

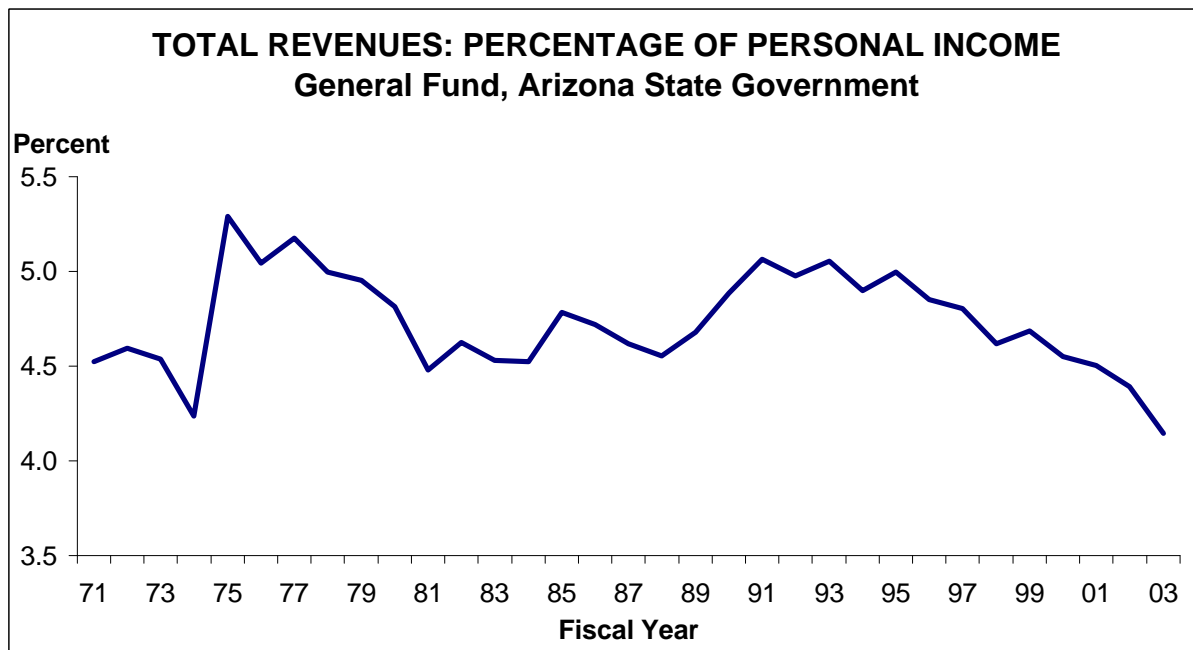
POPULATION GROWTH PLUS INFLATION: SCR1003 Shortchanging Our Future

Policy Analysis Brief
By David Wells, Ph.D.
(Political Economy and Public Policy)
Arizona State University
(480) 727-7038
wellsda@mainex1.asu.edu

Arizona faces an unprecedented budget shortfall and lawmakers are seeking ways to balance the budget this year and also address long-term problems. SCR1003, the budget stabilization act, aims to limit state spending increases to population growth plus inflation. Unfortunately, while SCR1003 would limit spending and provide a framework for budgeting, it would come at great cost to the state's future, ultimately undermining economic growth and our ability to improve wage levels. In short, SCR1003 would lead to poorer government service, make it more difficult to improve our educational system and make it harder for state government to recover from recessions.

The challenges posed by SCR1003

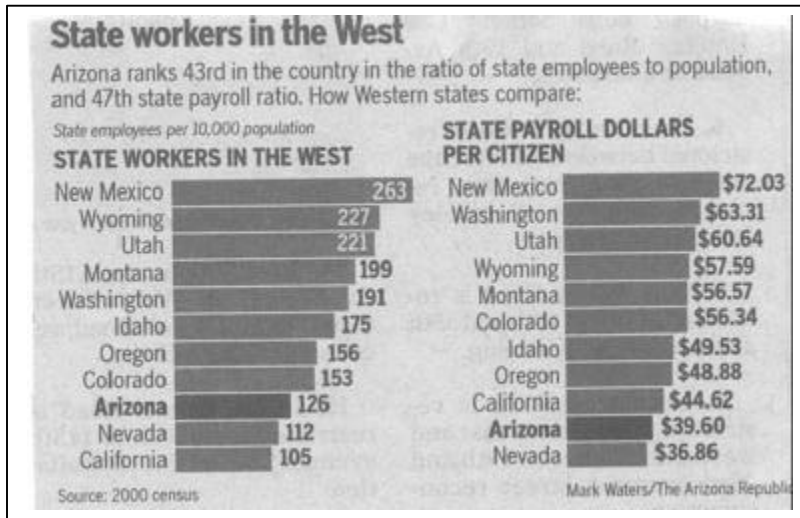
Presently state spending is limited by a ceiling measured by population growth plus inflation plus economic growth. The statutory benchmark used is total state personal income. State spending may not exceed 7% of state personal income. State legislators have kept state spending well-below this level, and this is not the cause of our current budget problem.



Source: Joint Legislative Budget Committee, "Historical General Fund Revenue Collections" spreadsheet.

SCR1003 would limit growth in state expenditures to population growth plus inflation. By necessity, assuming economic growth, state expenditures would FALL relative to the size of the economy. To fiscal conservatives this makes ideological sense, but practically speaking would create significant problems. Some of the key problems are identified below.

Problem 1: Employee Pay Raises that Just Match Inflation In Good Times Won't Make For Productive Government

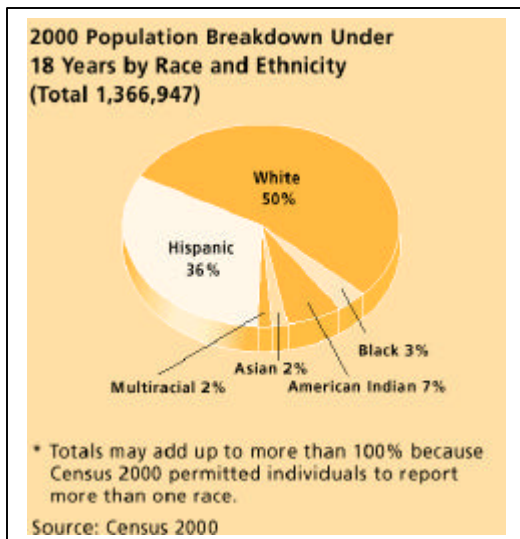


State Employees are underpaid leading to costs of turnover and poor morale, which undermines governmental effectiveness. Leading example: corrections officers paid \$25K a year with a 25% annual turnover rate.

Addressing issues like this requires that salaries be adjusted to market levels—but that means salaries need to rise FASTER than inflation. When you recognize that during a low revenue year state employees

receive a real pay cut (no adjustment for inflation), we would expect already low state employee pay to sink relative to the private sector wages or other states. Ultimately we lose our most productive employees. Employees are any institution's greatest asset. Citizens have a right to expect good government service. SCR1003 is not a path to better government service.

Problem 2: Education Is Our Future, But We'd Likely See Worse Educational Performance.



While the 2000 census showed that Arizona was becoming increasingly Hispanic, the largest growth in the Hispanic population is among young people. Drop out rates among Hispanics are alarmingly high. School districts must make significant investments in teachers, small class sizes, and support services to help students build a foundation for success.

If population grows faster among children, then funding for K-12 would need to grow faster than overall population. This would exacerbate the challenge of adequately funding education. We know that those without a high school degree will face significant economic challenges and are far more likely to be a future financial burden on the state.

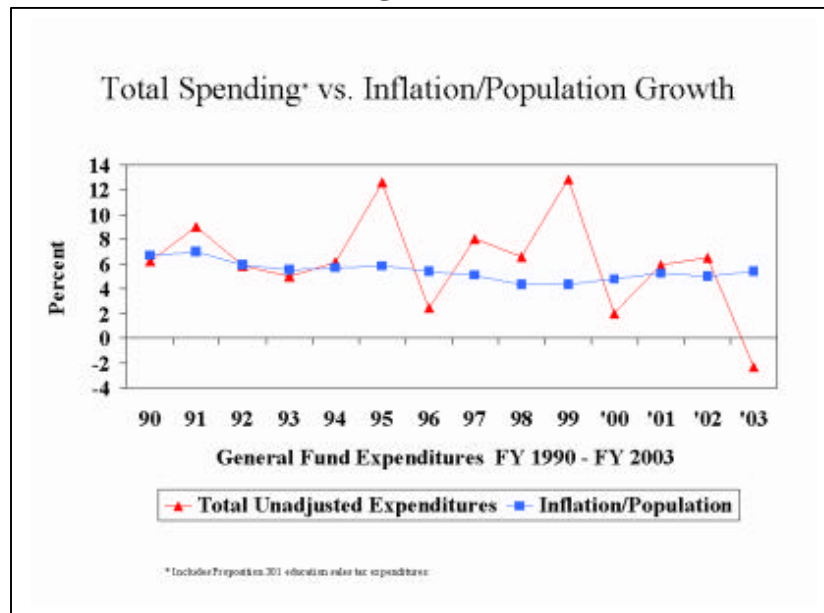
Investing in our future is important. As economies become more prosperous and efficient, they invest a greater share of GDP in education and health care. This is true not only in the United States, but among all leading economies from Europe to Japan. In layman's terms, this means that expenditures for education and health care grow faster than population growth plus inflation. In fact, they grow faster than population growth plus inflation plus economic growth. Since state government plays a key role in these areas, it would be dangerous to limit the ability of state government to meet educational and health care needs. Companies are going to be less likely to bring high paying jobs here if our educational system under performs.

Problem 3: Colorado may have passed something like SCR1003 in 1992, but it's not a path that Ronald Reagan took or most cities would advise.

While many conservatives applaud the notion of smaller government, in fact, during the Reagan Revolution, the federal government grew faster than population growth plus inflation. We simply do not have sufficient historical evidence that imposing such a stern limit would have positive outcomes. Even Colorado hasn't been tested across a business cycle (see below).

After all, if this is good policy for the state, shouldn't it also be good policy for cities? Which city has limited its expenditure growth to population growth plus inflation? Population growth typically requires building infrastructure. Infrastructure may well last for a long time, but the building costs on top of operations will normally outpace population growth plus inflation. Perhaps the former Mayor of Chandler, now a State Senator, could help explain his experience with how a city meets the costs of growth. Arizona is a growing state. We need the spending flexibility to manage growth effectively.

Problem 4: During economic expansions, the state wouldn't be able to compensate for a failure to fund needs during recessions



If you look at state spending you see that it is far more variable than inflation plus population growth. Even though on average the state has roughly matched inflation and population growth in the last decade, recessions see significant drops. SCR1003 would prevent state government from addressing this imbalance once revenues improve.

Currently many state agencies are being asked to take significant cuts. When

SCR1003: Shortchanging Our Future

revenues rise, state governments often need to play catch up. Building maintenance has been delayed. Staff vacancies need to be filled, and needed public services that were temporarily cut need to be restored. While the budget stabilization fund would partially act to stabilize state spending, it's unlikely to eliminate this business cycle effect completely. When revenues fall, the state would find itself challenged to maintain sufficient levels of services and then pre-empted by SCR1003 from making up for lost ground when revenues recovered.

We currently have a spending limit formula, 7% of State Personal Income. We're not close to this limit presently, and it gives the state ample flexibility in meeting needs, while guarding against too large of a government. As Arizona spends 85% of what the typical state spends per capita, imposing the added limits of SCR1003 would imperil the state's ability to provide the necessary public investment and public services to assure strong economic growth in the future.