PROPOSED BUDGET
FY 1997

SUMMARY OF RECOMMENDATIONS

AND

ECONOMIC AND REVENUE FORECAST

Prepared By

JOINT LEGISLATIVE BUDGET COMMITTEE

SENATOR CAROL SPRINGER
Chairman 1996

REPRESENTATIVE ROBERT "BOB" BURNS
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JLBC

JOINT LEGISLATIVE BUDGET COMMITTEE

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

Senator Carol Springer Chairman 1996	Representative Robert "Bob" Burns Chairman 1995
Senator Gus Arzberger	Representative J. Ernest Baird
Senator A. V. "Bill" Hardt	Representative Carmen Cajero
Senator James Henderson, Jr.	Representative Lori S. Daniels
Senator Thomas C. Patterson	Representative Jeff Groscost
Senator Gary Richardson	Representative Herschella Horton
Senator Marc Spitzer	Representative Laura Knaperek
Senator John Wettaw	Representative Bob McLendon

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

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TED A. FERRIS
DIRECTOR

RICHARD STAVNEAK
DEPUTY DIRECTOR

January 9, 1996

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 1997.

Our recommendations are contained in two 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. This volume also includes information on non-appropriated funds.

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 completing the state budget for FY 1997.

Sincerely,

Ted A. Ferris
Director

TAF:lm

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BUDGET IN BRIEF
FISCAL YEAR 1997 - GENERAL FUND
JLBC STAFF RECOMMENDATION

The combination of $106 million more in FY 1995 surplus, and $195 million more in the FY 1996 revenue estimate, leads to a revised projection of a record surplus of $271 million at the end of the current fiscal year (FY 1996). This carry-forward (which is $269 million more than expected in March 1995) makes it possible to go forward with the $200 million reserved for property tax relief without major budget cuts.

The prospects of slower economic growth, pending federal funding cuts, continuing phased-in state tax cuts, and pending lawsuits against the state suggest that caution is in order. Accordingly, the JLBC Staff continues to recommend "sound fiscal practices" to keep the State of Arizona "fiscally fit" including:

- "Pay-as-you-go" financing of new facilities;
- 2nd highest funding ever for building renewal;
- Improved oversight over Information Technology projects;
- More aggressive implementation of "Program Authorization Reviews" under budget process reform;
- Enhanced oversight over non-appropriated funds;
- Legislative appropriation of Federal Block Grants.

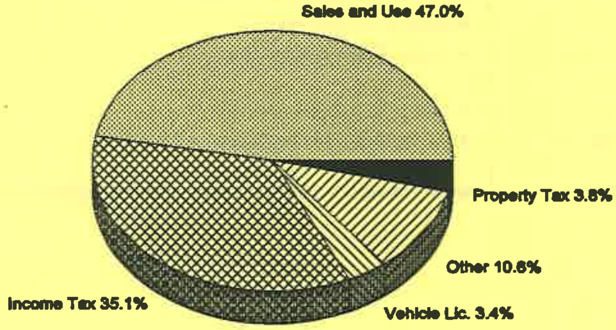
OPERATING APPROPRIATIONS

	$ Change From FY 96	JLBC Staff FY 97 Rec.
	($ Millions)	
• Dept. of Education (K-12)	$ 84.8	$1,860.5
• Universities	11.6	620.9
• AHCCCS	0.8	480.2
• Dept of Corrections	41.4	429.3
• Dept of Economic Security	(4.5)	390.7
• Dept of Health Services	(2.8)	215.9
• Judiciary	10.4	115.6
• Community Colleges	2.3	104.5
• Dept of Public Safety	11.9	55.2
• Dept of Revenue	0.1	51.3
• Dept of Juvenile Corrections	4.1	46.8
• Dept of Administration	(0.9)	25.4
• ASDB	0.5	17.3
• Dept of Environ. Quality	0.0	14.0
• All Other	(7.8)	190.1
TOTAL	$151.9	$4,617.7

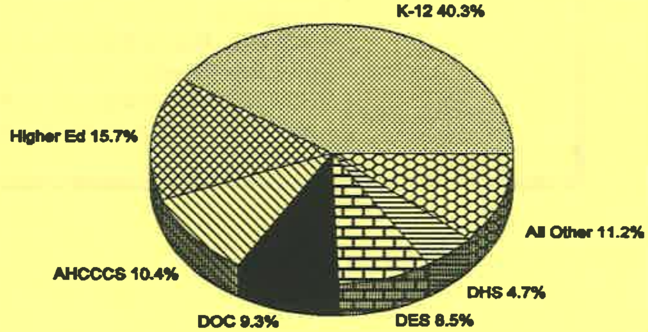
REVENUES AND YEAR-END BALANCES

	FY 96	FY 97
	($ Millions)	
REVENUES:		
• Beginning Balance	$ 269.5	$ 271.2
• Base Revenues	4568.2	4,702.1
SUBTOTAL-REVENUES	$4,837.7	$4,973.3
EXPENDITURES:		
• Annual Budgets	$4,217.1	$4,376.4
• Annual Supplementals	11.9	0.0
• Biennial Budgets	249.0	235.7
• Biennial Supplementals	0.0	5.6
• Capital	99.0	109.3
• Capital Supplementals	4.3	0.0
• Other Legislative Priorities	0.0	70.0
• Admin Adjust/Emergencies	40.0	25.5
• Revertments	(54.7)	(55.0)
SUBTOTAL-EXPENDITURES	$4,566.5	$4,767.5
Property Tax Relief	0.0	(200.0)
PROJECTED ENDING BALANCE	$ 271.2	$ 5.8

Where It Comes From



Where It Goes



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

FY 1997
COMPARISON OF MAJOR POLICY ISSUES

MAJOR ISSUES	JLBC STAFF RECOMMENDATION	EXECUTIVE RECOMMENDATION
Parameters of General Fund Budget	• $201 M, or 4.4% General Fund Increase • 458 FTE, or 1% Increase • (329) FTE Decrease, excluding Corrections	• $152 M, or 3.3% General Fund Increase • 703 FTE, or 1.7% Increase • (80) FTE Decrease, excluding Corrections
Tax Cuts	• $200 M Property Tax Relief	• Same Recommendation • $50 M Income Tax Cut
Capital Outlay	• *$10 M Change Above FY 96* • $59 M for Construction (Pay-As-You-Go) • 1,875 New Prison Beds and Infrastructure for 4,000 Beds at New Complex (FY 97: $46 M GF & FY 98: $16 M GF, $8 M OF) • 200 New DJC Beds and Infrastructure for 400 Beds at New Complex (FY 97: $9 M GF & FY 98: $5 M GF) • No Health Lab Funding • $3.9 M for 1993 Flood Relief (Supplemental Bill) • $23 M for 75% Funding of Building Renewal Formula • $27 M for Advance Appropriations	• *$(25) M Change Below FY 96* • $27 M for Construction (Pay-As-You-Go) • 4,550 New Prison Beds Over 3 Years Using Lease-Purchase Financing (FY 97: $4.3 GF, $2 M OF & FY 98: $35.5 M GF) • 244 New DJC Beds at New Complex (FY 97: $4 M GF, $6 M OF & FY 98: $3 M GF) • New Health Lab (FY 97: $10 M/FY 98: $4 M) • $5 M for 1993 Flood Relief • $20 M for 65% Funding • Same
Other Legislative/ Executive Priorities	• *$70 M for Legislative Priorities which may include*: • Education Finance Reform • State Employee Pay • Other Bills	• *$75 M for Executive Initiatives, including:* • Education Reform - Capital, $30 M • Education Current Year Funding, $20 M • HURF Realignment, $8 M • CJEF Distribution, $1.9 M • Elected Officials Salaries, $0.4 M • 2% Merit Pay and Inequity Adjustments, $15 M
AGENCIES		
K-12	• *$84.8 M Change Above Original FY 96* • $66.6 M for Enrollment Growth • $50.1 M for Charter Schools Growth • $9 M for Homeowners' Rebate (a.k.a., Additional State Aid) • $(7.4) M Net Savings Due to Assessed Value Growth • $(9.9) M Savings Due to Increase in Endowment Revenue • $(5.1) M Savings in Sudden Growth Funding Requirement • $(2.2) M Due to Elimination of Dropout Prevention Program • $250,000 for Information Technology • $(5.0) M Temporary Base Adjustment for Preschool At-Risk	• *$93.7 M Change Above Original FY 96* • $82.7 M for Enrollment Growth • $55.3 M for Charter Schools Growth • Same Recommendation • $(4.9) M Net Savings Due to Assessed Value Growth • $(9.6) M Savings Due to Increase in Endowment Revenue • $(5.9) M Savings in Sudden Growth Funding Requirement • Same Recommendation • Does Not Recommend • Same Recommendation

MAJOR ISSUES	JLBC STAFF RECOMMENDATION	EXECUTIVE RECOMMENDATION
Universities	• *$11.6 M Change Above FY 96* • $7.1 M for Pay Annualization • $2.3 M for Enrollment • $1 M for New Facilities Support • $1.2 M for Retirement Buy-Back • $1.4 M for NAUNet • $1.2 M for Telemedicine Network • $(3.4) M for Collections Fund Adjustment	• *$3.1 M Change Above FY 96* • Does Not Recommend • $1.6 M for Enrollment • Same Recommendation • Does Not Recommend • $2 M for NAUNet • Does Not Recommend • $(2.1) M for Collections Fund Adjustment
Community Colleges	• *$2.3 M Change Above FY 96* • $0.5 M State Aid Enrollment Growth and "Hold Harmless" Funding • $0.7 M Equalization Aid • $1.1 M Technology Assisted Learning (Telecommunications)	• *$0.7 M Change Above FY 96* • $47 K Net State Aid Enrollment Growth Without Capital "Hold Harmless" Funding • Same Recommendation • Does Not Recommend
Juvenile Corrections	• *$4.1 M Change Above FY 96* • Adds $3.7 M for New Beds: 92 Beds Reopened in FY 96 and 48 New Beds in FY 97 • Adds $0.3 M For YCO and YPO Series for Salary Parity with DOC	• *$3.3 M Change Above FY 96* • Adds $3.5 M for Same New Beds • Does Not Recommend
Corrections	• *$41.4 M Change Above FY 96* • Opens 1,400 Beds, $24.2 M • 14.9% Inmate Population Growth, $9.3 M	• *$40.6 M Change Above FY 96* • Opens Same Number of Beds, $24.4 M • 14.7% Inmate Population Growth, $9 M
Judiciary	• *$10.4 M Change Above FY 96* • Adds 1,145 Juvenile Probation Slots (a 25% Increase) for $3.1 M • Adds $2.4 M for Juvenile Treatment Services • Adds 535 Adult Probation Slots (a 1.6% Increase) and Other for $2.7 M	• *No $ Change from FY 96*
DPS	• *$11.9 M Change Above FY 96* • Reduces HURF/Highway Funds by $10 M Pursuant to Laws 1993, Ch. 249 •Total Anti-Gang Funding of $5.5 M, Including $4 M for Locals • Adds 28 Highway Patrol Officers • Recommends an Increase of $2.2 M GF for Highway Patrol Equipment, Including 110 Vehicles and Communications Equipment	• *$2.6 M Change Above FY 96* • Does Not Reduce HURF/Highway Funds as Required by Statute • Same Total Anti-Gang Funding, $1.6 M for Locals • Does Not Recommend • Recommends an Increase of $4.9 M for Equipment, Including 145 Vehicles and Communications Equipment
AHCCCS	• *$0.8 M Change Above FY 96* • Utilizes Tobacco Tax Fund to Discontinue $10 M Private Hospital Reduction; to Resume Phase Down of the Quick Pay Discount of $4.5 M; and to Offset the Reduction in Federal Matching Assistance Percentage (FMAP) of $2 M • Freezes County Acute Care Contribution at $66.7 M and Estimates ALTCS County Increase of $15.7 M • Counts Gaming Revenues Toward Income Eligibility • Applies Enforceable Copays	• *$(3.5) M Change Below FY 96* • Utilizes Tobacco Tax Fund for both $10 M Private Hospital and $4.5 M Quick Pay Discount as Does JLBC Staff; Also Uses $11.2 M to Pay for State Emergency Services and Recommends a Transfer of $71.3 M to MN/MI Stabilization Account; Does Not Use for FMAP Change • Increases County Acute Care Contribution by $1.7 M and Estimates ALTCS County Increase of $17.6 M • Does Not Recommend • Does Not Recommend

MAJOR ISSUES	JLBC STAFF RECOMMENDATION	EXECUTIVE RECOMMENDATION
Economic Security	• *$(4.5) M Change Below FY 96* • Reduces $(9.4) M for AFDC, GA Surplus • Does Not Fund New CPS Staff • Adds 18.5 FTE Positions and $2.3 M for Child Welfare Automation • Adds $5.8 M for DD	• *$(3.2) M Change Below FY 96* • Reduces $(11.6) M for this Issue • Adds 49 FTE Positions and $2.6 M • Same Recommendation • Adds $3.6 M for DD
Health Services	• *$(2.7) M Below FY 96* • Funds Movement of ASH Clients to Community Settings • Privatizes SAMHC, Savings Retained in Mental Health Programs • Privatizes ASH Functions, $(0.5) M • Eliminates Excess Newborn Intensive Care Payments to Hospitals, $(0.7) M • Funds Poison Control through Existing Telecommunication Excise Tax • Creates County Health Block Grant by Consolidating 5 Programs.	• *$0.5 M Above FY 96* • Same Recommendation • Same Recommendation • Same Recommendation • Does Not Recommend • Continues to Fund Poison Control through Emergency Medical Services Fund • No Change
DEQ	• *$50 K Change Above FY 96* • Adds $0.3 M for WQARF	• *$16 K Change Above FY 96* • Maintains Current WQARF Funding
Parks Board	• *Supplemental Appropriation of $3.5 M in FY 96 to Complete Kartchner Caverns State Parks* • *$(0.5) M Change Below FY 96* • Eliminates Funding for Arizona Conservation Corps • Eliminates Funding for McFarland State Park	• *Supplemental Appropriation of $3.4 M for Same Purpose* • *$(0.2) M Change Below FY 96* • Maintains Funding • Maintains Funding
ADOT	• *Reduces Operating Budget by $(4.1) M and (19) FTE Positions* • Consolidates Non-Appropriated County Auto License Fund into State Highway Fund and Appropriates $23.9 M and 573 FTE Positions from State Highway Fund, in Addition to Operating Budget Changes	• *Reduces Operating Budget by $(3.9) M and Adds 7 FTE Positions* • Same Proposal Regarding Funds and Appropriates $24.1 M and 573 FTE Positions
Veterans' Comm.	• *$(2.4) M Change Below FY 96* • Eliminates GF Support for Nursing Home	• *$(2.4) M Change Below FY 96* • Same Recommendation

FY 1995 Review and FY 1996 Update

FY 1995 Surplus of $269.5 Million was $106.2 Million Greater than Expected

In April 1995, at the conclusion of the 1995 regular legislative session, the forecasted ending General Fund balance for FY 1995 was $163.3 million and for FY 1996 was a mere $1.9 million. These projections were reported in the JLBC Staff's FY 1996-97 Appropriations Report, and utilized a consensus revenue forecast that split the difference between the higher JLBC Staff revenue forecast and the lower OSPB forecast. As it turned out, we ended FY 1995 with a $269.5 million General Fund surplus, as compared to FY 1994's surplus of $229.2 million. The $106.2 million higher surplus in FY 1995 was largely the result of $59 million more revenue than expected in the March consensus forecast, and $50.9 million more of agency revertments (unspent appropriations) than previously forecast.

Higher FY 1995 Surplus Impacts Favorably on FY 1996

The higher carry-forward from FY 1995, in and of itself, increases the projected ending balance in the current fiscal year (FY 1996) from $1.9 million to $108.1 million. However, we have made several other adjustments to the FY 1996 projection, which on balance, provide a further substantial increase in our FY 1996 surplus forecast. The JLBC Staff released updated budget projections on July 10, 1995 and November 28, 1995, which raised our revenue forecasts and projected year-end balance for FY 1996. The estimates included in this budget recommendation for FY 1997 reflect yet another increase in our projections for General Fund revenue (to a consensus level agreed to by the Governor's OSPB and the JLBC Staff); however, a portion of the increase is offset by supplemental appropriations we are recommending be enacted for the current fiscal year.

FY 1996 Surplus is Now Estimated to be $271.2 Million, or $1.7 Million More than FY 1995

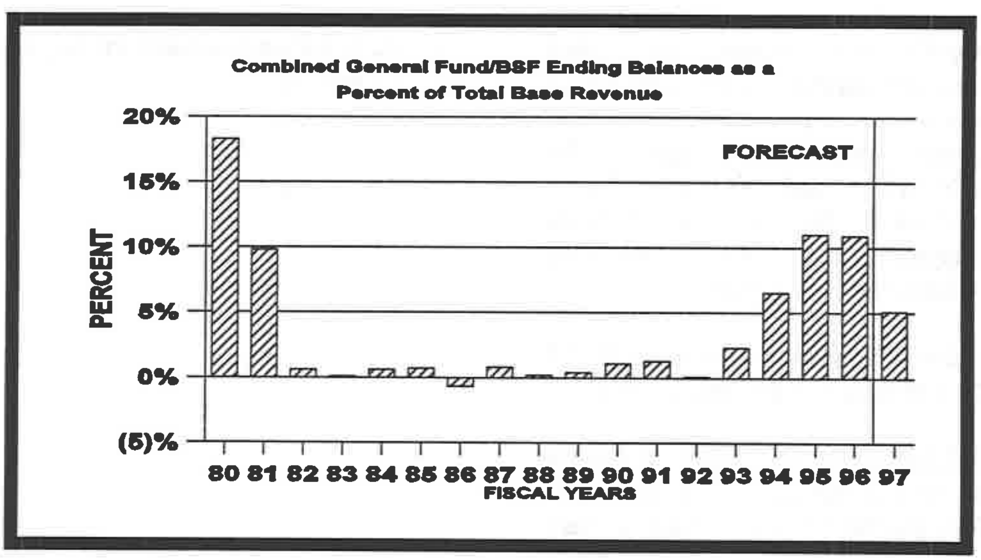
The new JLBC Staff forecasted ending balance for FY 1996 is $271.2 million, which is largely unchanged from the $269.5 million carry-forward from FY 1995. Essentially, this suggests that revenues will equal expenditures in the current fiscal year, and the General Fund surplus will neither be added to nor diminished by the current operating budget. The new consensus revenue forecast for FY 1996 is some $194.7 million higher than the consensus forecast utilized when the budget was enacted 10 months ago.

Arizona's "Rainy Day Fund" has a Projected Balance of $230 Million, Equal to 5% of Revenue

The Legislature amended the Budget Stabilization Fund (BSF) (Laws 1995, Chapter 3, 1st Special Session) to limit the accumulated balance in the state's "Rainy Day Fund" to no more than 5% of General Fund revenues at year-end. Previously, in 1994, the Legislature had established so-called "Triple-Trigger Provisions", designed to earmark any excess FY 1994 surplus and, thereafter, any excess FY 1995 revenues, for the twin purposes of eliminating the "K-12 Rollover" and fully funding FY 1995's required deposit to the Budget Stabilization Fund. As it turned out, the triggers worked and the BSF received a full $168.7 million deposit in FY 1995. When combined with the prior year's deposit of $42.0 million and accrued interest earnings, the BSF reached the 5% limit at the end of FY 1995. The BSF is expected to have a balance in the fund of nearly $230 million at the end of FY 1996, followed by $235 million at the end of FY 1997. This budgetary cushion for the next recession allows us to recommend a FY 1997 operating budget that includes only a modest $5.8 million surplus.

JLBC STAFF RECOMMENDATION
GENERAL FUND REVENUES AND EXPENDITURES
FISCAL YEARS 1996 AND 1997
(dollars in thousands)

	FY 96	FY 97
REVENUES		
Balance Forward	269,526.0	271,205.8
Base Revenues	4,568,187.2	4,702,082.2
TOTAL REVENUES	$4,837,713.2	4,973,288.0
EXPENDITURES		
Operating Appropriations		
Annual Budget Units	4,217,051.1	4,376,440.4
Supplemental Appropriations	11,863.9	0.0
Subtotal	4,228,915.0	4,376,440.4
Biennial Budget Units	249,032.2	235,660.4
Supplemental Appropriations	0.0	5,629.7
Subtotal	249,032.2	241,290.1
Operating Subtotal	4,477,947.2	4,617,730.5
Capital Outlay	98,987.2	109,278.6
Supplemental Appropriations	4,300.0	0.0
Subtotal	103,287.2	109,278.6
Other Legislative Priorities	0.0	70,000.0
Admin Adjustments/Emergencies	40,000.0	25,500.0
Revertments	(54,727.0)	(55,000.0)
TOTAL EXPENDITURES	4,566,507.4	4,767,509.1
Property Tax Relief	0.0	(200,000.0)
PROJECTED ENDING BALANCE	271,205.8	5,778.9



Overview of the JLBC Staff Recommended
General Fund Budget for FY 1997

$421.6 Million of Incremental General Fund Resources are Available

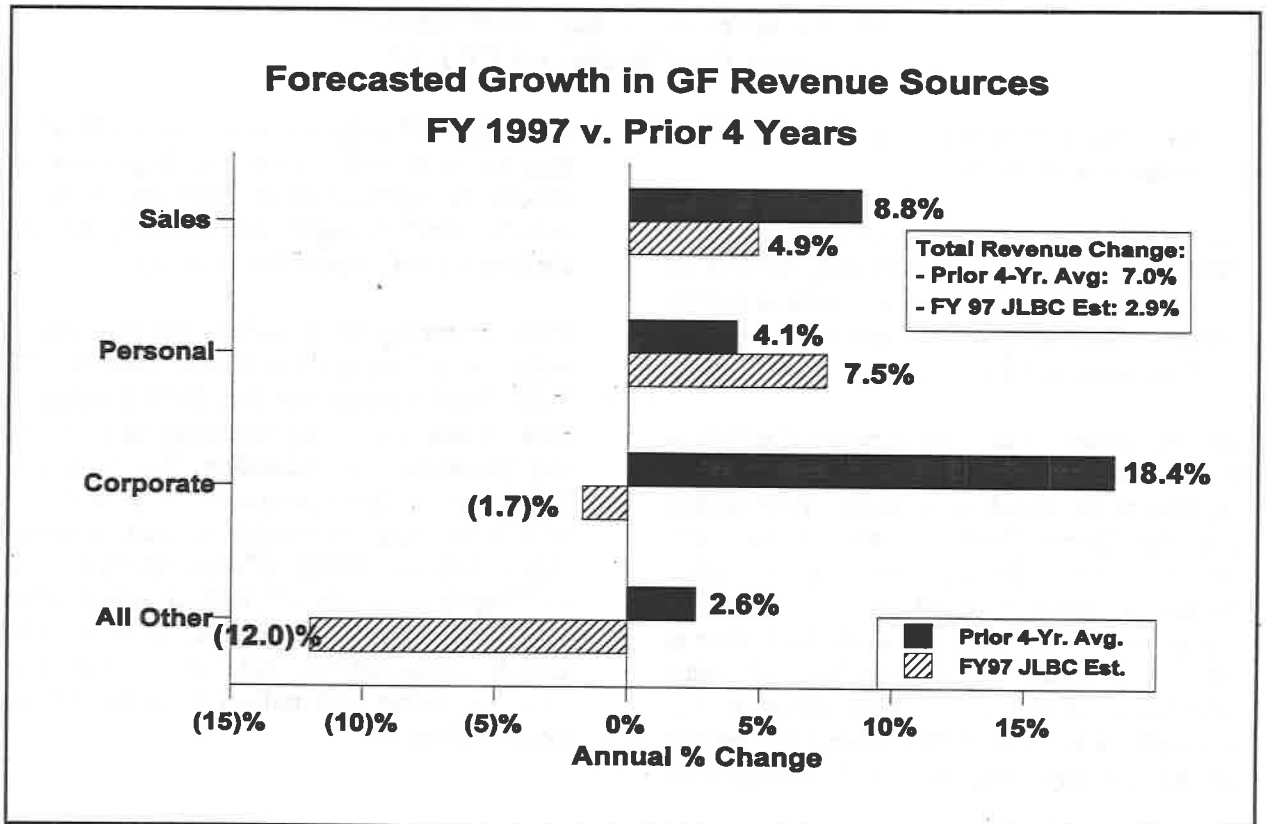
The JLBC Staff recommended budget for FY 1997 includes a projected beginning balance of $271.2 million and base revenue growth of $133.9 million. Thus, some $421.6 million is available for distribution in FY 1997 as shown below.

The first commitment of the incremental dollars is in the area of property tax relief, in that the Legislature has already appropriated $200 million from the General Fund to a property tax relief fund in FY 1997. Depending upon the route taken for cutting property taxes, the impact of the policy change will show up as either a loss of revenue to the state, higher state spending, or some combination of the two. In fact, given that the state collects less than $200 million from real and personal property taxes, and given that the greatest beneficiary of property taxes are local school districts, it is probable that the Legislature will choose an approach to property tax relief that actually results in higher state spending (to offset the local loss of property tax revenue).

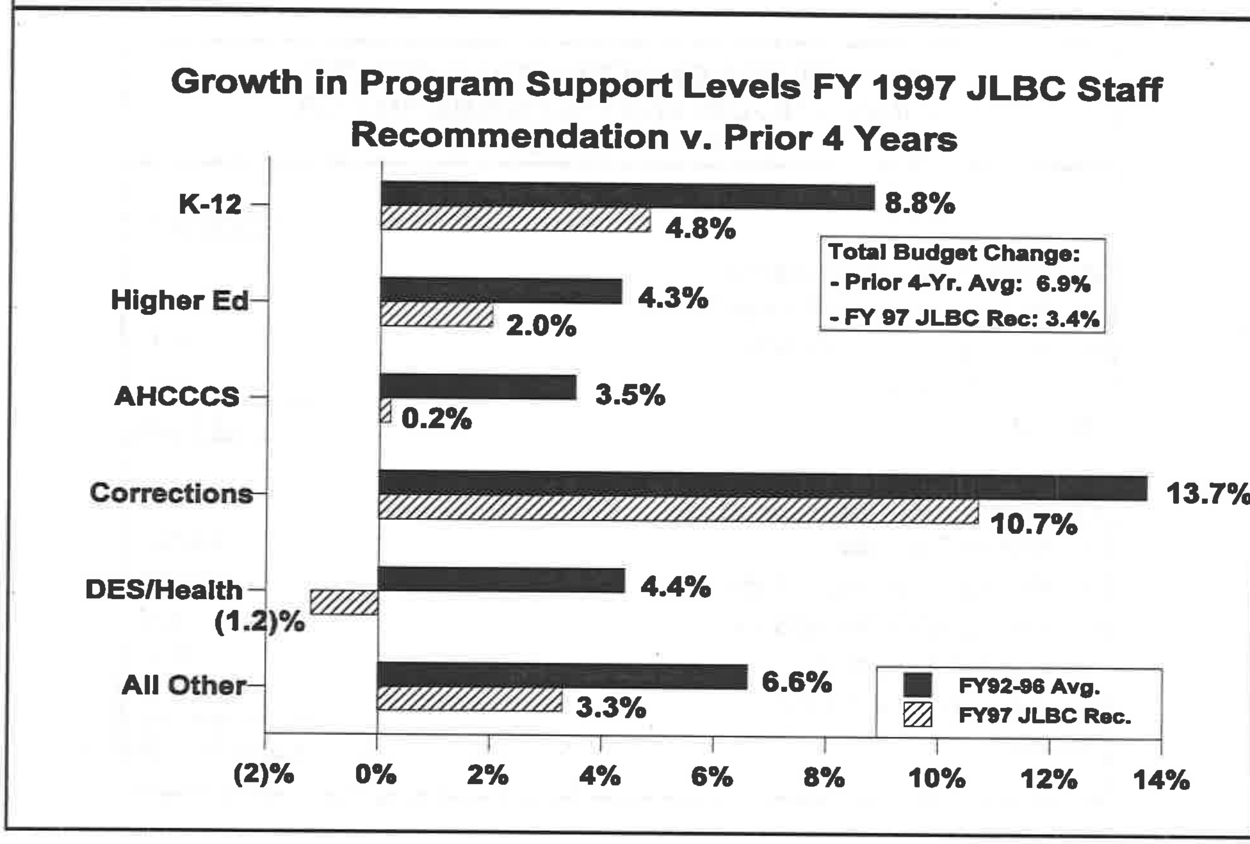
After allocating $200 million for property tax relief, an estimated $222 million remains. The JLBC Staff recommends that: $139.8 million be used to increase agency operating budgets, with the Department of Education (K-12) and the Department of Corrections accounting for the bulk of this increase; $6 million be used to increase capital outlays; another $70 million be set aside for "legislative priorities", such as school finance reform, state employee pay, and other bills that include appropriations; and, "at the end of the day," a modest $5.8 million be carried forward into FY 1998.

DISTRIBUTION OF INCREASED RESOURCES
UNDER THE JLBC STAFF RECOMMENDATION
FY 1997–GENERAL FUND

	$ (Millions)
Available Incremental Resources	
• Projected Beginning Balance 7-1-96	$271.2
• Projected Revenue Growth	133.9
• Other Changes	16.5
TOTAL	$421.6
Distribution of Incremental Resources	
• Property Tax Relief	$200.0
• Net Operating Budget Additions	139.8
• Net Capital Outlay Additions	6.0
• Legislative Priorities	70.0
• Ending Balance 6-30-97	5.8
TOTAL	$421.6



Forecasted Growth in GF Revenue Sources
FY 1997 v. Prior 4 Years
Sales
8.8%
4.9%
Total Revenue Change:
- Prior 4-Yr. Avg: 7.0%
- FY 97 JLBC Est: 2.9%
Personal
4.1%
7.5%
Corporate
18.4%
(1.7)%
All Other
2.6%
(12.0)%
Prior 4-Yr. Avg.
FY97 JLBC Est.
(15)%
(10)%
(5)%
0%
5%
10%
15%
Annual % Change



Growth in Program Support Levels FY 1997 JLBC Staff Recommendation v. Prior 4 Years
K-12
8.8%
4.8%
Total Budget Change:
- Prior 4-Yr. Avg: 6.9%
- FY 97 JLBC Rec: 3.4%
Higher Ed
4.3%
2.0%
AHCCCS
3.5%
0.2%
Corrections
13.7%
10.7%
DES/Health
4.4%
(1.2)%
All Other
6.6%
3.3%
FY92-96 Avg.
FY97 JLBC Rec.
(2)%
0%
2%
4%
6%
8%
10%
12%
14%

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, 1995, there were outstanding issuances of $541 million with an annual lease-purchase requirement of $65 million.

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

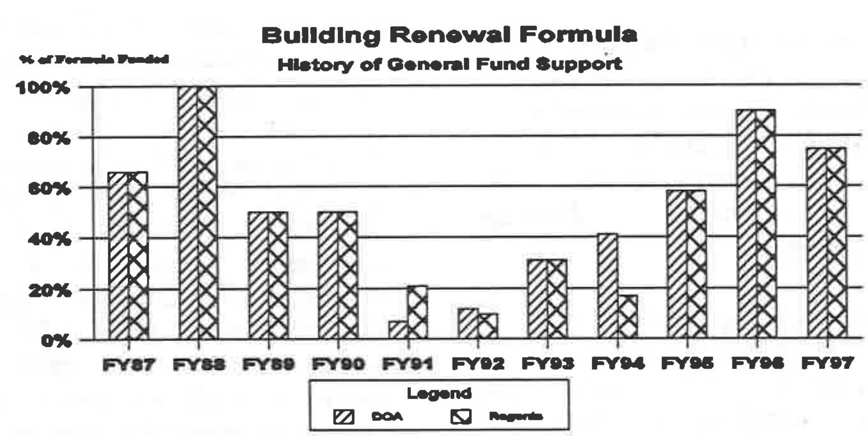
Accordingly, the JLBC Staff recommends $46 million of General Fund monies for prison projects including the construction of 1,875 new beds and infrastructure for a new complex near Buckeye. The JLBC Staff also recommends $9 million for the construction of 200 new juvenile beds and infrastructure for a new complex adjacent to the new prison complex. Completion of these projects will require $29 million in FY 1998.

Major Maintenance and Repair of State Buildings

Major maintenance and repair would be funded at 75% 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, **although the state has not funded 100% of the Building Renewal Formula since FY 1988 the recommended 75% level would be the 2nd highest ever.** 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%	59%	90%	75%
Regent	66%	100%	50%	50%	21%	10%	31%	17%	59%	90%	75%

Enhanced Oversight of Non-Appropriated Funds

In 1996, legislation will be introduced to reduce 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 limit the proliferation of separate state funds and exercise greater oversight of non-appropriated funds. As required by Laws 1994, Chapter 366, the JLBC Staff 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 in November 1994.

For FY 1996, we determined in our November 1995 report that there are 625 separate funds, and that non-appropriated resources constitute $4.35 billion, or 52%, of the state's overall spending authority. To reduce the number of funds and to increase legislative oversight, the JLBC Staff is recommending:

- to eliminate or consolidate 85, or 14%, of all funds and
- to convert $278 million, or 6%, of fund expenditures to appropriated status.

Separate legislation will be introduced to accomplish each of these purposes.

Improved Legislative Oversight of Information Technology Purchases

The JLBC Staff recommends the introduction of legislation to create 1) a Government Information Technology 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 Arizona Department of Administration (ADOA), 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 $500,000. The JLBC Staff recommends that the funding for new information technology projects over $100,000 be appropriated in this separate bill, as we do not recommend these additional expenditures without fundamental system reform.

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 nearly $200 million spent annually on information technology for state government. The JLBC Staff made a similar recommendation for FY 1996. Please refer to the January 1995 JLBC Staff report on information technology for more information. The Auditor General's November 1995 Performance Audit of the ADOA Information Services Division also supports these reforms.

Continuing Implementation of Budget Reform - Program Authorization Reviews

The JLBC Staff recommends the elimination of 3 programs as a result of the Program Authorization Review process. In addition, legislation will be introduced to expand the number of programs subject to PAR.

Required by Laws 1995, Chapter 283, a total of 25 state government programs were identified to undergo Program Authorization Review (PAR). Ten programs were reviewed during 1995 (12 if the Department of Health Services programs were counted separately) and 15 for review during 1996. The PAR's began with an initial agency self-assessment. Subsequently, the JLBC Staff and OSPB jointly reviewed the 10 agencies' programs. On November 1, 1995, JLBC Staff and OSPB issued individual PAR reports for each of the programs. In addition to the individual reports, the two offices prepared a composite PAR document, the <u>Program Authorization Review Executive</u>

Summaries, which provides for each program a summary of the joint JLBC Staff and OSPB findings. This composite document has been distributed to each legislator, the Governor, and the affected agencies.

The remaining 15 of the 25 programs identified for PAR are currently undergoing PAR during this second year of the 4-year pilot. The 15 affected agencies are now conducting their self-assessment for their selected program. Since Laws 1995, Chapter 283 identified only 25 of the 75 programs to be reviewed during the 4-year pilot, legislation will need to be introduced during the 1996 legislative session to specify the remaining 50 programs. Of the remaining 50 PARs, a total of 30 will be conducted during 1997, with the remaining 20 being conducted during 1998.

As directed by Chapter 283, the JLBC Staff and OSPB recommend either to "Retain, Eliminate, or Modify" (R.E.M.) the program. The Staff recommendation is contained in each agency's narrative as is a discussion of the Executive recommendation. In addition, a brief summary of the first year PAR report for each affected agency is provided in these 10 agencies' analysis and recommendation narrative. For specific detail on each PAR, see the narrative for each agency. Since the Medical Student Loan Program is not a major budget unit and, therefore, does not have a budget recommendation, its discussion is under the University of Arizona's Health Sciences Center.

Of the 12 programs reviewed, the JLBC Staff recommends 3 programs to be retained, 3 eliminated, and 6 to be modified. The JLBC Staff recommends eliminating the Department of Education's Drop-Out Prevention program, the Board of Regents' Arizona Health Education Centers program, and the Department of Health Services' Medical Malpractice program. The highlights of the JLBC Staff recommended modifications are as follows:

- The Department of Administration's Enterprise Network Services program: Appropriate the Telecommunications Revolving Fund.
- The Department of Agriculture's State Agricultural Laboratory program: Privatize the analysis of feed and fertilizer formulations.
- The Department of Environmental Quality's Underground Storage Tank Program: Increase the percentage of the co-payment amount for each missed deadline, reduce the maximum corrective action coverage from $1,000,000 to $200,000, and adjust the co-payment amount upward based on the corporation's assets and ability to pay in order to ensure fund solvency for both Assurance Accounts.
- The Judiciary's Judicial Collection Enhancement Fund (JCEF): Appropriate the fund.

JLBC Staff Program Authorization Review Recommendation

Agency/Department	Program/Subprogram	JLBC Staff Recommendation	OSPB Recommendation
Administration	Enterprise Network Services	Modify	Modify
Agriculture	State Agriculture Laboratory	Modify	Retain
Corrections	Complex Administration	Modify	Retain
Education	Drop-Out Prevention	Eliminate	Eliminate
Environmental Quality	Underground Storage Tank	Modify	Modify
Juvenile Corrections	Diagnostic Services	Retain	Modify
Judiciary	Judicial Collection Enhancement	Modify	Modify
Board of Regents	AZ Health Education Centers	Eliminate	Eliminate
Health Services	Medical Malpractice	Eliminate	Eliminate
Health Services	Primary Care	Retain	Retain
Health Services	Loan Repayment Program	Modify	Retain
Medical Student Loan Program	Medical Student Loan	Retain	Retain

Appropriation of Federal Block Grants

The JLBC Staff recommends that the Legislature be fully involved in the re-design and implementation of any programs affected by federal block grants and that block grant funds be subject to legislative appropriation.

While the federal government is embroiled in an on-going dialog on the budget as of the writing of this document, there are several block grant proposals which have been set forth that may ultimately become law. These proposals include provisions in House Resolution 2491, House Resolution 4, and "The Seven Year Balanced Budget Act of 1995"; all of which have been vetoed by the President and are a part of current budget negotiations. The various proposals have included block grants for: Medicaid, (known popularly as "Medigrant"); Child Care; Child Protection; Family-Based Nutrition; School-Based Nutrition; Services to Disabled Children; State-Option Food Stamps; and Cash Assistance. Due to the sheer number of proposed block grants, it seems likely that if a federal budget compromise agreement is reached that it will include one or more of those listed above. It is also important to note that many of the current provisions would make changes retroactive back to October 1, 1995.

The original language of these proposals focused almost exclusively on the Governors of each state as the implementors of new block grants. Most of the proposals have had such language amended and replaced with Senator Hank Brown's (Colorado) amendment that all block grants must be appropriated according to the laws and procedures applicable to expenditure of a state's own revenue. Of the grants, only the Child Protection and Child and Family Services grants do not currently contain this language.

The proposed block grants would allow states to radically change or even eliminate and replace major existing programs, including all of AHCCCS, most of DES, and parts of many other state agencies. The wide latitude given to the states in the expenditure of federal block grants fundamentally alters their character. The block grants would no longer be "custodial" monies, unlike categorical grants where the use of the monies is narrowly prescribed by the Congress. Instead, they could be used far more broadly, and the states would be given fairly wide latitude with fewer restrictions. Hence, as the new federal block grants become state monies, the Legislature should assert its primary role in the appropriation of state funds.

Both the JLBC Staff and Executive budget recommendations are based on current federal law. However, both the JLBC Staff and the Executive are also maintaining a close watch on developments and will be prepared to provide additional information and policy analysis as necessary should federal block grants be enacted.

State Employees

The state work force of appropriated FTE Positions would grow by 458, or 1% under the JLBC Staff recommendation. This growth is largely centered in the criminal justice agencies. Of the new positions, 787 will staff new prisons or Juvenile Correction facilities. When these FTE Position are excluded, the number of statewide FTE Positions actually declines by 329.

Education

Department of Education

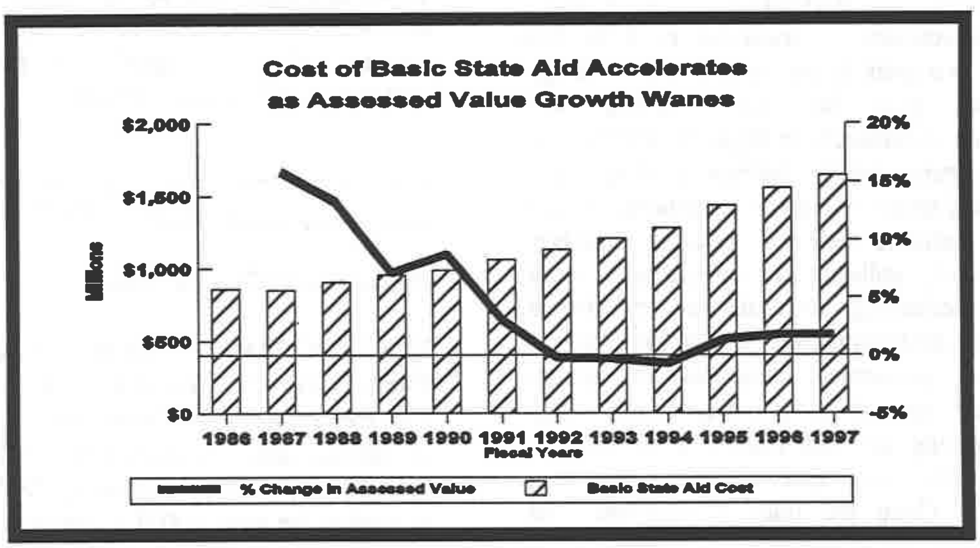
The JLBC Staff recommends $84.8 million in new K-12 funding, a 4.8% increase. This increase includes $66.6 million for enrollment growth and $50.1 million for charter schools growth ($34.4 million increase after the required FY 1996 supplemental), both based on formula funding projections. Offsetting these increases are projected net savings of $(7.4) million for assessed valuation growth, $(9.9) million for endowment earnings growth, and $(5.1) million due to lower Sudden Growth funding requirements. A $(2.2) million savings from eliminating the Dropout Prevention program also is incorporated into the budget recommendation, as well as a $(5) million savings due to the use of carry-forward monies for partial funding of the Preschool At-Risk program.

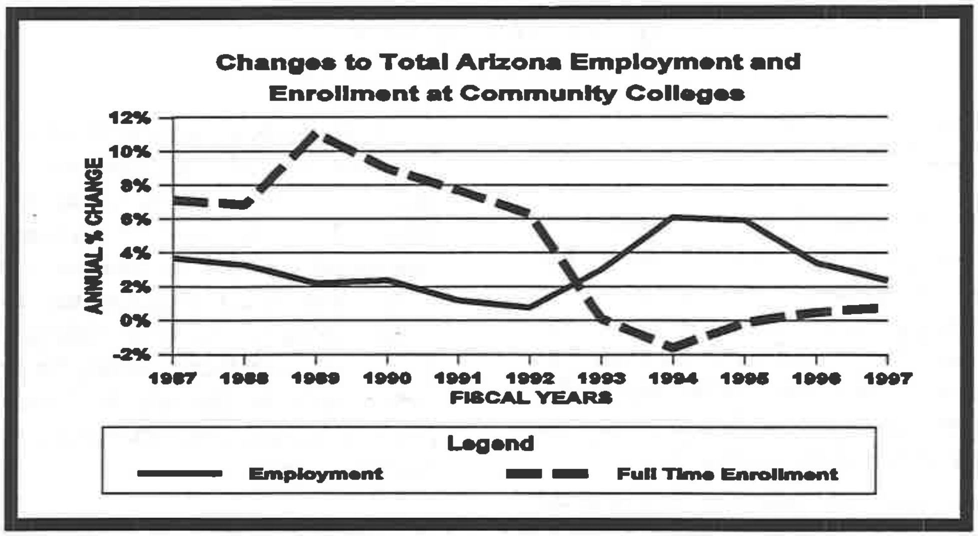
The JLBC Staff concurs with the agency request to consolidate all vocational education funding into a new State Block Grant for Vocational Education. Likewise it concurs with the department's request to restructure the FY 1996 State Block Grant program into a State Block Grant for Early Childhood Education program. This would consolidate funding for programs that pertain only to students in Preschool through Grade 3, including the aforementioned Preschool At-Risk program.

Universities

The JLBC Staff recommends $11.6 million in new university funding, a 1.9% increase. The recommendation includes $7.1 million to annualize the January pay adjustment, $4.4 million for student enrollment growth, employee benefit/Risk Management charges and new facilities support, $1.2 million for retirement buy-back pursuant to S.B. 1108 (Laws 95, Ch. 143), and $2.6 million for NAUNet and a telemedicine network to facilitate distance learning capabilities and to improve cost efficiencies in rural and institutional health care.

In addition, the JLBC Staff recommends $17.2 million for university building renewal *(See Capital Outlay section of Detailed Analysis and Recommendation Book).*





Community Colleges

The JLBC Staff recommends a $2.3 million, or 2.3% increase in Community Colleges funding, reflecting increases in full-time student enrollment (FTSE) and "hold harmless" funding, equalization aid, and a technology assisted learning (telecommunications) initiative.

For FY 1997 formula computations, system-wide FTSE declined (0.1)%, representing the second consecutive year of FTSE decline. Laws 1995, Chapter 196, modified the formula to "hold harmless" districts with declining FTSE by adjusting state aid in an amount that reflects only growth in the FTSE enrollment count.

The JLBC Staff recommends $1.1 million for Technology Assisted Learning (Telecommunications). Included is $100,000 designated as a grant to the State Board to design a statewide plan for interconnecting and consolidating community college, university and K-12 telecommunication systems (video, voice and data) and to tie individual community college districts' electronic delivery systems together. The community colleges are increasingly using information technology to create new educational access in remote communities, and to interconnect college and university campuses throughout Arizona and beyond its borders. Technology assisted learning includes classroom computers, interactive television and distance education networks. Once the plan is complete and reviewed by the Joint Legislative Budget Committee, the remaining $1 million can be allocated to community college districts based on a statewide plan emphasizing coordination of effort, efficient resource utilization and telecommunication system compatibility, with priority given to service in rural areas. Technology assisted learning may also be a cost-effective means for accommodating some of Arizona's anticipated postsecondary enrollment growth.

Arizona Schools for the Deaf and the Blind

The JLBC Staff recommends a $507,700 increase in ASDB funding, a 1.9% increase. The recommendation includes $237,300 for ASDB salary adjustments effective January 1, 1996, and $465,000 for replacement buses. In addition, the JLBC Staff recommends $345,000 in capital outlay to upgrade the phone/intercom system at the Phoenix Campus.

Criminal Justice

Department of Corrections

The JLBC Staff recommends a total General Fund increase of $41.4 million, or 10.7% for the Department of Corrections budget. The recommendation includes $24.2 million to open 1,400 state run prison beds, $4.6 million to annualize the cost of 400 privately-operated beds,

$9.3 million for inmate population growth, $3.4 million to continue the CSO pay plan approved in FY 1996, and a $(4.6) million reduction for one-time costs from FY 1996.

The JLBC Staff recommendation would reduce the current 3,177 bed shortfall to 2,708 by the end of FY 1997. The projected bed deficit at the end of FY 1996 is 1,838. The inmate population is projected to increase by 150 inmates per month in FY 1997, 50 more inmates per month than was projected for FY 1996. As noted above, a total of 1,400 new beds are recommended for opening in FY 1997. Given the projected increase in the prison population, bed deficits would range from a low of 1,558 to a high of 2,708 in FY 1997.

The JLBC Staff capital recommendation includes funding to construct 1,875 new prison beds. Of the 1,875 beds, 400 tent beds will open in FY 1997. The remaining 1,475 beds would not open until FY 1998.

Department of Juvenile Corrections

The JLBC Staff recommends a $3.7 million increase for 140 new secure, institutional beds for the Department of Juvenile Corrections. In addition, the JLBC Staff recommends a FY 1996 supplemental of $1.8 million for staffing and other operating costs associated with using 92 existing beds at the Adobe Mountain Juvenile Institute that had been held vacant due to the *Johnson vs. Upchurch (J vs. U)* consent decree. The FY 1997 recommendation includes $2.8 million for operating these same beds. Also, the FY 1997 amount includes $0.9 million to operate 48 new beds that are due to open in January 1997 at the Black Canyon Juvenile Institute.

The Capital Outlay Bill includes funding to design and build 200 additional beds, which will be at a new site. This will bring the total number of DJC beds to 814 by early 1998. The bed deficit is currently about 53. Based on the recent growth rate of the secure care population, we project that the new beds will meet bed needs through 1999. (See table below).

The committee of consultants which is monitoring the *J vs. U* consent decree reported in May 1995 that DJC is making acceptable progress in most areas, although population caps, staffing ratios, and the work program were areas of concern. The Court has provisionally approved DJC's use of the new beds to alleviate overcrowding. DJC is negotiating the staffing ratio requirements in order to utilize existing staff most efficiently, and has also been redesigning its work program to improve youth participation.

DJC BED SURPLUS/DEFICIT PROJECTION

	Population [1/]	Bed Openings [2/]	# of Beds	Surplus (Deficit)
Actual:				
December 1, 1995	595	92 at Adobe Mountain, Black Canyon	542	(53)
Projection:				
January 1, 1996	601	24 Boot Camp (Feb.)	566	(35)
January 1, 1997	672	48 at Black Canyon	614	(58)
January 1, 1998	743	200 - New Site	814	71
January 1, 1999	814		814	0

1/ The fiscal year-to-date average daily secure care population (ADP) in November of 1994 was 467. A year later, in November of 1995, the fiscal year-to-date average daily secure population was 538, an increase of 71. This projection assumes a constant growth in ADP of 71 per year, or 6 per month.

2/ Bed opening dates are approximate.

Judiciary

The JLBC Staff recommends a $10.4 million increase for the Judiciary. Recognizing that pre- and post-adjudication services remain vital components in the treatment of juveniles and adults prior to incarceration in the Arizona Department of Juvenile Corrections (ADJC) or the Department of Corrections (DOC), the JLBC Staff has recommended for FY 1997 the following increases in probation and treatment services. On the juvenile side, a $5.5 million increase in the Superior Court budget is recommended, which reflects the creation of 1,145 new state-funded probation slots, additional treatment dollars (which, for the first time, include monies for juvenile services for youths transferred to adult court), and an additional 12 county-level intake officers and related positions to improve pre-sentencing supervision and risk/needs assessment services at the "front end" of the Juvenile Justice System. On the adult side, a $2.7 million increase in the Superior Court budget is recommended, which reflects the creation of 535 new state-funded probation slots. It also reflects the full establishment of the Interstate Compact program in the Supreme Court budget to oversee the transfer of adult probationers between states' probation programs.

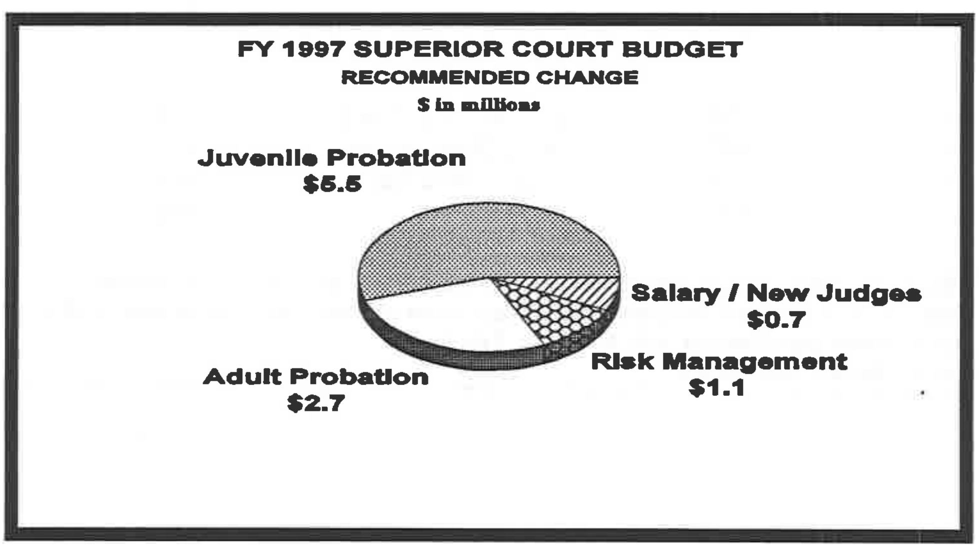
As required by law, the Executive does not recommend on the Judiciary budget; however, neither does the Executive reserve any monies for the typically fast-growing probation programs.

Transportation/Public Safety

Arizona Department of Transportation

The JLBC Staff recommendation provides $136 million from the State Highway Fund for statewide highway construction, which is $44 million more than the FY 1996 estimate and $9 million more than the Executive. The JLBC Staff can recommend more for highway construction, because we divert $10 million less for the funding of the DPS highway patrol (see below). The JLBC Staff recommends an ADOT operating budget reduction of $(4) million and (19) FTE Positions. In addition, it is recommended that the non-appropriated County Auto License Fund be consolidated into the State Highway Fund, and that $24 million and 573 FTE Positions be appropriated from the State Highway Fund to increase legislative oversight and simplify administration of this area. A maximum of $2.1 million from the State Highway Fund is recommended as final payment for Maricopa County's title and registration facilities.

The JLBC Staff recommends no additional development funding for the Enterprise Project, which has suffered repeated setbacks. The latest problems include insufficient mainframe computer capacity to run Enterprise, and the consultant (CACI) leaving the job entirely in November 1995, when the state withheld payment as the contractor had fallen seriously behind schedule. ADOT is to present its revised plan for Enterprise



to the JLBC not later than February 1996. The JLBC Staff recommendation includes $1.7 million to lease a larger mainframe computer for Enterprise, which ADOT installed in November 1995.

The JLBC Staff recommends that ADOT report to the Joint Legislative Budget Committee by July 1996 on its plan and estimated savings for integrating the Maricopa County auto license facilities and operations into the Motor Vehicle Division, and that ADOT use any savings from the Maricopa County auto license merger to address the Motor Vehicle Division's customer service wait time problems and port-of-entry NAFTA needs. The JLBC Staff suggests several options that ADOT might try to increase its rate of vehicle registration renewal by mail, which costs the department less than staffing for walk-in renewals. The JLBC Staff further recommends that ADOT report on its success and any savings in this area by November 30, 1996. The JLBC Staff also recommends that ADOT report on the feasibility of privatizing a Motor Vehicle Division office by November 30, 1996.

Department of Public Safety

The JLBC Staff recommends a total General Fund increase of $11.9 million for the Department of Public Safety. Laws 1995, Chapter 3; 1st Special Session, A.R.S. § 28-1538 and A.R.S. § 28-1822 jointly limit the amount of monies from the Highway User Revenue Fund (HURF) and the Highway Fund available for appropriation to DPS. Aside from recommending the appropriation of $2.1 million of State Highway Funds to complete the purchase of Maricopa drivers' license facilities, the JLBC Staff recommendation adheres to these laws. The JLBC Staff recommendation decreases the available non-General Fund sources by $(10) million and replaces this loss of funding with General Fund dollars in the same amount of $10 million. The Executive does not recommend this statutory fund shift.

Overall, the JLBC Staff recommends policy changes in FY 1997 which will focus resources on the department's primary mission; enforcement of traffic laws and motorist assistance along Arizona roads and highways. For example, the JLBC Staff recommends the addition of 28 highway patrol officers. Total funding for GITEM, the state Anti-Gang Enforcement program, would be $5.5 million, a funding amount similar to the Executive. While the Executive would continue to expend most funding at the state level, the JLBC Staff would shift more resources to local law enforcement. This recommendation preserves the role of coordinator and trainer for DPS and provides $4.0 million of funding to local law enforcement for "front-line" anti-gang activities. This is consistent with the original legislative intent for the GITEM program.

Health and Welfare

AHCCCS

The JLBC Staff recommends a total General Fund increase of less than $1 million for AHCCCS. In addition, the JLBC Staff recommends appropriating $16.5 million of Tobacco Tax Funds to eliminate the private hospital discount ($10 million), resume the phase out of the quick-pay discount ($4.5 million) and to offset the loss of federal funds due to the reduction in the federal matching assistance percentage ($2 million). In that these uses will increase the state's payments to hospitals, help reduce their burdens for uncompensated care for indigent clients, and offset reductions in federal matching percentages that might otherwise result in service or eligibility reductions, the JLBC Staff believes these uses are consistent with A.R.S. § 42-1241(C).

Overall, the AHCCCS caseload continues to remain relatively flat in FY 1996, and this trend is expected to continue in FY 1997. With a stable population, the primary cost increases are due largely to an estimate of medical cost inflation of 4% and continued increases in fee-for-service expenditures for Indian Health Service referrals and undocumented aliens. These increases are offset to a great degree by an expected General Fund reversion in FY 1996 of $22.7 million due to lower than expected population growth. **The proposal to eliminate Medicaid and repeal Title 19 of the Social Security Act and replace it with**

Medigrant and a new Title 21 may have significant impacts on the AHCCCS program. Some proposed block grants may financially benefit Arizona due to prior cost containment efforts, while other options proposed may result in reduced federal funding. The JLBC Staff is monitoring federal actions and will be prepared to offer additional information and policy analysis as changes occur.

Department of Health Services

The JLBC Staff recommends a total General Fund decrease of $(2.7) million for the Department of Health Services budget. DHS has signed an agreement listing the requirements for settling the *Arnold v. Sarn* lawsuit. A major requirement of this agreement is that the ASH population be reduced significantly. The JLBC Staff has taken the first step towards meeting this requirement by recommending the transfer of $6.7 million from the ASH operating budget to a Special Line Item to provide 125 ASH clients with appropriate placements in the community. Ultimately, these placements should provide a more suitable living environment for these clients as well as produce some savings over ASH residency.

The size of the behavioral health population is expected to remain fairly stable in FY 1997, although capitation rates paid to Title 19 clients are forecasted to increase by 4%. The greatest change in population and funding needs is expected in the Title 19-qualifying General Mental Health and Substance Abuse service population. This program began in October of 1995 and the JLBC Staff forecast reflects the first full year of funding.

The JLBC Staff recommends an alternative funding source for the state's 2 Poison Control Centers. This will protect the Emergency Medical Services (EMS) Operating Fund from depletion and allow rural EMS programs to be retained. The JLBC Staff recommendation also focuses on transferring greater autonomy and flexibility to counties in planning programs and prioritizing health needs in their regions. Overall, 7 Special Line Items are combined and block granted to the counties in the new County Health Block Grant Line Item and the Prenatal Services Grant Line Item.

Department of Economic Security

The JLBC Staff is recommending a $(4.5) million reduction for the Department of Economic Security. The recommendation includes several reductions due to FY 1996 surpluses, specifically in AFDC, General Assistance, Developmental Disabilities' Purchase of Care, and Adoption Services. The JLBC Staff recommendation includes no FY 1997 caseload growth for AFDC and a 3.5% General Assistance caseload increase.

The remaining recommendation focuses on caseload growth for Long Term Care, development money for the Children's Information Library and Data Source (CHILDS) information technology project, and additional money for Children's Services and Child Care subsidies. In addition, the recommendation includes an offset to the General Fund by implementing a co-pay or sliding fee schedule for developmentally disabled services for clients under 18.

Natural Resources

Arizona Department of Environmental Quality

The JLBC Staff recommends a net decrease of $(613,600) from the Emissions Inspection Fund. This change includes an increase of $1.4 million for the I/M 240 Buydown Program, a decrease of $(1.2) million for the Repair-Grant Program, and a decrease of $(802,100) in operating expenditures. However, the JLBC Staff recommended expenditures exceed projected revenues by $1.3 million. This shortfall is primarily due to the elimination of the FY 1996 Underground Storage Tank (UST) Fund $8 million transfer to the Emissions Inspection Fund per the 1995 4th Special Session. The FY 1996 Area A (Maricopa) portion of the UST Fund was declared insolvent at the beginning of FY 1996.

The JLBC Staff recommends a General Fund increase of $273,000 million for WQARF (state-

Superfund) remediation. Of the recommended increase, $155,000 is to augment current state site remediation and $118,000 is to meet a 10% federal match of certain federal Superfund sites located in Arizona.

Arizona State Parks

The JLBC Staff recommends a FY 1996 supplemental appropriation of $317,300 from the General Fund to reimburse the department for expenditures to keep the Grand Canyon National Parks open during the temporary federal shutdown. In addition, the JLBC Staff recommends $807,100 from the Enhancement Fund for one-time operating start-up costs for Kartchner Caverns State Park, which is scheduled to open November 1997. Finally, the JLBC Staff recommends eliminating state funding for McFarland Historical State Park and for the Arizona Conservation Corps, for a combined General Fund reduction of $(226,200).

Other Legislative Priorities

The JLBC Staff recommendation sets aside $70 million from the General Fund for legislative priorities. This amount could include funding for school finance reform, state employee pay and other bills.

The Executive includes $75 million in their budget for certain initiatives. This amount specifically includes the following: education capital reform, $30 million; education current year funding, $20 million; Highway User Revenue Fund realignment, $8 million; Criminal Justice Enhancement Fund realignment, $1.9 million; and elected official salary increases, $366,800.

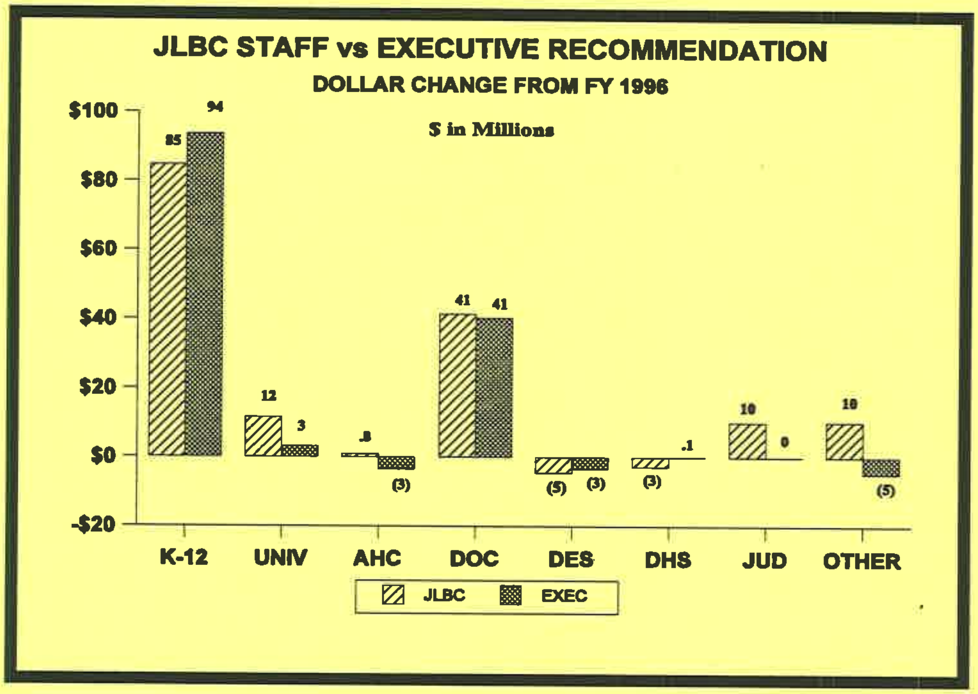
A.R.S. § 41-1904 requires the Governor to make a recommendation in his annual budget submission with regard to the recommendations of the Commission on Salaries for State Elected Officials. The Commission has recommended salary increases for all state elected officials. Some officials, however, will not be eligible for the increase until their next term of office begins. The Governor has accepted the Commission's recommendations at a cost of $383,400 in FY 1997, $648,700 in FY 1998 and $311,800 in FY 1999. The FY 1997 amounts reflect adjustments for the Corporation Commission and the Judiciary. (For FY 1997, the Corporation Commission cost is reflected as a supplemental and is not included in the Executive initiatives.) The JLBC Staff has not set aside any funding for these salary adjustments.

Under the provisions of Section 41-1904, the Governor's recommendation takes effect unless either house of the Legislature specifically disapproves all or part of such recommendations within 90 days of the Governor's budget submission.

TABLES AND GRAPHS

GENERAL FUND AGENCIES
FY 1997 JLBC STAFF RECOMMENDATION
COMPARISON WITH EXECUTIVE RECOMMENDATION AND FY 1996 APPROPRIATIONS

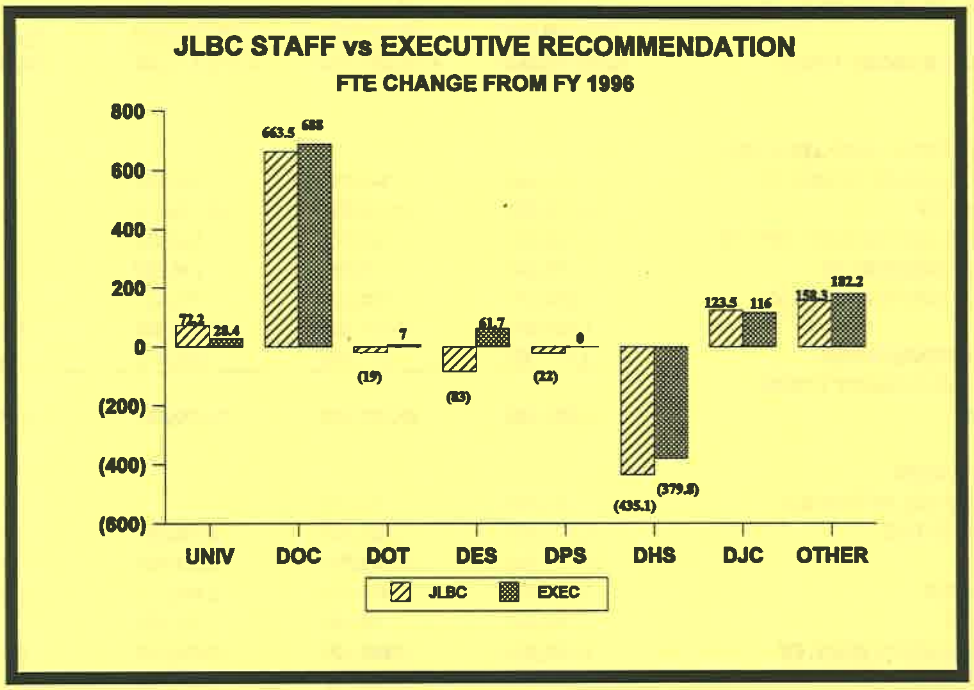
AGENCY	FY 1996 Estimate	FY 1997 Executive Recommendation	FY 1997 JLBC Staff Recommendation	$ Difference JLBC - Executive	$ Difference JLBC - FY 1996
K-12	1,775,746,200	1,869,471,700	1,860,528,300	(8,943,400)	84,782,100
UNIVERSITIES	609,323,800	612,465,100	620,945,200	8,480,100	11,621,400
AHCCCS	479,355,000	475,896,500	480,188,800	4,292,300	833,800
DEPT OF CORRECTIONS	387,926,500	428,526,600	429,317,300	790,700	41,390,800
DEPT OF ECONOMIC SECURITY	395,249,600	391,975,500	390,722,200	(1,253,300)	(4,527,400)
DEPT OF HEALTH SERVICES	218,713,200	218,855,100	215,866,000	(2,989,100)	(2,847,200)
JUDICIARY	105,272,700	105,272,700	115,631,100	10,358,400	10,358,400
COMMUNITY COLLEGES	102,189,600	102,935,500	104,527,300	1,591,800	2,337,700
DEPT OF PUBLIC SAFETY	43,272,700	45,903,000	55,160,700	9,257,700	11,888,000
DEPT OF JUV CORRECTIONS	42,659,500	45,968,500	46,772,400	803,900	4,112,900
ALL OTHER	306,106,900	294,635,200	298,071,200	3,436,000	(8,035,700)
TOTAL	4,465,815,700	4,591,905,400	4,617,730,500	25,825,100	151,914,800



FULL-TIME EQUIVALENT POSITIONS - TOTAL APPROPRIATED FUNDS
FY 1997 JLBC STAFF RECOMMENDATION
COMPARISON WITH EXECUTIVE RECOMMENDATION AND FY 1996 FTE POSITIONS

AGENCY	FY 1996 Estimate 1/	FY 1997 Executive Recommend. 1/	FY 1997 JLBC Staff Recommend.	# Difference JLBC - Executive	# Difference JLBC - FY 1996
UNIVERSITIES	14,096.6	14,125.0	14,168.8	43.8	72.2
DEPT OF CORRECTIONS	7,944.4	8,632.4	8,607.9	(24.5)	663.5
DEPT OF TRANSPORTATION	4,151.0	4,158.0	4,132.0	(26.0)	(19.0)
DEPT OF ECONOMIC SECURITY	2,689.6	2,751.3	2,606.6	(144.7)	(83.0)
DEPARTMENT OF PUBLIC SAFETY	1,592.0	1,592.0	1,570.0	(22.0)	(22.0)
DEPT OF REVENUE	1,245.0	1,244.0	1,244.0	0.0	(1.0)
DEPT OF HEALTH SERVICES	1,614.2	1,234.4	1,179.1	(55.3)	(435.1)
AHCCCS	1,070.2	1,069.8	1,074.8	5.0	4.6
DEPT OF ADMINISTRATION	1,039.1	1,042.5	1,047.0	4.5	7.9
DEPT OF JUVENILE CORRECTIONS	724.0	840.0	847.5	7.5	123.5
ALL OTHER	6,070.4	6,250.6	6,217.2	(33.4)	146.8
TOTAL	42,236.5	42,940.0	42,694.9	(245.1)	458.4

1/ Adjusted for comparability with the JLBC Staff recommendation.



FY 1997 GENERAL FUND SUMMARY

	FY 1996 ESTIMATE	FY 1997 EXEC REC.	FY 1997 JLBC REC.	JLBC REC.- FY 1996	JLBC REC. - EXEC REC.
ANNUAL BUDGET UNITS					
ADMINISTRATION, DEPARTMENT OF	26,217,900	26,917,300	25,367,000	(850,900)	(1,550,300)
AHCCCS	479,355,000	475,896,500	480,188,800	833,800	4,292,300
COMMUNITY COLLEGES	102,189,600	102,935,500	104,527,300	2,337,700	1,591,800
CORRECTIONS, DEPARTMENT OF	387,926,500	428,526,600	429,317,300	41,390,800	790,700
DEAF AND THE BLIND, SCHOOL FOR THE	16,798,000	16,970,300	17,305,700	507,700	335,400
ECONOMIC SECURITY, DEPARTMENT OF	395,249,600	391,975,500	390,722,200	(4,527,400)	(1,253,300)
EDUCATION, DEPARTMENT OF	1,775,746,200	1,869,471,700	1,860,528,300	84,782,100	(8,943,400)
ENVIRONMENTAL QUALITY, DEPT OF	13,984,000	13,450,100	14,033,900	49,900	583,800
HEALTH SERVICES, DEPARTMENT OF	218,713,200	218,855,100	215,866,000	(2,847,200)	(2,989,100)
JUDICIARY					
Court of Appeals	8,956,000	8,943,700	8,935,100	(20,900)	(8,600)
Comm on Appellate and Trial Court Appts	10,000	10,000	20,000	10,000	10,000
Commission on Judicial Conduct	263,700	263,400	260,500	(3,200)	(2,900)
Superior Court	83,985,000	83,953,300	94,131,600	10,146,600	10,178,300
Supreme Court	12,058,000	12,102,300	12,283,900	225,900	181,600
TOTAL	105,272,700	105,272,700	115,631,100	10,358,400	10,358,400
JUVENILE CORRECTIONS, DEPT OF	42,659,500	45,968,500	46,772,400	4,112,900	803,900
PUBLIC SAFETY, DEPARTMENT OF	43,272,700	45,903,000	55,160,700	11,888,000	9,257,700
TRANSPORTATION, DEPARTMENT OF	74,800	74,500	74,500	(300)	0
UNIVERSITIES				0	0
Arizona State University - Main	209,999,300	208,906,400	211,949,800	1,950,500	3,043,400
Arizona State University - East	1,842,700	2,658,700	2,481,500	638,800	(177,200)
Arizona State University - West	33,438,800	33,394,600	33,680,900	242,100	286,300
Northern Arizona University	86,473,300	88,397,800	89,015,200	2,541,900	617,400
Board of Regents	5,979,200	6,189,200	6,198,000	218,800	8,800
University of Arizona - Main	225,182,800	226,101,200	229,354,900	4,172,100	3,253,700
University of Arizona - Health Sciences Center	46,407,700	46,817,200	48,264,900	1,857,200	1,447,700
TOTAL	609,323,800	612,465,100	620,945,200	11,621,400	8,480,100
TOTAL - ANNUAL BUDGET UNITS	**4,216,783,500**	**4,354,682,400**	**4,376,440,400**	**159,656,900**	**21,758,000**
BIENNIAL BUDGET UNITS - NOT ADOPTED					
ADMINISTRATIVE HEARINGS, OFFICE OF	475,000	843,000	848,800	373,800	5,800
AGRICULTURE, DEPT. OF	10,128,000	10,362,300	10,374,900	246,900	12,600
EQUAL OPPORTUNITY, GOVERNOR'S OFC OF	159,000	160,700	160,800	1,800	100
INDIAN AFFAIRS, COMMISSION OF	189,800	173,300	174,500	(15,300)	1,200
MINES & MINERAL RESOURCES, DEPT.OF	688,400	700,500	702,100	13,700	1,600
PARKS BOARD	6,468,600	6,254,400	6,016,000	(452,600)	(238,400)
VETERANS' SERVICE COMMISSION	3,372,500	893,000	928,400	(2,444,100)	35,400
TOTAL - BIENNIAL BUDGET UNITS - NOT ADOPTED	**21,481,300**	**19,387,200**	**19,205,500**	**(2,275,800)**	**(181,700)**
BIENNIAL BUDGET UNITS					
AGRIC. EMPLOYMENT RELATIONS BD.	61,300	62,900	0	(61,300)	(62,900)
ARTS, COMMISSION ON THE	1,511,300	1,523,300	1,526,300	15,000	3,000
ATTORNEY GENERAL	23,129,000	21,840,700	23,226,000	97,000	1,385,300
BANKING DEPARTMENT	2,838,600	2,448,300	2,446,300	(392,300)	(2,000)
BOXING COMMISSION	67,500	68,100	68,000	500	(100)
BUILDING AND FIRE SAFETY, DEPT. OF	3,125,800	2,861,100	2,858,200	(267,600)	(2,900)
COMMERCE, DEPARTMENT OF	11,210,700	9,529,700	9,431,400	(1,779,300)	(98,300)
CONSTITUTIONAL DEFENSE COUNCIL	0	300,000	300,000	300,000	0
CORPORATION COMMISSION	5,243,500	5,209,500	5,170,100	(73,400)	(39,400)

FY 1997 GENERAL FUND SUMMARY

	FY 1996 ESTIMATE	FY 1997 EXEC REC.	FY 1997 JLBC REC.	JLBC REC.- FY 1996	JLBC REC. - EXEC REC.
CRIMINAL JUSTICE COMMISSION, ARIZONA	1,102,500	500,000	0	(1,102,500)	(500,000)
EMRG. & MILITARY AFFAIRS, DEPT. OF	7,581,700	4,459,400	8,377,700	796,000	3,918,300
ENVIRONMENT, COMMISSION ON THE AZ	105,900	0	0	(105,900)	0
EQUALIZATION, STATE BOARD OF	593,400	820,200	849,300	255,900	29,100
EXECUTIVE CLEMENCY, BOARD OF	1,731,500	1,684,800	1,684,800	(46,700)	0
GEOLOGICAL SURVEY, ARIZONA	754,900	740,200	740,200	(14,700)	0
GOVERNOR, OFFICE OF THE	6,484,300	6,487,800	6,208,600	(275,700)	(279,200)
GOVERNOR - OSPB	1,711,000	1,726,300	1,726,300	15,300	0
HEARING IMPAIRED, COUNCIL FOR THE	224,600	251,900	251,900	27,300	0
HISTORICAL SOCIETY, ARIZONA	4,023,600	4,093,300	4,140,300	116,700	47,000
HISTORICAL SOCIETY, PRESCOTT	609,400	613,000	612,900	3,500	(100)
INSURANCE, DEPARTMENT OF	4,641,400	4,365,600	4,422,900	(218,500)	57,300
LAND DEPARTMENT	11,455,600	13,194,000	12,971,100	1,515,500	(222,900)
LAW ENFORCEMENT MERIT SYS COUNCIL	46,700	47,600	47,900	1,200	300
LEGISLATURE					
Auditor General	9,504,100	9,498,600	9,498,600	(5,500)	0
House of Representatives	7,811,000	8,111,700	8,111,700	300,700	0
Joint Legislative Budget Committee	2,125,000	2,128,300	2,128,300	3,300	0
Legislative Council	4,344,800	3,505,200	3,505,200	(839,600)	0
Library, Archives & Public Records	5,275,400	5,320,000	5,362,600	87,200	42,600
Senate	6,005,000	6,045,600	6,045,600	40,600	0
TOTAL	35,065,300	34,609,400	34,652,000	(413,300)	42,600
LIQUOR LICENSES AND CONTROL, DEPT.	2,653,300	2,535,400	2,497,200	(156,100)	(38,200)
MEDICAL STUDENT LOANS BOARD	113,900	236,600	236,600	122,700	0
MILITARY AIRPORT PRESERVATION CMTE., AZ	200,000	0	0	(200,000)	0
MINE INSPECTOR	770,900	811,600	813,600	42,700	2,000
NAVIGABLE STREAM ADJUDICATION COMM., AZ	116,100	114,100	116,800	700	2,700
OSHA REVIEW BOARD	9,000	9,000	9,000	0	0
PERSONNEL BOARD	306,700	310,400	309,900	3,200	(500)
PIONEERS' HOME	2,030,700	1,986,400	1,959,200	(71,500)	(27,200)
POSTSECONDARY EDUCATION, COMM. FOR	1,234,000	1,234,000	1,234,000	0	0
RACING, DEPARTMENT OF	2,632,300	2,540,900	2,537,500	(94,800)	(3,400)
RADIATION REGULATORY AGENCY	1,082,100	1,122,500	1,122,500	40,400	0
RANGERS' PENSIONS	10,300	10,500	10,500	200	0
REAL ESTATE DEPARTMENT	2,870,000	2,834,200	2,831,600	(38,400)	(2,600)
REVENUE, DEPARTMENT OF	51,191,500	51,276,900	51,295,400	103,900	18,500
SECRETARY OF STATE	5,518,400	4,293,900	4,281,200	(1,237,200)	(12,700)
TAX APPEALS, BOARD OF	269,000	264,400	268,600	(400)	4,200
TOURISM, OFFICE OF	7,419,400	7,679,700	7,690,700	271,300	11,000
TREASURER, STATE	3,757,900	3,840,700	3,842,200	84,300	1,500
UNIFORM STATE LAWS, COMMISSION ON	28,200	29,200	29,200	1,000	0
WATER RESOURCES, DEPARTMENT OF	19,926,500	17,682,400	17,702,700	(2,223,800)	20,300
WEIGHTS AND MEASURES, DEPT. OF	1,771,000	1,585,900	1,584,000	(187,000)	(1,900)
TOTAL - BIENNIAL BUDGET UNITS	227,230,700	217,835,800	222,084,600	(5,146,100)	4,248,800
OPERATING BUDGET TOTAL	4,465,495,500	4,591,905,400	4,617,730,500	152,235,000	25,825,100
Unallocated Salary Adjustment	232,000	0	0	(232,000)	0
Unallocated CMR	88,200	0	0	(88,200)	0
GRAND TOTAL	4,465,815,700	4,591,905,400	4,617,730,500	151,914,800	25,825,100

FY 1997 OTHER APPROPRIATED FUNDS SUMMARY

	FY 1996 ESTIMATE	FY 1997 EXEC REC.	FY 1997 JLBC REC.	JLBC REC.- FY 1996	JLBC REC.- EXEC REC.
ANNUAL BUDGET UNITS					
ADMINISTRATION, DEPARTMENT OF	99,261,300	124,000,500	124,943,600	25,682,300	943,100
COMMUNITY COLLEGES	140,200	135,700	144,800	4,600	9,100
DEAF AND THE BLIND, SCHOOL FOR THE	5,411,200	5,362,200	5,330,500	(80,700)	(31,700)
ECONOMIC SECURITY, DEPARTMENT OF	416,400	9,366,900	417,000	600	(8,949,900)
ENVIRONMENTAL QUALITY, DEPT	14,944,700	17,630,800	18,110,000	3,165,300	479,200
HEALTH SERVICES, DEPARTMENT OF	17,165,000	17,151,400	17,162,000	(3,000)	10,600
SUPREME COURT	1,632,100	1,632,100	1,461,100	(171,000)	(171,000)
JUVENILE CORRECTIONS, DEPT OF	1,978,300	2,007,600	2,038,600	60,300	31,000
LOTTERY, ARIZONA	49,188,500	42,469,000	42,773,700	(6,414,800)	304,700
PUBLIC SAFETY, DEPARTMENT OF	53,162,000	54,105,600	44,072,700	(9,089,300)	(10,032,900)
TRANSPORTATION, DEPARTMENT OF	187,594,400	207,731,600	207,460,300	19,865,900	(271,300)
UNIVERSITIES					
Arizona State University - Main	73,206,900	71,170,400	71,170,400	(2,036,500)	0
Arizona State University - East	204,000	2,314,100	2,697,900	2,493,900	383,800
Arizona State University - West	5,540,500	5,584,700	5,584,700	44,200	0
Northern Arizona University	24,462,200	26,750,100	26,750,100	2,287,900	0
University of Arizona - Main	63,171,300	62,864,700	63,821,000	649,700	956,300
University of Arizona - Health Sci Ctr	5,025,200	5,025,200	5,025,200	0	0
TOTAL	171,610,100	173,709,200	175,049,300	3,439,200	1,340,100
TOTAL - ANNUAL BUDGET UNITS	628,904,000	673,843,700	665,504,700	36,600,700	(8,339,000)
BIENNIAL BUDGET UNITS - NOT ADOPTED					
ADMINISTRATIVE HEARINGS, OFFICE OF	186,800	419,700	226,800	40,000	(192,900)
AGRICULTURE, DEPT. OF	1,749,800	1,932,900	1,774,800	25,000	(158,100)
PARKS BOARD	2,465,600	2,607,000	3,613,600	1,148,000	1,006,600
VETERANS' SERVICE COMMISSION	521,600	7,944,400	7,876,100	7,354,500	(68,300)
TOTAL - BIENNIAL BUDGET UNITS - NOT ADOPTED	4,923,800	12,904,000	13,491,300	8,567,500	587,300
BIENNIAL BUDGET UNITS					
ACCOUNTANCY, BOARD OF	1,040,000	1,056,800	1,051,500	11,500	(5,300)
APPRAISAL, BOARD OF	258,900	250,600	250,500	(8,400)	(100)
ATTORNEY GENERAL	3,389,400	2,585,000	3,584,100	194,700	999,100
BARBERS, BOARD OF	150,700	151,100	154,100	3,400	3,000
BEHAVIORAL HEALTH EXAMINERS, BD OF	342,900	357,100	350,800	7,900	(6,300)
CHIROPRACTIC EXAMINERS, BOARD OF	261,400	246,300	244,800	(16,600)	(1,500)
COLISEUM AND EXPOSITION CENTER	14,510,200	15,341,100	15,340,700	830,500	(400)
COMMERCE, DEPARTMENT OF	5,209,500	3,488,500	2,763,100	(2,446,400)	(725,400)
CONTRACTORS, REGISTRAR OF	5,240,900	4,571,000	4,672,700	(568,200)	101,700
CORPORATION COMMISSION	6,125,500	6,637,300	6,584,000	458,500	(53,300)
COSMETOLOGY, BOARD OF	810,500	688,200	688,200	(122,300)	0
CRIMINAL JUSTICE COMMISSION, ARIZONA	577,900	572,300	576,100	(1,800)	3,800
DENTAL EXAMINERS, BOARD OF	600,300	594,400	594,100	(6,200)	(300)
EMRG. & MILITARY AFFAIRS, DEPT. OF	52,600	47,700	47,700	(4,900)	0
FUNERAL DIRECTORS & EMBALMERS, BD	172,400	177,500	179,500	7,100	2,000
GAME AND FISH DEPARTMENT	17,953,100	17,839,800	17,841,400	(111,700)	1,600
GAMING, DEPARTMENT OF	2,849,000	3,826,700	3,757,100	908,100	(69,600)
GOVERNOR, OFFICE OF THE	500,000	600,000	500,000	0	(100,000)
HOMEOPATHIC EXAMINERS, BOARD OF	29,400	33,100	33,100	3,700	0
INDUSTRIAL COMMISSION	12,949,800	12,798,600	12,739,100	(210,700)	(59,500)
LEGISLATURE - AUDITOR GENERAL	0	0	0	0	0
MEDICAL EXAMINERS, BOARD OF	2,916,400	2,900,700	2,896,200	(20,200)	(4,500)
NATUROPATHIC PHYSICIANS BOARD	71,300	70,400	71,800	500	1,400
NURSING, BOARD OF	1,564,000	1,541,300	1,540,800	(23,200)	(500)
NURSING CARE INSTITUTIONAL ADMIN. BD.	78,000	90,800	91,700	13,700	900
OCCUPATIONAL THERAPY EXAM., BD OF	96,100	91,900	91,800	(4,300)	(100)

FY 1997 OTHER APPROPRIATED FUNDS SUMMARY

	FY 1996 ESTIMATE	FY 1997 EXEC REC.	FY 1997 JLBC REC.	JLBC REC.- FY 1996	JLBC REC.- EXEC REC.
OPTICIANS, BOARD OF DISPENSING	67,500	67,900	67,000	(500)	(900)
OPTOMETRY, BOARD OF	108,600	108,900	109,200	600	300
OSTEOPATHIC EXAMINERS, BOARD OF	311,800	322,500	322,300	10,500	(200)
PHARMACY, BOARD OF	746,600	704,000	726,400	(20,200)	22,400
PHYSICAL THERAPY EXAMINERS, BOARD	91,400	91,800	92,800	1,400	1,000
PIONEERS' HOME, ARIZONA	1,189,400	1,158,600	1,147,800	(41,600)	(10,800)
PODIATRY EXAMINERS, BOARD OF	58,100	57,500	58,000	(100)	500
POSTSECONDARY EDUCATION, COMM. FOR	2,984,500	2,931,000	2,927,300	(57,200)	(3,700)
PRIVATE POSTSECONDARY EDUCATION	147,700	159,600	159,600	11,900	0
PSYCHOLOGIST EXAMINERS, BOARD OF	224,900	260,300	254,200	29,300	(6,100)
RACING, DEPARTMENT OF	289,000	292,300	292,200	3,200	(100)
RADIATION REGULATORY AGENCY	105,800	107,200	107,100	1,300	(100)
RESIDENTIAL UTILITY CONSUMER OFFICE	1,009,000	1,001,000	1,001,000	(8,000)	0
RESPIRATORY CARE EXAMINERS BOARD	166,000	164,000	164,900	(1,100)	900
RETIREMENT SYSTEM	3,673,300	3,751,500	3,752,800	79,500	1,300
REVENUE, DEPARTMENT OF	426,800	330,600	331,000	(95,800)	400
STRUCTURAL PEST CONTROL COMM	1,279,200	1,301,600	1,338,200	59,000	36,600
TECHNICAL REGISTRATION, BOARD OF	878,500	871,700	871,800	(6,700)	100
VETERINARY MED EXAMINING BOARD	191,600	188,100	216,200	24,600	28,100
WEIGHTS AND MEASURES, DEPT. OF	549,500	524,100	523,500	(26,000)	(600)
TOTAL - BIENNIAL BUDGET UNITS	92,249,400	90,952,400	91,108,200	(1,141,200)	155,800
OPERATING BUDGET TOTAL	726,077,200	777,700,100	770,104,200	44,027,000	(7,595,900)
Unallocated Salary Adjustment	200,600	0	0	(200,600)	0
Unallocated CMR	269,100	0	0	(269,100)	0
OPERATING BUDGET TOTAL	726,546,900	777,700,100	770,104,200	43,557,300	(7,595,900)

ECONOMIC AND REVENUE FORECAST

THE ECONOMY

Overview

The state's budget surpluses of the past two fiscal years have largely reflected the robust performance of the Arizona economy. Near-record employment gains, solid personal income and retail sales growth, economic development coups, surging corporate profits, and a booming residential housing market all contributed to the very strong revenue picture.

At our Finance Advisory Committee (FAC) meeting in December, most economists in attendance believed that this favorable picture will continue through 1996, although at a slower pace, with the first possibility for a recession not happening until the later half of 1997. The JLBC Staff generally concurs with this outlook. Conspicuously absent from the discussion was the identification of factors driving the current economy. What happens to these "drivers" may determine, to a large extent, whether the state will continue its excellent economic performance for the next two years.

We believe the following factors are the major drivers of the economy in the present business cycle:

- **The National Economy**. The Arizona economy is much more diversified now than in the 1980s. This makes our links to the national and global economy stronger; and, as a result, the state may be more vulnerable to any weakness in these larger economies. Thus, a key question is: How much will the predicted slowdown in the U.S. economy affect Arizona?

- **Construction.** Historically, the Arizona economy has been volatile due to reliance on the construction sector. Single family housing has been a major "driver" in the current expansion, peaking in 1994, surprisingly strong in 1995, but with further declines in the rate of expansion during our forecast period. It is expected that growth in commercial construction, and office and hotel construction will mitigate the decline.

- **The Direction of Interest Rates**. Low and falling interest rates helped to spur the residential housing market out of the recession of the late 1980s and early 1990s. Will current interest rates stay low? That depends on inflation remaining tame and the effectiveness of Federal Reserve policy. Also, a federal budget agreement is expected to have a favorable impact on interest rates.

- **The California Exodus**. Census data show that California in the 1990s is Arizona's biggest source of in-migration with Texas a distant second. In 1994, net migration to the state increased by about 40%. Also, many businesses have moved or expanded here from California. When California's economy regains its strength, will this reduce the flow of people and firms to Arizona and how much will that impact our housing and employment markets? Of course, a stronger California will boost interstate trade with California.

- **Improved Business Environment.** Arizona has made great strides in improving its national image and attracting new businesses into the state. As the economy slows, will firms continue to relocate or expand into the state, especially in the developing high-tech clusters of Maricopa and Pima counties?

In light of the above questions, this section will discuss the economic outlook for the nation and Arizona in 1996 and 1997. The JLBC Staff economic outlook is essentially that of the consensus of economists, and is consistent with recent economic evidence. However, if certain economic indicators, such as personal income, should strengthen, appropriate adjustments will be made in our mid-session forecast. But first let's see how we are doing so far in 1995.

<u>1995 Update -- U.S. Economy Loses Speed</u>

Table 1 displays JLBC's summary of key national and state economic indicators for 1995 through 1997. The 1995 indicators are still estimates, but since 1995 is now completed they reflect how we think the year ended. Compared to 1994, which recorded the best economic performance in years, the U.S. economy in 1995 definitely slowed:

- After spurting by 4.1% in 1994, real GDP output grew at a 2.7% annual rate in the first quarter of 1995 and a 1.3% annual rate in the second quarter, but rebounded to a surprising 4.3% growth in the third quarter. A notable slowdown in the rate of consumer spending in the fourth quarter may mean a lackluster finish to 1995, when these results are reported shortly.

- Job growth has slowed from 3% in 1994 to an expected 2.3% in 1995.

- Inflation has been moderating at around 2.7% in the third quarter of this year, below the 3% exhibited in the second quarter, but slightly higher than the 2.6% in all of 1994. The Consumer Price Index should show an increase of 2.8% for all of 1995.

Table 1

JLBC STAFF ECONOMIC OUTLOOK

FOR THE NATION

	Calendar Years			Fiscal Years		
	1995	**1996**	**1997**	**1995**	**1996**	**1997**
National Economic Indicators						
Real Gross Domestic Product (Billions)	$5,519.7	$5,656.4	$5,691.2	$5,439.7	$5,592.7	$5,723.6
% Change	3.3	2.5	2.4	3.9	2.8	2.3
Wage & Salary Employment (Millions)	116.6	118.2	119.9	115.6	117.4	119.1
% Change	2.3	1.4	1.5	2.9	1.6	1.5
Pre-Tax Corporate Profits (Billions)	$562.6	$581.3	$606.4	$559.1	$563.8	$593.8
% Change	7.2	3.3	4.3	13.7	0.8	5.3
Housing Starts (Millions)	1.3	1.4	1.4	1.4	1.4	1.4
% Change	(7.6)	4.0	(0.3)	(0.2)	0.9	1.2
New Car Sales (Millions)	8.9	9.0	9.1	9.0	8.9	9.0
% Change	(3.8)	0.7	1.3	(0.8)	(0.6)	0.8
Consumer Price Index - % Change	2.8	2.5	2.4	2.9	2.6	2.5
Prime Interest Rate - %	8.8	7.9	7.8	8.4	8.4	7.8
Unemployment Rate - %	5.6	5.8	6.0	5.7	5.6	5.8

As we enter 1996, most economists expect real GDP to rebound from its summer slump, but not at the level of the surprising third quarter growth. Overall, yearly growth is expected to be 3.3% for 1995. Housing starts, which were strong early in 1995, slumped a little in the summer, but in July and August showed signs of stirring again, probably responding to falling interest rates; however, in September housing starts declined again unexpectedly. Likewise, auto sales were down in the summer, but in August rebounded with its best month ever. These mixed signals indicate that there is still a certain amount of uncertainty in the economic outlook.

1995 Update -- Arizona Economy Slows, But Still Ranks Near Top Of All States

The Arizona economy grew in 1995 at a healthy pace, but softened as compared to our stellar performance in 1994, which we believe was the peak year of the current business cycle. Wage and salary employment for the first nine months of 1995 rose 4.9% -- significantly less than the 6.7% experienced in the first nine months of 1994. Construction job growth especially has dropped dramatically from more than 20% in 1994 to 7.4% in 1995 and it appears to be heading lower. Likewise, growth in taxable retail sales, net-migration, and housing starts were all down from the pace set in 1994.

One exception is personal income growth which in October was revised upward by the Bureau of Economic Analysis (BEA). Growth in the first quarter of 1995 when compared to the same period last year was changed from the original 8.8% to a vigorous 10.8%. Furthermore, the initial estimate for the second quarter showed a solid increase of 9.2%. This implies that the Arizona economy may not have slowed as much as the jobs data indicated

When compared to the nation, Arizona ranks near the top in economic performance. For every month in 1995, Arizona was consistently been among the top ten states in terms of employment growth. A recent quarterly study by Everen Securities of Chicago ranked Arizona's economy No.1 among all states. The study measures information for the 12 months that ended June 30th of 1995. The indicators rated were two in employment (job growth and the unemployment rate) and four in real estate (home sales, building permits, mortgage foreclosures, and mortgage delinquencies).

The U.S. Outlook for 1996 and 1997

The U.S. economy is about to enter its sixth year of expansion since the trough of the last recession in March 1991. Real Gross Domestic Product (GDP) grew at an annual rate of 4.1% in calendar year 1994 and 3.9% in FY 1995 which ended June 30, 1995. Most economists expect national growth will continue for the next few years, although at a slower rate. The JLBC Staff also forecasts slower, but steady growth in the national economy through calendar and FY 1997. The consensus of economists expects annual real GDP growth of 3.2% for 1995, which is a number with which we agree. The present JLBC Staff outlook is for growth of 2.5% in 1996 and 2.4% in 1997. The consensus of economists expects a national growth rate of 2.6% in 1996. Our view for FY 1997 is based on the WEFA Group's "baseline" forecast. Our forecast of declining growth is predicated on the maturity of this expansion, which has now surpassed the average length of post WWII growth periods, and the six interest rate increases by the Federal Reserve Board throughout 1994 in addition to the one increase in February 1995. Monetary policy changes generally have impacts up to 12 to 18 months afterward, which would mean effects in FY 1996 and FY 1997.

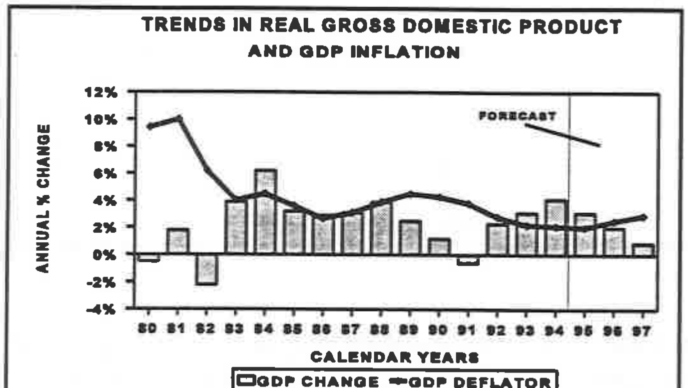


Chart 1

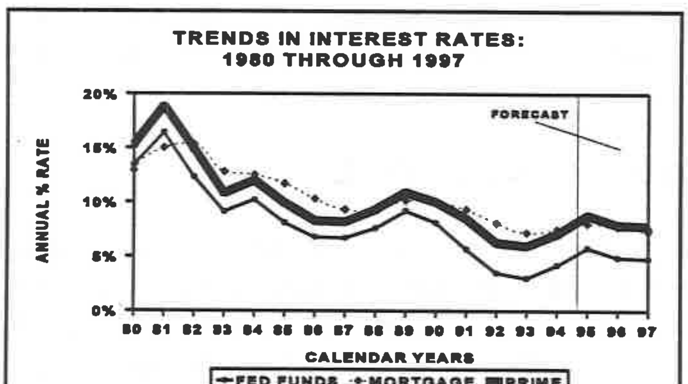


Chart 2

The Federal Reserve has publicly said that it believes a rate of 2.5% per year in real GDP growth is about right for non-inflationary expansion in the U.S. economy. The 4.1% seen in 1994 was clearly too high by their standards. It has been trying to engineer a "soft landing," a reduction in the rate of growth to their target 2.5% rate. But this level of precision in hitting economic targets is rare, perhaps exceptional. The normal scenario is for targets to be overachieved in one direction or another. Growth usually slows too much or is too fast. The "middle way" is rarely achieved by design, although this period appears to be one of the rare exceptions.

We still believe the monetary tightening during 1994 could have its full effect by early 1996. In addition, many analysts have recently been forecasting that pre-tax corporate profit growth will grow at slower rates in 1996 and 1997. This could lead to a long awaited stock market "correction" and, thereby damage, consumer confidence and spending.

Inflation, as measured by the Consumer Price Index, should remain moderate and even fall from the expected 2.8% level of 1995 to 2.5% per annum in 1996 and 2.4% in 1997. In this area, the Federal Reserve Board has clearly done a good job in reducing inflationary expectations among consumers, workers and businesses. Alternatively, many think with interest rates at such low levels, the stock market will continue to be in high demand by savers.

We believe the trend for interest rates will be down after 1995. This will be due to the prior effects of tight "real" money conditions by the Federal Reserve Board, and the slowing economy which will reduce the demand for funds. It should be noted that while interest rates have come down in recent months they are, after adjustment for inflation which has also been falling, still at a comparatively high rate by historical standards.

Housing starts, which enjoyed a record year nationally in 1995, are already starting to cool. We expect this moderation to continue in 1996 and 1997. The rate of increase in auto sales in the U.S. which have also been at near record levels for several years, should start to decline slightly because of a slower economy, some satiation of demand, and expected continued increases in the average price of cars at or above the Consumer Price Index.

The federal government's leading forecasting tool, the Index of Leading Indicators, has been negative for seven months this year. The Leading Index forecasts economic activity about 9 to 15 months ahead. The declines in the Index during the spring of 1995 were a warning of activity in 1996. Finally, there have been signs that consumers have been spending ahead of income growth and running up record balances on credit cards. This could portend a reduction in the rate of growth in consumer spending sometime in 1996.

Outlook–Lower But Steady Growth

Any scenario for the economy is done on an "expected value" basis. In other words, whether subjectively or quantitatively, an analyst has to weigh the chances of high, middle, or low growth economic scenarios based on the risks identified in the economy and choose the one which fits the current data. Recent events, while not yet convincing, could lead to a somewhat more optimistic mid-session forecast.

First, after seven successive increases during 1994 and early 1995, the Federal Reserve Board lowered short-term interest rates in mid-1995, and again in December 1995, perhaps believing that it was too zealous in 1994. Economic growth in the first half of 1995 was sharply lower than in 1994, but real GDP was 3.3% higher in the third quarter than a year earlier. The Fed has seen that its growth moderating policies have worked in 1995 and may loosen up the monetary "brakes" before a recession is in sight. Most economists believe the Fed has moved at about the right time rather than too late in order to keep the growth rate of the economy positive in the next 12 to 24 months.

Second, most economists believe the efforts made in Congress to eliminate the federal budget deficit will result in a higher national savings rate, lower interest rates, and higher private investment. These will increase employment and personal incomes over time.

Third, the low value of the U.S. dollar against most major currencies, notably the yen and Deutsche mark, has already started a resurgence of U.S. export sales. This should continue for the next several years, depending on the health of our major trading partners.

Fourth, despite the maturity of the current expansion, most executives reportedly remain bullish about the economy. Many companies have reduced their break-even point, admittedly by reducing staff in many cases, and have diversified their sales to try to avoid the severity of the cyclical swings of the past. Whether they will be successful remains to be seen, but newspapers and magazine reports indicate that they are not fearful of a recession in the next year or two.

In conclusion, we feel that our forecast of a slower but steady trend in growth is appropriate. The JLBC mid-session forecast will be modified as appropriate, given economic trends existing at the time.

Table 2

JLBC STAFF ECONOMIC OUTLOOK

FOR ARIZONA

	Calendar Years			Fiscal Years		
	1995	**1996**	**1997**	**1995**	**1996**	**1997**
Arizona Economic Indicators						
Personal Income (Millions)	$85,306	$91,789	$98,122	$81,846	$88,557	$94,800
% Change	9.3	7.6	6.9	9.7	8.2	7.0
Personal Income Millions of 1987 Dollars	$66,489	$70,175	$73,335	$64,294	$68,437	$71,655
% Change	7.4	5.5	4.5	7.5	6.4	4.7
Personal Income - Per Capita 1987 Dollars	$15,914	$16,354	$16,656	$15,609	$16,162	$16,484
% Change	4.4	2.8	1.8	4.5	3.5	2.0
Population (Thousands)	4,178	4,291	4,403	4,119	4,235	4,347
% Change	2.9	2.7	2.6	2.8	2.8	2.7
Retail Sales (Millions) 1/	$26,240	$28,077	$29,480	$25,293	$27,088	$28,416
% Change	9.2	7.0	5.0	11.6	7.1	4.9
Wage & Salary Employment (Thousands)	1,762.8	1,818.5	1,856.1	1,734.4	1,793.1	1,836.4
% Change	4.2	3.2	2.1	5.9	3.4	2.4
Residential Building Permits (Thousands)	53.4	43.7	39.1	52.2	48.6	41.4
% Change	4.9	(18.2)	(10.5)	16.5	(6.9)	(14.8)
New Car Registrations (Thousands)	250.7	251.4	244.0	247.0	252.9	249.9
% Change	5.0	0.3	(2.9)	12.7	2.4	(1.2)
Unemployment Rate - %	5.2	5.5	6.4	5.8	5.3	5.0

1/ Distribution Base + Combined Non-Shared Tax Collections as reported by DOR.

The Arizona Outlook for 1996 and 1997

While JLBC Staff believes Arizona will avoid a recession during the forecast period, our outlook as seen on Table 2 calls for slower growth. All Arizona economic indicators are projected to trend lower for the next two years. The lower growth forecast hinges mainly on the slowing national economy and a slackening of the California exodus to Arizona as prospects for the Golden State improve in the next two years. The slackening of the California exodus to Arizona will probably be mitigated by increased interstate trade with California as their economy improves. On the other hand, recent higher than expected revisions in the employment and personal income growth might indicate a stronger Arizona economy than the one underlying our forecast. This implies that there may be some upside risk to the forecast.

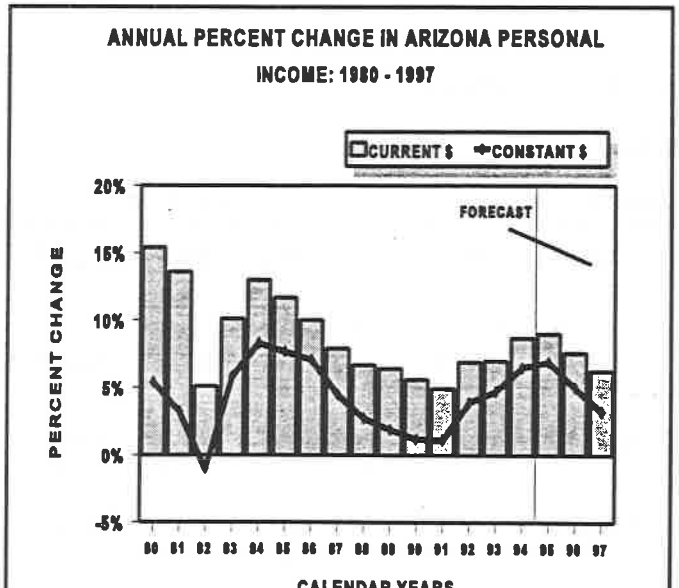


Chart 3

Personal Income to Grow Modestly

In terms of state revenue, no economic variable is more important than personal income. Chart 3 shows how personal income has performed in recent years. During the 1980s, personal income growth averaged 9.3% in current dollars and 4.4% in real terms. So far in the 1990s (1990 through 1994), income growth in current dollars has been weaker, averaging 6.8%, but is only off slightly in real dollars, averaging 4.0%, mostly reflecting the big improvement in inflation during the 1990s. The estimated 9.3% gain for 1995 is significantly greater than the average 6.8% experienced thus far in the 1990s.

In 1996 and 1997, we see personal income rising more modestly at 7.6% and 6.9%, respectively. Historically, Arizona's economic recoveries feature double-digit personal income growth that lasts two to four years, but that has not happened this time. The 9.3% growth forecasted for 1995 will be the peak for this expansion. Since the national economy, whose expansion has been uncharacteristically mild and appears to be slowing, is one of the "drivers" of the state economy, we expect Arizona's personal income to grow modestly.

Real Per Capita Income to Increase Slightly

Real per capita personal income is one indicator of a state's standard of living. It also is a principal determinant of consumer expenditures, which accounts for about two-thirds of spending, output, and jobs. So, trends in real per capita income also can reveal much about the overall strength of the economy. In recent years, there has been much ballyhoo about Arizona always being below the national average in real per capita income, leading some (including the JLBC Staff) to question the underlying economic vitality of the state.

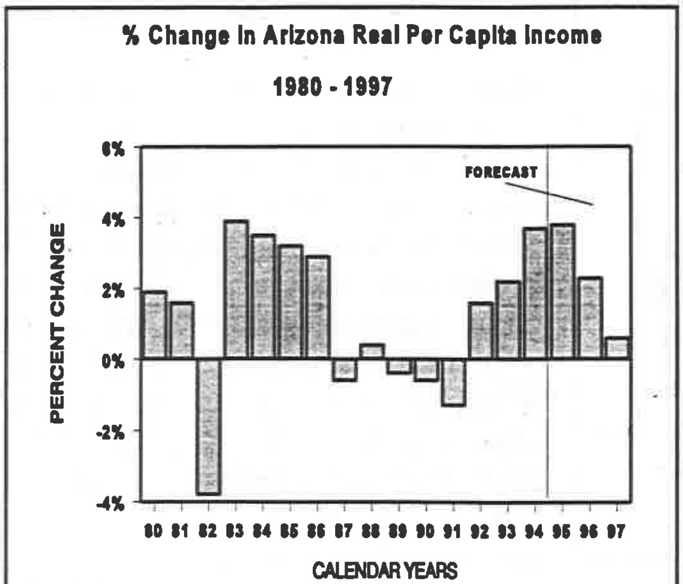


Chart 4

In response to this, the JLBC Staff recently published a report identifying the main reasons behind Arizona's lower real per capita income. The report found that Arizona's poor showing has little to do with its economic performance, but more to do with such factors as age demographics, industry mix, and historically low wages. The report also points out that, because real per capita income depends on relative rates of growth in total income and population, it can be misleading when compared to other states. Southern states have exhibited the highest growth rates of this indicator for the past three decades. But much of this effect is due to their population migrating to cities in other states in search of better jobs. Likewise in the 1980s, northeastern states ranked the highest, but this was due to severe economic recessions in these states which resulted in population declines greater than those in personal income.

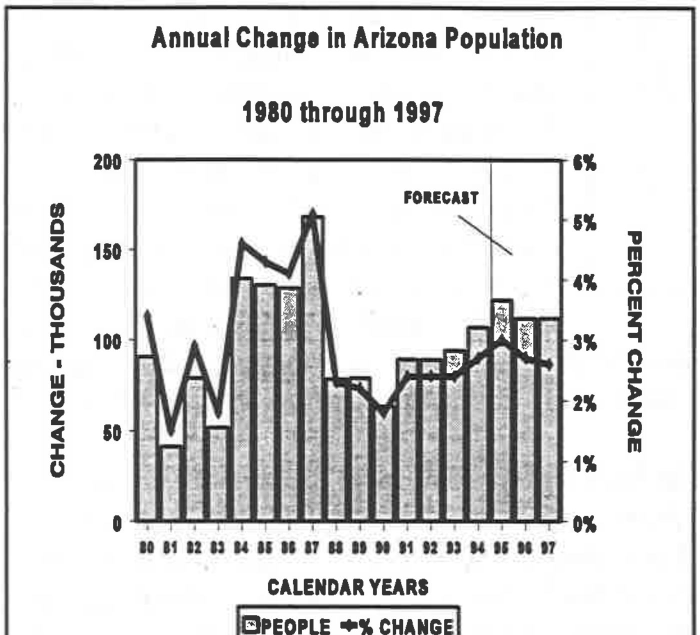


Chart 5

Thus, in measuring economic vitality, an examination of the underlying trends show that Arizona's average growth in personal income and population during the last three decades has been far above the national average. So, it appears that among Arizona's problems are (1) that personal income growth just has not kept up with population growth and (2) that increased emphasis must be placed on higher paying jobs. Chart 4 shows that Arizona's real per capita income growth went negative starting in 1987 as growth in population was greater than income, but has rebounded since 1992. We predict that income growth will continue to outweigh population growth which is seen on Chart 5, but by declining rates during the forecast period.

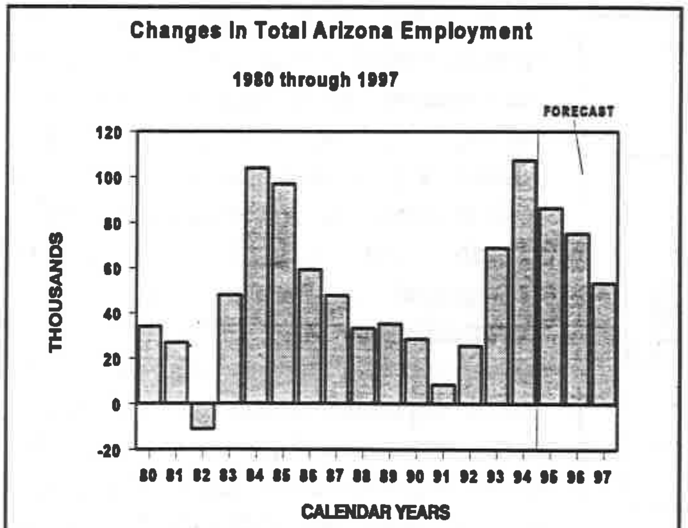


Chart 6

Employment Still Rising - But Slowly

Chart 6 shows the changes in Arizona employment since 1980. During this period, Arizona did not experience any yearly declines. In fact, for the post WWII period, the state has had only three years of employment loss -- 1949, 1975, and 1982. In this business cycle, 1991 was the low point for Arizona, eking out a 0.6% gain, corresponding with the national recession when U.S. employment dropped 1.1%. Since 1991, job growth has accelerated with 1994's 6.2% gain expected to be the peak year of the current cycle.

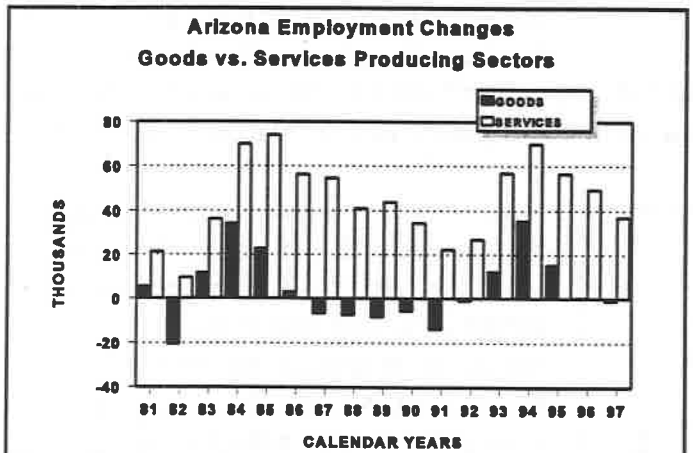


Chart 7

This data, however, masks the economic tumult Arizona experienced during this time. Arizona's goods-producing sector, defined as manufacturing, construction, and mining, went through a recession in the latter half of the 1980s. National defense budget cuts led to military base closings and sharp layoffs in defense-related firms. At the same time, the 1986 Tax Reform Act triggered massive savings and loan bankruptcies. All this resulted in significant losses in manufacturing and construction jobs. But the losses were more than made up by gains in the service-producing sector of the economy. Chart 7 reveals the displacement of jobs in the goods-producing sector by jobs in the service-producing sector particularly during the 1987 to 1992 period.

Since 1993, manufacturing and construction jobs have made a comeback; the rebound, though, has not been as strong as previous recoveries. Some of the manufacturing rebound was due to a perceived improved business environment. For instance, Phoenix recently appeared in *Fortune* magazine's annual list of the top 10 most attractive cities for businesses. In addition, many high-tech firms have relocated or expanded into Arizona. *Intel* and the recent announcement by *Sumitomo Sitix* are prime examples. Legislation providing tax reductions and regulatory reform has contributed to this success.

Table 3 below shows a moderation of growth in our job outlook for both the goods-producing and service-producing sectors starting in 1995. The goods-producing sector will again experience the cyclical nature of the economy by declining a modest 0.4% in 1997. CY 1995 employment numbers are shown in the forecast category because (1) data is not yet complete and (2) the data will be rebenched early in 1996.

Table 3

ARIZONA WAGE AND SALARY EMPLOYMENT
YEAR OVER PRIOR YEAR GROWTH – CALENDAR YEARS

	CY 1994		FORECAST CY 1995		CY 1996		CY 1997	
	Number	%	Number	%	Number	%	Number	%
Goods Producing:								
Manufacturing	192,500	9.1	200,900	4.4	201,600	0.3	203,400	0.9
Mining	12,100	(1.6)	12,900	6.6	13,100	1.6	13,100	0.0
Construction	108,700	21.9	114,900	5.7	116,100	1.0	114,100	(1.7)
Total Goods Producing	313,300	12.7	328,700	4.9	330,800	0.6	330,600	(0.1)
Service Producing:								
Trans, Comm. & Public Utilities	90,000	7.4	93,900	4.3	96,300	1.6	98,500	2.3
Trade	411,100	5.5	429,600	4.5	447,900	4.3	459,900	2.7
Finance, Insurance & Real Estate	110,800	9.5	111,200	0.4	112,100	0.8	113,400	1.2
Services	479,800	6.4	505,700	5.4	531,200	5.0	547,000	3.0
Government	286,800	1.4	293,700	2.4	300,200	2.2	306,700	2.2
Total Service Producing	1,378,500	5.4	1,434,100	4.0	1,487,700	3.7	1,525,500	2.5
Total Wage & Salary Employment	1,691,800	6.7	1,762,800	4.2	1,818,500	3.2	1,856,100	2.1

Where Will the Jobs Come From?

Chart 8 on the next page shows that job growth will be highly concentrated in services and trade. In 1995, 1996, and 1997 combined, only services and trade will increase in their share of total jobs.

In contrast, construction and manufacturing will experience relatively slow growth. For example:

- More than 7 out of 10 jobs will come from services and trade. By comparison, these industries accounted for slightly half of existing jobs in 1994.

- Manufacturing in 1994 had 11% of all jobs, but will account for only 6% of new jobs. Construction will decline further -- having 6% of jobs now, but contributing only 3% in the next three years.

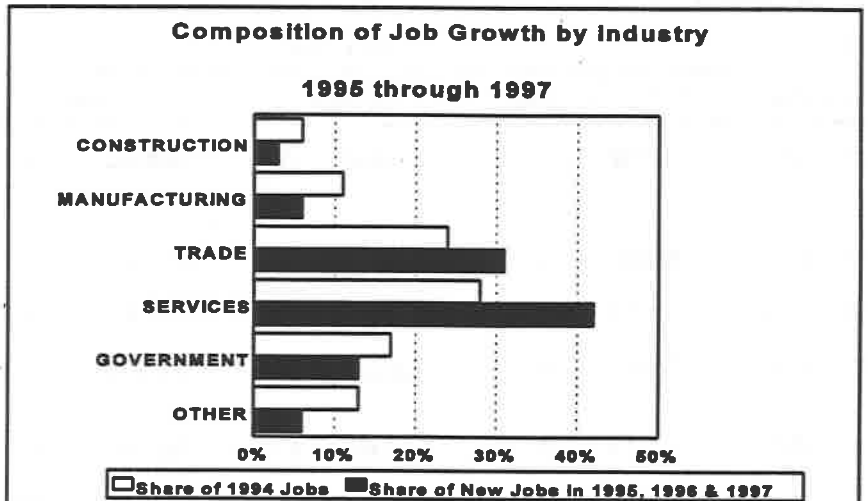


Chart 8

Overall, the trend is toward a more service oriented economy, which mirrors what's happening on the national level. This has been a long-term trend in Arizona since 1969, the last year in which more manufacturing job existed than services jobs. As technological advances continue, we expect the evolution toward a service and information economy to accelerate.

Housing Market in Transition

Although direct employment in the construction industry accounts for only 6% of total Arizona jobs, its impact on the economy is far greater in the short run. Construction influences economic activity in many other areas of the economy, including equipment and building materials, retail sales, financial services, manufacturing, and trade. We expect construction employment to mildly decline in the next two years because the housing market in Arizona is in transition.

Judging by chart 9 on the next page, it appears Arizona's housing market was relatively unaffected by the national recession in 1991, but that's because we had an earlier recession as explained above. So by 1991, when mortgage rates began to plummet, pent-up demand caused housing sales to climb. At the same time, California's problems started an exodus of people and firms to other nearby Western states. Arizona has benefited greatly from this movement as net migration and housing starts have escalated each year since 1991 until 1995.

Chart 9 also reveals that the housing boom was almost all in single family homes. This began to change in 1994 as the Federal Reserve raised interest rates seven times. By 1995, the single family market slowed as housing sales and permits declined. But at the same time, vacancy rates at apartments dropped sharply and rents increased steadily, making it viable for multi-family construction to rise again. More recently, multi-family building permits (3 or more units) jumped

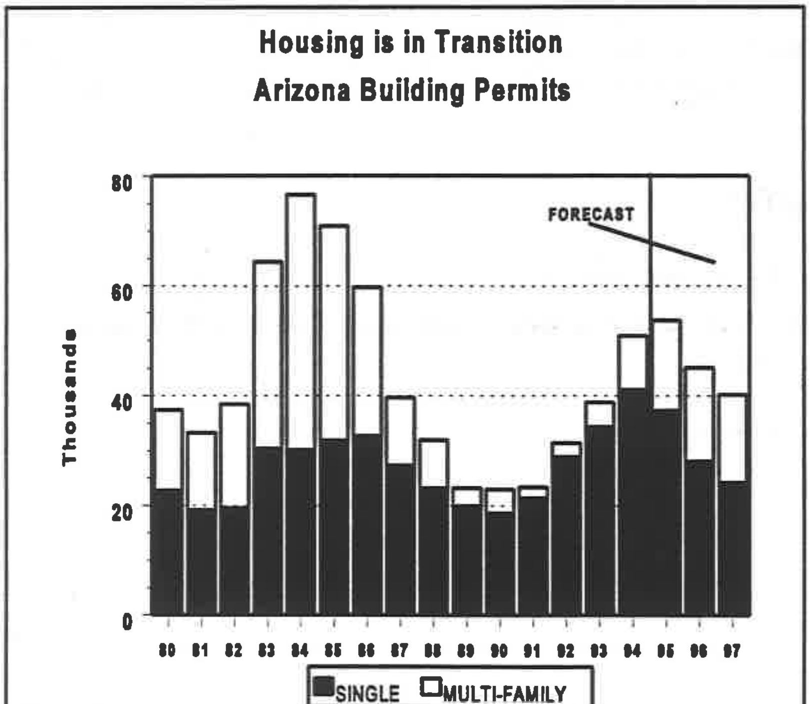


Chart 9

from about 3,500 units in 1993 to almost 9,000 units by 1994, an increase of 155%. In 1995, multi-family permits are estimated to have added another 13,500 units.

For 1996 and 1997, we expect total building permits to gradually decline as single-family building permits decline and multi-family permits increase. Building permits in retail, industrial, and office are also expected to pick up. The California exodus has been fueling much of the housing boom, but lately, economists have been more optimistic about the California economy as recent data indicate the state has indeed started to turn around. This will slow down the migration to Arizona; however, improved trade between the two states will offset the impact somewhat.

Main Risks to Forecasts

Peso continues to add uncertainty to the forecast. The dramatic devaluation of the Mexican peso in 1994 reverberated throughout the world. Hoping to prevent loan defaults of worldwide proportions, the U.S. spearheaded a $50 billion aid package to Mexico. In return, the Mexican government had to implement austerity measures which plunged its economy into a steep recession. However, the economy in Mexico has started to recover as exports rose 32% in the first half of 1995 and most financial markets have stabilized. Their domestic economy, though, is still very weak. It is too early to know whether the recovery will last or how strong it will be.

The peso crisis has affected southern Arizona's economy significantly. Trade and tourism between the border regions have suffered. Pima County, especially, has seen retail sales, jobs, and building permits all deteriorate this year. The declining situation there may not all be attributed to the peso devaluation, but it is important enough to factor into our forecasts.

Federal Reserve action on future interest rates is also uncertain. Though we have forecasted interest rates to move lower in 1996 and 1997, it is by no means etched in stone. Although the Federal Reserve lowered short-term interest rates in December, at this time, most economists predict the Federal Reserve will further lower short-term rates in 1996. However, some analysts lately are beginning to say the Federal Reserve may keep rates as they are or even raise them. This is mainly due to the belief that the economy is much stronger than the data has shown and also that the Federal

Reserve is much more concerned about keeping inflation in check than whether the economy continues to grow. If the Federal Reserve does not lower interest rates, the stock and bond market will respond negatively and increase the likelihood that the nation and possibly Arizona could slip into a mild recession.

Is the Economic Forecast Reasonable?

The JLBC Staff's basic assumption of a slowing national economy with a modest uptick in inflation is shared by the vast majority of forecasters. In this sense, our national outlook is reasonable. The same can be said of our Arizona outlook.

GENERAL FUND REVENUE

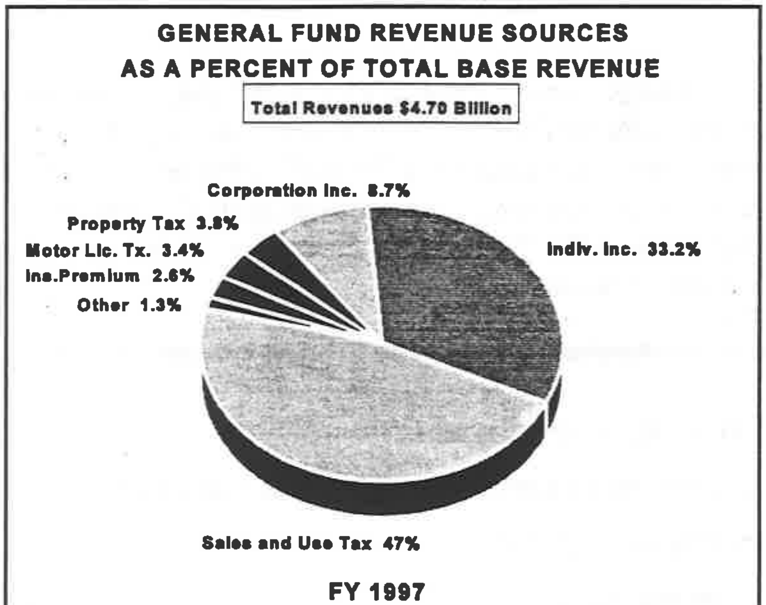


Chart 10

Chart 10 shows that the bulk of General Fund revenue is raised from three sources, known as the "Big Three." The largest of these is the Sales and Use Tax which is projected to generate 47.0% of General Fund revenues in FY 1997. The Individual Income Tax (IIT) is the next largest source, accounting for 33.2%, while the Corporation Income Tax (CIT) share is 8.7%. Together, these three taxes are expected to provide 88.9% of total FY 1997 General Fund revenue. The Federal Retiree Refunds have not been included as part of the IIT. These percents may increase slightly when we are able to reduce total General Fund revenue by the as yet unknown appropriate share of the $200.0 million provided for Property Tax reduction. The current JLBC Staff revenue forecast is summarized on Table 6. Table 7 compares the Governor's and the JLBC revenue forecasts for FY 1996 and FY 1997.

Table 4

SUMMARY OF LEGISLATIVE CHANGES
BY REVENUE CATEGORY
FY 1996 AND FY 1997
($ Thousands)

Revenue Category	Reduction FY 1996	Reduction FY 1997
Sales	$44,033.9	$64,182.5
Individual Income	214,690.6	230,085.2
Corporation Income	29,940.0	42,578.8
Property (Includes Salt River Project)	4,967.4	12,057.5
Luxury	6,300.0	8,100.0
Insurance	--	3,500.0
Pari Mutuel	3,579.7	3,856.7
Licenses, Fees and Permits	25.0	25.3
	$303,536.6	$364,386.0 1/

1/ Not included is any part of $200.0 million appropriated by the Legislature for Property Tax reduction (S.B. 1009) (L95, 1SS, C9). It has not yet been determined how this amount will be split between (1) a reduction of General Fund Revenue and (2) an increase in General Fund appropriations.

Legislative Changes

Apart from the economy, the most important influence on General Fund revenue collections is legislative adjustments to the tax base. Legislation impacting General Fund revenue for the first time in the two forecast years, FY 1996 and FY 1997, will reduce collections in FY 1996 by $303.5 million and by $364.4 million in FY 1997. A Property Tax reduction (L95, 1SS, C9) aggregating $200.0 million will be effective in FY 1997. However, at this juncture, it is not known how this amount will be split between (1) a reduction of General Fund revenue and (2) an increase in General Fund appropriations. Because of this, we have not included it in our forecast calculations. A summary of the legislative changes by revenue category is shown on Table 4.

Little Revenue Growth Projected

The impact of the legislative changes on General Fund revenue is shown in Table 5. Revenue growth before legislative changes is 9.1% and 4.0% for FY 1996 and FY 1997 respectively. After deduction of the legislative changes, revenue growth is reduced to 2.3% in FY 1996 and to 2.9% in FY 1997. In short, it now appears that there will be little revenue growth during our forecast period, particularly since there may be a further reduction in FY 1997 revenue for an as yet unknown share of the $200.0 million appropriated for Property Tax reduction.

Table 5

GENERAL FUND REVENUE FORECAST

BEFORE AND AFTER LEGISLATIVE CHANGES EFFECTIVE IN FY 1996 AND FY 1997

FY 1996 AND FY 1997

($ Thousands)

	FY 1996	% Change from FY 1995	FY 1997	% Change from FY 1996
Before Legislative Changes	$4,871,727.2	9.1%	$5,066,466.0	4.0%
Legislative Changes	(303,536.6)		(364,386.0) 1/	18.8
Forecast	**$4,568,190.6**	**2.3%**	**$4,702,080.0**	**2.9%**

1/ Not included is any part of $200.0 million appropriated by the Legislature for Property Tax reduction (S.B. 1009) (L95, 1SS, C9). It has not yet been determined how this amount will be split between (1) a reduction of General Fund Revenue and (2) an increase in General Fund appropriations.

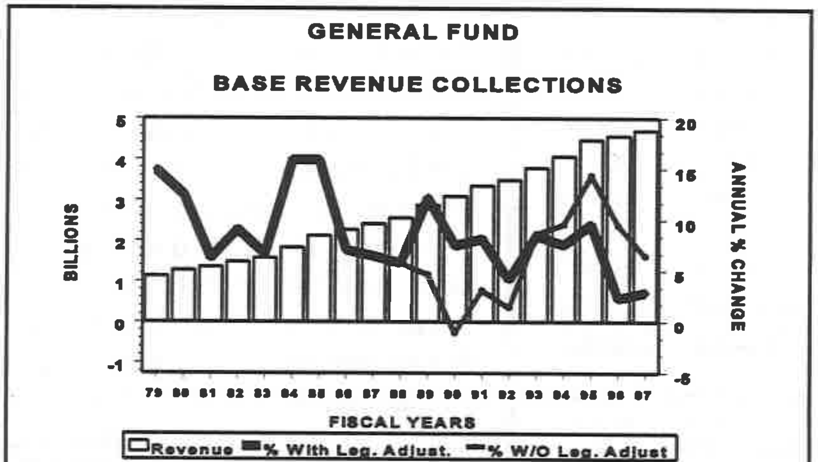


Chart 11

As was noted earlier, the current JLBC Staff revenue forecast is summarized in Table 6. You will note that "new money" aggregates only $102.8 million in FY 1996 and $133.9 million in FY 1997 and reflects increases of 2.3% in FY 1996 and 2.9% in FY 1997. The "new money" for FY 1997 may ultimately be reduced by a share of the $200.0 million appropriated for Property Tax reduction.

General Fund History

Chart 11 shows General Fund Base Revenue collections as a bar chart and percent change as a line graph for 19 years. In terms of dollars collected, the chart appears to show a relatively smooth upward growth curve. The truth is revealed by the percent change lines where Arizona is shown to have had very strong years and also some years which have shown much lower growth. It should be noted that the period FY 1979 through FY 1982 were years when the Consumer Price Index was at or near double digit inflation. Starting with the base year FY 1989, we have shown growth rates before legislative adjustments (underlying growth rates) and after legislative adjustments. It is interesting to note that for the period FY 1989 through FY 1993, the line showing "% with Leg. Adjust." is above the line showing "% w/o Leg. Adjust." indicating a period when the cumulative legislative adjustments since FY 1988 showed positive growth. In FY 1993, legislative adjustments were negative and eliminated any growth in the cumulative legislative adjustments since FY 1988. Since then, total legislative adjustments each year have been significantly negative and cumulative legislative adjustments have also been declining significantly.

Federal Actions Impacting on the Arizona Tax Structure

Washington is in a state of ferment over tax reform. Tax reform is still at an early stage and there are many different ideas and plans. Among the reasons given for restructuring our national tax system are:

1. Simplicity
2. Promotion of savings and investment
3. Improvement of international competitiveness
4. Capture revenue from the underground economy
5. Reduction of role of IRS

Among the national taxes being considered are:

1. National Retail Sales Tax
2. Various Kinds of Value Added Tax
3. Various Kinds of Flat Income Tax

It is far too early to speculate about the makeup of the final federal tax reform package. Regardless of the makeup, however, it is very likely that there will be negative impacts on Arizona revenue collections, possibly necessitating extensive revisions to the Arizona Tax Code.

Individual General Fund Revenue Forecasts

Total Base Revenue

You will note on Table 7 that both JLBC and the Governor show identical forecasts for Total Base Revenue for both FY 1996 and FY 1997. Although we had a slightly lower forecast for Total Base Revenue in each of the two fiscal years, we agreed to the Governor's slightly higher forecast while disagreeing on the component pieces.

Sales and Use Taxes

Sales and Use Tax collections are currently forecast to increase by 7.1% in FY 1996 and by 4.9% in FY 1997. The forecast has been reduced by legislative reductions aggregating $44.0 million in FY 1996 and $64.2 million in FY 1997. The major reduction items are (1) reimbursement of taxpayers for the cost of preparing tax returns, $11.9 million in FY 1996 and $12.5 million in FY 1997, (2) reduction of the Commercial Lease Tax to 3%, $18.5 million in FY 1996 and $18.9 million in FY 1997 and (3) reduction of the Commercial Lease Tax to 2%, $18.8 million in FY 1997. Without the effect of the legislative reductions, the forecast would have been for increases of 9.3% in FY 1996 and 5.8% in FY 1997.

Individual Income Tax

Individual Income Tax collections are forecast to decline by (3.4)% in FY 1996 and increase by 7.5% in FY 1997. This forecast has been reduced by legislative reductions aggregating $214.7 million in FY 1996 and $230.1 million in FY 1997. By far, the major item included in these reductions was the tax reduction package (L95, 1SS, C9) which reduced collections by $200.0 million in FY 1996 and $211.8 in FY 1997. Without the effect of the legislative reductions, the forecast would have been for increases of 10.8% for FY 1996 and 7.4% in FY 1997.

Corporation Income Tax

Arizona's economic growth begins to slow in FY 1996 which reduces growth of corporate profits, but firms continue to move to Arizona which provides an offset to the slowing growth of corporation profits. In FY 1997, the economy is making a soft landing which results in flat growth rates for corporation profits and tax refunds will increase substantially as corporation cash flow becomes tight. Corporation Income Taxes are forecast to decrease by (0.4)% in FY 1996 and by (1.7)% in FY 1997. The forecast has been reduced by legislative reductions aggregating $29.9 million in FY 1996 and $42.6 million. The major reduction items are (1) Defense Restructuring and Military Reuse Zones (L91), $10.0 million in both FY 1996 and FY 1997 and (2) Consolidated Returns (L94, 2RS, C41), $13.4 million in FY 1996 and $17.8 million in FY 1997. Without the effect of legislative reductions, the forecast would have shown an increase of 6.8% in FY 1996 and an increase of 1.3% in FY 1997.

Property Tax

Assessed valuation is expected to increase by 1.8% in FY 1996 and by 1.8% again in FY 1997. Property Tax collections, however, are expected to increase by 5.5% in FY 1996 and decline by (5.6)% in FY 1997. The forecast has been reduced by legislative reductions aggregating $4.4 million in FY 1996 and $10.9 million in FY 1997. The reductions do not include the effect on Salt River Project. The major item in the reductions is the reduction of assessment ratios for mines and utilities (L94) aggregating $3.9 million in FY 1996 and $7.7 million in FY 1997. Without the effect of the legislative reductions, the forecast would have shown an increase of 8.0% in FY 1996 and a decrease of (2.1)% in FY 1997. General Fund collections are still being negatively impacted by (1) the phase down of the assessment ratios for Property Class 1 (mines) and Property Class 2 (Utilities) and (2) the continued depreciation of properties involved in the Minimum Qualifying Tax Rate (QTR) tax.

Motor Vehicle License Tax

The JLBC Staff forecast is for an increase of 12.0% in FY 1996 and 8.0% in FY 1997. New car sales will level out in FY 1996 after three years of strong growth. The sluggishness will continue into FY 1997 due to modest economic growth.

Lottery

Our forecast is for weak General Fund Lottery collections, with a decrease of (17.3)% in FY 1996 and no change in FY 1997. The General Fund has a measure of protection in that $45.0 million must be received by the General Fund before any transfers may be made on the maximum entitlement of $18.0 million for LTAF mass transit. On the other hand, this places General Fund Lottery collections at a maximum of $45.0 million for the foreseeable future. As yet, no such mass transit transfers have been made and our forecast does not provide for any. Probably the major problems facing the lottery are (1) declining interest in the Fantasy 5 game and (2) loss of sales to Indian gaming.

Interest

Our forecast calls for an increase of 14.6% in FY 1996 and a decrease of (18.0)% in FY 1997. The increase in FY 1996 is brought about by modest increases in the Operating Fund average balance and in applicable interest rates. The decline in FY 1997 is brought about by an anticipated decline of (15.6)% in the Operating Fund average balance and a slight decline in applicable interest rates.

Federal Retiree Project

Revenue reductions due to the Federal Retiree Project (FRP) are expected to aggregate $15.4 million in FY 1996 and $57.9 million in FY 1997. The FRP reduces FY 1997 General Fund revenue growth by almost one full percentage point, from 4.1% down to 3.2%.

Table 6

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

	Actual - FY 1995		Forecast - FY 1996		Forecast - FY 1997	
	Amount	% Change	Amount	% Change	Amount	% Change
Taxes						
Sales and Use	$1,968,613.5	9.8	$2,107,500.0	7.1	$2,211,500.0	4.9
Income - Individual	1,503,867.1	3.0	1,452,000.0	(3.4)	1,560,303.9	7.5
- Federal Retiree Project	(24,985.2)	(54.7)	(15,400.0)	(38.4)	(57,900.0)	276.0
- Corporation	416,710.3	37.7	415,000.0	(0.4)	408,000.0	(1.7)
- Urban Revenue Sharing	(205,607.1)	10.9	(218,500.0)	6.3	(257,800.0)	18.0
Property	178,657.8	(4.0)	188,500.0	5.5	178,000.0	(5.6)
Luxury	74,039.9	1.0	68,700.0	(7.2)	67,600.0	(1.6)
Insurance	111,658.8	0.8	115,300.0	3.3	123,300.0	6.9
Motor Vehicle License	132,102.6	14.0	148,000.0	12.0	159,900.0	8.0
Estate	48,771.4	20.1	47,493.9	(2.6)	48,500.0	2.1
Other Taxes	7,005.1	(2.3)	3,100.0	(55.7)	3,100.0	0.0
Subtotal - Taxes	4,210,834.2	9.4	4,311,693.9	2.4	4,444,503.9	3.1
Non-Tax Revenue						
Lottery	38,088.2	17.4	31,500.0	(17.3)	31,500.0	0.0
Licenses, Fees, Permits	40,201.3	(13.1)	41,800.0	4.0	41,400.0	(1.0)
Interest	37,344.6	101.1	42,800.0	14.6	35,100.0	(18.0)
Sales and Services	3,647.7	4.5	3,900.0	6.9	3,800.0	(2.6)
Other Miscellaneous	38,065.8	(12.1)	32,700.0	(14.1)	43,900.0	34.3
From BSF Due to 5% Cap	1,812.4	--	7,130.0	293.4	5,210.0	26.9
Transfers and Reimbursements	10,703.0	(51.6)	27,000.0	152.3	27,000.0	0.0
Disproportionate Share	84,715.8	45.5	69,666.1	(17.8)	69,666.1	0.0
Subtotal - Non-Tax Revenue	254,578.8	13.5	256,496.1	0.8	257,576.1	0.4
Total Base Revenue	$4,465,413.0	9.6%	$4,568,190.0	2.3%	$4,702,080.0	2.9%

Table 7

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

	Forecast - FY 1996			Forecast - FY 1997		
	Governor's Estimate	JLBC Staff Estimate	Difference	Governor's Estimate	JLBC Staff Estimate	Difference
Taxes						
Sales and Use	$2,090,000.0	$2,107,500.0	$17,500.0	$2,210,000.0	$2,211,500.0	$ 1,500.0
Income- Individual	1,465,400.0	1,452,000.0	(13,400.0)	1,547,900.0	1,560,303.9	12,403.9
- Federal Retiree Project	(15,400.0)	(15,400.0)	0.0	(57,900.0)	(57,900.0)	0.0
- Corporation	420,000.0	415,000.0	(5,000.0)	430,000.0	408,000.0	(22,000.0)
- Urban Revenue Sharing	(218,540.0)	(218,500.0)	40.0	(257,800.0)	(257,800.0)	0.0
Property	190,320.0	188,500.0	(1,820.0)	180,000.0	178,000.0	(2,000.0)
Luxury	69,000.0	68,700.0	(300.0)	68,500.0	67,600.0	(900.0)
Insurance Premium	107,000.0	115,300.0	8,300.0	123,000.0	123,300.0	300.0
Motor Vehicle License	149,000.0	148,000.0	(1,000.0)	147,000.0	159,900.0	12,900.0
Estate	49,000.0	47,493.9	(1,506.1)	42,000.0	48,500.0	6,500.0
Other Taxes	3,180.0	3,100.0	(80.0)	2,670.0	3,100.0	430.0
Subtotal Taxes	4,308,960.0	4,311,693.9	2,733.9	4,435,370.0	4,444,503.9	9,133.9
Non-Tax Revenue						
Lottery	32,000.0	31,500.0	(500.0)	34,000.0	31,500.0	(2,500.0)
Licenses, Fees and Permits	40,000.0	41,800.0	1,800.0	40,000.0	41,400.0	1,400.0
Interest	41,600.0	42,800.0	1,200.0	36,000.0	35,100.0	(900.0)
Sales and Services	6,000.0	3,900.0	(2,100.0)	6,000.0	3,800.0	(2,200.0)
Other Miscellaneous	37,500.0	32,700.0	(4,800.0)	50,500.0	43,900.0	(6,600.0)
From BSF Due to 5% Cap	7,130.0	7,130.0	0.0	5,210.0	5,210.0	0.0
Transfers and Reimbursements	27,000.0	27,000.0	0.0	27,000.0	27,000.0	0.0
Disproportionate Share Revenue	68,000.0	69,666.1	1,666.1	68,000.0	69,666.1	1,666.1
Subtotal - Non-Tax Revenue	259,230.0	256,496.1	(2,733.9)	266,710.0	257,576.1	(9,133.9)
Total Base Revenue	$4,568,190.0	$4,568,190.0	$ 0.0	$4,702,080.0	$4,702,080.0	$ 0.0

OPERATING FUND CASH BALANCES

Operating Fund Cash Balances are those monies held by the Treasurer on which the interest earned is unallocated. The interest is transferred to the General Fund. Average balances in the Operating Fund for the twelve months of FY 1995, from July through June, were $742 million compared to $450 million in FY 1994 and $252 million during FY 1993. This was an increase of 65% in one year and 194% over the past two fiscal years. (see Chart 12). This increase was due to faster growth in revenues received by the State Treasurer's Office. Sales tax and, particularly, corporation income taxes were up more than forecasted a year ago. Also, the reversal of certain accounting gimmicks such as the "K-12 Rollover" ($142 million) and "Midnight Reversion Law" ($27 million) improved our cash balances, as did a lower-than-expected levels of social services spending.

We are forecasting that balances will rise to an average level of $800 million in FY 1996, a higher level than FY 1995 because of revenues exceeding the official forecast. We anticipate a lower average balance of $675 million in FY 1997 due to the effects of anticipated tax cuts and slower revenue growth.

Higher Interest Earnings Expected in FY 1996

Short-term interest rates rose in FY 1995 as a result of Federal Reserve tightening to combat excessive economic growth. The average Federal Funds rate rose from 3.3% in FY 1994 to 5.4% in FY 1995. The "Fed" raised the Federal Funds rate seven times in that fiscal year. The higher interest rates for investments combined with the climbing Operating Fund balances had a very positive effect on General Fund interest earnings for FY 1995. As mentioned above, the Federal Reserve Board has already lowered rates once in FY 1996. Further cuts may be forthcoming if the economy shows any weakness. This reduction will have an impact on interest earnings.

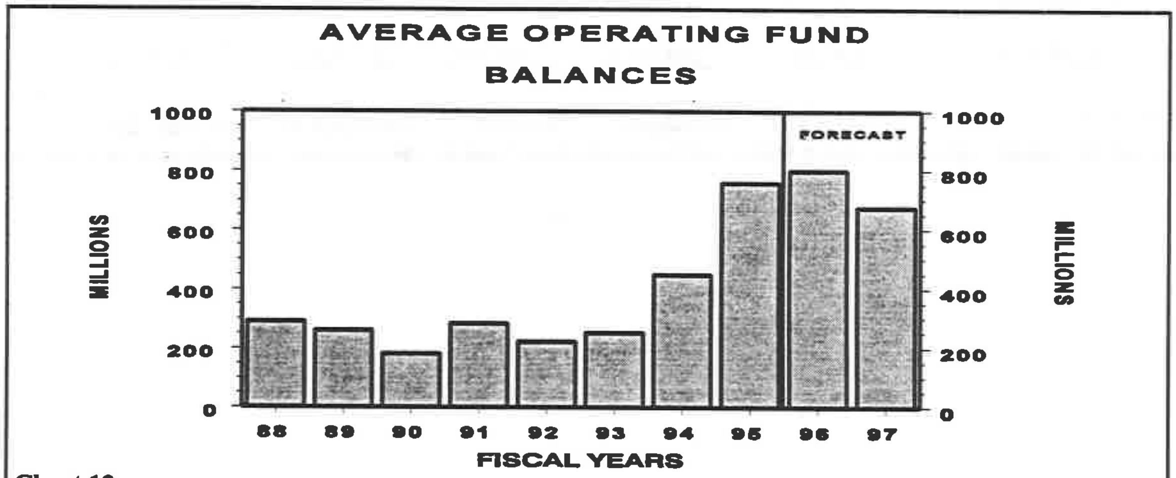


Chart 12

The State Treasurer's Office believes (as does the JLBC Staff) that interest rates may fall slightly if the U.S. economy slows and if a federal deficit reducing budget agreement can be concluded in Washington. The Treasurer's Office usually keeps Operating Fund investments in short maturity investments to maintain liquidity and to avoid being locked into low yields if interest rates change 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.

General Fund interest earnings have been very cyclical in recent years, along with interest rates. Earnings fell from $15.7 million in FY 1992 to $11.4 million in FY 1993 but then rose to $18.6 million in FY 1994 due to record Operating Fund balances (see Chart 13). Balances rose even further in FY 1995 and earnings reached $37.3 million, the best performance since FY 1989's $35 million.

The result of the expectation of higher Operating Fund balances is that interest earnings for the General Fund are expected to increase slightly to $42.8 million in FY 1996 but then fall to $35.1 million in FY 1997. However, it is possible that the FY 1997 estimates may be revised upward if, as discussed above, the Arizona economy continues to show strength which may help to mitigate some of the reductions in revenue flows due to scheduled tax reductions.

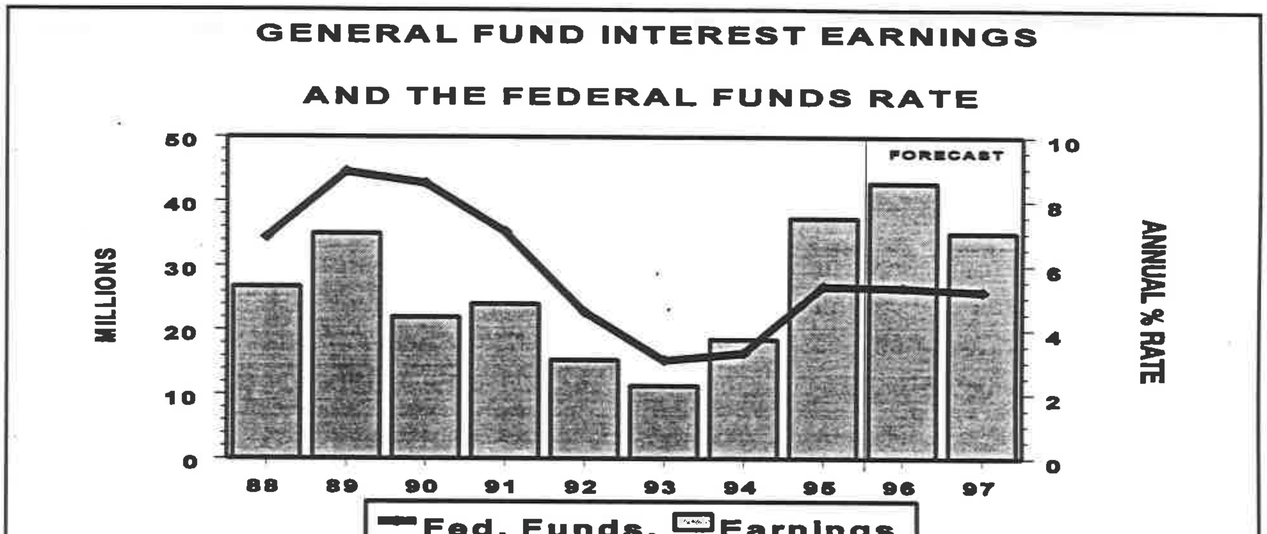


Chart 13

Table 8 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 8

FUNDS MANAGED BY THE STATE TREASURER IN FY 1996*

($ Millions)

Account	Average Balance	Percent of Total
Local Governments Investment Pools	$1,305.9	31.3%
Permanent Land Trust	707.7	17.0
State Agencies	830.0	19.9
Operating Fund Balance	828.8	19.9
Central AZ Water Conservation District	173.5	4.2
AZ Department of Transportation	250.9	6.0
ADOT Bond Issues	21.2	0.5
Arizona Risk Retention Fund	9.0	0.2
Game & Fish	30.3	0.7
AZ Power Authority	10.4	0.3
Arbitrage Funds	0.0	0.0
Other	3.0	0.1
TOTAL AVERAGE BALANCE	$4,170.8	100.0%

* Average for 3 months through, July through September

Source: Arizona Treasurer's Office

ARIZONA BUDGET STABILIZATION FUND

Background

The Budget Stabilization Fund (BSF) for Arizona was passed during the 1990 Third Special Session (A.R.S. § 35-144). The fund is a separate account administered by the State Treasurer, who is responsible for transferring General Fund money into and out of the BSF as required by law. The BSF is designed to set revenue aside during times of above-trend economic growth and to transfer this revenue to the General Fund during times of below-trend growth. It is designed to provide revenue stabilization across a typical business cycle. Under the economic formula which drives the Budget Stabilization Fund, the first payment into the fund was made in FY 1994.

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 time frame.

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 <u>annual growth rate</u> of inflation adjusted Arizona Personal Income (AZPI) for the calendar year ending in the fiscal year to the <u>trend growth rate</u> of inflation adjusted AZPI for the most recent 7 years (see Chart 14).

- 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 15).

- 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 15).

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

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 recovered from the long, slow period in the national and Arizona economies.

The Legislature 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 FY 1995 budget was subsequently enacted with "trigger" provisions. Specifically, with respect to the Budget Stabilization Fund the "trigger" provided for the following:

- Any FY 1994 General Fund ending balance in excess of $107.2 million would be appropriated in FY 1995 first to the K-12 rollover and then to the BSF. In actuality, the ending balance turned out to be substantially higher than this. As a result, the sum of $68.4 million was deposited into the BSF from the FY 1994 carry-forward in November, 1994. (See General Fund Year End Balances)

- The State Treasurer would calculate in June 1995, the "excess" revenue over $4,237.1 million. This excess revenue would be appropriated into the BSF in FY 1995. The total BSF appropriation would not exceed the amount required by the BSF formula (see A.R.S. § 35-144).

The provisions of the "trigger" were satisfied in FY 1995. The "K-12 Rollover" was repaid and there was a full funding of the BSF according to its statutory formula. A total of $178,816,944 was deposited to the fund in FY 1995. The FY 1995 ending balance, including accumulated interest, in the BSF was $224,999,044.

However, the 1995 Legislature also decided to change the maximum balance in the BSF at the end of a fiscal year from 15% to 5% of General Fund revenues. The result of this change is that the BSF is now "capped," and is at its maximum level. In fact, when continuing interest earnings are credited to the BSF, it can become slightly over funded against the new 5% limit. This happened in FY 1995 and $1.8 million was actually transferred back into the General Fund. These excess interest earnings are expected to continue in FY 1996 and FY 1997, with $7.1 million and $5.2 million expected to be added back to the General Fund from the BSF. No new deposits will be made to the BSF as long as it is at its maximum balance.

Table 9 below shows the estimated changes to the BSF, including interest reversions to the General Fund, if economic and revenue growth are as projected for FY 1996 and FY 1997.

Table 9

ESTIMATED CHANGES TO THE BUDGET STABILIZATION FUND
FY 1994 TO FY 1997
($ Dollars)

	Actual FY 1994	Actual FY 1995	Estimate FY 1996	Estimate FY 1997
General Fund Revenues		$4,463,733,000	$4,561,060,000	$4,696,870,000
5% Limit for BSF Balances		223,187,000	228,053,000	234,843,500
BSF Formula Recommended Deposit or (Withdrawal)	$78,346,000	178,817,000	197,371,000	52,345,000
BSF Beginning Balance	0	42,146,000	223,187,000	228,053,000
Actual Deposit	42,000,000	68,504,000	0	0
Actual Deposit		110,313,000		
Total Deposits	42,000,000	178,817,000	0	0
Estimated Interest Rate		5.5%	5.4%	5.3%
Estimated Interest Earned in Fiscal Year	146,000	4,036,000	11,996,000	12,000,500
Ending BSF Balance	42,146,000	224,999,000	235,183,000	240,053,500
Excess/ Amount Reverted to General Fund	0	1,812,000	7,130,000	5,210,000
Adjusted BSF FYE Balance	$42,146,000	$223,187,000	$228,053,000	$234,843,500

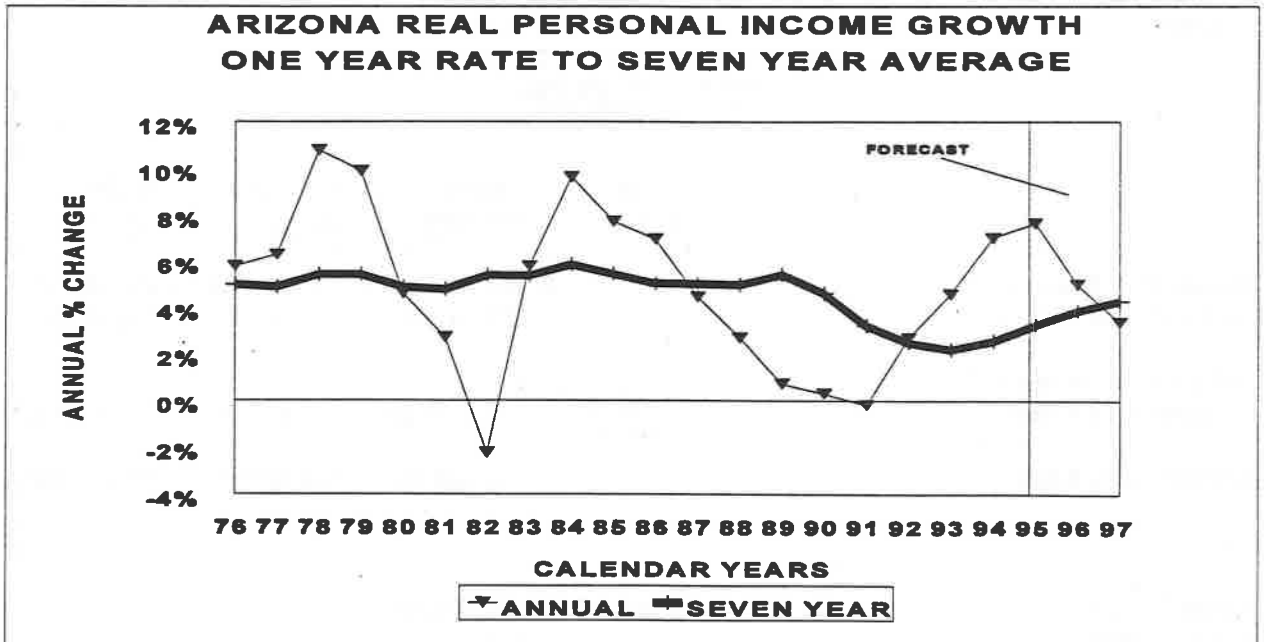


Chart 14

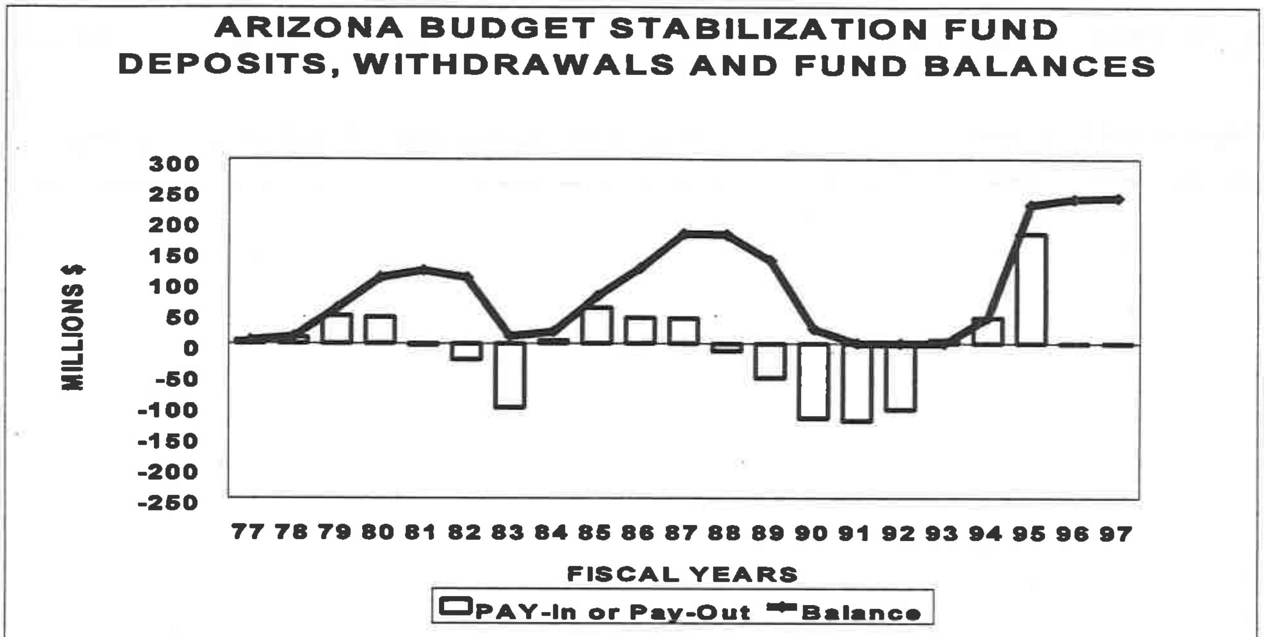


Chart 15