

Arizona Budget 2015: Incremental Movement for Children

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Introduction

The Fiscal Year 2015 (July 1, 2014–June 30, 2015) Arizona budget showed modest revenue improvements. However, the Joint Legislative Budget committee’s three-year forecast continues to show an overall weak budget picture moving forward.

In times of economic growth, albeit modest in this case, the state normally pays back accounting maneuvers used to keep a “balanced budget” during economic slow times and to fund possible new initiatives. Arizona lacked the financial resources to accomplish this, meaning the fiscal situation remains precarious and quite vulnerable to an economic downturn in coming years.

Court decisions and public outcry forced the legislature to adjust K-12 funding for inflation and remedy a crisis in Child Protective Service. In addition, the Medicaid expansion narrowly passed in 2013 seems to have made possible the resolution of a 30-year lawsuit regarding underserving the mentally ill.

In September 2013, the state Supreme Court ruled that the legislature since 2009 had improperly funded the inflation formula for K-12 education and remanded the case back to the Superior Court to work out the details. While this has the potential to cost the state up to \$2.9 billion through FY2019, the legislature only appropriated a small portion for FY2015.

In November 2013 it became publicly known that more than 6,000 cases of possible child neglect or abuse had failed to be investigated by Child Protective Services. Governor Brewer in her final state of the state address called for separating Child Protective Services from the Department of Economic Security into an independent agency and a complete review and development of best practices. Child Safety and Family Services received an additional \$115 million in the FY2015 budget, substantially increasing staff. However, Arizona’s very high rate of children in foster care continues to put pressure on the agency.

In January 2013, *Arnold v. Sarn*, a 1981 case, was settled whereby the state agreed to improve the coverage provided for the severely mentally ill. Medicaid expansion and the financial help provided through that combined with the governor’s interest with her son’s experience seem to have been leading factors to the resolution of this case.

Arizona’s Weak Economic Growth

Arizona’s job growth, while historically better than the national average, has been significantly different since the 2008 recession. Population growth has been a key component of the

state's economic growth as Arizona is in the lower portion of states in terms of per capita income. Population growth has slowed more substantially than that in neighboring states or the nation as a whole. In the years prior to the recession, the state population grew around five percent annually, then dropped dramatically to closer to one percent (Toll 2014).

In December 2008, the labor force in Arizona peaked at 3.14 million and the unemployment rate stood at 8.2 percent. Then a continual drop in the labor force persisted until January 2013 when the labor force reached a low of 3.01 million with unemployment at 7.7 percent. This behavior is unprecedented in Arizona's post World War II history, and even by December 2014, despite an unemployment rate of 6.2 percent, the labor force was still below its level six years earlier at 3.12 million. Figure 1 illustrates that, compared to Arizona's most recent 25-year history which included two earlier recessions, Arizona would expect to have half a million more jobs than they have today (Bureau of Labor Statistics 2015).

Among neighboring states, a similar pattern is only found in New Mexico. California, Colorado and Utah have seen significantly stronger growth. Even Nevada, which arguably was hit harder during the Great Recession than Arizona, has recovered somewhat faster (Bureau of Labor Statistics 2015).

Budget Process

Arizona approves an annual budget together with a three-year budget plan. Real negotiations address the next fiscal year's budget, while general parameters are set for the two subsequent years. With a fairly unified Republican caucus this year, the minority Democrats were excluded from the budget negotiations and opposed the budget.

The executive and legislative budgets were not substantially out of alignment. As is often the case in Arizona, the executive assumes more robust growth and has higher spending targets (see Table 1).

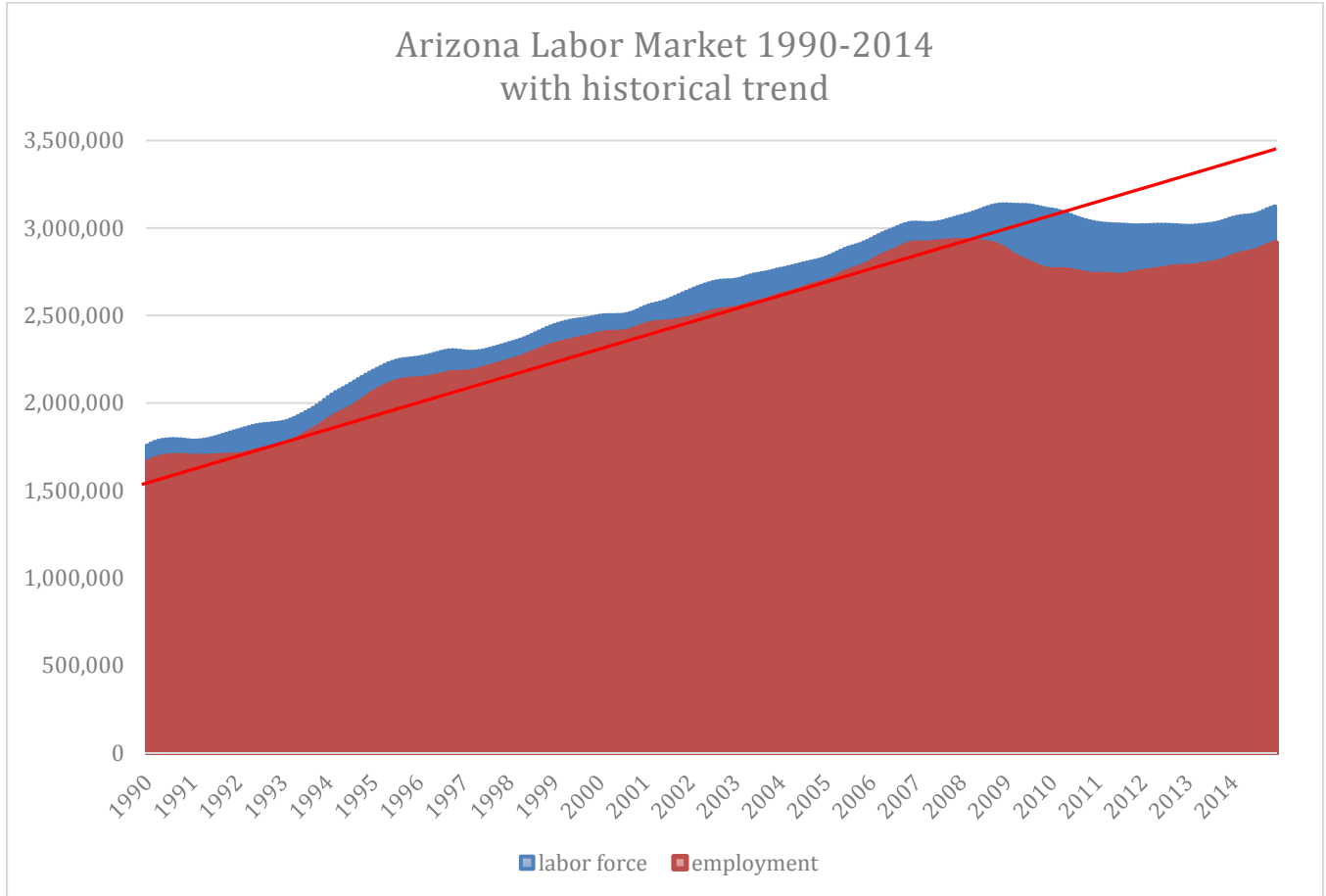
Consequently negotiations focused around the total level of spending and in particular two specific areas that had to be increased: Child Protection and K-12 Education.

Child Protection

The primary area of disagreement related to start up funds and expansion of support for Child Protection Services. In November 2013, Child Protection Services (CPS), part of the Department of Economic Security, revealed that going back to 2009, 6,554 cases of suspected child abuse had not been investigated or were misclassified. Five thousand of those had been in the prior 20 months (Pitzl and Reinhardt 2013). In Arizona CPS caseworker caseloads are 77 percent higher than the national standard. The case made national news and led to numerous calls for a thorough investigation and revamping of how Arizona handles foster children and those suspected of being abused and neglected. CPS Director Clarence Carter's agency request was for 444 more workers and \$115 million (Governor Janice K. Brewer's Independent Child Advocate Response Examination (CARE) Team 2014).

Caseloads, while high, had been dropping due to a supplemental appropriation in FY2013 that had enabled the hiring of 200 more staff. Consequently, Arizona's performance relative to the national caseload standard improved from double the national standard to 177 percent of it, and the number of inactive cases (in addition to the cases noted above) had dropped from a peak

Figure 1. Arizona Labor Force, Employment and Historical Trend



Source: Current Population Survey.

of nearly 14,000 in December 2012 to just over 10,000 in August 2013. The cases have been started, but may be neglected. “Non-Active Cases are defined as cases that have had no case notes or service authorizations for 60 days or more” (Child Protection Services Oversight Committee 2013). They may be ready for closure, but not necessarily (see Figure 2).

In many ways the noninvestigated cases were a symptom of a much deeper problem, a huge increase in the number of children in foster care, which seems to be causing stress on the agency. In FY2003 Arizona had a lower rate of children in foster care than the national average and was one of 15 states with the lowest rate of children in foster care. By FY2008 and FY2009, Arizona was in line with the national average, and as of FY2013, Arizona’s rate of children in foster care was nearly double the rate in FY2003 and nearly double the national average (which has been falling) placing the state among the 10 highest in the country (Kids Count Data Center 2015). The dramatic rise in children in foster care has correlated with very tight fiscal times and the highest poverty rates since the Great Recession as shown in Figure 3. While some speculate that the under-resourced agency began relying on federal Title IV-E funding that pays for foster care, no independent analysis has been done to date.

Table 1. Executive versus Senate Budget Proposals

	FY15 Exec.	FY15 Senate	FY16 Exec.	FY16 Senate	FY17 Exec.	FY17 Senate
<i>Beginning Balance</i>	\$676.0	\$600.9	\$244.0	\$180.1	\$236.4	(128.4)
Revenues – January Baseline	\$8708.1	\$8,708.1	\$9,061.1	\$9,061.1	\$9,465.1	\$9,465.1
Executive Base Revenue Adjustment	\$217.5		\$331.1		\$357.7	
Proposed Tax Legislation	(\$30.0)	(\$30.0)	(\$30.0)	(\$30.0)	(\$30.0)	(\$30.0)
Long Term Care System Fund Transfer	\$25.0	\$35.0	\$25.0	\$35.0	\$25.0	\$35.0
DOR Fraud Detection	\$8.0		\$8.0		\$8.0	
Technical Agency Shifts	(\$0.2)		(\$3.9)		(\$3.3)	
Total Revenues	\$9,604.4	\$9,314.0	\$9,635.3	\$9,246.2	\$10,058.9	\$9,341.7

* \$ in Millions

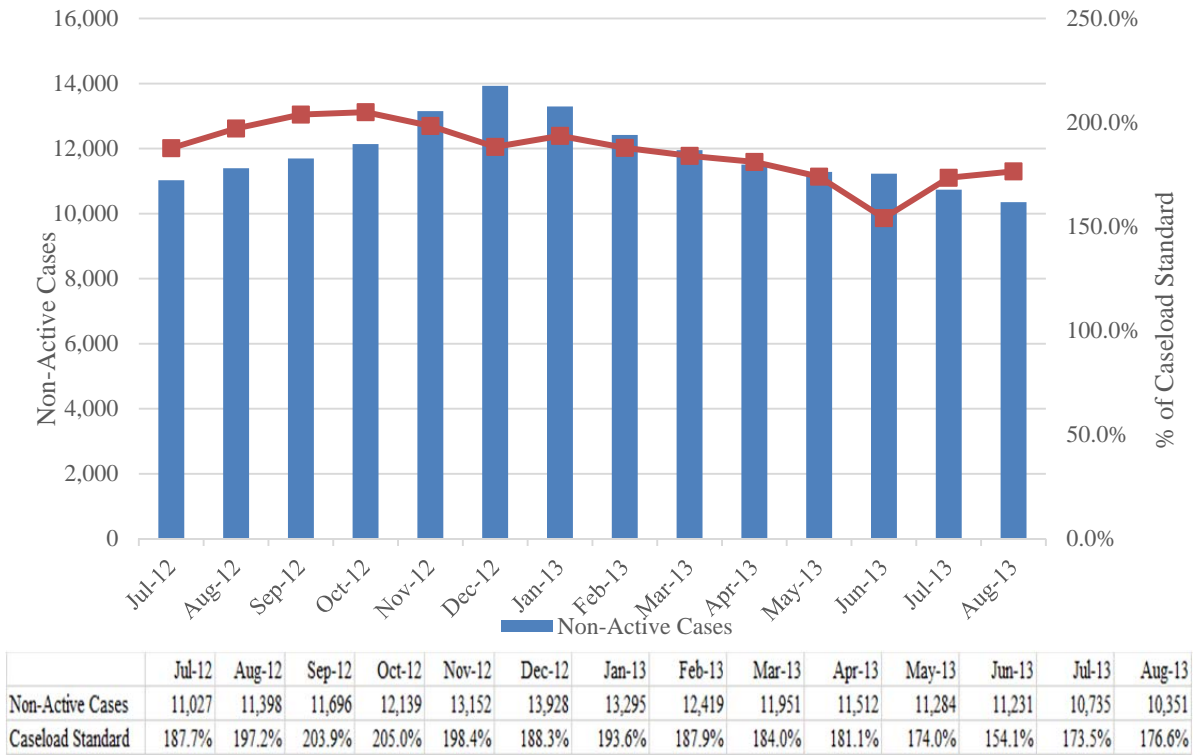
Source: Joint Legislative Budget Committee, Senate Budget Compared with Executive Budget, March 18, 2014, <<http://www.azleg.gov/jlbc/fy15comptexec.pdf>>.

Consequently, Child Protective Services was in crisis. Brewer responded with an executive order announced in her State of the State address in January creating a new child protection agency separate from the Department of Economic Security. The new Child Safety and Family Services (CSFS) became organizationally distinct while retaining the same director. The executive budget included about \$90 million in new funding for FY2015, including \$21.5 million to hire 350 more case workers and support staff.

The senate released a more stringent budget in March 2014 included only \$34 million with 11.1 million to hire 192 more case workers and support staff (Joint Legislative Budget Committee 2014a). The agreed upon budget passed on April 7, 2014, increased funding by \$59 million, including \$15.3 million to fund 242 additional case workers and support staff (Children's Action Alliance 2014).

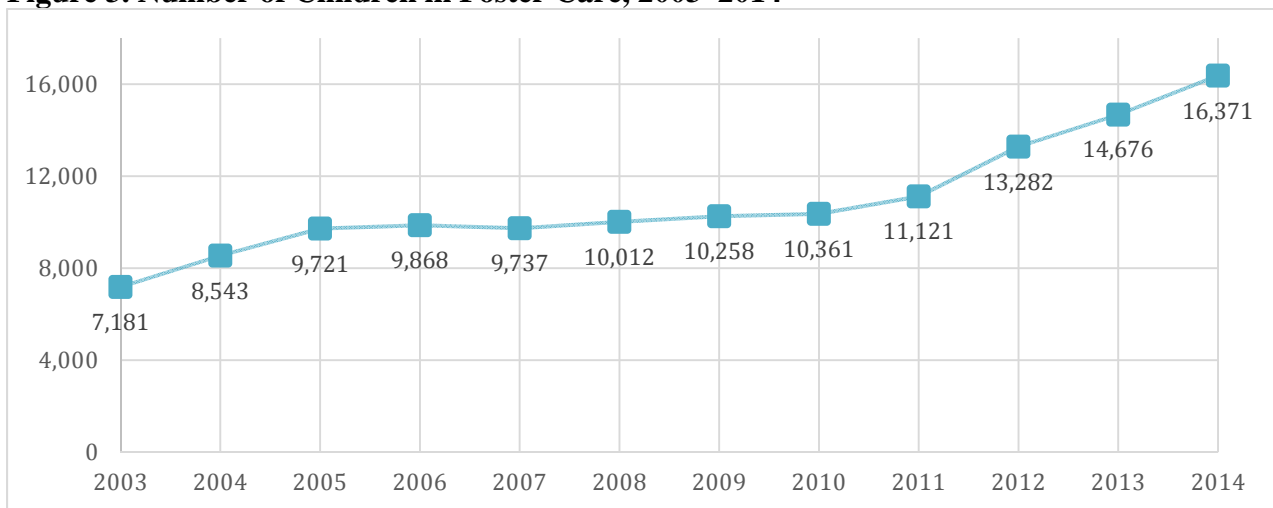
As expected on May 22, 2014, the governor called a special session, seeking legislation that would make her executive action law as well as \$55 million in added funding. A three-day session followed and concluded on May 29 giving the governor what she asked for (Associated Press 2014). Child protection investments increased by about \$115 million for FY2015.

Figure 2. Child Protection Backlog and Caseload Standard



Source: Child Protective Services Oversight Committee, Dec. 16, 2013, <[https://www.azdes.gov/uploads/Children_Youth_and_Families/Child_Protective_Services_\(CPS\)/CPS_Oversight_FS_Hotline.pdf](https://www.azdes.gov/uploads/Children_Youth_and_Families/Child_Protective_Services_(CPS)/CPS_Oversight_FS_Hotline.pdf)>.

Figure 3. Number of Children in Foster Care, 2003–2014



Source: selected Child Welfare Reporting Requirements Semi-Annual Reports, average of each year's two reports.

K-12 Education

In 2000, the legislature referred to the ballot Prop. 301, which was passed by voters and dedicated a 0.6 percent sales tax to K-12 education. The proposition also guaranteed to increase base funding level by an inflation factor every year. Despite a temporary special election for a three-year one-cent sales tax that began in June 2010 (fiscal year 2011), when the federal stimulus funds ran out in 2010 the legislature stopped funding the full inflation adjustment and only applied the inflation adjustment to the transportation portion of student funding (not the much larger base student funding). A lawsuit ensued, *Cave Creek Unified School District et al. v. State of Arizona*, saying that the Voter Protection Act, a citizen initiative from 1998, precluded the ability of the legislature to undermine the intent of Prop. 301. While the state won at the superior court level, the appellate court reversed it, and in September 2013 the Arizona State Supreme Court ruled the legislature's actions contrary to Prop. 301 (Arizona Center for Law In the Public Interest 2014).

The legislature anticipated losing the case and the FY2014 budget had restored the full inflation adjustment to a base that had not been adjusted since 2009. The supreme court remanded the case back to the superior court to work out details, but the total exposure to the state could be as high as \$1.7 billion over three years, a huge amount for total General Fund that's just above \$9 billion, especially given how tight revenues remain.

The bases the Arizona Legislature had established were as follows (Grado 2014):

Per-pupil base level FY 2009–13: \$3,267.72

Per-pupil base level FY 2013–14: \$3,326.54

Per-pupil base level if inflation adjustments had been made: \$3,559.62

Plaintiffs argue the state needs to increase the current base level to the appropriate amount, which would cost more than \$300 million each year. FY2009–2014 were systematically underfunded, and plaintiffs said the state should pay back that part over five years, which the Joint Legislative Budget Committee (JLBC) calculates as \$252 million per year (see Table 3).

Not surprisingly, the conservative leadership of the state is not immediately complying, and the plaintiffs will have to see whether the courts will be willing or even able to enforce this hefty price tag on the state. Evidentiary hearings were held in fall of 2014, and negotiations continue with no resolution during FY2014–2015.

As can be seen in Table 4, K-12 education funding increased in the recently passed budget but is only scheduled to increase by about half what plaintiffs want related to the full base level increase, and back payments are not addressed in FY2015–FY2017. While back payments may not be ordered, the base level adjustment is highly likely. As \$184 million falls short of \$317 million a base formula change would require, the state may very well be accruing a minimum past due amount of \$130 million in K-12 spending.

Mental Health Services

The *Arnold v. Sarn* lawsuit dates to 1981 for the state's failure to fund comprehensive mental health services for the severely mentally ill in the state's most populous county, Maricopa, as required by state law. The trial court agreed with the plaintiffs in 1986 and the state supreme court upheld that verdict in 1989, but a resolution failed (Arizona State Senate Research 2009). The January 8, 2014 settlement agreement was historic in setting service and enforcement standards. The agreed services for the seriously mentally ill included funding Assertive Community Treatment (ACT) teams, supported housing, employment, and peer and family support services.

Table 2. State Failure to Fully Fund Base Level Inflation Factor Per-Pupil

<i>Fiscal Year</i>	Actual		If Always Inflated		\$ Difference
	<i>Base Level</i>	<i>% Change</i>	<i>Base Level</i>	<i>% Change</i>	
2006	3,001.00	3.2%	N/A	N/A	N/A
2007	3,133.53	4.4%	N/A	N/A	N/A
2008	3,226.88	3.0%	N/A	N/A	N/A
2009 ¹	3,203.65	(0.7%)	3,291.42	2.0%	87.77
2010	3,267.72	2.0%	3,357.25	2.0%	89.53
2011	3,267.72	0.0%	3,397.54	1.2%	129.82
2012	3,267.72	0.0%	3,428.11	0.9%	160.39
2013	3,267.72	0.0%	3,496.68	2.0%	228.96
2014	3,326.54	1.8%	3,559.62	1.8%	233.08
2015 est	3,373.11	1.4%	3,609.45	1.4%	236.34

¹ Original FY09 budget set base level at \$3,291.42, but mid-year cuts caused “effective” base level to be \$3,203.65

Source: Joint Legislative Budget Committee, “K-12 Funding Lawsuit,” January 24, 2014, <<http://www.azleg.gov/jlbc/K-12InflationFundingLawsuit.pdf>>.

Table 3. K-12 Education Funding Lawsuit Financial Implications

Plaintiff Proposal on K-12 Inflation Lawsuit			
Fiscal Year	Base Level increase (\$)	Back Payments (\$)	Total (\$)
2015	\$316,837,500	\$252,593,300	\$569,430,800
2016	\$320,837,500	\$252,593,300	\$573,233,000
2017	\$324,808,100	\$252,593,300	\$577,401,400
2018	\$329,355,400	\$252,593,300	\$581,948,700
2019	\$334,295,700	\$252,593,300	\$586,889,000
3-year total	\$962,285,300	\$757,779,900	\$1,720,065,200
5-year total	\$1,625,936,400	\$1,262,966,500	\$2,888,902,900

Source: Joint Legislative Budget Committee, “K-12 Funding Lawsuit,” January 24, 2014, <<http://www.azleg.gov/jlbc/K-12InflationFundingLawsuit.pdf>>.

Over the following two years, the state agreed to meet benchmarks of 1,200 additional supportive housing units, an additional 800 people served by ACT teams, and significantly expand the

Table 4. FY2015–2017 Budget Framework

Budget Proposal Spending Changes by Category Compared to Prior Year (\$ in Millions)			
Spending Changes by Category	Enacted 4/11 FY 2015*	Enacted 4/11 FY 2016	Enacted 4/11 FY 2017
K-12 Education	184	147	181
Higher Education	35	(1)	5
Health and Welfare	124	68	95
Public Safety	33	10	3
ADOA Automation	17	(16)	(9)
Transportation	30	-	30
Capital	(26)	(24)	-
Other Agencies	18	(9)	-
Technical/Other	7	18	-
	422	191	304

*Relative to original FY14 JLBC Baseline

Source: Joint Legislative Budget Committee, "FY2015 Enacted Budget," April 11, 2014, <<http://www.azleg.gov/jlbc/enactedbudget4-11041414.pdf>>.

other services with an independent entity in subsequent years defining what future needs were to be met (Arizona Center for Law in the Public Interest 2014)

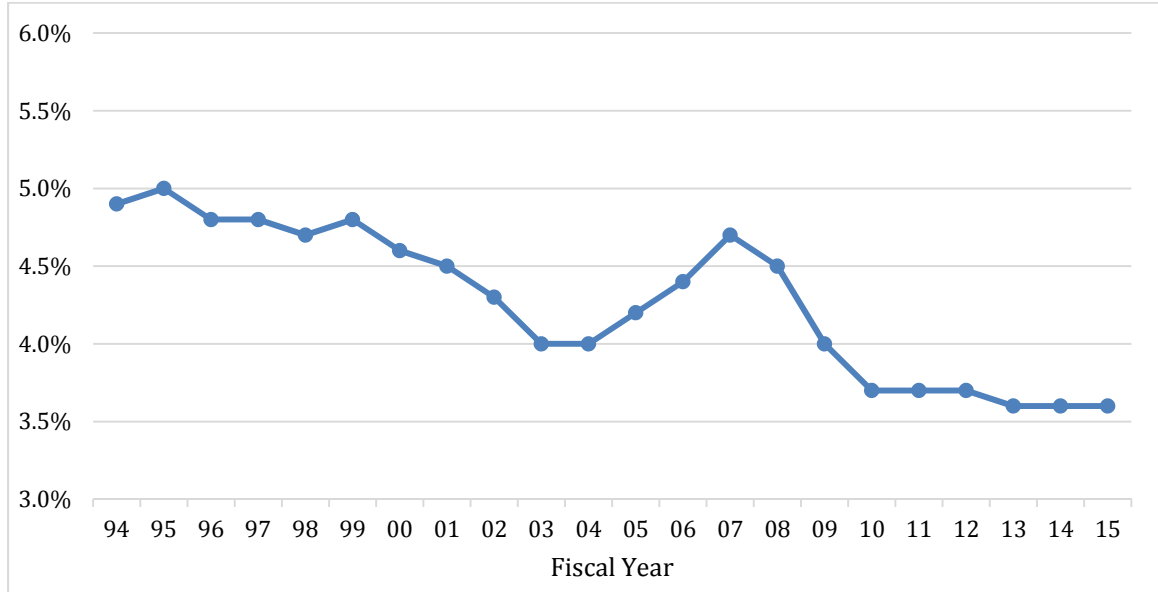
Medicaid expansion appears to have been a key factor in the settlement. The agreement relies on \$38 million for the state General Fund to be supplemented substantially by resources from Medicaid. The state estimates that a quarter of those covered by the state will shift to Medicaid, saving the state nearly \$10 million a year. Additional savings were expected through the higher federal government payment rate under Medicaid expansion, about 90 percent of costs instead of two-thirds (Pitzl 2014).

Overall Assessment

The Arizona budget situation is increasingly precarious, especially in light of the state's loss in the K-12 funding *Cave Creek v. Arizona* legal case. Ongoing revenues, current and projected, fall short of ongoing expenditures based on JLBC calculations. These calculations exclude one-time monies such as fund transfers and apply statutory funding requirements (excluding the K-12 funding lawsuit).

The JLBC estimates the structural deficit at \$400 million for FY2014, almost \$500 million in the enacted FY2015 budget, and projects it at \$350 and \$250 million in the subsequent two fiscal years. This means budgets will utilize any carry forward monies, along with fund transfers that are supposed to fund other areas outside the General Fund, as a means to balance the budget. In FY2014 it was a \$900 million balance forward and \$154 million in fund sweeps, and in FY2015 it was a \$600 million balance forward and \$54 million in fund sweeps (Joint Legislative Budget Committee 2014b).

Figure 4. General Fund Spending as a Percent of Arizona Personal Income



Source: Joint Legislative Budget Committee, General Fund Spending as a Percent of State Personal Income, September 16, 2014, <<http://www.azleg.gov/jlbc/GF-SpendingasPercentageofPersonalIncome91614.pdf>>.

Not included in these calculations are any additional monies to meet the K-12 funding lawsuit. Likewise, the state still has not paid back accounting maneuvers, such as rollovers where payments from one fiscal year are transferred to the next. Government buildings have been sold and are being repurchased through a lease-purchase agreement. Lottery proceeds were borrowed against during the last budget crisis, from which Arizona still has not emerged.

Yet at the state level there is very little discussion about how serious the potential ramifications are of the current budget situation. Tax increases require a two-thirds vote of the legislature, which is impossible with the Republican majority. The only other way to raise revenue is through a referral to the ballot, which requires a majority vote in both chambers, presents a highly challenging issue for Republicans, and is not likely to happen until 2015–16 at the earliest. A 2012 citizen’s initiative to make the temporary one-cent sales tax permanent failed two to one.

Doug Ducey, the former state treasurer who led the campaign opposing that ballot measure, replaced Jan Brewer in January 2015 as governor, and has vowed to find ways each year to reduce taxes. The consequence to date has been a significant deterioration of the General Fund as a percent of state personal income as demonstrated in Figure 4. General Fund spending that formally approached five percent of state personal income is now approaching 3.5 percent. It’s shrunk by nearly a quarter since FY2007, and that year was close to its historical norm over the prior twenty years as shown in Figure 4.

Underaddressed fiscal needs combined with a tight budget will continue as Republican leadership tries to maintain fiscal discipline for what they call the excesses leading up to the 2008 recession. Tax cuts remain on the agenda, with corporate tax cuts passed in 2011 continuing to

phase in through FY2018 at a cost of about half a billion dollars. Policy interest advocates continue to view state investments as inadequate—but so far it has taken lawsuits such as *Cave Creek v. Arizona* or major crises in state agencies, as with Child Protective Services, to make incremental changes.

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