	1,840,000	1,889,100	2,014,300	174,300	125,200
RANGERS' PENSIONS	10,100	10,300	10,300	200	0
VETERANS' SERVICE COMMISSION	862,300	3,323,500	3,363,800	2,501,500	40,300
TOTAL - HEALTH AND WELFARE	**1,099,544,000**	**1,132,452,300**	**1,100,206,100**	**662,100**	**(32,246,200)**
INSPECTION AND REGULATION					
AGRIC. EMPLOYMENT RELATIONS BD.	58,800	60,900	60,800	2,000	(100)
AGRICULTURE, DEPT. OF	10,276,100	10,089,900	10,091,200	(184,900)	1,300
BANKING DEPARTMENT	2,558,700	2,957,400	2,824,400	265,700	(133,000)
BOXING COMMISSION	63,400	67,000	67,000	3,600	0
BUILDING AND FIRE SAFETY, DEPT. OF	2,982,900	3,110,500	3,112,500	129,600	2,000
CORPORATION COMMISSION	4,985,700	5,290,800	5,211,500	225,800	(79,300)
INSURANCE, DEPARTMENT OF	4,450,100	4,770,400	4,702,300	252,200	(68,100)

FY 1996 GENERAL FUND SUMMARY
By Function of Government

	FY 1995 ESTIMATE	FY 1996 EXEC REC.	FY 1996 JLBC REC.	JLBC REC.- FY 1995	JLBC REC. - EXEC REC.
LIQUOR LICENSES AND CONTROL, DEPT.	2,055,700	2,111,300	2,685,200	629,500	573,900
MINE INSPECTOR	843,700	737,500	766,300	(77,400)	28,800
OSHA REVIEW BOARD	9,000	9,000	9,000	0	0
RACING, DEPARTMENT OF	2,522,200	2,643,400	2,622,400	100,200	(21,000)
RADIATION REGULATORY AGENCY	1,016,100	1,068,700	1,071,700	55,600	3,000
REAL ESTATE DEPARTMENT	2,922,000	2,896,400	2,895,700	(26,300)	(700)
WEIGHTS AND MEASURES, DEPT. OF	1,429,300	1,508,200	1,761,400	332,100	253,200
TOTAL - INSPECTION & REGULATION	36,173,700	37,321,400	37,881,400	1,707,700	560,000
EDUCATION					
ARTS, COMMISSION ON THE	1,492,600	1,907,300	1,507,300	14,700	(400,000)
COMMUNITY COLLEGES	98,045,700	96,235,300	96,216,500	(1,829,200)	(18,800)
DEAF AND THE BLIND, SCHOOL FOR THE	16,168,800	16,317,700	16,658,500	489,700	340,800
EDUCATION, DEPARTMENT OF	1,655,753,900	1,735,627,800	1,731,828,000	76,074,100	(3,799,800)
HISTORICAL SOCIETY, ARIZONA	3,639,200	3,701,100	3,991,300	352,100	290,200
HISTORICAL SOCIETY, PRESCOTT	566,900	574,800	604,900	38,000	30,100
MEDICAL STUDENT LOANS BOARD	114,600	148,900	113,900	(700)	(35,000)
POSTSECONDARY EDUCATION, COMM. FOR	0	1,234,000	1,234,000	1,234,000	0
UNIVERSITIES					
Arizona State University - Main	198,293,900	202,886,500	206,385,400	8,091,500	3,498,900
Arizona State University - East	2,122,600	2,027,000	1,434,900	(687,700)	(592,100)
Arizona State University - West	32,235,700	32,854,600	32,747,600	511,900	(107,000)
Northern Arizona University	81,583,400	84,540,200	84,775,700	3,192,300	235,500
Board of Regents	7,463,400	7,773,100	5,628,600	(1,834,800)	(2,144,500)
University of Arizona - Main	214,823,400	219,517,400	221,268,600	6,445,200	1,751,200
University of Arizona - Health Sciences Center	44,543,200	45,628,600	45,413,600	870,400	(215,000)
TOTAL	581,065,600	595,227,400	597,654,400	16,588,800	2,427,000
TOTAL - EDUCATION	2,356,847,300	2,450,974,300	2,449,808,800	92,961,500	(1,165,500)
PROTECTION AND SAFETY					
CORRECTIONS, DEPARTMENT OF	338,779,800	378,515,800	373,825,500	35,045,700	(4,690,300)
CRIMINAL JUSTICE COMMISSION, ARIZONA	7,100,000	5,350,000	1,100,000	(6,000,000)	(4,250,000)
EMRG. & MILITARY AFFAIRS, DEPT. OF	4,738,600	4,891,700	4,417,600	(321,000)	(474,100)
EXECUTIVE CLEMENCY, BOARD OF	1,766,200	1,723,700	1,729,200	(37,000)	5,500
PUBLIC SAFETY, DEPARTMENT OF	37,653,500	43,347,700	43,776,600	6,123,100	428,900
YOUTH TREATMENT REHAB., DEPT OF	35,195,800	39,609,700	42,315,900	7,120,100	2,706,200
TOTAL - PROTECTION AND SAFETY	425,233,900	473,438,600	467,164,800	41,930,900	(6,273,800)
TRANSPORTATION					
TRANSPORTATION, DEPARTMENT OF	75,500	73,500	74,300	(1,200)	800
NATURAL RESOURCES					
ENVIRONMENT, COMMISSION ON THE AZ	101,200	111,800	105,200	4,000	(6,600)
GEOLOGICAL SURVEY, ARIZONA	625,900	760,100	750,600	124,700	(9,500)
LAND DEPARTMENT	10,223,000	11,416,900	11,327,500	1,104,500	(89,400)
MINES & MINERAL RESOURCES, DEPT.OF	660,300	683,500	685,700	25,400	2,200
NAVIGABLE STREAM ADJUDICATION COMM.,	120,400	113,000	115,300	(5,100)	2,300
PARKS BOARD	6,534,800	6,406,700	6,430,000	(104,800)	23,300
WATER RESOURCES, DEPARTMENT OF	16,538,800	13,773,900	13,786,400	(2,752,400)	12,500
TOTAL - NATURAL RESOURCES	34,804,400	33,265,900	33,200,700	(1,603,700)	(65,200)
OPERATING BUDGET TOTAL*	4,209,298,300	4,393,756,000	4,357,174,500	147,876,200	(36,581,500)

* FY 1995 does not include one-time appropriations of $53,500,000 for K-12 Rollover repayment, $5,050,000 for flood relief, $423,000 for impeachment expenses, $75,000 for county gang prevention, and $480,100 for unallocated adjustments. Also includes upward adjustment of $27,600 for Tourism Fund.

FY 1996 OTHER APPROPRIATED FUNDS SUMMARY
By Function of Government

	FY 1995 ESTIMATE	FY 1996 EXEC REC.	FY 1996 JLBC REC.	JLBC REC.- FY 1995	JLBC REC.- EXEC REC.
GENERAL GOVERNMENT					
ADMINISTRATION, DEPARTMENT OF	88,059,200	99,210,200	99,000,100	10,940,900	(210,100)
ATTORNEY GENERAL	3,716,600	3,710,500	2,384,500	(1,332,100)	(1,326,000)
COLISEUM AND EXPOSITION CENTER	14,484,000	14,510,200	14,510,200	26,200	0
COMMERCE, DEPARTMENT OF	4,117,900	3,215,300	3,202,100	(915,800)	(13,200)
GOVERNOR, OFFICE OF THE	0	500,000	500,000	500,000	0
LEGISLATURE - AUDITOR GENERAL	80,000	0	0	(80,000)	0
SUPREME COURT	1,125,000	1,125,000	1,624,500	499,500	499,500
LOTTERY, ARIZONA	46,350,800	56,315,500	48,336,200	1,985,400	(7,979,300)
RETIREMENT SYSTEM	3,451,200	3,634,400	3,647,900	196,700	13,500
TOTAL - GENERAL GOVERNMENT	161,384,700	182,221,100	173,205,500	11,820,800	(9,015,600)
HEALTH AND WELFARE					
ECONOMIC SECURITY, DEPARTMENT OF	698,700	414,700	414,700	(284,000)	0
ENVIRONMENTAL QUALITY, DEPT	11,589,900	14,841,700	14,908,800	3,318,900	67,100
HEALTH SERVICES, DEPARTMENT OF	16,129,800	17,708,900	16,863,800	734,000	(845,100)
PIONEERS' HOME, ARIZONA	1,235,900	1,264,100	1,180,800	(55,100)	(83,300)
VETERANS' SERVICE COMMISSION	441,100	514,900	514,900	73,800	0
TOTAL - HEALTH AND WELFARE	30,095,400	34,744,300	33,883,000	3,787,600	(861,300)
INSPECTION AND REGULATION					
AGRICULTURE, DEPT. OF	1,738,900	1,730,700	1,735,000	(3,900)	4,300
CONTRACTORS, REGISTRAR OF	4,959,000	5,124,600	5,345,700	386,700	221,100
CORPORATION COMMISSION	5,919,100	6,114,800	6,070,500	151,400	(44,300)
INDUSTRIAL COMMISSION	14,721,500	12,762,000	12,796,500	(1,925,000)	34,500
RACING, DEPARTMENT OF	1,599,200	3,363,200	2,824,000	1,224,800	(539,200)
RADIATION REGULATORY AGENCY	102,500	103,600	105,200	2,700	1,600
RESIDENTIAL UTILITY CONSUMER OFFICE	975,300	1,001,500	977,100	1,800	(24,400)
WEIGHTS AND MEASURES, DEPT. OF	789,900	805,400	546,500	(243,400)	(258,900)
ACCOUNTANCY, BOARD OF	1,063,000	1,028,600	1,019,300	(43,700)	(9,300)
APPRAISAL, BOARD OF	256,600	250,700	249,600	(7,000)	(1,100)
BARBERS, BOARD OF	145,300	149,800	149,400	4,100	(400)
BEHAVIORAL HEALTH EXAMINERS, BD OF	359,600	341,000	341,400	(18,200)	400
CHIROPRACTIC EXAMINERS, BOARD OF	237,900	263,900	260,300	22,400	(3,600)
COSMETOLOGY, BOARD OF	636,900	813,700	636,500	(400)	(177,200)
DENTAL EXAMINERS, BOARD OF	591,700	588,500	597,600	5,900	9,100
FUNERAL DIRECTORS & EMBALMERS, BD	179,600	171,600	171,600	(8,000)	0
HOMEOPATHIC EXAMINERS, BOARD OF	30,000	29,200	29,300	(700)	100
MEDICAL EXAMINERS, BOARD OF	2,844,400	2,894,700	2,903,800	59,400	9,100
NATUROPATHIC PHYSICIANS BOARD	57,200	66,600	66,800	9,600	200
NURSING, BOARD OF	1,128,300	1,243,000	1,419,300	291,000	176,300
NURSING CARE INSTITUTIONAL ADMIN. BD.	66,100	79,000	77,800	11,700	(1,200)
OCCUPATIONAL THERAPY EXAM., BD OF	100,700	95,900	95,600	(5,100)	(300)
OPTICIANS, BOARD OF DISPENSING	72,100	67,200	67,200	(4,900)	0
OPTOMETRY, BOARD OF	100,900	107,900	108,000	7,100	100
OSTEOPATHIC EXAMINERS, BOARD OF	322,700	312,500	305,000	(17,700)	(7,500)
PHARMACY, BOARD OF	649,700	731,500	731,500	81,800	0
PHYSICAL THERAPY EXAMINERS, BOARD	78,000	90,700	91,100	13,100	400
PODIATRY EXAMINERS, BOARD OF	53,800	56,700	57,800	4,000	1,100
PRIVATE POSTSECONDARY EDUCATION	134,500	135,000	146,800	12,300	11,800
PSYCHOLOGIST EXAMINERS, BOARD OF	223,500	207,900	224,100	600	16,200
RESPIRATORY CARE EXAMINERS BOARD	137,800	144,000	165,400	27,600	21,400
STRUCTURAL PEST CONTROL COMM	1,052,700	1,241,700	1,191,900	139,200	(49,800)

FY 1996 OTHER APPROPRIATED FUNDS SUMMARY
By Function of Government

	FY 1995 ESTIMATE	FY 1996 EXEC REC.	FY 1996 JLBC REC.	JLBC REC.- FY 1995	JLBC REC.- EXEC REC.
TECHNICAL REGISTRATION, BOARD OF	858,700	879,500	871,900	13,200	(7,600)
VETERINARY MED EXAMINING BOARD	188,800	190,800	189,600	800	(1,200)
TOTAL - INSPECTION & REGULATION	42,375,900	43,187,400	42,569,100	193,200	(618,300)
EDUCATION					
COMMUNITY COLLEGES	136,900	139,500	139,500	2,600	0
DEAF AND THE BLIND, SCHOOL FOR THE	5,274,500	5,234,000	5,350,500	76,000	116,500
POSTSECONDARY EDUCATION, COMM. FOR	0	273,500	2,981,900	2,981,900	2,708,400
UNIVERSITIES					
Arizona State University - Main	66,418,800	67,884,800	67,884,800	1,466,000	0
Arizona State University - East	0	109,800	109,800	109,800	0
Arizona State University - West	5,304,500	5,469,400	5,469,400	164,900	0
Northern Arizona University	22,445,900	23,264,200	23,264,200	818,300	0
University of Arizona - Main	62,331,700	61,665,600	60,358,900	(1,972,800)	(1,306,700)
University of Arizona - Health Sci Ctr	3,860,300	4,836,500	4,836,500	976,200	0
TOTAL	160,361,200	163,230,300	161,923,600	1,562,400	(1,306,700)
TOTAL - EDUCATION	165,772,600	168,877,300	170,395,500	4,622,900	1,518,200
PROTECTION AND SAFETY					
CORRECTIONS, DEPARTMENT OF	14,799,200	26,399,800	26,399,800	11,600,600	0
CRIMINAL JUSTICE COMMISSION, ARIZONA	538,000	576,100	553,100	15,100	(23,000)
EMRG. & MILITARY AFFAIRS, DEPT. OF	63,900	52,600	52,600	(11,300)	0
PUBLIC SAFETY, DEPARTMENT OF	48,800,000	48,581,100	48,162,000	(638,000)	(419,100)
YOUTH TREATMENT REHAB., DEPT OF	2,952,300	3,652,800	1,978,300	(974,000)	(1,674,500)
TOTAL - PROTECTION AND SAFETY	67,153,400	79,262,400	77,145,800	9,992,400	(2,116,600)
TRANSPORTATION					
TRANSPORTATION, DEPARTMENT OF	196,823,200	197,151,900	182,841,000	(13,982,200)	(14,310,900)
NATURAL RESOURCES					
GAME AND FISH DEPARTMENT	17,340,800	17,582,200	17,862,600	521,800	280,400
PARKS BOARD	2,242,400	2,454,500	2,454,600	212,200	100
TOTAL - NATURAL RESOURCES	19,583,200	20,036,700	20,317,200	734,000	280,500
OPERATING BUDGET TOTAL*	683,188,400	725,481,100	700,357,100	17,168,700	(25,124,000)

* Original FY 1995 appropriations totalled $672,847,200. These amounts have been adjusted for a variety of factors including carry forward balances.

FY 1997 GENERAL FUND SUMMARY
By Function of Government

	FY 1996 JLBC REC.	FY 1997 EXEC REC.	FY 1997 JLBC REC.	JLBC REC.- FY 1996	JLBC REC.- EXEC REC.
GENERAL GOVERNMENT					
ATTORNEY GENERAL	22,008,100	21,585,600	22,008,100	0	422,500
COMMERCE, DEPARTMENT OF	6,689,500	10,340,200	6,750,500	61,000	(3,589,700)
CONSTITUTIONAL DEFENSE COUNCIL	500,000	0	1,000,000	500,000	1,000,000
EQUAL OPPORTUNITY, GOVERNOR'S OFC OF	238,100	238,200	238,100	0	(100)
EQUALIZATION, STATE BOARD OF	0	290,900	96,700	96,700	(194,200)
GOVERNOR, OFFICE OF THE	6,059,200	6,058,600	6,059,200	0	600
GOVERNOR - OSPB	1,699,500	1,699,500	1,699,500	0	0
LAW ENFORCEMENT MERIT SYS COUNCIL	46,400	48,200	47,400	1,000	(800)
LEGISLATURE					
Auditor General	9,343,300	8,822,800	9,328,900	(14,400)	506,100
House of Representatives	7,763,100	7,975,100	7,975,100	212,000	0
Joint Legislative Budget Committee	1,999,900	2,040,000	2,040,000	40,100	0
Legislative Council	3,797,200	3,216,500	3,124,300	(672,900)	(92,200)
Library, Archives & Public Records	5,113,600	5,047,900	5,053,200	(60,400)	5,300
Senate	5,969,600	5,923,200	5,969,600	0	46,400
TOTAL	33,986,700	33,025,500	33,491,100	(495,600)	465,600
PERSONNEL BOARD	306,000	331,500	308,400	2,400	(23,100)
REVENUE, DEPARTMENT OF	50,072,800	50,860,800	50,581,600	508,800	(279,200)
SECRETARY OF STATE	5,453,100	3,954,800	3,958,900	(1,494,200)	4,100
TAX APPEALS, BOARD OF	764,000	884,500	999,700	235,700	115,200
TOURISM, OFFICE OF	7,513,000	9,019,900	7,760,500	247,500	(1,259,400)
TREASURER, STATE	3,746,500	3,756,000	3,793,800	47,300	37,800
UNIFORM STATE LAWS, COMMISSION ON	27,000	29,200	28,600	1,600	(600)
TOTAL - GENERAL GOVERNMENT	139,109,900	142,123,400	138,822,100	(287,800)	(3,301,300)
HEALTH AND WELFARE					
HEARING IMPAIRED, COUNCIL FOR THE	219,500	223,100	219,500	0	(3,600)
INDIAN AFFAIRS, COMMISSION OF	184,800	178,700	180,300	(4,500)	1,600
PIONEERS' HOME	2,014,300	1,889,100	2,014,300	0	125,200
RANGERS' PENSIONS	10,300	10,500	10,500	200	0
VETERANS' SERVICE COMMISSION*	3,363,800	892,900	0	(3,363,800)	(892,900)
TOTAL - HEALTH AND WELFARE	5,792,700	3,194,300	2,424,600	(3,368,100)	(769,700)
INSPECTION AND REGULATION					
AGRIC. EMPLOYMENT RELATIONS BD.	60,800	60,900	60,800	0	(100)
AGRICULTURE, DEPT. OF	10,091,200	10,073,400	10,045,100	(46,100)	(28,300)
BANKING DEPARTMENT	2,824,400	2,767,900	2,663,900	(160,500)	(104,000)
BOXING COMMISSION	67,000	67,000	67,000	0	0
BUILDING AND FIRE SAFETY, DEPT. OF	3,112,500	3,110,500	3,112,500	0	2,000
CORPORATION COMMISSION	5,211,500	5,161,200	5,184,000	(27,500)	22,800
INSURANCE, DEPARTMENT OF	4,702,300	4,808,100	4,735,700	33,400	(72,400)
LIQUOR LICENSES AND CONTROL, DEPT.	2,685,200	2,111,300	2,685,200	0	573,900
MINE INSPECTOR	766,300	807,700	764,300	(2,000)	(43,400)
OSHA REVIEW BOARD	9,000	9,000	9,000	0	0
RACING, DEPARTMENT OF	2,622,400	2,540,600	2,519,100	(103,300)	(21,500)
RADIATION REGULATORY AGENCY	1,071,700	1,093,000	1,096,700	25,000	3,700
REAL ESTATE DEPARTMENT	2,895,700	2,887,100	2,899,900	4,200	12,800
WEIGHTS AND MEASURES, DEPT. OF	1,761,400	1,420,400	1,672,000	(89,400)	251,600
TOTAL - INSPECTION & REGULATION	37,881,400	36,918,100	37,515,200	(366,200)	597,100

FY 1997 GENERAL FUND SUMMARY
By Function of Government

	FY 1996 JLBC REC.	FY 1997 EXEC REC.	FY 1997 JLBC REC.	JLBC REC.- FY 1996	JLBC REC.- EXEC REC.
EDUCATION					
ARTS, COMMISSION ON THE	1,507,300	1,910,800	1,507,300	0	(403,500)
DEAF AND THE BLIND, SCHOOL FOR THE	16,658,500	16,553,000	16,619,400	(39,100)	66,400
HISTORICAL SOCIETY, ARIZONA	3,991,300	3,714,100	4,061,100	69,800	347,000
HISTORICAL SOCIETY, PRESCOTT	604,900	574,800	604,500	(400)	29,700
MEDICAL STUDENT LOANS BOARD	113,900	306,200	236,600	122,700	(69,600)
POSTSECONDARY EDUCATION, COMM. FOR	1,234,000	1,234,000	1,234,000	0	0
TOTAL - EDUCATION	24,109,900	24,292,900	24,262,900	153,000	(30,000)
PROTECTION AND SAFETY					
CRIMINAL JUSTICE COMMISSION, ARIZONA	1,100,000	0	0	(1,100,000)	0
EMRG. & MILITARY AFFAIRS, DEPT. OF	4,417,600	4,760,000	4,163,900	(253,700)	(596,100)
EXECUTIVE CLEMENCY, BOARD OF	1,729,200	1,676,400	1,681,400	(47,800)	5,000
TOTAL - PROTECTION AND SAFETY	7,246,800	6,436,400	5,845,300	(1,401,500)	(591,100)
NATURAL RESOURCES					
ENVIRONMENT, COMMISSION ON THE AZ	105,200	111,800	102,700	(2,500)	(9,100)
GEOLOGICAL SURVEY, ARIZONA	750,600	699,500	726,300	(24,300)	26,800
LAND DEPARTMENT	11,327,500	11,770,700	11,697,300	369,800	(73,400)
MINES & MINERAL RESOURCES, DEPT.OF	685,700	680,500	681,100	(4,600)	600
NAVIGABLE STREAM ADJUDICATION COMM.,	115,300	113,000	115,300	0	2,300
PARKS BOARD	6,430,000	6,285,600	6,310,800	(119,200)	25,200
WATER RESOURCES, DEPARTMENT OF	13,786,400	13,747,200	18,766,400	4,980,000	5,019,200
TOTAL - NATURAL RESOURCES	33,200,700	33,408,300	38,399,900	5,199,200	4,991,600
OPERATING BUDGET TOTAL	247,341,400	246,373,400	247,270,000	(71,400)	896,600

* JLBC Staff recommends deferring a FY 1997 recommendation until next year.

FY 1997 OTHER APPROPRIATED FUNDS SUMMARY
By Function of Government

	FY 1996 JLBC REC.	FY 1997 EXEC REC.	FY 1997 JLBC REC.	JLBC REC.- FY 1996	JLBC REC.- EXEC REC.
GENERAL GOVERNMENT					
ATTORNEY GENERAL	2,384,500	3,710,500	2,584,500	200,000	(1,126,000)
COLISEUM AND EXPOSITION CENTER	14,510,200	15,340,700	15,340,700	830,500	0
COMMERCE, DEPARTMENT OF	3,202,100	2,778,300	2,675,100	(527,000)	(103,200)
GOVERNOR, OFFICE OF THE	500,000	500,000	500,000	0	0
RETIREMENT SYSTEM	3,647,900	3,606,200	3,703,000	55,100	96,800
TOTAL - GENERAL GOVERNMENT	24,244,700	25,935,700	24,803,300	558,600	(1,132,400)
HEALTH AND WELFARE					
PIONEERS' HOME, ARIZONA	1,180,800	1,264,100	1,180,800	0	(83,300)
VETERANS' SERVICE COMMISSION	514,900	514,900	0	(514,900)	(514,900)
TOTAL - HEALTH AND WELFARE	1,695,700	1,779,000	1,180,800	(514,900)	(598,200)
INSPECTION AND REGULATION					
AGRICULTURE, DEPT. OF	1,735,000	1,721,200	1,708,400	(26,600)	(12,800)
CONTRACTORS, REGISTRAR OF	5,345,700	5,047,300	4,827,900	(517,800)	(219,400)
CORPORATION COMMISSION	6,070,500	6,568,000	6,573,900	503,400	5,900
INDUSTRIAL COMMISSION	12,796,500	12,565,000	12,494,000	(302,500)	(71,000)
RACING, DEPARTMENT OF	2,824,000	3,997,200	3,019,700	195,700	(977,500)
RADIATION REGULATORY AGENCY	105,200	103,600	105,200	0	1,600
RESIDENTIAL UTILITY CONSUMER OFFICE	977,100	995,500	953,500	(23,600)	(42,000)
WEIGHTS AND MEASURES, DEPT. OF	546,500	804,500	546,500	0	(258,000)
ACCOUNTANCY, BOARD OF	1,019,300	1,030,900	1,023,800	4,500	(7,100)
APPRAISAL, BOARD OF	249,600	250,800	249,600	0	(1,200)
BARBERS, BOARD OF	149,400	149,800	149,400	0	(400)
BEHAVIORAL HEALTH EXAMINERS, BD OF	341,400	376,600	354,700	13,300	(21,900)
CHIROPRACTIC EXAMINERS, BOARD OF	260,300	260,400	258,300	(2,000)	(2,100)
COSMETOLOGY, BOARD OF	636,500	643,200	636,500	0	(6,700)
DENTAL EXAMINERS, BOARD OF	597,600	592,000	588,800	(8,800)	(3,200)
FUNERAL DIRECTORS & EMBALMERS, BD	171,600	171,400	171,400	(200)	0
HOMEOPATHIC EXAMINERS, BOARD OF	29,300	29,100	29,200	(100)	100
MEDICAL EXAMINERS, BOARD OF	2,903,800	2,897,000	2,898,200	(5,600)	1,200
NATUROPATHIC PHYSICIANS BOARD	66,800	67,100	67,200	400	100
NURSING, BOARD OF	1,419,300	1,243,000	1,226,100	(193,200)	(16,900)
NURSING CARE INSTITUTIONAL ADMIN. BD.	77,800	79,300	78,100	300	(1,200)
OCCUPATIONAL THERAPY EXAM., BD OF	95,600	95,600	95,300	(300)	(300)
OPTICIANS, BOARD OF DISPENSING	67,200	67,000	67,000	(200)	0
OPTOMETRY, BOARD OF	108,000	107,800	107,900	(100)	100
OSTEOPATHIC EXAMINERS, BOARD OF	305,000	315,800	312,700	7,700	(3,100)
PHARMACY, BOARD OF	731,500	678,400	681,400	(50,100)	3,000
PHYSICAL THERAPY EXAMINERS, BOARD	91,100	90,400	91,000	(100)	600
PODIATRY EXAMINERS, BOARD OF	57,800	55,600	56,700	(1,100)	1,100
PRIVATE POSTSECONDARY EDUCATION	146,800	135,900	158,800	12,000	22,900
PSYCHOLOGIST EXAMINERS, BOARD OF	224,100	209,700	227,600	3,500	17,900
RESPIRATORY CARE EXAMINERS BOARD	165,400	145,200	165,000	(400)	19,800
STRUCTURAL PEST CONTROL COMM	1,191,900	1,246,300	1,196,900	5,000	(49,400)
TECHNICAL REGISTRATION, BOARD OF	871,900	885,400	873,100	1,200	(12,300)
VETERINARY MED EXAMINING BOARD	189,600	189,300	185,800	(3,800)	(3,500)
TOTAL - INSPECTION & REGULATION	42,569,100	43,815,300	42,179,600	(389,500)	(1,635,700)

FY 1997 OTHER APPROPRIATED FUNDS SUMMARY
By Function of Government

	FY 1996 JLBC REC.	FY 1997 EXEC REC.	FY 1997 JLBC REC.	JLBC REC.- FY 1996	JLBC REC.- EXEC REC.
EDUCATION					
DEAF AND THE BLIND, SCHOOL FOR THE	5,350,500	5,234,000	5,365,400	14,900	131,400
POSTSECONDARY EDUCATION, COMMISSION	2,981,900	275,700	2,920,900	(61,000)	2,645,200
TOTAL - EDUCATION	8,332,400	5,509,700	8,286,300	(46,100)	2,776,600
PROTECTION AND SAFETY					
CRIMINAL JUSTICE COMMISSION, ARIZONA	553,100	561,100	563,100	10,000	2,000
EMRG. & MILITARY AFFAIRS, DEPT. OF	52,600	47,700	47,700	(4,900)	0
TOTAL - PROTECTION AND SAFETY	605,700	608,800	610,800	5,100	2,000
NATURAL RESOURCES					
GAME AND FISH DEPARTMENT	17,862,600	17,512,100	17,741,000	(121,600)	228,900
PARKS BOARD	2,454,600	2,634,000	2,634,100	179,500	100
TOTAL - NATURAL RESOURCES	20,317,200	20,146,100	20,375,100	57,900	229,000
OPERATING BUDGET TOTAL	97,764,800	97,794,600	97,435,900	(328,900)	(358,700)

ECONOMIC AND REVENUE FORECAST

THE U. S. ECONOMY

Mid-Year Review of FY 1995 — Continuing Growth

The U.S. economy has had 43 months of overall national economic growth to date since the trough of the last recession in March 1991. Gross Domestic Product (GDP) grew at annualized, real (inflation removed) rates of 3.3%, 4.1%, and 3.4% in the first three quarters of calendar (CY) 1994. The expectation is that growth will continue for the remainder of the fiscal year (FY) ending June 30, 1995, although there should be some slowing in the rate of expansion.

The consensus of economists expects quarterly growth rates to start to slowly decline starting in the last quarter of CY 1994, but only to a 2.5% annual growth rate for the remainder of FY 1995. We expect that FY 1995 will show an overall 2.5% real growth rate for the national economy. The Consumer Price Index should increase by 3.4%. Economic strength in the U.S., improving conditions in Europe, and the continuing boom in most of Asia (except Japan) have pulled commodity prices up steadily, which will continue to increase the inflation rate. U.S. wage and salary employment growth should again be 2.5% this year, and unemployment should be down to 6.2% nationally, the third year of decline. Corporate profits have been at record levels. The severe cost cutting in corporate America over the last decade has paid off in terms of the "bottom line" in this phase of the expansion.

The Outlook for FY 1996 and FY 1997: Slowing Growth Leading to a Mild Recession

We tend to disagree with the consensus of economists about the future path of growth. Instead of drifting down from the 3% range to the low 2% range in the next two years, we see a growth rate of 1.7% in FY 1996 and then a slight decline (0.1%) in FY 1997. Our July Budget Status Report had forecast growth of 3.3% for FY 1995 and 3.0% in FY 1996, but that forecast had not counted on the continued aggressive Federal Reserve actions to date.

Despite the fact that inflation, as measured by the Consumer Price Index, has been increasing quarterly at annualized rates of only about 3.0%, the Federal Reserve has increased its discount rate and the Federal Funds interest rate six times so far in calendar 1994. The latest move was a 0.75% increase on November 15. They are concerned that the steadily growing economy is building inflation pressures that should be nipped early in order to prolong this growth phase of the business cycle. They are hoping to mitigate a "boom-bust" cycle into a "soft landing" of slower growth without recession. However, we believe that the interest rate increases that have already occurred, which will take from three to nine months to work through the economy, are enough to have a negative effect on the interest rate sensitive areas of the economy, such as auto sales and housing and help to push the economy gradually toward a very low growth path by FY 1996 and certainly by FY 1997. Many analysts believe further interest rate increases by the Fed will occur early this year if real GDP growth continues above its target of 2.5% annual growth. Critics argue that the Federal Reserve appears to be more preoccupied with forestalling any inflationary surge than sustaining higher growth rates in the economy, or that it is making mountains out of molehills in the leading-inflation-indicator data.

Table 1

POST KOREAN WAR RECESSION DATES AND LENGTHS

Trough	Peak	Expansion Length	Recession Starts Months After Fed Tightened
May 1954	August 1957	39	N/A
April 1958	April 1960	24	16
February 1961	December 1969	106	55
November 1970	November 1973	36	9
March 1975	January 1980	58	23
July 1980	July 1981	12	10
November 1982	July 1990	92	74
Average		**52**	**31**

Regardless of the view of "the Fed", forecasting a slowdown in FY 1996 followed by a recession in FY 1997 is not an aggressive scenario. It is true that Table 1 reveals no regular pattern in terms of either the duration of expansions or the time lag between a Fed tightening and the start of a recession. For example, the table reveals that the Fed's tightening in May 1984 was followed by a recession—after a lag of six years, which was longer than five of the seven expansions listed! On the other hand some analysts have observed that recessions start 18 months after the third of a series of Fed rate increases, and there have been six increases so far in 1994. Nevertheless, by the end of FY 1996 this recovery will be 62 months old, and 74 months old by the end of FY 1997. Based on historical patterns and recent small signs of hesitation on the part of consumers, some slowdown is almost certain during this forecast period.

Table 2

SOURCES OF REAL GROSS DOMESTIC PRODUCT GROWTH [1/]

(Billions of 1987 $)

	FY 1993	FY 1994	FY 1995	FY 1996	FY 1997
Consumption - Services	$56.8	$49.9	$38.5	$33.3	$37.5
- Nondurables	21.2	24.3	21.4	15.6	10.0
- Durable Goods	33.3	42.0	28.8	19.1	(14.8)
Nonresidential Fixed Investment	40.1	78.3	53.8	51.5	(23.8)
Residential Fixed Investment	22.3	19.5	(1.9)	(10.1)	(17.8)
Change in Business Inventories	6.9	14.8	15.9	(31.0)	(4.6)
Federal Government Purchases	(6.5)	(22.5)	(11.9)	(25.2)	(13.0)
State/Local Government Purchases	4.1	13.8	12.2	11.0	6.0
Net Exports	(27.1	(45.0)	(25.9)	27.0	15.0
Change in GDP (1987 $)	$151.2	$175.2	$130.8	$91.2	$(5.5)

Table 2 shows estimates of how the seven main categories that combine to form total GDP may perform through FY 1997. Residential fixed investment and consumer durables purchases could take the burden of the slowdown, but these outcomes are consistent with the increases in interest rates that started earlier this year.

Major Issues

Inflation

The Federal Reserve has made clear its intention to hold the line on inflation by switching from a "neutral" stance to tightening or even "contractionary." Again, the Fed has hiked the federal discount rate six times since January to 5.5%, up 2.5% overall. Yet the markets still see momentum in the economy and potentially more inflation in the Republicans' plans to cut taxes.

We expect that the weak dollar, strong commodity prices, and possible expansionary fiscal policies by Congress will gradually increase the rate of inflation.

A rising inflation rate could destabilize growth in several ways. It makes planning more difficult in a more unpredictable environment compared to greater certainty of prices in times of low inflation. If inflation is rising at a rapid rate, people do not know how to allocate resources. Second, higher expected inflation could cause real interest rates (the difference between nominal interest rates and expected inflation) to rise. This raises the real cost of capital for all borrowers. Third, higher inflation has often destabilized business cash flow and caused businesses to take a shorter 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. Higher interest rates increase cash outflow to service borrowing and decrease the number of ventures which appear viable.

Consumer Spending

Growth in consumer spending, which contributed heavily to FY 1994's strong GDP growth, is expected to slow a bit in FY 1995 and FY 1996 and then drop sharply in FY 1997. There has been a torrent of pent-up demand in the car and housing markets for the past two years, and both of these markets are expected to stay fairly healthy. Yet, they do not have much room to go up further, especially in view of the recent rise in interest rates, and almost all analysts are looking for year over year declines in the rates of growth by FY 1996 and FY 1997.

Employment Growth

Total employment growth is expected to accelerate to 2.5% in FY 1995 and drop slightly to 2.3% in FY 1996. It will remain to be seen whether employment will continue to increase sharply, although incomes should improve in the economy. Manufacturing employment, typically one of the highest paying sectors, is expected to show positive growth in FY 1995, the best performance in six years. Many 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, or they have started their own businesses.

<u>Health Care Reform</u>

The Clinton Administration created fierce debate when it introduced its Health Security Act to Congress on October 27, 1993. However, the debate failed to produce a piece of legislation capable of mustering a majority in either House, and Congress adjourned without passing even a modest reform. With the Republican victories in the House and Senate it now looks as if health care reform may be dead for the rest of President Clinton's term. The good news for employers is that the uncertainty about how they would be impacted under the Clinton package will dissipate. However, there may be a resumption of the higher rates of medical cost inflation, which has been growing much more slowly for the past two years, (coincidental with discussions of a national health plan) if the threat of health care reform is removed.

<u>Foreign Trade</u>

The positive effects expected from the North American Free Trade Agreement, which took effect on January 1, 1994, are already starting to show up in the national economy. Preliminary estimates indicate strong increases in both U.S. exports to Mexico and Mexican exports to the U.S., despite the recent economic slump in Mexico which is inhibiting demand there. After a long delay, the recently concluded Uruguay Round of the General Agreement on Tariffs and Trade (GATT) treaty passed both houses of Congress by surprisingly wide margins in a special session. The majority of business and academic economists say that the net benefits to the United States will be in the billions of dollars annually after passage, and positive effects from GATT should show up in the U.S. economy by FY 1996.

<u>Bank Lending</u>

Commercial bank lending has started to surge in the last twelve months. Banks had taken advantage of lower short-term 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 to rebuild their capital after the losses from excesses of the late 1980's and then the 1990 recession. As interest rate spreads narrow, and some banks are selling off parts of their bond portfolios to free up money for loans, banks will continue to be more aggressive in seeking quality new loans in a fiercely competitive market. There have been some opinions recently that banks have possibly been too aggressive in extending credit, in the same manner as they did in the 1980's but on a smaller scale.

Summary

Overall, FY 1995 and FY 1996 should see declining rates of growth in a rising inflation environment, which should be followed by a mild recession in FY 1997. Since few economists are even predicting what 1996 will bring, we naturally note uncertainty about a forecast out to FY 1997. Accordingly, the timing and path of this medium term forecast are subject to more research and debate.

Table 3 shows the percentage increases in Key U.S. Economic Indicators expected for FY 1995 through FY 1997, as well as historical results starting with FY 1992.

Risks to the Forecasts

The nation's economic performance for the remainder of FY 1995 and until FY 1997 will depend in large part on interest rates. The bond market may continue its unpredictable behavior; and if interest rates continue to rise, the housing and car markets, which are doing so well now, will be hurt. The fortunes of our major trading partners will also be important. The moribund European and Japanese economies are showing early signs of recovery; if the recovery is stronger than expected, the export sector will give the U.S. a strong boost in FY 1995. Conversely, if Europe and Japan slip back into recession or experience only very weak recoveries, it will act as a drag on U.S. growth. The Clinton Administration has also been experiencing trade frictions with Japan and Canada. A trade war with either would hurt U.S. exports and add to inflation.

Overall, we estimate the downside risk to be minor—about a 15% chance for real growth to be around 2% instead of in the 3% range for FY 1995. We estimate the upside risk to be perhaps a 30% chance of real growth of 4% or better.

Positive Alternative — Stronger Growth Than Anticipated

Looking at FY 1995 and even out to FY 1997, the higher growth alternative would depend on a continued strong rebound in hiring caused by continued increases in investment 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 even higher than anticipated and manufacturing would also rebound. This higher growth alternative assumes that the Fed is successful in engineering a "soft landing" and does not tip the economy into recession.

Negative Alternative - New Hiring Delayed and Weak Growth

The Clinton Administration loses credibility in some way, because of some domestic scandal (e.g., Whitewater) or a foreign crisis (e.g., Korea), reducing confidence. Inventory restocking and business fixed investment would not increase as expected because of reduced sales forecasts.

In agreement with our view, even Goldman, Sachs and Co. has recently (11/17/94) raised the possibility that "recession risks are rising". They said "the chance of a recession in the next year or two has risen and will continue to rise as long as growth (GDP) remains above its long-term 2.5% target limit. Above trend growth will aggravate upward pressures on short-term interest rates, causing any subsequent slowdown in domestic demand to be sharper than it otherwise would be."

Table 3

KEY U.S. ECONOMIC INDICATORS

	Actual FY 1992	Actual FY 1993	Actual FY 1994	Forecast FY 1995	Forecast FY 1996	Forecast FY 1997
Real Gross Domestic Product 1/	$4,906.7	$5,058.0	$5,233.1	$5,363.2	$5,455.2	$5,449.8
Percent Change - %	0.7	3.1	3.5	2.5	1.7	(0.1)
GDP Deflator Index	119.4	122.3	124.7	128.1	133.5	139.8
Percent Change	3.3	2.5	2.0	2.8	4.2	4.7
Consumer Price Index	138.3	142.6	146.3	151.2	158.2	166.8
Percent Change	3.2	3.1	2.6	3.4	4.6	5.4
Industrial Production Index	105.3	108.7	114.0	118.8	119.8	119.2
Percent Change	0.7	3.2	4.8	4.3	0.9	(0.5)
Three Month T-Bill Rate	4.4	3.0	3.3	5.6	7.1	7.8
Aaa Corporate Bond Rate	8.4	7.8	7.2	9.2	10.5	10.0
Wage and Salary Employment 1/	108.2	109.5	111.8	114.6	115.8	115.7
Percent Change	(0.6)	1.1	2.1	2.5	1.0	(0.1)
Manufacturing Employment 1/	18.2	18.1	18.0	17.9	17.6	17.0
Percent Change	(2.6)	(0.9)	(0.6)	0.0	(2.2)	(3.4)
Unemployment Rate	7.1	7.2	6.5	6.2	7.1	7.7

1/ Millions

JLBC Staff
11/28/94

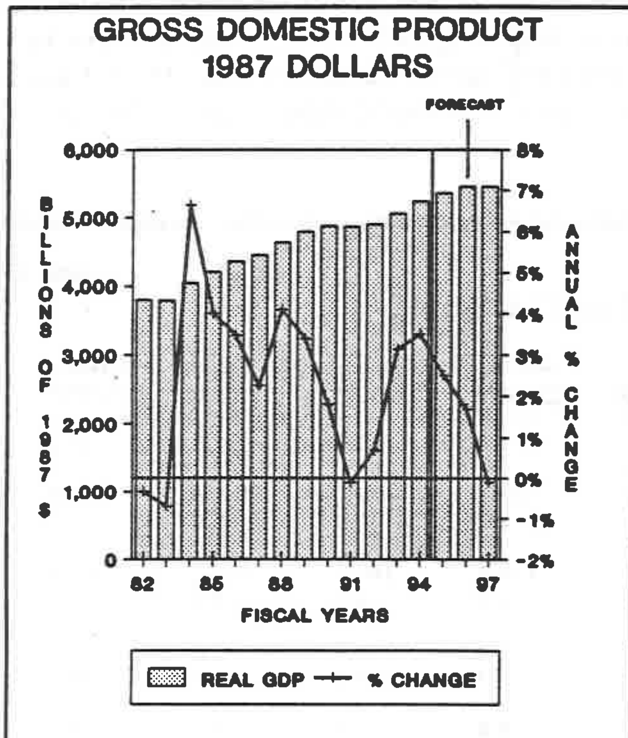


CHART 1

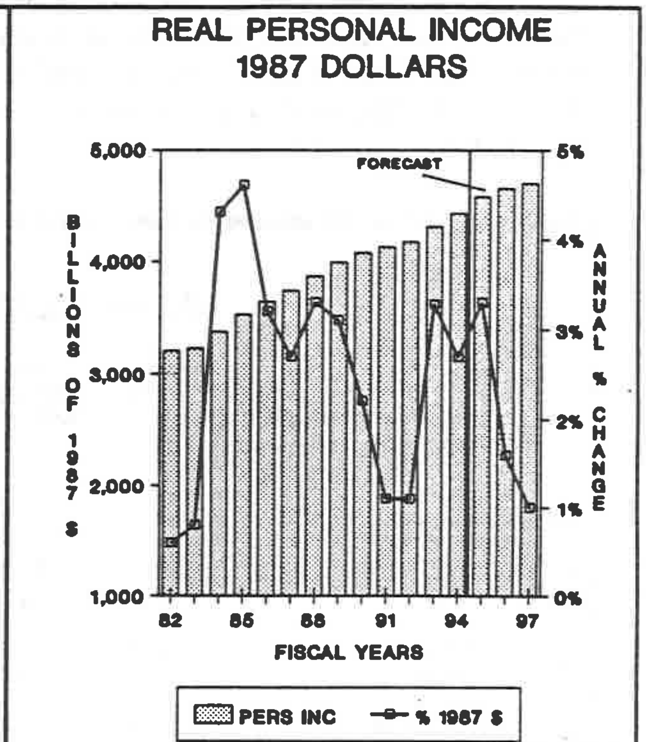


CHART 2

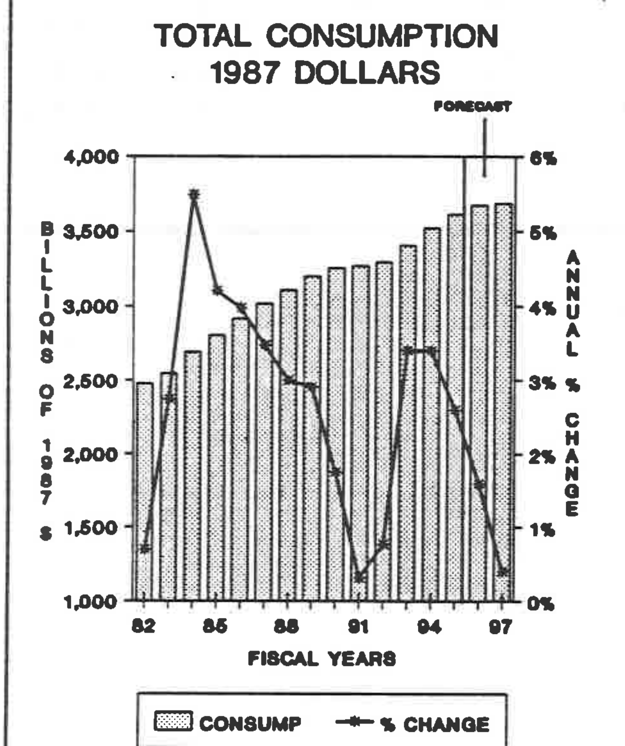
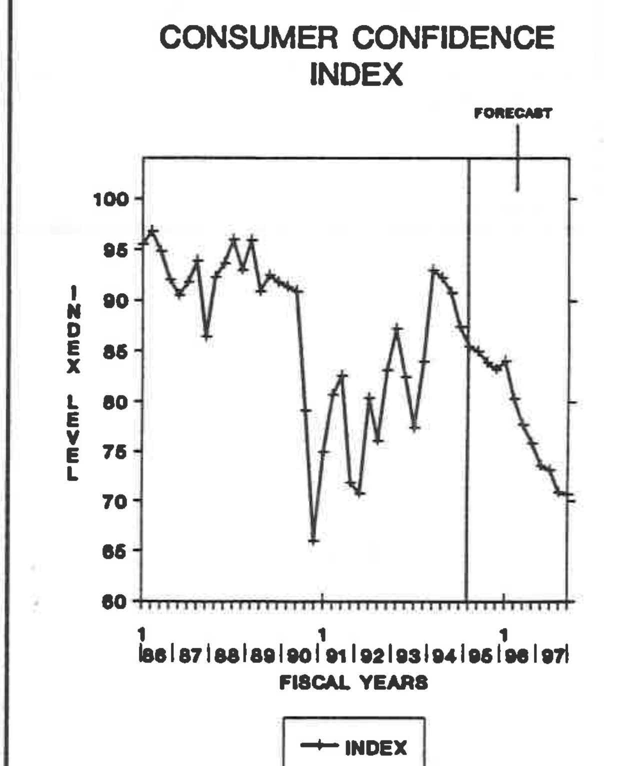
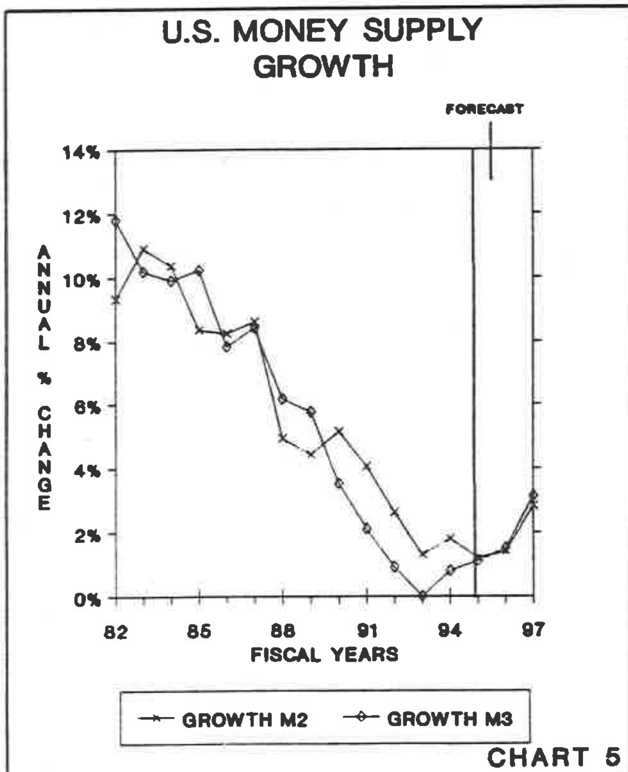


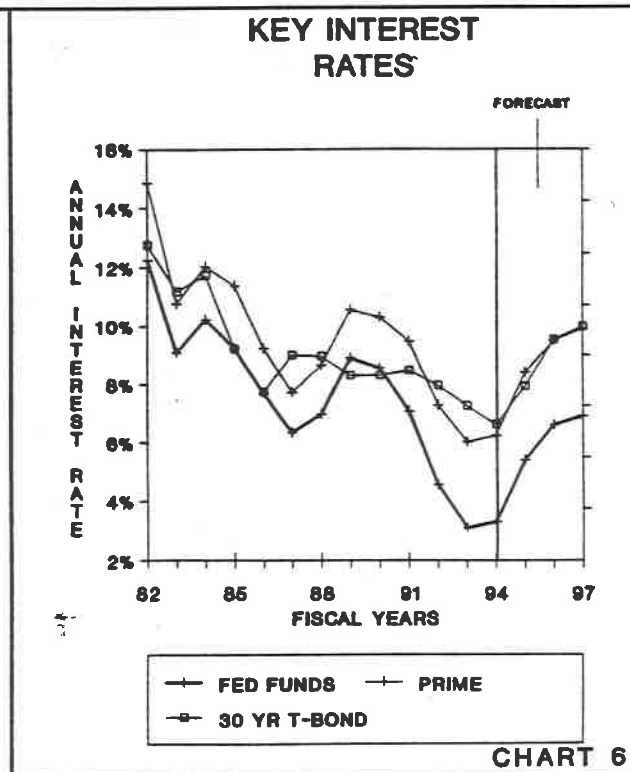
CHART 3

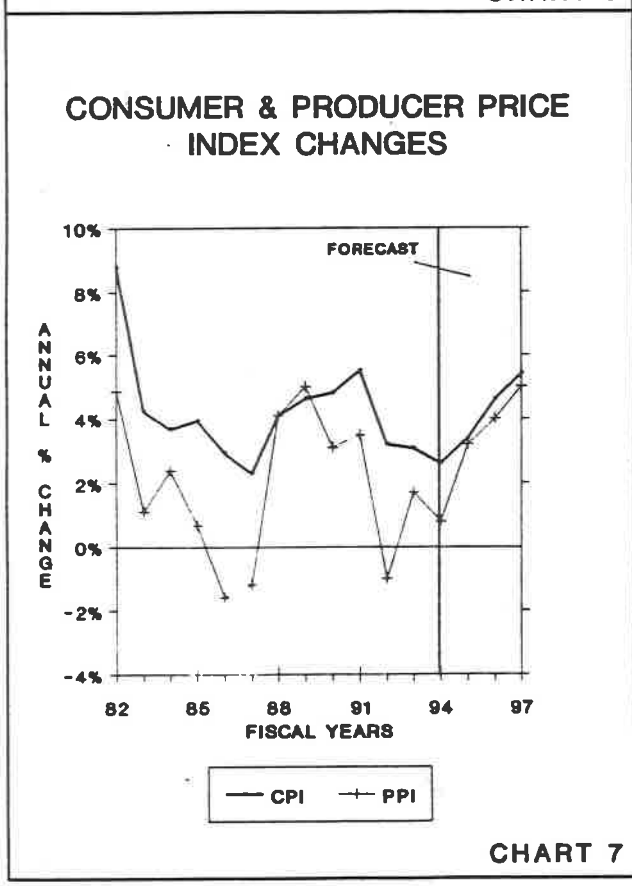


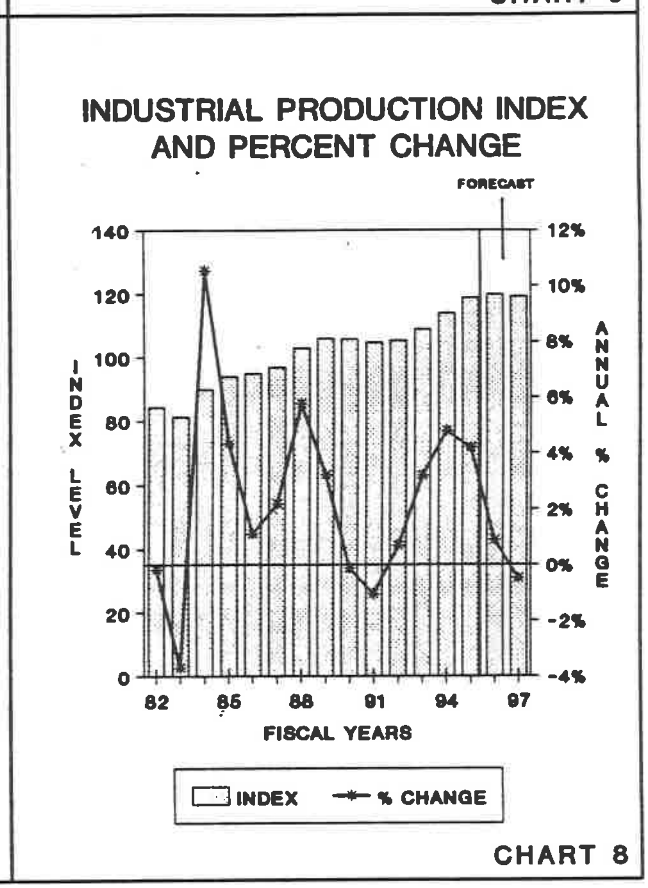
SOURCE: U. OF MICHIGAN

CHART 4


U.S. MONEY SUPPLY GROWTH
FORECAST
14%
12%
10%
8%
6%
4%
2%
0%
ANNUAL % CHANGE
82
85
88
91
94
97
FISCAL YEARS
GROWTH M2
GROWTH M3
CHART 5


KEY INTEREST RATES
FORECAST
16%
14%
12%
10%
8%
6%
4%
2%
ANNUAL INTEREST RATE
82
85
88
91
94
97
FISCAL YEARS
FED FUNDS
PRIME
30 YR T-BOND
CHART 6


CONSUMER & PRODUCER PRICE INDEX CHANGES
FORECAST
10%
8%
6%
4%
2%
0%
-2%
-4%
ANNUAL % CHANGE
82
85
88
91
94
97
FISCAL YEARS
CPI
PPI
CHART 7


INDUSTRIAL PRODUCTION INDEX AND PERCENT CHANGE
FORECAST
140
120
100
80
60
40
20
0
INDEX LEVEL
12%
10%
8%
6%
4%
2%
0%
-2%
-4%
ANNUAL % CHANGE
82
85
88
91
94
97
FISCAL YEARS
INDEX
% CHANGE
CHART 8

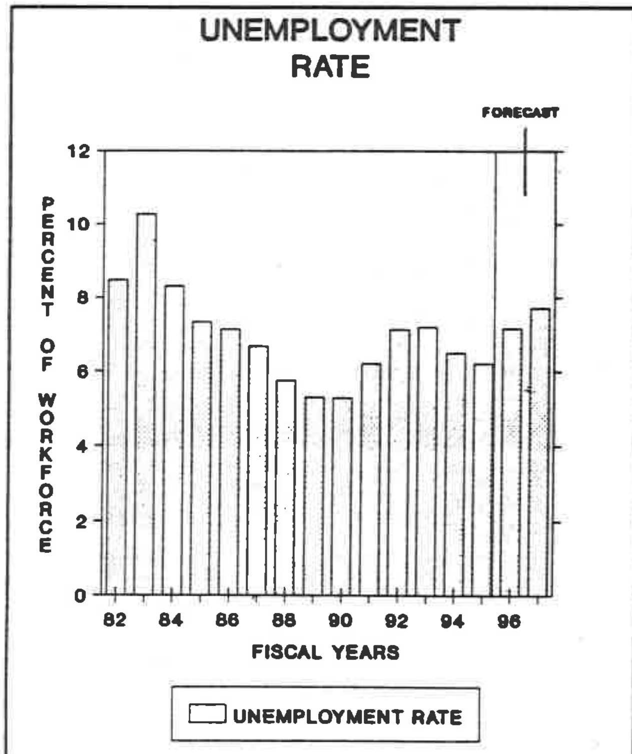


CHART 9

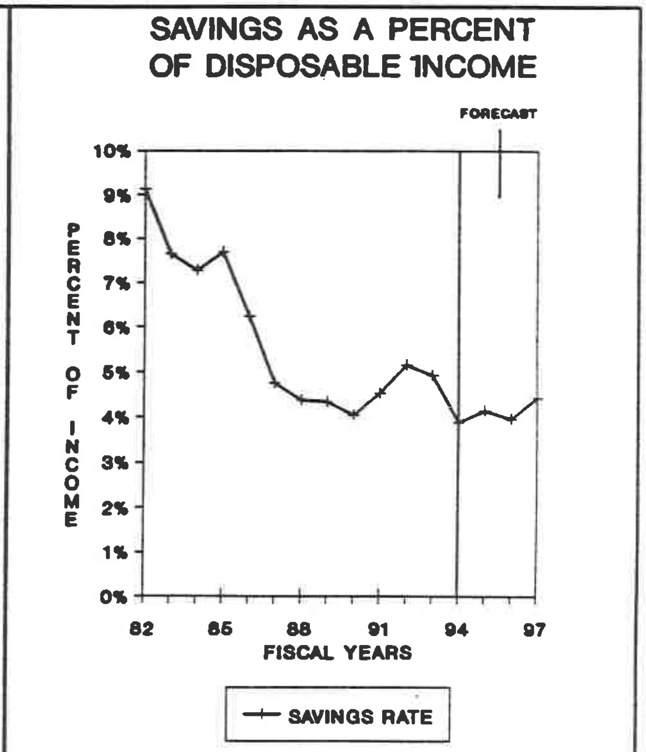


CHART 10

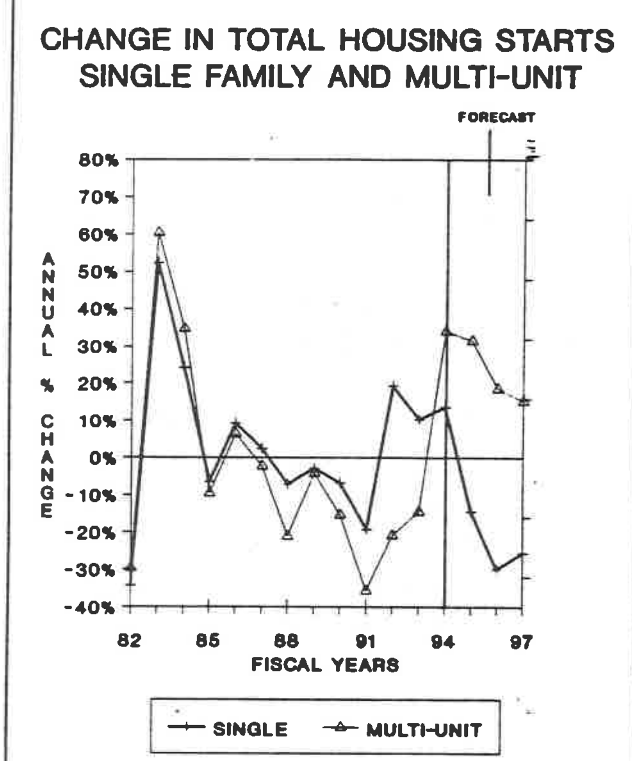


CHART 11

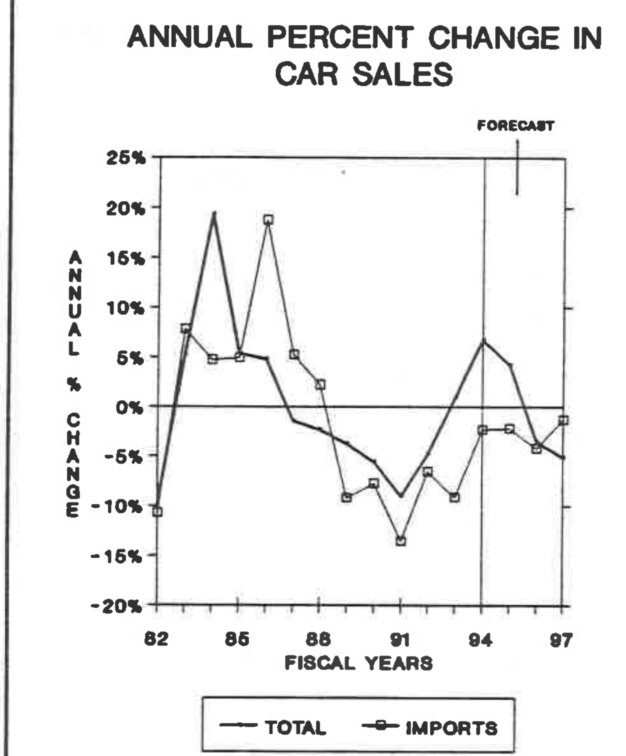


CHART 12

THE ARIZONA ECONOMY

The Arizona economy continues to expand as we welcome the new year. For the first half of CY 1994, Arizona ranked sixth nationally in nonfarm job growth with an over-the-year (June 1994 vs. June 1993) rate of 3.9%. Since then, Arizona has maintained this ranking, but has increased its job growth to 4.6%. Currently, most of our key economic indicators point to a strong and confident economy which likely resulted in a robust Christmas for retailers.

Lately, many analysts have begun to question the sustainability of this surprising growth in Arizona. Likewise, we see some signs that the growth may be slowing, so that our current forecasts project FY 1995 as the peak growth year in this present cycle with FY 1996 as the transition year into a mild recession in FY 1997.

FY 1995 Outlook: Strong Growth

Recent evidence regarding the strength of Arizona's economy abound:

- **Personal income** jumped at a 9.0% annual rate in the first quarter of 1994 and 8.0% in the second quarter. This is the highest two quarter increase since 1986.

- **The unemployment rate** dropped from 6.7% to 6.1% in October and stayed at 6.1% in November, fueled by large monthly increases in total employment of 13,300 in October and 15,700 in November. Total employment in November grew by almost 74,000 jobs since last November.

- **Total wage and salary employment** (nonfarm) grew for the first five months of the fiscal year (July to November) by 4.5% over the same period last year. Construction led the way with 13.7% growth, followed by manufacturing and services with growth of 5.0% and 4.7%, respectively. Trade recorded a big gain of 9,300 from the previous month as retailers prepared for the holiday shopping. Moreover, trade rose by 16,900 jobs from the previous November.

- **Manufacturing employment** is finally recovering from the defense cutbacks of the late 1980's and is benefiting from recent economic development efforts and the expansion of hi-tech firms. Manufacturing gained 300 jobs in November and 8,900 since last November, which is the largest year-over-year gain in ten years.

- **Annual net migration** into Arizona from California has leap-frogged from a negative 6,800 in fiscal 1989 to a positive 18,600 in fiscal 1994, says a Salomon Brothers report based on drivers license address changes between the two states. According to the 1990 Census, California constitutes Arizona's biggest source of in-migration at 21.0%, with Texas a distant second at 6.7%.

- **The Survey of Purchasing Managers** conducted each month by Dr. Harold Fearon of the College of Business at Arizona State University indicates that the economy has continued to record new highs since June of this year.

- **Consumer confidence** in Maricopa County as measured by the Behavior Research Center remained high in August. Compared to the same time last year, confidence in the economy is about three times better. However, in November, the survey showed some caution creeping in among the middle and lower income households.

- **Taxable retail sales** for October climbed 10.5% for a FY 1995 year-to-date gain of 13.4%. Overall taxable sales for the fiscal year are growing a healthy 11.1%.

- **A housing boom** still rages in Arizona, especially in single family homes. Multifamily and commercial construction are also rising, but remain weak by historical standards.

What does all this sparkling news portend for the rest of fiscal 1995? A look at our table of Key Arizona Economic Indicators (Table 4) shows that the economy is forecasted to improve in FY 1995 over FY 1994, which was a year of solid growth. The only FY 1995 indicators not exceeding FY 1994 are retail sales and construction employment; but this is mainly due to the higher interest rates recently enacted by the Federal Reserve, which will eventually restrain auto sales and housing starts. Otherwise, the overall Arizona economy will be advancing strongly and reaching a peak during the fiscal year.

KEY ARIZONA ECONOMIC INDICATORS — **Table 4**

	Actual FY 1992	Actual FY 1993	Actual FY 1994	Forecast FY 1995	Forecast FY 1996	Forecast FY 1997
Personal Income - Current Dollars 1/	$64,473	$69,156	$74,296	$80,834	$87,382	$93,760
Percent Change %	5.0	7.3	7.4	8.8	8.1	7.3
Personal Income - Constant Dollars 1/	53,997	56,546	59,580	63,053	65,455	67,067
Percent Change	1.6	4.7	5.4	5.8	3.8	2.5
Personal Income - Per Capita Constant Dollars 1/	14,158	14,479	14,866	15,299	15,442	15,430
Percent Change	(0.7)	2.3	2.7	2.9	0.9	(0. 1)
Retail Sales 1/4/	934.7	1,008.6	1,120.8	1,220.3	1,292.6	1,358.5
Percent Change	5.0	7.9	11.1	8.9	5.9	5.1
Population 2/	3,814.0	3,905.5	4,007.7	4,121.3	4,238.7	4,346.6
Percent Change	2.4	2.4	2.6	2.8	2.8	2.5
Wage and Salary Employment 2/	1,499.7	1,541.3	1,607.8	1,689.8	1,753.6	1,794.5
Percent Change	0.8	2.8	4.3	5.1	3.8	2.3
Manufacturing Employment 2/	173.3	173.7	176.8	185.4	185.8	184.4
Percent Change	(4.5)	0.2	1.8	4.9	0.2	(0.8)
Construction Employment 2/	77.5	82.7	97.6	110.1	113.5	110.9
Percent Change	(3.0)	6.7	18.0	12.8	3.1	(2.3)
Unemployment Rate 3/	6.9	7.1	5.7	5.4	5.5	5.8

1/ Millions
2/ Thousands
3/ Dollars
4/ Collections, Distribution Base + Nonshared

Likewise, a closer examination of our employment forecast, as shown on Table 5, reveals that both the Goods Producing and Service Producing sectors will be peaking in FY 1995 as well, driven by the dramatic improvement in manufacturing and the continued growth in services. Also, one may have noticed that the FY 1995 wage and salary employment forecast of 5.1% growth is significantly higher than the current performance of 4.5% growth. This is because we believe, as do most other economists, that the current job estimates will be revised upward in the coming months. Historically, the establishment survey, which produces the job estimates, has understated the number of new firms started during an economic recovery. This will be especially true during this recovery due to the recent influx of firms fleeing California. Thus, we are expecting an upward revision in job growth of at least a half a percentage point.

FY 1996 Outlook: Moderate Growth

Looking into FY 1996, we see the Arizona economy still growing but at a slower pace. We view FY 1996 as a transition year before the start of another recession. Personal income will increase by 8.1%, still strong growth, but not as much as in FY 1995. Real personal income will slow to 3.8% from 5.8%, due to less growth and much higher inflation. Growth estimates in all key economic indicators are projected to be lower in FY 1996, except for population growth, which remains flat.

As for employment growth, the big decline is in the Goods Producing sector, where manufacturing, mining, and construction will experience a significant moderation in growth. Meanwhile, growth in the Service Producing sector will remain relatively stable, decreasing slightly from 4.5% in FY 1995 to 4.3% in FY 1996. Overall, total wage and salary employment growth is forecasted at 4.3%, slightly lower than the 4.5% in FY 1995. Again, the greatest growth, in terms of the number of jobs gained and percent increase, will occur in the service industry with 26,700 new jobs for a 5.5% gain.

What factors will contribute to the moderation of growth which eventually leads to a recession? First, we contend that the Federal Reserve will once again miss the mark in its attempt to fine tune the economy. As discussed in our U.S. Economy outlook, we believe the Federal Reserve has been overly aggressive in fighting inflation. This will cause interest rate sensitive sectors of the economy, such as auto sales and construction, to substantially slow down by FY 1996. Since Arizona is tied closely to the national economy, the state's economy will also decelerate. Secondly, housing construction has accounted for such a disproportionately high share (about 18%) of Arizona's job growth during this expansion. Thus, we believe that the higher interest rates and a reduction in net migration to Arizona by Californians, which will adversely affect construction, makes Arizona especially vulnerable to a possible recession.

FY 1997 Outlook: Mild Recession

We are forecasting a recession in FY 1997. However, we expect the recession to be mild and of short duration. The sectors of the economy impacted most will be manufacturing and construction. We are projecting declines in jobs for these two sectors. Also, per capita personal income will drop by a slight 0.1%

Table 5

ARIZONA WAGE AND SALARY EMPLOYMENT
EMPLOYMENT AND PERCENT GROWTH OVER PRIOR YEAR FORECAST

	FY 1994		Forecast FY 1995		Forecast FY 1996		Forecast FY 1997	
	Number	%	Number	%	Number	%	Number	%
Goods Producing								
Manufacturing	176.8	1.8	185.4	4.9	185.8	0.2	184.4	(0.8)
Mining	12.2	(2.8)	13.0	6.2	13.2	1.5	13.1	(0.8)
Construction	97.6	18.0	110.1	12.8	113.5	3.1	110.9	(2.3)
Total Goods Producing	286.6	6.6	308.5	7.6	312.5	1.3	308.4	(1.3)
Service Producing								
Transp., Communic. & Public Utilities	83.2	1.8	85.2	2.4	87.6	2.8	89.4	2.1
Trade	393.8	4.1	412.9	4.9	432.2	4.7	445.9	3.2
Finance, Insurance, Real Estate	101.2	3.9	105.0	3.8	109.6	4.4	112.3	2.5
Services	460.0	5.5	488.8	6.3	515.5	5.5	535.5	3.9
Government	283.0	1.5	289.4	2.3	296.2	2.4	303.0	2.3
Total Services Producing	1,321.2	3.8	1,381.3	4.5	1,441.1	4.3	1,486.1	3.1
Total Wage and Salary Employment	1,607.8	4.3	1,689.8	5.1	1,753.6	3.8	1,794.5	2.3

Risks to the Forecasts

The main risk to the forecast is the Federal Reserve's recent string of interest rate increases as previously mentioned. Most economists are uncertain about how these increases will affect the magnitude and timing of economic growth or inflation. Also, the Federal Reserve may raise rates even further, which would certainly compound the uncertainty surrounding Arizona's continued expansion.

Another risk to the forecast is a weaker than expected national economy. Arizona has a diversified economy which correlates closely with the national and global economies. Most national economists are predicting a big uptick in U.S. exports for 1995. This is reliant on expected accelerating growth in Europe, Mexico, and the Pacific Rim. If this does not materialize, then the Arizona economy will likely suffer.

Also, on a regional basis, Arizona's economy is significantly tied to California. Most economists in California are forecasting a rebound for the Golden state in 1995. This could slow down net migration into Arizona, which would then affect the housing market. However, trade in goods and services between the two states would improve, which may offset any loss due to the slower net migration; but there is some uncertainty as to which factor will have the greater effect.

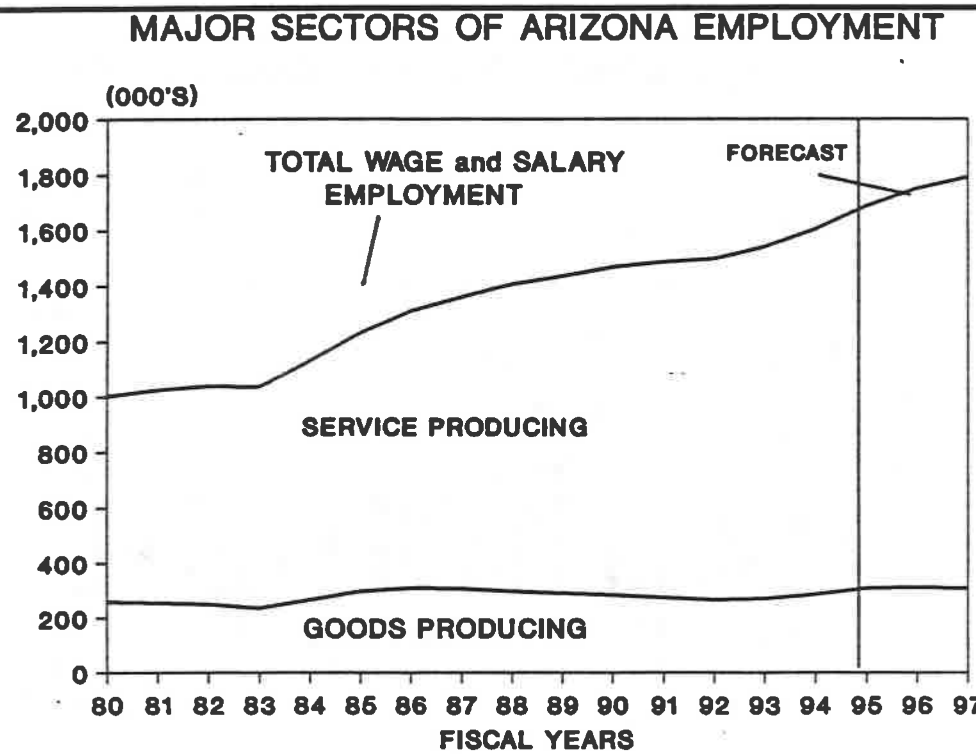


CHART 13

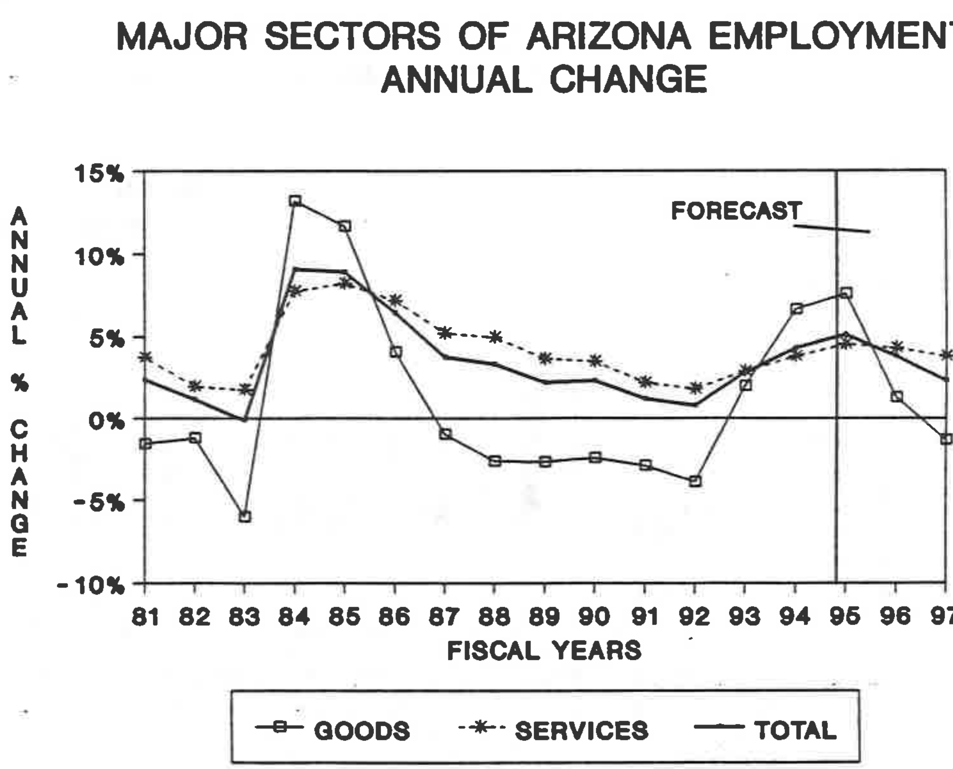
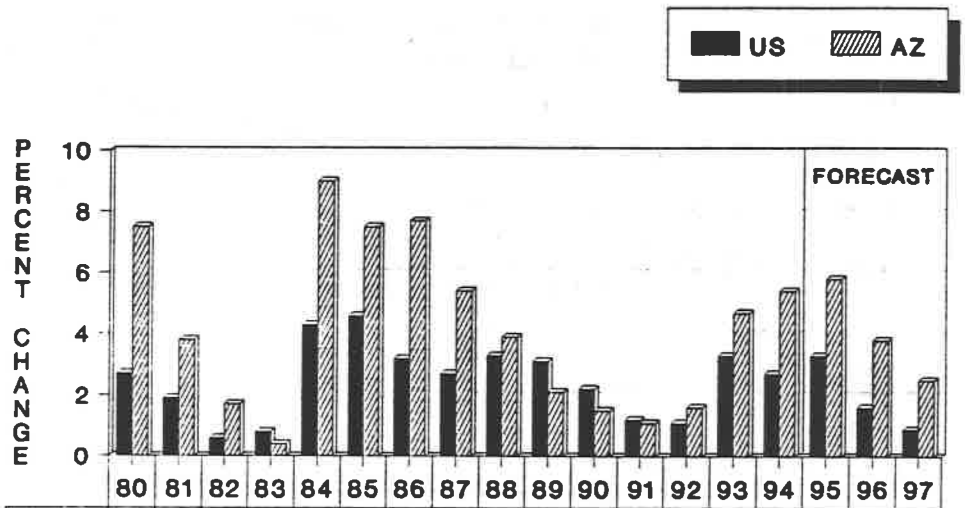


CHART 14

U.S. and Arizona
CONSTANT DOLLAR PERSONAL INCOME

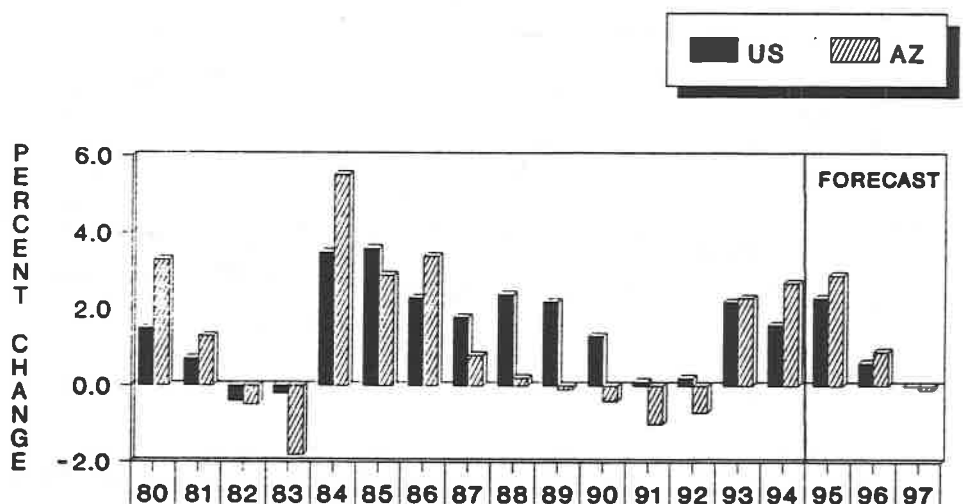


	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97
US	2.7	1.9	0.6	0.8	4.3	4.6	3.2	2.7	3.3	3.1	2.2	1.2	1.1	3.3	2.7	3.3	1.6	0.9
AZ	7.5	3.8	1.7	0.4	9	7.5	7.7	5.4	3.9	2.1	1.5	1.1	1.6	4.7	5.4	5.8	3.8	2.5

FISCAL YEARS

CHART 15

U.S. and ARIZONA
REAL PER CAPITA INCOME



	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97
US	1.5	0.7	-0.4	-0.2	3.5	3.6	2.3	1.8	2.4	2.2	1.3	0.1	0.2	2.2	1.6	2.3	0.6	0.0
AZ	3.3	1.3	-0.5	-1.8	5.5	2.9	3.4	0.8	0.2	-0.1	-0.4	-1.0	-0.7	2.3	2.7	2.9	0.9	-0.1

FISCAL YEARS

CHART 16

GENERAL FUND REVENUE

The current JLBC Staff revenue forecast is shown on Table 6. In order to preserve the continuity and comparability of the revenue series, we have elected to show the Federal Retiree Refunds as a separate deduction and not merged with the Individual Income Tax. Our forecasts for the three fiscal years are appropriately cautious. To put it another way, the risk of actual collections coming in below the forecast for any of these fiscal years is relatively small.

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 5.0% in FY 1992, followed by accelerating increases of 7.3% in FY 1993, 7.4% in FY 1994, and 8.8% in FY 1995.

We are now in the position of forecasting another turning point, this time for a downward turn. During the First Regular Session - 1993, legislation was passed which provided for biennial budgets for all agencies except "Major Budget Units". The requirement for separate budgets for each of two years into the future creates a need for revenue forecasts one additional year into the future, in this case, FY 1997. The business cycle is still in operation and somewhere in the future the next downturn is lurking. For the U.S. Economy, the JLBC Staff is forecasting that FY 1996 will be a growth year, but at reduced rates of growth, and that FY 1997 will be a mild recession year. Accordingly, our forecasted growth of AZPI steps down to 8.1% in FY 1996 followed by 7.3% in FY 1997.

Table 7 compares the Governor's and the JLBC Staff revenue forecasts for FY 1995 and FY 1996.

FY 1995 Forecast

The official budget forecast of revenues (in this case, the lower OSPB forecast, made in March 1994) provided for revenue collections, after adjustment for legislative revenue reductions, of 1.4% and $55.6 million above actual FY 1994. Subsequently, the JLBC Staff forecast from July 1995 provided for revenue collections of 5.0% and $205.1 million above actual FY 1994. Our updated forecast (See Table 6) provides for an increase over FY 1994 of 7.0% and $284.5 million. It should be noted that both of the FY 1995 forecasts have been reduced by legislative adjustments (revenue reductions) aggregating $141.0 million. Adjusting for these revenue reductions as well as for the elimination of the reductions for County Property Tax Relief and Disease Control Research, our new forecast is consistent with an increase over actual FY 1994 of 10.1% and $412.6 million.

Although our revenue estimate for FY 1995 is nearly $230 million higher than the estimate used when the budget was enacted in March 1994, revenue growth is running well ahead of our revised estimate. For example, it appears that General Fund revenue collections for the first half of the fiscal year are 16% greater than a year earlier. However, much of the tax relief enacted last session will largely occur in the second half of this year, and will lower the revenue growth rate by roughly 4% from what would otherwise occur. When combined with the impact of a slowing economy, we are anticipating a rather precipitous slowing of the revenue growth rate during the second half of FY 1995. Nonetheless, there is a good chance that we will exceed this year's revenue estimate.

Sales Tax collections are expected to increase by 9.1%. Our forecast is consistent with an increase of 10.7% and $191.9 million when adjusted for the Sales Tax content of the adjustments noted above.

Individual Income Tax collections are expected to increase by 4.1% in FY 1995. Legislative reductions aggregating $103.2 million become effective in FY 1995 without which the FY 1995 increase would have been 11.2%.

Corporation Income Tax collections are expected to increase by 1.5%, reflecting slower growth in corporation profits and a reduced level of tax credits from the defense restructuring program. However, based upon extremely strong growth in this tax during the first half of the fiscal year, we may handily exceed this estimate.

Property Tax collections will increase by a minuscule 0.1%, reflecting little growth in assessed valuation together with depreciation of Utility properties involved in the Minimum Qualifying Tax Rate (QTR).

Insurance Premium Taxes are forecast to decline by 2.9%. This is largely due to past legislation which affected the deductibility of tax credits by lowering the deductibility percents in the early years and raising them in later years. We are now in the "later" years.

Vehicle License Tax collections are expected to grow by 9.8%. This reflects a continued high level of new car sales, although at a slower growth rate than in FY 1994.

The *Lottery* has not been performing up to expectations so far during FY 1995 and we have reduced the General Fund Lottery forecast to $39.0 million. While this is a 20.2% improvement from last year it is less than expected given the advent of the "Powerball" game. There is a possibility that the forecast will be further reduced.

Interest collections are expected to increase by 64.2% largely because of higher Operating Fund cash balances, which are now routinely above $500 million, and also because of higher interest rates. (Note: "Operating Fund" balances consist of the daily investable balances of any funds under the control of the State Treasurer, which by law are not required to be separately accounted for and invested.)

Chart 17 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 1995, the Retail Sales Tax collections are 13.4% ahead of the same period last year. Chart 18 shows Restaurants and Bars Sales growth, which are also doing reasonably well with an increase of 8.9% for the five months year-to-date in FY 1995. Chart 19 shows Hotel/Motel Sales which are up 9.4%. Chart 20 shows the improved level of Contracting Sales (largely construction) where collections are above the same period last year by 23.1%. Because the states share of the Distribution Base has been reduced, the percentage increases noted refer to the total collections in the category.

FY 1996 Forecast

As was noted earlier, we expect FY 1996 to be a growth year, but a year in which the rates of growth begin to taper off. Also, General Fund revenue will be further reduced by $85.4 million by legislation passed during the Forty-First Legislature, Second Regular Sessions and Eighth Special Session, together with an additional reduction in the Commercial Lease Tax.

Sales and Use Tax collections are expected to increase by 4.0%, down from the 9.1% increase in FY 1995. The negative impact of the above mentioned legislation will be $44.8 million.

Individual Income Tax collections will increase by 8.9% in FY 1996. Forecasted collections have been reduced by $3.5 million due to the above mentioned legislation.

Corporation Income Tax collections are expected to decrease by 7.2% as we expect collections to be negatively impacted by $13.6 million due to the above mentioned legislation and $15.0 million due to the initial impact of credits provided under 1992's defense restructuring program.

Property Tax collections will decrease by 0.8%. Assessed valuation will increase by 3.0% which includes reduction in assessment ratios for Property Class 1 (Mines) and Property Class 2 (Utilities). A "Minimum QTR" collections will drop by $4.8 million due to further depreciation of the properties involved.

Insurance Premium Tax collections will still be negatively impacted for the same reasons noted under the FY 1995 forecast.

Interest collections will increase by 6.6% with primarily lower levels of Operating Fund cash balances offset by higher interest rates.

Vehicle License Tax collections will rise by 7.8% reflecting modest growth in new car sales.

FY 1997 Forecast

The major factor in this forecast will be the anticipated mild recession previously noted as well as further reductions in the assessment ratios for Property Classes 1 and 2.

Chart 21 shows dollars of General Fund Base Revenue as a bar chart and percent change as a line graph for 19 fiscal years. In terms of percent change, Arizona has had very strong years and also some years which exhibited much lower growth. It should be noted that FY 1979 through FY 1982 were years when the Consumer Price Index was near or at double digit inflation. Also shown are "underlying growth rates" (after elimination of tax increases or decreases) for FY 1989 through FY 1997. Chart 22 shows Sales and Use Tax Revenue to the General Fund for the period FY 1986 through FY 1997. Chart 23 and Chart 24 show Individual and Corporation Income Tax revenue for the same period. Chart 25 shows Total General Fund Revenue also for the same period. Chart 26 relates to Chart 25, but shows, on a bar chart, growth of Total General Fund Revenue for the period FY 1973 through

FY 1997. Chart 27 shows, the changes in major categories of General Fund Revenue from FY 1995 to FY 1996 in both percent and dollar terms. Chart 28 shows percentage growth in major tax categories, as well as Total General Fund for FY 1994 through FY 1997. Chart 29 shows, as a pie chart, FY 1997 General Fund Revenue sources as a percent of Total Base Revenue, excluding the effect of Federal Retiree Refunds.

Federal Retiree Refunds

Prior to 1989, Arizona exempted from taxation 100% of state, county and municipal retirement benefits, while exempting only the first $2,500 of federal retirement benefits. The majority of other states have had similar practices. The U.S. Supreme Court, in a landmark decision in 1988 (Davis vs. State of Michigan), ruled that states granting exemptions to state government retirees, but not to federal retirees, were in violation of federal law. Arizona immediately changed its laws to provide equal $2,500 exemptions for federal and state retiree benefits. In June 1993, however, the Supreme Court ruled (in Harper vs. State of Virginia) that the states must grant "retroactive" relief to the federal retirees, although the court did not specify the form that the relief should take.

In late 1993, Governor Symington established (through Executive Order) a four-year program through which qualified federal retirees are provided refunds for any tax paid to the State of Arizona on federal retirement benefits for the years 1984 through 1988, were provided relief. Under the plan, people who no longer pay taxes or have moved out of the state, received cash refunds, as did the estates of deceased persons. Others were issued tax credits, which could be used as an offset to their tax liability during the four-year period. It is expected that some cash payments will be made at the close of the four-year period to those who still have an unused balance. The cost of the program covers five fiscal years, largely due to taxpayers obtaining extensions, but also includes some cash payments at the end of the period.

The program is expected to cover 44,502 taxpayers, with a cost over the period as follows:

	Interest and Principal ($ Millions)
FY 1994	$ 55.2
FY 1995	22.0
FY 1996	18.3
FY 1997	57.7
FY 1998	6.2
	$159.4

Table 6

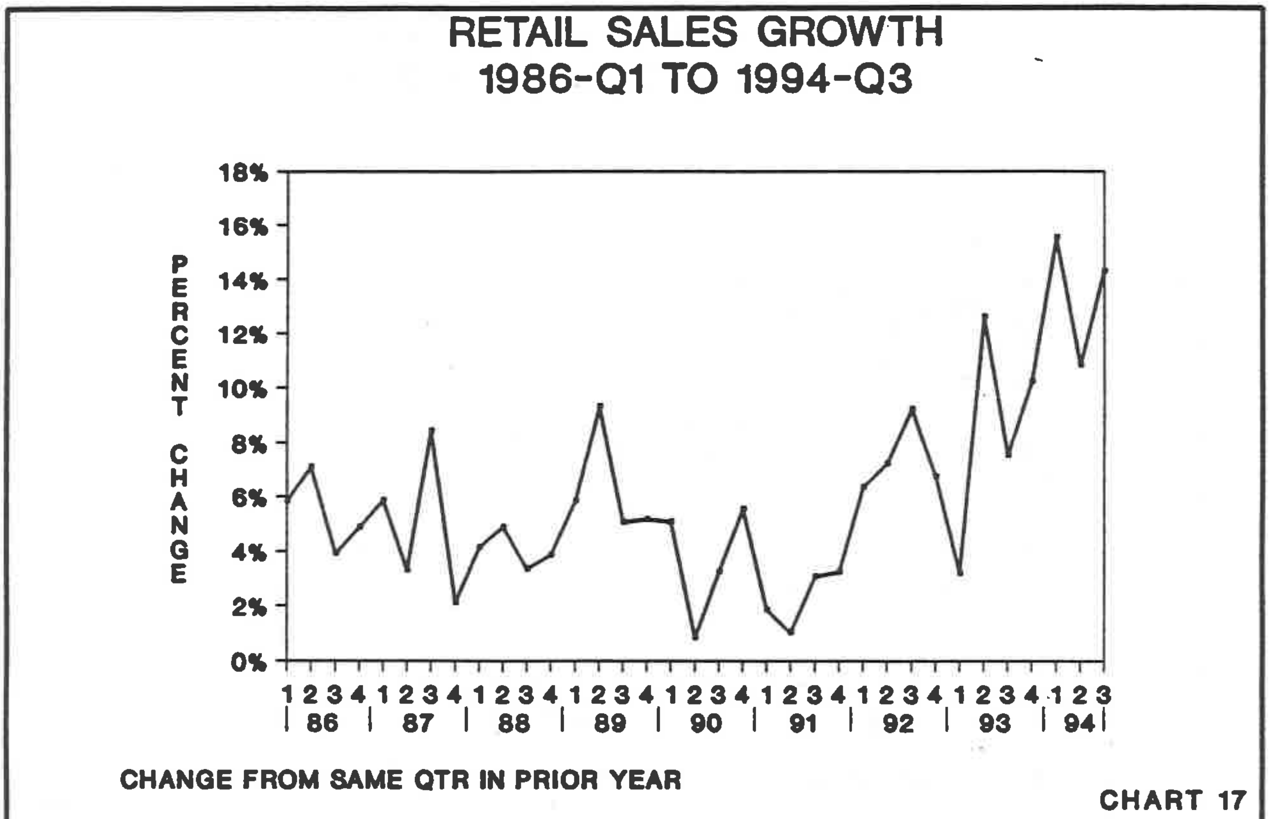
STATE OF ARIZONA
GENERAL FUND
STATEMENT OF PROJECTED BASE REVENUE
JLBC STAFF ESTIMATE
(Thousands)

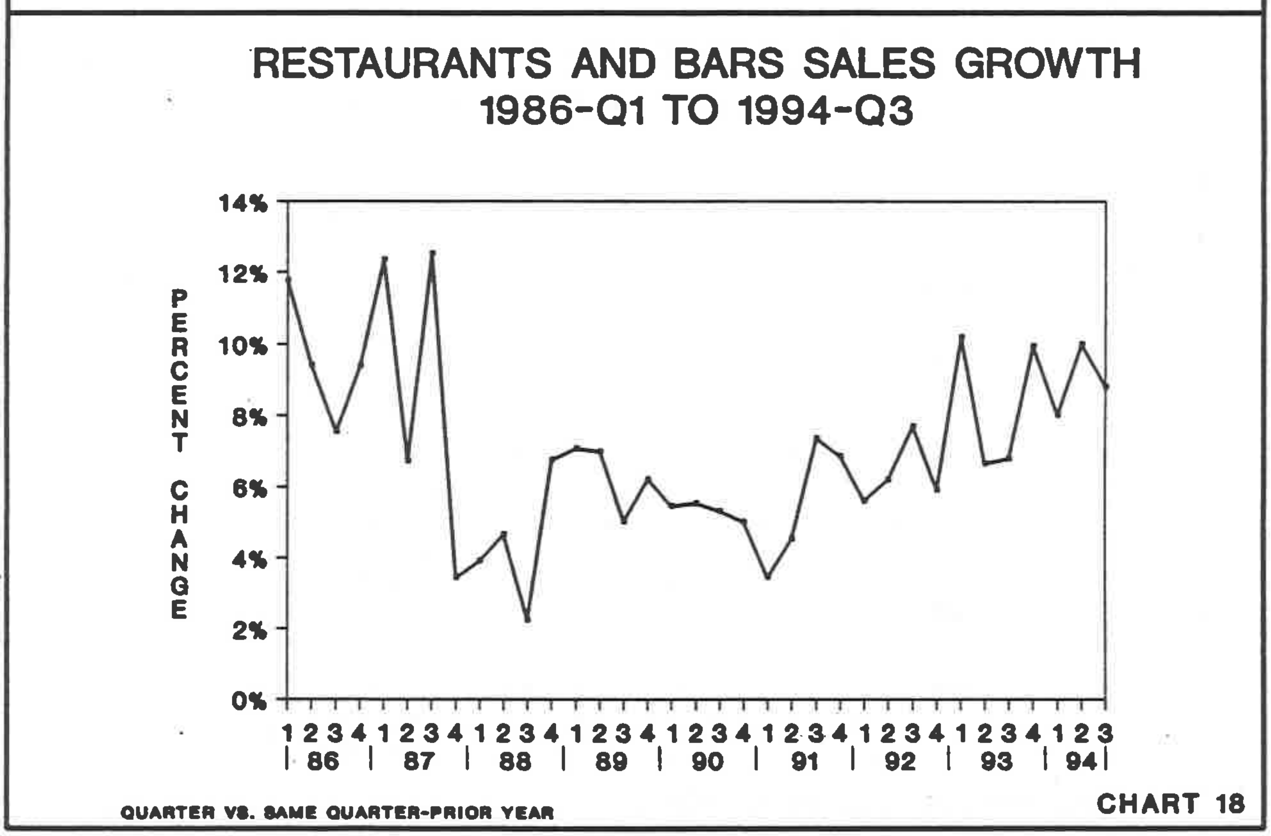
	Actual - FY 1994		Forecast - FY 1995		Forecast - FY 1996		Forecast - FY 1997	
	Amount	% Change	Amount	% Change	Amount	% Change	Amount	% Change
Taxes								
Sales and Use	$1,792,997.6	9.9%	$1,957,000.0	9.1%	$2,035,700.0	4.0%	$2,117,200.0	4.0%
Income - Individual	1,460,031.7	6.8	1,520,000.0	4.1	1,656,000.0	8.9	1,810,000.0	9.3
- Federal Retiree Project	(55,186.7)	--	(22,000.0)	(60.1)	(18,300.0)	(16.8)	(57,700.0)	215.3
- Corporation	302,524.3	26.5	307,200.0	1.5	285,000.0	(7.2)	263,000.0	(7.7)
- Urban Revenue Sharing	(185,405.3)	0.9	(205,700.0)	10.9	(218,500.0)	6.2	(245,100.0)	12.2
Property	186,193.2	(8.4)	186,400.0	0.1	185,000.0	(0.8)	182,300.0	(1.5)
Luxury	73,333.4	0.4	72,200.0	(1.5)	64,000.0	(11.4)	63,300.0	(1.1)
Insurance	110,731.7	7.5	107,500.0	(2.9)	106,800.0	(0.7)	113,100.0	5.9
Motor Vehicle License	115,891.1	12.4	127,200.0	9.8	137,100.0	7.8	145,900.0	6.4
Pari-Mutuel	5,189.6	5.3	4,700.0	(9.4)	1,000.0	(78.7)	800.0	(20.0)
Estate	40,616.7	2.3	45,000.0	10.8	45,500.0	1.1	46,000.0	1.1
Other Taxes	1,981.7	8.1	2,200.0	11.0	2,300.0	4.5	2,300.0	0.0
Subtotal - Taxes	3,848,899.0	7.4	4,101,700.0	6.1	4,281,600.0	4.4	4,441,100.0	3.7
Other Non-Tax Revenue								
Lottery	32,444.8	(6.0)	39,000.0	20.2	37,000.0	(5.1)	38,000.0	2.7
Licenses, Fees, Permits	46,251.6	14.3	40,400.0	(12.7)	40,000.0	(1.0)	40,300.0	0.8
Interest	18,569.3	63.0	30,500.0	64.2	32,500.0	6.6	30,300.0	(6.8)
Sales and Services	3,491.8	(22.8)	3,700.0	6.0	3,800.0	2.7	3,900.0	2.6
Other Miscellaneous	43,293.7	9.0	36,500.0	(15.7)	35,000.0	(4.1)	36,000.0	2.9
Subtotal - Other Non-Tax Revenue	144,051.2	10.3	150,100.0	4.2	148,300.0	(1.2)	148,500.0	0.1
Total Base Revenue Before Other Revenue Sources	3,992,950.2	7.5	4,251,800.0	6.5	4,429,900.0	4.2	4,589,600.0	3.6
Other Revenue Sources								
Transfers and Reimbursements	22,109.0	188.7	27,000.0	22.1	27,000.0	0.0	27,000.0	0.0
Disproportionate Share	58,219.7	(8.6)	79,000.0	35.7	68,000.0	(13.9)	68,000.0	0.0
Subtotal - Other Revenue Source	80,328.7	12.6	106,000.0	32.0	95,000.0	(10.4)	95,000.0	0.0
Total Base Revenue	$4,073,278.9	7.6%	$4,357,800.0	7.0%	$4,524,900.0	3.8%	$4,684,600.0	3.5%

Table 7

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

	Actual - FY 1995			Forecast - FY 1996		
	Governor's Estimate	JLBC Staff Estimate	Difference	Governor's Estimate	JLBC Staff Estimate	Difference
Taxes						
Sales and Use	$1,945,000.0	$1,957,000.0	$12,000.0	$2,049,000.0	$2,035,700.0	$(13,300.0)
Income - Individual	1,520,000.0	1,520,000.0	0.0	1,648,300.0	1,656,000.0	7,700.0
- Federal Retiree Project	(22,000.0)	(22,000.0)	0.0	(18,300.0)	(18,300.0)	0.0
- Corporation	300,000.0	307,200.0	7,200.0	275,000.0	285,000.0	10,000.0
- Urban Revenue Sharing	(205,610.0)	(205,700.0)	(90.0)	(218,540.0)	(218,500.0)	40.0
Property	188,000.0	186,400.0	(1,600.0)	185,000.0	185,000.0	0.0
Luxury	74,470.0	72,200.0	(2,270.0)	67,000.0	64,000.0	(3,000.0)
Insurance Premium	108,500.0	107,500.0	(1,000.0)	99,000.0	106,800.0	7,800.0
Motor Vehicle License	127,400.0	127,200.0	(200.0)	131,800.0	137,100.0	5,300.0
Pari Mutuel	4,430.0	4,700.0	270.0	1,000.0	1,000.0	0.0
Estate	43,000.0	45,000.0	2,000.0	39,000.0	45,500.0	6,500.0
Other Taxes	2,000.0	2,200.0	200.0	1,900.0	2,300.0	400.0
Subtotal Taxes	4,085,190.0	4,101,700.0	16,510.0	4,260,160.0	4,281,600.0	21,440.0
Other Non-Tax Revenue						
Lottery	35,900.0	39,000.0	3,100.0	34,000.0	37,000.0	3,000.0
Licenses, Fees and Permits	40,854.5	40,400.0	(454.5)	42,272.0	40,000.0	(2,272.0)
Interest	28,500.0	30,500.0	2,000.0	31,600.0	32,500.0	900.0
Sales and Services	5,527.9	3,700.0	(1,827.9)	5,575.6	3,800.0	(1,775.6)
Other Miscellaneous	35,000.0	36,500.0	1,500.0	37,500.0	35,000.0	(2,500.0)
Subtotal - Other Non-Tax Revenue	145,782.4	150,100.0	4,317.6	150,947.6	148,300.0	(2,647.6)
Total Base Revenue Before Other Revenue Source	4,230,972.4	4,251,800.0	20,827.6	4,411,107.6	4,429,900.0	18,792.4
Other Revenue Sources						
Transfers and Reimbursements	27,000.0	27,000.0	0.0	27,000.0	27,000.0	0.0
Disproportionate Share Revenue	79,020.0	79,000.0	(20.0)	68,000.0	68,000.0	0.0
Subtotal - Other Revenue Source	106,020.0	106,000.0	(20.0)	95,000.0	95,000.0	0.0
Total Base Revenue	$4,336,992.4	$4,357,800.0	$20,807.6	$4,506,107.6	$4,524,900.0	$18,792.4


RETAIL SALES GROWTH
1986-Q1 TO 1994-Q3
PERCENT CHANGE
18%
16%
14%
12%
10%
8%
6%
4%
2%
0%
1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3
86 87 88 89 90 91 92 93 94
CHANGE FROM SAME QTR IN PRIOR YEAR
CHART 17


RESTAURANTS AND BARS SALES GROWTH
1986-Q1 TO 1994-Q3
PERCENT CHANGE
14%
12%
10%
8%
6%
4%
2%
0%
1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3
86 87 88 89 90 91 92 93 94
QUARTER VS. SAME QUARTER-PRIOR YEAR
CHART 18

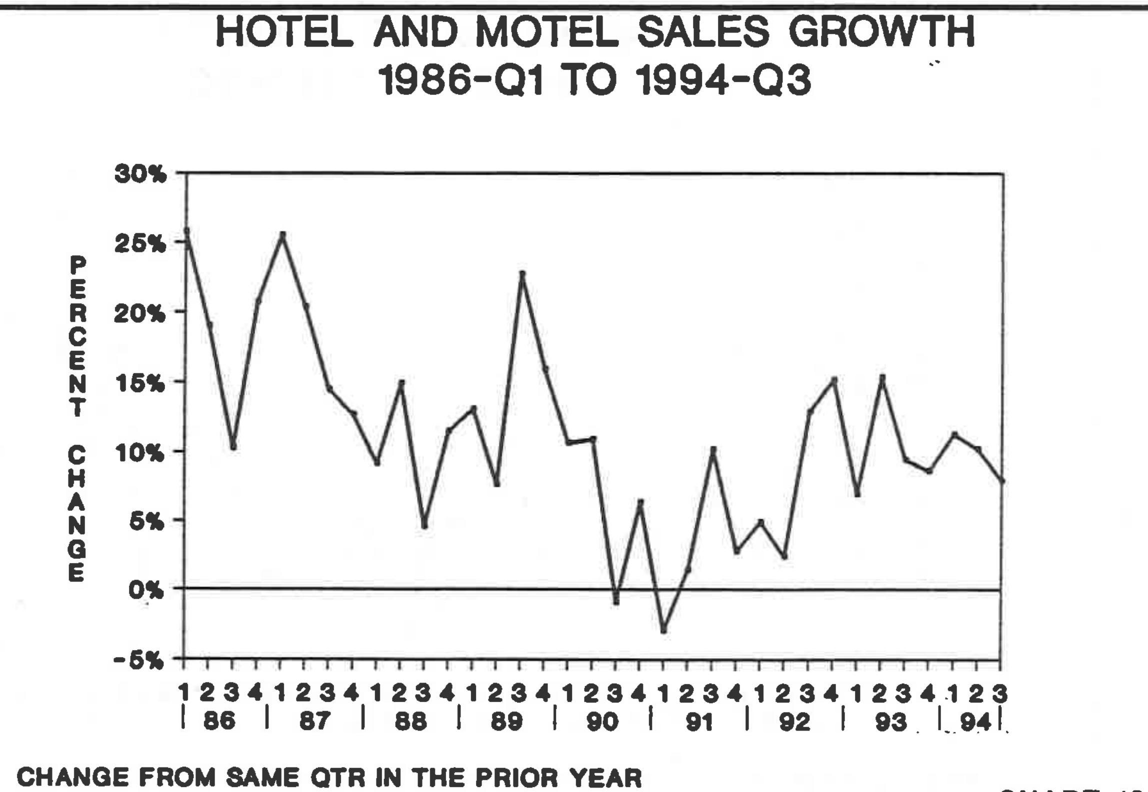


CHART 19

CHART 20

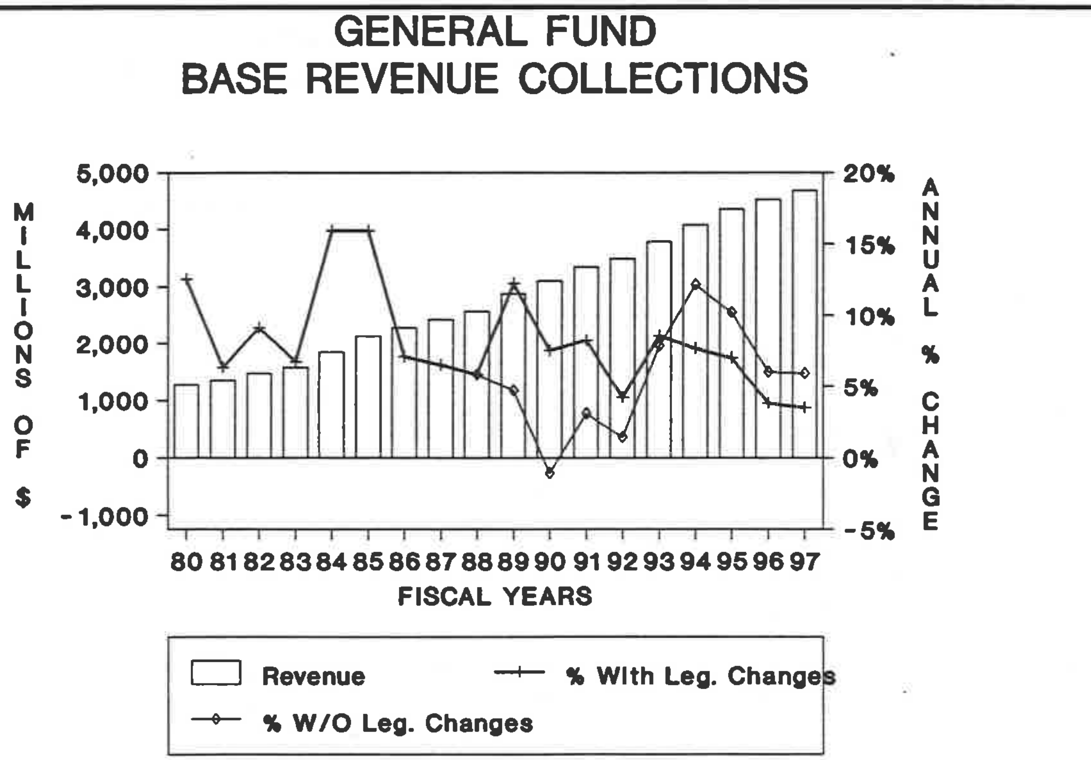


CHART 21

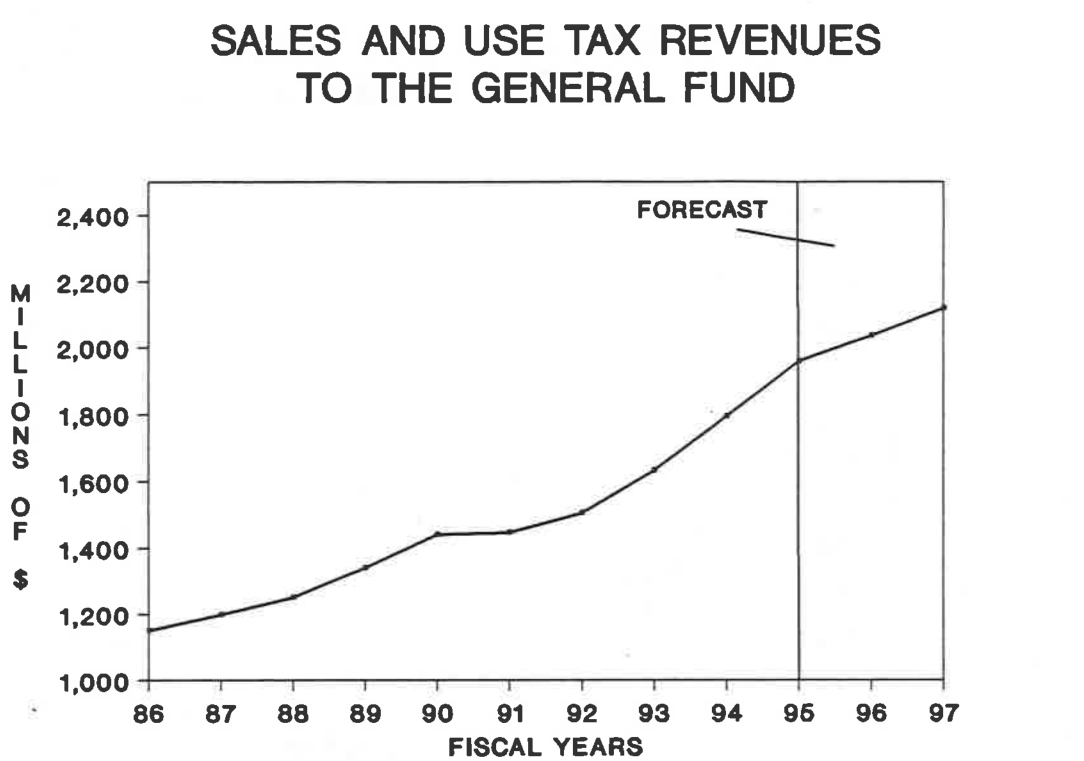


CHART 22

INDIVIDUAL INCOME TAXES TO THE GENERAL FUND

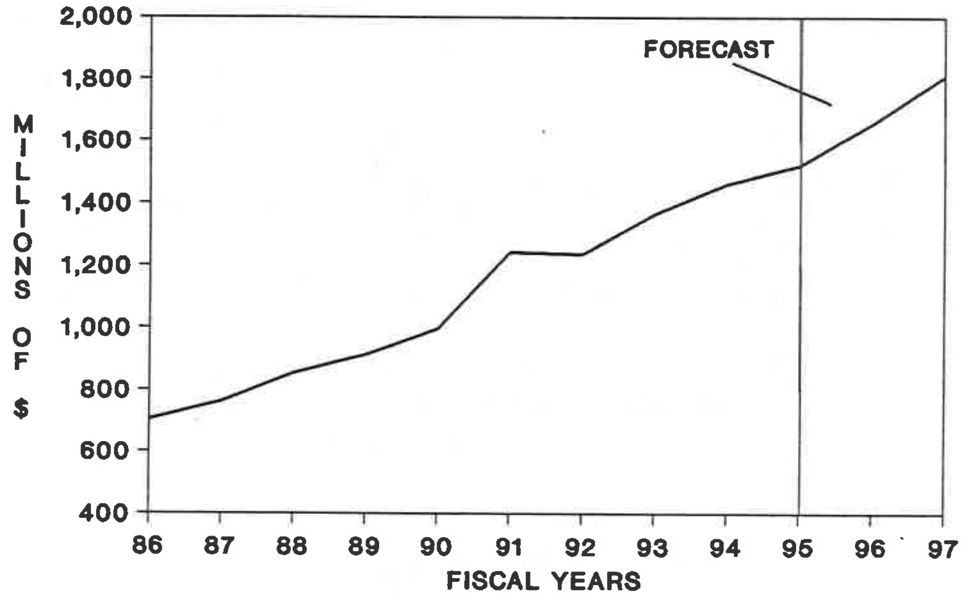


CHART 23

CORPORATION INCOME TAXES TO THE GENERAL FUND

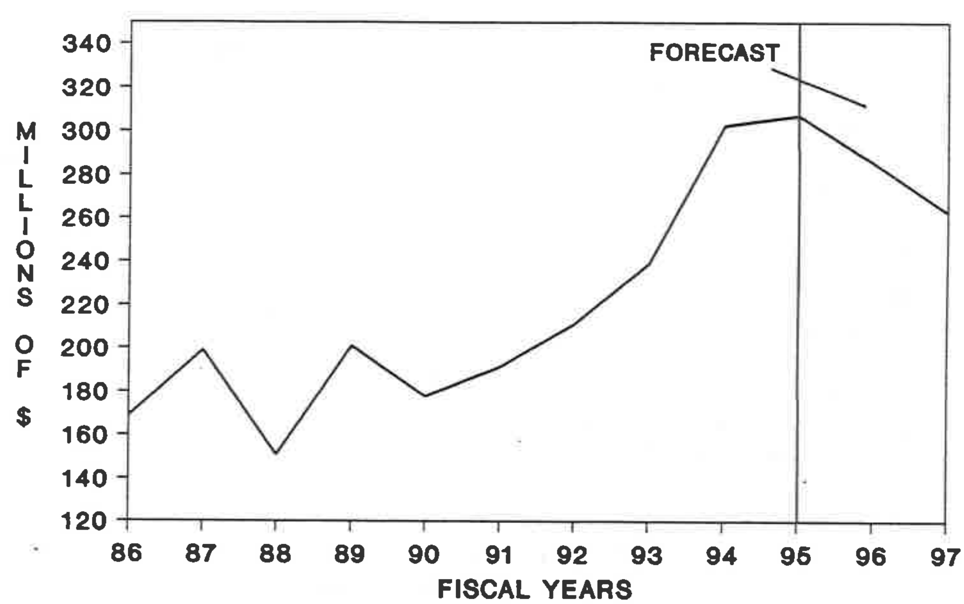


CHART 24

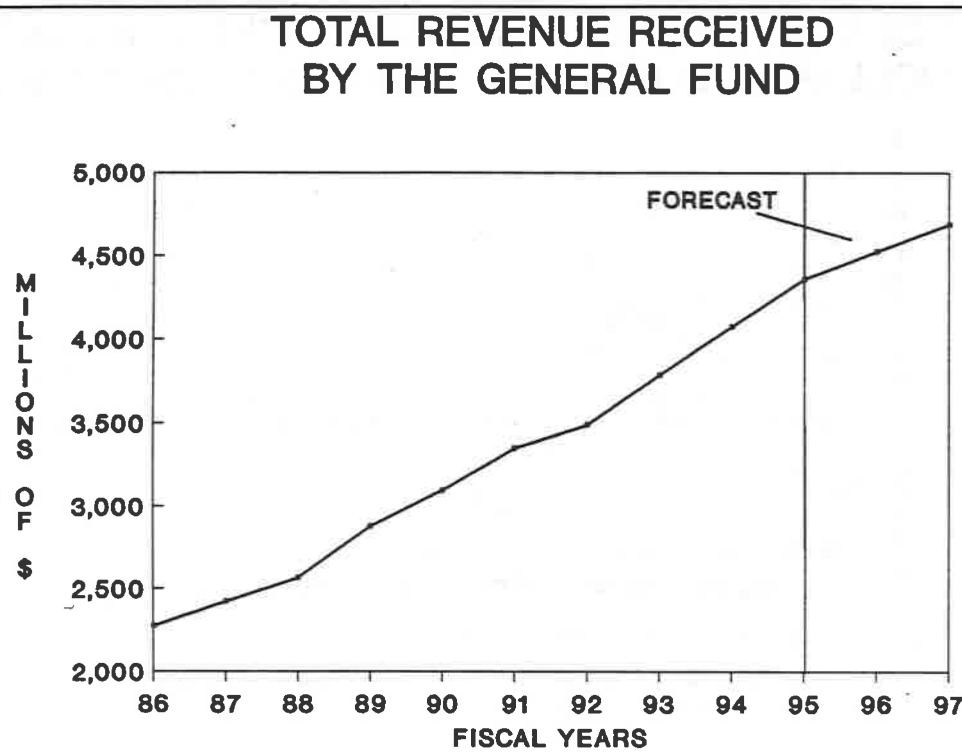


CHART 25

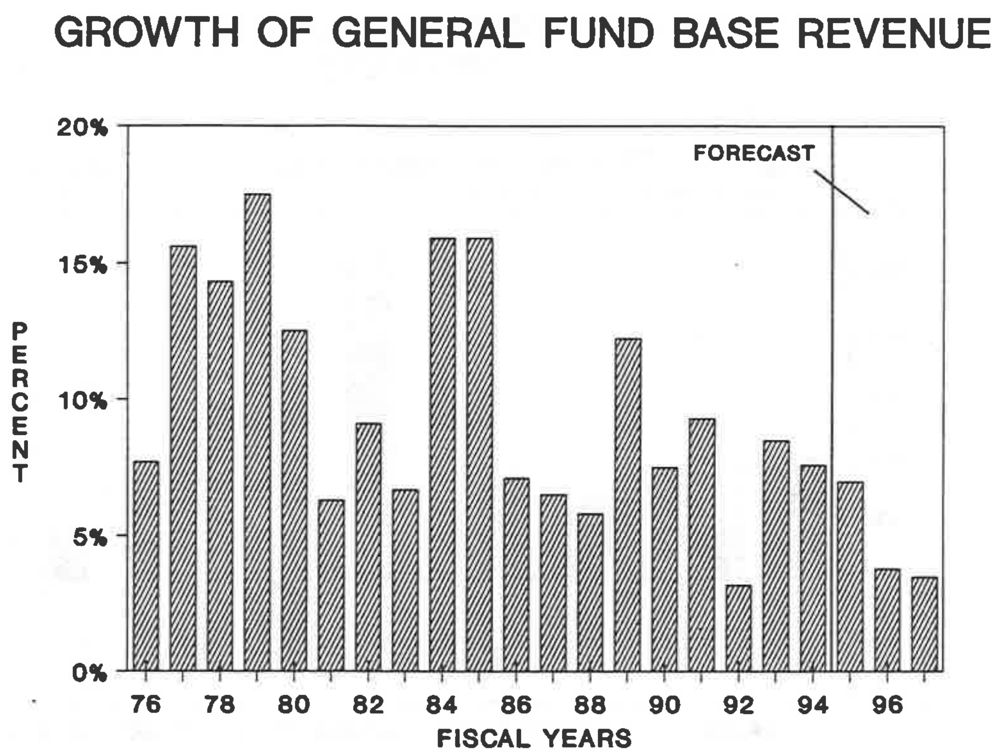


CHART 26

FORECAST FY 1996 MAJOR REVENUE SOURCES DOLLAR AND PERCENT CHANGE FROM FY 1995

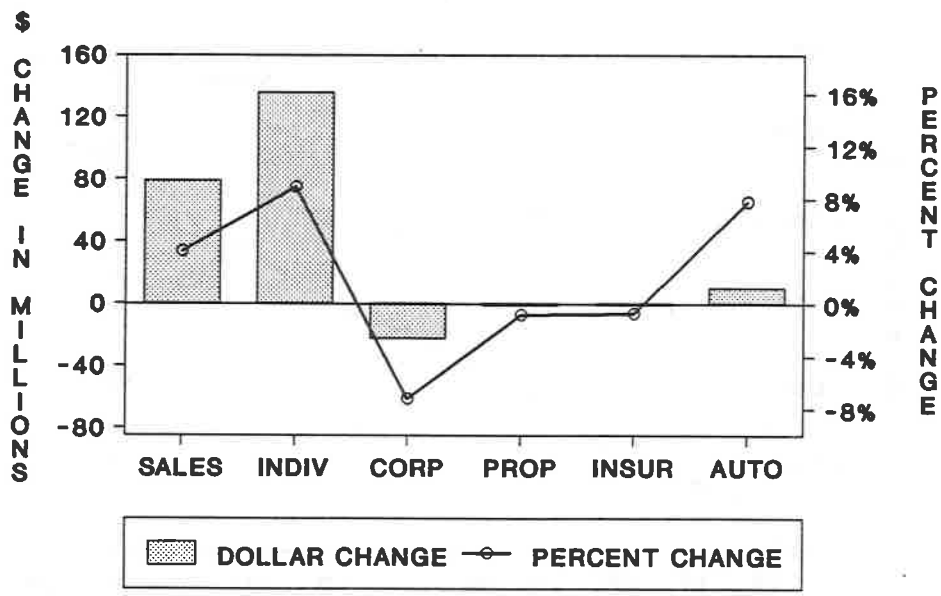


CHART 27

PERCENTAGE GROWTH IN STATE TAX REVENUES

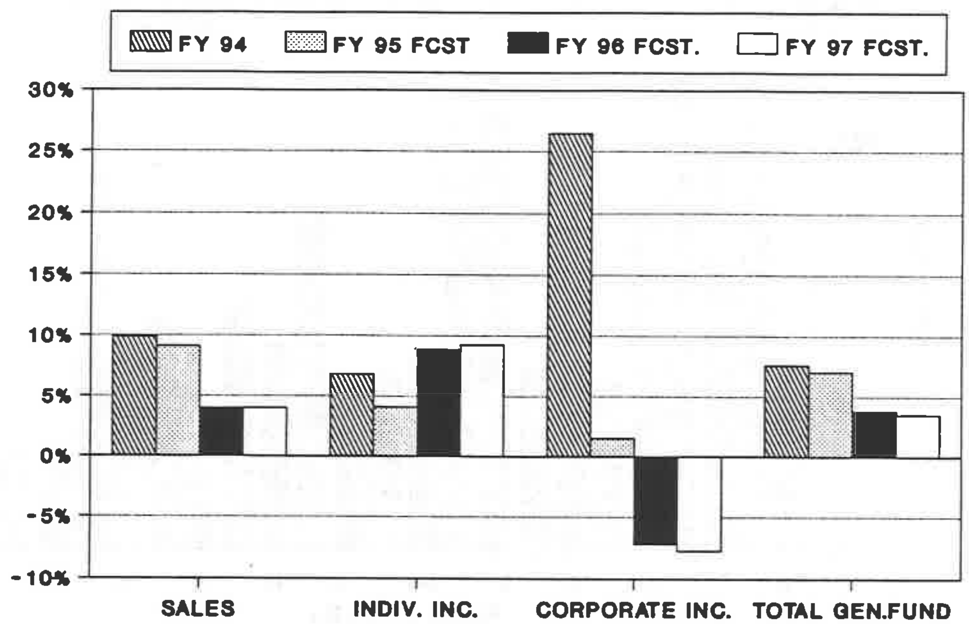
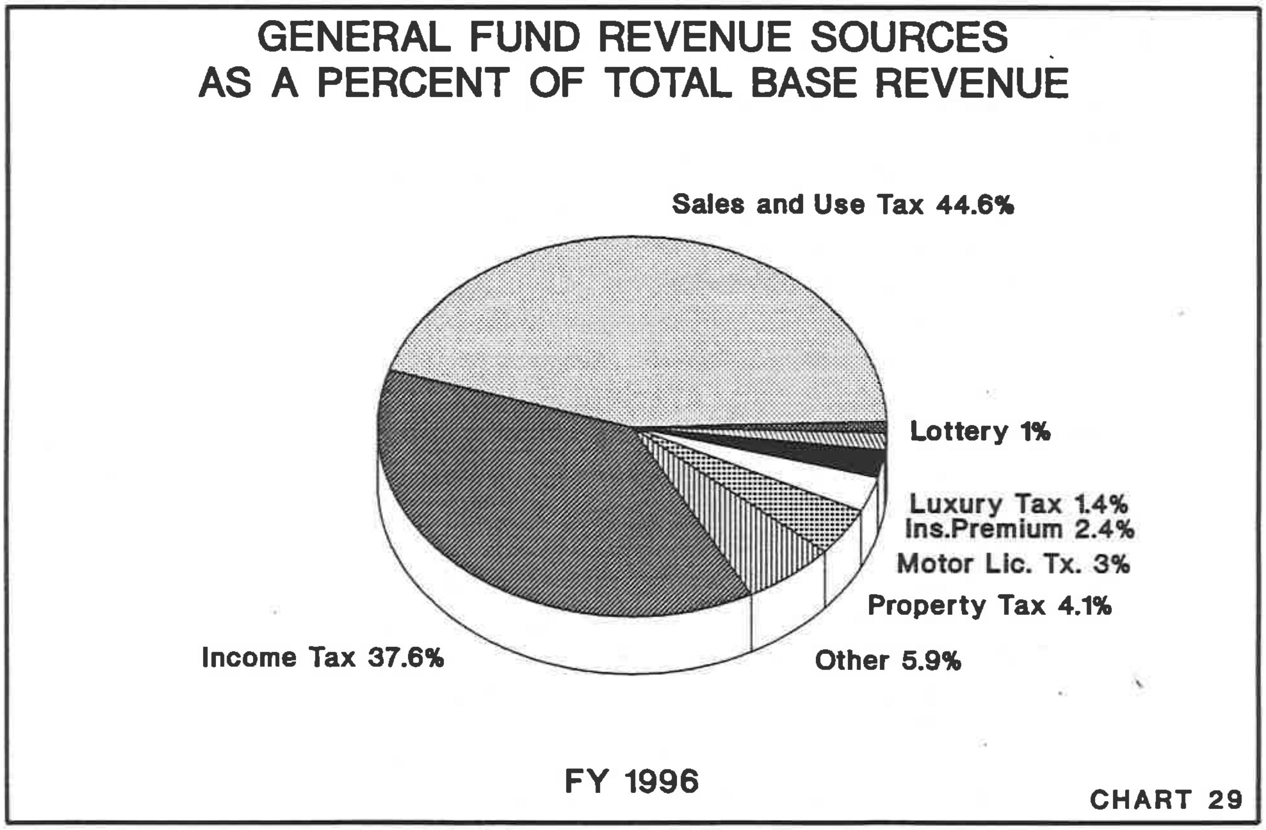


CHART 28


GENERAL FUND REVENUE SOURCES
AS A PERCENT OF TOTAL BASE REVENUE
Sales and Use Tax 44.6%
Lottery 1%
Luxury Tax 1.4%
Ins.Premium 2.4%
Motor Lic. Tx. 3%
Property Tax 4.1%
Other 5.9%
Income Tax 37.6%
FY 1996
CHART 29

ARIZONA BUDGET STABILIZATION FUND

Background

The Arizona Budget Stabilization Fund (BSF) 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 utilize this revenue during times of below-trend growth to mitigate spending cuts or cut taxes in a recession. 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 was required and made in 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 as in 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 beyond a level that is sustainable. 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 30).

- 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 31).

- 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 31).

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

- The balance in the BSF cannot exceed 15% of General Fund revenue at the close of a fiscal year (the JLBC Staff is recommending that this cap be lowered to 5%).

Simulated Results

Chart 33 shows the growth of real Arizona Personal Income over a 20-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 occur 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.

Appropriations (Deposits) to BSF

The Economic Estimates Commission reported (May 2, 1994) that the first pay-in would be required in FY 1994 in the amount of $78.3 million. This pay-in was, as expected, due to the sharp "above trend" improvement in Arizona's economy as it recovers from the long, slow period in the national and Arizona economies.

However, as discussed in detail in the previous "General Fund Year End Balances" section, prior to the end of the 1994 Legislative Session, it was decided repay a portion of the "K-12 Rollover." These are state funds to local education which had, for six consecutive years, been delayed by a few days to move or "roll" them into the next fiscal year in order to balance the budget during the recession. It was decided that only $42.0 million should be put into the Budget Stabilization Fund and $89.0 million should go towards repaying the

$142.5 million "K-12 Rollover" deferral in FY 1994. The budget was subsequently enacted with the "triple trigger" provisions discussed at length earlier. Specifically, with respect to the Budget Stabilization Fund the "triple trigger" provides for the following:

- Any FY 1994 General Fund ending balance in excess of $107.2 million is appropriated in FY 1995 first to the K-12 rollover and then to the BSF. The ending balance turned out to be substantially higher than this. As a result, the sum of $68.5 million was deposited into the BSF from the FY 1994 carry-forward in November, 1994.

- The State Treasurer will determine, in June 1995, whether there is any revenue in excess of $4,237.1 million. If so, this "excess" revenue is appropriated into the BSF in FY 1995, except that the total BSF appropriation shall not exceed the amount required by the BSF formula (see A.R.S. § 35-144). We estimate that "excess" revenues will be greater than the amount necessary to bring the total FY 1995 BSF deposit to our estimate of the statutorily-required amount ($156.0 million). This would require a final deposit of $87.5 million to reach this level for FY 1995.

Looking to FY 1996, it is expected that legislation will be passed which will limit the balances in the BSF to 5% of current fiscal year revenues. The 5% level for reserves is considered to be the appropriate amount by many fiscal and credit analysts. Since the expected BSF balance will be $202.7 million at the end of FY 1995, no deposit would have to be made in FY 1996. Instead, estimated interest earnings of at least $13.5 million, when added to the beginning balance, will increase the BSF balance to the 5% limit.

Table 8 below shows the estimated deposits to the BSF if economic and revenue growth are as projected for FY 1995 and FY 1996.

Table 8

ESTIMATED DEPOSITS TO BSF
FY 1994 AND FY 1995
(Millions of 1987 $)

Fiscal Year	Real Adjusted AZPI*	Annual Growth	7-Year Average Growth	Excess Growth	Estimated Revenues***	Deposits/ Withdrawals	Interest Earnings	Balance
1994	$46,872	4.04%	1.97%****	2.07%	$3,784.8	$42.0**	$0.1	$ 42.1
1995	$49,741	6.12%	2.29%*****	3.83%	$4,073.2	$156.0	$4.6	$202.7
1996	$52,213	4.97%	2.62%******	2.35%	$4,357.8	0.0**	$13.5	$216.2

* For calendar year ending in fiscal year (e.g. - CY 1993 for FY 1994)
** Amount deposited by legislative agreement.
*** For prior fiscal year, excluding beginning balance.
**** Average for 1987 through 1993.
***** Average for 1988 through 1994.
****** Average for 1989 through 1995.

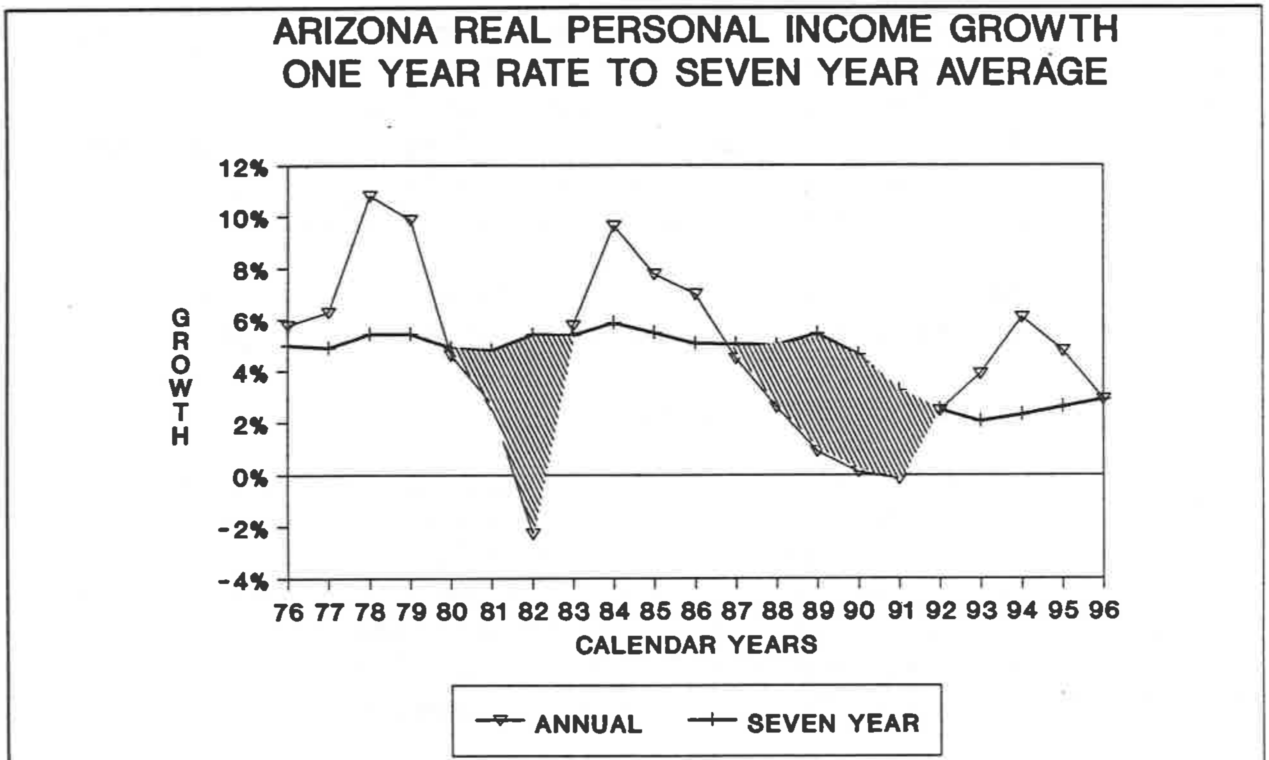
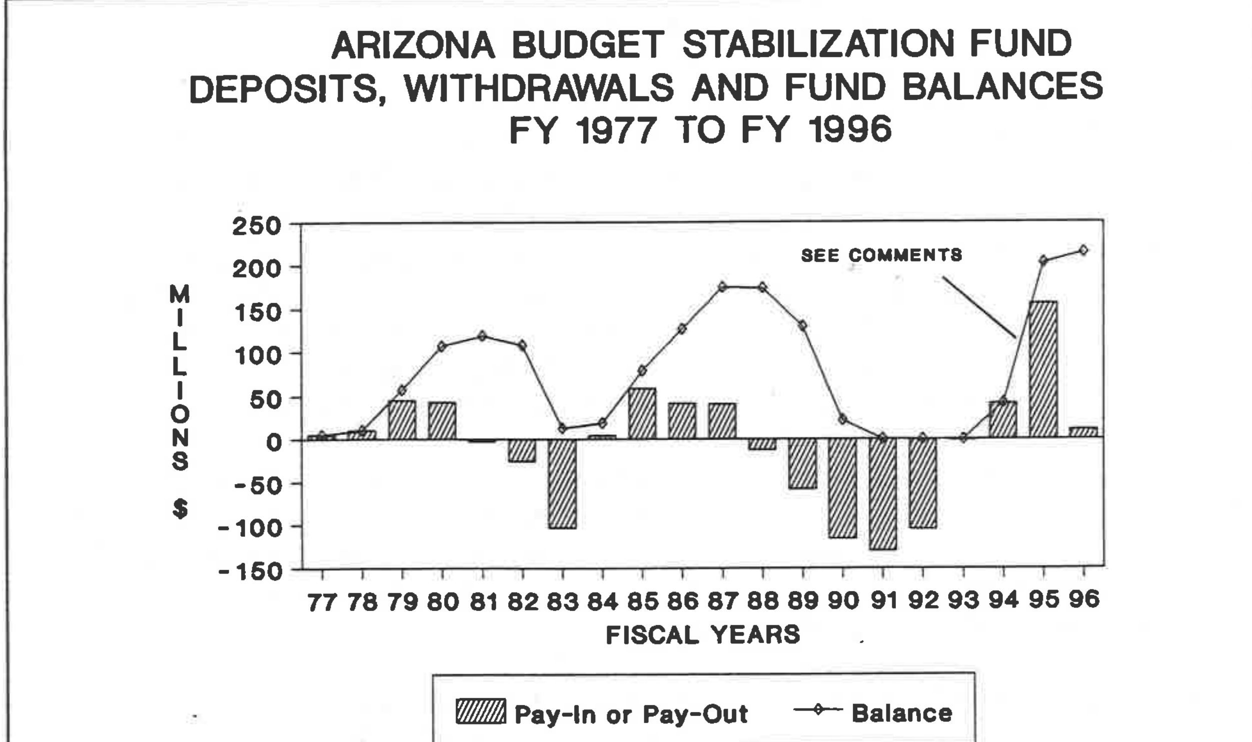


CHART 30



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

CHART 31

OPERATING FUND CASH BALANCES

Average balances in the Operating Fund for the twelve months of FY 1994, from July through June, were $450 million compared to $252 million in FY 1993 — an increase of 79% (see Chart 32). This increase was due to faster growth in revenues received by the State Treasurer's Office. Sales tax and individual withholding taxes are up more than forecast a year ago. It also appears that certain areas of social services spending are rising less than expected, which would help explain this surge in Operating Fund balances.

We are forecasting that balances will rise to an average level of $605 million in FY 1995, although this average could rise if revenues continue to grow rapidly this year.

Slightly Higher Interest Earnings Expected

Short-term interest rates started to rise last January in line with Federal Reserve tightening. By December, "the Fed" had raised the Federal Funds rate six times in CY 1994. The fourth quarter (September through December) of CY 1994 saw the Federal Funds interest rate at about 5.5% compared to about 3% in the fourth quarter of CY 1993. Three-month Treasury Bills yielded about 5.4% compared to 2.96% in FY 1994, and 10-year U.S. Treasury Bonds were 7.5% compared to 5.6% in the same period one year earlier. Mortgage rates also increased from 7.27% to over 9% during the same period.

The State Treasurer's Office believes interest rates may continue to increase slightly as the U.S. economy continues to improve. In the meantime, it usually keeps 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 such as the Federal Funds or U.S. T-Bill rates clearly have the dominant role. For example, with 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. While both numbers in this example have changed by the same percent, interest rates have historically been more volatile then Operating Fund balances, which causes them to have the larger influence.

Interest earnings fell in recent years, along with interest rates for the past several years, from $15.7 million in FY 1992 to $11.4 million in FY 1993 but they rose to $18.6 million in FY 1994 due to record balances (see Chart 33). Since interest rates are rising and there are sharply higher balances in the Operating Fund there should be positive effects for General Fund earnings in FY 1995 and FY 1996.

The result of the sharply higher current and expected balances is that interest earnings for the General Fund are expected to increase to $30.5 million in FY 1995 and $32.5 million in FY 1996. It is very possible that these estimates may be slightly upward if interest rates continue to rise and operating balances continue to grow.

Table 9 shows the average balances managed by the Treasurers Office for the first four months of FY 1995, through October, including the Operating Fund Balance.

Table 9

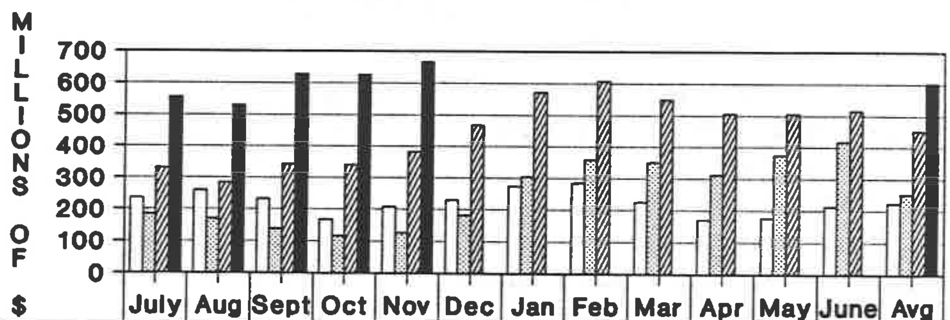
FUNDS MANAGED BY THE STATE TREASURER IN FY 1994*
(Millions of Dollars)

Account	Average Balance	Percent of Total
Local Governments Investment Pools	$1,324	38.1%
Permanent Land Trust	657	18.9
State Agencies	406	11.7
Operating Fund Balance	586	16.9
Central AZ Water Conservation District	184	5.3
AZ Department of Transportation	209	6.0
ADOT Bond Issues	64	1.8
Arizona Risk Retention Fund	6	0.2
Game & Fish	26	0.7
AZ Power Authority	10	0.3
Arbitrage Funds	3	0.1
TOTAL AVERAGE BALANCE	$3,475	100.0%

* Average for 4 months through, July through October

Source: Arizona Treasurer's Office

OPERATING FUND
AVERAGE MONTHLY INVESTED BALANCES
FY 1992 through FY 1995 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	572	607	550	505	505	516	450
94/95	556	530	629	627	666								601

CHART 32

INTEREST EARNINGS AND THE FEDERAL FUNDS RATE

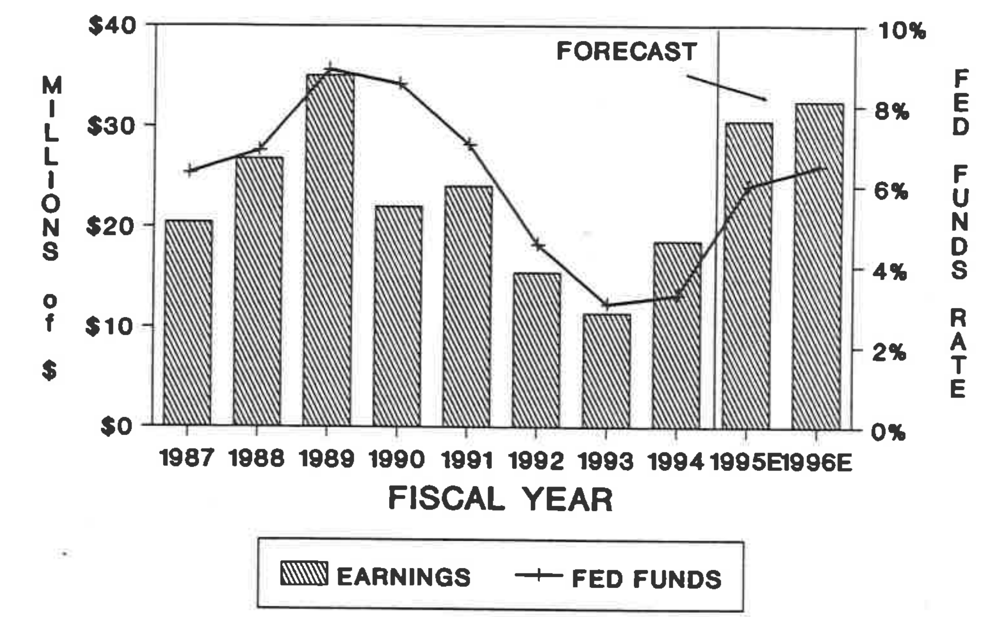


CHART 33