

Joint Legislative Budget Committee Staff Memorandum

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TO: Richard Stavneak, Director

FROM: Stefan Shepherd, Deputy Director
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SUBJECT: VOTER PROTECTED SPENDING

You requested information on spending subject to the "voter protection" provisions of Proposition 105. Of the \$10 billion General Fund budget, \$3.6 billion could be viewed as voter protected. This estimate is intended as more of a guideline than a definitive estimate. While there are legal questions concerning the scope of several ballot measures, there has been no litigation to resolve these issues. We have, however, received Legislative Council's input in our analysis.

Beyond the General Fund, \$1.2 billion in non-General Fund spending appears subject to the provisions of Proposition 105.

General Fund Voter Protected Spending

In 1998, Arizona voters approved Proposition 105, which stipulates that the Legislature cannot amend statutory language in other ballot propositions unless the amendment "furthers the purposes" of the proposition and is approved by a three-fourths majority vote of the Legislature.

Voter protected General Fund spending affects budgets for the Arizona Department of Education (ADE), Arizona Health Care Cost Containment System (AHCCCS), Department of Health Services (DHS), Arizona State Parks Board, and Citizens Clean Election Commission. Voter protected spending for these 4 agencies for FY 2009 is estimated at approximately \$3.6 billion (*see Table 1*). The estimate for each affected agency is described further below.

Table 1	
Estimated Statewide General Fund Voter Protected Spending (millions)	
<u>Agency</u>	<u>Amount</u>
ADE ^{1/}	\$2,201
AHCCCS ^{2/}	990
DHS ^{2/}	380
Arizona State Parks Board	20
Citizens Clean Elections ^{3/}	7
Totals	\$3,598

^{1/} Based on the Attorney General opinion concerning the scope of inflation adjustments. Would be reduced to \$1.6 billion under more limited Legislative Council interpretation.

^{2/} Represents cost of protected population. This cost could be reduced if capitation rates can be adjusted.

^{3/} This amount can be offset by periodic transfers to the General Fund.

ADE

Proposition 301 from the 2000 election requires annual inflation adjustments over and above the FY 2002 level. The proposition does not cover all elements of the K-12 funding formula, including the “weights,” soft capital, Capital Outlay Revenue Limit (CORL) funding, and charter additional assistance. This non-protected share of the K-12 formula is at least \$2.2 billion. Depending on the interpretation of the inflation adjustment, this non-protected share could be higher.

Background

The funding formula for K-12 operating spending is estimated to cost about \$6 billion in FY 2009. School districts contribute the first \$1.6 billion through property taxes. The state then contributes \$4.4 billion to fulfill the requirements of the funding formula. (We have adjusted the state cost to include the \$330 million rollover payment into FY 2010.)

While there are a few property-wealthy “zero aid” districts, most districts are contributing their full level of property taxes to the cost of operating their schools. As a result, most of the fiscal impact of any changes to the Basic State Aid formula is borne by the state General Fund.

Most formula funding for Arizona public schools is linked to a per pupil “base level” amount defined in A.R.S. §15-901B2. Funding generated by the base level plus transportation “route miles” together equal a school district’s “revenue control limit” (A.R.S. §15-947). Proposition 301 from the November 2000 General Election requires “the base level or other components of the revenue control limit (RCL)” to be increased each year for inflation (A.R.S. §15-901.01).

Differing legal opinions exist regarding the interpretation of A.R.S. §15-901.01. In October 2001, Legislative Council opined that it required the Legislature to increase *either* the base level or route mile funding rates each year (the “or” interpretation). In November 2001, however, the Attorney General opined that it required *both* items to be increased annually (the “and” interpretation). Since FY 2002 (the first year of implementation for Proposition 301), both the base level and route mile funding rates have been increased each year by at least 2%.

Protected “Base” Funding

Proposition 301 prohibits the Legislature from ever reducing the base level below the FY 2002 per pupil amount of \$2,687. Funding a base level of \$2,687 for the currently-projected FY 2009 student count of 1,060,000 pupils would cost approximately \$3.0 billion. The cost of inflating all components of the RCL is \$900 million since FY 2002. That would make the voter-protected base \$3.8 billion. If only route mile costs are inflated, the voter-protected base would be \$3.2 billion.

Unprotected Funding

With a total cost of \$6 billion and up to \$3.8 billion in protected costs, the unprotected share is at least \$2.2 billion. This is because Proposition 301 does not appear to protect approximately \$1.6 billion for base level “weights” prescribed in statute (including Career Ladder funding) and \$0.6 billion for Capital Outlay Revenue Limit (CORL), Soft Capital, and charter school “additional assistance” funding combined.

AHCCCS/DHS

Proposition 204 from the November 2000 General Election increased the income eligibility limit for certain Title XIX programs to 100% of the federal poverty level (FPL). Title XIX is the federal Medicaid program that provides 2:1 matching payments for indigent health care programs. The federal government also requires coverage for certain groups above 100% FPL, including pregnant women and young

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children. After adjusting for the 100% FPL population and federal requirements, approximately 123,000 members are not voter protected. The primary unprotected programs are KidsCare and the Arizona Long Term Care System (ALTCS). The latter includes programs for the elderly and physically disabled, as well as the developmentally disabled.

Beyond membership, the second main determinant of AHCCCS costs is the benefit package. The federal government requires that certain mandatory services be provided. While the income limits established by Proposition 204 are voter protected, the level of capitation payments is not. Capitation rates are the monthly payments made to the health plans for each enrolled member. The federal government requires that the capitation rates be “actuarially sound” and that they be sufficient to maintain adequate access to care. The federal government may permit adjustments less than the medical inflation rate, but it is unlikely that significant reductions to existing rates would meet the “adequate access to care” standard.

Within both the federally mandated and Proposition 204 programs, AHCCCS provides optional services. The majority of spending on optional services is attributable to prescription drugs and ALTCS home and community based services (HCBS). FY 2009 spending on non-HCBS optional services is estimated to be \$160 million from the General Fund. Of that amount, \$126.3 million is for prescription drugs. If eliminated, cost savings would need to be re-estimated as it may cause higher costs in the long run. The elimination of optional HCBS services may also cause higher costs in the long run; if ALTCS home and community based services were eliminated, more AHCCCS recipients might be placed in nursing homes.

Behavioral health services for the Title XIX program, including the Proposition 204 population, are funded through the Department of Health Services (DHS) budget. The federal government requires “medically necessary services” to be provided, including behavioral health services. For the sake of this analysis, we have assumed that all matched behavioral health services funding is “medically necessary.”

The FY 2009 AHCCCS appropriation is \$1.4 billion from the General Fund. Of that amount, \$990 million is expended on the voter protected and federally mandated populations. That amount is not totally “protected” as there could be limited rate adjustments to reduce that level of funding. Apart from the \$990 million, \$435 million is expended for non-Proposition 204 programs. Of the \$435 million, however, \$237 million is for prescription drugs and ALTCS costs. In addition, DHS expends \$380 million for its Title XIX programs below 100% of the federal poverty line.

Arizona State Parks Board

Proposition 303 (“Growing Smarter”) from the November 1998 General Election requires \$20 million to be deposited each year for 11 years (from FY 2001 through FY 2011) into the Land Conservation Fund administered by the Arizona State Parks Board (A.R.S. § 41-511.23). The annual \$20 million deposit through FY 2011, therefore, is voter protected.

“Growing Smarter” monies are to be used to provide grants to purchase state trust land for conservation purposes. All grants must be matched by the public or private entity that is applying for the grant. Grant applications are reviewed by the Conservation Acquisition Board, which recommends grants to the Arizona State Parks Board.

Citizens Clean Election Commission

Proposition 200 (“Citizens Clean Elections”) from the November 1998 General Election established 2 individual income tax credits for contributions to the Citizens Clean Election Fund created by the Proposition. Those 2 credits are voter protected and have the effect of reducing state revenues. The first is a \$5 tax credit that a taxpayer receives if they mark a check-off box on their individual income tax form

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indicating that they want \$5 to be deposited into the Citizens Clean Election Fund. If checked, the Arizona Department of Revenue (ADOR) must grant the taxpayer a \$5 credit and also transfer \$5 to the Citizens Clean Election Fund, for a net state impact of \$10. For FY 2007, ADOR indicates that the total amount attributed to the Clean Elections Fund check-off box was \$6.1 million. This amount is assumed to continue in FY 2009.

The second related credit pertains to voluntary contributions that a taxpayer may make to the Citizens Clean Election Fund, pursuant to A.R.S. § 16-954B. Such credits are limited to either 20% of the filers overall tax liability or \$610 (\$1,220 for a married couple filing jointly), whichever is more. In FY 2006, approximately \$800,000 was claimed for this credit. This amount is also assumed to continue in FY 2009. This indicates that the total “voter protected” revenue impact from the 2 tax credits is estimated at approximately \$6.9 million (\$6.1 million + \$0.8 million).

Proposition 200, however, also requires the Citizens Clean Elections Commission to transfer to the General Fund at least once per year any “excess” monies in the Citizens Clean Election Fund that it projects will not be needed for agency operations and election funding (A.R.S. §16-954.E). Such transfers likewise are voter protected and potentially can offset the negative revenue impact of the 2 tax credits described above. A total of \$27.8 million has been transferred to the General Fund, pursuant to A.R.S. §16-954(E), since establishment of the Citizens Clean Elections Commission in FY 2000.

Independent Redistricting Commission

At the November 2000 General Election, Arizona voters approved Proposition 106, which created the Independent Redistricting Commission (IRC) for the purpose of drawing new legislative and congressional district boundaries after each U.S. Census. Proposition 106 allocated \$6 million from the General Fund to the IRC in FY 2001 for the purpose of redrawing the district lines following the 2000 Census. For future years, the proposition instructs the Arizona Department of Administration to submit to the Legislature a recommendation for adequate redistricting expenses. The Legislature is to make the necessary appropriations by a majority vote.

Non-General Fund Revenues

Voter protected non-General Fund spending affects the budgets of the following agencies: AHCCCS, the Citizens Clean Elections Commission, Community Colleges, Universities, ADE, the School Facilities Board (SFB), the Arizona Game and Fish Department, the Department of Gaming, DHS, Early Childhood Development and Health Board, and the Office of Tourism. Voter-protected revenue for these 11 agencies for FY 2009 is estimated at approximately \$1.2 billion (an agency may not expend all its revenues in a year). The revenue estimate for each agency is summarized in *Table 2*, and is described further below.

Since 2004, any ballot initiative must be funded from non-General Fund sources. Proposition 101 from the November 2004 General Election requires that any initiative must provide for an increased funding source sufficient to cover the costs of the proposal and that the increased funding cannot be derived from the state General Fund. Proposition 201 (Smoke-Free Arizona Act) and Proposition 203 (Early Childhood Development), both passed in 2006, are the only ballot initiatives affected by Proposition 101.

<u>Agency</u>	<u>Amount</u>
AHCCCS	\$251.3
Citizens Clean Elections	10.3
Community Colleges	17.1
Early Childhood Development	162.5
ADE	491.6
AZ Game and Fish Department	6.5
Department of Gaming	10.1
DHS	31.7
School Facilities Board	65.8
Office of Tourism	6.5
Universities	66.5
State Retirement Systems	--
Total ^{1/}	\$1,199.9

^{1/} Does not include Prop. 301 \$25 M income tax credit for sales tax paid.

AHCCCS

In the November 2000 General Election, Proposition 204 established the Tobacco Litigation Settlement Fund in AHCCCS to receive all monies the state receives under the tobacco litigation master settlement, an agreement entered into on November 23, 1998, plus interest on the fund. As one of the 46 states that entered into the master settlement agreement against the 4 largest cigarette manufacturers, Arizona receives an annual payment, adjusted for inflation, the volume of cigarette sales in the state, and the market share of non-participating manufacturers. As described above, Proposition 204 requires coverage for individuals up to 100% FPL. Currently, these funds are only used to offset state match costs of coverage for individuals up to 100% FPL. The fund has expected FY 2009 revenues of \$114.0 million.

Proposition 303 from the November 2002 General Election established the Tobacco Products Tax Fund, which distributes monies to the Proposition 204 Protection Account, the Medically Needy Account, and the Emergency Health Services Account in AHCCCS. The fund and its sub-accounts receive revenue from a \$0.60 per pack cigarette tax, along with taxes on various other tobacco products. The estimated FY 2009 revenue for each sub-account is shown in *Table 3*. AHCCCS is projected to receive an estimated \$114.4 million in Proposition 303 revenue in FY 2009. These monies are all used to offset Title XIX Medicaid costs.

Proposition 202 from the November 2002 General Election established the Trauma and Emergency Services Fund, which receives 28% of the state's annual share of gaming proceeds from the Arizona Benefits Fund. Pursuant to A.R.S. § 36-2903.07C, monies in this fund are to only be used to reimburse hospitals for unrecovered trauma center readiness costs and unrecovered clinical, professional, and operational costs incurred while providing emergency services. The Gaming Department estimates that this fund will receive \$22.9 million in FY 2009 revenues.

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<u>Source</u>	<u>Amount</u>
Prop. 204 (2000) - Tobacco Litigation Settlement Fund	\$114.0
Prop. 303 (2002)	
-- Prop. 204 Protection Account	54.0
-- Medically Needy Account	34.7
-- Emergency Health Services Account	<u>25.7</u>
Total	\$114.4
Prop. 202 (2002) - Trauma and Emergency Services Fund	<u>22.9</u>
Grand Total	\$251.3

Citizens Clean Elections Commission

Proposition 200 (“Citizens Clean Elections”) from the November 1998 General Election established the Citizens Clean Elections Fund to receive revenue from a new 10% surcharge on civil and criminal fines and penalties (A.R.S. § 16-954C), along with monies associated with 2 individual income tax credits. Revenues from the income tax credits are treated as General Fund monies, as described in the previous section. The agency reports \$10.3 million in expected FY 2009 revenues for this fund from the court fine surcharge.

Community Colleges

Proposition 301 from the November 2000 General Election increased the state sales tax rate by 0.6% through June 30, 2021. Of these revenues, 3% of the monies remaining after the payment of School Facilities Board debt service are transferred to the workforce development accounts of the Community Colleges. If a Community College is owned by an Indian tribe, it then receives an additional one-twelfth of the amount otherwise allotted to it. In FY 2009, an estimated \$16.6 million will be expended for workforce development and \$0.5 million for tribal assistance. These amounts are shown in *Table 4*.

Early Childhood Development and Health Board

Proposition 203 from the November 2006 General Election established the Early Childhood Development and Health Fund to receive revenue from a \$0.80 per pack tobacco tax as well as various other increases on tobacco products. These monies are to be used for preschool, child care, parent and family education and support programs, and children’s health programs. The monies are distributed so that up to 10% may be used for administrative costs, and of the remaining monies, at least 35% is to be spent on regional plans based on the population of children age 5 and younger in that region, at least 40% on regional plans based on the population of children whose families are under 100% FPL, and up to 25% on other regional programs. This fund has expected FY 2009 revenues of \$162.5 million, but is not expected to expend most of these monies as it remains in start-up mode.

ADE

Proposition 301 from the November 2000 General Election increased the state sales tax rate by 0.6% through June 30, 2021. The revenue is distributed to ADE, in addition to the universities and community colleges, for various purposes. After the payment of school facility bonds, \$86.3 million is to be used for additional school days each fiscal year after FY 2006, \$7.8 million for school safety, \$1.5 million for failing schools tutoring funds, \$0.2 million for Character Education Matching Grants, and \$25 million to reimburse the General Fund for the cost of the income tax credit allowed by A.R.S § 43-1072.01. Also, up to \$7 million may be appropriated by the Legislature to pay for accountability measures (A.R.S. 42-5029E7). After the payment of all the previous items, the remaining monies are to be transferred to the

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Classroom Site Fund for teacher compensation increases, maintenance, and operating expenses. The expected distribution of Proposition 301 funds for FY 2009 is shown in *Table 4*. Expected FY 2009 revenues for ADE are \$445.8 million.

Proposition 202 from the November 2002 General Election established the Instructional Improvement Fund, which is to receive 56% of the state's share of gaming proceeds. Pursuant to A.R.S. § 15-978 (D), up to 50% of the amount allocated to each school district or charter school may be used for teacher salary increases and class size reductions. Funds not spent on these two purposes are to be used for dropout prevention and instructional improvement programs. Expected FY 2009 revenues are \$45.8 million.

Table 4	
Estimated FY 2009 Proposition 301 Voter-Protected Revenue (millions)	
<u>Agency</u>	<u>Amount</u> ^{1/}
ADE	
-- Classroom Site Fund	\$343.1
-- Additional School Days	86.3
-- School Safety	7.8
-- Failing Schools Tutoring	1.5
-- Character Education Matching Grants	0.2
-- Accountability Measures	<u>7.0</u>
Total	\$445.8
Community Colleges	
-- Workforce Development	\$16.6
-- Tribal Assistance	<u>0.5</u>
Total	\$17.2
School Facilities Board - Debt Service	65.8
Universities - Technology and Research Initiative Fund	<u>66.5</u>
Subtotal – Agencies	\$595.4
Income Tax Credit for Sales Tax Paid	\$25.0
Grand Total	\$620.4

^{1/} Numbers may not add due to rounding.

Arizona Game and Fish Department

In the November 2002 General Election, Proposition 202 established the Arizona Wildlife Conservation Fund, which is to annually receive 8% of the state's share of gaming proceeds. Pursuant to A.R.S. § 17-299C, the money is to be spent by the Arizona State Fish and Game Commission to conserve and protect Arizona's wildlife resources. Expected FY 2009 revenues for this fund are \$6.5 million.

Department of Gaming

Proposition 202 from the November 2002 General Election established the Arizona Benefits Fund to be administered by the Department of Gaming (A.R.S. § 5-601.02H1). The greater of \$8 million or 9% of the state's annual share of gaming proceeds is to be deposited in the fund for the department's regulatory and administrative costs. In FY 2009, the Department of Gaming estimates \$8.3 million will be deposited for this purpose. Additionally, 2% of the state's portion of gaming proceeds is to be allocated for the prevention and treatment of problem gaming. This fund will receive an estimated \$1.8 million in revenues for FY 2009.

Department of Health Services

Proposition 303 from the November 2002 General Election established the Tobacco Products Tax Fund, which distributes monies to the Health Education Account and the Health Research Account in DHS. In addition, the Health Education Account, which also receives monies from a \$0.40 per pack increase approved in 1994, was reestablished under the Tobacco Products Tax Fund as voter protected by this proposition. These 2 funds will receive an estimated \$29.9 million in FY 2009 revenues, including the portion of the \$0.40 per pack 1994 increase directed to the Health Education Account.

Proposition 201 (“Smoke-Free Arizona Act”) from the November 2006 General Election established the Smoke-free Arizona Fund to receive revenue from a \$0.02 per pack tobacco tax increase. Pursuant to A.R.S § 36-601.1L2, this money is to be used for the enforcement of the Smoke-Free Arizona Act. If money is remaining in the fund after the department has met its enforcement obligations, it is to be deposited in the Tobacco Products Tax Fund to be used only for tobacco-use education programs. The fund also receives any fines assessed by DHS on those in violation of this statute. In FY 2009, the fund is estimated to receive \$1.8 million in voter-protected revenue.

School Facilities Board

Proposition 301 from the November 2000 General Election increased the state sales tax rate by 0.6% through June 30, 2021. Pursuant to A.R.S. § 42-5029E, this revenue must first be used to pay the debt service up to \$800 million in school improvement bonds. In FY 2009, \$65.8 million will be spent on debt service, as shown in *Table 4*.

Office of Tourism

Proposition 202 from the November 2002 General Election requires 8% of the state’s share of gaming proceeds to be deposited in the Tourism Fund annually. Pursuant to A.R.S. § 41-2306A4, these monies may only be used to promote tourism within the state. In FY 2009, the fund will receive an expected \$6.5 million in revenues attributable to Proposition 202.

Universities

Proposition 301 from the November 2000 General Election increased the state sales tax rate by 0.6% through June 30, 2021. Of these revenues, 12% of the monies remaining after the payment of School Facilities Board debt service are to be transferred to the Technology and Research Initiative Fund for the universities. In FY 2009, this amount is estimated to be \$66.5 million as shown in *Table 4*.

State Retirement Systems

In addition to the obligations listed above, Proposition 100 from the November 1998 General Election added Article 29 to the State Constitution. Article 29 contains 3 provisions regarding public retirement systems, requiring that:

1. The systems use actuarial methods and assumptions consistent with generally accepted actuarial standards,
2. The assets of the systems are separate and independent trust funds and shall be invested, administered and distributed as determined by law solely in the interests of the members and beneficiaries, and
3. Membership in the systems is a contractual relationship and benefits shall not be diminished or impaired.

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The state currently appropriates approximately \$146 million from the General Fund yearly for the employers' share of retirement costs. The provisions of Article 29 restrict, but do not entirely eliminate, the Legislature's ability to change retirement provisions. Article 29 may prevent the transfer of retirement funds into the state General Fund.

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