



WESTMARC Annual Economic Development Symposium

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Presentation Overview



- How We Got Where We Are Today: *A Brief History of Arizona's Economic Growth*
- The State Budget: *How Bad Is It?*
- How We Can Grow Our Way Out of the Fiscal and Jobs Dilemma Through Competitive Tax and Workforce Policies

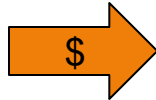
Economic Growth

- For an economy to grow, it needs to import money from outside sources.
- This “new money” generally enters the economy via one of the following:

Migration/Tourism



Exports



Investment



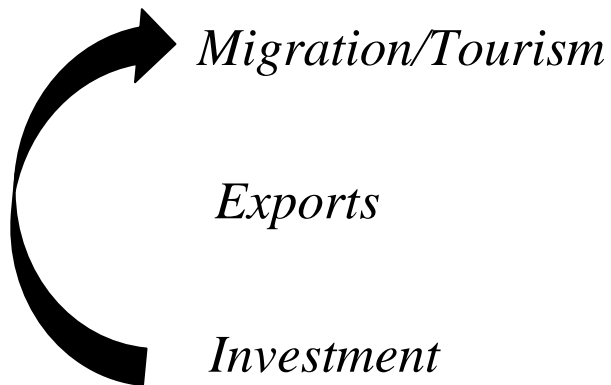
- Through the multiplier effect, this initial inflow of money stimulates economic activity throughout other sectors of the economy.

Growth

December 2001 - December 2007



- Prior to the Great Recession, **migration** and **tourism** were the primary drivers of “new money” entering the Arizona economy.
- Investment capital flowed to firms whose business models depended on continued migration and growth.



432,000
Arizona jobs created

3.7%
Unemployment rate, summer 2007

Growth

December 2001 - December 2007



Selected Industry Employment Changes

Industry	Employment Change	Percentage Change
Health Care	72,000	36%
Professional & Business Services	94,000	30%
Retail Trade	66,000	23%
Construction	40,000	23%
Leisure & Hospitality	49,000	21%
Manufacturing	-12,000	-6%

The Great Recession

- The global economic downturn severely impacted Arizona's growth-dependent economy.

Migration/Tourism



Exports



Investment



The Great Recession



335,000

Arizona job losses since December, 2007

9.7%

Current unemployment rate (highest in 27 years)

30

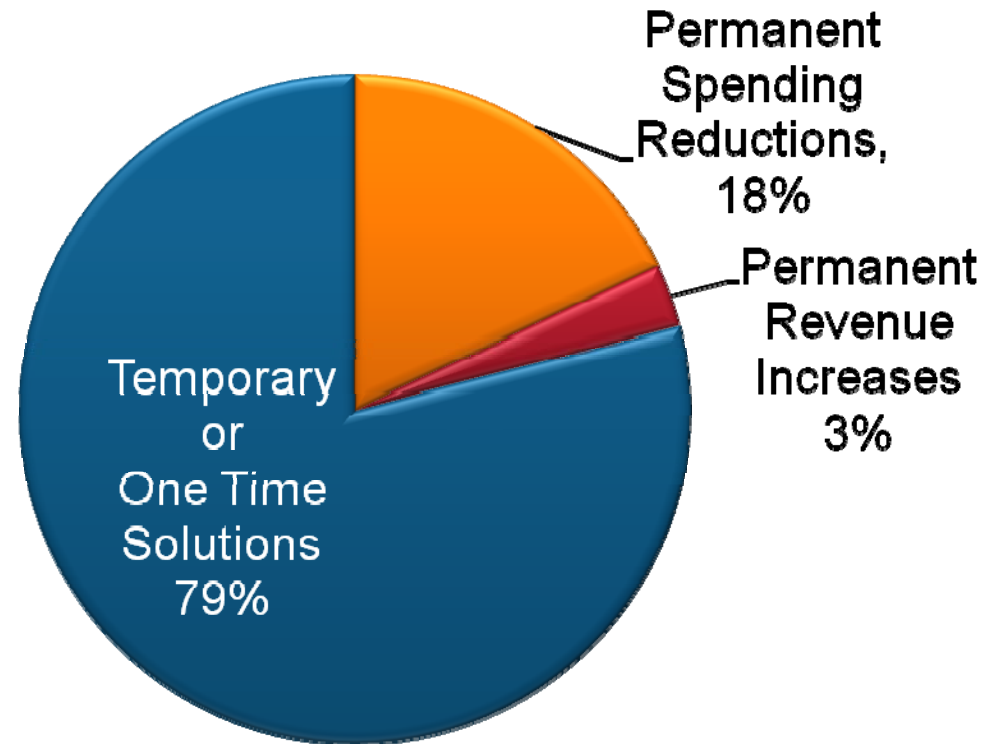
Consecutive months with year over year job losses
(March 2008-August 2010)

Budget Deficits, 2008-2011



\$12.5 Billion

- Since 2008, Arizona has dealt with budget shortfalls totaling \$12.5 billion
- The majority of the budget solutions have included fund sweeps, a temporary sales tax increase, federal assistance, use of debt, and other one time savings.



Budget Deficits, 2011 & 2012



FY 2011

Enacted Budget

\$8.5 Billion

Current Year Shortfall

\$825 Million

FY 2012

Ongoing Revenue

\$8.1 Billion

Ongoing Expenditures

\$9.6 Billion

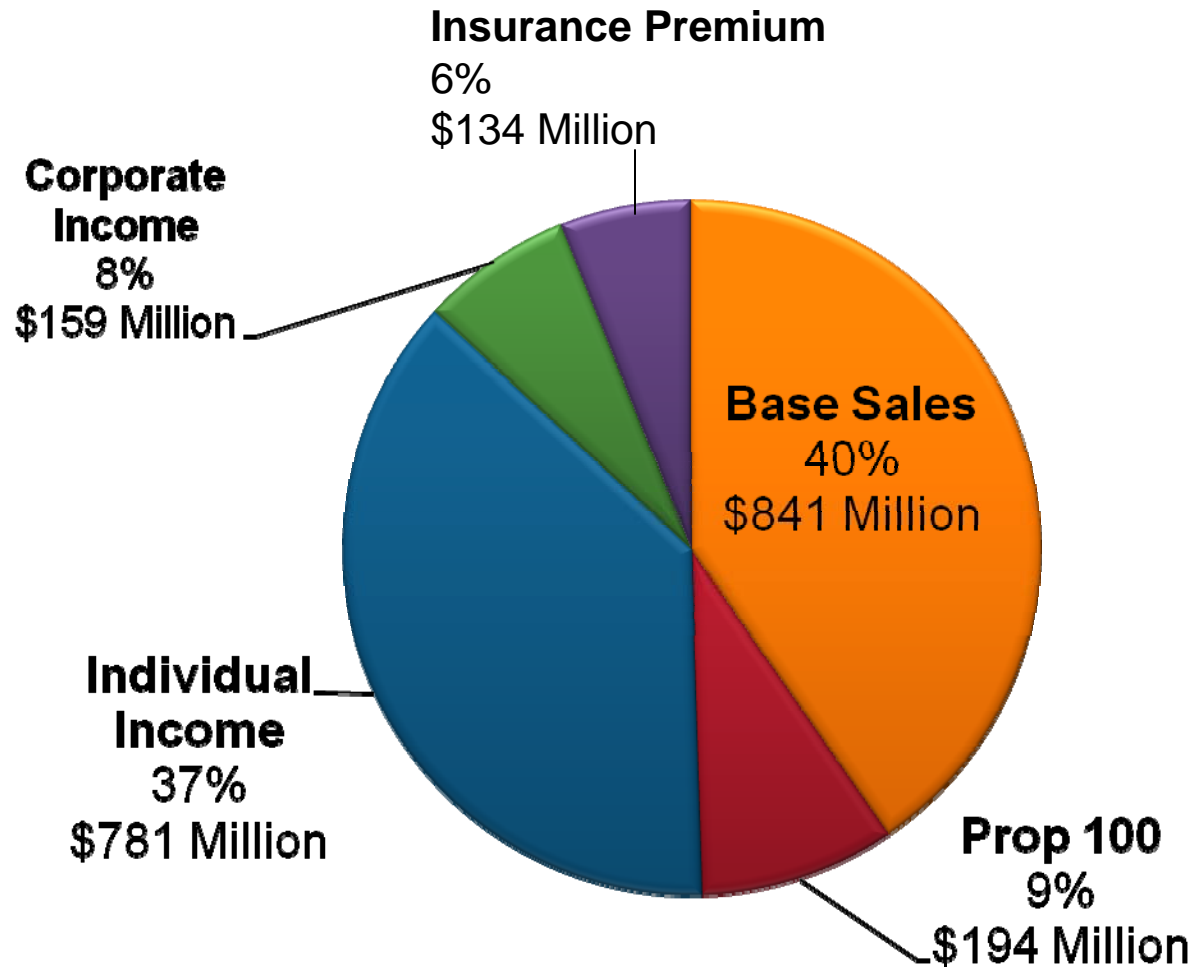
Structural Deficit

\$1.5 Billion

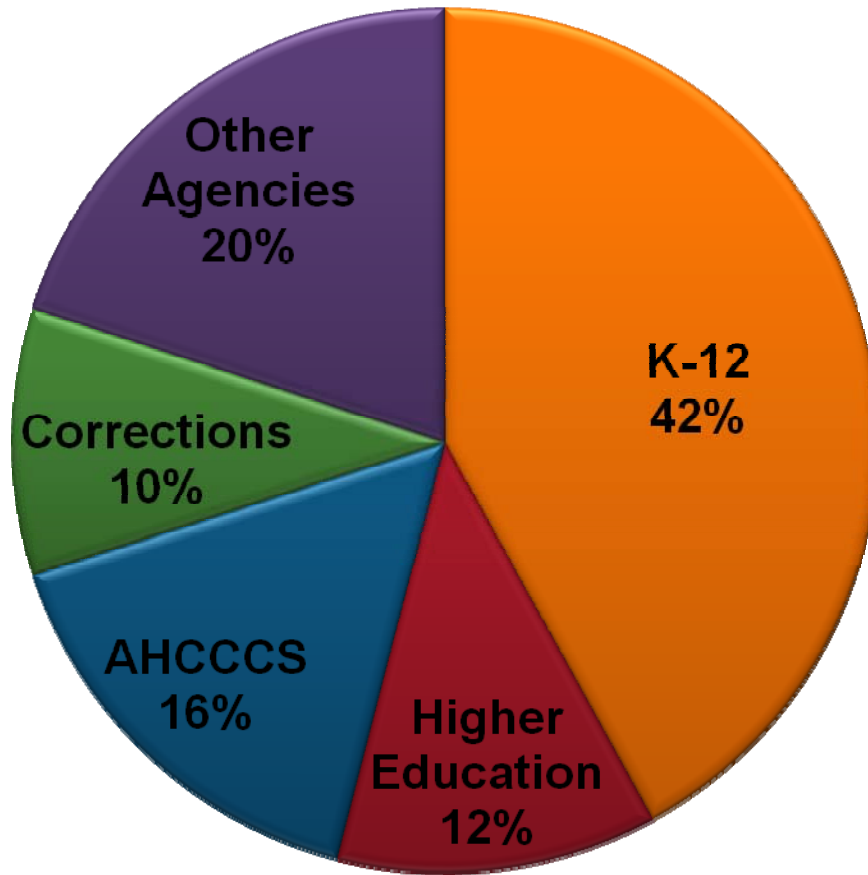
Q1 General Fund Revenue Update



Total Q1 Revenue:
\$2.1 Billion



2011 General Fund Budget: \$8.5 Billion



K-12 & Higher Education

\$4.5 Billion

Funding Priorities



- Programs that draw down exponential federal matching funds – Don't forfeit billions of dollars
- Proven educational training – Career and Technical Education
- Core healthcare funding – AHCCCS, Graduate Medical Education (hospital residencies), Disproportionate Share Hospital (DSH)
- Universities – Creative solutions to maintain research capabilities and provide cost-effective education.

The Long-Term Solution



- We can't CUT or TAX our way out of the dilemma
- Debt, fund sweeps, temporary federal stimulus funds, and accounting gimmicks have been exhausted
- The only sustainable path to recover and prosperity is to GROW our way out through economic diversification and the creation of high-wage jobs

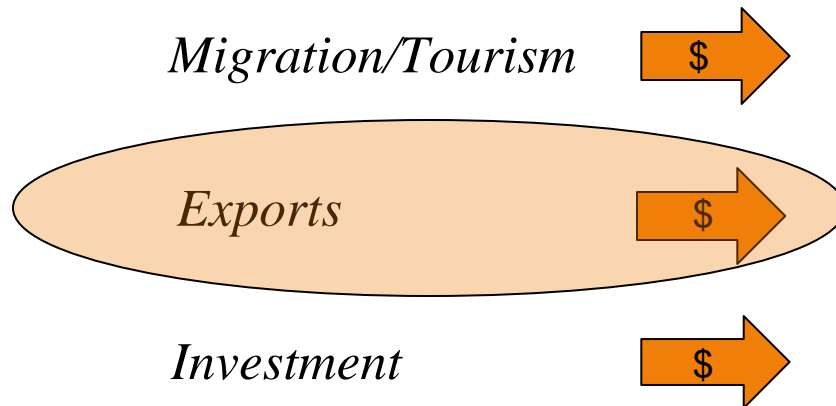
The Long-Term Solution



- Phased-in restructuring of the tax system to send a positive signal to businesses that Arizona is a great place to invest
- Strong workforce development and educational reform policies
- Smart fiscal strategies to eliminate structural deficit
 - Cut anything that is not a core government function
 - Privatize where possible
 - Streamline throughout government
 - Entitlement and pension reform
 - Wise utilization of debt with better financing terms

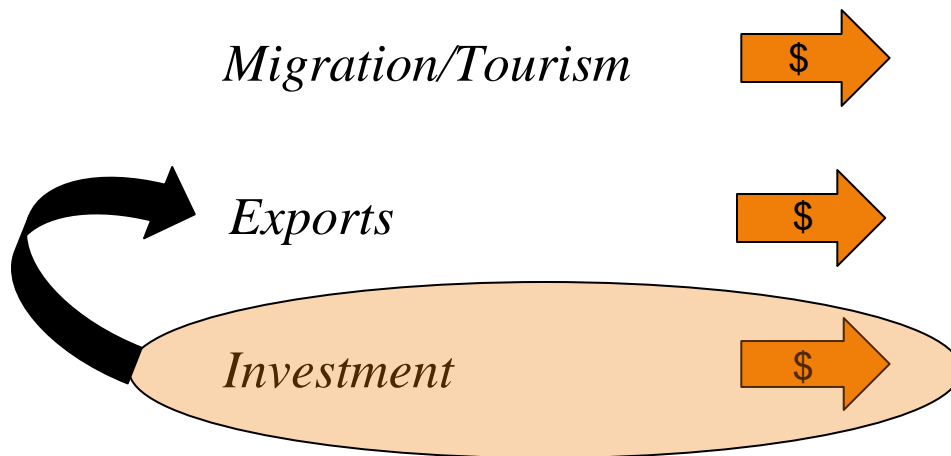
The Transition

- Arizona needs to shift from **migration** and **tourism** driven growth to **export** driven growth by retaining and attracting businesses that sell goods and services to customers beyond Arizona's borders.



The Transition

- By creating an attractive business environment for firms that sell goods and services in national and global markets, Arizona will be able to attract job creating investments by these companies.



- These companies generate new wealth for the state, which goes on to stimulate economic activity in other sectors of the economy.

Corporate Income Tax Rate



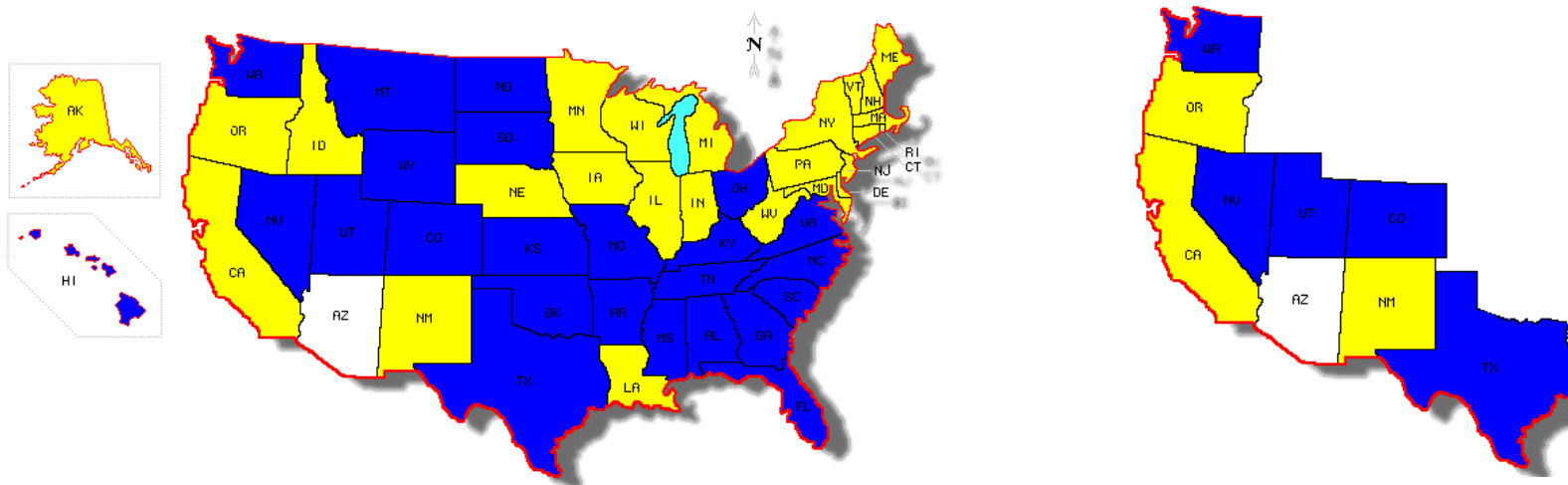
Current Arizona Rate: 6.968%

National Rank

24

Regional Rank

6



Blue States: **Lower** rate than Arizona
Yellow States: **Higher** rate than Arizona

Corporate Income Tax Rate



Regional Rank	State	Top Marginal Rate
1	Nevada	None
2	Colorado	4.63%
3	Utah	5.00%
4	Washington	5.22%*
5	Texas	5.56%*
6	Arizona	6.968%
7	New Mexico	7.60%
8	Oregon	7.90%**
9	California	8.84%

*WA and TX levy a gross receipts tax. Effective income tax rates, according to 2010 ALEC-Laffer State Economic Competitiveness Index.

** 7.6% starting Jan 1 2011.

Corporate Income Tax Rate



Taxing corporate income at the same level as individual income significantly improves Arizona's competitiveness both regionally and nationally.

Top Marginal Rate	National Rank	Regional Rank
6.968%	24	6
4.54%	4	2

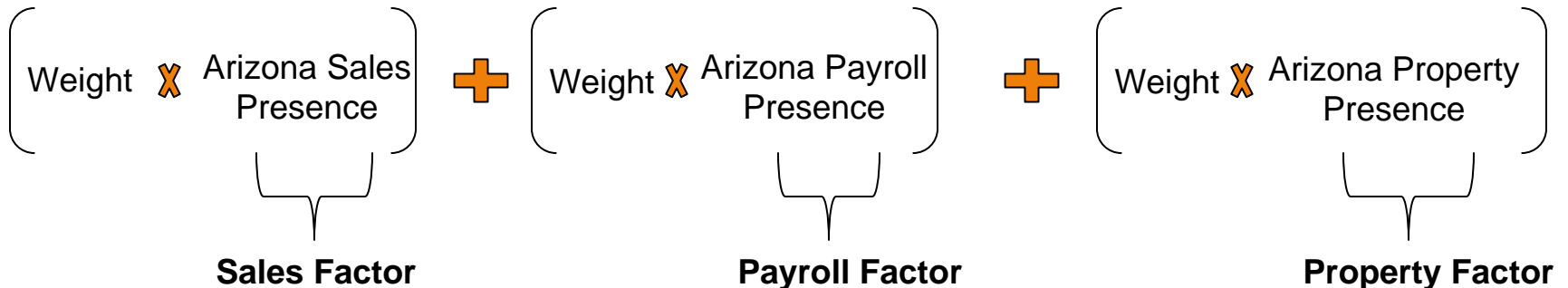
- By lowering the corporate income tax rate to the top individual rate of 4.54%, Arizona would offer the lowest corporate income rate in the country, excluding states that tax neither corporate profits nor gross receipts. (NV, SD, WY)

Elective 100% Sales Factor



Apportionment of corporate income based on location of sales rather than location of payroll or property attracts investment from companies with customers located beyond Arizona's borders.

- Firms must consider Arizona payroll and property presence when calculating Arizona tax liability.



Elective 100% Sales Factor



Currently two options in Arizona:

50% Sales

25% Payroll

25% Property

OR

80% Sales

10% Payroll

10% Property

Elective 100% Sales Factor



Throughout the country, states are attracting investment by eliminating the payroll and property factors and considering only sales factor.



Elective 100% Sales Factor

Property and payroll factors penalize investment.

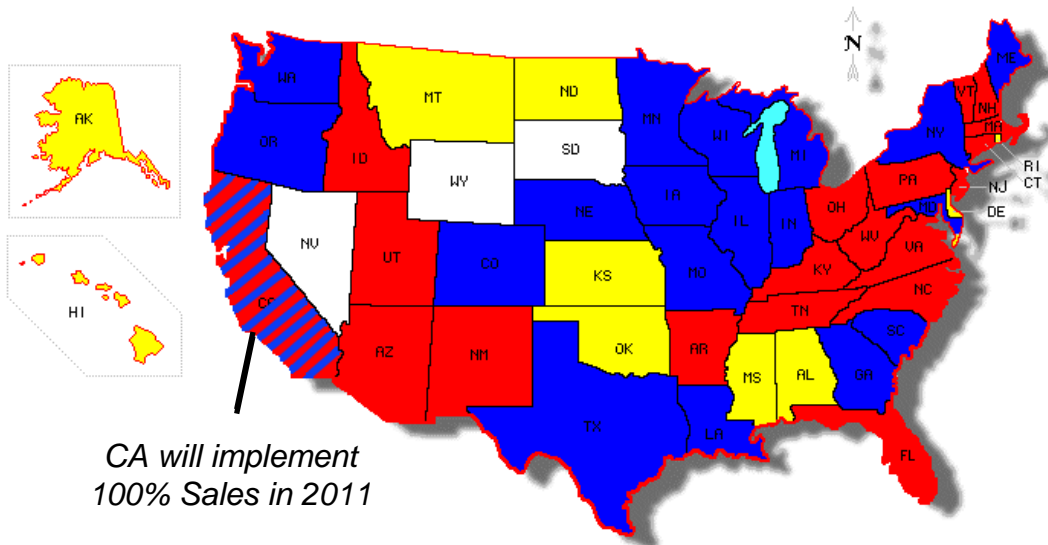


Investment



Tax Exposure

- **18 states** have eliminated the investment penalty by offering a 100% sales factor.



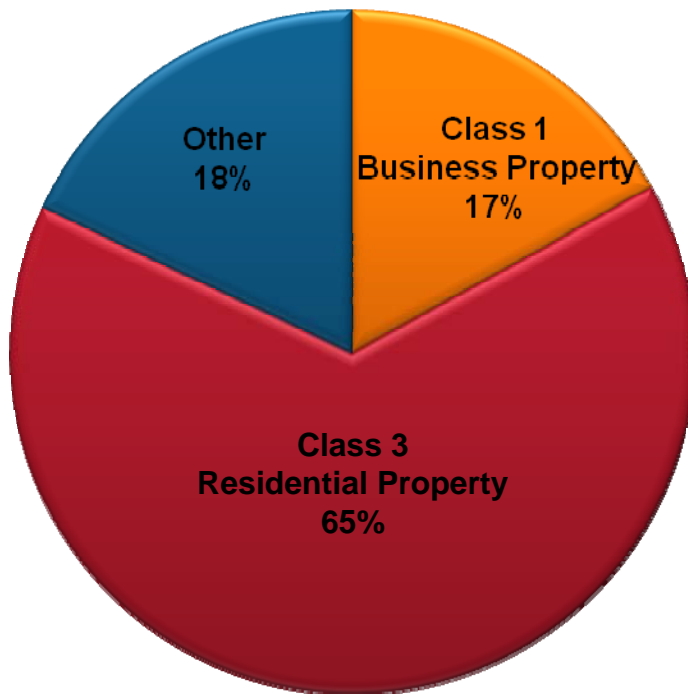
18 Blue States: 100% Sales
19 Red States: Weighted Sales
11 Yellow States: 3 Equal
Factors
3 White States: Not applicable.

Arizona Property Taxes

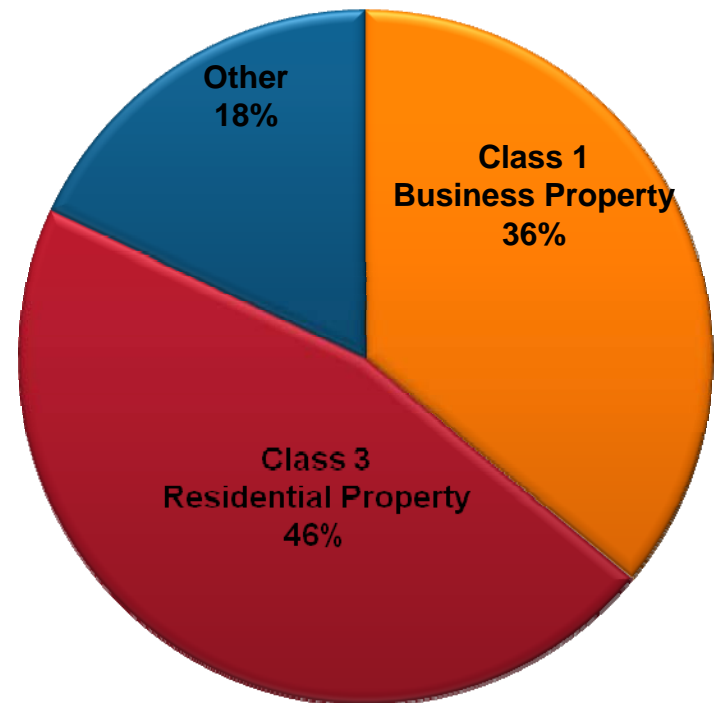


Businesses account for disproportionate share of Arizona property tax collections.

Property Tax Base



Property Tax Collections



Arizona Property Taxes



Different classes of property are taxed based on different assessment ratios



Class 3 Residential
10%



Class 1 Business
20%



Other Classes
(Historic, railroad, FTZ, etc.)
1%-18%

For residential property, 40% of the tax that goes to fund schools is subsidized by the state general fund, through the Homeowners Rebate. For FY 2011, the cost of the rebate is around \$400 million. Business property does not qualify for a rebate.

Regional Property Tax Rankings



Compared to our Western state competitors, Arizona's residential property taxes are still low and business property taxes are high.

Residential Rank - 3rd



Business Rank - 8th



Blue States: **Lower** burden than Arizona
Yellow States: **Higher** burden than Arizona

Capital Gains Tax



Favorable treatment of capital gains taxes increase the realized benefits of long term investments, creating an incentive to invest.

Capital Gains Treatment

Federal Government

Taxed at a 57% lower rate than ordinary income.

Top Individual Rate: 35%

Top Capital Gain Rate: 15%

Arizona

Treated as ordinary income

Top Individual Rate: 4.54%

Capital Gains Tax



Arizona can conform Arizona's capital gains tax with the federal system by using the same proportion of capital gains tax rate to ordinary income tax rate.

Under current state and federal law, the Arizona rate would be 1.95%.

$$\text{Federal} \longrightarrow \frac{15\%}{35\%} = \frac{1.95\%}{4.54\%} \longleftarrow \text{Arizona}$$

Job Training Program



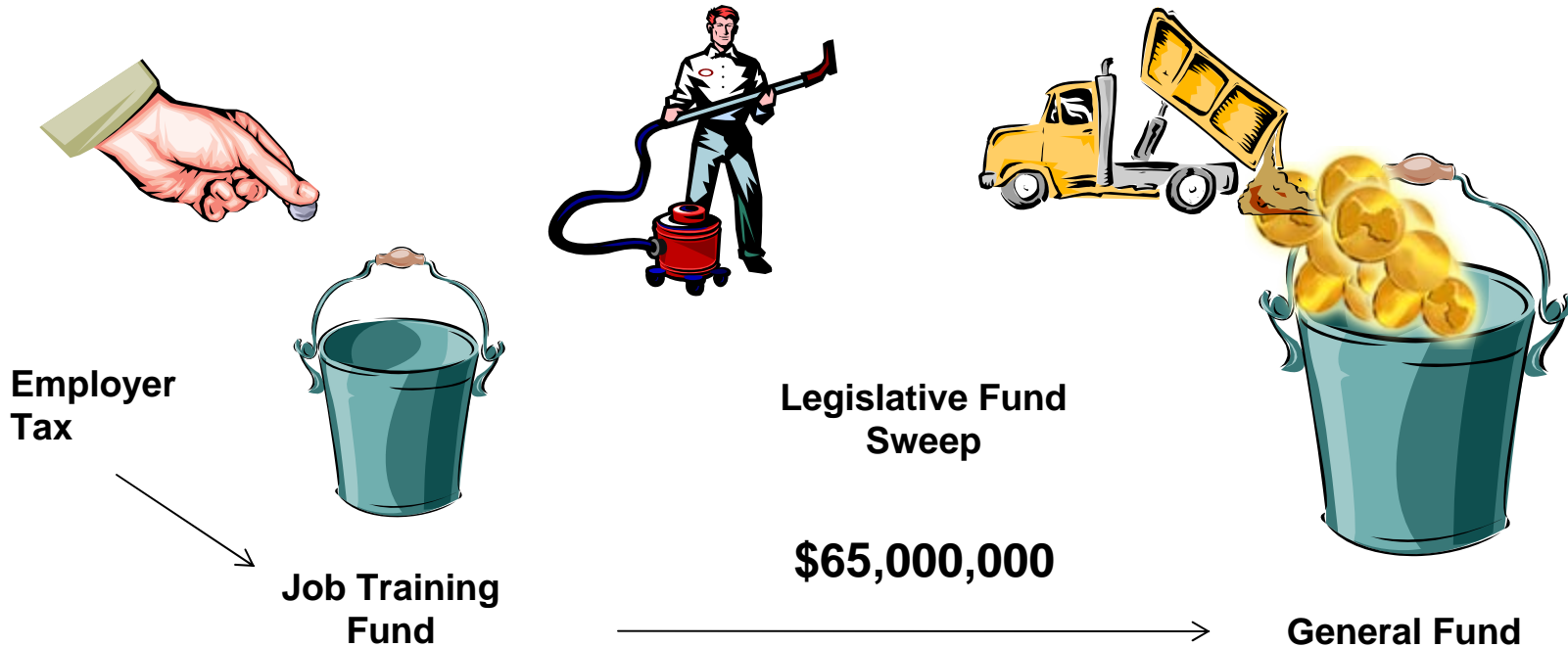
To attract export industries that create high wage jobs, employers need access to a qualified, highly adaptable workforce.

- Popular grant program that supports customized training plans for employers creating new jobs or increasing the skill and wage levels of current employees.
- Funded by a \$7 per employee tax on businesses.
- For several years, Arizona was the **only state** without a funded Job Training program

Job Training Program



*\$65 million transferred from Job Training Fund to General Fund
2008 –2010**



*For FY 2011, the Job Training program has received funding.

2011 Legislative Session



- Business community must work together towards big strategic goals, not parochial interests
 1. Resolve the budget crisis
 2. Pursue a Job Creation and Retention package
 3. Seek further regulatory reforms at the state and county levels
 - Fairness in fee setting authority
 - Regulatory accountability for new and existing agency rules
 - Online permitting and licensing