



APRIL 2024

Arizona Government Budget Competitiveness Index

*Authors: Dr. Steven Byers, Ph.D.,
Zach Milne, & Glenn Farley*

COMMONSENSEINSTITUTEAZ.ORG

Table of Contents

<i>About the Authors</i>	3
<i>About Common Sense Institute</i>	4
<i>Common Sense Institute Teams & Fellows Statement</i>	4
<i>Introduction</i>	5
<i>Key Findings</i>	5
<i>State Budget Competitiveness Index</i>	6
<i>State and Local Government Debt, Tax and Fee Revenue</i>	8
<i>Government Debt Service as a Percentage of Tax Revenue</i>	13
<i>Government Employment as a Percentage of Population</i>	13
<i>Government Spending as a Percentage of GDP</i>	15
<i>Future Outlook</i>	16
<i>Sources and Notes</i>	18

About the Authors



Dr. Steven Byers is a Senior Economist for the Common Sense Institute. Steven spent three years working for the Coalition for a Prosperous America, a nonprofit organization. Steven's experience as an economist spans twenty-three years, including work at federal regulatory agencies (SEC, CFTC, PCAOB) and quantitative economic analysis supporting international trade litigation cases brought before the U.S. International Trade Commission. His Ph.D. dissertation topic was based on a computable general equilibrium model (CGE) he developed to evaluate the economic impact of regional tax incentives in a small city (Fort Collins, CO).



Glenn Farley is CSI Arizona's Director of Policy & Research, where he leads its research efforts. Glenn has helped CSI provide accurate, timely, and insightful public information on issues ranging from tax and regulatory policy, to Arizona's changing K-12 landscape since the pandemic. Prior to joining CSI in 2022, Glenn ended his 8 years in the Office of the Arizona Governor as Gov. Doug Ducey's Chief Economist and a policy advisor.



Zach Milne is CSI Arizona's Senior Economist and Research Analyst. Prior to joining CSI, Zachary served as an economist and budget analyst for the Arizona Governor's Office of Strategic Planning & Budgeting. In this capacity he developed the state's revenue forecasts, and advised a team of budget analysts on the creation of K-12 and Medicaid caseload figures for the State's annual budget. He also advised the Executive policy and leadership teams on fiscal policy, and regularly presented detailed analyses on each of the dozens of tax bills introduced in the Arizona Legislature each year. Originally from upstate New York, Zach's then-active-duty service with the United States Air Force brought him to Arizona, where he has remained.

About Common Sense Institute

Common Sense Institute is a non-partisan research organization dedicated to the protection and promotion of Oregon's economy. CSI is at the forefront of important discussions concerning the future of free enterprise and aims to have an impact on the issues that matter most to Oregonians. CSI's mission is to examine the fiscal impacts of policies, initiatives, and proposed laws so that Oregonians are educated and informed on issues impacting their lives. CSI employs rigorous research techniques and dynamic modeling to evaluate the potential impact of these measures on the economy and individual opportunity.

Common Sense Institute Teams & Fellows Statement

CSI is committed to independent, in-depth research that examines the impacts of policies, initiatives, and proposed laws so that Oregonians are educated and informed on issues impacting their lives. CSI's commitment to institutional independence is rooted in the individual independence of our researchers, economists, and fellows. At the core of CSI's mission is a belief in the power of the free enterprise system. Our work explores ideas that protect and promote jobs and the economy, and the CSI team and fellows take part in this pursuit with academic freedom. Our team's work is informed by data-driven research and evidence. The views and opinions of fellows do not reflect the institutional views of CSI. CSI operates independently of any political party and does not take positions.

Introduction

At the state and local levels, where government must operate on a cash-balanced basis, the free enterprise system depends on an efficient government at sustainable levels. If government budgets grow too large, they can crowd out private spending and investment, and reduce private opportunities. If too small, local public infrastructure and public goods suffer and economic activity moves elsewhere.

Over the past decade and under the leadership of then-Gov. Doug Ducey, Arizona established a reputation for fiscal moderation and conservative and prudent management of its State Budget. Thanks to that management, the State of Arizona went from persistent \$500 million structural deficits in 2015 to multibillion-dollar cash surpluses by 2022. It did this while still growing the state budget – including some of the state’s largest-ever increases in K-12 funding – and cutting taxes.

Unfortunately, unsustainable spending growth over the last two budget cycles now threatens this reputation, and it remains to be seen whether current policymakers can right the state’s budget ship.

Key Findings

- Arizona’s Budget Competitiveness Index increased from 76 in 2011 to 86 in 2021. Arizona ranked 14th in the country for the overall strength and competitiveness of its state and local budgets.
- State debt is at one of its lowest levels in state history. As a percentage of total tax revenue, state and local debt service is 5% - 23rd lowest in the United States in 2021. At the end of fiscal year 2024, the State of Arizona is projected to owe just \$750 per person in outstanding debtⁱ.

- Arizona’s State Government Spending Competitive Index as a Percentage of GDP rose from 76 in 2011 to 84 in 2021. Over those ten years, total spending grew 62.4% (just under 5% per year – for context, inflation and population growth over this same period averaged about 4.3%/year), and this conservative approach to managing the state budget allowed the state to accumulate its largest reserves ever. Going into FY 2023, the State had over \$5.5 billion in total cash reserves (including the nearly \$1 billion in the State’s “Rainy Day” fund).
- Unfortunately, over the past three years, spending growth has outpaced historical norms. Today, the State Budget is \$4.2 billion larger (+31%) than it was in 2021, and revenue growth is slowing. The State is now facing its first cash deficits in a decade, and despite its strong historic position, our overall budget outlook is now negative.

State Budget Competitiveness Index

A thriving economy depends in part on an efficient government that operates at sustainable levels. One measure of efficiency: given the powers and duties reserved to and assumed by a government, how much does it take from the broader economy to accomplish them? States, then, provide a lab-like opportunity; all fifty states share a similar set of responsibilities, but vary in how (and how expensively) they carry them out.

An inefficient government wastes resources and can lead to the deterioration of public assets that the free enterprise system depends on, while a bloated and unsustainable government will crowd out private investment and inevitably destroy the productive capacity of the economy through high taxes. At the other extreme, if the government tries to do too little and is resource-starved, essential basic functions – e.g. public infrastructure, policing, and a common education – suffer.

Because of this, sound budgeting and fiscal restraint are important for the growth and success of a state’s economy.

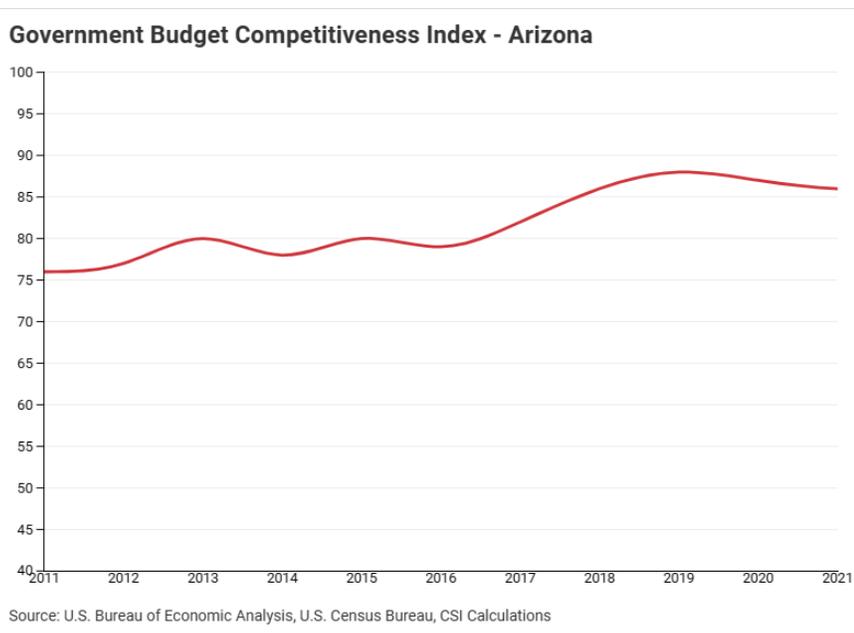
The Common Sense Institute has therefore developed a State Budget Competitiveness Index for all 50 states and the District of Columbia to gauge each state’s relative performance on sound budgeting and fiscal restraint. This index was first included in CSI’s 2024 state Free Enterprise Reports released in late 2023, and consists of three metrics:

1. Debt service as a percentage of tax revenue,
2. State & local government employment as a percentage of the state’s population, and
3. State & local government spending as a percentage of state GDP.

The index ranks each state under each metric relative to its fifty peers and the District of Columbia. It then equally weights, sums, and ranks each of the three metrics to produce the aggregate measure of state budget competitiveness shown in **Figure 1**. An increase in either the comprehensive budget competitiveness metric or the three sub-metrics represents a positive qualitative change - i.e. the state is more competitive relative to other states as the index approaches 100.

Arizona’s State Budget Competitiveness index remained relatively flat during the period of 2011 to 2016, increasing a mere 3 points in the 5-year span and coincident with the state’s broader struggles with its budget during the post-Great Recession period. This changed drastically in the subsequent three years and Arizona’s index score rose to 88 in 2019 (up 9 points from 79 in 2016).

Figure 1 – Arizona Government Budget Competitive



Over this time, the Arizona State government, in particular, experienced a period of budget stability; a growing economy led to growing revenues, and policymakers kept spending and the overall growth of government modest. While the state’s index fell slightly after 2019, it is today the 14th best performing state in the country under this metric.

Figure 2 – Arizona Budget Competitive Index Components

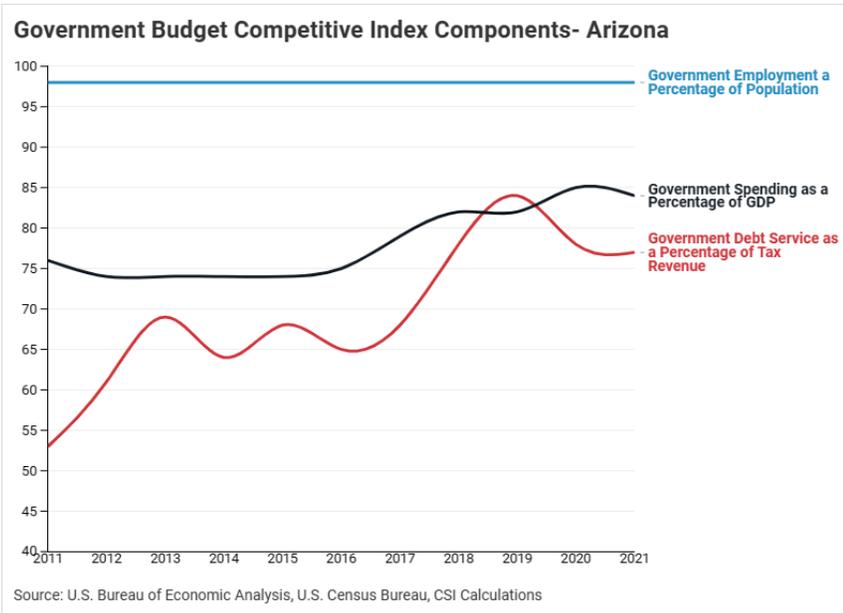


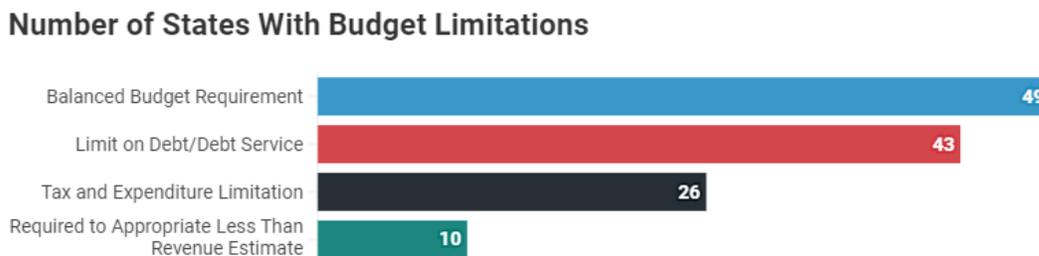
Figure 2 shows the evolution of the three components that are included in the State Government Budget Competitiveness Index. The State Government Spending as a Percentage of GDP Index rose from 76 in 2011 to 84 in 2021, peaking at 85 in 2020, due to a combination of a growing economy and fiscal restraint. The State Government Employment as a Percentage of Population remained flat during the 13-year period, eventually ending at 98 in 2021 – unchanged from the 2011 value. The State & Local Government Debt Service as a Percentage of Tax Revenue Index

increased from 53 in 2011 to 77 in 2021 as the state eliminated debt accumulated during the Great Recession.

State and Local Government Debt, Tax and Fee Revenue

State and Local Governments often have limiting factors imposed on their budget process. In 2021 the National Association of State Budget Officers (NASBO) published the figures on the number of states that have these limitations by type of limit. **Figure 3** shows the published figures in NASBO’s 2021 report.ⁱⁱ Forty-nine states have balanced budget amendments, forty-three have limits on debt and debt service, twenty-six have limits on tax and expenditure, and ten have appropriation limits.

Figure 3 – Number of States with Budget Limitations



Arizona lawmakers face several restrictions that shape what can and cannot be included each annual budget. Those restrictions are as follows:

- Lawmakers must annually enact a budget that provides sufficient revenues to meet an accurate accounting of expenditures. When revenues are insufficient to meet expenses, lawmakers may provide for new taxes sufficient to close the deficit.
- The Governor is provided to provide the Legislature with a proposed budget for the upcoming fiscal year, in consultation with the various state agencies. By law, this budget must be “balanced” – it must provide sufficient revenues to meet all proposed expenses.
- The annual budget is subject to an appropriation limit outlined in the state’s constitution, which limits the expenditure of certain revenue streams to no more than 7.41% of Arizona personal income. Exceeding this limit requires a 2/3rds majority in both houses of the state congress.
- Arizona is subject to strict limits on how and when taxes can be increased – to provide for a net increase in revenues, the Legislature must approve the new tax or fee with at least a two-thirds majority. An initiative or referendum doing the same must pass with at least 60% of the public vote.
- Arizona is limited in the total general obligation debt the state can incur against the General Fund (\$350,000).

Because of the crowding out effect on the free enterprise system, CSI chose to include metrics that capture state and local governments revenue and debt over time to measure the amount of taxation and debt issuance from the state and local governments. Data on public debt for state and local governments is available from the U.S. Census, Annual Survey of State and Local Finances. The following table shows revenue from taxes, charges, and miscellaneous revenue for state and local government in Arizona. Additionally, it shows state and local government debt.

Figure 4 – Arizona Government Revenue and Debt

Arizona Government Revenue and Debt												
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	% change 2011-2021
Revenue ⁱⁱⁱ												

State Government Tax Revenue	\$12.3B	\$13.0B	\$13.8B	\$13.4B	\$13.7B	\$15.0B	\$15.3B	\$16.2B	\$18.2B	\$17.6B	\$20.8B	69.7%
Local Government Tax Revenue	\$9.3B	\$9.1B	\$9.3B	\$9.1B	\$9.6B	\$10.1B	\$10.7B	\$11.2B	\$11.9B	\$12.1B	\$12.9B	38.5%
State Government Revenue from Charges & Misc. Revenue	\$3.8B	\$4.8B	\$5.1B	\$5.3B	\$4.6B	\$5.3B	\$5.1B	\$5.1B	\$5.4B	\$5.6B	\$5.6B	45.3%
Local Government Revenue from Charges & Misc. Revenue	\$5.4B	\$5.2B	\$5.4B	\$5.3B	\$5.1B	\$5.3B	\$5.5B	\$5.6B	\$6.1B	\$6.0B	\$6.1B	14.5%
State Government Revenue from Taxes and Charges & Misc. Revenue	\$16.1B	\$17.8B	\$18.9B	\$18.7B	\$18.4B	\$20.2B	\$20.4B	\$21.3B	\$23.6B	\$23.3B	\$26.4B	63.9%
Local Government Revenue from Taxes and Charges & Misc. Revenue	\$14.7B	\$14.3B	\$14.6B	\$14.4B	\$14.8B	\$15.3B	\$16.2B	\$16.8B	\$18.0B	\$18.1B	\$19.0B	29.7%
Total State and Local Revenue from Taxes and Charges & Misc. Revenue	\$30.8B	\$32.0B	\$33.6B	\$33.2B	\$33.1B	\$35.6B	\$36.6B	\$38.2B	\$41.6B	\$41.4B	\$45.4B	47.6%

State Government Share Revenue from Taxes and Charges & Misc.	52.3%	55.4%	56.4%	56.5%	55.4%	56.9%	55.7%	55.9%	56.7%	56.2%	58.1%	
Local Government Share Revenue from Taxes and Charges & Misc.	47.7%	44.6%	43.6%	43.5%	44.6%	43.1%	44.3%	44.1%	43.3%	43.8%	41.9%	
Debt ^v												
State Government Debt Outstanding	\$14.2B	\$14.5B	\$14.2B	\$14.3B	\$14.2B	\$14.4B	\$14.3B	\$9.4B	\$9.3B	\$8.6B	\$9.0B	-36.7%
Local Government Debt Outstanding	\$36.1B	\$34.9B	\$34.9B	\$33.6B	\$34.1B	\$34.1B	\$32.8B	\$32.8B	\$31.1B	\$31.9B	\$31.0B	-14.1%
State & Local Government Debt Outstanding	\$50.3B	\$49.4B	\$49.1B	\$47.9B	\$48.3B	\$48.5B	\$47.1B	\$42.2B	\$40.3B	\$40.5B	\$40.0B	-20.5%
State Government Share of Debt Outstanding	28.2%	29.4%	28.9%	29.9%	29.5%	29.7%	30.4%	22.4%	23.0%	21.2%	22.4%	
Local Government Share of Debt Outstanding	71.8%	70.6%	71.1%	70.1%	70.5%	70.3%	69.6%	77.6%	77.0%	78.8%	77.6%	
GDP ^v												

Arizona GDP	\$261B	\$271B	\$279B	\$288B	\$299B	\$313B	\$332B	\$352B	\$372B	\$382B	\$420B	61%
Spending ^{vi}												
State & Local Government Direct Expenditures	\$52.6B	\$51.1B	\$52.2B	\$53.7B	\$51.7B	\$56.1B	\$60.1B	\$62.7B	\$66.5B	\$71.8B	\$76.5B	45.4%

State government tax revenue increased 69.7% from \$12.3 billion in 2011 to \$20.8 billion in 2021¹, with the period between 2017 and 2021 accounting for most of that growth. This later period marked a boon in tax receipts nationwide as well as in Arizona, despite the implementation of tax reductions at both the Federal and State level. Most notably in 2019 Arizona’s individual income tax rate schedule was reduced from five to four marginal brackets, along with rate reductions for three of the four remaining brackets. Additionally, the standard deduction amounts were increased and indexed to inflation for the first time. Local governments also benefited from this period of strong revenue growth. While local government tax revenues rose 38.5% between 2011 and 2021, they grew over 20% between 2017 and 2021 alone.

State Government revenue from fees (charges) and miscellaneous revenue continued to rise as well during this time, climbing 45.3% from \$3.8 billion in 2011 to \$5.6 billion in 2021. Local government revenues from fees (charges) and miscellaneous revenue increased at a more modest pace of 14.5% from \$5.4 billion in 2011 to \$6.1 billion in 2021. The increases in both state and local government revenues combined for a 47.6% growth in the total revenue from all sources during the 10-year period, with the State’s share of this overall revenue growing from 52% in 2011 to 58% in 2021.

The rise in revenues contributed to a decline in the amount of debt issued from state and local governments, decreasing 20.5% from \$50.3 billion in 2011 to \$40 billion in 2021. The share of public debt between the State and local governments changed from 28.2% state share (71.8% local share) in 2011 to 22.4% state share (77.6% local share) – a product of recent paydowns of State-held debt accumulated during the Great Recession. As of the most recent data available, the state government owes about \$750 per resident in outstanding debt.

Additionally, Arizona ranks 25th in the total amount of public debt in 2021 among all fifty states and the District of Columbia. By comparison, California ranks first with \$541.2B and Wyoming

¹ CSI relies on data from the US Census Bureau to calculate the indexes outlined in this report. Because of the release timing of the Census data, CSI is not able to make calculations beyond 2021 currently.

ranks 51st with \$2 billion. However, after accounting for population Arizona has the 7th lowest public debt per-capita.

Government Debt Service as a Percentage of Tax Revenue

Evaluating debt service costs as a share of tax revenue provides a useful tool to gauge the fiscal stability of state and local governments. A high ratio of debt services costs to tax revenue implies that governments could face increased difficulties meeting their budgetary obligations in years when revenues slow. In such an environment, state and local governments would have to increase taxes or cut services – or some combination of both – in order to meet their debt obligations, which would carry negative implications for the local economy. Given the constitutional restraint on increasing taxes in Arizona (Proposition 108 discussed above), the state government in particular would likely have to resort to a rollback of services and other appropriations.

Total debt service as a percentage of tax revenue in Arizona decreased from 11.6% in 2011 to 5% in 2021. This decline is the result of a 20.5% decrease in state and local debt while state & local tax revenues increased 45.3%. This change increased Arizona’s ranking in terms of lowest debt services costs relative to tax revenues from 47th to 23rd, represented by an increase in the competitiveness metric from 53 to 77.

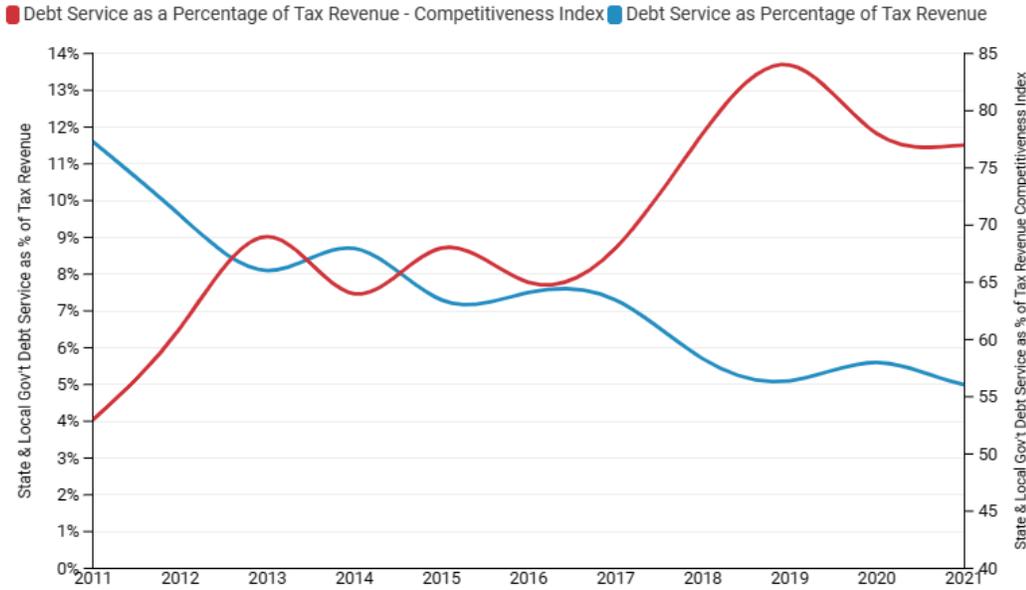
In particular, the State’s costs for servicing debt fell to \$380.8 million in 2021 from \$662.6 in 2011. Some of this decline is due to the expiration of debt over time. However, since 2020 the state Legislature in partnership with then Governor Doug Ducey allocated over \$1B in General Fund revenues toward the elimination of debt accumulated during the Great Recession, which included certificates of participation for the lease of state-owned properties. These actions helped to reduce debt services costs over the 10-year period by 74%.

Government Employment as a Percentage of Population

The relative size of state and local government employment serves as a useful proxy for the size of government, generally.

Figure 4 – Arizona Government Debt Service as Percentage of Tax Revenue – Competitiveness Index & Metric

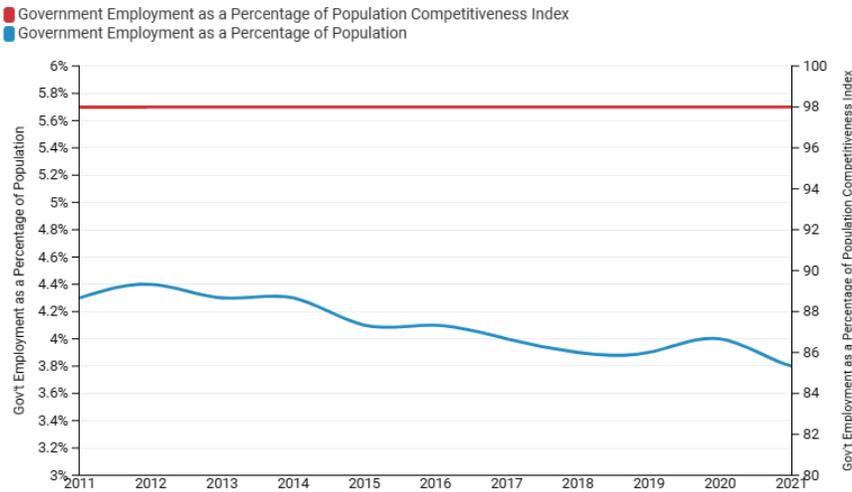
Arizona Government Debt Service as Percentage of Tax Revenue - Competitiveness Index and Metric



Source: U.S. Census Bureau, CSI Calculations • A competitiveness metric may rise at the state level, however, fall relative to the U.S., thus decreasing overall competitiveness. The inverse may also be true.

Figure 5 – Arizona Government Employment as Percentage of Population

Arizona Government Employment as Percentage of Population - Competitiveness Index and Metric



Source: U.S. Census Bureau, CSI Calculations • A competitiveness metric may rise at the state level, however, fall relative to the U.S., thus decreasing overall competitiveness. The inverse may also be true.

Figure 5 shows the competitive index for state & local government employment as a percentage of the population. Arizona’s performance in this area has put it near the top of all states since 2011 (2nd), with Arizona’s index value remaining fixed at 98 over the 13-year span.

State & local employment as percentage of population decreased from 4.3% in 2011 to 3.8% in 2021 – the result of stable overall government employment and a population that increased over 12%. Despite the stability of government employment during this time (total employment grew only 0.8% between 2011 and 2021), Arizona ranks 28th in overall government employment growth, as half of all states experienced declines in their government employment.

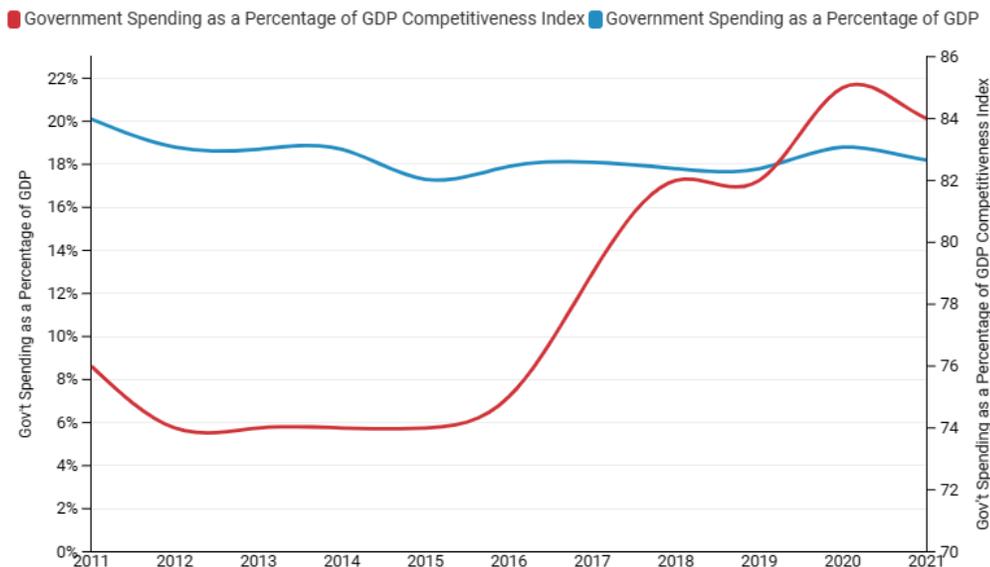
Government Spending as a Percentage of GDP

Besides employment, spending as a percentage of overall GDP provides useful context as to the size of state and local governments. While some government spending may be deemed necessary, particularly for public safety and infrastructure, excess spending risks burdening the local economy. In most cases, the government does not produce value that people voluntarily pay for, meaning any expenses are necessarily funded through the taking of resources from other productive corners of the economy. The more spending the government engages in, the more must be taken from the local economy, increasing the deadweight loss to society.

For Arizona, the Government Spending as a Percentage of GDP Competitive Index rose from 76 in 2011 to 84 in 2021, due primarily to the strong economic growth that Arizona experienced over the last decade. Between 2011 and 2021, Arizona’s economy grew 61% as measured by nominal GDP according to the Bureau of Economic Analysis. In this same period, government spending (both state and local) increased 45.4%, bringing the ratio of government spending to

GDP down from 20.1% in 2011 to 18.2% in 2021. While this ratio declined for most states over the 11-year span, Arizona experienced the 13th fastest decline, thus raising the relative competitive index value and the state’s ranking.

Arizona Government Spending as Percentage of GDP - Competitiveness Index and Metric



Source: U.S. Bureau of Economic Analysis, U.S. Census Bureau, CSI Calculations • A competitiveness metric may rise at the state level, however, fall relative to the U.S., thus decreasing overall competitiveness. The inverse may also be true.

Figure 6 – Arizona Government Spending as Percentage of GDP

Future Outlook

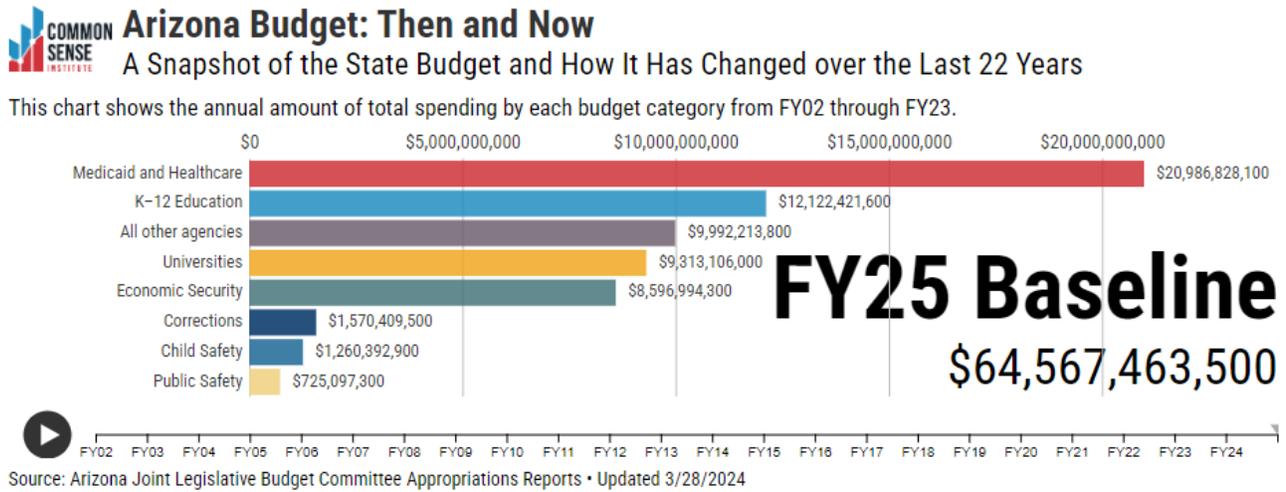
Despite Arizona’s strong performance among all metrics considered in this report, the recent spending history at the state level – otherwise not captured here due to availability of Census data – is a cause for concern moving forward. Temporary booms in state General Fund revenues following the COVID-19 pandemic led lawmakers to make drastic changes to budgeting norms. Lulled into a false sense of security by classifying spending as “one-time”, lawmakers enacted large spending increases well beyond the historical spending trajectory. Between 2011 and 2021, state General Fund spending increased 62.4%, equating to an average annual growth rate just south of 5%^{vii}. However, in the three intervening years between fiscal 2021 and 2024 spending increased 31.1%, or an average growth of 9.4% per year – well above historical averages. As of the passing of the most recent budget in the spring of 2023, budget offices at the state level contemplated a razor-thin cash surplus of \$10 million^{viii}, leaving no room for deviations from revenue and spending estimates.

These large increases are threatening the State’s ability to enact balanced budgets in the coming years, as the short-lived revenue boom appears to finally be at an end. Previously fast-growing income tax streams have slowed relative to prior expectations as capital gains income continues to fall from its peak in 2021, and the persistently high inflation in Arizona has taken a toll on Transaction Privilege Tax revenues as consumers’ pocketbooks continue to be stretched thin.

As of this writing, the state General Fund is facing a cash deficit north of \$800 million in the current fiscal year, which is anticipated to grow over the next three years if no actions are taken. Accruing debt to withstand the deep yet temporary cash deficits in the current high interest rate environment would further jeopardize the state’s fiscal situation. More likely, the state will need to cut back on previous obligations, particularly the large amount of unspent one-time obligations made in the past two years when policy makers believed revenues would remain strong. With the current state government divided along party lines, any negotiations to that effect will likely be drawn out towards the end of the fiscal year. CSI will continue to monitor the situation, as these recent developments threaten to undo the last decade of budget competitiveness for the state of Arizona.

Figure 7 shows the composition of the State spending through the Baseline estimates for FY 2025. Spending on Medicaid and Healthcare and K-12 education continues to dominate overall spending in the state. Since 2011, K-12 spending in the state has generally remained between 18%-19% of all State spending.

Figure 7 – Arizona Budget: Then & Now



Sources and Notes

- i [*"FY 2024 Appropriations Report"*](#), Joint Legislative Budget Committee, Jul. 12, 2023.
- ii [*"Budget Processes in the States"*](#), National Association of State Budget Officers, 2021.
- iii [*"Annual Surveys of State and Local Government Finances"*](#), U.S. Census Bureau, 2012 -2023.
- iv [*"Annual Surveys of State and Local Government Finances"*](#), U.S. Census Bureau, 2012 -2023.
- v [*"SAGDP1 State annual gross domestic product \(GDP\) summary"*](#), U.S. Bureau of Economic Analysis, March 2023 revision.
- vi [*"Annual Surveys of State and Local Government Finances"*](#), U.S. Census Bureau, 2021 - 2023.
- vii [*"General Fund Spending as a Percent of Arizona Personal Income"*](#), Joint Legislative Budget Committee, accessed on Mar. 26, 2024.
- viii [*"FY 2024 Appropriations Report"*](#), Joint Legislative Budget Committee, Jul. 12, 2023.