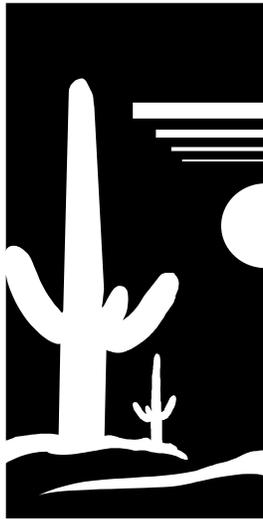


S U M M A R Y

Executive Budget

Fiscal Years 2003 - 2005

Janet Napolitano
Governor



S U M M A R Y

Executive Budget

Fiscal Years 2003 - 2005

Janet Napolitano
Governor

Provisions for Individuals with Disabilities

If individuals with disabilities require reasonable accommodation in order to use this document, please contact the Governor's Office of Strategic Planning and Budgeting at (602) 542-5381.

January 2003

To the Citizens of Arizona and
the Members of the Forty-Sixth Legislature:

In a spirit of promise and opportunity tempered by sacrifice, and emboldened by expectations for a brighter future, I respectfully convey to you the Executive Budget for fiscal years 2003, 2004 and 2005.

We have been assembled at this time to respond to an unprecedented budget crisis. The wisdom necessary to help lead Arizona out of its fiscal condition rests within us, and through thoughtful study and informed debate, together we will restore fiscal sanity to State government. In the process, we will indeed forge a stronger future for Arizona and foster an environment in which businesses and families will ultimately thrive as never before.

As we absorb the magnitude of the challenges before us, and as we remember the prosperity of the 1990s and the relative ease of governing that accompanied it, it is natural for us to wonder how things could have changed so drastically and so quickly. Of the likely causes for our dramatic turnaround, three dominate.

- The economy of any state is inextricably linked to the health of the national economy. At the same time that Arizona enjoyed its fiscal bonanza, so did virtually every other state. Now, the national pendulum has swung in the other direction, and state governments across America are paying the price.
- Washington continues to fail to pay its share of costs for programs for which a substantial federal nexus exists.
- Not all the causes of our budget crisis were beyond our control. As Shakespeare wrote: “Men at some time are masters of their fates: The fault ... is not in our stars, but in ourselves ...” Today we are feeling the predictable effects of tax policies adopted in the 1990s, when the good times seemed as though they would last forever.

Sharp declines in revenue are particularly damaging to a rapidly growing state such as Arizona. During the decade of the ‘90s, our state’s population grew by over 42%, creating huge demands for expanded services and infrastructure. Today, we are facing the same level of revenues that the State collected in fiscal year 1999, but we serve 300,000 more AHCCCS participants and 100,000 more students, and our prisons house 5,000 more inmates.

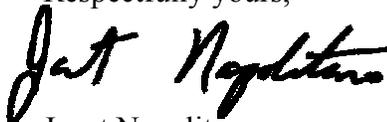
While policies followed in the 1990s have contributed to the precarious state of our budget, we must resist simplistic solutions – such as arbitrary, across-the-board cuts to State agency budgets or ill-conceived revenue enhancements – that would undermine Arizona’s long-term health and create more costly problems down the road. A 40% across-the-board spending reduction would theoretically balance the fiscal year 2004 budget, but it would cripple State government’s ability to perform its essential functions. Instead, the Executive Budget reflects a commitment to certain policies:

- We will preserve the core functions of State government and continue our commitment to excellence in the quality of essential services and the manner in which we provide them.
- Spending reductions are applied with specificity, agency by agency, program by program. For fiscal year 2004, the Executive branch is recommending over \$100 million in specific operating budget reductions, not across-the-board cuts.
- Programs and services that directly benefit children – including but not limited to K-12 education – are immune to net spending reductions. A degradation of services to children will only give rise to future societal burdens that will confound future planning.
- Our universities and community colleges are crucial to economic development – a key ingredient to fiscal health – and are protected from net spending cuts.
- We will make appropriate use of accepted cost-shifting methods to address immediate needs until the current period of fiscal stress has passed.
- We will take full advantage of federal funds available to the State.

As the national economy improves, as the benefits of our sound decision-making begin to be felt, and as we subordinate the narrow interests of various constituencies to the interests of the state as a whole, we will weather the chaos of fiscal year 2004.

It has been said that there are no great generals in peacetime. That is not true. However, it is in time of conflict that the greatness in people becomes evident. And it is in difficult times such as this that statecraft replaces politics, as “mere” elected officials emerge as leaders to whom the quality and health of government become a legacy. Restoring fiscal sanity and economic health to Arizona will be our shared legacy. An effective partnership between the Legislative and Executive branches will create an environment of progress and prosperity that propels Arizona through the current fiscal crisis to new and exhilarating heights.

Respectfully yours,



Janet Napolitano
Governor

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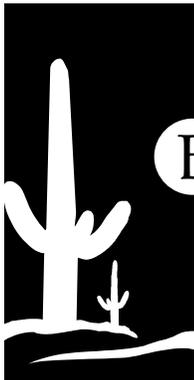
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Budget Summary

**STATE OF ARIZONA
SOURCES AND USES OF FUNDS
GENERAL FUND**

	FY2002 <u>Actual</u>	FY2003 <u>Approp.</u>	FY2003 <u>Estimate</u>	FY2004 <u>Estimate</u>
SOURCES OF FUNDS				
Adjusted Balance Forward	13,334.0	1,000.0	1,000.0	61,236.5
Revenue Estimate	5,760,033.0	6,105,234.4	5,676,300.0	5,889,600.0
Budget Stabilization Fund	166,150.0	50,000.0	29,715.3	0.0
Budget Stabilization Fund End of Year Transfer	84,400.0	0.0	0.0	0.0
Enacted Fund Transfers	315,720.0	93,624.4	93,624.4	0.0
6th Special Session Fund Transfers			51,228.0	
Revenue Measures			80,600.0	734,600.0
REVENUE SUBTOTAL	<u>6,339,637.0</u>	<u>6,249,858.8</u>	<u>5,932,467.7</u>	<u>6,685,436.5</u>
Ladewig Case/Tax Conformity		(75,000.0)	(15,500.0)	(15,500.0)
TOTAL SOURCES OF FUNDS	<u><u>6,339,637.0</u></u>	<u><u>6,174,858.8</u></u>	<u><u>5,916,967.7</u></u>	<u><u>6,669,936.5</u></u>
Operating Budgets	6,366,826.2	6,194,323.9	6,027,742.7	6,677,370.4
Supplementals			50,626.4	
Expenditure Measures-Operating & Capital			(230,111.5)	(61,569.9)
Emergency Fire Suppression			3,000.0	3,000.0
Health Insurance				46,552.0
Retirement Contribution Rate Adjustments				29,828.6
Total Operating Budgets	6,366,826.2	6,194,323.9	5,851,257.6	6,695,181.1
Capital Outlay Appropriations	9,448.7	2,642.9	2,642.9	500.0
Administrative Adjustments	34,489.3	23,000.0	53,000.0	23,000.0
Revertments	(72,127.2)	(51,169.3)	(51,169.3)	(51,169.3)
USES OF FUNDS	<u>6,338,637.0</u>	<u>6,168,797.5</u>	<u>5,855,731.2</u>	<u>6,667,511.8</u>
ENDING BALANCE	<u>1,000.0</u>	<u>6,061.3</u>	<u>61,236.5</u>	<u>2,424.7</u>
TOTAL USES OF FUNDS	<u><u>6,339,637.0</u></u>	<u><u>6,174,858.8</u></u>	<u><u>5,916,967.7</u></u>	<u><u>6,669,936.5</u></u>

**STATE OF ARIZONA
GENERAL FUND
REVENUE SUMMARY
FY 2002 THROUGH FY 2004
(in thousands)**

<u>TAXES</u>	Actual FY 2002	Estimate FY 2003	Estimate FY 2004
Corporate Income Tax	353,021.1	310,000.0	320,000.0
Individual Income Tax	2,113,102.9	2,070,000.0	2,150,000.0
Property Taxes	35,681.6	35,000.0	35,000.0
Sales and Use	3,001,040.3	3,010,000.0	3,150,000.0
Luxury Taxes	66,069.6	65,000.0	65,000.0
Insurance Premium Taxes	195,333.0	215,000.0	225,000.0
Vehicle License Taxes	70.2	0.0	0.0
Estate Taxes	80,552.2	65,000.0	36,000.0
Other Taxes	2,153.2	2,420.0	2,100.0
TOTAL TAXES	5,847,024.2	5,772,420.0	5,983,100.0
 <u>OTHER REVENUES</u>			
Licenses, Fees & Permits	61,752.2	58,239.1	55,733.0
Charges for Services/ Fines and Forfeitures	12,580.1	6,900.0	6,900.0
Interest Earnings	33,023.7	23,000.0	23,000.0
Lottery	31,000.0	28,000.0	28,000.0
Miscellaneous Revenues	34,223.1	44,000.0	45,320.0
Transfers & Reimbursements	72,716.4	25,000.0	25,000.0
Disproportionate Share	87,623.9	149,300.0	87,600.0
Fund Transfers	481,867.8	174,567.7	0.0
TOTAL OTHER REVENUES	814,787.2	509,006.8	271,552.9
TOTAL REVENUE	6,661,811.5	6,281,426.8	6,254,652.9
 <u>ADJUSTMENTS</u>			
Urban Revenue Sharing	(421,880.0)	(430,559.1)	(365,052.9)
B.S.F. Deposit	0.0	0.0	0.0
GRAND TOTAL REVENUES	6,239,931.5	5,850,867.7	5,889,600.0

General Fund Operating Budgets Summary

	FY 2002 Actual	FY 2003 Approp	FY 2004 Exec Rec	'04 Exec - '03 App.	FY 04 Growth	FY 2005 Exec Rec	'05 Exec - '03 App.	FY 05 Growth
<u>General Government</u>								
Arizona Department of Administration	24,802.4	23,319.3	24,321.0	1,001.6	4.3%	0.0	0.0	0.0%
Office of Administrative Hearings	1,193.5	1,069.6	1,076.3	6.7	0.6%	1,076.3	6.7	0.6%
Attorney General - Department of Law	25,897.4	23,071.3	22,891.1	(180.2)	-0.8%	22,872.1	(199.2)	-0.9%
Auditor General	11,970.0	11,076.6	11,076.6	0.0	0.0%	11,076.6	0.0	0.0%
Department of Commerce	4,319.2	3,909.1	3,610.9	(298.2)	-7.6%	3,610.9	(298.2)	-7.6%
Governor's Office for Equal Opportunity	182.6	213.7	215.9	2.2	1.0%	215.9	2.2	1.0%
State Board of Equalization	591.7	543.4	547.3	3.9	0.7%	548.7	5.3	1.0%
Governor's Office for Excellence in Government	1,289.5	1,350.4	0.0	(1,350.4)	-100.0%	0.0	(1,350.4)	-100.0%
Governor's Office	5,761.6	5,389.0	5,949.8	560.8	10.4%	5,955.7	566.7	10.5%
House of Representatives	10,978.4	11,149.3	11,149.3	0.0	0.0%	11,149.3	0.0	0.0%
Joint Legislative Budget Committee	1,148.0	2,106.1	2,106.1	0.0	0.0%	2,106.1	0.0	0.0%
Judiciary	144,935.5	137,153.9	137,153.9	0.0	0.0%	0.0	0.0	0.0%
Legislative Council	4,938.8	4,447.7	4,447.7	0.0	0.0%	4,447.7	0.0	0.0%
Arizona State Library, Archives & Public Records	7,350.0	6,805.7	6,805.7	0.0	0.0%	6,805.7	0.0	0.0%
Personnel Board	292.0	334.0	333.1	(0.9)	-0.3%	333.1	(0.9)	-0.3%
Arizona State Retirement System	2,819.2	0.0	0.0	0.0	0.0%	0.0	0.0	0.0%
Department of Revenue	58,236.4	54,090.6	54,193.4	102.8	0.2%	54,151.5	60.9	0.1%
Department of State - Secretary of State	2,967.0	5,538.5	5,716.2	177.7	3.2%	5,540.9	2.4	0.0%
Senate	6,750.3	6,105.0	6,105.0	0.0	0.0%	6,105.0	0.0	0.0%
Governor's Office of Strategic Planning and Budgeting	1,808.2	1,664.0	1,682.7	18.7	1.1%	1,682.7	18.7	1.1%
State Board of Tax Appeals	231.5	268.5	274.6	6.1	2.3%	275.3	6.8	2.5%
Office of Tourism	10,332.4	9,001.1	8,966.0	(35.1)	-0.4%	8,969.2	(31.9)	-0.4%
State Treasurer	4,795.3	4,829.2	2,094.8	(2,734.4)	-56.6%	2,072.1	(2,757.1)	-57.1%
Commission on Uniform State Laws	41.4	33.7	49.6	15.9	47.2%	52.4	18.7	55.5%
General Government Total	333,632.3	313,469.8	310,767.0	(2,702.8)	-0.9%	149,047.2	(3,949.3)	-1.3%
<u>Health and Welfare</u>								
Department of Economic Security	456,642.6	422,105.3	505,284.3	83,179.0	19.7%	0.0	0.0	0.0%
Department of Environmental Quality	20,572.8	22,717.2	22,796.5	79.3	0.3%	22,801.0	83.8	0.4%
Arizona Health Care Cost Containment System	508,590.2	630,532.0	796,568.3	166,036.3	26.3%	0.0	0.0	0.0%
Department of Health Services	279,044.3	289,346.9	345,719.7	56,372.8	19.5%	0.0	0.0	0.0%
Arizona Commission of Indian Affairs	222.4	200.3	201.2	0.9	0.4%	201.2	0.9	0.4%
Arizona Pioneers' Home	34.6	285.3	3,868.2	3,582.9	1255.8%	3,868.2	3,582.9	1255.8%
Arizona Rangers' Pension	11.8	12.0	12.3	0.3	2.5%	12.6	0.6	5.0%
Department of Veterans' Services	2,249.0	2,332.7	2,165.1	(167.6)	-7.2%	2,166.8	(165.9)	-7.1%
Health and Welfare Total	1,267,367.7	1,367,531.7	1,676,615.6	309,083.9	22.6%	29,049.8	3,502.3	0.3%
<u>Inspection and Regulation</u>								
Arizona Department of Agriculture	11,949.4	10,304.3	2,952.9	(7,351.4)	-71.3%	2,997.6	(7,306.7)	-70.9%
State Banking Department	2,695.4	2,716.1	2,765.0	48.9	1.8%	2,765.0	48.9	1.8%
Department of Building and Fire Safety	3,400.6	3,128.8	3,190.0	61.2	2.0%	3,201.6	72.8	2.3%
Corporation Commission	5,269.6	5,007.3	4,932.9	(74.4)	-1.5%	4,938.7	(68.6)	-1.4%
Department of Insurance	5,844.6	6,094.4	6,165.0	70.6	1.2%	6,165.0	70.6	1.2%
Department of Liquor Licenses and Control	2,439.1	2,207.9	2,194.9	(13.0)	-0.6%	2,198.9	(9.0)	-0.4%
State Mine Inspector	1,180.8	1,033.6	1,082.0	48.4	4.7%	1,082.0	48.4	4.7%
State Board of Nursing	125.5	130.9	134.8	3.9	3.0%	134.8	3.9	3.0%
OSHA Review Board	0.0	4.8	4.8	0.0	0.0%	4.8	0.0	0.0%
Arizona Department of Racing	2,702.6	2,404.1	0.0	(2,404.1)	-100.0%	0.0	(2,404.1)	-100.0%
Radiation Regulatory Agency	1,641.7	1,485.4	1,505.6	20.2	1.4%	1,505.6	20.2	1.4%

	FY 2002 Actual	FY 2003 Approp	FY 2004 Exec Rec	'04 Exec - '03 App.	FY 04 Growth	FY 2005 Exec Rec	'05 Exec - '03 App.	FY 05 Growth
Department of Real Estate	3,110.8	3,105.0	3,125.5	20.5	0.7%	3,125.5	20.5	0.7%
Department of Weights and Measures	1,459.8	1,314.1	1,313.5	(0.6)	0.0%	1,324.7	10.6	0.8%
Inspection & Regulation Total	41,820.0	38,936.7	29,366.9	(9,569.8)	-24.6%	29,444.2	(9,492.5)	-24.4%
<u>Education</u>								
Arizona State University - East Campus	12,971.2	12,425.6	12,425.6	0.0	0.0%	0.0	0.0	0.0%
Arizona State University - Main Campus	268,213.1	263,293.7	268,114.8	4,821.1	1.8%	0.0	0.0	0.0%
Arizona State University - West Campus	37,991.0	36,116.5	36,116.5	0.0	0.0%	0.0	0.0	0.0%
Arizona Commission on the Arts	2,372.2	2,073.3	2,083.4	10.1	0.5%	2,083.5	10.2	0.5%
State Board for Charter Schools	561.7	498.1	683.1	185.0	37.1%	683.1	185.0	37.1%
Arizona Community Colleges	133,701.3	127,569.2	133,898.4	6,329.2	5.0%	0.0	0.0	0.0%
Arizona State Schools for the Deaf and the Blind	16,478.1	16,122.3	15,660.0	(462.3)	-2.9%	15,705.2	(417.1)	-2.6%
Department of Education	2,602,223.5	2,611,845.1	2,888,846.1	277,001.0	10.6%	0.0	0.0	0.0%
Arizona Historical Society	4,497.9	4,192.3	3,658.6	(533.7)	-12.7%	3,852.3	(340.0)	-8.1%
Board of Medical Student Loans	283.4	283.4	283.4	0.0	0.0%	283.4	0.0	0.0%
Northern Arizona University	111,974.9	110,980.3	111,998.4	1,018.1	0.9%	0.0	0.0	0.0%
Commission for Postsecondary Education	1,643.1	1,391.3	1,391.3	0.0	0.0%	1,391.3	0.0	0.0%
Prescott Historical Society of Arizona	723.1	669.9	670.2	0.3	0.0%	670.2	0.3	0.0%
Arizona Board of Regents	7,581.5	7,561.9	7,572.3	10.4	0.1%	0.0	0.0	0.0%
School Facilities Board	1,591.8	39,845.5	101,725.1	61,879.6	155.3%	0.0	0.0	0.0%
University of Arizona - Health Sciences Center	55,930.0	52,858.4	53,113.6	255.2	0.5%	0.0	0.0	0.0%
University of Arizona - Main Campus	271,132.5	263,687.9	263,612.0	(75.9)	0.0%	0.0	0.0	0.0%
Education Total	3,529,870.3	3,551,414.7	3,901,852.8	350,438.1	9.9%	24,669.0	(561.6)	0.0%
<u>Protection and Safety</u>								
Department of Corrections	541,093.3	579,765.4	591,998.0	12,232.6	2.1%	0.0	0.0	0.0%
Arizona Criminal Justice Commission	2,582.2	1,551.7	1,551.7	0.0	0.0%	1,551.7	0.0	0.0%
Department of Emergency Services and Military Affairs	10,085.9	11,625.7	11,711.3	85.6	0.7%	11,711.3	85.6	0.7%
Board of Executive Clemency	1,281.8	915.7	886.3	(29.4)	-3.2%	886.3	(29.4)	-3.2%
Department of Juvenile Corrections	62,949.7	63,743.7	64,061.2	317.5	0.5%	0.0	0.0	0.0%
Law Enforcement Merit System Council	56.3	56.4	56.7	0.3	0.5%	56.7	0.3	0.5%
Department of Public Safety	48,875.0	42,291.9	38,389.5	(3,902.4)	-9.2%	38,398.6	(3,893.3)	-9.2%
Protection and Safety Total	666,924.2	699,950.5	708,654.7	8,704.2	1.2%	52,604.6	(3,836.8)	-0.5%
<u>Transportation</u>								
Department of Transportation	3,582.0	63.5	75.2	11.7	18.4%	0.0	0.0	0.0%
Transportation Total	3,582.0	63.5	75.2	11.7	18.4%	0.0	0.0	0.0%
<u>Natural Resources</u>								
Arizona Geological Survey	878.1	774.9	778.6	3.7	0.5%	778.6	3.7	0.5%
State Land Department	19,671.0	14,698.2	14,613.2	(85.0)	-0.6%	14,600.0	(98.2)	-0.7%
Department of Mines and Mineral Resources	734.9	647.6	648.3	0.7	0.1%	648.3	0.7	0.1%
Arizona Navigable Stream Adjudication Commission	155.9	157.7	157.4	(0.3)	-0.2%	157.4	(0.3)	-0.2%
State Parks Board	27,355.3	26,173.4	20,000.0	(6,173.4)	-23.6%	20,000.0	(6,173.4)	-23.6%
Department of Water Resources	15,630.7	13,918.0	13,840.7	(77.3)	-0.6%	13,855.0	(63.0)	-0.5%
Natural Resources Total	64,425.9	56,369.8	50,038.2	(6,331.6)	-11.2%	50,039.3	(6,330.5)	-11.2%
General Fund Operating Total	5,907,622.4	6,027,736.6	6,677,370.4	649,633.7	10.8%	334,854.1	(20,668.4)	-0.3%

**STATE OF ARIZONA
OTHER APPROPRIATED FUNDS*
REVENUE SUMMARY
FY 2002 THROUGH 2004
(in thousands)**

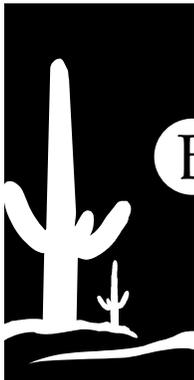
<u>TAXES</u>	Actual FY 2002	Estimate FY 2003	Estimate FY 2004
Motor Fuel Taxes	50,950.5	56,552.8	55,500.2
Other Taxes	1,168,964.6	1,001,315.9	1,137,899.0
TOTAL TAXES	1,219,915.1	1,057,868.7	1,193,399.2
 <u>OTHER REVENUES</u>			
Licenses, Fees & Permits	317,538.9	349,761.0	365,058.0
Charges for Services	666,518.4	517,279.5	548,479.1
Fines and Forfeitures	68,827.0	62,645.4	65,560.9
Interest Earnings	86,681.5	74,335.8	73,156.6
Lottery	294,823.7	260,000.0	260,000.0
Miscellaneous Revenues	135,145.4	498,222.3	411,675.2
Transfers & Reimbursements	2,333,921.6	2,998,414.5	3,045,125.6
TOTAL OTHER REVENUES	3,903,456.6	4,760,658.4	4,769,055.4
TOTAL REVENUE	5,123,371.7	5,818,527.1	5,962,454.6

* Other Appropriated Funds Revenues includes all revenues of funds which may only be partially subject to statutory or legislative appropriation. The expenditures shown in the "Other Funds Budget Summary" are for the appropriated portion of these funds only and may represent only a small portion of the funds total expenditures.

Other Appropriated Funds Operating Budgets Summary

	FY 2002 Actual	FY 2003 Approp	FY 2004 Exec Rec	'04 Exec - '03 App.	FY 04 Growth	FY 2005 Exec Rec	'05 Exec - '03 App.	FY 05 Growth
<u>General Government</u>								
Arizona Department of Administration	137,024.2	169,404.4	176,842.6	7,438.2	4.4%	0.0	0.0	0.0%
Office of Administrative Hearings	8.8	13.9	13.9	0.0	0.0%	13.9	0.0	0.0%
Attorney General - Department of Law	22,046.7	24,341.8	24,501.4	159.6	0.7%	24,499.9	158.1	0.6%
Department of Commerce	2,942.7	3,483.0	3,407.0	(76.0)	-2.2%	3,407.0	(76.0)	-2.2%
Governor's Office for Excellence in Government	14.0	25.0	0.0	(25.0)	-100.0%	0.0	(25.0)	-100.0%
Arizona Exposition & State Fair	11,653.7	14,208.0	14,434.8	226.8	1.6%	14,434.8	226.8	1.6%
Government Information Technology Agency	2,133.5	2,502.3	2,472.0	(30.3)	-1.2%	2,474.1	(28.2)	-1.1%
Arizona Department of Housing	262.0	438.8	424.0	(14.8)	-3.4%	424.0	(14.8)	-3.4%
Judiciary	21,396.1	32,849.0	32,849.0	0.0	0.0%	0.0	0.0	0.0%
Arizona State Library, Archives & Public Records	213.0	313.0	313.0	0.0	0.0%	313.0	0.0	0.0%
Arizona State Lottery Commission	46,913.3	42,925.3	45,209.3	2,284.0	5.3%	45,216.6	2,291.3	5.3%
Arizona State Retirement System	17,836.7	24,033.6	23,590.0	(443.6)	-1.8%	23,819.3	(214.3)	-0.9%
Department of Revenue	2,060.6	2,316.9	2,305.5	(11.4)	-0.5%	2,304.7	(12.2)	-0.5%
State Boards Office	248.9	275.2	275.9	0.7	0.3%	275.9	0.7	0.3%
Office of Tourism	3,828.7	2,000.0	2,100.0	100.0	5.0%	2,020.5	20.5	1.0%
General Government Total	268,582.9	319,130.2	328,738.4	9,608.2	3.0%	119,203.7	2,326.9	0.7%
<u>Health and Welfare</u>								
Commission for the Deaf and the Hard of Hearing	5,081.2	5,434.2	5,458.5	24.3	0.4%	5,460.0	25.8	0.5%
Department of Economic Security	367,148.5	469,299.0	433,226.1	(36,072.9)	-7.7%	0.0	0.0	0.0%
Department of Environmental Quality	41,693.6	68,564.5	64,961.0	(3,603.5)	-5.3%	64,974.3	(3,590.2)	-5.2%
Arizona Health Care Cost Containment System	71,488.1	139,541.3	179,519.0	39,977.7	28.6%	0.0	0.0	0.0%
Department of Health Services	48,148.9	47,208.6	46,298.0	(910.6)	-1.9%	0.0	0.0	0.0%
Arizona Pioneers' Home	5,383.2	5,167.7	1,592.7	(3,575.0)	-69.2%	1,592.7	(3,575.0)	-69.2%
Department of Veterans' Services	10,248.7	11,177.8	11,382.9	205.1	1.8%	11,384.6	206.8	1.9%
Health and Welfare Total	549,192.2	746,393.1	742,438.2	(3,954.9)	-0.5%	83,411.6	(6,932.6)	-0.9%
<u>Inspection and Regulation</u>								
State Board of Accountancy	1,607.3	2,114.5	2,106.8	(7.7)	-0.4%	2,108.7	(5.8)	-0.3%
Acupuncture Board of Examiners	54.5	60.5	78.4	17.9	29.6%	76.7	16.2	26.8%
Arizona Department of Agriculture	2,045.4	2,661.2	11,295.5	8,634.3	324.5%	11,250.4	8,589.2	322.8%
State Board of Appraisal	449.6	462.5	477.7	15.2	3.3%	477.7	15.2	3.3%
Arizona Medical Board	4,308.8	4,811.0	4,647.9	(163.1)	-3.4%	4,608.3	(202.7)	-4.2%
Board of Barber Examiners	190.6	192.2	215.6	23.4	12.2%	208.9	16.7	8.7%
Board of Behavioral Health Examiners	585.4	717.0	767.3	50.3	7.0%	767.3	50.3	7.0%
State Board of Chiropractic Examiners	336.2	345.7	432.9	87.2	25.2%	413.5	67.8	19.6%
Corporation Commission	15,154.1	16,790.2	16,910.9	120.7	0.7%	16,789.8	(0.4)	0.0%
Board of Cosmetology	1,242.1	1,488.6	1,519.4	30.8	2.1%	1,514.9	26.3	1.8%
State Board of Dental Examiners	746.1	774.7	869.1	94.4	12.2%	870.5	95.8	12.4%
State Board of Dispensing Opticians	84.6	98.7	108.4	9.7	9.8%	100.0	1.3	1.3%
State Board of Funeral Directors & Embalmers	230.4	263.4	277.1	13.7	5.2%	277.2	13.8	5.2%
Department of Gaming	5,115.7	5,077.1	5,067.6	(9.5)	-0.2%	5,072.7	(4.4)	-0.1%
Board of Homeopathic Medical Examiners	53.2	78.0	68.1	(9.9)	-12.7%	68.7	(9.3)	-11.9%
Industrial Commission of Arizona	14,592.1	15,983.5	16,265.1	281.6	1.8%	16,265.1	281.6	1.8%
Naturopathic Physicians Board of Medical Examiners	171.6	214.1	194.7	(19.4)	-9.1%	194.7	(19.4)	-9.1%
State Board of Nursing	2,896.7	2,902.7	3,281.2	378.5	13.0%	3,072.2	169.5	5.8%
Nursing Care Ins. Admin. Examiners	272.8	339.5	348.8	9.3	2.7%	348.8	9.3	2.7%
Board of Occupational Therapy Examiners	160.3	208.8	208.2	(0.6)	-0.3%	208.7	(0.1)	0.0%

	FY 2002 Actual	FY 2003 Approp	FY 2004 Exec Rec	'04 Exec - '03 App.	FY 04 Growth	FY 2005 Exec Rec	'05 Exec - '03 App.	FY 05 Growth
State Board of Optometry	150.4	145.9	157.6	11.7	8.0%	153.6	7.7	5.3%
Arizona Board of Osteopathic Examiners	471.9	412.1	462.9	50.8	12.3%	437.9	25.8	6.3%
Arizona State Board of Pharmacy	1,029.8	1,227.6	1,317.1	89.5	7.3%	1,317.1	89.5	7.3%
Board of Physical Therapy Examiners	209.1	232.2	231.0	(1.2)	-0.5%	231.0	(1.2)	-0.5%
State Board of Podiatry Examiners	86.5	102.4	102.8	0.4	0.4%	102.8	0.4	0.4%
State Board for Private Postsecondary Education	234.6	254.6	250.0	(4.6)	-1.8%	248.1	(6.5)	-2.6%
State Board of Psychologist Examiners	229.8	327.1	315.9	(11.2)	-3.4%	315.9	(11.2)	-3.4%
Arizona Department of Racing	316.0	406.9	382.3	(24.6)	-6.0%	382.2	(24.7)	-6.1%
Radiation Regulatory Agency	183.0	222.6	246.5	23.9	10.7%	246.5	23.9	10.7%
Registrar of Contractors	8,416.7	9,128.4	10,147.0	1,018.6	11.2%	9,345.4	217.0	2.4%
Residential Utility Consumer Office	887.6	1,101.4	1,106.2	4.8	0.4%	1,108.2	6.8	0.6%
Board of Respiratory Care Examiners	153.5	177.4	189.2	11.8	6.7%	189.2	11.8	6.7%
Structural Pest Control Commission	1,722.3	1,851.1	1,848.6	(2.5)	-0.1%	1,849.3	(1.8)	-0.1%
State Board of Technical Registration	1,047.8	1,238.2	1,298.0	59.8	4.8%	1,301.0	62.8	5.1%
State Veterinary Medical Examining Board	306.8	384.9	388.4	3.5	0.9%	388.4	3.5	0.9%
Department of Weights and Measures	976.3	1,172.3	1,168.8	(3.5)	-0.3%	1,174.3	2.0	0.2%
Inspection & Regulation Total	66,719.6	73,969.0	84,753.0	10,784.0	14.6%	83,485.7	9,516.7	12.9%
<u>Education</u>								
Arizona State University - East Campus	4,519.1	8,454.2	8,977.6	523.4	6.2%	0.0	0.0	0.0%
Arizona State University - Main Campus	109,040.1	109,458.3	128,281.3	18,823.0	17.2%	0.0	0.0	0.0%
Arizona State University - West Campus	3,940.8	5,725.8	8,031.3	2,305.5	40.3%	0.0	0.0	0.0%
Arizona State Schools for the Deaf and the Blind	10,065.8	12,291.2	12,362.4	71.2	0.6%	12,688.4	397.2	3.2%
Department of Education	78,351.1	78,421.7	28,370.7	(50,051.0)	-63.8%	0.0	0.0	0.0%
Board of Medical Student Loans	64.9	13.2	47.2	34.0	257.6%	13.2	0.0	0.0%
Northern Arizona University	28,197.8	30,202.5	25,496.1	(4,706.4)	-15.6%	0.0	0.0	0.0%
Commission for Postsecondary Education	2,028.6	2,782.4	2,779.5	(2.9)	-0.1%	2,779.5	(2.9)	-0.1%
University of Arizona - Health Sciences Center	7,832.2	7,188.5	7,972.6	784.1	10.9%	0.0	0.0	0.0%
University of Arizona - Main Campus	76,638.6	84,320.1	93,973.4	9,653.3	11.4%	0.0	0.0	0.0%
Education Total	320,679.0	338,857.9	316,292.1	(22,565.8)	-6.7%	15,481.1	394.3	0.1%
<u>Protection and Safety</u>								
Automobile Theft Authority	3,872.1	3,914.0	3,917.2	3.2	0.1%	3,917.2	3.2	0.1%
Department of Corrections	12,625.9	34,485.9	45,614.4	11,128.5	32.3%	0.0	0.0	0.0%
Arizona Criminal Justice Commission	5,809.0	5,022.3	5,137.3	115.0	2.3%	5,113.1	90.8	1.8%
Arizona Drug and Gang Prevention Resource Center	2,944.2	5,142.9	1,459.7	(3,683.2)	-71.6%	1,462.1	(3,680.8)	-71.6%
Department of Emergency Services and Military Affairs	132.7	132.7	132.7	0.0	0.0%	132.7	0.0	0.0%
Department of Juvenile Corrections	3,703.8	4,999.2	3,865.7	(1,133.5)	-22.7%	0.0	0.0	0.0%
Department of Public Safety	84,088.0	98,122.4	101,736.3	3,613.9	3.7%	101,615.3	3,492.9	3.6%
Protection and Safety Total	113,175.7	151,819.4	161,863.3	10,043.9	6.6%	112,240.4	(93.9)	-0.1%
<u>Transportation</u>								
Department of Transportation	299,040.5	317,697.2	305,309.2	(12,388.0)	-3.9%	0.0	0.0	0.0%
Transportation Total	299,040.5	317,697.2	305,309.2	(12,388.0)	-3.9%	0.0	0.0	0.0%
<u>Natural Resources</u>								
Arizona Game & Fish Department	22,083.5	23,994.4	22,908.8	(1,085.6)	-4.5%	23,146.3	(848.1)	-3.5%
State Land Department	564.0	776.0	620.0	(156.0)	-20.1%	620.0	(156.0)	-20.1%
State Parks Board	5,010.5	7,459.6	13,757.2	6,297.6	84.4%	13,757.2	6,297.6	84.4%
Natural Resources Total	27,658.0	32,230.0	37,286.0	5,056.0	15.7%	37,523.5	5,293.5	16.4%
Other Appropriated Funds Operating Total	1,645,047.9	1,980,096.8	1,976,680.2	(3,416.6)	-0.2%	451,346.0	10,504.9	0.5%



Budget Message

Modest Recovery, Limited Options

The erosion of Arizona's tax base will not be restored in the near future, leaving State policymakers with difficult choices

THE CONSENSUS AMONG the nation's economists is that 2003 will be better than 2002, and 2004 will be better yet. But there are no predictions for a return to the prosperity that America enjoyed during much of the 1990s, and the road back could be a treacherous one for Arizona State government.

The national outlook

The U.S. economy grew modestly in 2002, while equity markets suffered through their third year of declines. Most economists call for a modest recovery during calendar 2003, with growth in the gross domestic product approaching capacity levels late in 2003 or early 2004. This growth will come with modest inflation and slowly rising interest rates.

Equity markets should stabilize in anticipation of at- or above-trend 2004 growth. The climate for home purchases will remain conducive to continuation of a strong housing market, but not at levels observed over the last two years.

Unemployment rates will slowly de-

cline to the 5% level in early 2004.

Risks. Considerable risks remain for the national economy, which explains why the equity markets are not already "pricing in" the recovery as a baseline forecast. The predominant risks are geo-

Most economists call for a modest recovery during calendar 2003, with GDP growth approaching capacity levels late in 2003 or early 2004.

political, with Iraq, Korea and terrorism at the forefront. The link between these risks and the national economy include prospects of a massive erosion in consumer, investor and business investment confidence, or the possibility of a real interruption in the flow of OPEC oil.

Other risks include the implosion of the real estate market or further confidence erosion on Wall Street due to accounting improprieties. Shocks in these areas could result in a deflationary spiral that parallels Japan's decade-long

experience - a truly unthinkable phenomenon several years ago.

Economics textbooks have traditionally outlined "liquidity trap" scenarios when injections of credit are simply absorbed by consumers or investors - not spent on goods or investment opportunities - because none of those options appear attractive even at very low interest rates. If Washington can "jump start" the national economy with a proper fiscal stimulus, it will be very welcome medicine in this environment.

The state economy

The scenarios for Arizona personal income, employment and population growth appear in the table below and are discussed in the GLOBAL INSIGHT U.S. GDP growth forecast.

Arizona Outlook

Forecast Growth Assumptions

	2002	2003	2004
Population	2.3	2.3	2.2
Employment	-0.9	1.8	3.0
Personal Income	4.2	5.8	6.9
GDP (U.S.)	2.3	2.6	4.1

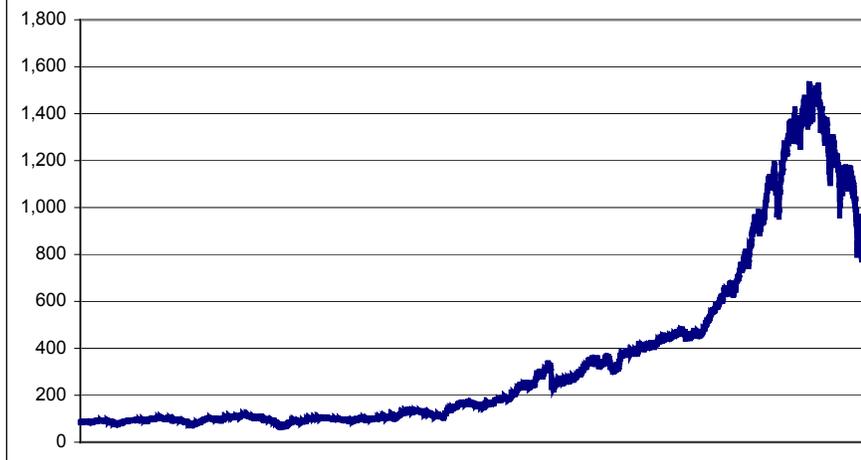
Population growth is dictated by both demographic and economic factors.

Employment growth will be positive in 2003, a welcome change from the rare decline experienced in 2002.

Personal income growth will be very modest in 2003 and will accelerate in 2004. It continues to be eroded by the decline in job creation, the low inflationary environment, and the absence of significant bonus income that fueled double-digit growth in the late 1990s - a condition that is not likely to return in the near future.

S&P 500 Composite Stock Prices

1965 to 2002



Employment

Arizona employment growth is “the lowest” in recent memory, resulting in net losses in job growth. The losses are particularly striking since Arizona is traditionally one of the leaders in job creation nationwide.

Job Gains and Losses

2002

Manufacturing.....	(14,700)
Construction	(9,400)
Services	(7,300)
TCPU.....	(6,500)
Local Government.....	8,100
Trade.....	7,300
Net Change	(22,500)

The outlook for 2004 is for employment to regain growth at rates closer to the long-run trend but well below the robust levels of the mid-1990s. Overall, state job attrition in 2002 was largely attributable to the decline in manufacturing jobs, where the work force declined by over 5%.

Only modest recovery - about 1% growth - in the manufacturing sector is expected in 2003, with little likelihood that 2004 will see a return to the healthy figures turned in during the mid- to late 1990s. Jobs in the sector will continue to be exported to overseas manufacturing plants.

Indeed, the job growth projections for 2003 and 2004, while positive in contrast to 2002, are lower than the growth rates observed in any of the years from 1993 through 2000. The stagnant job picture looks very much like it did in the 1990-91 recession. Arizona will depend on the service, hospitality, finance and real estate sectors to sustain positive growth rates, with electronics manufacturing continuing to consolidate for the foreseeable future.

Risks

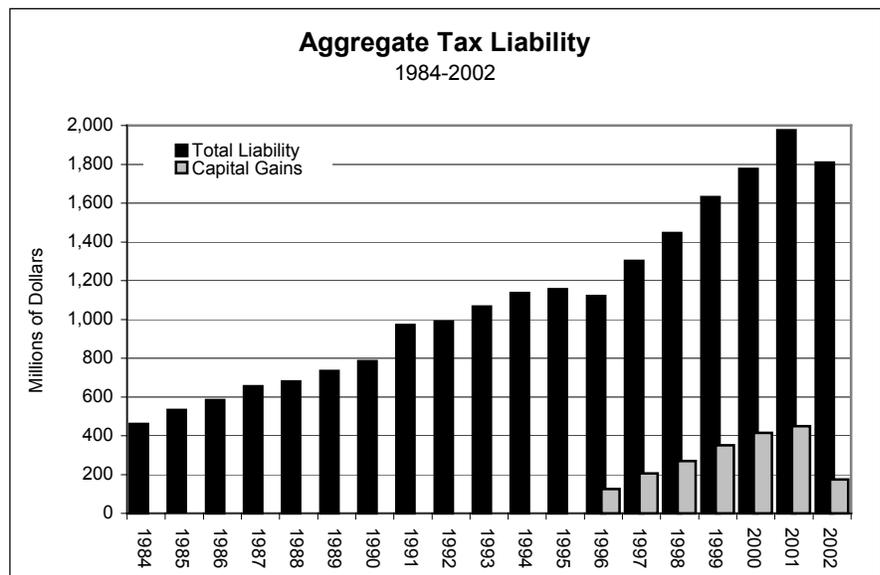
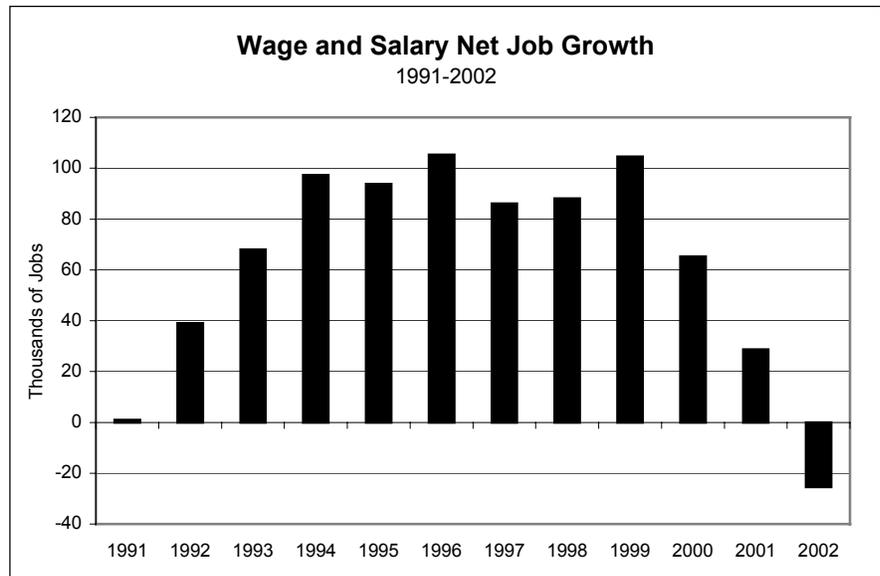
The risks that apply to this scenario are similar to those outlined for the national economy. Arizona’s strong reliance on the electronics manufacturing industry exposes it to dependence on the pace of business investment in IT products and services. Clearly, this de-

pendence worked to the state’s advantage in the late 1990s, but more recently it has exacerbated the downturn in this cycle. In addition, Arizona’s dependence on the hospitality and construction industries exposes its economy to shocks in consumer confidence.

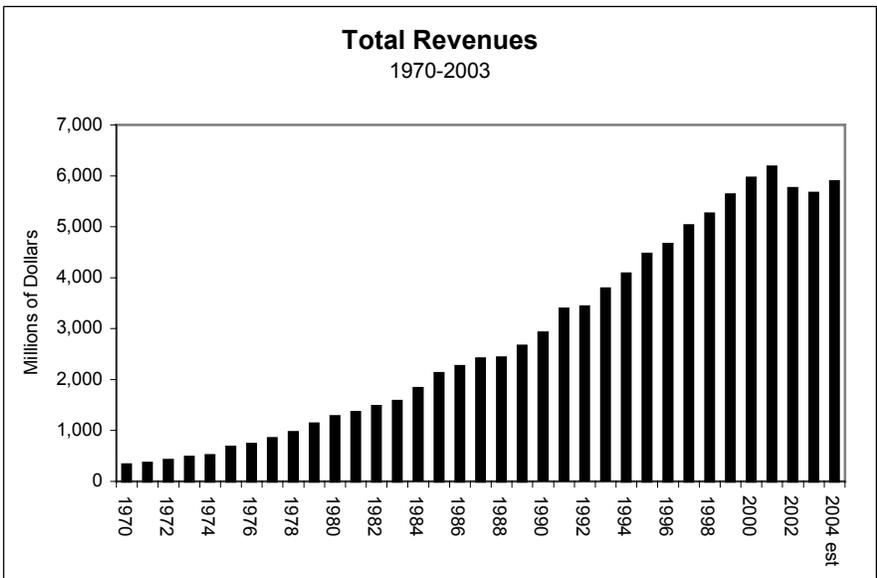
A significant wild card is the influence of capital gains income and the pace of corporate profits and corresponding equity valuation on Arizona’s economy. Clearly, the health of such corporations as Honeywell, American Express, Motorola, Bank One, Intel, etc., is linked to their ability to expand, hire and pay significant wages/salaries and bonuses to their employees. The pace of corporate profits, as reported in public

documents, is clearly related to the flow of corporate income tax collections, but it is also key to Arizona’s personal income growth and employment rates. Further, growth in capital gains income serves as a very significant component of overall taxable income growth.

The table at the bottom of this page depicts the growth in aggregate liability (overall annual tax bills) owed by resident filers and the share of the liability attributable to capital gains in the late 1990s. Much of the annual increase in income tax collections may have come directly as a windfall from Wall Street. Of course, nearly all the appreciation in capital gains income forthcoming from Wall Street since 1995 has been “un-



Total Revenues
1970-2003



done” in the decline of equity prices – with few prospects for a repeat performance in the near future.

Real estate

The real estate industry has served Arizona well during the recent economic tempest. The single-family housing market has remained reasonably strong, and the commercial market, while softening recently, has remained quite solid for this stage of the business cycle, as reported by Elliot Pollack in his *Real Estate Forecast* address at the December 2002 forecast luncheon.

The key clearly is a very favorable interest rate climate coupled with a less than attractive equity market. Real estate has served as a haven for individuals looking for real rather than financial market investments. Moreover, low interest rates have boosted affordability indexes and lifted the net rate of return to investors in commercial properties.

As interest rates rise, these factors will tend to reverse, but significant interest rate appreciation will occur only as the national economy reverts to long-term growth. Demographic and employment-based stimuli for the real estate market will replace the current climate of favorable interest rates.

It is certainly conceivable that the pace of growth in the real estate market will abate from the high levels of recent

years. At the same time, we may not see our customary surge in real estate demand as the economy recovers, since the market never dipped to low levels typically observed in recessions.

Revenue forecasts

States across the nation have been rocked by the current downturn, and most state governments are experiencing woes similar to Arizona’s. That is not a coincidence, for at least two reasons.

States share more or less equally in national prosperity, just as they are vulnerable to nationwide downturns.

When, just a few years ago, unexpected revenue windfalls and huge budget surpluses seemed to be a permanent condition, many state legislatures – like Arizona’s – significantly cut their tax bases. As the windfall petered out, so has the pace of state revenue collections.

In Arizona, General Fund revenue flow is dominated by individual income tax and sales tax collections, with corporate income taxes accounting for less than 10% even in robust years. The chart above illustrates the unprecedented decline in Arizona General Fund collections observed in the last several years.

For Arizona, the “perfect storm” of equity price declines, sharp drops in electronics manufacturing, and the de-

cline of the hospitality and travel industry following the 9/11 attacks, translated into significant erosion of the tax base. State General Fund revenues will display very slow growth for FY 2003 and only modest growth in FY 2004

Sales and use tax. Sales tax growth approached double digits annually in the late 1990s as Arizona’s economy boomed along with the electronics manufacturing industry and the equity markets. As electronics manufacturing declined rapidly in recent years, so did the rate of increase in retail spending.

Projections for FY 2003 call for only slight increases, with rates of increase in FY 2004 modest but well below historical averages. A return to 3%+ inflation would act as a catalyst for additional growth while there exists a risk of additional consumer confidence erosion, as discussed in the national review. Geopolitical shocks could result in even slower growth than is projected.

The key to sales and use growth will be the pace of the national recovery. The GLOBAL INSIGHT scenario will result in more travel, greater disposable incomes, and resilience of consumer confidence that will sustain purchases of consumer durables. The risks to this upbeat scenario are clear and outlined in the national review above.

General Fund Revenue Sources

Sales and Use Tax.....	50%
Individual Income Tax	38%
Corporate Income Tax.....	6%
All Other Taxes.....	6%

Individual income taxes. Collections of individual income taxes have slipped due to lower inflation, erosion of the employment base and, most important, the loss of capital gains income that fueled the growth of the late 1990’s.

Essentially, all of the gains attributable to the equity market appreciation of the late 1990s have unwound. Recent and projected individual income tax collections appear in the top chart on the next page.

Growth is projected to recover somewhat in FY 2004, but a return to double-digit growth is highly unlikely even if the equity markets recover, since taxpayers will credit any new capital gains against the capital losses they have

already realized. Indeed, capital losses and the absence of bonus income (commensurate to that received in the late 1990s) will act as a “drag” on individual income tax collections for some time to come. For perspective, total individual

income tax collections in FY 2004 will not match collections in either FY 2000 or 2001. Without significant Wall Street recovery, it may take another two years to return to those collection levels.

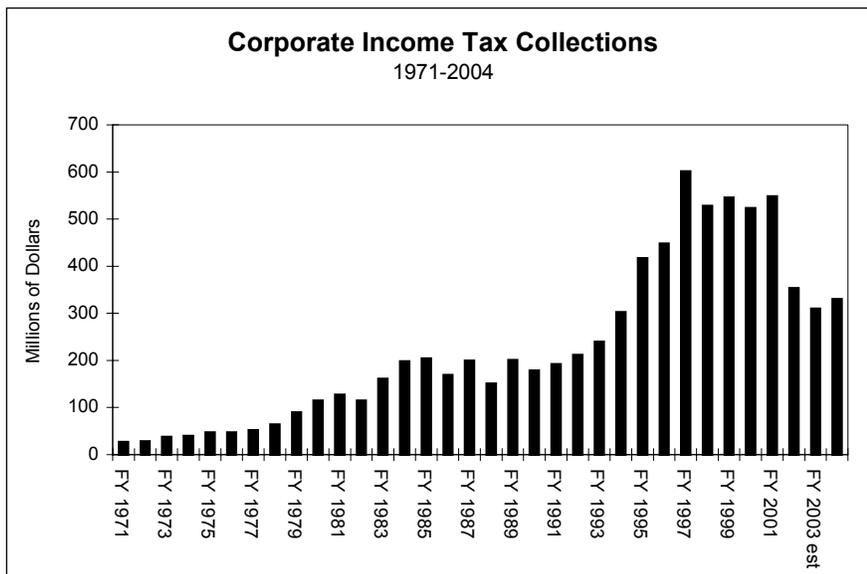
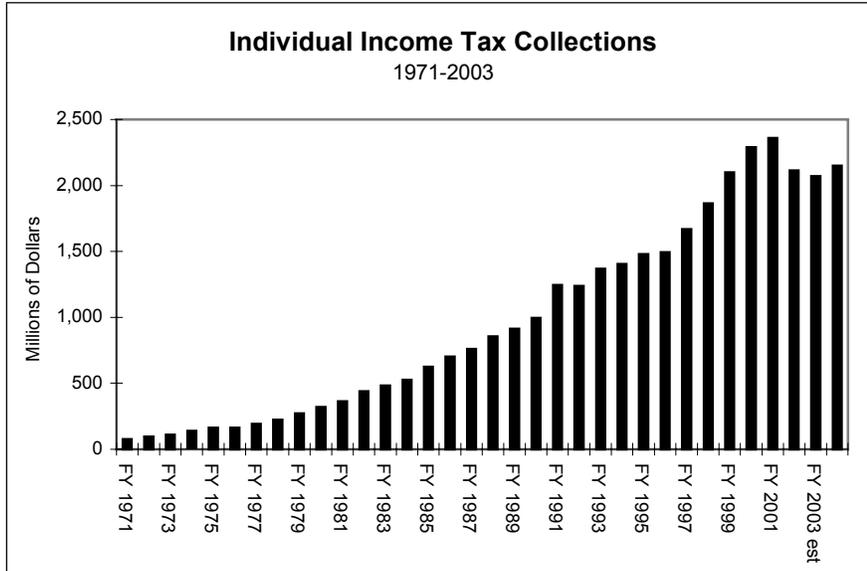
Finally, as the federal government modifies the tax code and the definition of Federal Adjusted Gross Income, the flow of State individual income taxes will be affected unless the Legislature takes offsetting action.

The flow of individual income tax collections is extremely volatile at this juncture. As of tax year 2000, 2% of Arizona taxpayers earning \$200,000 or more pay over 37% of total Arizona income taxes, and that the 8.5% of taxpayers earning \$100,000 or more pay about 56% of total Arizona income taxes.

The problem with this scenario is *not* the progressive nature of the Tax Code, but that these incomes have proven highly volatile (driven by bonus and capital gains income) so that significant individual income tax collections come from highly volatile sources.

Corporate income taxes. The flow of corporate income tax collections has declined sharply (about 50%) from its peak in FY 1997. A review of income statements produced by publicly traded corporations that have a strong presence in Arizona (e.g., Honeywell, American Express, Motorola, Bank One and Intel) reveals that corporate taxable income declined dramatically in the last several years and is unlikely to improve in the immediate future. Indeed, it may take several years of vibrant growth for the flow of corporate income taxes to approach that of late 1990s.

General Fund summary. A summary of recent and projected General Fund revenues appears in the table below. The rate of growth displayed in these totals is anemic by any historical standards and reflects the reliance on a highly volatile tax base dependent on economic factors largely outside the control of State policymakers. With the current General Fund tax structure, the pace of revenue flow will clearly be whipsawed by the swings in some of the most volatile components of the national economy. ■



Recent and Projected General Fund Revenues
Millions of Dollars

	FY 2002	FY 2003 Est.	FY 2004 Est.
Individual Income Tax	2,113.2	2,070.0	2,150.0
Corporate Income Tax	353.0	310.0	330.0
Sales and Use Tax	3,001.0	3,010.0	3,150.0
All Other	292.9	460.8	259.6
Total	5,760.1	5,850.8	5,889.6

The Plan for Balancing the Budget: FY 2003 – FY 2004

Resolving the State's budget crisis requires a number of Temporary Fiscal Measures

	FY 2003	FY 2004
Balance Forward	(\$ 309,500,000)	(\$ 967,000,000)
<i>Temporary Fiscal Measures:</i>		
A. Fiscal Year End Transfer	50,000,000	
B. Fiscal Year End Transfer-School Facilities Board	40,000,000	
C. AHCCCS Building Refinance		12,000,000
D. Tax Amnesty Program		25,000,000
E. Asset Sale - Veteran's Coliseum		5,000,000
F. Asset Sale - Black Canyon Building	900,000	
G. Continuing Appropriations General Fund Revertments	10,000,000	
H. Agency Consolidations & Efficiencies		30,000,000
I. DOR Revenue Generating Proposals	6,700,000	52,500,000
J. Maximizing Federal Funding Opportunities		25,000,000
K. Highway Expansion & Extension Loan Program	20,000,000	
L. K-12 Rollover-Additional 1/2 Month		95,500,000
M. Ladewig Settlement	60,000,000	
N. School Facilities Board Revenue Bonding	100,000,000	(38,900,000)
O. Judicial Collections Proposal		50,000,000
P. School Facilities Board Lease-Purchase 15-Year Wrap		16,000,000
Q. Proposition 303 Proceeds	19,200,000	31,100,000
R. Assessed Valuation Growth		20,000,000
S. Dept. of Transportation Funding Shift		134,000,000
T. Removal of Medicaid Special Exemption		50,000,000
U. K-8 Qualifying Tax Rate Equity		13,000,000
V. Sale & Lease-back of State Owned Aircraft		4,100,000
W. Asset Sale & Lease-back		250,000,000
X. Lottery Revenue Anticipation Financing		75,000,000
Y. Other Fund Operating Reduction	10,000,000	
Z. Capital Budget Fund Shift	900,000	500,000
AA. State-County Corrections Partnership		14,700,000
AB. General Fund Operating Budget and Fund Reductions (FY 2003-only fund reduction)	53,000,000	104,900,000
<i>Total Reductions</i>	\$ 370,700,000	\$ 969,400,000
Ending Balance	\$ 61,200,000	\$ 2,400,000

A. Fiscal Year-End Transfer

Description: Permits the balances associated with continuing appropriations (i.e., appropriations that do not lapse at the end of a fiscal year) to be counted in the fiscal year-end General Fund balance.

Discussion:

- No monies are being taken away from any agency; the funds are simply being counted as part of the ending balance at midnight, June 30, 2003. They will be immediately available July 1, 2003.
- This was the practice in Arizona State Government in the 1980s and 1990s and was utilized as recently as 1996.

General Fund impact: \$50 million (FY 2003)

B. Fiscal Year-End Transfer: School Facilities Board

Description: Similar to the more general “Fiscal Year-End Transfer” discussed above, this permits the balances associated with the unspent appropriation in the New School Facilities Fund of the School Facilities Board to be counted in the fiscal year-end General Fund balance.

Discussion:

- Just as in the case of the general Fiscal Year-End Transfer, the unspent funds from the appropriations to the School Facilities Board do not now count in the General Fund ending balance. To the extent that this level of fund balance is constant from year to year, these funds represent a continuing financial resource to State government.
- In times of fiscal stress, it is acceptable for the State to follow what was once standard practice and count these funds in the ending balance.
- As with the more general provision described in Measure A (*above*), once the period of fiscal stress has passed, this provision could be reversed.
- The School Facilities Board staff projects an ending balance of \$56 million in the new School Facilities Fund.

General Fund impact: \$40 million (FY 2003)

C. AHCCCS Building Refinancing

Description: Extend the term of the financing and withdraw the State’s equity in the buildings at 701 and 801 E. Jefferson St. in Phoenix, which are being acquired through a lease-purchase transaction.

Discussion:

- This proposal is essentially the same as selling and leasing back State assets, or purchasing new office space on a lease-purchase or lease-to-own basis.
- In times of fiscal stress, extracting the accumulated equity in State assets is preferable to the alternatives of raising taxes or reducing programs.
- Interest rates for refinancing are currently quite favorable.

General Fund impact: \$12 million (FY 2004)

D. Tax Amnesty Program

Description: A limited one-time tax amnesty for taxpayers who have failed to file their taxes. The program will waive penalties, but not interest, and will be accompanied by enhanced enforcement efforts described below.

Discussion:

- The incentives for taxpayers to take advantage of this opportunity would be the waiving of penalties and the knowledge that substantial additional State resources will be devoted to discovering them in the near future.
- The program is a relatively low-cost method to identify taxpayers that have failed to file with the Department of Revenue, thus increasing revenues in a time when the revenues are needed most.

General Fund impact: \$25 million (FY 2004)

E. Asset Sale: Veterans Memorial Coliseum

Discussion:

- The Coliseum and State Fairgrounds have traditionally lost money.
- These facilities are not competitive with newer venues such as Bank One Ballpark and America West Arena and have difficulty attracting events.
- There is no permanent tenant.
- It is anticipated that the fairground property could be converted to retail, warehousing and low-income housing.

General Fund impact: \$5 million (FY 2004) net of demolition and transaction costs.

F. Asset Sale: Black Canyon Building

Discussion and Discussion: With the addition of new office space on the Capitol Mall, the Black Canyon building is no longer needed.

General Fund impact: \$900,000 (FY 2003)

G. Continuing Appropriations: General Fund Reversions

Description: Cancel or ex-appropriate certain open appropriations that the Legislature originally enacted as non-lapsing appropriations.

Discussion:

- As of September 2002, the State had almost \$27 million in this category, some dating back to 1991.
- Of this amount, approximately \$13 million is attributable to appropriations made for years prior to fiscal year 2002.
- The purposes of many of these appropriations have been realized, and the balances can therefore be returned to the General Fund.

General Fund impact: \$10 million (FY 2003)

H. Agency Consolidations and Efficiencies

Description: Consolidate the administrative functions of 90/10 regulatory boards (as well as some other agencies) into one service agency that serves all of the boards. The boards are actually retained, but the processing of licenses and other administrative activities are centralized.

Discussion:

- Legislation was introduced to this effect in 2002.
- Consolidating many small entities would inevitably lead to economies of scale in administrative costs.
- The ending fund balances of only the agencies included in the above-referenced legislation exceeded \$30 million; thus, at least that amount of "excess

cash" exists in these agencies' ending balances for FY 2004. Consolidation of these and other agencies could increase that amount through efficiencies in future fiscal years.

General Fund impact: \$30 million (FY 2004)

I. DOR Revenue Generating Proposals

Description: In addition to, but in concert with, the Tax Amnesty Program discussed in ITEM D above, this proposal involves a significant enhancement to the Department of Revenue's enforcement programs (i.e., auditors and collectors).

Discussion:

- This type of staff has been proven to bring in more in revenues than it costs to pay them.
- Reductions to DOR's budget during times of fiscal stress are shortsighted. With the recent budget reductions and hiring freezes, DOR has been forced to divert staff from revenue-generating activities to maintaining basic production and customer-related activities. As a result, revenue collection suffers, as do basic customer service activities, including income tax refund processing.
- This proposal will restore funding to allow existing staff to return to revenue-producing job functions.
- The presence of additional revenue-producing staff will provide additional incentive for some taxpayers to participate in the Tax Amnesty Program.

General Fund impact: \$6.7 million (FY 2003) and **\$52.5 million** (FY 2004), both net of costs (\$4.3 million in FY 2003 and \$8.3 million in FY 2004).

J. Maximizing Federal Funding Opportunities

Description: Replace State-funded State expenditures that could be paid with federal funds.

Discussion:

- The State receives and expends approximately \$4 billion in federal funds annually, making up approximately 25% of the State's total fund expenditures.
- For some programs, particularly Medicaid and various children's programs, the rules and opportunities for drawing down federal funds are ambiguous and confusing.
- Other states have recognized this fact and have hired consultants to review (in conjunction with the existing staff) programs for opportunities to identify additional federal funds.

General Fund impact: \$25 million (FY 2004)

K. Revertment from the Highway Expansion and Extension Loan Program (HELP)

Description: HELP would repay a \$20 million General Fund appropriation. This loan fund has utilized a combination of Highway Fund, General Fund and federal monies and State Transportation Board Funding Obligations to capitalize a State Infrastructure Bank (SIB). The program allows local communities to borrow funds to be used in approved transportation projects. As the communities repay the loans, the funds are redeposited in the HELP fund to be reloaned for additional projects.

Discussion:

- The HELP Fund was originally capitalized with \$20 million from the General Fund.
- As of November 2002 the Fund had a balance of over \$112 million.
- ADOT reports that repayment of the General Fund appropriation will not severely hinder the program's ability to manage its projects.

General Fund impact: \$20 million (FY 2003)

L. K-12 Rollover: Additional Half Month

Description: Increase the amount of the "K-12 Rollover" from one month's Basic State Aid payment (\$191 million) to one and a half month's payment. The increase of the one half month would save the State expenditures of approximately \$95 million during the FY.

For FY 2003, the Legislature provided that, rather than making the June 2003 Basic State Aid payment to schools, the State would delay the payment to July. This provision has two effects: First, rather than 12 payments to schools in FY 2003, the State would make only 11; second, the State would move \$191 million of expenditures that would otherwise count against FY 2003 resources to count against FY 2004 resources. Without an additional change to the law, the FY 2004 budget will be required to provide not only the normal 12 months of State aid to the schools, but it would also have to repay the one month shifted from FY 2003 to 2004. In essence, the budget would have to provide 13 monthly payments to the schools if the State had the funds available to repay the original rollover amount.

The recommendation is to again revise the law, and rather than provide 13 payments to the schools, provide 11½ payments. By deferring an additional one half (or \$95 million) payment to the schools, the General Fund expenditures for FY 2004 will be reduced.

Discussion:

- The impact of this financing technique on the school districts is minimal. If school districts do not have the cash in their operating budgets to get through the one and one-half months that Basic State Aid is deferred, they can register warrants with their servicing bank.

- For the FY 2003 rollover of \$191 million, the Legislature provided less than \$300,000 in funds to pay the interest costs of the districts. It is estimated that the total interest cost for the combined month and one-half in FY 2004 would be less than \$1.1 million.

General Fund impact: \$95.5 million (FY 2004)

M. Ladewig Settlement

Description: The Legislature has appropriated \$75 million in the FY 2003 budget to provide for payments under the *Ladewig v. State of Arizona* lawsuit. These funds will be used to pay \$15.5 million in administration and attorney fees. The balance of the funds were to be reserved and used to make a portion of the \$155 million FY 2005 payment that is due between July and September 2004. Therefore, the \$59.5 million that is not needed until FY 2005 can be reverted to the General Fund in FY 2003.

Discussion:

- While it is commendable that the State has begun to set aside funds to pay the settlement costs, given the current fiscal situation this \$59.5 million set-aside should be redesignated as one of the Temporary Fiscal Measures required to balance the budget.
- The Executive Budget contains a recommendation of an additional \$15.5 million for FY 2004 to continue to pay for ongoing administrative and attorney fees related to the *Ladewig* case.

General Fund impact: \$60 million (FY 2003)

N. School Facilities Board Revenue Bonding

Description: Provides \$280 million of additional funds to complete the School Facilities Board's Deficiencies Correction Program and provides the General Fund with \$100 million of additional resources in FY 2003 through a total of \$380 million of revenue bonding. The income stream backing these instruments comes from the State Land Trust, and \$38.9 million in debt service is required in FY 2004. Since State Land Trust proceeds are used to fund the State Aid to Education program, the \$38.9 million from the Trust used to service debt must be replaced in FY 2004 with General Fund monies.

Discussion:

- The School Facilities Board's Deficiencies Correction Program is short \$280 million; if funds are not provided, the program will have to suspend the awarding of contracts.
- If the Deficiencies Correction Program is suspended, the State's case over the amount appropriated for building renewal will be seriously compromised.
- Since the General Fund does not have the means to provide the \$280 million, authority should be

granted to bond against the revenues earmarked for education from the State Land Trust.

General Fund impact: \$100 million (FY 2003) and \$38.9 million in additional spending for debt service (FY 2004)

O. Judicial Collections Proposal

Description: The Judicial Branch has recommended a revenue generation plan to increase collections of court-imposed penalties, fines and surcharges. This program is modeled after other offset programs that withhold, for example, income tax refunds for certain types of debt owed.

Discussion:

- Additional monies could be generated and devoted to the General Fund through requiring all eligible agencies to participate in the already authorized debt-setoff program through the Department of Revenue; enforcement of the ADOT vehicle registration suspension program; and development of a centralized traffic ticket/citation processing and collection center.
- Revenues currently derived from the setoff programs involved would continue to go to the victims of certain crimes and existing statutory purposes.
- The first \$50 million in incremental revenues from this enhanced enforcement would be directed to the General Fund in FY 2004.

General Fund impact: \$50 million (FY 2004)

P. School Facilities Board Lease-Purchase 15-Year Wrap

Description: The School Facilities Board is presently authorized to enter into a \$400 million lease-purchase arrangement for new school construction. To minimize costs in FY 2004, the new issue would be made for a 15-year term and would wrap around existing State debt.

Discussion:

- This financing approach will provide a more level debt service requirement.
- It will also reduce the originally estimated debt service costs for FY 2004 from \$68 million to \$52 million.

General Fund impact: \$16 million (FY 2004)

Q. Proposition 303 Proceeds

Description: Arizona voters recently passed Proposition 303, raising the Tobacco Tax by \$0.60 per package. While the proceeds from this tax are to be used for certain health-related programs, not all of these programs are currently using their full allotments. Therefore, a certain amount of the proceeds can be used to balance the General Fund budget.

Discussion:

- As a Temporary Fiscal Measure, until these funds are fully utilized by the designated programs, it is reasonable to use them to balance the budget.
- There is no prohibition in Proposition 303 on supplanting existing General Fund monies with Tobacco Tax proceeds.

General Fund impact: \$19.2 million (FY 2003) and \$31.1 million (FY 2004)

R. Assessed Valuation Growth

Description: Currently, State law requires a yearly reduction in the local school district property tax rate sufficient to offset the growth in revenues caused by the growth in assessed valuation. The General Fund reimburses school districts for their reduction in revenues. This Temporary Fiscal Measure would suspend that statutory provision.

Discussion:

- The basic agreement reached when the original school finance formula was crafted, i.e., that the local taxpayers would contribute to the funding of their schools, is compromised somewhat by this provision of law. That level of funding was to be determined by the application of a "qualifying tax rate" to the value of the property within the school district.
- In these times of fiscal stress, automatic tax reductions should be temporarily suspended.

General Fund impact: \$20 million (FY 2004)

S. Department of Transportation Funding Shift

Description: For FY 2004, ADOT has presented a plan to:

- reduce its use of the Vehicle License Tax (VLT) by \$128 million; and
- maintain the current law splitting the Flight Property Tax equally between the Aviation Fund and General Fund, thereby increasing the amount of revenues to the General Fund by approximately \$6 million.

Discussion:

- Transferring Aviation Fund monies to the General Fund can be accomplished by a legislative change. Precedent for this approach exists in that, in recent

years, the Flight Property Tax (a large source of funds for the Aviation Fund) has been partially diverted to the General Fund.

- Making these operating budget cuts and fund transfers will have virtually no impact on the completion of the Five-Year Transportation Facilities Construction Program, which includes the Maricopa Regional freeway System.
- ADOT's plan will permit operating budget savings to be realized over the next five years to be used to offset any impact the \$128 million VLT transfer may have on ADOT's capital construction program.

General Fund impact: \$134 million (FY 2004)

T. Removal of the Medicaid Special Exemption

Description: Remove the special exemption from the State's insurance premium tax that has been granted to Medicaid health plans. Currently, State statutes provide for a 2% tax on the premiums collected by all health insurers, HMOs and other providers of health insurance. Medicaid health plans are specifically exempted.

Discussion:

- Several states, including Minnesota, Tennessee and Nevada, impose insurance premium taxes on Medicaid health plans.
- Because of the matching arrangement with the federal government for the operating costs of the program, the imposition of the tax is, in essence, nothing more than a transfer of federal funds to the State.
- The federal government has indicated that removal of this exemption is permissible under federal law.
- No Arizona taxpayer will be adversely effected.

General Fund impact: \$50 million (FY 2004)

U. K-8 Qualifying Tax Rate Equity

Description: Realign the allocation of the Qualifying Tax Rate (QTR) between grades K-8 and 9-12 to better reflect the distribution of students.

Discussion:

- The current QTR is split 50/50 between grades K-8 and 9-12. However, more than 70% of students are in grades K-8.
- The current allocation has the effect of overpaying Basic State Aid to some districts and underpaying Basic State Aid to others.

General Fund impact: \$13 million (FY 2004)

V. Sale and Leaseback of State-Owned Aircraft

Description: Sell and leaseback eight DPS aircraft: four helicopters and four-fixed wing aircraft.

Discussion:

- It is often less expensive to rent aircraft on an as-needed basis than to have them constantly available.
- The Corporation Commission used this approach in the 1990s.

General Fund impact: \$4.1 million in FY 2004 (\$2.8 million to the General Fund and \$1.3 million deposited in RICO accounts to offset General Fund or Highway Patrol Fund expenditures)

W. Asset Sale and Leaseback

Description: Sell and leaseback \$250 million of State assets. The assets being sold are essential public facilities and are therefore being recommended for sale/leaseback rather than a straight sale. The sale will be structured to permit the State to reacquire ownership in 10 years. It is estimated that the first \$24 million debt payment would be due early in FY 2005. The total cost of financing is estimated to be approximately \$42 million.

Discussion:

- In times of fiscal stress, extracting the accumulated equity in State assets is a better short-term remedy than the alternatives of raising taxes or reducing programs.
- Proceeds from the recommended transactions would be used for deficit elimination, not to expand programs or fund tax cuts.
- Interest rates are quite favorable in this market.

General Fund impact: \$250 million (FY 2004)

X. Lottery Revenue Anticipation Financing

Description: Issue revenue bonds pledging Lottery proceeds for the next 10 years that would otherwise go to the General Fund.

Discussion:

- As a Temporary Fiscal Measure, pledging this revenue stream to balance the General Fund budget for FY 2004 is a better short-term remedy than a tax increase or a significant reduction in government services.
- The Lottery revenues that are pledged represent a conservative estimate of those monies that would flow into the General Fund; no Lottery revenues that support other programs are affected.
- The current interest rate environment makes this a relatively attractive time to initiate this type of financing.

General Fund impact: \$75 million (FY 2004)

Y. Other Fund Operating Budget Reductions

Description: As the result of a line-item veto, the Department of Transportation did not undergo a budget reduction during the 6th Special Session. ADOT has presented its own budget reduction plan that includes \$10 million in non-General Fund reductions. These monies will be used to supplant General Fund monies currently being used by other agencies.

Discussion:

- While HURF monies can be used only for roadway purposes, it is permissible to transfer HURF revenues to another agency, such as the Department of Public Safety, thereby supplanting General Fund monies.
- This is a common practice that has been used to help balance the General Fund.

General Fund impact: **\$10 million** (FY 2003)

Z. Capital Budget Fund Shift

Description and Discussion: The State has no General Fund Capital Outlay program for FY 2004. Some shifts have been made that reduce the amount of General Funds used for capital outlay purposes in both FY 2003 and FY 2004.

General Fund impact: **\$900,000** (FY 2003) and **\$500,000** (FY 2004)

AA. State-County Corrections Partnership

Description: Identify approximately 2,000 non-violent inmates in the Department of Corrections system and transfer them to the custody of Maricopa County.

Discussion: Maricopa County would be paid by the State for taking these prisoners; however, the rate paid to the County would result in a savings in General Fund revenues.

General Fund impact: **\$14.7 million** (FY 2004)

AB. General Fund Operating Budget and Fund Reductions

Description: For FY 2003, this represents transferring balances in State special funds that are expended annually to fulfill the agency's statutory obligations. At the present time, these fund balances have no contractual or financial encumbrances, but in many cases would be expended during the course of the fiscal year to meet the agency's objectives (\$53 million).

For FY 2004, this category represents a collection of:

- shifting some agencies from General Fund support to being funded by user fees (\$15.9 million);
- program eliminations, partial freezes, or consolidations (\$33.9 million); and
- transferring balances in State special funds that are expended annually to fulfill the agency's statutory obligations. At the present time, these fund balances have no contractual or financial encumbrances, but in many cases would be expended during the course of the fiscal year to meet the agency's objectives (\$55.1 million).

Discussion:

- Having the users of services pay for those services is a basic economic principle that applies to both the public and private sectors.
- Shifting the administrative and enforcement costs of regulating certain industries to the regulated entity is a long-standing practice in government. In Arizona, the Corporation Commission is a prime example.
- In the sessions prior to the 6th Special Session, over \$90 million in fund reductions or transfers were implemented.
- These fund reductions and transfers will reduce reliance on the General Fund.

General Fund impact: **\$53 million** (FY 2003) and **\$104.9 million** (FY 2004)

Promises to Keep: Preserving Arizona Schools

Budget crises have short lives, but underfunded education afflicts society for decades

COMMITMENT TO K-12 EDUCATION dominates the Governor's agenda. Her pledge to protect education spending, focus on student achievement – especially in strengthening literacy – and ensure accountability in the form of adequate academic progress, provides the theme for her education policy.

In striving for educational excellence, the Executive Budget Recommendation provides for statutory per-pupil funding, including inflationary increases, for all K-12 formula programs.

Funding for K-12 education programs remains virtually intact despite the State's fiscal crisis. In fact, the K-12 education system is one of the few policy areas targeted for increased financial resources over the next fiscal year.

The Governor's recommendation provides for \$367 million in new General Fund monies for K-12 schools in FY 2004. This increase consists of:

- \$343.2 million in Basic State Aid, which includes the 2% inflation factor as required by Proposition 301 and \$191 million rolled over from FY 2003;
- \$22.3 million in other formula programs; and
- \$1.5 million for the State's Achievement Testing program.

Basic State Aid

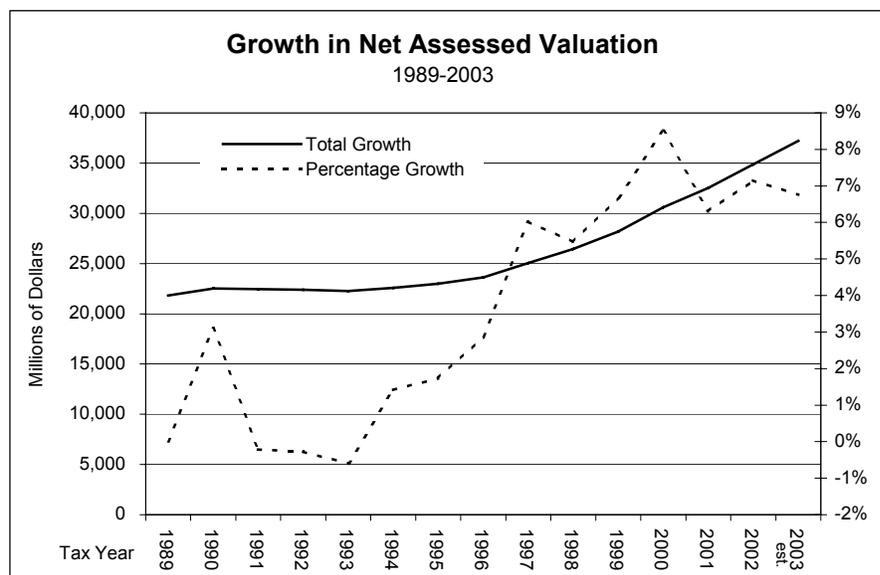
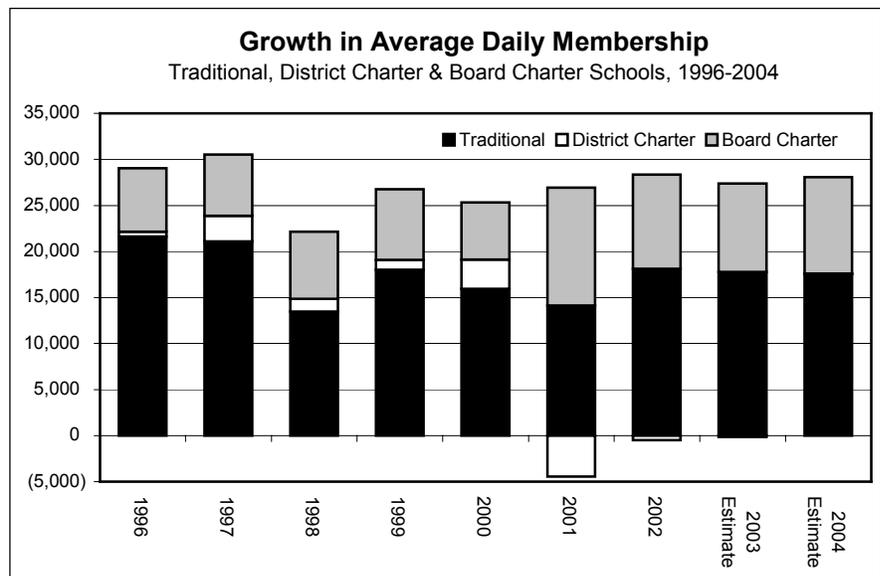
The largest formula-funding program for K-12 education, Basic State Aid provides financial assistance to school districts and charter schools for their maintenance and operations and "soft" capital needs.¹ The recommendation is based on the following growth assumptions in FY 2004:

¹ "Soft" capital funding can be used only for short-term capital items, such as technology, textbooks, library resources, instructional aids, pupil transportation vehicles, furniture and equipment.

- 3.1% growth in new students;
- 2.1% growth in traditional district students;
- 15% growth in charter students;
- 6.75% increase for net assessed valuations; and
- 2% inflationary growth for per-pupil maintenance and operations funding.

In FY 2004, the Executive recommendation of \$343.2 million fully funds student growth in traditional and charter schools. The overall district student growth is expected to rise by 17,533 students, and combined board- and district-sponsored charters are projected to increase by 10,550 students.

For school districts, the primary net



assessed valuation growth is estimated at 6.75% and is expected to yield approximately \$71.3 million through local property tax levies and \$8.3 million in county equalization assistance, both of which offset the State cost. The increased valuations are based on appreciation due to new and existing properties.

Other Statutory Programs

The Executive recommendation also includes \$19 million for the Additional State Aid program, which provides relief to residential property owners toward the local obligation for funding public schools, and \$3.3 million for additional resources to special education programs.

Achievement testing

As prescribed by law, the Arizona’s Instrument to Measure Standards (AIMS) tests are used to assess student achievement of State academic standards. State law requires AIMS testing in grades 3, 5, 8 and 12 to evaluate proficiency in reading, writing and mathematics. For 12th graders, the AIMS test serves as a prerequisite for graduation.

All public schools, including charter schools, are mandated to participate in the AIMS testing process. The Executive recommends \$1.5 million in FY 2004 for cost increases related to growth and continued enhancements.

FY 2003 supplemental

The Executive budget recommendation includes a supplemental for formula program shortfalls in FY 2003. Due to greater than expected student growth, the Executive recommends \$4.7 million in additional resources for the Basic State Aid program, \$4 million for Additional State Aid due to increased local tax rates, and \$437,900 for special education voucher funding.

Proposition 301

In its first year, Proposition 301 generated \$313.2 million in additional resources for K-12 public schools. Of this amount, \$251.5 million was distributed directly to the classroom in the way of teacher base salary adjustments, per-

formance pay, and supplemental funding for maintenance and operations funding. (See chart below.)

Charter school oversight

The Executive recommends shifting the sponsorship responsibilities of the State Board of Education for Charter Schools to the State Board for Charter Schools.

Since the inception of the charter movement, many have questioned the general accountability of Arizona’s charter schools. Part of the public’s confusion rests on the different operational policies adopted by the three sponsoring entities.

Although there have been attempts at coordination between the State Board for Charter Schools and the State Board of Education, there still appears to be a disconnect between the Boards. The State Board of Charter Schools counts charter oversight as its “core business,” while the State Board of Education has been more focused on broader education policies than on specific management of charter school issues.

Originally, having multiple sponsoring entities was intended to provide choice and to promote the charter school movement. Now that the charter school system is firmly in place and growing by leaps and bounds, the need for multiple sponsorship options is not as crucial. Shifting sponsorship from the State Board of Education to the State Board

for Charter Schools will:

- eliminate dual sponsorship,
- promote consistency in policies,
- provide one point of referral,
- enhance oversight, and
- result in General Fund savings.

The Executive recommends consolidating (a) the State Board of Education for Charter Schools and (b) the Charter Schools Administration Division in the Department of Education and integrating them into the State Board for Charter Schools.

The savings associated with this consolidation include a reduction of 3.0 FTE positions and \$150,000.

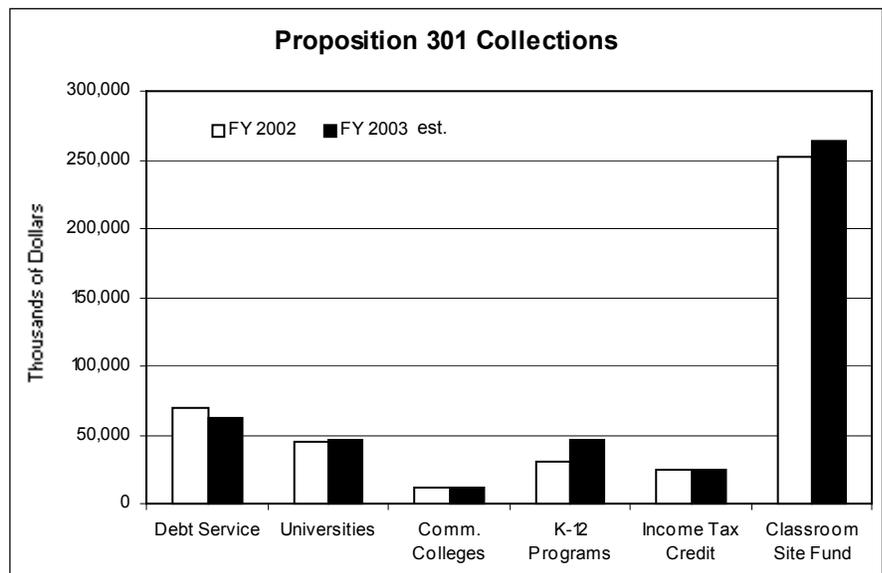
Half-month rollover

The delay in the payment of the final month(s) apportionment of Basic State Aid and additional State aid to school districts from one fiscal year to the next fiscal year is commonly referred to as the “K-12 Rollover.”

The delay in the payment of State aid moves payment from one fiscal year budget to the next. The Executive proposes adding an approximate half-month rollover - \$95.5 million - in FY 2004, over and above the FY 2003 rollover of \$191 million.

Assessed valuation

Legislation in 1998 requires the Joint Legislative Budget Committee to compute a new qualifying tax rate (QTR)



and county equalization rate each year to exclude the portion of property value appreciation that is attributable to existing properties.

Since passage of this legislation, the State has spent over \$100 million on reducing tax rates.

For the FY 2004 budget, the Executive estimates that the cost of changing the current rates is approximately \$20 million. However, due to budget shortfalls, the Executive recommends that in FY 2004 the rates be maintained at the FY 2003 levels of \$2.0296 per \$100 of assessed value for elementary and high school districts (doubled for unified districts) and \$0.4889 for the county rate.

K-8 QTR equity

The QTR is used to calculate the “local share” under the K-12 equalization funding formula. Currently, these revenues are split equally between K-8 and 9-12 grade levels. The remaining formula costs are then funded through the General Fund.

This proposal would modify the 50/50 split to 70/30 (70% of the QTR to grades K-8 and 30% to grades 9-12), to accurately reflect the breakdown of total formula costs. By changing the mix, the State aid obligation to K-8 would be reduced, since the portion of the QTR that is left unused for grades 9-12 could be shifted to cover more costs in K-8.

For FY 2004, the Executive Recommendation assumes savings of approximately \$13 million, realized from school districts with assessed valuation greater than \$250 million.

School facilities

The School Facilities Board (SFB) is charged with the administration of three capital programs: Deficiencies Corrections, New School Construction, and Building Renewal.

Under the “Students FIRST” mandate, the Board is required to improve school buildings to established minimum standards, fund construction of new facilities as needed, and ensure proper maintenance of the physical facilities of the State school system.

The Students FIRST legislation also authorizes the School Facilities Board to

request funding and receive transfers directly from the State Treasurer. However, the Executive and the Legislature must adopt budgets within the context of those transfers.

Deficiencies correction. Students FIRST requires the School Facilities Board to establish minimum facility guidelines for Arizona schools and address any deficiencies discovered by the June 30, 2004.

Funding for K-12 education programs remains virtually intact despite the State’s fiscal crisis. In fact, the K-12 education system is one of the few policy areas targeted for increased financial resources over the next fiscal year.

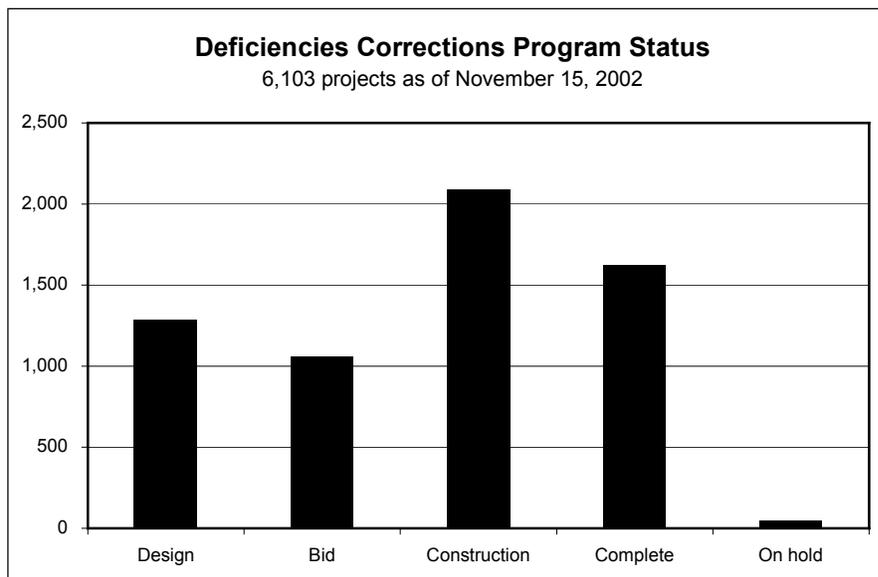
To date, the SFB has received \$1.014 billion for the deficiencies corrections program, which includes the proceeds from \$800 million in revenue bonds authorized by Proposition 301. The SFB reports that \$280 million is needed to complete the program, for a total cost of \$1.294 billion. The SFB contends that, without further expenditure authority above the \$1.014 billion, it cannot enter into contractual obligations and therefore must halt the program until funding is secured. The SFB estimates that its expenditure authority will expire by February 2003.

The Executive recommends the issuance of \$380 million in revenue bonds in FY 2003. Earnings from State trust lands will provide the funding source for the bonds. Once the proceeds of this issuance are deposited into the Deficiencies Corrections Fund, \$100 million previously appropriated from the General Fund will be transferred back to the General Fund. Since SFB reports that the program will come to a standstill by February 2003 and that further costs will be incurred because of the stoppage, the Executive strongly encourages Legislative resolution of this recommendation by the end of March 2003.

Debt service for these bonds is expected to be approximately \$38.9 million. Since the funding source dedicated to the debt service payments was previously used to offset General Fund costs for Basic State Aid, the Executive recommends a backfill of \$38.9 million in General Fund monies to the Basic State Aid program.

New school construction. In FY 2003, instead of cash financing new construction, the Legislature authorized \$400 million in lease-to-own purchase transactions (Laws 2002, 2nd Regular Session, Chapter 330).

According to the SFB, this authorization will provide for new construction program costs through mid-FY 2004 and reports that an additional \$250 million will be needed for the rest of FY 2004.



The Executive supports the concept of long-term financing for school buildings and therefore recommends the SFB's request of \$250 million in increased lease-purchase authority.

To minimize costs in FY 2004 and FY 2005 and to provide more level debt service for State budgeting purposes, the new SFB lease purchase issue will be for a 15-year term and wrap around existing State debt service. Current debt service for the State is approximately \$30 million. Straight-level 15-year debt service for the lease-purchase program will be approximately \$38 million, for a total state cost of \$68 million. Under the revised structure, total State debt service will be \$52 million and \$64 million in, respectively, FY 2004 and FY 2005, for a savings of \$16 million in FY 2004 and \$4 million in FY 2005.

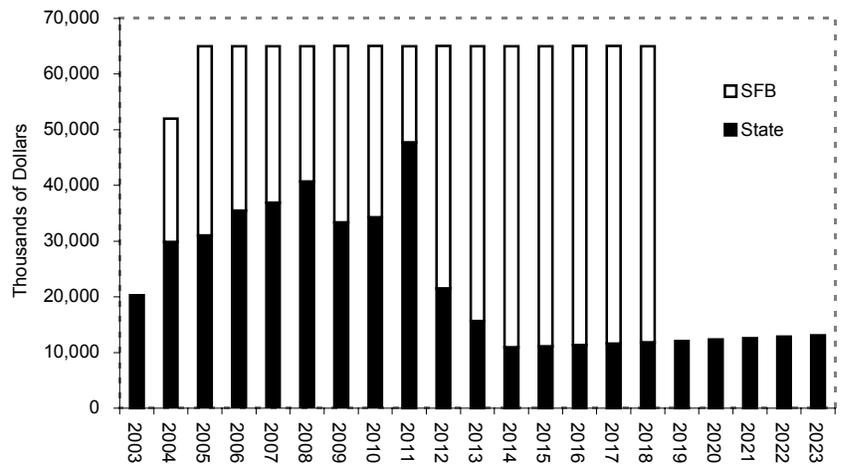
Building renewal. Students FIRST established the Building Renewal Program to ensure maintenance of existing facilities in the form of major renovations and repairs; upgrading systems and areas that will extend the useful life of the building; and infrastructure costs.

The SFB has interpreted this definition to apply to projects that are for renovations, major maintenance, life safety and code upgrades, handicapped access, asbestos abatement, and school infrastructure. Despite a Legislative suspension of the Building Renewal program in FY 2004, the Executive recommends fully funding the current building renewal formula. However, the Executive also proposes several statutory changes to the building renewal formula that will reduce the estimated FY 2004 level from \$113 million to \$78 million.

Community colleges

Arizona's community colleges provide a vital service to citizens who wish to further their education, learn new skills, or strengthen current work skills. In FY 2004, the Executive recommends an increase of \$10.7 million for Arizona's community colleges.

Aggregate State Lease Obligations
With 15-Year "Wrapped" SFB Debt



The Executive also recommends a decrease in combined operating and capital outlay aid of \$4 million due to the elimination of funding to community colleges for dual enrollment students. "Dual enrollment" refers to classes offered at high school campuses during normal operating hours and taken by high school students who receive both high school and community college credit. Both the high schools and community colleges are receiving full funding for offering these classes, even though the high schools provide the vast majority of direct services to the student.

State Board of Community Colleges. Laws 2002, Chapter 330 removed the State Board for Community Colleges' oversight over the ten community college districts. At the time of passage, the Executive expressed strong concern regarding the long-term effect of surrendering all oversight to local districts. While the Executive believes that the community college districts require a regulatory board to oversee statewide policies, an oversight board with no relevant or jurisdictional authority is merely a drain on valuable and limited state resources. Therefore, in FY 2004, the Executive recommends the elimination of the State Board of Community Colleges. All current statutory reporting and program administration require-

ments will transfer to the individual community college districts.

Universities

Higher education is the fuel for future economic growth and must not be impaired by flawed, shortsighted decisions. Despite the State's fiscal crisis, funding for the Universities not only remains intact; it grows. At a time when other states are imposing enrollment caps and laying off faculty, the Executive recommendation invests in the state's labor force and enhances Arizona's ability to compete globally for business relocation and development.

For those and other reasons, the Executive Recommendation reflects a net funding increase to the universities of \$6 million from the General Fund. The Executive budget includes an almost \$12 million increase for the traditionally appropriated 22:1 funding formula, which provides funding increases for estimated enrollment growth.

Increases in health insurance costs are addressed centrally in the Executive Recommendation and represent a further increase to university budgets. Also, the Executive recommendation for the Omnibus Reconciliation Bill "notwithstanding" A.R.S. § 15-1628(C), which otherwise would have required significant cuts in State funding for the Universities' optional retirement system. ■

Providing for the Neediest Arizonans

The needs of seriously disadvantaged citizens will not wait for the return of a healthy economy

WHILE THERE IS LITTLE DOUBT that an economic downturn hurts all sectors of society, there is also little question that the greatest pain is inflicted on our citizens who live “on the bubble” – survival in good times, desperation in bad.

State budget crises raise far more than a fiscal dilemma; they also carry with them great issues of principle and priority. It is at difficult times such as these that we are reminded that the moral measure of our society is how we treat the least among us.

In traversing the State’s budget problems, the Executive recommendation reaffirms Arizonans’ commitment to children, adults and families whose existence depends on the ability of government to provide essential and irreplaceable services.

Children

In meeting the needs of Arizona children, the Executive recommendation provides critical support in the areas of children services, child care, and adoption services.

Children Services. The recommendation for children services includes a \$21.5 million General Fund increase, including:

- \$13.8 million to replace Temporary Assistance for Needy Families (TANF) funds transferred to the Social Services Block Grant (SSBG);
- \$6.6 million to replace federal Title IV-E funds in the FY 2003 expenditure plan; and
- \$1.1 million to increase the Department’s total fund expenditure plan.

TANF transfer. One of the more complicated technical adjustments involves the transfer of TANF monies to SSBG in order to supplement funding for children services. The federal government allows states to transfer up to 10% of their TANF Block Grant to SSBG. For FY 2003, the legislature appropriated \$36.4 million of TANF funds for

this purpose, including transfers from both the FY 2002 and FY 2003 TANF Block Grants. For FY 2004, the Executive expects that the State will be able to transfer only 10% of the FY 2004 TANF Block Grant.

The Executive recommends decreasing the SSBG expenditures that result from these transfers from \$36.4 million in FY 2003 to \$22.6 million in FY 2004. There would be corresponding increases in the General Fund so that no net reduction in funding would result from decreases in the amount transferred.

Title IV-E. The recommendation would also replace \$6.6 million of federal Title IV-E monies in children services with General Fund monies. The Executive does not believe that the Department of Economic Security (DES) will serve enough Title IV-E- eligible children to draw down all of the IV-E funds in the Department’s FY 2003 expenditure plan.

Total fund expenditure plan. The Executive also recommends a \$2 million increase in the FY 2003 total fund expenditure plan to \$103.5 million. About half of that \$2 million increase will be covered with other non-appropriated funds.

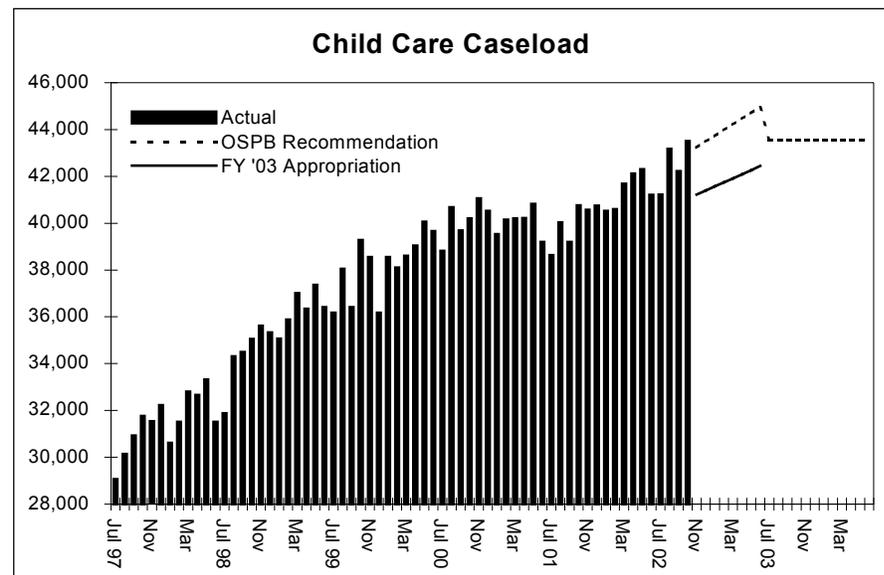
Child care caseloads. For FY 2004, the Executive recommends an increase of \$13.2 million total funds for the low-income working, TANF-related and transitional child care programs. This net total includes \$41.7 million in General Fund monies to replace TANF monies.

The FY 2004 appropriation will provide:

- 28,530 clients an average subsidy of \$286 per child per month for low income working;
- 6,210 children an average of \$261 per month for TANF-related child care; and
- 8,830 children an average of \$288 per month in the transitional child care program.

The recommendation also includes an FY 2003 supplemental appropriation of \$6 million. The Executive believes that DES will need these additional funds to cover subsidies for an average of 43,570 children.

The FY 2004 recommendation will fund the same total number of children. The increase of \$13.2 million is included to cover the FY 2003 shortfall, mandatory quality activities and a 3% increase



in rates for all three programs.

Fund shifts. The Executive also proposes some significant fund shifts for child care. In order to address the TANF Block Grant shortfall, the entire TANF appropriation for child care services would be replaced with either General Fund monies or Child Care and Development Fund (CCDF) monies. Including both child care administration and direct services costs, the recommendation includes a \$39.5 million TANF reduction, an \$11 million increase in the CCDF appropriation, and a \$41.7 million General Fund increase.

Adoption Services. For FY 2004, the recommendation includes a \$6.3 million total fund increase for adoption services, including \$4.8 million from the TANF Block Grant and \$1.5 million from the General Fund. The Executive anticipates an 11.5% caseload increase in FY 2003 and a 10.5% increase in FY 2004. The appropriation would provide services to an average of 7,224 children at a cost of \$320 per child per month from appropriated funds. The recommendation is a 29.5% increase over the \$21.4 million appropriation for FY 2003.

Assistance for families and adults

For FY 2004, the recommendation would double the appropriation for General Assistance to a total of \$4.3 million.

The recommendation includes a supplemental appropriation of \$2.1 million that would also increase the FY 2003 appropriation to \$4.3 million. When Legislators reduced the appropriation for General Assistance in FY 2003, they expected to see significant decreases in caseloads; unfortunately, average caseloads remain much higher than anticipated.

TANF shortfall. The Executive recommendation includes a number of significant changes in the appropriation for the federal Temporary Assistance for Needy Families Block Grant (TANF). The proposal includes reductions because the \$284 million appropriation for TANF is \$58 million higher than the amount of TANF funds that the Executive expects to be able to draw down from the federal government in FY 2004. The appropriation is unusually high because the State has a significant reserve balance of unspent TANF funds – about \$69 million at the end of FY 2002.

For FY 2004, the Executive is proposing net reductions totaling \$47 million, and State government would also

spend its entire TANF reserve by the end of FY 2004. The most significant TANF changes were the reductions for child care and the TANF transfer to SSBG.

The recommendation also includes a \$7.3 million reduction in the appropriation for Job Opportunities and Basic Skills (JOBS). Of that amount, \$4.4 million is DES's FY 2002 surplus. The other \$2.9 million eliminates funding for the volunteer services contract that ended on June 30, 2002. JOBS contracted with volunteer coordinators statewide to place JOBS participants in unpaid work experience.

Other funding increases. The Executive uses \$10.6 million of the TANF reductions to provide increases in funding for:

- Healthy Families,
- substance abuse treatment, and
- permanent guardianship.

Healthy Families. In FY 2003, Healthy Families was funded primarily with Tobacco Settlement funds, but DES may not receive any additional Tobacco Settlement monies in FY 2004. The FY 2004 recommendation includes an increase of \$5 million TANF. The Department's total expenditures for Healthy Families would increase to \$7.5 million.

Substance abuse. The FY 2004 recommendation includes \$4.7 million for substance abuse treatment, including \$3.4 million from the TANF Block Grant and \$1.2 million from the General Fund. The recommendation would maintain funding for the program at \$5 million because DES would be able to use prior-

year non-lapsing funds to cover its expenditures in FY 2003.

Permanent guardianship. For FY 2004, the Executive recommends an increase of \$2.2 million TANF for permanent guardianship. Total funds for the program would be \$3.1 million, which would cover an average of 980 clients each month. The Executive anticipates a 28% increase in the caseload in FY 2004.

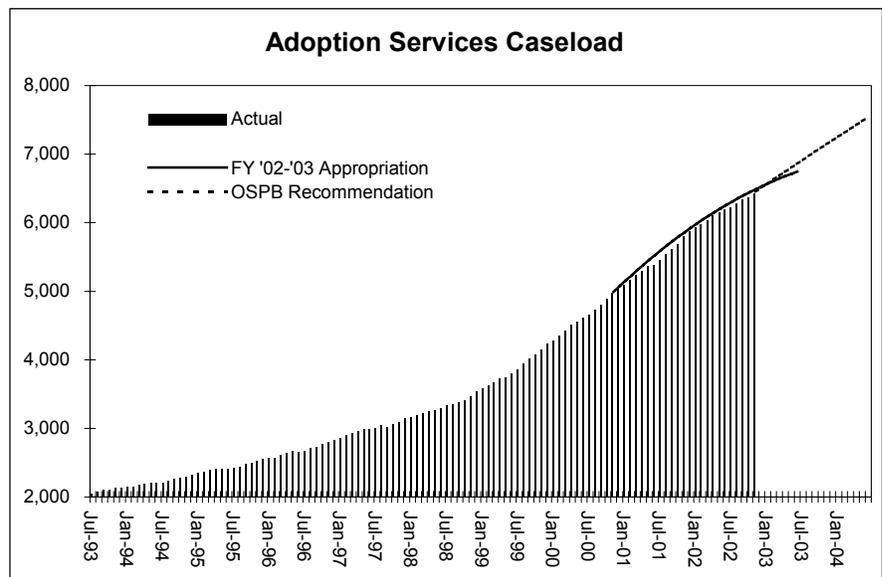
Disease control and behavioral health

Demand for a wide range of health-related programs and services will continue to grow. The Executive recommendation will allow State government to accommodate that growth.

Mental health. Title XIX enrollment continues to increase substantially, with approximately 17% growth estimated for FY 2003, tapering slightly to 15% for FY 2004. The impact on funding is substantial, with more than \$46 million for behavioral health statewide recommended for the FY 2003 supplemental and more than \$108 million for FY 2004. Proposition 204, which provides care for individuals up to 100% of the federal poverty level, adds additional resources, for nearly \$200 million in total funding for FY 2004.

Inpatient care. With the opening of new facilities at the Arizona State Hospital, inpatient care remains a priority. The state-of-the-art design of the new hospital is conducive to effective treatment. Appropriate staffing levels are integral to successful therapies, and the Executive budget includes \$120,000 to annualize existing, partially funded positions.

Adoption Services Caseload



Assurance & Licensure Services. The Department of Health Services' Assurance & Licensure Services (ALS) Division continues to endure staffing shortages that compromise the principal function of the entity: to protect the health and welfare of Arizonans who are dependent on licensed health and child care facilities.

Although significant improvements in the efficiency and responsiveness of the Division have been achieved, growth in the number of facilities, time intensive investigations, and lengthy staff training times threaten to erode the progress.

The personnel deficiency is evident. By August 2002, the child care license renewal backlog had climbed to 254 from 135, an 88% increase in less than a year. Similarly, the behavioral health facility licensure backlog had risen by 87% to 168, from 90 only nine months earlier.

To ensure that ALS receives the resources required to adequately fulfill its responsibilities, the Executive recommends providing funding to annualize 12.6 FTE positions that had been partially funded for FY 2002.

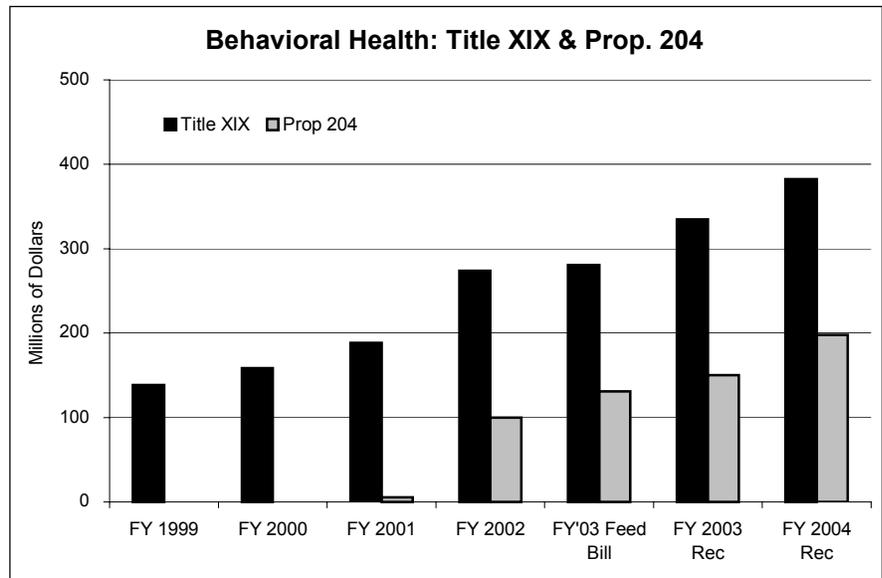
Prevention, education, and direct care. Preventive care remains a cornerstone of the Department of Health Services, and the Health Start program exemplifies the State's commitment to critical health and educational services.

Health Start participants are women and children. The program's major goals include improving birth outcomes, reducing childhood diseases, and improving preventive healthcare. The Executive recommendation provides \$2.2 million of General Fund for Health Start.

Vaccinations. Ten years ago, Arizona ranked in the bottom 10% of states in complying with recommended vaccinations. Today, it has become a national leader.

In spite of the State's recent achievements, Arizona remains vulnerable due to rising vaccination costs and notch groups that may not otherwise qualify for preventive care without additional funds.

The Executive recommendation provides \$1.6 million for vaccinations to reach individuals who have conditions that put them at risk for infection or who are otherwise paradigm candidates for inoculations. For example, Prevnar is recommended for those with sickle cell disease and immune system deficiencies to prevent pneumococcal disease, the leading cause of childhood meningitis



(infection of the brain). Additionally, funding will provide vaccinations for underinsured children, those with catastrophic insurance but without the financial means for preventive care.

Rehabilitative services. The Children's Rehabilitative Services Title XIX program continues its successful path after shifting to a capitated payment methodology in July 2000. Although enrollment remains relatively level, an inflationary increase was assumed to provide additional funding - a total of \$1.2 million when combined with federal matching monies.

Health care

Providing health and welfare services is a principal driver in Arizona's budget, and passage of Proposition 204, compounded by the growth in the existing program, presents a significant challenge in a time of fiscal crisis.

Of the 5.5 million residents in Arizona, 16% or 870,000 are enrolled in AHCCCS, the State's Medicaid program. Given the trends of population and enrollment growth, the caseload forecast in this budget anticipates providing coverage for approximately 18% of Arizona's population.

Proposition 204. Since November 2000, when Proposition 204 was passed by the voters, AHCCCS has experienced a 60% growth in total enrollment, adding over 320,000 enrollees to its coverage. Over half of the additional enrollees - 167,000 - were made eligible under Proposition 204.

Fully implemented in FY 2002, Proposition 204 grew by over 300%

during that year. Proposition 204 caseloads are anticipated to grow by 69% in FY 2003 and by 30% in FY 2004.

The mounting costs of Proposition 204 have created both difficulty and ingenuity in funding this program. Arizona was among the first states able to negotiate with the Federal government a Health Insurance Flexibility and Accountability (HIFA) waiver. Arizona received two waivers to help fund Proposition 204 and provide additional coverage to those in need.

Under the waivers, Arizona can utilize enhanced federal participation to pay for selected Proposition 204 groups, which will save the already burdened General Fund approximately \$8.8 million. The waivers also allow Arizona to expand coverage to the parents of Kids-Care or Medicaid-eligible children. Parents whose income does not exceed 200% of the Federal Poverty Level (FPL) can now be covered by AHCCCS. The HIFA waivers allow AHCCCS to utilize all of its federal Title XXI allotment, in contrast to prior years when unspent portions reverted back.

Proposition 303. Another significant development related to Proposition 204 was the passage of Proposition 303 in 2002, which increased the tobacco tax by 150%. The newly generated revenues are earmarked for health care programs, including Proposition 204.

For FY 2003, the Legislature has designated the use of \$50 million of this new revenue against Proposition 204 and Acute Care costs. For FY 2004, the Executive budget recommends utilizing

\$92 million of Proposition 303 revenues for and Proposition 204 costs.

To satisfy the burgeoning costs of Proposition 204 and to cover one-time uses of funds, the Executive recommends a General Fund supplemental appropriation of \$16.1 million for FY 2003 and an additional \$134.5 million for FY 2004.

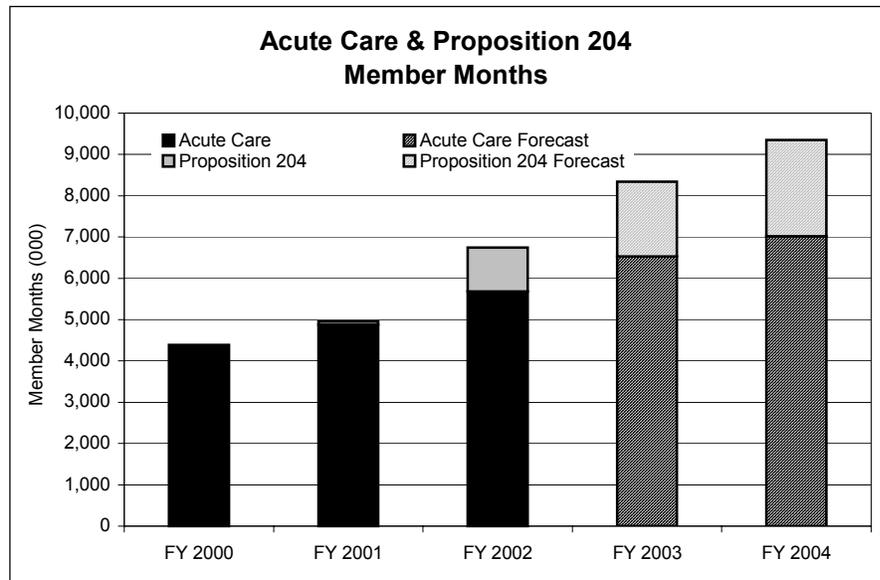
Acute Care. With the slowdown in the economy, and as more and more Arizonans become aware of AHCCCS programs like Proposition 204, traditional Medicaid, known as Acute Care, continues to grow. Many of the Acute Care programs have seen enrollments increase because individuals interested in Proposition 204 are determined eligible for another program. This is one piece of the growth puzzle of Arizona Medicaid.

Acute Care populations grew by 19% in FY 2002, due primarily to growth in the Temporary Assistance to Needy Families (TANF) population. In FY 2002, AHCCCS added 152,000 or 35% more TANF-eligible individuals to its rolls. So far, in FY 2003, the TANF population has grown by another 31,000 individuals or 9% for the first six months of the year.

The Executive Recommendation anticipates TANF growth at 23% in FY 2003 and 9.4% in FY 2004. Further, it assumes overall Acute Care growth at 15% for FY 2003 and 8% in FY 2004. The Executive budget recommends several offsetting and cost reduction options that result in a FY 2004 General Fund increase of \$10.7 million for Acute Care.

ESP kidney dialysis

The Emergency Services Program (ESP) serves, on an emergency basis, individuals who would qualify for AHCCCS if not for their undocumented status.



The program contains two components: the Federal Emergency Services (FES) population and the State Emergency Service (SES) population.

FES enrollees are those who would be eligible for a Title XIX program (such as SOBRA) if they met the citizenship requirement. Approximately 90% of FES cases are maternity cases.

SES enrollees are those who would be eligible for the Proposition 204 program if not for their undocumented status. However, the Legislature has directed that SES pay only for non-hospital care.

The Executive Recommendation adds \$300,000 from the General Fund in FY 2003 for kidney dialysis for SES eligible patients. In FY 2004, this recommendation adds \$1.5 million more of General Fund to manage demand for this service within the SES program.

Premium Sharing

The Premium Sharing program provides coverage for individuals whose

income is less than 250% of the FPL and, for those who are chronically ill, less than 400% of FPL.

With the implementation of the Health Insurance Flexibility and Accountability (HIFA) II waiver, many of the individuals covered under this program were transferred to coverage under the KidsCare Parents program. The Premium Sharing program is funded with an allocation of the Tobacco Tax Medically Needy Account.

For FY 2004, the Executive recommends the elimination of the Premium Sharing program and the use of the \$10.9 million Tobacco Tax allocation to offset the agency's General Fund requirement.

Conclusion

In total, with all fund sources combined (State and Federal), the budget is poised to expend an additional \$500 million for health care for needy Arizonans. ■

Protecting Arizona's Citizens

Keeping our state safe for residents and visitors requires continuing investment in facilities and people

PUBLIC SAFETY IS ONE OF government's fundamental responsibilities. Despite the budget crisis, the Executive recommendation provides for modest funding increases for targeted programs that increase the security of Arizona's citizens.

Crime lab

Laws 2002, Chapter 226 requires, by January 1, 2004, the taking of DNA samples from all felons for inclusion in the statewide DNA database. The Executive recommends new funding to allow additional samples to be processed into the database by FY 2005.

Further, the Executive recommends that funding be provided for an investigator dedicated exclusively to using DNA evidence to analyze cases where there is no suspect but where significant DNA evidence exists in the DPS crime lab. These initiatives will enhance the effectiveness of this emerging law enforcement tool, the "new fingerprint."

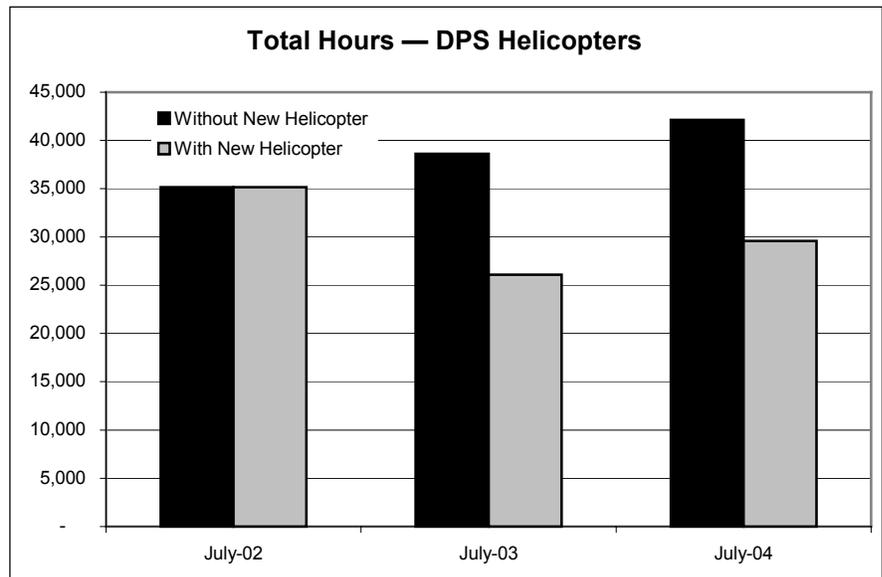
Additionally, the Executive provides resources for local jurisdictions to replace Livescan fingerprint scanning machines in local booking agencies. Those machines were initially provided by the State in 1995 and are beginning to become due for replacement.

Aircraft refurbishment

The Department of Public Safety's air fleet is aging; some aircraft are in need of replacement, while others are due for major servicing to maintain their airworthiness.

While two helicopters have been replaced in recent years, two of the remaining three helicopters exceed the 10,000 flight-hour replacement standard. The oldest helicopter will have an estimated 12,500 flight hours by the beginning of FY 2004, and the Executive recommends replacing it, appropriating funds for the first two years of a three-year lease-purchase.

Additionally, the King Air B200 turboprop is due for a major 3,000-hour



overhaul. The Executive recommends additional funds be appropriated for this one-time expense, which is too large to be accommodated in the DPS base appropriation

Adult corrections

The Department of Corrections continued to experience growth of approximately 127 inmates per month during calendar year 2002. The growth rate was lower than expected, thanks to a September 2002 change in the criminal code that allows inmates to be properly credited with time served while in jail before entering a State prison, thus reducing by a short time the length of their prison stay. The code change has resulted in over 500 inmates leaving the State prisons slightly ahead of schedule.

However, other factors on the horizon may stimulate the incarceration rate. In recent years, successful efforts to increase the number of police officers, judges and prosecutors have led to higher arrest totals and larger court caseloads, which is likely to lead to more offenders sentenced to prisons.

Correctional officers. Arizona prisons are already operating above capac-

ity, housing more than 3,000 more inmates than the facilities were designed to hold. That is due in part to delays in the opening of new facilities. The Rast Unit at the Lewis Prison Complex was built in 1998 but remains closed, due primarily to the difficulty in hiring more correctional officers, as one out of three correction officer positions at the Lewis prison is vacant. Similar problems are being experienced at the Eyman and Florence prisons.

The Executive recommends the implementation of a hiring bonus for correctional officers at those locations. A previous hiring bonus for correctional officers at the Lewis Prison proved to be very successful.

Yuma expansion. Finally, a new State-owned facility is also planned: a 1,100-bed level-4 unit within the existing Yuma Prison Complex. This facility is scheduled to open in the summer of 2005.

County partnership. The Executive also proposes partnering with county jails. The State prison system has thousands of first-time, non-violent, and non-sex offenders who could be incarcerated at county jails at a lower cost

than at State facilities. The purchase of incarceration services from the counties will save approximately \$17 million and will house inmates in local facilities, closer to their families.

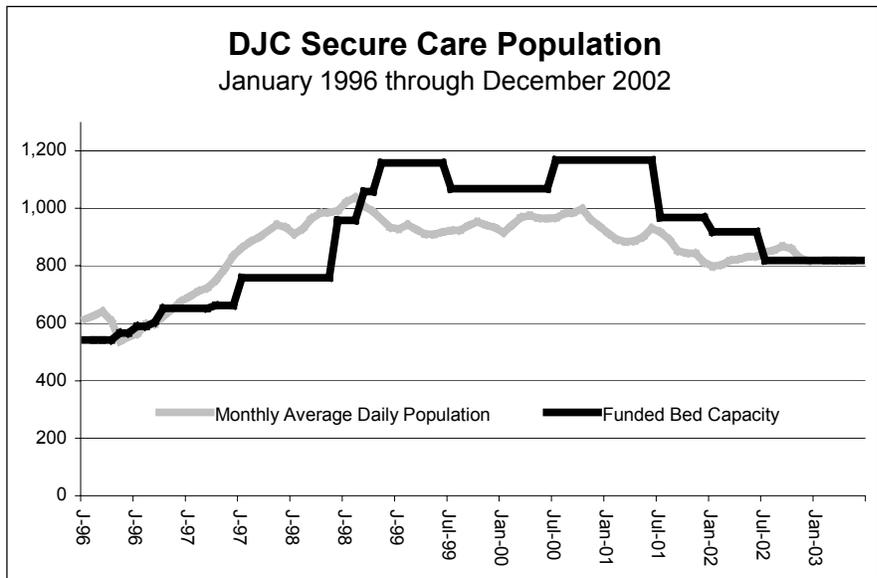
Medical care. As the DOC system's population grows, so does the demand for medical services. Several court decisions have reaffirmed the State's responsibility for proper medical treatment of inmates.

Hepatitis C and other blood-borne diseases are widespread in the prisons; in a survey of the inmate population, over 21% tested positive for Hepatitis C. The Executive budget recommendation provides funding for treatment of Hepatitis C and HIV and for the increased costs of medical care and drugs.

Juvenile corrections

After experiencing significant growth from 1996 to mid-1998, when the average daily population rose from 538 to 1,037, the Department of Juvenile Corrections (DJC) has seen a decline in its secure care population.

The average daily population has dropped from 936 in FY 2001 to 839 in



FY 2002 and 845 in the first half of FY 2003. DJC has attributed some of the decrease to a parole violator program that was instituted in February 2001. The program has reduced the average length of stay for parole violators from seven months to about 45 days. Parole violators go through this program instead of repeating the standard secure

care program that didn't correct the juvenile's behavior the first time.

As a result of the decline in population, DJC's budget has been reduced by \$5.9 million over the last two years. The Executive expects the population to remain relatively constant and is not recommending any change to the funded bed capacity. ■

Sustaining Productivity and Quality of Life

The FY 2004 Executive Budget provides integrated funding mechanisms and calls for innovation to continue the acceleration of highway construction

THE PROSPERITY AND ECONOMIC growth experienced in Arizona for much of the 1990s was undeniably due in part to the quality of the State's physical infrastructure.

However, that growth has also increased demand for many modes of surface travel. Adequate and predictable funding for the State's transportation system is necessary to energize and sustain Arizona's economy, productivity and quality of life.

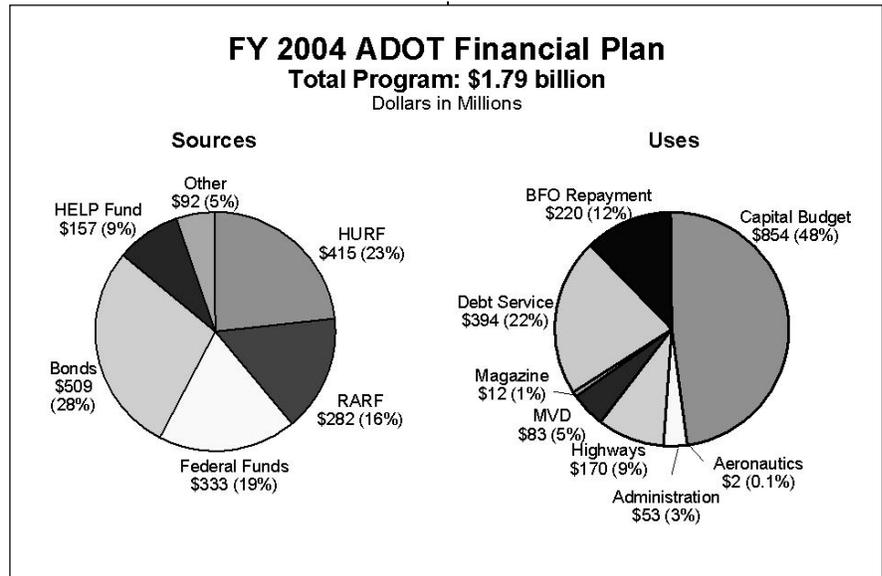
The FY 2004 Executive Budget includes an operating budget of \$305.4 million and 3,775 positions to enable the Arizona Department of Transportation (ADOT) to:

- carry out its \$4 billion Five-Year Transportation Facilities Construction Program for fiscal years 2003 through 2007, and
- complete the Maricopa Regional Freeway System by the accelerated date of December 31, 2007.

ADOT FY 2004 budget

ADOT receives very little of its operating or construction budgets from the General Fund. Its primary funding sources are federal highway trust funds, the State Highway User Revenue Fund (HURF), bond proceeds, and the Maricopa County Transportation Excise Tax, which is deposited into the Regional Area Revolving Fund (RARF).

While these funding sources have not been immune to the economic downturn, the HURF and the RARF have posted increases. In FY 2003, the HURF is projected to receive \$1.1 billion, reflecting an increase of 2.9% over FY 2002. In FY 2004, the HURF is projected to receive \$1.15 billion or 3.9% over FY 2003. The RARF is projected to receive \$284 million in FY 2003, an increase of 6.1% over FY 2002. During FY 2004 its collections are expected to reach \$302.7 million, an increase of 6.6% over the FY 2003 estimate.



Almost half (50.5%) of the monies flowing into the HURF are shared with cities and counties; the balance remains with the State. RARF monies are exclusively dedicated to the Maricopa Regional Freeway System. The overall ADOT financial plan for FY 2003, including operating and construction budgets, totals \$1.65 billion.

During FY 2004, the Executive proposes an integrated financing strategy designed to help address revenue shortfalls in the General Fund while maintaining ADOT's ability to operate and continue with its construction program.

For FY 2004 the Executive recommends a one-time transfer to the General Fund of \$128 million of Vehicle License Tax (VLT) receipts from the HURF. The recommendation also calls for maintaining the 50-50 split of the Flight Property Tax between the Aviation Fund and the General Fund, thus adding approximately \$6 million to the General Fund. (All of the Flight Property Tax is scheduled to go into the Aviation Fund beginning in FY 2004).

To maintain the momentum of ADOT's construction program, the Ex-

ecutive is recommending a combination of mechanisms to make up for the one-time use of the VLT for the General Fund, including additional use of bonding capacity, operating budget reductions and fund shifts.

Bond financing for capital and transportation infrastructure offers distinct advantages over pay-as-you-go financing, especially when the economy is fragile. Initiated and approved by the Federal Highway Administration, Grant Anticipation Notes (GANs) are an innovative finance tool that enables ADOT to supplement traditional financing methods (i.e., pay-as-you-go) and to fund and accelerate highway construction projects with anticipated future federal highway monies. Further, these bonds are secured solely by and backed by a pledge of future federal receipts and are not obligations of the State. While the GANs proceeds would not subsidize expenditures in the General Fund, they will help to expedite completion of transportation projects and reduce costs associated with highway construction by avoiding cost increases resulting from inflation.

Accelerated construction program

In 2002, the State Transportation Board approved a \$4 billion highway construction program as part of the Five-Year Transportation Facilities Construction Program for fiscal years 2003 through 2007. That program includes transportation corridors under both the National Highway System and the statewide system. The Five-Year Transportation Facilities Construction Program includes approximately:

- \$1.18 billion for freeway and expressway construction in Maricopa County, funded partially from the Regional Area Road Fund;
- \$1.82 billion for system improvements, including \$172 million to advance freeway and expressway construction in Maricopa County;
- \$688 million for system preservation; and
- \$336 million for system management.

The Regional Freeway System in Maricopa County was originally planned for completion in 2014, but through the prudent use of innovative revenue bonding mechanisms an accelerated construction program with a new completion date of December 2007 has been set.

In these difficult economic times, meeting the challenge of this accelerated construction program will require judicious management of cash raised through the leveraging of State and federal resources. The Governor will work to establish an integrated statewide transportation system that will provide a safe, reliable and efficient network of highways.

Transportation Equity Act

In 1998, Congress authorized the Transportation Equity Act for the 21st Century (TEA-21), providing a 40% increase in highway funding to Arizona. The TEA-21 will expire on September 30, 2003.

Congress will be reviewing the reauthorization of the program during the

2003 session. As reauthorization efforts take place, the Executive will work with Arizona's congressional delegation and other members of Congress to seek increased funding for our State and maintain funding guarantees and firewalls.

ADOT FY 2003 budget

During the 6th Special Session of the 45th Legislature, the Executive did not include ADOT in its proposed operating budget reductions, since ADOT receives very little of its appropriation from the General Fund. Nonetheless, the Legislature imposed on ADOT a \$27.7 million budget reduction that was vetoed.

ADOT has presented an alternative plan to help partially eliminate the remaining FY 2003 General Fund deficit. The plan involves fund transfers of \$33 million and an operating budget reduction of \$10 million to offset expenditures that would otherwise have to be made from the General Fund. ■

Recommended FTE Increases

The net increase of 309.5 FTE is comprised of two components: (32.0) FTE reduced through technical changes to the appropriations base, and 341.5 resulting from newly funded or eliminated programs

THE EXECUTIVE BUDGET IS DIVIDED into one- and two-year budget recommendations. One-year recommendations are made for 17 selected agencies; they are generally large agencies with difficult issues requiring frequent and critical reviews and, ultimately, more resources. Agencies that are eligible for two-year review are smaller in size and normally do not contain program issues that are of the same level of complexity as those receiving one-year reviews.

In the following analysis of *full-time equivalent* positions (or "FTE"), the FY 2004 recommendation includes all 130 State agencies. In contrast, the FY 2005 recommendation includes only those agencies that qualify for two-year reviews.

As reported in the FY 2003-2004 budget detail that follows, the net increase in positions of 309.5 FTE is comprised of two components:

- a net decrease of (32.0) FTE reduced through technical changes to the appropriations base (*see below*); and
- a net increase of 341.5 FTE resulting from newly funded or eliminated programs.

FY 2004: FTE Technical Changes

Dept. of Economic Security..... 42.8 FTE
42.8 FTE to provide authorization for positions funded through previous program expansions

Dept. of Health Services 16.0
16.0 FTE to provide authorization for positions funded through previous program expansions

Bd. of Behavioral Health Examiners(1.0)
Elimination of (1.0) FTE positions not funded

Board of Osteopathic Examiners(2.5)
Elimination of (2.5) FTE positions not funded

Dept. of Water Resources..... (2.5)
Reduction of (2.5) FTE to reflect a shift of funding from personal services to rent

Dept. of Gaming (7.0)
Elimination of (7.0) FTE not funded

Dept. of Public Safety..... (9.0)
Transfers (9.0) FTE to a non-appropriated funding source from the General Fund

Dept. of Agriculture (22.0)
A reduction of (22.0) FTE to reflect a shift of staffing from appropriated to non-appropriated funding sources

Dept. of Racing (46.8)
Reduction of (46.8) FTE to reflect the elimination of General Fund appropriations so that the racing and boxing industries may become self-sustaining through cost recovery fees

FY 2004: New FTE Positions

FTE totals were adjusted to reflect only programs that were newly funded or eliminated in FY 2004. Thus, information presented here may differ from individual agency operating budget recommendations and from tables in other sections of the Executive Budget. The specific adjustments are detailed below by agency.

The Executive Budget provides an aggregate increase of 341.5 FTE for all budget units, the majority concentrated in specific, high-priority programs of State government. The increases are necessary to respond to:

- student growth at Arizona's Universities;
- growing caseloads at AHCCCS eligibility determination offices and the Department of Economic Security's unemployment insurance and job service programs; and
- service demands at the Arizona State Retirement System and the

Department of Transportation's ports of entry at border crossings between Mexico and Arizona.

Following is an itemized listing, by agency, of the Executive's recommendation for increased FTE positions:

Universities..... 190.2 FTE
Increased staffing to maintain the 22 to 1 faculty-to-staff ratios at the State's universities

122.5 FTE at Arizona State University

56.2 FTE at the University of Arizona

11.5 FTE at Northern Arizona University

AHCCCS 110.0
110.0 FTE for eligibility determination staff for the Proposition 204 and acute medical services programs

Dept. of Economic Security 37.0
37.0 FTE for automation and administration related to the unemployment insurance and job service programs

State Retirement System 26.0
26.0 FTE for the Member Services call center, information technology planning and investment management

Dept. of Transportation..... 15.0
15.0 FTE for ports of entry workloads and compliance and registration compliance programs

Dept. of Administration 11.0
11.0 FTE for information technology security upgrade

State Board for Charter Schools 3.0
3.0 FTE for the consolidation of charter school functions

Dept. of Agriculture..... 1.8
1.8 FTE to create a registration database for feed, fertilizer and pesticide products for the uniform

regulation of products and manufacturers

Criminal Justice Commission 1.5
1.5 FTE for criminal history improvement and the evaluation and improvements of criminal justice grants

Commission for the Deaf and the Hard of Hearing 1.0
1.0 FTE for a voucher and inventory technician

Dental Examiners 1.0
1.0 FTE for an administrative services officer for information technology

Board of Barber Examiners 1.0
1.0 FTE for an administrative assistant to perform inspections

Acupuncture Board of Examiners 0.5
0.5 FTE for increased workload

Board of Naturopathic Physicians Examiners (0.5)
Reduction of (0.5) FTE oversight staff to reflect the closing of one of two naturopathic physicians schools

State Land Department (2.0)
Reduction of (2.0) FTE to reflect sunset of the Environmental Education Council

Community Colleges Board (5.0)
Reduction of (5.0) FTE to reflect elimination of the Board

Dept. of Education (6.0)
Reduction of (6.0) FTE to reflect consolidation of charter school functions within the State Board for Charter Schools

Dept. of Juvenile Corrections (18.0)
Reduction of (18.0) FTE to reflect declining revenues in other appropriated funds

Drug and Gang Prevention (26.0)
Reduction of (26.0) FTE to reflect a decline in the number and funding of Intergovernmental Agreements made with the Center

**FTE Change From Prior Year by Area of Government
FY 2003-FY 2004
ALL APPROPRIATED FUNDS
ALL BUDGET UNITS**

Area of Government	FY 2003 FTE Budgeted	FY 2004 FTE Recommended	FY 2004 FTE Change
General Government	4,253.9	4,290.9	37.0
Health and Welfare	7,548.6	7,755.4	206.8
Inspection and Regulation	1,812.5	1,737.0	(75.5)
Education	16,161.7	16,343.9	182.2
Protection and Safety	13,589.7	13,538.2	(51.5)
Transportation	3,760.0	3,775.0	15.0
Natural Resources	909.7	905.2	(4.5)
Total	48,036.1	48,345.6	309.5

**FTE Change From Prior Year by Area of Government
FY 2003-FY 2004
OTHER APPROPRIATED FUNDS
ALL BUDGET UNITS**

Area of Government	FY 2003 FTE Budgeted	FY 2004 FTE Recommended	FY 2004 FTE Change
General Government	1,533.1	1,559.8	26.7
Health and Welfare	2,130.5	2,087.0	(43.5)
Inspection and Regulation	1,074.7	1,236.7	162.0
Education	395.7	395.7	0.0
Protection and Safety	1,509.1	1,466.6	(42.5)
Transportation	3,758.0	3,773.0	15.0
Natural Resources	381.5	519.8	138.3
Total	10,782.6	11,038.6	256.0

**FTE Change From Prior Year by Area of Government
FY 2003-FY 2004
GENERAL FUND
ALL BUDGET UNITS**

Area of Government	FY 2003 FTE Budgeted	FY 2004 FTE Recommended	FY 2004 FTE Change
General Government	2,720.8	2,731.1	10.3
Health and Welfare	5,418.1	5,668.4	250.3
Inspection and Regulation	737.8	508.6	(229.2)
Education	15,766.0	15,948.2	182.2
Protection and Safety	12,080.6	12,071.6	(9.0)
Transportation	2.0	2.0	0.0
Natural Resources	528.2	385.4	(142.8)
Total	37,253.5	37,315.3	61.8

FY 2005: FTE Positions

The FY 2005 Executive Recommendation provides for the addition of 0.2 FTE positions. As with the FY 2004 recommendation, this increase is comprised of two types of FTE changes: the decrease of (2.6) FTE through technical adjustments to the FY 2004 recommended base budget.

Dept. of Water Resources.....(2.6) FTE
Reduction of (2.6) FTE to reflect a shift of funding from personal services to rent

The FY 2005 Executive Budget provides for the addition of 2.8 FTE for various State agency programs. The new FTE are distributed in the following manner:

State Retirement System 2.0 FTE
2.0 FTE for the Member Services call center

Dept. of Public Safety..... 1.0
1.0 FTE for "no-suspect" DNA profile analysis

Dept. of Agriculture(0.2)
Reduction of (0.2) FTE for the feed, fertilizer and pesticide product database development due to reduced workload

**FTE Change From Prior Year by Area of Government
 FY 2004-Y 2005
 ALL APPROPRIATED FUNDS
 BIENNIAL BUDGET UNITS**

Area of Government	FY 2004 FTE Budgeted	FY 2005 FTE Recommended	FY 2005 FTE Change
General Government	4,290.9	4,292.9	2.0
Health and Welfare	7,755.4	7,755.4	0.0
Inspection and Regulation	1,737.0	1,736.8	(0.2)
Education	16,343.9	16,343.9	0.0
Protection and Safety	13,538.2	13,539.2	1.0
Transportation	3,775.0	3,775.0	0.0
Natural Resources	905.2	902.6	(2.6)
Total	48,345.6	48,345.8	0.2

**FTE Change From Prior Year by Area of Government
 FY 2004-Y 2005
 GENERAL FUND
 BIENNIAL BUDGET UNITS**

Area of Government	FY 2004 FTE Budgeted	FY 2005 FTE Recommended	FY 2005 FTE Change
General Government	2,731.1	2,731.1	0.0
Health and Welfare	5,668.4	5,668.4	0.0
Inspection and Regulation	500.3	500.3	0.0
Education	15,948.2	15,948.2	0.0
Protection and Safety	12,071.6	12,071.6	0.0
Transportation	2.0	2.0	0.0
Natural Resources	385.4	382.8	(2.6)
Total	37,307.0	37,304.4	(2.6)

**FTE Change From Prior Year by Area of Government
 FY 2004-Y 2005
 OTHER APPROPRIATED FUNDS
 BIENNIAL BUDGET UNITS**

Area of Government	FY 2004 FTE Budgeted	FY 2005 FTE Recommended	FY 2005 FTE Change
General Government	1,559.8	1,561.8	2.0
Health and Welfare	2,087.0	2,087.0	0.0
Inspection and Regulation	1,236.7	1,236.5	(0.2)
Education	395.7	395.7	0.0
Protection and Safety	1,466.6	1,467.6	1.0
Transportation	3,773.0	3,773.0	0.0
Natural Resources	519.8	519.8	0.0
Total	11,038.6	11,041.4	2.8

Proposed Legislative Changes

The following changes are necessary to implement the Executive Budget Recommendation

Agency/Program	Issue	Citation	Comment
AHCCCS	Annual Immunization Audit	Repeal A.R.S. § 36-2904(O)	A.R.S. § 36-2904.O requires an annual immunization audit to be submitted to the Governor, the President of the Senate, and the Speaker of the House of Representatives. This report is being eliminated due to the administrative budget cuts passed during the Sixth Special Session. The Executive recommendation would require the repeal of Section O of A.R.S. § 36-2904.
AHCCCS	County Acute Care Contribution	Amend 2nd Regular Session, Laws 2002, Chapter 329 § 20	To address the budget shortfall in FY 2003, the various counties were required to contribute a total of \$6.5 million for the Acute Care program within AHCCCS. The Executive budget recommendation would require the continuation of these increased contributions for one more year.
AHCCCS	Disproportionate Share Hospital Program	New section within the Health ORB Modify General Appropriation Act footnote	Due to the federal government's delay in approving Arizona's new OBRA limit calculations, specified amounts to be paid and withheld cannot be calculated with any certainty. Once approval is provided, specified amounts can be placed in the Health ORB and the appropriations footnote regarding the DSH program.
AHCCCS	Eliminate Premium Sharing	Repeal A.R.S. § 36-2923.01 and related statutes	The Executive budget eliminates this program, which is funded by Tobacco Tax revenues, and utilizes the Tobacco Tax funds to offset amounts paid from the General Fund.
AHCCCS	Freeze County ALTCS Growth Contribution	Amend 2nd Regular Session, Laws 2002, Chapter 329 § 31	To address the budget shortfall in FY 2003, Maricopa and Pima counties were required to contribute 100% of the ALTCS program growth within their counties. Previously, the counties and the State split equally the costs of growth in ALTCS. The Executive budget recommendation would require the continuation of these increased contributions for one more year.
AHCCCS	Inpatient Hospital Reimbursement Pilot Program	Amend Laws 2001, Chapter 234 § 3	The Executive recommendation requires the extension of the pilot program for one more year.
Community Colleges	Dual Enrollment	Session Law (Notwithstanding A.R.S. §§ 15-1464 and 15-1466)	The Executive recommendation eliminates funding for dual-enrollment students for both Operating State Aid and Capital Outlay State Aid. The funding previously appropriated for these students allowed the Community College districts to cover costs associated with their administrative duties for the program. A notwithstanding clause is needed for the statutes that govern the funding formulas for operating and capital outlay aid.

Agency/Program	Issue	Citation	Comment
Community Colleges	Eliminate the State Board for Community Colleges	Eliminate and/or modify all references to the State Board for Community Colleges in A.R.S. Title 15, Chapter 12 and all other related statutes pursuant to this recommendation.	Due to diminished authority and responsibilities resulting from Laws 2002, 2nd Regular Session, Chapter 310, the Executive recommends that the State Board for Community Colleges be dismantled and the State agency resources dedicated for support services be eliminated. All duties currently in statute, including transfer articulation and Arizona-Mexico exchange program administration and annual reporting, will transfer to the individual community college districts.
Department of Administration	Contribution of Pro Rata Share for Personnel Division Fund	A.R.S. § 41-764(A)	Laws 2002, First Regular Session, Chapter 236, § 109 established the pro rata rate at 1.04% for Fiscal Year 2003. This rate was established to provide a funding source for the new Human Resources Information System (HRIS). It is necessary to keep the pro rata rate at 1.04% for the continued funding of the HRIS. If the rate is not made permanent or increased it will revert to 0.9% as of July 1, 2003. Increases since 1997 have been made in Session Law. Maintaining the current 1.04% pro rata share has no additional General Fund impact, since appropriations have currently been set at this rate.
Department of Administration	State Surplus Materials Revolving Fund Transfer	Repeal Laws 2002, Sixth Special Session, Chapter 1 § 117 (Item # 5)	The bill contains a fund transfer of \$1 million from the State Surplus Materials Revolving Fund to the General Fund. The State Surplus Fund does not have the necessary fund balance to support the transfer. The Department of Administration has projected a decline in revenues for fiscal years 2003 and 2004, since there will be less General Fund and other fund monies available for the replacement of equipment and furnishings.
Department of Agriculture	Create a Commercial Truck Fee Fund	New legislation	The Executive recommend the establishment of a \$1.00 fee for commercial trucks entering Arizona. The funds are to be deposited into a Commercial Truck Fee Fund and used to fund the pest exclusion program and homeland security.
Department of Agriculture	Create a Livestock Inspection Fee Fund	A.R.S. § 3-1337	The Executive recommends that the service charge be replaced with a travel fee of up to \$20 and that the inspection fee for all livestock be raised to \$0.75 per head. The Executive also recommends that the fees be deposited into the Livestock Inspection Fee Fund to be used for the Livestock Inspection program.
Department of Agriculture	Create an Agriculture Administrative Services Fund	New legislation	The Executive recommends that agency administrative costs be allocated to other programs and funds within the Department. The other programs and funds would pay an allocation to the newly created Agriculture Administrative Services Fund.
Department of Economic Security	CPS Training and Family Group Decision Making	Eliminate legislative footnote in General Appropriations Act	The Executive recommends eliminating the footnote that requires DPS to train CPS caseworkers before they handle a caseload. The Executive believes that the requirement should be addressed in statute, not in the General Appropriations Act.

Agency/Program	Issue	Citation	Comment
Department of Economic Security	Domestic Violence	Modify General Appropriation Act footnote	The General Appropriations Act footnote regarding expenditures from the Domestic Violence Shelter Fund should be updated to reflect FY 2004 rather than FY 2003.
Department of Economic Security	JOBS	Modify General Appropriation Act footnote	The Executive recommends that the General Appropriations Act footnotes regarding the use of non-permanent and seasonal positions and contracts with education and training entities be updated to reflect FY 2004 rather than FY 2003.
Department of Economic Security	Spinal and Head Injuries Trust Fund	Modify General Appropriation Act footnote	The Executive recommendation would update the General Appropriations Act footnote to reflect FY 2004 rather than FY 2003.
Department of Economic Security	TANF Transfer to SSBG	Eliminate Legislative Footnote in General Appropriations Act	The Department will spend all of the funds transferred from TANF to SSBG in children services in both FY 2003 and FY 2004, so the Executive recommends eliminating the footnote for both years.
Department of Economic Security	Workforce Investment Act	Modify General Appropriation Act footnote	The Executive recommends that the General Appropriations Act footnote regarding use of revenues be updated to reflect FY 2004 rather than FY 2003.
Department of Economic Security	Child Support Enforcement	Modify General Appropriation Act footnote	The Executive recommends that the General Appropriations Act footnote regarding the division's escalator clause be updated to reflect FY 2004 rather than FY 2003.
Department of Economic Security	Pima County Child Support	Eliminate Legislative Footnote in General Appropriations Act	The footnote addresses implementation issues that have already been resolved.
Department of Economic Security	Child Care	Modify General Appropriation Act footnote	The Executive recommends that the General Appropriations Act footnote regarding child care expenditures in the day care subsidy special line item be updated to reflect FY 2004 rather than FY 2003.
Department of Economic Security	Information & Referral	Eliminate Legislative Footnote in General Appropriations Act	The Executive recommendation transfers funding from the information and referral special-line item to the operating budget in the administration division.
Department of Economic Security	FY 2003 Lump Sum Reductions	Eliminate Legislative Footnote in General Appropriations Act	The two footnotes address implementation of FY 2003 lump sum reductions.
Department of Economic Security	Cash Assistance	Eliminate legislative footnote in General Appropriations Act	The Executive should have the prerogative to transfer funds in and out of the cash assistance special-line item without JLBC approval.
Department of Economic Security	Substance Abuse Treatment	Change FY 2001 lapsing appropriation to non-lapsing	DES needs TANF funds that were appropriated in FY 2001 to cover their expenditures for substance abuse treatment in FY 2003. Those funds lapsed at the end of FY 2002.

Agency/Program	Issue	Citation	Comment
Department of Education	Basic State Aid: K-12 Rollover	New Session Law	The delay in the payment of the final month apportionment of Basic State Aid to school districts from one fiscal year to the next fiscal year is commonly referred to as the "K-12 Rollover." The Executive recommendation in FY 2004 for an additional one-half month of K-12 Rollover requires a notwithstanding clause to A.R.S. § 15-973, subsection B, paragraph 10, which would delay the statutorily set apportionment date for Basic State Aid from June 15, 2004 payment to July 1, 2004.
Department of Education	Basic State Aid: Reduction in Trust Land Earnings	Modify General Appropriation Act footnote	In FY 2004, the Executive estimates that the income generated from Permanent State School Fund will be \$58,263,300. The projected amount is (\$12 million) less than the FY 2003 collection levels. The decrease is due primarily to changes in the formula used to calculate the portion of the revenue total that is attributable to Treasurer's income. A footnote which exists in the General Appropriations Act that specifies the amount derived from the fund must be used to support basic state support to school districts must be updated to reflect the new FY 2004 appropriation.
Department of Education	Basic State Aid: Reduction in Trust Land Earnings	Modify General Appropriation Act footnote	In FY 2004, the Executive estimates that the income generated from Permanent State School Fund will be \$58,263,300. The projected amount is (\$12 million) less than the FY 2003 collection levels. The decrease is due primarily to changes in the formula used to calculate the portion of the revenue total that is attributable to Treasurer's income. A footnote which exists in the General Appropriations Act that specifies the amount derived from the fund must be used to support basic state support to school districts must be updated to reflect the new FY 2004 appropriation.
Department of Education	Basic State Aid: K-8 QTR Equity	A.R.S. § 41-1276 and A.R.S. § 15-972	When calculating State Equalization Aid to public schools, 50% of the revenues generated from the levy are applied to K-8 and 50% to 9-12. This proposal would modify the 50/50 split to 70/30 - 70% of the QTR to the K-8 grades and 30% to the 9-12 grades. Therefore, new language must be added to A.R.S. § 41-1276 to specify the QTR percentage allocation change. Also, conforming language is needed in several sections of Title 15 that reference the application of the QTR to the equalization assistance calculation.
Department of Education	Basic State Aid: Assessed Valuation Growth	A.R.S. § 41-1276	To meet budget shortfalls in FY 2004, the Executive recommends a cap of the QTR at the FY 2003 levels. The current statute requires that the Joint Legislative Tax Committee adjust the QTR rate on an annual basis. A notwithstanding clause to A.R.S. § 41-1276 would allow the State to forgo the supermajority vote needed to hold the rate constant.

Agency/Program	Issue	Citation	Comment
Department of Education	Consolidate Charter School functions	A.R.S. § 15-183(C)	The Executive recommends that the State Board of Education for Charter Schools and the Charter Schools Division of the Department of Education consolidate with the State Board for Charter Schools to establish one State agency dedicated to charter school issues. This consolidation is expected to result in a reduction of 3.0 FTE positions and \$150,000. In addition to modifications in the General Appropriations Act to reflect the funding changes, existing charter school statutes must also be revised to reflect this recommendation.
Department of Education	Consolidate Charter School Functions	A.R.S. § 15-183(C)	The Executive recommends that the State Board of Education for Charter Schools and the Charter Schools Division of the Department of Education consolidate with the State Board for Charter Schools to establish one State agency dedicated to charter school issues.
Department of Education	School Accountability Fund	A.R.S. § 15-241	The Executive proposes that the School Accountability Fund be established permanently in statute to avoid end-of-year reconciliation issues that are caused due to the existing fund's status as a sub-account of the General Fund.
Department of Education	Teacher Certification Fund	A.R.S. § 15-531	Session law exists that creates the Teacher Certification Fund used by the Department of Education to deposit teacher certification fees, as authorized by A.R.S. § 15-531. The revenues from this fund are used to support the Teacher Certification, Certification Investigations and Teacher Evaluation programs. The Executive proposes that this fund be established permanently in statute to avoid end-of-year fund reconciliation issues that are caused due to the fund's status as a sub-account of the General Fund.
Department of Environmental Quality	Air Quality Fee Fund (In Lieu Fee Account)	A.R.S. § 49-551	For FY 2004, the Executive recommends transferring \$12 million to the State General Fund from the in-lieu fee account of the Air Quality Fee Fund.
Department of Environmental Quality	Water Quality Assurance Fund Transfer (WQARF)	A.R.S. § 49-282	The Executive recommendation reduces the amount transferred from the corporate income tax pursuant to Title 43, Chapter 11, Article 2. While A.R.S. § 49-282 provides that the WQARF receives \$15 million annually, the Executive recommendation decreases this amount by \$10 million in FY 2004, therefore allowing \$5 million to go to WQARF.
Department of Health Services	Restoration to Competency	Laws 2002, Second Regular Session, Chapter 329, § 26	The legislation is necessary to continue county contributions for restoration-to-competency costs.
Department of Health Services	Southern Arizona Mental Health Center (SAMHC)	Repeal A.R.S. §§ 36-545.09 and 36-3403(A)(8)	The property was sold June 2002.
Department of Health Services	Suicide Prevention	A.R.S. § 36-3415	Laws 2001, Chapter 319 established the Suicide Prevention Program and appropriated \$140,000 for FY 2002 and \$120,000 for FY 2003. As part of its budget reduction plan, DHS did not expend these funds, and repealing legislation is required to eliminate the program and associated requirements.

Agency/Program	Issue	Citation	Comment
Department of Health Services	Telecommunication Service Excise Tax	Laws 2002, Second Regular Session, Chapter 329, § 25	This continues the existing tax.
Department of Health Services	Title XIX Reporting Requirement	A.R.S. § 36-2959	The legislation was intended to be a one-time reporting requirement for FY 2003. Repealing the language will achieve this.
Department of Public Safety	CJEF Distribution to General Fund Redirected to Crime Lab Assessment Fund	A.R.S. §§ 41-2401(D)(11) and 41-2415(C)	This recommendation continues the policy from the last biennium of redirecting to the Crime Laboratory Assessment Fund the 9% CJEF distribution to the General Fund.
Department of Public Safety	HURF/Highway Fund DPS Expenditure Limits	A.R.S. §§ 28-6537 and 28-6993	In order to appropriate amounts recommended in the Executive Budget, these two sections should be deferred for the biennium or repealed.
Department of Transportation	Aviation Fund	A.R.S. § 28-8202	For FY 2003, the Executive recommends transferring \$3 million to the State General Fund from the State Aviation Fund.
Department of Transportation	Aviation Fund	A.R.S. § 28-8202	The Executive's recommended language will amend a session law passed in 2001 (Laws 2001, Chapter 286) for the purpose of extending the effective date related to the distribution of flight property tax. Laws 2001, Chapter 286 provides an effective date of July 1, 2003. The Executive recommends deleting 2003 and replacing this date with 2004.
Department of Transportation	Vehicle License Tax Distribution	A.R.S. § 28-5808	The Executive recommendation includes a one-time transfer of \$128 million from Vehicle License Tax to the General Fund in FY 2004.
Department of Water Resources	Water Protection Fund	A.R.S. § 45-2112	The Executive is not recommending the \$5 million transfer to the Water Protection Fund.
School Facilities Board	Building Renewal	A.R.S. § 15-2031	The Executive recommends four statutory changes to the Building Renewal formula: (1) limit age of buildings to 30 years, (2) portable space equalization, (3) change from full cost to replacement cost, and (4) change from design square footage to minimum square footage. The School Facilities Board estimates that these changes will result in savings of \$35 million.
School Facilities Board	Deficiencies Corrections Revenue Bonding	A.R.S. §§ 15-2051, 15-2053 to -2055, 15-2060 to -62, and 42-5030.01	For FY 2003, the Executive proposes issuing \$380 million in revenue bonds to meet the \$280 million shortfall in the School Facilities Board Deficiencies Correction program. The Executive recommendation includes a \$100 million transfer (previously appropriated General Fund dollars) from Deficiencies Correction to the General Fund once the \$380 million in bond proceeds are deposited. Statutory changes are needed to permit the use of these monies for the Deficiencies Correction program. Bonding authority under this proposal was passed as part of Students FIRST legislation and intended for new school construction programs.

Agency/Program	Issue	Citation	Comment
School for the Deaf and the Blind	Excess Voucher Funds	Modify General Appropriations Act footnote	A footnote currently exists in the General Appropriations Act that allows the Arizona School for the Deaf and the Blind (ASDB) to expend non-endowment monies in excess of its appropriation for the Arizona Schools For the Deaf and the Blind Fund (if revenues exceed their appropriation). This footnote must be updated to reflect FY 2004 projected amounts.
State Board for Charter Schools	Parent Charter School Survey	Eliminate Legislative Footnote in General Appropriations Act	The Executive recommends the elimination of charter school parent surveys. In Laws 2002, 6th Special Session, Chapter 1, a legislative footnote exists that requires that all charter school parents rate the quality of their respective schools through a survey mechanism. In order to eliminate this requirement, the legislative footnote must be removed from the appropriation bill.
State Land Department	Environmental Special Plate	A.R.S. § 37-1015	For the Natural Resource Conservation districts to be funded through the Environmental Special Plate Fund, the usual grant procedures for the Environmental Special Plate Fund must be waived.
State Parks	Off-Highway Vehicle Recreation Fund	A.R.S. § 28-1176	The Executive's recommended language will authorize the Parks Board to use \$680,000 in FY 2003 from the Off-Highway Vehicle Recreation Fund for operation of parks.
State Parks	Off-Highway Vehicle Recreation Fund	A.R.S. § 28-1176	The Executive's recommended language will authorize the Parks Board to use \$680,000 in FY 2004 and FY 2005 from the Off-Highway Vehicle Recreation Fund for operation of parks.
State Treasurer	Justice of the Peace Compensation	A.R.S. § 22-117(B)	As part of the reduction of state expenditures, an elimination of the state's rate of compensation for Justice of the Peace salaries is recommended.
Tourism	Tourism and Sports Authority	A.R.S. § 5-835	The Executive recommendation provides the State Treasurer with the following: Prior to making any transfers to the Tourism and Sports Authority, the Treasurer shall transfer up to \$2.3 million in FY 2004 and FY 2005 to the General Fund. Under current law, this special-line item receives an estimated \$4 million per year plus 5% growth over the preceding year (estimated at \$400,000). The present statutory formula would provide a total of \$4.4 million in FY 2004 and \$4.5 million in FY 2005 to this activity.
University System	Optional Retirement System appropriation contribution rate	A.R.S. § 15-1628(C)	The Executive recommends that the statute be changed to permit the appropriations to the Universities to include the optional retirement plan contribution rate to be 7% even when the ASRS contribution is lower.

ELECTED OFFICIALS' SALARIES

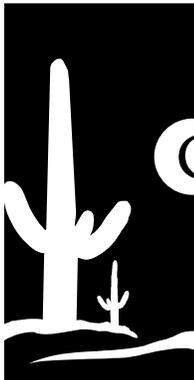
In 1970, the Arizona Legislature established the Commission on Salaries for Elective State Officers. Every two years, the Commission is required to review and recommend to the Governor the salaries for elective State officers, justices and judges of courts of record, judges and clerks of the Superior Court, and others. After receiving the recommendations, the Governor is required to include the Governor's recommendations for exact rates of pay in the next budget transmitted to the Legislature.

The Legislature has 90 days to take action to establish a different effective date for the proposed salary adjustments, establish rates of pay other than those proposed by the Governor, or disapprove the Governor's recommendation.

On May 31, 2002, the Commission on Salaries for Elected State Officers forwarded to the Governor its recommendations for salary adjustments. The table below summarizes the Executive recommendation for the FY 2004 and FY 2005 biennium. In short, the Executive recommends that no adjustments be made to current salaries. The salaries identified under "Executive Proposed Salary" will become effective unless the House or Senate takes action in 90 days.

Judges	<i>Current Salary</i>	COMMISSION		EXECUTIVE	
		<i>Proposed Salary</i>	<i>Proposed Eff. Date</i>	<i>Proposed Salary</i>	<i>Proposed Eff. Date</i>
Supreme Court, Chief Justice	\$129,150	\$155,000	January 1, 2003	\$129,150	January 1, 2003
Supreme Court, Associate Justices	126,525	150,000	January 1, 2003	126,525	January 1, 2003
Appellate Judges, Division I	123,900	145,000	January 1, 2003	123,900	January 1, 2003
Appellate Judges, Division II	123,900	145,000	January 1, 2003	123,900	January 1, 2003
Superior Court Judges	120,750	140,000	January 1, 2003	120,750	January 1, 2003

Other Elected Officials	<i>Current Salary</i>	COMMISSION		EXECUTIVE	
		<i>Proposed Salary</i>	<i>Proposed Eff. Date</i>	<i>Proposed Salary</i>	<i>Proposed Eff. Date</i>
Governor	\$95,000	\$155,000	January 1, 2003	\$95,000	January 1, 2003
Secretary of State	70,000	110,000	January 1, 2003	70,000	January 1, 2003
Attorney General	90,000	130,000	January 1, 2003	90,000	January 1, 2003
State Treasurer	70,000	105,000	January 1, 2003	70,000	January 1, 2003
Superintendent	85,000	125,000	January 1, 2003	85,000	January 1, 2003
Mine Inspector	50,000	73,500	January 1, 2003	50,000	January 1, 2003
Corporation Commissioners	79,500	95,000	January 1, 2003	79,500	January 1, 2003
Clerk of the Court, Maricopa & Pima Cos.	60,000	100,000	January 1, 2003	60,000	January 1, 2003
Clerk of the Court, Other Counties	50,000	80,000	January 1, 2003	50,000	January 1, 2003
Legislators	24,000	36,000	<i>Voter Approval</i>	24,000	January 1, 2003



Capital Outlay

Preserving State infrastructure

The FY 2004 Executive Budget provides for a number of capital projects throughout Arizona

THE EXECUTIVE BUDGET recognizes the importance of capital projects to Arizona, even in a time of severe budget shortfalls.

The Governor recommends building renewal monies; expansion of the prison at Yuma; Game and Fish projects; and relocation monies for the second set of privatized lease-to-own (PLTO II) projects. The PLTO II projects include a replacement for the State Health Laboratory and a new Department of Health Services (DHS) building.

Yuma prison construction

The Department of Corrections (DOC) is estimated to grow at about 135 inmates per month, from a population of 29,581 to approximately 33,700 by the end of FY 2005.

The Executive recommends construction of an additional 1,100 level-4 beds inside the perimeter of Yuma prison. The recommendation is to start the project in July 2003, with an estimated completion date of July 2005.

Of the total cost of \$62 million, the Executive recommends that \$42 million come from the federal Violent Offender and Truth in Sentencing (VOI/TIS) funds and the remaining \$20 million come from the issuance of a certificate of participation (COP). No appropriations are needed in FY 2004. The COP recommended by the Executive would require payments of \$2.1 million in FY 2005 and \$1.9 million in FY 2006.

The Executive also recommends reverting expenditure authority from completed and cancelled DOC capital projects.

Agency requests

State agency requests for Capital Outlay funding in FY 2004 were \$910.6 million. The total included \$736.7 million in General Fund requests and \$173.9 million in Other Appropriated Funds. Requests do not include the \$500,000 in General Fund monies that the Legislature has already approved for FY 2004.

Agency capital requests from the General Fund include:

- \$596.7 million from DOC;
- \$5.5 million from the Department of Administration (ADOA);
- \$32.2 million from the Universities;
- \$71 million from ADOA and the Universities' Building Renewal;
- \$6.9 million from the Department of Juvenile Corrections (DJC); and
- \$24.4 million from the Department of Public Safety (DPS), Department of Economic Security (DES), Department of Emergency and Military Affairs (DEMA), and Arizona Veterans' Service Commission.

Other Fund requests consisted of \$159.8 million from the Department of Transportation (ADOT), the majority of which

is for highway construction; \$9.3 million total from the Department of Game and the Fish and the State Parks Board; and \$4.8 million from various funds for Building Renewal.

Fund shift: FY 2003 capital outlay supplemental

State Health Lab Lease-Purchase Payment

- General Fund..... (\$911,500)
- Legislative, Executive, Judicial Land Fund\$911,500

The Executive recommends a \$911,500 fund shift for the previously appropriated lease-purchase payment for the newly constructed State Health Lab. The recommendation is for the \$2,342,900 General Fund appropriation in Laws 2001, Chapter 237 to be reduced to \$1,431,400. The Legislative, Executive and Judicial Land Fund is recommended to replace the (\$911,500) General Fund reduction.

Building Renewal: FY 2004

The FY 2004 Executive Budget provides \$3,652,500 for Building Renewal, as outlined in Table I. Though no General Fund monies are recommended, the Executive proposes appropriating \$1,894,900 from the Capital Outlay Stabilization Fund for ADOA Building Renewal. The Executive also recommends 2.0 FTE positions to supervise ADOA FY 2004 Building Renewal projects.

Additionally, the Executive recommends \$1 million for Building Renewal for the ADOT Building System from the State Highway Fund. The Executive recommends 100% of Building Renewal formula funding for "Other Fund" agencies, including Game and Fish and the Lottery.

The Southern Arizona Mental Health Center (SAMHC) was sold in June 2002, and no further building renewal appropriations will be necessary. Reflecting the Executive's plans to sell the Veterans Memorial Coliseum, that facility is excluded from the Building Renewal calculation for the Arizona Expositions and State Fair Board.

Fund Shift: FY 2004 capital outlay

Pioneers Home Plumbing Renovation

- General Fund..... (\$469,900)
- Legislative, Executive, Judicial Land Fund\$469,900

The Executive recommends a fund switch for the Pioneers Home Plumbing system, to include a \$469,900 reduction in a prior General Fund appropriation and an additional \$469,900 FY 2003 supplemental appropriation from the Legislative, Executive and Judicial Land Fund. The General Fund would continue to pay \$30,100, and other appropriations would remain unchanged from the amounts appropriated in Laws 2001, Chapter 237 and Laws 2002, Chapter 343.

Other Funds: FY 2004

As is detailed in Table I, several Game and Fish Department projects are recommended as part of the FY 2004 Executive Capital Outlay Budget. This agency has a dedicated source of funds that can be used solely for projects that support its mission.

The ADOA Capital Outlay Stabilization Fund has two projects for which monies from a similar revolving fund may be used.

The majority of the funding is recommended for ADOT for its highway construction program. The State Transportation Board has specific responsibility for establishing project priorities. Historically, the Legislature has provided a lump-sum appropriation for the statewide highway construction program.

CORRECTIONS FUND

- Project Reversions (\$6,175,700)
The Executive recommends that \$6.2 million be reverted from previously appropriated Capital Projects to the Corrections Fund. Among those projects are:
 - \$197,900 from the FY 1996 appropriation for Lewis Prison Complex planning and site acquisition;
 - \$280,800 from FY 1996 and FY 1997 appropriations for construction of 800 level-4 beds in Yuma;
 - \$4,692,100 appropriations for the cancelled Tucson II prison complex;
 - \$351,600 from a FY 1995 Globe 100-bed buildout;
 - \$153,100 from the FY 1999 Douglas Wastewater project; and
 - \$500,200 from DJC projects.

CAPITAL OUTLAY STABILIZATION FUND

- Privatized Lease to Own Relocation \$291,800
DHS will be consolidating its operations into one of two PLTO II project buildings being constructed on the Capitol Mall. No monies from the annual \$60,000 appropriation to the ADOA Relocation Special-Line Item (SLI) have been expended since FY 2000. This funding does not lapse, so \$288,400 in unspent expenditure authority is available. The Executive recommends expending all of the unspent Relocation SLI monies, as well as \$291,800 in new appropriation, in FY 2004 for relocation expenses associated with the second PLTO project. Additionally, the Executive recommends 3.0 FTE positions to supervise and provide administrative help for the relocation.
- Health Lab COP Payment \$2,371,600
The Executive recommends \$2,371,600 from the Capital Outlay Stabilization Fund for the initial lease-purchase payment for the new State Health Lab, which is scheduled to open in June 2003. The Health Lab and the new DHS building are the second group of buildings lease-purchased under the PLTO program. The lease-purchase payment for the new DHS building is appropriated in the DHS operating budget.

GAME AND FISH FUND

- Game and Fish facilities improvements \$360,000
The Executive recommendation provides \$360,000 for facilities improvements to the Canyon Creek Fish Hatchery. This appropriation will allow the purchase of two clarifiers to improve the quality of water being discharged into Canyon Creek.
- Shooting Range Development \$100,000
Continued support of the annual statewide Shooting Range Development program provides competitive matching grants for improvements on a 50-50 basis. The State monies will be matched by \$100,000 in user group contributions, and Game and Fish work crews will provide the labor.

GAME AND FISH CAPITAL IMPROVEMENT FUND

- Deer Valley headquarters expansion (\$1,512,300)
The Executive recommends the reversion of (\$1.5 million) in previously appropriated funding for the expansion of the Game and Fish Department's Deer Valley Headquarters. The Department is considering relocating its headquarters, but the decision will take some time to finalize and implement. At that time, the Department will request a modified amount for the headquarters relocation. In the interim, the Game and Fish Department wishes to use these monies for other projects.
- Bellemont shooting range development \$500,000
The Executive recommendation provides \$500,000 to complete roads, parking, and the main 50-station shooting range at Bellemont, near Flagstaff. This range has been under development since 1995, in cooperation with the Northern Arizona Shooters Association, and has previously received \$1 million for fencing and road construction.
- Pinetop warehouse and paving \$310,000
The Executive recommendation provides \$310,000 to complete a warehouse and paving of the main driveway to the Pinetop regional office parking lots. Both of these items were intended to be included in the original FY 2000 \$500,000 and FY 2002 \$300,000 appropriations, but the bids for that project came in significantly higher than anticipated.
- Headquarters security systems \$200,000
The Executive recommendation provides \$200,000 to improve the security system for the Deer Valley Department Headquarters complex. These improvements would include the installation of card readers, compatible security alarm panels, and the improvement of video monitoring systems.
- Lake Havasu shooting range \$300,000
The Executive recommends an appropriation of \$300,000 for a shooting range in the Lake Havasu area. With this appropriation and another \$300,000 in a future appropriation, the Department is planning to provide

perimeter fencing, gravel roads, utilities, and five shooting areas. The shooting will include public, pistol, practical pistol, trap and skeet, and sporting clays ranges.

WATERFOWL HABITAT FUND

- Migratory waterfowl habitat..... \$100,000
Revenues are generated through the sale of duck stamps and earmarked for purchasing land suitable for waterfowl habitat. The recommendation is an estimate of the revenues that will be generated during FY 2004.

STATE HIGHWAY FUND

ADOT Building System

- Highway construction \$31,300,400
The FY 2002 Executive Budget includes \$31.1 million for highway construction from the State Highway Fund.
- Highway construction, controlled-access..... \$63,068,600

The Highway User Revenue Fund (HURF) formula earmarks a specific percentage of funds for the construction of controlled access roads in Maricopa and Pima counties. The Executive recommends the estimate of available monies be utilized for this purpose.

- Debt service..... \$62,220,000
The Executive recommends \$62.2 million for debt service payments associated with the issuance of revenue bonds.

Debt service

The Arizona Constitution places a \$350,000 ceiling on the level of General Obligation debt that the State may incur. However, State government has relied on COPs and revenue bonds to fund numerous construction projects.

Table II (*next page*) provides a summary of the projects that have been funded through debt instruments.

ADOT has the authority to issue up to \$1.3 billion in bonds against the Highway User Revenue Fund (HURF). The bond payments are enforceable only from the HURF.

Table I
Other Fund Capital Outlay

	Fund	Executive Recommendation
FY 2003 Appropriations Already Enacted		
Health Lab Lease-Purchase Payment	LEJ Land Fund	<u>911,500</u>
<i>Total FY 2003 Other Fund Supplemental</i>		911,500
FY 2004 Recommendation		
<u>Building Renewal</u>		
ADOA	COSF	1,894,900
ADOT – Highway Fund	State Highway	1,000,000
ADOT – Aviation	Aviation	64,000
State Fair Board	Enterprise	332,400
Game and Fish	Game and Fish	323,300
Lottery	Lottery	<u>37,900</u>
<i>Subtotal Building Renewal</i>		3,652,500
<u>Capital Projects</u>		
DOC Reversions of Prior Appropriations	Corrections	(6,175,700)
ADOA Pioneers Home Plumbing Renovation	LEJ Land	469,900
ADOA PLTO II Relocation	COSF	291,800
ADOA Health Lab Lease-Purchase	COSF	2,371,600
Game & Fish Facility Improvements	Game and Fish	360,000
Game & Fish Shooting Range Development	Game and Fish	100,000
Game & Fish Headquarters Expansion & Renovation	G&F CIP	(1,512,300)
Game & Fish Bellemont Shooting Range Development	G&F CIP	500,000
Game & Fish Pinetop Warehouse and Paving	G&F CIP	310,000
Game & Fish Headquarters Security System	G&F CIP	200,000
Game & Fish Lake Havasu Shooting Range	G&F CIP	300,000
Game & Fish Migratory Waterfowl Habitat	Waterfowl	100,000
ADOT Highway Construction	State Highway	31,300,400
ADOT Controlled-Access Highways	State Highway	63,068,600
ADOT Debt Service	State Highway	<u>62,220,000</u>
<i>Subtotal Capital Projects</i>		<u>153,904,300</u>
Total FY 2004 Other Funds		157,556,800

Table II
COPs and Revenue Bonds

<i>Project Year</i>	<i>Original Issue</i>	<i>FY04 Payment</i>	<i>Outstanding Balances 7-1-02</i>
ADOA Building System COPs			
1993B	\$ 31,250,000	\$ 2,504,100	\$ 25,398,900
2001A	56,480,000	9,104,500	70,263,400
2001B	1,450,000	-	1,497,100
2002A	63,270,000	3,816,100	94,339,100
2002B	<u>75,295,000</u>	<u>5,939,400</u>	<u>97,853,200</u>
<i>ADOA Building System Total</i>	227,745,000	21,364,100	289,351,700
Board of Regents Lease Purchase and Long-Term Debt			
University of Arizona - Various	320,732,000	28,852,000	298,328,000
Arizona State University - Various	172,559,000	13,198,000	154,772,000
Northern Arizona University - Various	<u>4,514,000</u>	<u>476,000</u>	<u>3,099,000</u>
<i>Subtotal</i>	497,805,000	42,526,000	456,199,000
Board of Regents Revenue Bonds			
University of Arizona - Various	294,725,000	27,821,000	237,285,000
Arizona State University - Various	344,301,000	25,042,000	280,093,000
Northern Arizona University - Various	<u>116,620,000</u>	<u>11,430,000</u>	<u>79,025,000</u>
<i>Subtotal</i>	755,646,000	64,293,000	596,403,000
SFB School Construction Bonds			
<i>Outstanding Bonds*</i>	767,135,000	26,280,000	488,500,000
Department of Transportation HURF Bonds			
<i>Outstanding Bonds</i>	1,246,900,000	86,496,000	734,155,000
Total	\$ 3,495,231,000	\$ 240,959,100	\$ 2,564,608,700

*An additional \$278.6 million was issued in August 2002, and is not recorded in the Outstanding Balances 7/1/02 figure for the School Facilities Board.

Acknowledgement

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