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A Comparison of State Spending Growth under Arizona Governors

by Robert Robb*

INTRODUCTION

One of the most important of all governing decisions is how much of a polity's resources to absorb through government taxation and spending. This paper compares Gov. Janet Napolitano's first term to that of previous Arizona governors going back to Bruce Babbitt, the last Democrat to be elected governor in Arizona prior to Napolitano, on one subcomponent of that decision—state general fund spending.

In nominal terms, state general fund spending increased during Napolitano's term by 70 percent. That is nearly twice as fast as the average of her predecessors, which was 37 percent. It is rivaled only by the increase during Babbitt's first elected term of 65 percent.

However, the last budget of Gov. Jane Hull's term (fiscal year [FY] 2003) featured some measures (not paying the last month of state aid to education and debt-financing of school construction) that had the effect of removing expenses from the state general fund budget books without actually reducing the spending itself. Also during Hull's term, voters approved a six-tenths of a percent increase in the state sales tax for education (Proposition 301). Although it was voter-approved, Hull championed the measure, which went for education programs that had customarily been the responsibility of the state's general fund.

Adjusting nominal state general fund expenditures for these factors increases reported spending during Hull's term and thus reduces the reported increase during Napolitano's first term to 54 percent. This is still above the adjusted average of her predecessors of 40 percent, but not as dramatically.

Further context is provided by comparing the rate at which spending increased during the respective terms of office with such common benchmarks as growth in personal income and increases in population and inflation.

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Using adjusted state general fund spending as the fairer comparison, spending during Napolitano's term increased 13 percentage points more than personal income growth, compared to predecessors' average of just over 1 percentage point. Napolitano's rate of increase was equaled during the term shared by Evan Mecham and Rose Mofford, and was approached during Babbitt's first term.

State spending growth under Napolitano stands out even more when compared to increases in population and inflation. Even with the adjustments, spending under Napolitano increased 29 percentage points more than population and inflation, compared to just 11 percentage points on average for her predecessors. The closest rival for increased spending was Babbitt's second term, during which spending increased 17 percentage points faster than population and inflation.

State spending cannot continue to increase so much faster than personal income, or the people's ability to pay for it, without economic consequences. This unprecedented spending expansion points out the need for spending discipline and eliminating unused spending capacity under the state's constitutional spending limit.

Napolitano and Spending: How Does She Compare?

General fund spending is a fraction of overall state spending. For example, for FY 2007, general fund spending is budgeted at

just over \$10 billion. Overall state spending is expected to run about \$26 billion.

However, the general fund is where most of the decision-making occurs. The bulk of the remainder consists of federal funds and earmarked revenues. Decisions can, of course, be made about the non-general-fund spending. The state can decide whether to take federal funds and to change earmarked revenues. As a practical matter, however, the general fund is where flexibility is the easiest and where judgment is most often exercised.

The budgetary decision-making of state policymakers is, of course, punctuated every four years by the decision-making of voters in selecting a governor to lead the state. For purposes of this paper, each four-year increment between elections is considered discretely. When governors have left during the middle of a term, this paper treats the term as shared. Hence FY 1996 to FY 1999 is considered a term shared by Fife Symington and Jane Hull, who took over from Symington after his resignation in 1997. Similarly, Evan Mecham and Rose Mofford are treated as having shared the FY 1988 to FY 1991 period. Bruce Babbitt's two fully elected terms are treated individually.

Governors are elected in November and take office the following January. The state's fiscal year runs from July to June. Hence, the governor takes office in mid-year budget-wise.

Sometimes, governors are called upon to make adjustments to the budgets they inherit. Napolitano had to do that after

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deteriorating state revenues made the budget she inherited from Hull's last term unsustainable.

even though it began in July 2006, since it will end in June 2007. That convention is followed here.

However, midyear adjustments do not offer the same scope for decision-making as when a governor offers the initial budget for consideration by the legislature. Therefore, for purposes of this study, the first budget of each governor's term is considered the one that went into effect after the governor took office, not the one he or she inherited upon being elected.

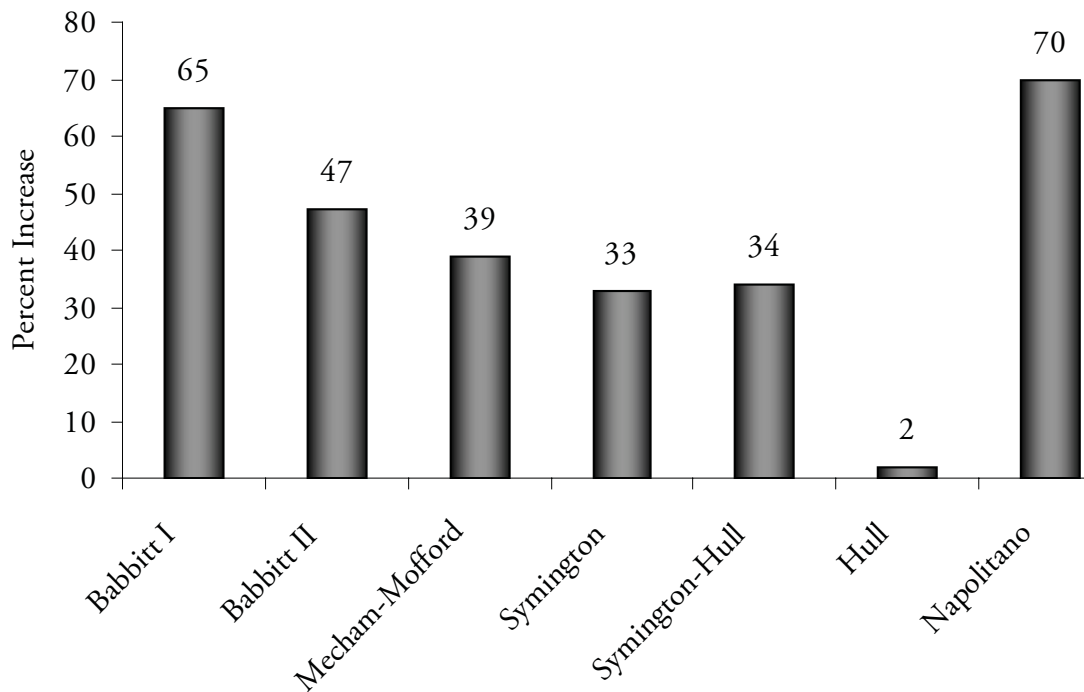
State government convention denominates budget years according to the year in which the fiscal year ends. Thus, the current budget year is considered FY 2007,

Nominal State General Fund Spending

Figure 1 shows the percentage of state general fund spending growth for each gubernatorial term as reported on the state's budget books.

Napolitano has the highest reported rate of growth at 70 percent. That is nearly twice the average rate of her predecessors,

Figure 1: Nominal General Fund Spending Increases



Sources: Joint Legislative Budget Committee, "General Fund Operating Budget Spending, Fiscal Years 1979-2007," August 28, 2006, <http://www.azleg.gov/jlbc/GF10year-8-06-Web.xls>; author's calculations.

which is 37 percent. The only growth rate even close was the 65 percent growth rate in Bruce Babbitt's first elected term as governor.

Nominal spending growth arguably overstates the real rate of state general fund spending growth that took place during Napolitano's first term. The FY 2003 budget used as a baseline for calculating spending increases during Napolitano's term included various fiscal measures adopted to make the state budget balance, at least on paper. For FY 2003, the state did not make its last payment of \$191 million to local school districts for state aid to education. It also debt-financed \$400 million of new school construction.

Neither of these two maneuvers actually reduced spending. School districts are authorized to spend according to a state funding formula. Deferring the last state aid payment did not reduce what schools could spend in FY 2003. It simply created a cash flow issue that had to be managed. Similarly, debt-financing school construction did not reduce the amount that was spent on constructing schools. However, since the state general fund budget only reports actual cash outlays and not obligations incurred, debt-financing had the effect of making the spending disappear from the state's general fund books, except for carrying costs.

The "education rollover," as it is called, was paid back in FY 2006. New school construction was paid in cash prior to FY 2003, and by FY 2007, the last budget year of Napolitano's first term, the state had gone back to paying cash for it.

Another item calls for an adjustment to make a closer apples-to-apples comparison. The state general fund budget treats deposits made to the Budget Stabilization Fund (BSF), popularly called the state's "rainy day fund," as an expenditure. It is reflected on the books the same as any other spending item. A deposit to the BSF, however, is in actuality savings, not spending. For an analysis of spending trends, a deposit to a savings account should not be counted the same as an expenditure.

Figure 2 shows spending by gubernatorial term reflecting these changes—adding spending to reflect the educational rollover and school construction debt-financing, and subtracting spending to reflect BSF deposits.

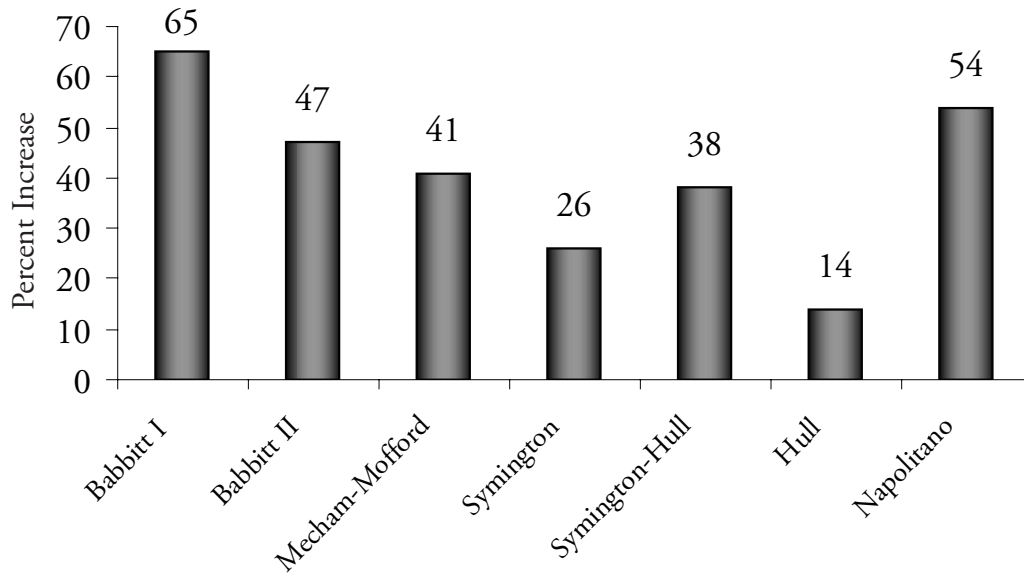
With these adjustments, state spending growth during Napolitano's first term is reduced from 70 percent to 54 percent. That is still substantially above the 39 percent adjusted average of her predecessors, but not nearly as dramatically as with nominal general fund spending. Therefore, the size of Napolitano's spending increase slips into second place, behind that of Bruce Babbitt's first term.

Proposition 301

To make the fairest comparison, an adjustment probably should be made for Proposition 301, as well. In 2000, voters approved Proposition 301, a six-tenths of a percent increase in the state sales tax, with the proceeds earmarked for education. The Proposition 301 sales tax is expected to

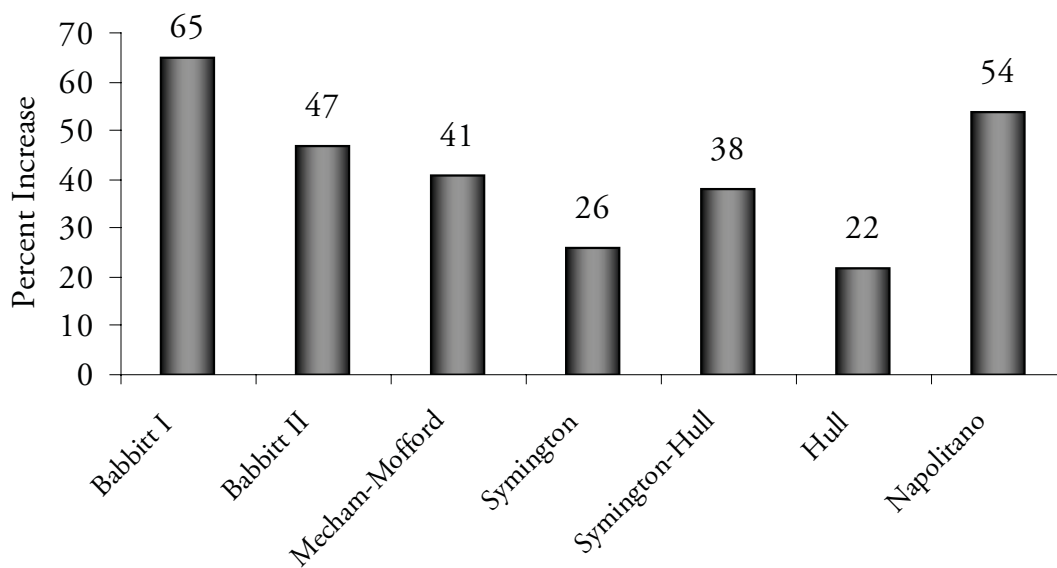
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Figure 2: Adjusted GF Spending Percentage Growth (Educational Rollover + Debt Financing - BSF Deposit)



Sources: Joint Legislative Budget Committee, "General Fund Operating Budget Spending, Fiscal Years 1979-2007," August 28, 2006, <http://www.azleg.gov/jlbc/GF10year-8-06-Web.xls>; author's calculations.

Figure 3: Fully Adjusted GF Spending Percentage Growth (Education Rollover + Debt Financing + Prop. 301 - BSF)



Sources: Joint Legislative Budget Committee, "General Fund Operating Budget Spending, Fiscal Years 1979-2007," August 28, 2006, <http://www.azleg.gov/jlbc/GF10year-8-06-Web.xls>; author's calculations.

raise \$660 million in FY 2007, so it is not a minor item.

Although voters approved Proposition 301, Gov. Jane Hull proposed and advocated the measure. Moreover, although the proceeds are not routed through the state's general fund, they go to support programs that customarily have been supported by the state's general fund.

Figure 3 shows what this paper will call "fully adjusted state general fund spending," which makes the adjustments discussed in the previous section and includes Proposition 301 spending.

The primary effect of adjusting for Proposition 301 spending is a more accurate picture of the state spending increase under Hull. Looking strictly at nominal state general fund spending, the increase during Hull's fully elected term is just 2 percent. Fully adjusted for accounting measures and Proposition 301, it is 22 percent.

This adjustment lifts the average rate of increase among Napolitano's predecessors to 40 percent, still well below Napolitano's fully adjusted rate of 54 percent.

Comparisons to Benchmarks

Even when fully adjusted, this comparison does not take into account economic and demographic trends during each term. Personal income growth and increases in population and inflation are two common benchmarks used to make

comparisons in spending trends.

Figures 4 and 5 take fully adjusted state general fund spending as the fairest measure of spending growth for each gubernatorial term and compare it to personal income growth and increases in population and inflation during the same period. The results are expressed as the percentage point differential between spending growth and the benchmarks. For example, fully adjusted state general fund spending under Napolitano grew by 54 percent. Personal income during the same period is projected to grow by 41 percent. That leaves a percentage point differential of +13.

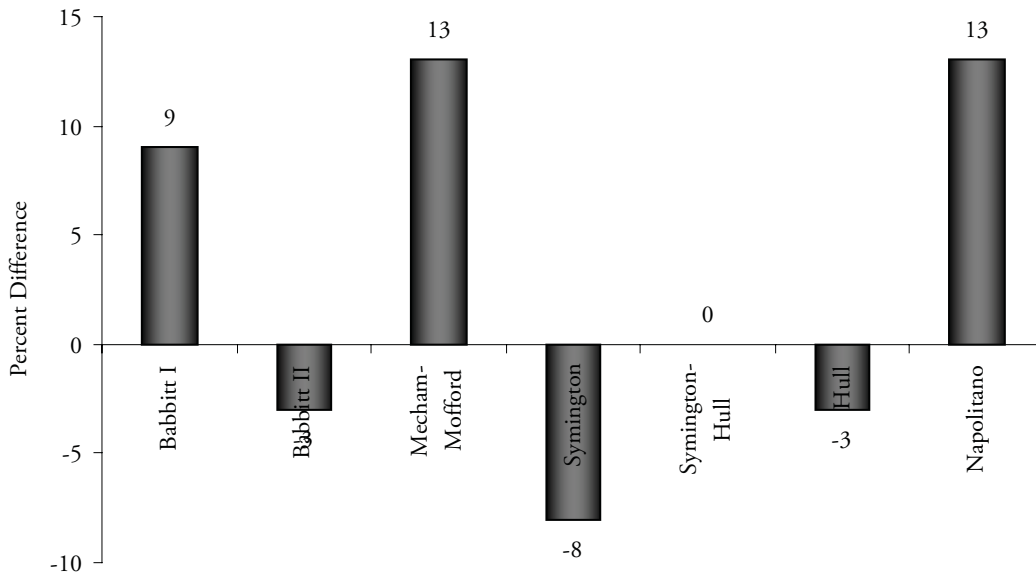
Put into this perspective, Napolitano's spending ties the Mecham-Mofford term at the top. Napolitano's spending, as indicated, outpaced personal income growth by 13 percentage points. The average of her predecessors was just over 1 percentage point, and four of her predecessors actually held state spending growth at or below personal income growth.

Compared to population growth and inflation, however, Napolitano has outstripped her predecessors. Napolitano's spending growth outpaced increased population and inflation by 29 percentage points, compared to an average among her predecessors of 11 percentage points. Babbitt's second term is the closest rival at 17 percentage points.

Babbitt's large nominal state general fund increase in his first term was substantially influenced by inflation. Inflation during Babbitt's first term was

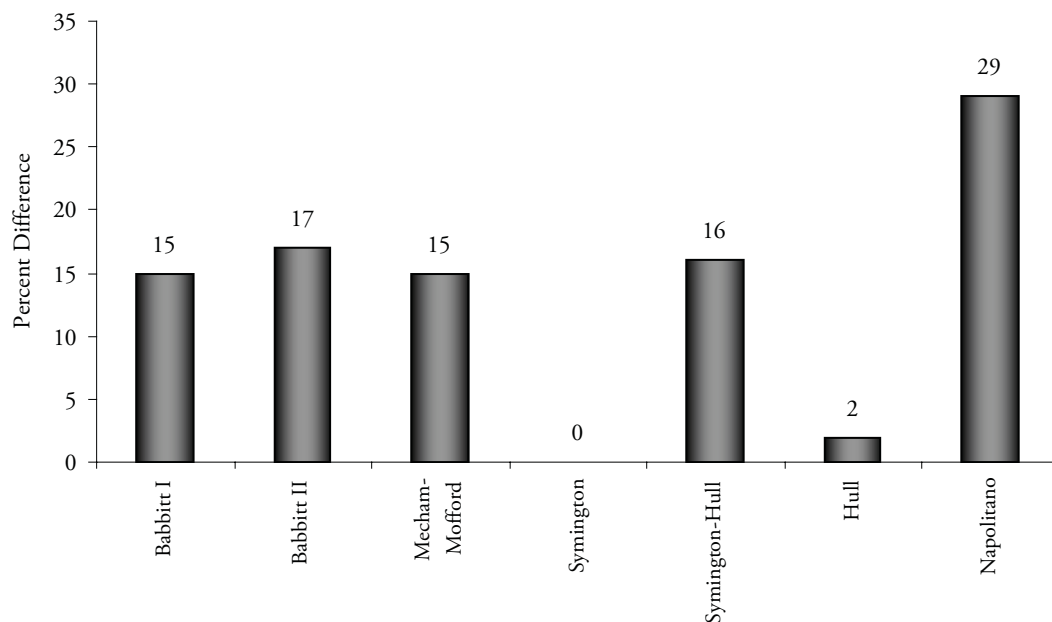
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**Figure 4: Fully Adjusted Spending Growth Compared to Personal Income
(%Spending Growth - %Personal Income Growth)**



Sources: Joint Legislative Budget Committee, “General Fund Operating Budget Spending, Fiscal Years 1979-2007,” August 28, 2006, <http://www.azleg.gov/jlbc/GF10year-8-06-Web.xls>; Bureau of Economic Analysis, “CA1-3—Personal Income, Population, Per Capita Income,” last updated December 29, 2006 <http://bea.gov/bea/regional/reis/default.cfm?catable=CA1-3§ion=2>; author’s calculations.

**Figure 5: Fully Adjusted Spending Growth Compared to Population + Inflation
Growth [%Spending Growth - (%Population+Inflation Growth)]**



Sources: Joint Legislative Budget Committee, “General Fund Operating Budget Spending, Fiscal Years 1979-2007,” August 28, 2006, <http://www.azleg.gov/jlbc/GF10year-8-06-Web.xls>; Arizona Department of Economic Security, Arizona Workforce Informer: Data Analysis, <http://www.workforce.az.gov/cgi/dataanalysis/dataTypeSelection.asp?tableName=notable>; author’s calculations.

37 percent, compared to just 11 percent during Napolitano's term.

under the age of 44—to the increase in general inflation. AHCCCS medical costs were increasing three times as fast.

Comparison to Drivers of Spending

Some criticize the use of population growth and inflation as a benchmark for governmental spending growth, contending that some vital programs naturally grow more rapidly than these benchmarks. For state government, enrollment growth in K-12 education and the Arizona Health Care Cost Containment System (AHCCCS, the state's Medicaid alternative), as well as increases in the prison population, are usually cited as examples.

During Napolitano's first term, as Figure 6 indicates, enrollment in education, AHCCCS, and the prison population did not increase appreciably faster than the general population. K-12 education enrollment increased at the same pace as the overall population. AHCCCS and the prison populations increased at a slightly faster rate. After voters expanded AHCCCS eligibility in 2000, enrollment in the program did increase rapidly. However, during Napolitano's term, that eligibility expansion appears to have been digested.

Medical costs associated with AHCCCS are also often cited as a reason why the population and inflation benchmark is not entirely appropriate. Here the case is stronger. Figure 7 compares the increase in the capitation rate for AHCCCS's two largest populations—children, and women

Catch-up Spending?

The Napolitano budget years followed three years of stagnant state revenues. As discussed above, these stagnant revenues were not accommodated entirely through spending discipline. To some extent, balanced budgets were created, at least on paper, by moving spending off the general fund books, through debt and the education rollover.

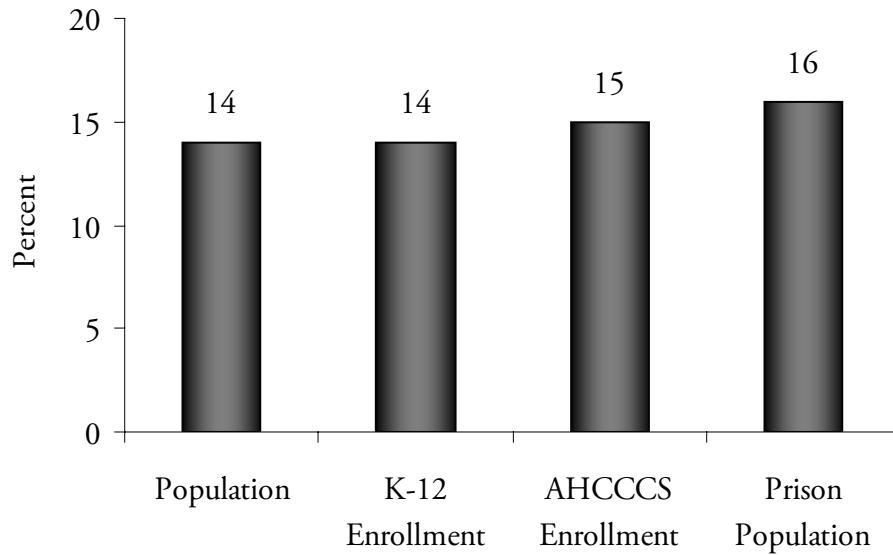
The question arises, nevertheless, about the extent to which the high spending growth during Napolitano's term was merely catching up for foregone spending during the years of tight revenues.

Revenues began to stagnate in FY 2001. Figure 8 compares what spending will have increased by the end of Napolitano's first term since FY 2000, the last year unaffected by the revenue downturn, to how much personal income and population and inflation have increased in the same period.

The spending increase has strongly outpaced personal income growth and increases in population and inflation. So, spending grew significantly faster than what would be justified by catching up for foregone spending during the early part of this decade.

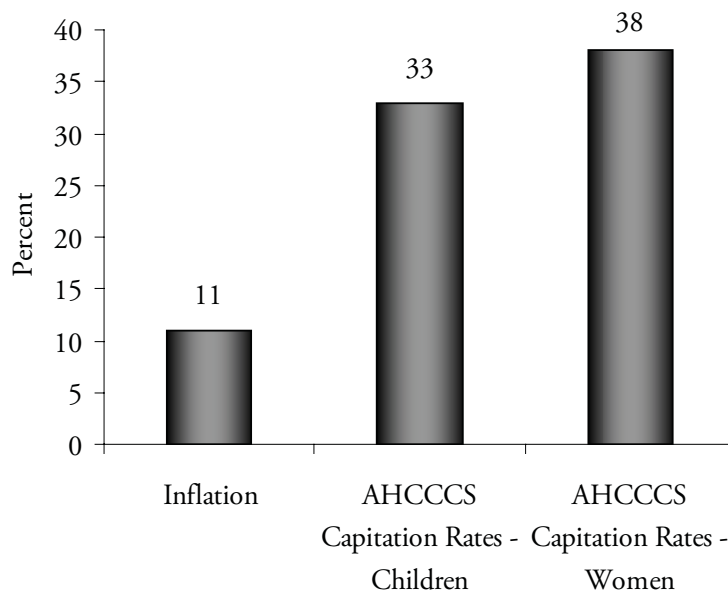
When Napolitano ran for governor in

Figure 6: Percentage Growth of Selected State Programs During Napolitano’s Term



Sources: Joint Legislative Budget Committee, “Appropriations Report,” FY 2003-FY 2007, <http://www.azleg.gov/jlbc.htm>; author’s calculation.

Figure 7: Inflation vs. AHCCCS Medical Costs (% Growth During Napolitano’s Term)



Sources: Joint Legislative Budget Committee, “Appropriations Report,” FY 2003-FY 2007, <http://www.azleg.gov/jlbc.htm>; author’s calculation.

2002, she was strongly critical of what she claimed was the neglect of state spending needs during the 1990s, in preference for tax cuts. Presumably, that was a reference to the Symington years, during which significant cuts in state income and property taxes were made, as well as in vehicle license fees.

Figure 9 compares the spending growth since the start of Symington’s first term to personal income growth and increases in population and inflation. By the end of Napolitano’s term, spending will have increased at basically the rate of personal

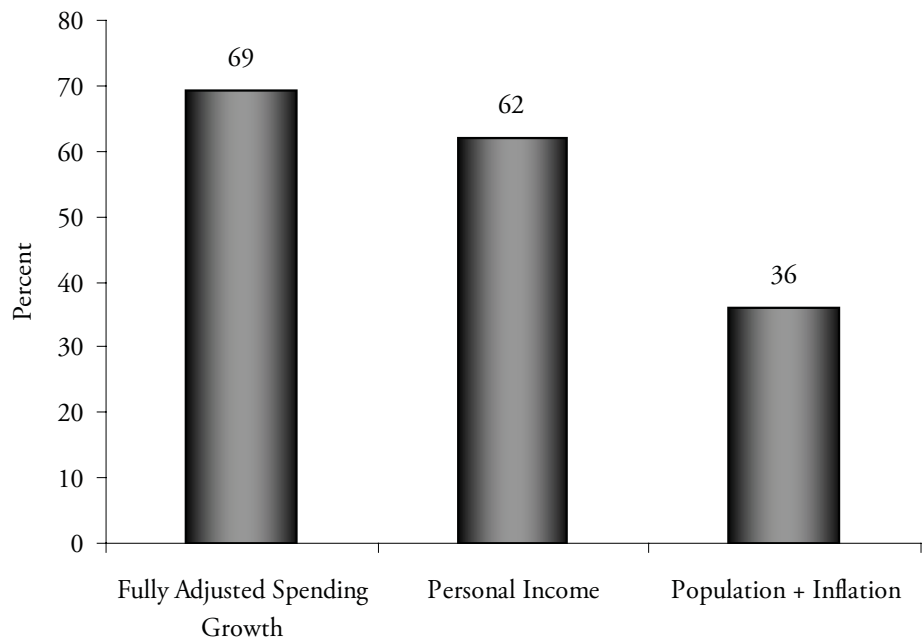
income growth since FY 1991 but more than twice as fast as population growth and inflation during that period.

So, a case could be made that, compared to personal income, the high spending growth during Napolitano’s first term simply caught up with what was prevailing before the Symington era.

Another way of looking at the data, however, is that whatever spending discipline was achieved during the 1990s was essentially erased during Napolitano’s first term.

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Figure 8: Spending Growth Since 2000



Sources: Joint Legislative Budget Committee, “General Fund Operating Budget Spending, Fiscal Years 1979-2007,” August 28, 2006, <http://www.azleg.gov/jlbc/GF10year-8-06-Web.xls>; Arizona Department of Economic Security, Arizona Workforce Informer: Data Analysis, <http://www.workforce.az.gov/cgi/dataanalysis/dataTypeSelection.asp?tableName=notable>; Bureau of Economic Analysis, Table 1.1.9.: “Implicit Price Deflators for Gross Domestic Product,” <http://www.bea.gov/national/nipaweb/TableView.asp>; Bureau of Economic Analysis, “CA1-3—Personal Income, Population, Per Capita Income,” last updated December 29, 2006,” <http://bea.gov/bea/regional/reis/default.cfm?catable=CA1-3§ion=2>; author’s calculations.

It Takes Two to Tango

Obviously, Napolitano did not craft the state budgets of her first term in a vacuum. The Republican-dominated state legislature also passed them and is equally accountable. However, it is fair to say that Napolitano was not a force for lower spending during negotiations with the legislature.

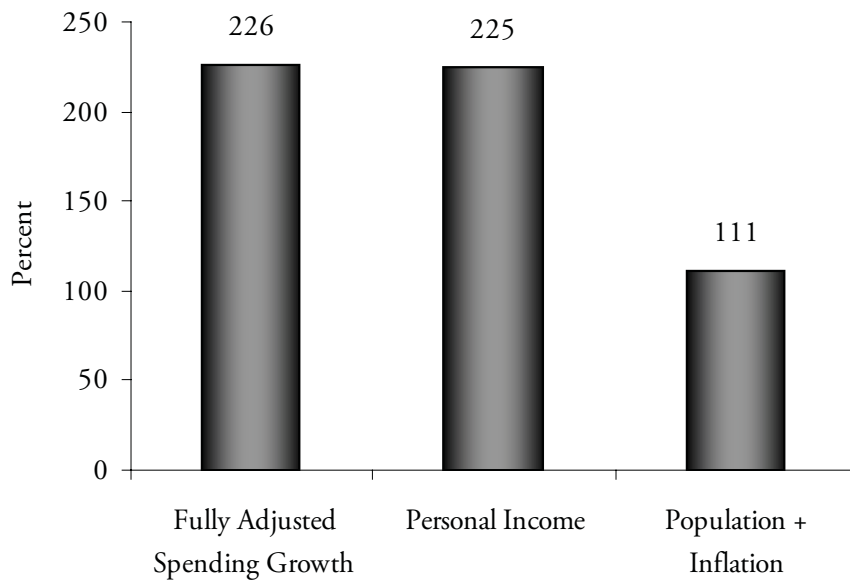
This was a period during which revenue growth consistently outpaced projections. So, comparing approved budgets with those initially recommended

by the executive, a common approach to determining the extent to which executive branch sentiment prevailed, is not useful here. Budget positions were moving targets for both the executive and legislative branches, as state revenues continued to gush.

For the same reason, it is not entirely fair to say that the legislature saved the state by avoiding many of the additional debt measures recommended in Napolitano’s initial budgets. During this period, there was no real opening legislative budget. Instead, the legislature used a

Obviously, Napolitano did not craft the state budgets of her first term in a vacuum. The Republican-dominated state legislature also passed them and is equally accountable.

Figure 9: Spending Growth Since 1991 Compared to Personal Income and Population + Inflation



Sources: Joint Legislative Budget Committee, “General Fund Operating Budget Spending, Fiscal Years 1979-2007,” August 28, 2006, <http://www.azleg.gov/jlbc/GF10year-8-06-Web.xls>; Arizona Department of Economic Security, Arizona Workforce Informer: Data Analysis, <http://www.workforce.az.gov/cgi/dataanalysis/dataTypeSelection.asp?tableName=notable>; Bureau of Economic Analysis, Table 1.1.9.: “Implicit Price Deflators for Gross Domestic Product,” <http://www.bea.gov/national/nipaweb/TableView.asp>. Bureau of Economic Analysis, “CA1-3—Personal Income, Population, Per Capita Income,” last updated December 29, 2006,” <http://bea.gov/bea/regional/reis/default.cfm?catable=CA1-3§ion=2>; author’s calculations.

constant services analysis as a starting point for budget deliberations.

Napolitano's initial budgets were based, for the most part, on revenue projections considerably below those used to craft the final budgets signed into law. If revenues had not regularly improved so rapidly, determining whether the legislature would have, indeed, reduced spending growth rather than adopt the debt mechanisms in Napolitano's initial budgets is entirely speculative.

In the final analysis, the spectacular growth in state revenues gave state policymakers broad discretion about fiscal policy choices. The final product is fairly attributed to both branches of government.

High-spending states lagged the national average considerably on GDP growth and slightly on average wage growth.

Why Spending Matters

The adverse relationship between taxes and state economic growth has been well documented. For example, the Cato Institute's Fiscal Policy Report Card on America's Governors: 2006 compares the performance of the 10 states that cut taxes the most from 1990 to 2005 to that of the 10 states that raised taxes the most.¹ The tax-cutting states had employment and personal income growth above the national average. The tax-increasing states lagged the national average in both categories.²

Spending, of course, creates the demand for taxation and has a similar inverse relationship with state economic growth. Table 1 lists the 10 states that from 1995 to 2004 increased per capita state

government spending the most, and their growth in state gross domestic product (GDP) and average wages compared to the national average. High-spending states lagged the national average considerably on GDP growth and slightly on average wage growth. Only two high-spending states had greater GDP growth than the national average, and only one state increased average wages more than the national average.

Arizona has a constitutional state spending limit of 7.41 percent of personal income (Article 9, Section 17). The limit restricts the amount of money that can be spent annually from "state revenues." The limit covers more than just general fund spending, but general fund spending makes up approximately two-thirds of total covered spending.

After voters adopted the spending limit in 1978, the general trend was for covered spending to decline as a percentage of personal income. It reached its low point of 5.38 percent in FY 2003. At that point, the state had approximately \$3 billion in unused spending capacity.³

The spending binge over the past four years has absorbed more than half of that unused capacity and increased covered spending to approximately 6.8 percent of state personal income. Currently, there is about \$1.2 billion in unused spending capacity under the limit.

Table 1: Highest Spending States and Their GDP and Wage Growth % Increases (1995-2004)

Top 10 States in Increased Per Capita Spending	% GDP Growth	% Average Wage Growth
1. Vermont	58	41
2. Mississippi	43	36
3. Arkansas	55	41
4. Wyoming	65	40
5. Maine	56	39
6. California	67	45
7. Kentucky	47	41
8. Ohio	45	35
9. Missouri	50	37
10. Wisconsin	55	39
High-Spending Average	54	39
National Average	61	41

Sources: Taxpayers Network, "10-Year Change in State Per Capita Total Expenditures, 1995-2004," <http://www.taxpayersnetwork.org/DesktopDefault.aspx>; Bureau of Economic Analysis, "Gross Domestic Product by State," <http://www.bea.gov/regional/gsp/default.cfm?series=NAICS>; Bureau of Economic Analysis, "CA34: Local Area Personal Income," <http://www.bea.gov/regional/reis/default.cfm?catable=CA34§ion=2>.

Conclusion

State general fund spending during Gov. Janet Napolitano's first term grew faster than personal income and considerably faster than population and inflation. In fact, compared to these two benchmarks, spending increased faster during Napolitano's term than during the term of any of her predecessors going back to Bruce Babbitt.

The trend of increasing spending faster than personal income, or the people's ability to pay for the spending, is pronounced and dangerous to the state's economic health. The governor and the legislature should limit the increase in state general fund spending in FY 2008 to the increase in state personal income

This disproportionate rate of spending increase is not explained by increases in demand for K-12 education, low-income health care, or prisons (although medical cost inflation for low-income health care did create some spending pressure). The need to catch-up for the revenue downturn from the early part of this decade also fails to explain the disproportionate rate of increased spending under Napolitano.

The spending increases during Napolitano's first term generally returned state spending to the level, as measured against personal income, that existed prior to Gov. Fife Symington's first term. That can be seen either as catching up for a neglect of state programs during the 1990s or as an erasure of whatever modest restraint on state spending growth was achieved during that period.

Regardless, the trend of increasing spending faster than personal income, or the people's ability to pay for the spending, is pronounced and dangerous to the state's economic health.⁴

The governor and the legislature should limit the increase in state general

fund spending in FY 2008 to the increase in state personal income, which lately has been trending around 6 to 7 percent. Additionally, the legislature should refer to the voters a reduction in the state spending limit to eliminate the large excess spending capacity that exists and to ensure that state government does not continue to grow faster than the ability of the people to pay for it.

ACKNOWLEDGMENTS

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GENERAL SOURCE NOTES

1. General fund expenditures are from a report by the Joint Legislative Budget Committee, "General Fund Operating Budget Spending, Fiscal Years 1979- 2007," August 28, 2006, azleg.gov/jlbc/GF10year-8-06-Web.xls. This was the most consistently prepared data source for the years covered by this paper. This report excludes some capital spending and revertsments and thus focuses on budgeted operational spending. Including the excluded items or using executive branch figures would not materially affect the relative findings.

2. Personal income data are from the Bureau of Economic Analysis. A projection for personal income growth during the remainder of Gov. Napolitano's term was made by using the average growth in quarterly personal income reported thus far in her term.

3. Population data are from the Department of Economic Security.

4. The inflation measure is the GDP Implicit Price Deflator, as reported by Bureau of Economic Analysis, which is used to calculate the spending limits for city governments under Arizona law.

ENDNOTES

1. Stephen Slivinski, "Fiscal Policy Report Card on America's Governors: 2006," Cato Institute Policy Analysis no. 581, October 24, 2006, <http://cato.org/pubs/pas/pa581.pdf>

2. See also Richard Vedder, "Taxes and Economic Growth," Taxpayers Network, September 2001, <http://www.taxpayersnetwork.org>.

3. Joint Legislative Budget Committee, "State Appropriations Limit," February 2007, <http://www.azleg.gov/jlbc/approp/limit0207.pdf>.

4. See also Noah Clarke, "Dollars and Sense: How Arizona's Spending Choices Affect Our Future," Goldwater Institute Policy Report no. 218, March 12, 2007, <http://www.goldwaterinstitute.org/aboutus/ArticleView.aspx?id=1456>.

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