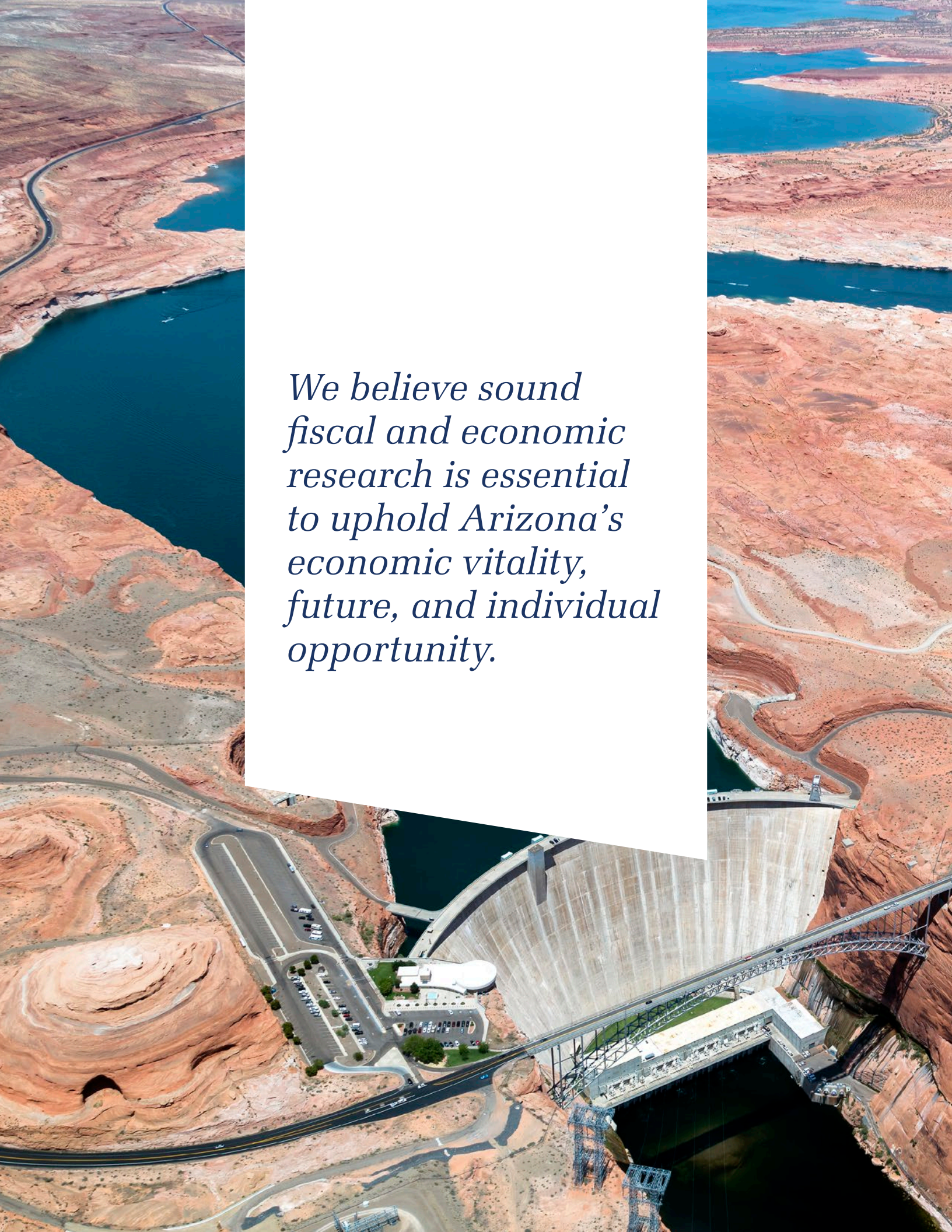




ARIZONA'S FREE ENTERPRISE REPORT

— 2023 EDITION —

An aerial photograph of a large concrete dam and reservoir in a desert canyon. The reservoir is a deep blue color, contrasting with the reddish-brown, layered rock formations of the canyon walls. A road with a parking lot and some buildings is visible near the base of the dam. The text is centered on a white rectangular background that overlaps the top and middle parts of the image.

*We believe sound
fiscal and economic
research is essential
to uphold Arizona's
economic vitality,
future, and individual
opportunity.*



About Common Sense Institute

Common Sense Institute is a non-partisan research organization dedicated to the protection and promotion of Arizona's economy. CSI is at the forefront of important discussions concerning the future of free enterprise in Arizona and aims to have an impact on the issues that matter most to Arizonans.

CSI's mission is to examine the fiscal impacts of policies, initiatives, and proposed laws so that Arizonans are educated and informed on issues impacting their lives. CSI employs rigorous research techniques and dynamic modeling to evaluate the potential impact of these measures on the Arizona economy and individual opportunity.

Common Sense Institute was founded in 2010 originally as Common Sense Policy Roundtable. CSI's founders were a concerned group of business and community leaders who observed that divisive partisanship was overwhelming policymaking and believed that sound economic analysis could help citizens make fact-based and common sense decisions.



Table of Contents

About the Free Enterprise Fellowship	1
Introduction	2
Evaluation Criteria – Arizona’s Free Enterprise Competitiveness Index.....	3
8 Policy Area Competitive Indices and Components.....	3
Performance Rating.....	3
Summary of Performance and Outlook Ratings.....	4
Bottom Line	4
Arizona’s 2024 Performance and Outlook Ratings	5
Ratings Insights.....	8
Education	17
Energy.....	24
Healthcare Market	30
Housing Market	36
Infrastructure	42
Public Safety and Our Community	48
State Budget.....	54
Taxes & Fees	60
Data and Methodology.....	66
Appendix: Sources of Index Metrics	69
Staff.....	73
Research Fellows.....	73
Board of Directors.....	73



About the Free Enterprise Fellowship

About the Honorable Jim Kolbe Free Enterprise Fellowship

Congressman Jim Kolbe's legacy is one of principled, community-driven leadership, bipartisan cooperation, and purposeful public good. Thanks to Congressman Jim Kolbe's hard work and determination, Arizona is now in a prime position to lead America in the 21st century economy – but we must continue to build upon his great legacy by promoting what he stood for. Through the Jim Kolbe Fellowship for Free Enterprise, the Common Sense Institute Arizona strives to make a difference in our communities by examining crucial issues hindering economic growth and proposing policy recommendations that advance entrepreneurship, innovation, and economic prosperity.

About The Inaugural Jim Kolbe Free Enterprise Fellow



Julie Katsel - At the University of Arizona, Julie is responsible for coordinating and maintaining positive working relationships with the Tucson and Greater Pima County community, local elected and appointed officials and their staffs, and community leaders from business, education, and non-profit sectors.

Before joining the University, Julie was the Southern Arizona Director for United States Senator Jeff Flake for five years. She worked for 17 years on Senator Jon Kyl's Tucson staff and for Congressman Jim Kolbe in Washington, D.C.

Julie is a Flinn-Brown Civic Leadership Fellow, an American Enterprise Institute Leadership Fellow, an Arizona Lottery Commissioner, a Pima County Trial Court Commissioner, and has served on the Board of Directors for the International Town & Gown Association, the Tucson Metro Chamber, and the Downtown Tucson Partnership, and as a DMAFB Honorary Commander. She received her bachelor's degree at the University of Arizona in Political Science and holds a Master's in Computer Information Systems.

Introduction

Arizona has witnessed an extraordinary economic resurgence over the last decade.

After being hit harder than almost any other state in the country during the great recession, today Arizona is the fastest growing state in the country with an economy that is more diverse, more resilient, and more dynamic than ever. This transformation was no accident, and is perhaps the best example in the country that policy matters to economic prosperity. Over the last decade, Arizona leaders at every level of government and from both political parties have worked together to craft thoughtful policy to advance free enterprise and economic flourishing.

Today, the state is seeing some of the fruits of these labors, and that's reflected in Arizona's strong economic outlook. In future years, CSI expects Arizona's rank in some of these indicators to grow as more recent policy changes begin to have an impact. For example, Arizona's adoption of universal school choice has only been in place for one year and its impact yet to be fully realized. CSI has written extensively about the implementation and effects of this program as a benefit to free enterprise. We've also focused on the economic impact of failing to improve our K-12 outcomes.

On other issues, time will tell which path the state will choose. Arizona's budget, for example, is currently on incredibly strong footing, but recent dramatic increases in spending threaten to undermine years of progress in righting the state's financial ship.

The record of history is clear: the tried-and-true principles of the free enterprise system remain the single best means of allowing the creativity and ingenuity of the people of Arizona to meet the needs of the state. Ultimately, the free enterprise system grants individuals the freedom to make their own choices in light of their own particular needs. By liberating economic activity from the heavy hand of government, individuals can best utilize their own strengths, markets can innovate to best meet consumer demand, and businesses can compete to deliver goods and services in the most efficient manner possible. In turn, this delivers greater wealth, better services, more advanced industries, and improved overall outcomes for the individuals, families, and communities throughout our state. A continued embrace of free enterprise principles will guide lawmakers and political leaders in their quest to bring Arizona to its full potential.

CSI was founded on these very principles, with a few simple goals in mind: produce sound economic analysis which will empower the citizens of our state to understand the policies before us, and provide data-driven research to equip all Arizonans with the information they need to make common sense decisions. This year, CSI is proud to publish its inaugural review of the state of free enterprise. *The Free Enterprise Report: 2023 Edition* provides a useful roadmap for Arizona citizens to understand the key economic metrics at play affecting the state's economy.

Evaluation Criteria – Arizona’s Free Enterprise Competitiveness Index

Within the free enterprise system, Arizona competes with forty-nine states and the District of Columbia for a share of the Nation’s job growth and economic output. CSI developed the Free Enterprise Competitive Index to evaluate how Arizona is positioned relative to competitors. The more (less) competitive Arizona’s economy is by comparison, the better (worse) its performance is likely to be.

The Free Enterprise Competitive Index is an equally weighted aggregate measure of eight indices that align with CSI’s policy areas: Education, Energy, Healthcare, Housing, Infrastructure, Public Safety, State Budget & Finances, and Taxes & Fees.

Arizona’s competitiveness in each of the policy areas is evaluated through metrics that are publicly available each year for all fifty states and D.C., and measure performance. For example, in education, the relevant metrics are standardized testing results for reading and math for 4th and 8th grade, percent of total spending on instruction per pupil, high school graduation rate, and percent of total enrollment in Charter schools. Each metric is ranked for fifty states and D.C. and then an aggregated measure is calculated by equally weighting each metric and summing. The aggregate measure is then ranked for fifty states and D.C.

8 Policy Area Competitive Indices and Components

In each policy section the first graph shows the aggregate index from 2011–2023. Each aggregate index is the equally weighted average of the component metrics shown in the second graph. The methodology for creating the policy area aggregate indices and the Free Enterprise Competitiveness Index is detailed in the methodology section of this report. If the index increases (decreases) then the state is more (less) competitive relative to 49 other states and D.C.

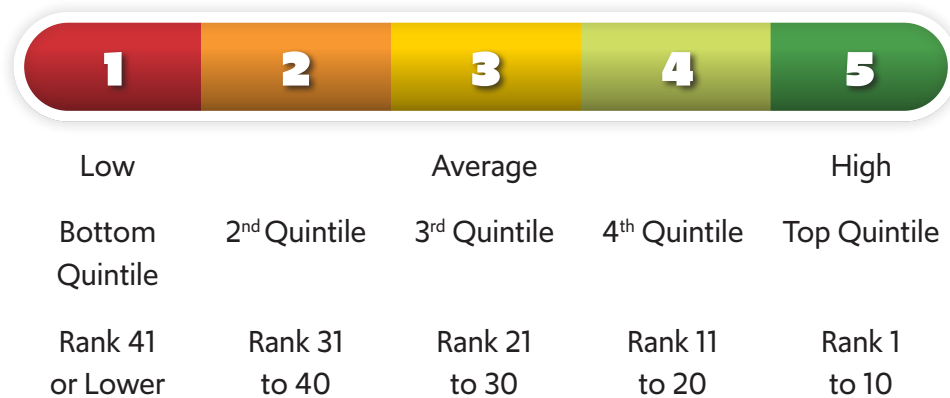
The second graph shows the value of each component metric over time. This provides useful information on the state’s competitiveness in more detail, as well as showing what component metrics are having the most impact on the aggregate competitiveness index. If the component metric index increases (decreases) then the state is more (less) competitive relative to 49 other states and D.C.

Performance Rating

This value is on a scale of 1 – 5 and is based on the relative ranking of the competitiveness index compared to all other states and D.C. A value of 1 reflects low performance and 5 reflects high performance. The purpose of these performance ratings is to help policymakers, stakeholders, and voters identify trends — both positive and negative — that demand their attention.

Summary of Performance and Outlook Ratings

Each performance rating reflects on a scale of 1 to 5, an assessment of historical data, primarily from the last year, about outcomes within its corresponding policy area. 1 indicates poor performance and 5 indicates high performance.



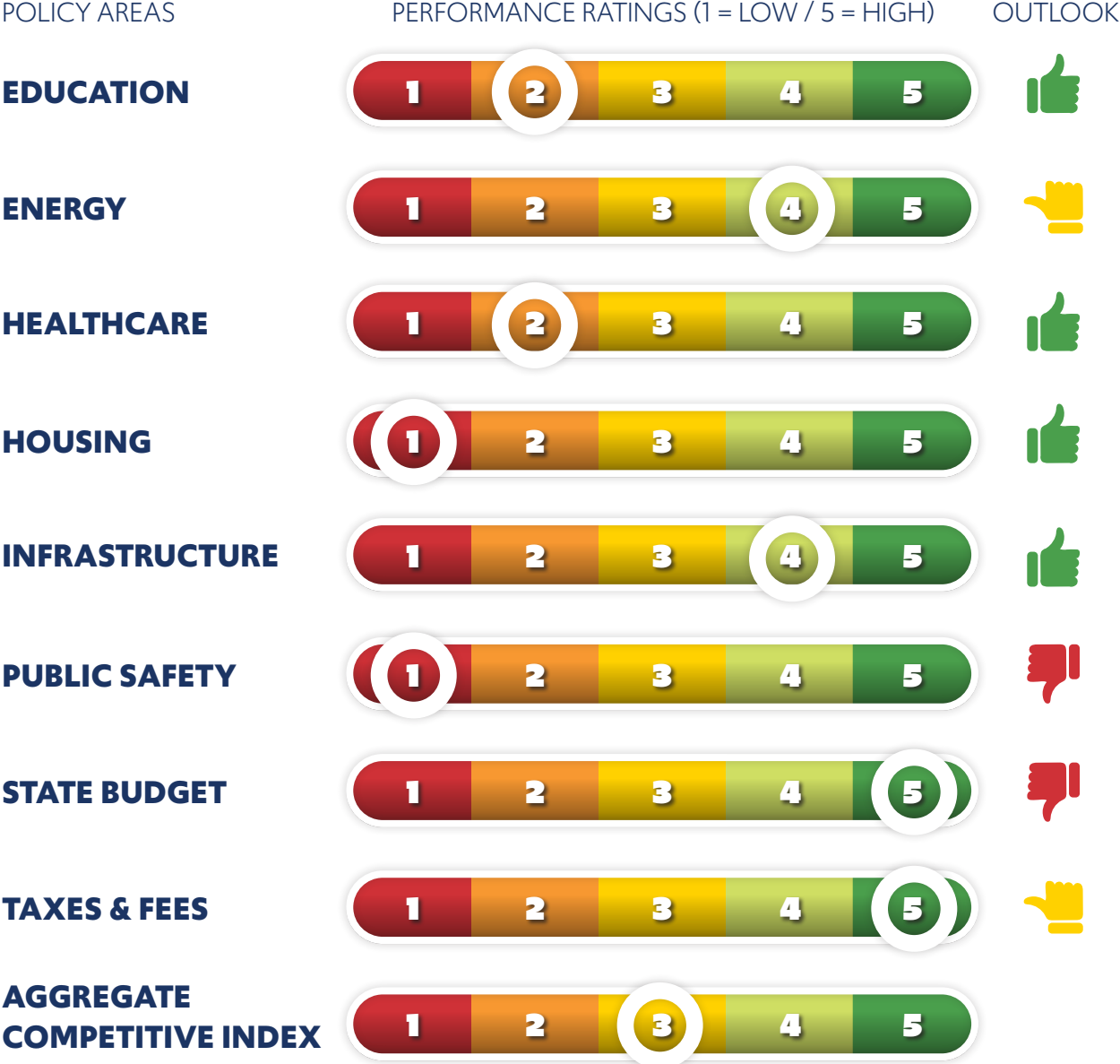
Outlook Rating

The outlook ratings indicate a negative, neutral, or positive outlook for the policy area in terms of where the performance is expected to be in the future relative to the current rating. Outlook is impacted by recent legislation, future legislation yet to be enacted, and bills before legislative bodies.

Bottom Line

Arizona stands at a crossroads – years of rapid economic and population growth made it one of the nation’s most successful growth stories in the past few years. But this has had costs. Prices rose faster in the Phoenix area in the past few years than anywhere else in the United States, and today home-buying costs are out of reach for many households. To navigate this, policymakers must balance a state budget that has grown quickly, while protecting the policies that have worked for Arizona (taxes, regulations, and business policy) and giving new policies in areas like education time to work.

Arizona 2021 Performance and Outlook Ratings



Historic Aggregate Competitiveness Performance Rating – Arizona

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
1	2	2	2	2	2	2	2	3	3	4	3	3

A photograph of a classroom with rows of wooden desks and metal chairs. The lighting is warm, creating a soft glow on the floor and desks. A large blue rectangular overlay is positioned in the center of the image, containing the title and a paragraph of text.

Rating Insights

The following findings summarize the performances and outlooks of each major policy area based upon important data trends, policy developments across the state, and recent CSI research.

Education

Competitiveness Ranking

- The pandemic in 2020 brought unprecedented challenges for Arizona's K-12 students and accelerated a period of already slowly declining school performance, according to the latest NAEP assessment scores.
- Learning loss in Arizona since 2020 could have a social cost of up to \$2.1 billion if not addressed, according to CSI research.
- High school graduation rates for Arizona's current K-12 cohort could be up to 1.5% lower than their (already low) pre-pandemic rate given the latest NAEP assessment scores if learning loss is not addressed.

Performance Rating:



Outlook:



Outlook

- Arizona has a mature school choice landscape – open enrollment allows any student to attend any District school; Charters educate a fifth of the state's public school students; and the existing School Tuition Organization private-school scholarship program issued nearly 100,000 scholarships last year.
- The new universal ESA law has grown rapidly, and today covers nearly 70,000 students.
- Rapid growth in the state's per-pupil funding formula due to unprecedented revenue and budget growth in recent years means today's students have more resources than ever, regardless of their school choices.

Energy

Competitiveness Ranking

- Arizona enjoys a reliable and economical energy system – electricity prices are very low in the state and the presence of America’s largest nuclear generator ensures a reliable base load.
- So far, Arizona has managed the current energy transition well – nearly 44% of its electricity generation comes from clean sources, but prices remain low and reliability hasn’t declined.

Performance Rating:



Outlook:



Outlook

- Palo Verde Nuclear Generating Station recently secured a license extension, enabling it to continue operating until 2045. However, the plant is getting older.
- Arizona has been adding renewable generation more slowly and deliberately than many other states, but recently the pace has accelerated. All of the state’s major utilities have made substantial commitments related to clean and renewable generation share.
- This summer was one of the hottest on record for the Phoenix metropolitan area – the continued growth and urbanization of Maricopa County will put increasing demands on the state’s energy infrastructure.

Healthcare Market

Competitiveness Ranking

- A third of Arizona's population is on Medicaid, the state's largely federally-funded health insurance program intended for its low-income population.
- A federal emergency requirement instituted during the pandemic prevented Arizona from dis-enrolling anyone from its Medicaid rolls through early 2023; this contributed to the rapid growth in enrollment (550,000 new members in 30 months) and cost (\$10.6 billion in new expenditures since FY2020).
- At the same time, the state's private insurance markets remain relatively small compared to other states, and the state has relatively fewer licensed medical doctors than other states.

Performance Rating:



Outlook:



Outlook

- In March 2023, the national emergency requirement on all states expired. Since then, enrollment in AHCCCS – Arizona's Medicaid program – has decreased by over 300,000 members.
- According to JLBC, the total cost of the state's Medicaid program will fall by over \$3 billion in the next year.
- The state has an expansive scope of practice for Nurse Practitioners, Physician Assistants, and other medical care providers, and ASU this year announced plans to open the state's fifth medical school in Phoenix.

Housing Market

Competitiveness Ranking

- The surge in population has driven up the demand for housing in Arizona such that housing affordability has become a significant concern for more households since 2020.
- The hours required to pay a mortgage in Arizona have gradually increased from 30 hours in 2011 to 84 hours in 2023.

Performance Rating:



Outlook:



Outlook

- Builders and developers have shown a willingness to adapt to changing market conditions, and supply chains are much improved today.
- As home buyers' preferences change in the face of current market conditions, many existing homeowners may be insulated from the worst parts of current market conditions, limiting the economic damage.
- Still, prices and interest rates probably aren't coming down quickly – which will continue to keep things painful for home buyers.

Infrastructure

Competitiveness Ranking

- While Arizona has maintained a relatively competitive position in the Infrastructure Competitiveness Index over the years, there are fluctuations and room for growth.
- Arizona's bridge maintenance has only improved since 2011 and this figure highlights the states' ability to prioritize bridge infrastructure improvements to ensure safety and reliability.

Performance Rating:



Outlook:



Outlook

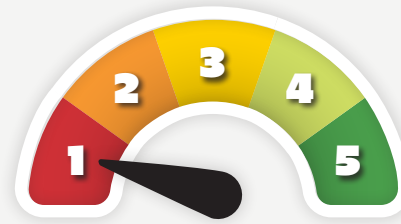
- Arizona currently ranks high compared to other states (14th out of 50 states and D.C.), and the state's ability to manage a large amount of population and economic growth has given us a competitive advantage.
- The state has a large amount of available land, a relatively moderate climate, and is not prone to major natural disasters. This should enable its infrastructure to continue expanding to support its growth and to do so efficiently.

Public Safety and Our Community

Competitiveness Ranking

- Arizona continues to struggle with opioid abuse, addiction, and overdose. Policies targeting prescription drugs put in place prior to 2020 have reduced abuse of that grey market, but since then the free flow of fentanyl across Arizona’s southern border with Mexico has refueled this epidemic.
- Arizona was not immune to the national reversal of decades of improvement in violent crime rates during 2020, and conditions have not returned to their prior trends in the years since.
- After some improvement in 2021, Arizona’s struggles with opioid abuse, homelessness, and crime rates may again be worsening.

Performance Rating:



Outlook:

 **Negative**

Outlook

- Data finds a link between illegal migrant crossings and the southern border and other smuggling – and recent record CBP encounters with illegal migrants suggest the free flow of fentanyl into the U.S. and Arizona from Mexico continues.
- According to the latest FBI data, violent crime rates in Arizona rose again last year.
- Arizona’s homeless population remains at official all-time-highs, and the difficulty the City of Phoenix has had in removing the so-called “Zone” of temporary street housing for homeless people (including competing State and Federal court orders, with Federal courts limiting the City’s ability to remove the encampments) is indicative of the challenge for local policymakers in addressing it.

State Budget

Competitiveness Ranking

- In recent years the state has enjoyed rapid revenue growth, which supported the accumulation of record reserves – including the largest rainy day fund balance in state history (\$1.4 billion).
- Arizona’s relatively low debt and low spending as a percentage of GDP give it a high competitiveness ranking relative to other states.
- Rapid spending growth in recent years is not sustainable forever; policymakers at all levels of government will again have to learn to make do with annual budgets that grow closer to the long-run average than the post-2020 norm.

Performance Rating:



Outlook:

 **Negative**

Outlook

- Particularly at the local level, the imminent loss of one-time emergency Federal dollars will create structural challenges for any government that devoted these resources to ongoing commitments (like payroll and ongoing new programs or services).
- Inflation and a slowing economy will put competing pressure on both sides of state and local budgets – and there will be a temptation to use tax and/or debt increases to offset them.
- The state has erased its large cash surpluses, and in its most recent projections is now facing the first shortfalls in almost a decade.

Taxes & Fees

Competitiveness Ranking

- Today Arizona has the lowest single individual income tax rate in the country – a flat 2.50% on all income earned in the state.
- Arizona has no local income taxes and no statewide property tax.
- Since 2018 it has subjected online and remote sellers to approximately the same sales tax as domestic sellers, creating fairness and efficiency.
- Thanks to this commitment to reform and competitiveness, Arizona has one of the most efficient and least burdensome tax regimes in the country.

Performance Rating:



Outlook:

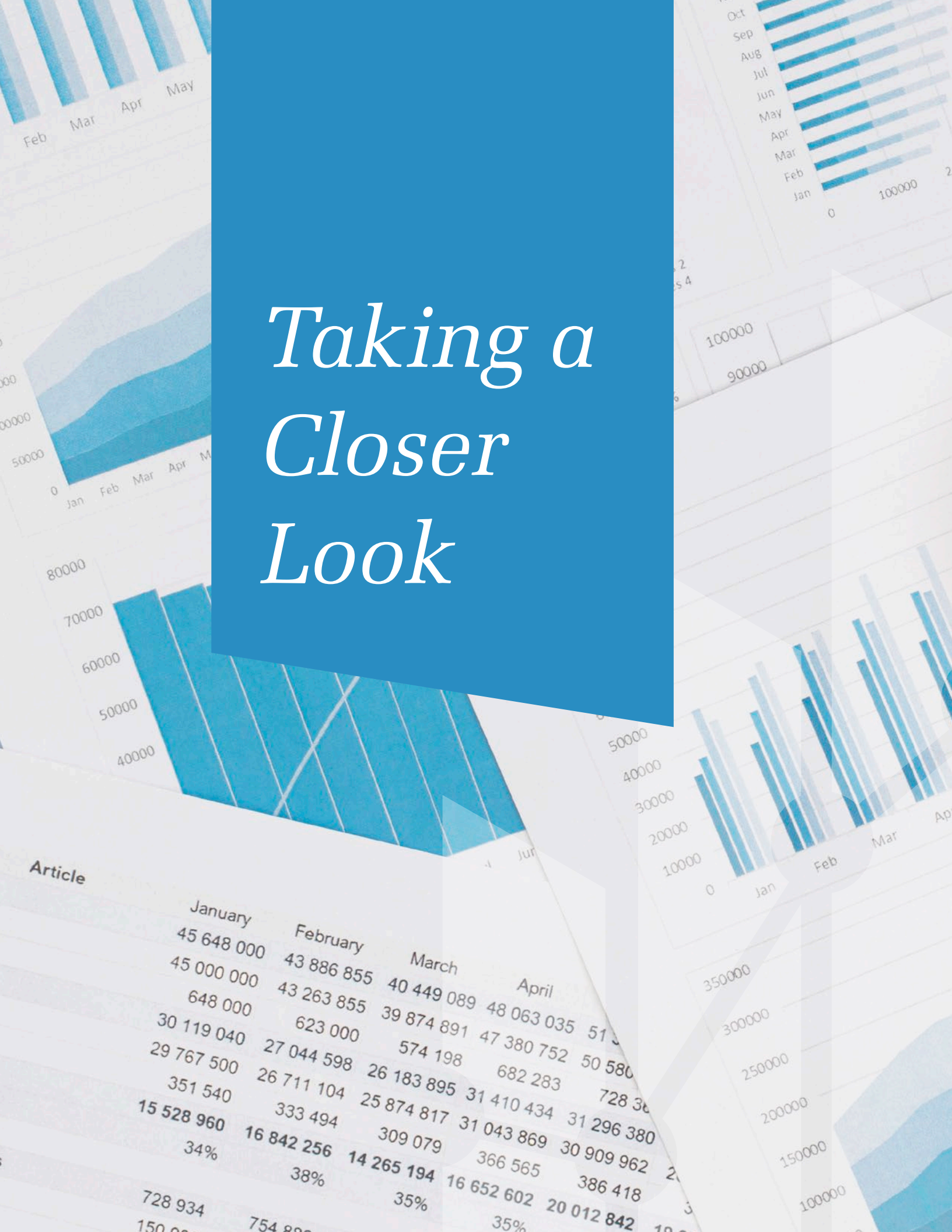


Outlook

- While Arizona remains very competitive today, its prospects for continued improvement are mixed – rapid spending growth and a slowing economy will increase pressure on the revenue side of the budget.
- On the other hand, the state has strong constitutional and statutory protections that should limit rapid tax increases.



Taking a Closer Look



Article

January	February	March	April
45 648 000	43 886 855	40 449 089	48 063 035
45 000 000	43 263 855	39 874 891	47 380 752
648 000	623 000	574 198	682 283
30 119 040	27 044 598	26 183 895	31 410 434
29 767 500	26 711 104	25 874 817	31 043 869
351 540	333 494	309 079	366 565
15 528 960	16 842 256	14 265 194	16 652 602
34%	38%	35%	35%
728 934	754 822		
150 000			

Education

Performance Rating:



Outlook:

 Positive



Overview

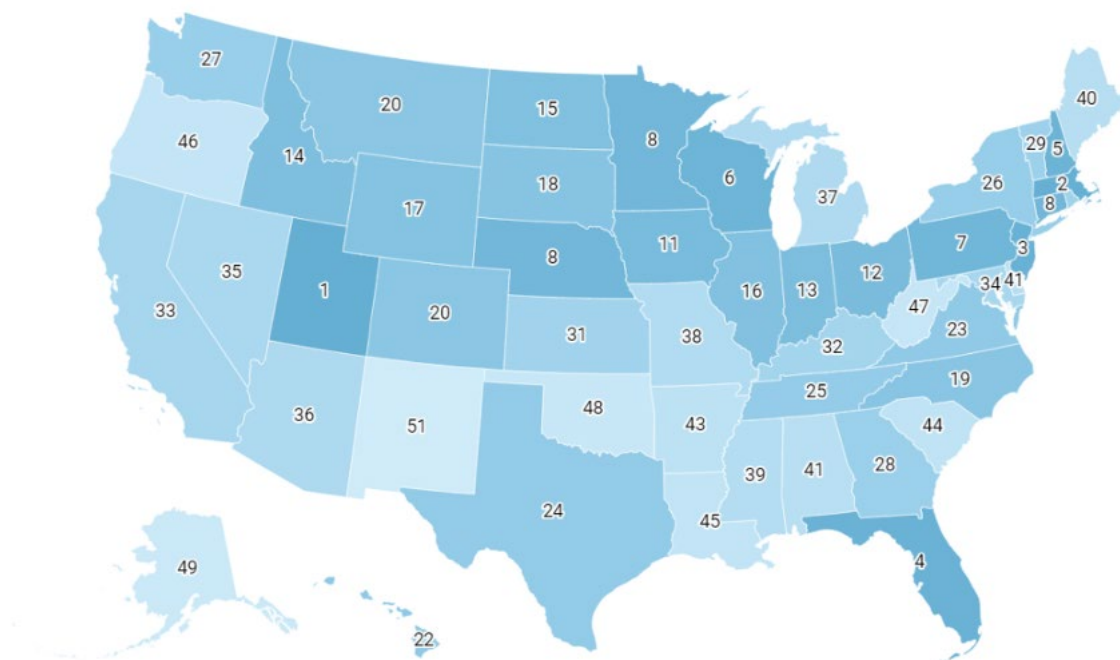
Education spending in Arizona has risen rapidly over the past five years. However, education spending has risen rapidly in most other states at the same time – and as a result, Arizona by the preferred metric of K-12 funding advocates (relative per pupil funding compared to the 49 other states) has made no progress despite that investment. This zero-sum metric keeps all of the states chasing each other with more funding, and ignoring their declining performance – first slowly, starting around 2010, and then quickly, during 2020 and the pandemic-era school closures. Today, the return on investment in public K-12 schooling is arguably lower than ever.

Though Arizona has not been immune to this trend – our study of learning loss captured in the latest NAEP assessment scores for public

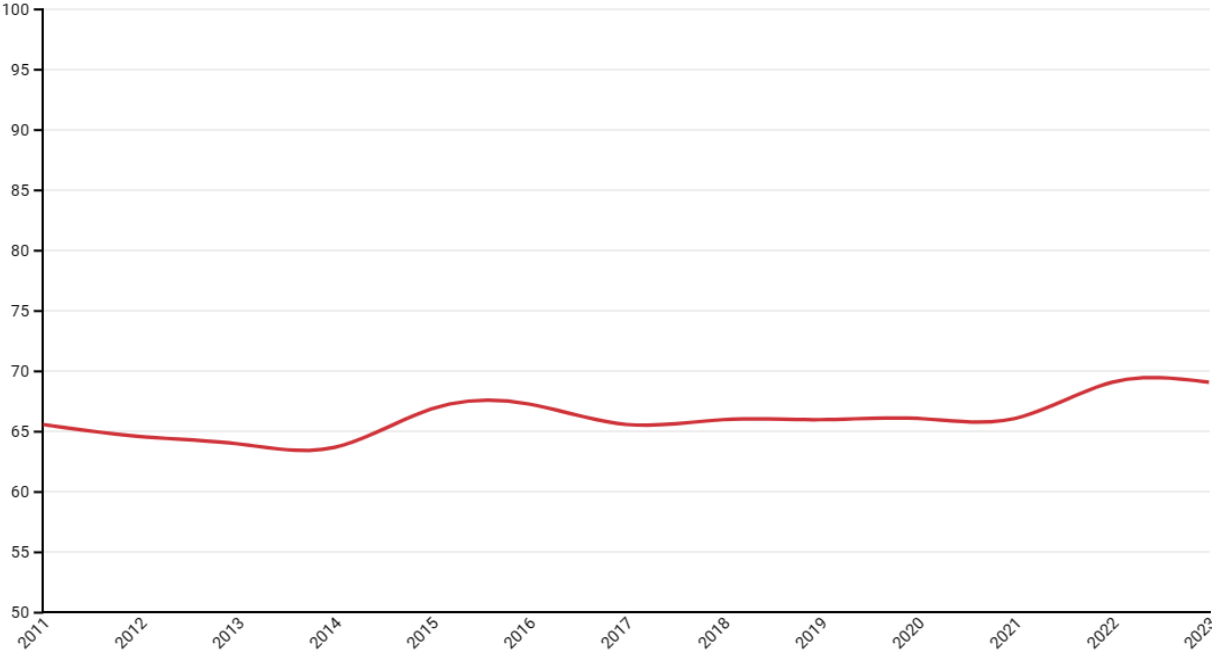
school students estimated its economic costs at \$2.1 billion over the next decade – the state has embraced school choice, innovation, and the spirit of competition to improve student outcomes and perhaps more importantly, give students ownership over their own education.

Over the years, Arizona has adopted one of the nation's most liberal Charter school models (which today educate 20% of all public school students); open enrollment which allows anyone to attend any District school; and most recently a first-of-its-kind universal educational savings account law which allows any student to take their state-supervised K-12 education funding anywhere in the state that they choose to pay for education-related expenses.

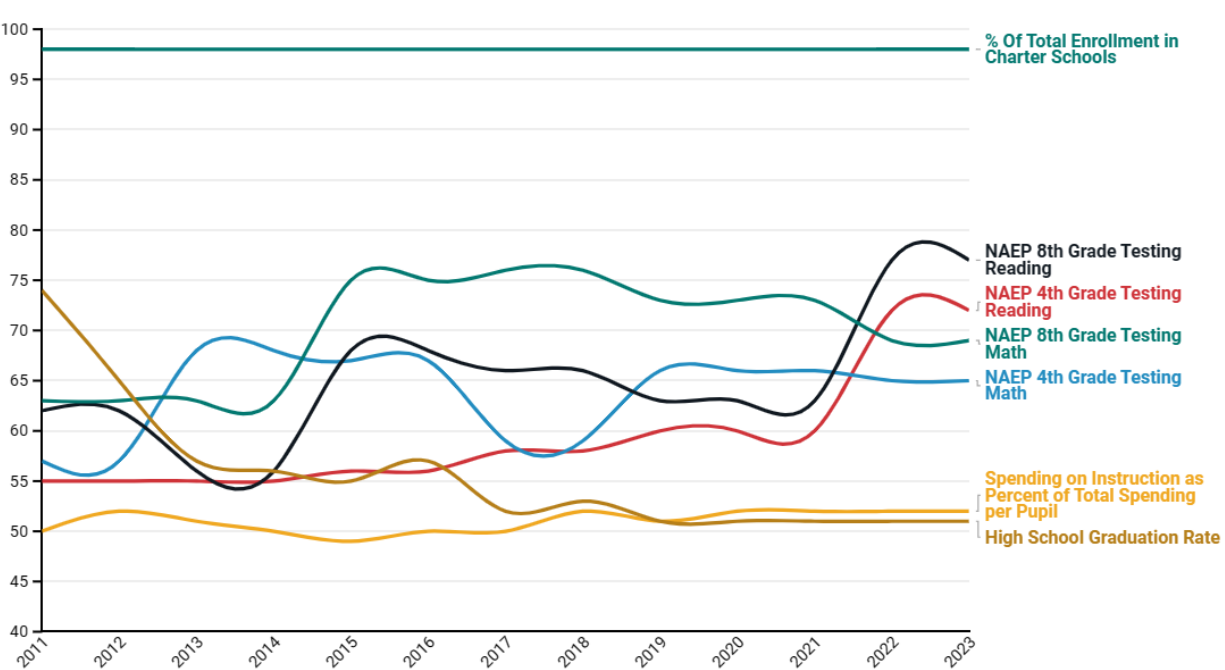
2023 Education Competitiveness Index Ranking



Education Competitive Index - Arizona



Education Competitive Index Components - Arizona



FAST FACTS

Total Spending per pupil (2023):
\$14,025

Total Spending per pupil (2018):
\$9,701

NAEP 8th grade math score (2023):
271

NAEP 8th grade math score (2018):
282

High school graduation rate:
77%

ISSUES TO WATCH

- How many students will ultimately enroll in Arizona's universal ESA program?
- How will demographic change and slowing population growth impact Arizona's public schools and school funding choices?
- Will the state successfully address the learning loss captured in the latest NAEP K-12 assessment results?

Performance

Arizona's education landscape has been changing in recent years. As state and local education funding shifts, Arizona's only dedicated, performance-tied K-12 funding stream has been repealed and CSI found in May that high-performing, low-income schools will take the largest impact of this policy decision. This year, Independence High School will receive over \$817,000 in Results-Based Funding awards; next year, under the budget plan, that would fall to ~\$34,000 in general formula funding. CSI found in September that a lack of focus on performance in Arizona's public schools could be related to a lack of improvement in academic performance as measured by the National Assessment of Education Performance (NAEP). Arizona's 4th and 8th grade Reading scores declined -0.2% and -0.4% respectively, and the states' 4th and 8th grade Math scores declined -2.4% and -3.3% respectively between 2019 and 2022. CSI found in September that the decline in testing scores in 2022 could lead to a high school graduation rate for Arizona's current K-12 cohort that is 1.5% lower than its predicted rate given 2019 assessment scores.

While Arizona ranks low in many of the standard metrics for measuring a state's educational performance, the areas that Arizona has focused on in order to improve education outcomes for students are difficult to measure across the United States and it takes time for the impact of recent policy measures to be realized. Arizona is leading the way in school choice policies as other states look for ways to implement policies that benefit individual student's educational outcomes. In many states, a shift in demand

Outlook

for education alternatives has shaped the enrollment trends since 2020. Arizona was responsive to this shift in ways that other states are now catching up on. For example, Arizona is among the few states with a Universal Empowerment Scholarship Accounts (ESA) program and enrollment has grown very quickly as students were not being served by existing school choice programs.

As state spending on public schools has increased, the performance of public District schools has declined as well as public school enrollment. In February, CSI found that the recent decline in public District school enrollment is a stark contrast to the growth they saw in the early 2000s when enrollment increased 12% between 2000 and 2007. The growth that public schools expected to see into the 2020s failed to appear and much of the preparation in terms of school space and increased funding has left schools with vacant buildings and unused land. Other schooling options have instead seen growth in Arizona. For example, making up only 5% of total public school enrollment in 2000, Charter schools have steadily increased enrollment in the last 20 years and now make up 20% of total public school enrollment.

Because ESAs are newly universal in Arizona and many families are still deciding what education system suits their child best, their impact on Arizona's education competitiveness relative to other states will take time to realize.

Arizona has made it possible for more parents to choose alternative education either through Charter schools, private, or home schools using Empowerment Scholarship Accounts or School Tuition Organization Scholarships. The impact this shift in demand for education alternatives could have relative to other states will take time to see. However, as Arizona schools must now compete against other options in order to provide the best education for students in Arizona could mean innovative solutions to economic difficulties in terms of school facilities and land use, academic improvements, and higher graduation rates in the future as younger cohorts benefit from educational choice.

Arizona is leading the way in school choice policies as other states look for ways to implement policies that benefit individual student's educational outcomes.

Recent Policy

H.B. 2853 – 2022: Arizona Empowerment Scholarship Accounts; Appropriation

- “Expands eligibility for an Arizona Empowerment Scholarship Account (ESA) to an Arizona resident who is eligible to enroll in an Arizona public school and who does not otherwise qualify for an ESA. Appropriates \$2,200,000 and 26 FTE positions from the state General Fund in FY 2023 to the Arizona Department of Education for ESA administration.”

H.B. 2057 – 2023: Classroom-based Preparation Program; Employment

- “Requires a school district or charter school to classify each teaching certificate candidate in a classroom-based preparation program as a paid employee.”

H.B. 2819 – 2023: K-12 Education

- “Increases the base level in FY 2024 from \$4,775.27 to \$4,914.71 per pupil and increases, from 0.018 to 0.022, the Group B weight for children who are eligible for the federal Free-and-Reduced-Price Lunch (FRPL) Program and other school programs dependent on a poverty measure.”
- “Increases FY 2024 per-pupil funding, from 72 percent of BSA to the full BSA, for a county jail education program operated through an accommodation school.”
- “Requires the Arizona Department of Education (ADE) to submit a quarterly report that includes the number of ESA Program students disaggregated by specified categories, the annual award amount associated with each ESA and the amount of approved expenses disaggregated by expense type.”
- “Repeals the Results-Based Funding Fund and the per-student distributions to school districts and charter holders for schools that receive an A letter grade.”

H.C.R. 2001 – 2023: School District Expenditures; Authorization

- “Effective February 8, 2023, authorizes school districts in FY 2023 to spend local revenues in the amount of \$1,385,809,642 more than the aggregate expenditure limitation.”

CSI Research

Arizona K-12 Funding & Enrollment Changes Since FY2019 Including After Universal ESA Expansion

School Facilities & The Accumulation of District Space Since 2007

Systems or Results? Results-Based Funding & The Public-School Funding Question

Universal ESAs: Where We Are and Where We Are Going

Failure to Launch: The Social and Economic Impacts of K-12 Learning Loss Since 2020

Energy

Performance Rating:



Outlook:

 **Neutral**

Overview

Arizona’s energy competitiveness has historically been strong, thanks to its reliable and low-cost electricity. Arizona’s Palo Verde Nuclear Generating Station is the largest nuclear power plant in the United States. It has consistently provided a substantial portion of Arizona’s electricity, contributing to the state’s reliability and low electricity costs; it is also a source of surplus export electricity that keeps domestic prices lower. Energy affordability has been a key driver of the state’s competitiveness, attracting businesses (particularly manufacturers) and residents alike. Arizona has made recent strides in incorporating other, renewable energy sources into its energy mix as well. Energy sources like solar and wind, driven by favorable geographical conditions and policy incentives, have grown rapidly in recent years.

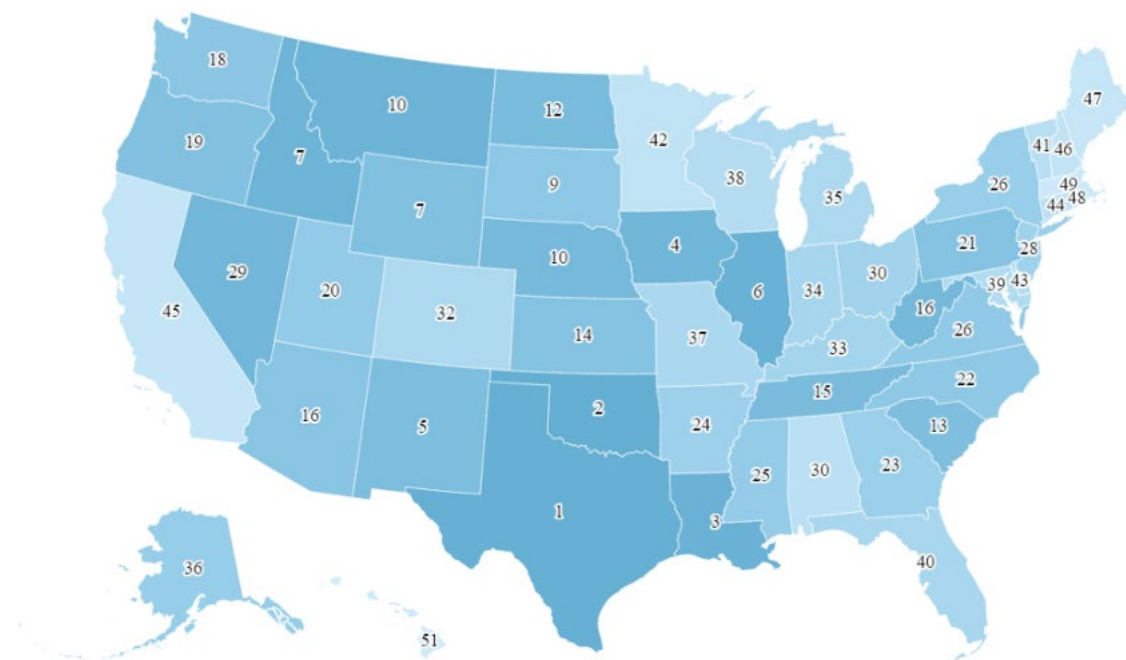
SECTOR SNAPSHOT

Average minutes per interruption:
1.5 hours

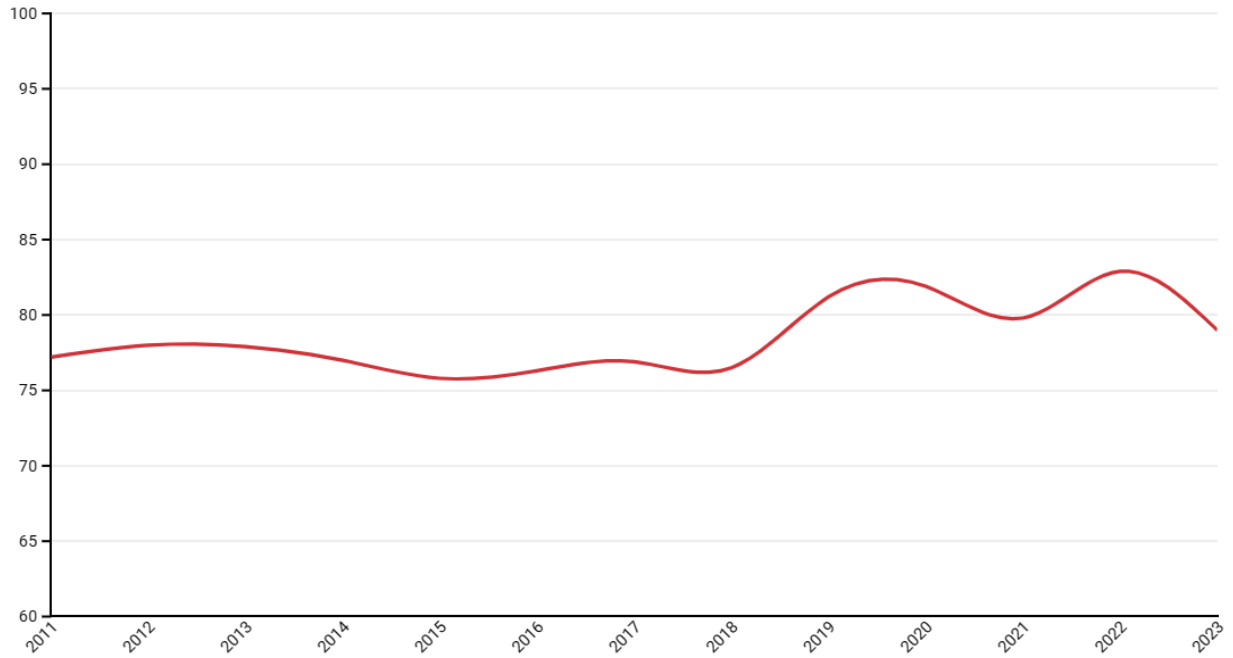
Residential electricity price
(cents/kWh):
12.54

Share of electricity produced by
Clean Energy:
44%

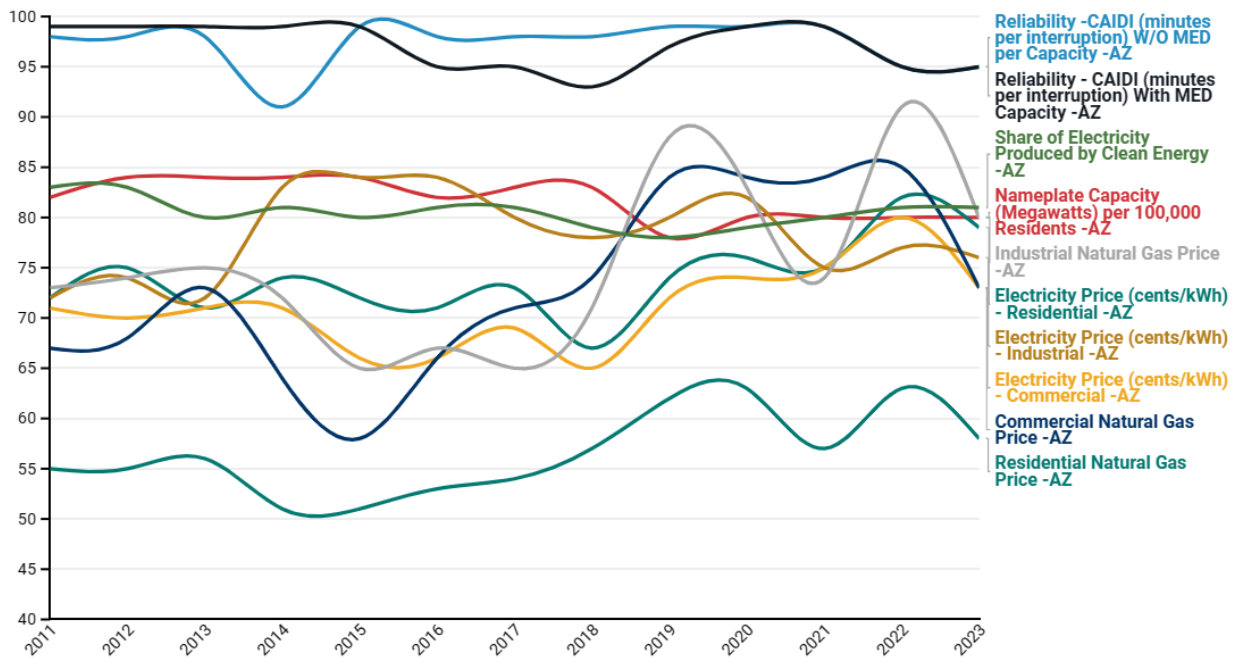
2023 Energy Competitiveness Index Ranking



Energy Competitive Index - Arizona



Energy Competitive Index Components - Arizona



Performance

Over the years, Arizona has maintained a tradition of providing competitively priced electricity despite rapid population and economic growth. Residential, commercial, and industrial electricity prices have consistently remained affordable despite inflation, an investment in clean generating technologies, and demand growth. Along with affordable energy, Arizona's commitment to reliability is evident in its consistently low CAIDI (Customer Average Interruption Duration Index) values. In particular, the CAIDI values without MED (Major Event Days) capacity have remained consistent (one of the lowest rates in the country), generally indicating a robust and reliable electricity supply. Arizona has shown progress in transitioning towards cleaner energy sources while maintaining affordable and reliable energy, as indicated by the consistently high share of electricity produced from clean sources. Ranking 19th among all states in the share of electricity produced from clean sources, 44% of all electricity produced in Arizona is from Nuclear, hydropower, wind, biomass, and solar energy.

Although the raw score in the Energy Competitive Index has remained relatively flat, Arizona's ranking has improved over time. This suggests that while the state's performance may not have significantly changed, it has outperformed other states in maintaining or improving its energy competitiveness – preserving its low-cost and reliable energy environment even as other parts of the country have struggled.

Outlook

Arizona's competitive energy position in recent years is at least in part attributable to performance issues in other states, more so than improvement in Arizona. High-profile winter outages in other states in recent years are telling; the consistent reliability of Arizona's own electric grid during the summer of 2023 is as well. The has demonstrated policy continuity and consistency in its approach to energy regulation and sustainability. A stable policy framework can encourage long-term investments and maintain competitiveness.

Today, that may be changing. Arizona is changing rapidly. The state continues to grow, and at the same time, policymakers are encouraging consumers and businesses to electrify – this will put greater demand on the state's electricity grid going forward than it has experienced in the past.

Simultaneously, there is a strong desire to shift to clean and renewable electricity sources. Rapid investment in wind, solar, and storage technologies has both cost and reliability implications. While it is possible the state will weather this transition efficiently and effectively – without significant increases in end-user prices or loss of grid reliability – it is not at all guaranteed.

Time will tell how Arizona's energy market will manage this period.

Recent Policy

H.B. 2410 – 2022: Environmental Programs; Amendments

- “Allows, rather than requires, the Arizona Department of Environmental Quality (ADEQ) to adopt rules for air pollution emission standards for: 1) golf cart engines, in counties with a population of more than 1,200,000 persons; and 2) off-road vehicles and engines beginning with the 1999 model-year. ADEQ may develop an air quality improvement program through vehicle emissions reduction. A property owner who has left contamination on the owner’s property that exceeds residential standards must record a declaration of environmental use restriction only if the property is at a site remediated by ADEQ”

H.B. 2411 – 2022: Coal Combustion Residuals Program

- “Allows the Director of the Arizona Department of Environmental Quality (ADEQ) to establish a Coal Combustion Residuals Program (CCR Program) and outlines requirements and procedures for CCR Program rules and enforcement. CCR Program rules must include a permitting process and fees. Coal combustion residuals are fly ash, bottom ash, boiler slag and flue gas desulfurization materials generated from burning coal to generate electricity by electric utilities and independent power producers.”

H.B. 2218 – 2023: Power Authority; Projects; Energy Storage

- “Requires the Arizona Power Authority (APA) to encourage activities deemed feasible for the storage of electric power or energy from solar, nuclear or geothermal energy. The APA may: 1) store electric power for the purpose of making the power available to Arizona marketing areas; and 2) acquire and dispose of real property by sale, lease or other means to persons engaged in projects deemed to be feasible for the storage of electric power of energy from solar, nuclear or geothermal energy.”

“H.B. 2324 – 2023: Nonprofit Generation and Transmission Cooperatives

- “Subjects a generation and transmission cooperative regulated by the Arizona Corporation Commission (ACC) to the annual ACC assessment, except the portion of gross revenues derived from electricity sales to another ACC-regulated cooperative electric utility that is subject to the annual ACC assessment.”

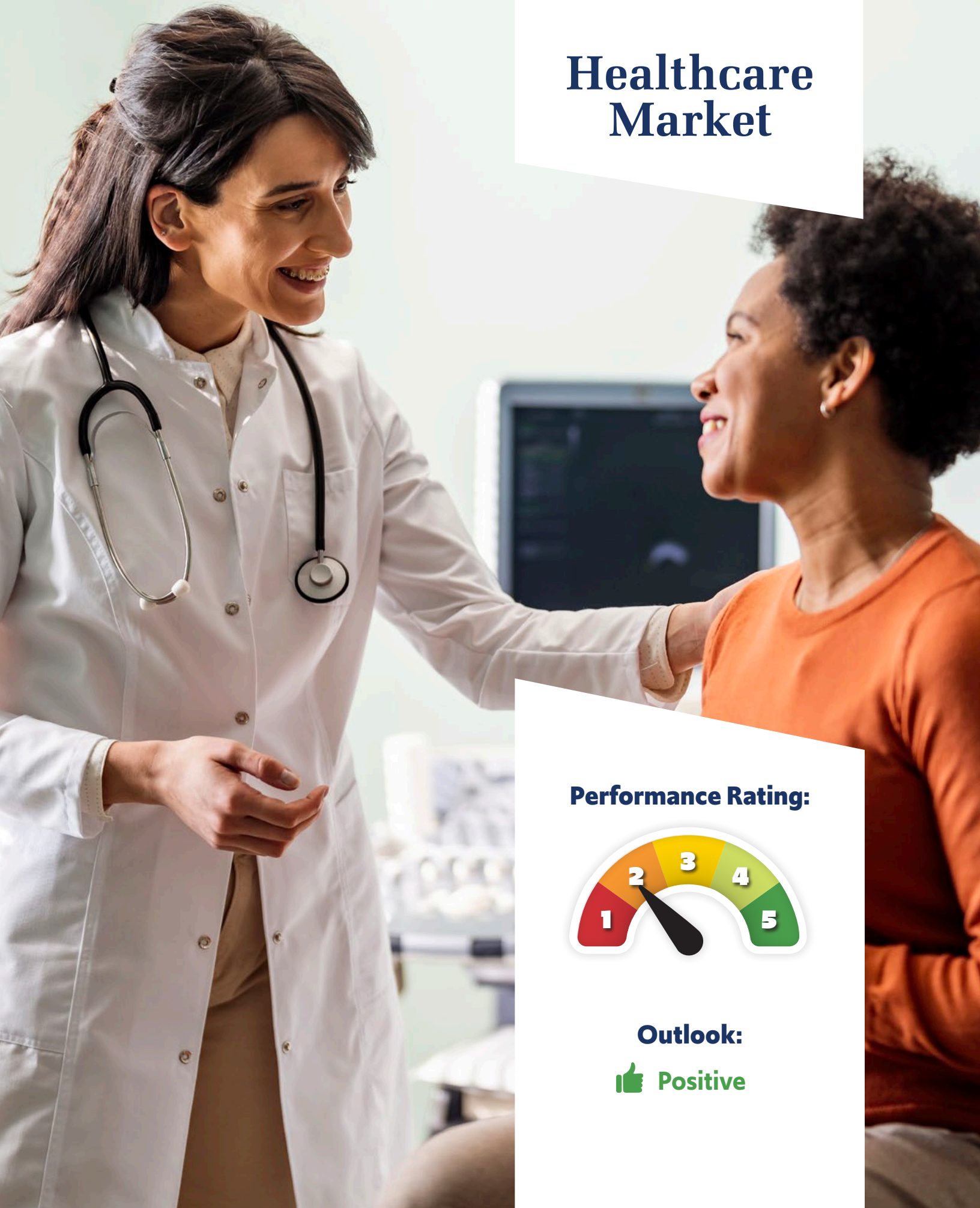
ISSUES TO WATCH

- What will the implications for costs and reliability be of Arizona's transition to renewable energy?
- Population and economic growth in Arizona are driving up energy demand. To meet this demand without compromising reliability, investment is needed in expanding energy infrastructure. Expanding energy infrastructure to accommodate growth while maintaining low costs and reliability can be a significant challenge.
- Will high and rising energy and gasoline costs jeopardize Arizona's future economic growth?
- How will the growing burdens of Federal environmental and air quality regulations affect Arizona and our local policymaking – particularly in Maricopa County?
- The state's growth in electricity demand creates a market opportunity for energy companies to invest in infrastructure. With Arizona's reliable electricity track record, there's a chance for providers to meet this demand while maintaining competitive pricing.

CSI Research

The Economic Impact of Arizona's Manufacturing Sector

Healthcare Market



Performance Rating:



Outlook:

 **Positive**

Overview

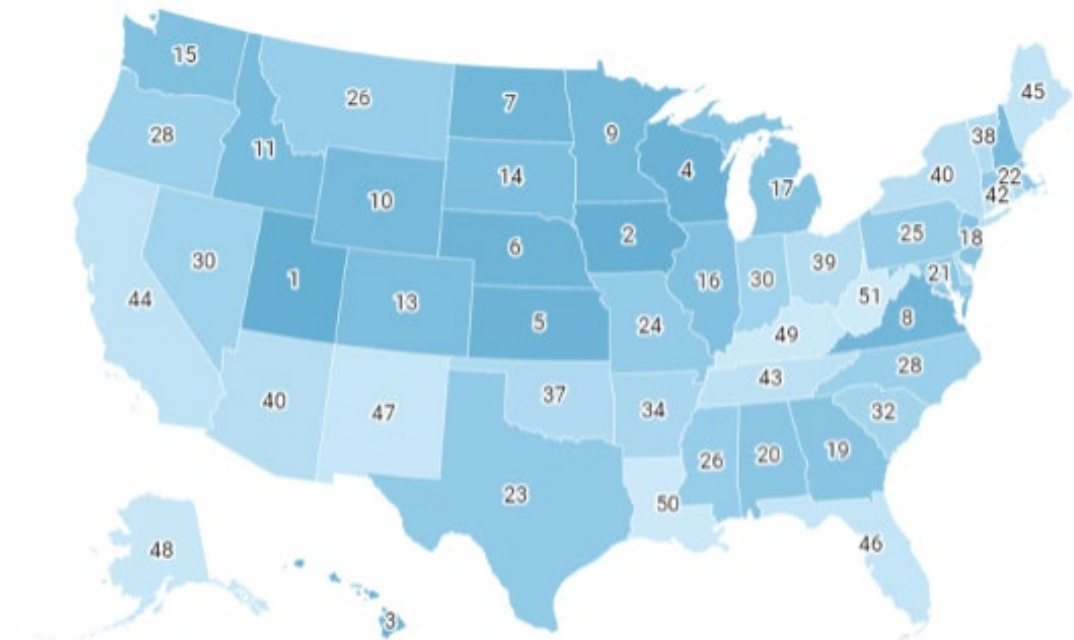
Arizona’s healthcare sector has traditionally been one of the state’s largest and most dynamic. For example, its largest private employer is the Banner Hospital System, and CSI in July found that the healthcare sector is Arizona’s largest in terms of contributions to GDP (at 20% of State GDP). The state is nationally known as a traditional destination for older Americans and retirees, who are disproportionate consumers of healthcare services.

At the same time, however, at 252 per 100,000 residents, Arizona has a below average number of practicing physicians per capita. A disproportionate share of its population is also on government-provided insurance (Medicaid and Medicare). This creates distinct pressures on the state’s healthcare system, including dependence on the government and susceptibility to public policy changes, and the potential for diminished individual choice.

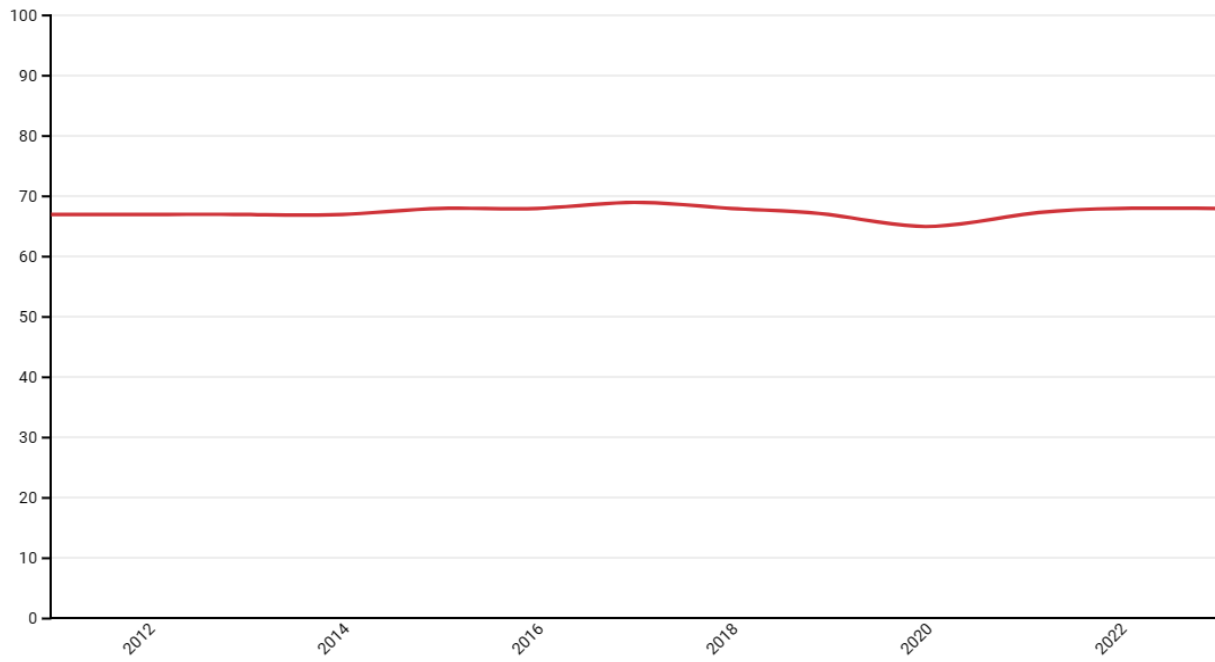
On the other hand, Arizona has a relatively liberal professional licensing regime, making it relatively easy for new medical providers to practice here. Nurse Practitioners, Physician Assistants, and other primary care providers enjoy relatively broad scopes of practice, which helps alleviate the physician’s shortage and introduce greater choice. All of Arizona’s major medical licensing boards are members of interstate compacts, allowing out-of-state healthcare professionals to relocate here with relative ease.

And finally, Arizona’s state-managed Medicaid program – the Arizona Healthcare Cost Containment System (AHCCCS) – is one of the most efficient in the nation, spending just \$1,812 per capita.

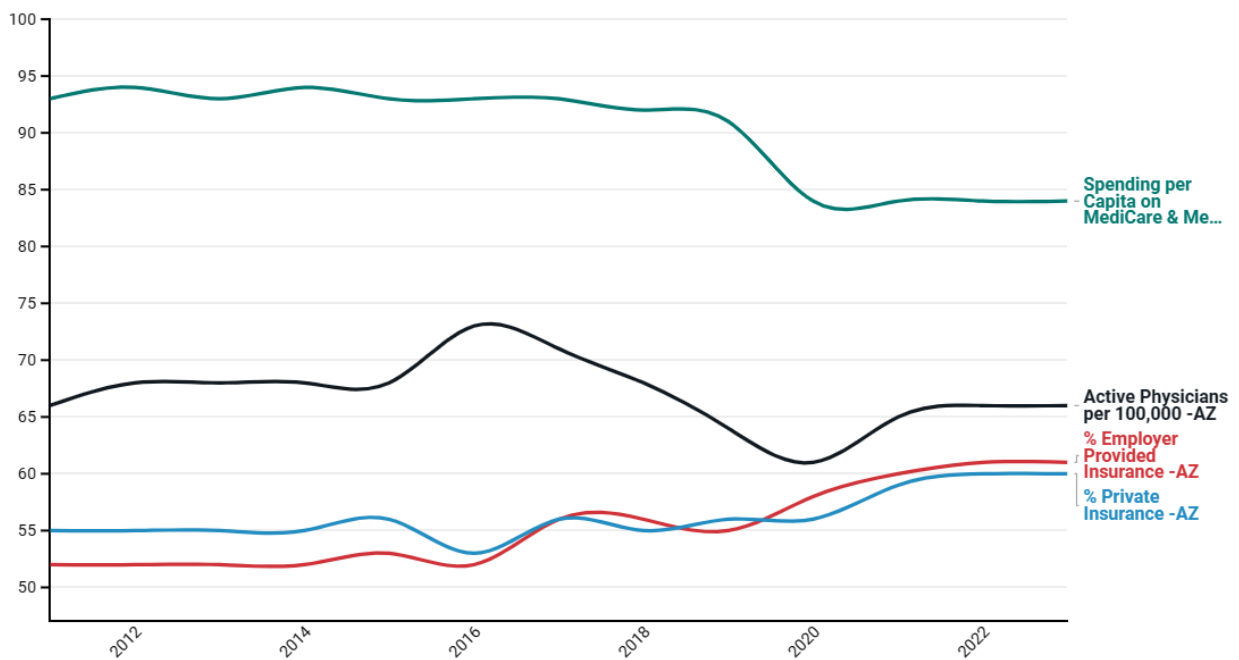
2023 Healthcare Competitiveness Index Ranking



Healthcare Competitive Index - Arizona



Healthcare Competitive Index Components - Arizona



Performance

Affordability, access, and choice remain areas of concern for many Arizonans.

The cost of private insurance coverage has risen rapidly, pricing many out and federal policy changes have increased the demand for public options like Medicaid. The primary care providers shortage, though, makes it relatively more difficult for members of the state's public programs in particular to get timely access to care. Per-capita spending on health care has increased rapidly since 2020 and over 46% of the state's population now live in health professional shortage areas¹.

Government spending on public health care, likewise, has skyrocketed in the last three years since the pandemic and is today one of the largest components of the Arizona state budget. The federal policy requiring Arizona to retain all existing members of the state's Medicaid program regardless of eligibility increased enrollment from 1.8 million to 2.5 million since 2020; the state's unwinding program that began in March 2020 now struggles to correctly place these individuals on eligible programs (be it Medicaid, the ACA marketplace, employer-provided coverage, or another option).

FAST FACTS

Hospitals in Arizona:

84 (52% non-profit, 43% for profit, and 5% public)

Hospital beds per 1,000 Population:

2.03

Insurance Coverage:

63.9% private insurance, 36% public insurance

Outlook

Arizona has had a larger share of adults over 65 than the United States as a whole (19% of the state's total population, as of 2022). Because the elderly are both disproportionate consumers of healthcare services and predominantly covered by the public system (via Medicare), Arizona will face ongoing challenges with the cost, quality, and accessibility of healthcare in the future.

Arizona, like the rest of the country, is facing a growing healthcare worker shortage. The Arizona Board of Regents estimated that 2,300 more healthcare professionals are needed annually to fill the shortages across 6 major healthcare occupationsⁱⁱ. CSI's own Healthcare Competitiveness Index found that Arizona had the 21st fewest practicing physicians per capita in the country.

However, the state has been responding to these challenges. Since the end of the federal Maintenance of Effort requirement, it has reduced its Medicaid enrollment by 306,000. Arizona State University this year announced it was opening a new medical school in downtown Phoenix. And according to the American Association of Nurse Practitioners, Arizona is a "full-practice" state that allows Nurse Practitioners to provide a wide range of primary care services traditionally provided by physicians. These steps should help introduce additional choice and competition into Arizona's healthcare marketplace while reducing the public cost.

ISSUES TO WATCH

- What are the implications of demographic change and an aging population on Arizona's already large healthcare sector?
- The professional pipeline for healthcare professionals is one of the most regulated in the state's economy – how do we solve the competing needs for a bigger healthcare labor force, high costs of care, and the regulatory requirements on new healthcare workers?

Recent Policy

HB 2624 – 2023: AHCCCS; Redeterminations:

- “Requires AHCCCS, by December 31, 2023, to issue decisions on redeterminations for all members who have not been redetermined since December 1, 2022, and who were identified as factually ineligible through AHCCCS’s auto-renewal process based on eligibility information provided from federal and state databases”

SB 1726 – 2023: Health Care:

- “Raises, beginning October 1, 2023, the maximum allowable income for member eligibility under the Children’s Health Insurance Program, from 200 percent to 225 percent of the federal poverty level, subject to approval by the U.S. Centers for Medicare and Medicaid Services (CMS).”

CSI Research

For further information about Healthcare in Arizona, please review the following CSI reports:

The Economic Impact of Arizona’s Health Care Sector

The Economic Impact of Prop 209, An Interest Rate Limit on Debt From Healthcare Services and New Collection Exemptions

Fentanyl, Crime, and Arizona’s Southern Border: August 2022

Housing Market

Performance Rating:



Outlook:

 Neutral

Overview

Housing availability and affordability directly impact Arizona families' financial wellbeing and play a pivotal role in the free enterprise system. Housing challenges significantly affect Arizona businesses' capacity to attract and retain skilled workers. When public safety and property rights are compromised by issues such as crime and homelessness, the economy faces adverse consequences.

Arizona's current housing market presents a complex picture. While affordability concerns persist, there are positive trends to consider. Deliberate policy choices, particularly those fostering economic growth since 2020, resulted in rapid population expansion and have contributed to the heightened housing demand.

FAST FACTS

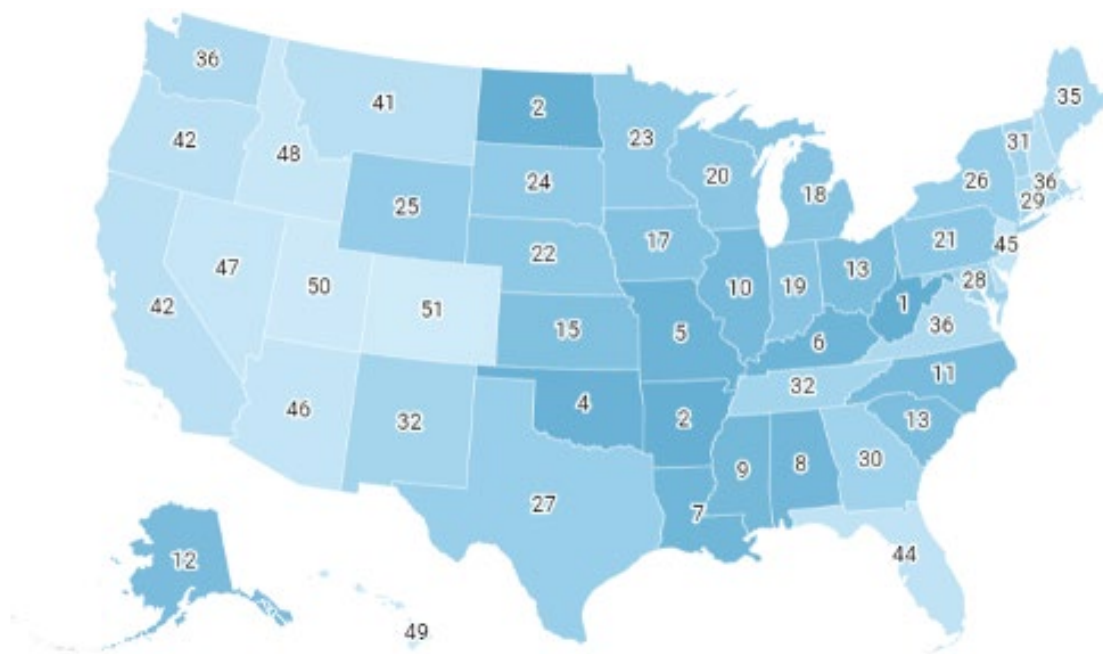
Housing units:
3,186,554

New housing units in 2022:
47,869

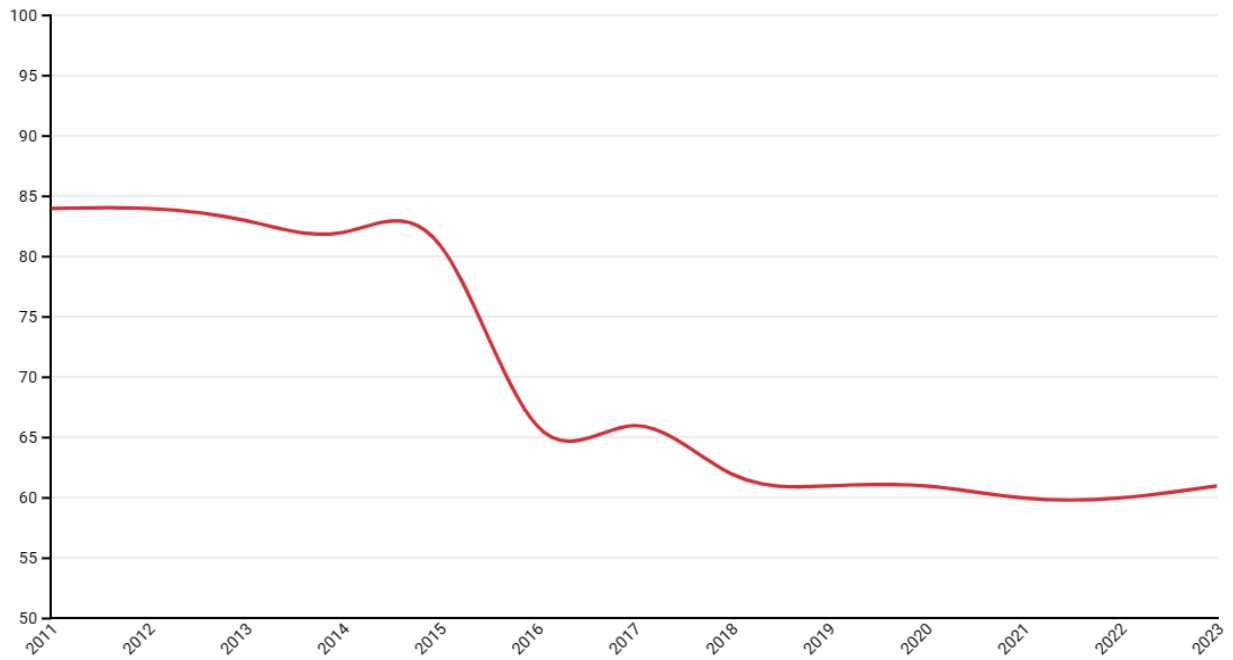
New Housing Permits in 2023 YTD:
36,715

Sheltered and Unsheltered Homeless People:
13,553

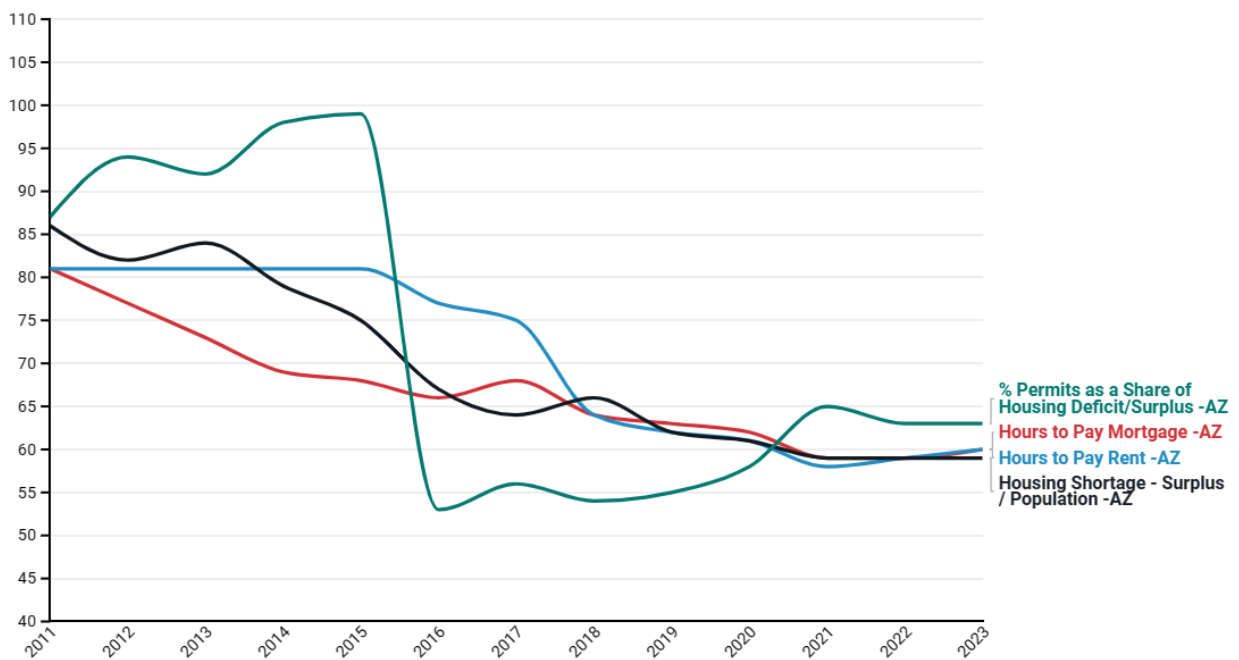
2023 Housing Competitiveness Index Ranking



Housing Competitive Index - Arizona



Housing Competitive Index Components - Arizona



Performance

Although the hours required to pay a typical 30-year mortgage rate has remained stable below 50 hours between 2011 and 2020, the surge in population has driven up the demand for housing in Arizona so that housing affordability has become a larger concern for many since 2020. The hours required to pay a mortgage in Arizona have gradually increased from 30 hours in 2011 to 84 hours in 2023. This indicates a decline in mortgage affordability over this period due to several factors such as slow wage growth, increased housing costs, and rising mortgage rates.

The housing shortage in relation to the population has shown a decline, with the shortage increasing from a surplus of 61,000 units in 2011 to an estimated shortage of 129,000 units. Part of this shortage of housing is due to a surge of in-migration and an inability of permitting and construction to keep pace with an elevated demand for housing. The Housing Competitiveness Index has fluctuated over the years, stabilizing at 61 in 2023. While this is a relatively low value among all states, Arizona remains competitive in the national housing market as homebuilders create innovative solutions to Arizona's housing shortage.

Outlook

The near-term outlook for Arizona's housing market is likely to be characterized by a delicate balance of supply and demand, affordability concerns, and the influence of interest rates. Arizona's housing market has exhibited complex characteristics as interest rates, prices, and overall costs of ownership are all higher than they have been in the past. Rapid price increases are likely behind us, and prices aren't likely to experience a dramatic decline soon either.

Instead, overall volume in the market will stay subdued and the new construction share of sales volume may be higher as home buyers' preferences change in the face of current market conditions. This will insulate many existing homeowners from the worst parts of current market conditions, limiting the economic damage.

At the same time, builders and developers have shown a willingness to adapt to changing market conditions, and supply chains are much improved today. New homes being built today are increasingly suited to first-time buyers, and builders are using creative techniques to manage interest rate costs.

Still, prices and interest rates soon are likely to remain elevated, keeping housing costs painful for buyers. While most prognosticators anticipate interest rates declining over the next two years to more manageable levels, they are unlikely to return to norms of the past two decades.

ISSUES TO WATCH

- Changes in interest rates will continue to have a significant impact on housing affordability. Interest rate fluctuations can influence the housing market's direction and buyer behavior.
- Keep an eye on rental affordability, which has remained relatively stable. Changes in rental affordability can affect the choices of renters and their potential transition to homeownership.
- Track the ongoing efforts to address the housing shortage, as a decreasing shortage suggests positive steps towards balancing supply and demand.
- Observe how the construction sector responds to housing demand, particularly in terms of permits issued. An increased share of permits relative to the housing deficit can influence market dynamics.
- Monitor CSI's 'Misery Index,' which summarizes normalized and equally weighted home prices and 30-year mortgage rates to measure effective costs of home buying relative to historical levels.

Recent Policy

H.B. 2547 – 2023: Zoning Ordinances; Property Rights; Costs

- “Requires the legislative body of a municipality, before adopting any zoning ordinance or zoning ordinance text amendment of general applicability, to consider a housing impact statement that includes: 1) an estimate of the probable impact on the average cost to construct housing for sale or rent within the applicable zoning districts; 2) a description of any data or reference material on which the proposed zoning ordinance or text amendment is based; and 3) a description of any less costly or less restrictive alternative methods of achieving the purpose of the proposed zoning ordinance or text amendment.”

H.B. 2810 – 2023: General Appropriation Act

- “Requires the transitional housing appropriation to be used to establish a program to provide grants to nonprofit organizations that meet outlined criteria and support individuals who are incarcerated by helping prepare the individual for release and transition back into the community.”

- “Allows ADOH to use a portion of the monies appropriated for the Housing Trust Fund to support an investment for a long-term lease facilitated by the state to create a campus for transitional housing, workforce affordable housing, crisis response, detox and recovery, workforce development programs and integrated wrap-around services.”

H.B. 2818 – 2023: Human Services

- “Homeless Shelter and Services Fund (Fund) – Establishes the Fund, administered by the Arizona Department of Housing (ADOH) and consisting of legislative appropriations and other specified monies. ADOH must use Fund monies to award grants in FYs 2024 through 2027 to outlined entities for programs that provide shelter and services to persons experiencing homelessness. Outlines ADOH reporting requirements.”

S.B. 1609 – 2023: Transitional Housing; DOC; Contracts

- “Requires, until October 30, 2024, the Arizona Department of Corrections, Rehabilitation and Reentry to only contract with state licensed facilities to provide inmate transitional housing services.”

CSI Research

Housing Affordability in Arizona: September 2023 Update

Arizona Housing Affordability Update June 2023

Zoning Reform and Arizona’s Housing Market

Housing Innovation in Arizona: Opening the Door to Arizona’s Housing Future

Arizona Housing Affordability Update: February 2023

Arizona Housing Affordability Update October 2022

Arizona Housing Affordability Update: August 2022

Arizona Housing Affordability Update: July 2022

Arizona Housing Affordability

Infrastructure

Performance Rating:



Outlook:

 **Positive**

Overview

Infrastructure, including transportation networks, utilities, and communication systems, enables the efficient movement of goods, services, and information. This efficiency reduces transaction costs, boosts productivity, and promotes economic growth. While Arizona has maintained a relatively competitive position in the Infrastructure Competitiveness Index over the years, there are fluctuations and room for growth. Continued investment and strategic planning will be crucial to ensuring that Arizona's infrastructure remains robust and supports its evolving needs as policymakers continue to grapple with the demands of a rapidly growing population and economy.

SECTOR SNAPSHOT

Federal Highway Administration

Total Lane Miles:

74,782

Percent of bridges that are structurally deficient:

1.1%

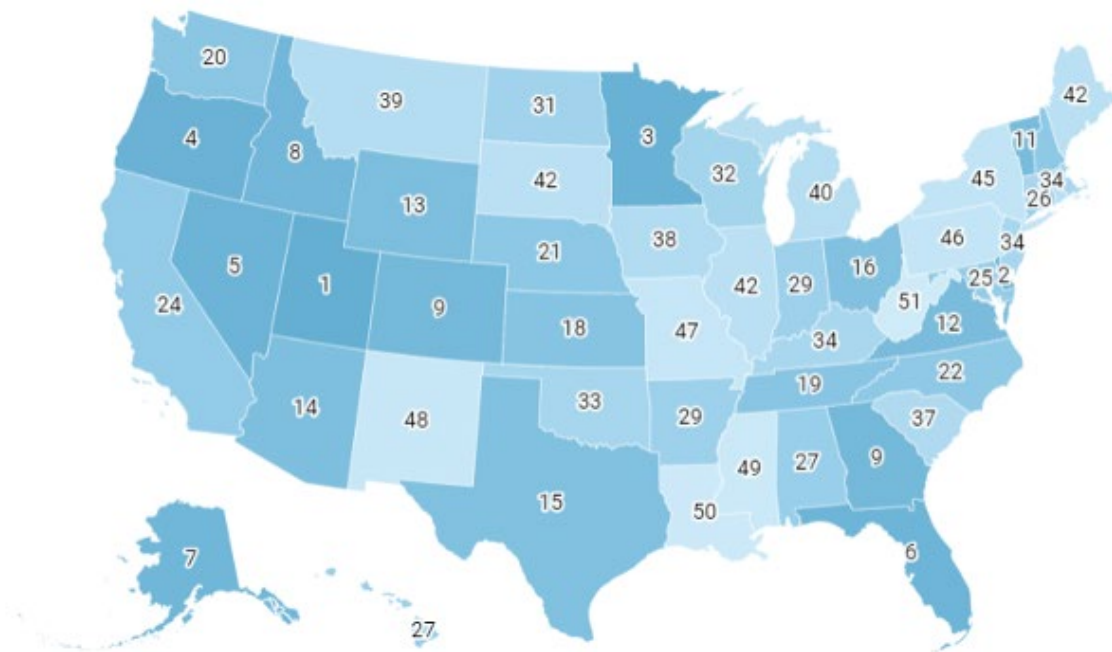
Households With High-Speed Internet Coverage:

90.5%

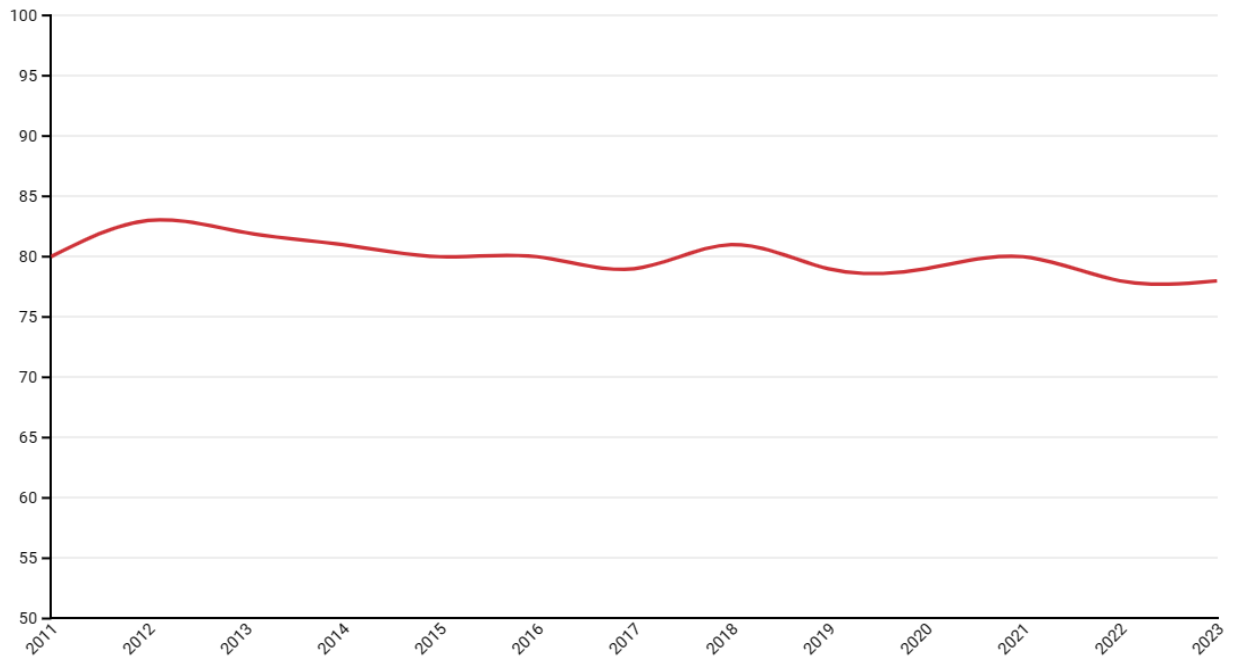
State Spending per Functional Mile of Road:

\$49.40

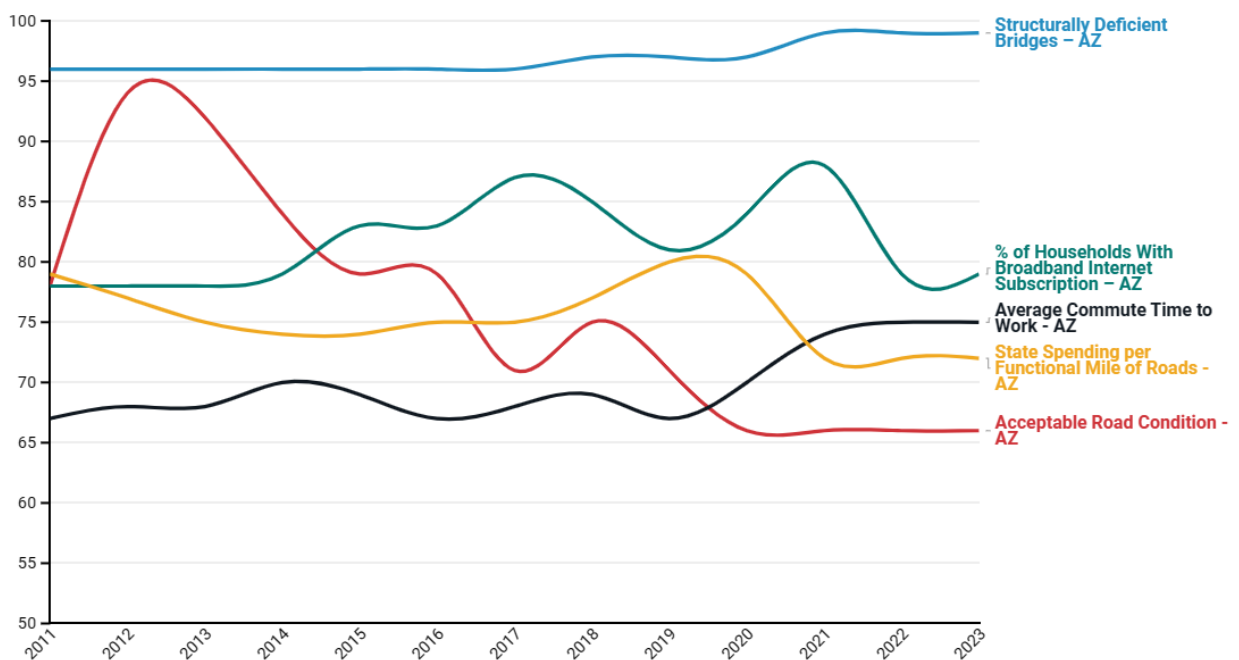
2023 Infrastructure Competitiveness Index Ranking



Infrastructure Competitive Index - Arizona



Infrastructure Competitive Index Components - Arizona



Performance

Arizona is experiencing a period of rapid population and economic growth, bringing both opportunities and challenges to the state's infrastructure. Key infrastructure indicators, spanning from 2011 to 2023, shed light on the state's capacity to meet evolving needs. Over this period, Arizona has witnessed a gradual decline in road condition ratings, with the percentage of roads deemed acceptable dropping from 85% in 2011 to 77% in 2023. This trend underscores the pressing need for substantial investments in road maintenance and expansion to accommodate growing traffic. Although overall road conditions have declined since 2011, Arizona has maintained bridges well with only 95 bridges across the state (1.1%) being structurally deficient. Arizona's bridge maintenance has only improved since 2011 and this figure highlights the state's ability to prioritize bridge infrastructure improvements to ensure safety and reliability. State spending per lane mile in Arizona has remained stable at around \$50, yet it may warrant reassessment given the escalating demands

on Arizona's infrastructure as the population and economy continue to expand. Further, Arizona has maintained an average commute time of 25 minutes since 2011. This not only impacts the quality of life for Arizonans but also emphasizes Arizona's competitiveness in addressing transportation infrastructure to alleviate congestion and enhance efficiency.

Finally, broadband internet adoption enjoyed growth in earlier years and now 90% of Arizona households have broadband access. In a world increasingly reliant on digital connectivity, achieving equitable and widespread broadband access is crucial for economic development and education.

Although the infrastructure competitiveness index has remained relatively steady compared to other states, its slight dip to 78 in 2023 serves as a reminder that sustained investments and strategic planning are essential to maintain and improve the state's competitive edge.

ISSUES TO WATCH

- Preservation activities that improve or sustain the condition of road pavement and bridge facilities to a state of good repair are the top priority for investment for many Arizonans, according to the Arizona Department of Transportation outreach.
- Ensuring the safety and maintenance of bridges, especially in rural areas, is a priority. The condition of bridges and the need for timely repairs or replacements can impact both safety and economic development.
- Infrastructure issues related to water supply, distribution, and the sustainability of water resources are critical.
- Identifying sustainable funding sources for infrastructure projects, including innovative financing models, is an ongoing challenge. Finding ways to fund critical infrastructure while adhering to free-market principles is a key consideration.

Outlook

The federal government has made significant funding available for infrastructure improvements nationwide, including Arizona. This legislation provides Arizona the opportunity to compete for funding a wide range of infrastructure projects, such as improving roads, bridges, public transit, broadband expansion, water systems, and electric vehicle charging infrastructure. However, bureaucratic limits on how those funds can be used may inhibit their timely and efficient deployment.

Arizona currently ranks high compared to other states (14th out of 50 states and D.C.), and the state's ability to manage a large amount of population and economic growth has given us a competitive advantage in terms of maintaining and improving infrastructure across the state. The state has a large amount of available land, a relatively moderate climate, and is not prone to major natural disasters. This should enable its infrastructure to continue expanding to support its growth and do so efficiently.

Recent Policy

S.B. 1340 – 2023: Toll Roads; Conversions; Prohibition

- “Prohibits a county board of supervisors (county BOS) from granting an application, and the Arizona Department of Transportation from entering into a public-private partnership agreement, to convert an existing publicly funded or maintained street or highway into a toll road. An airport that applies to the county BOS is excluded from the prohibition.”

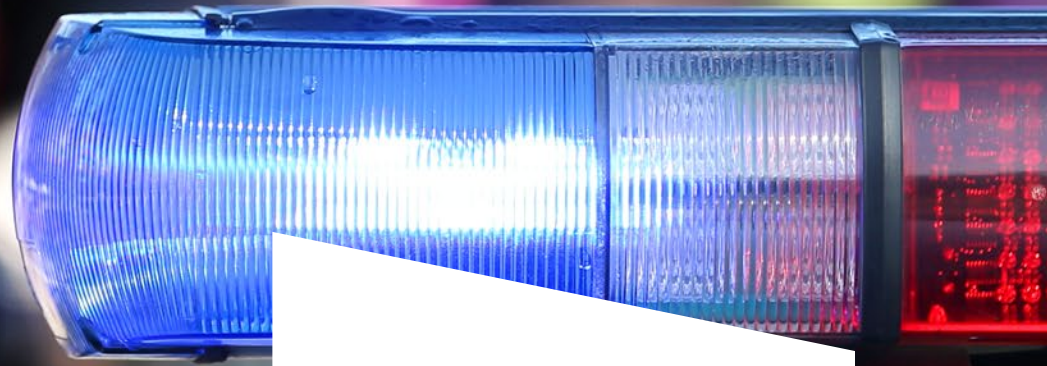
H.B. 2438 – 2023: Board of Supervisors; Powers; Water

- “Authorizes a county board of supervisors to participate in water reuse and recycling programs and regional wastewater recharge projects and related infrastructure.”

H.B. 2809 – 2023: Public Infrastructure Improvements; Reimbursements

- “Increases, from \$100,000,000 to \$200,000,000, the aggregate cap on the amount of state prime contracting transaction privilege tax revenues that must be paid to cities, towns and counties for public infrastructure improvements for the benefit of a manufacturing facility.”

Public Safety and Our Community



Performance Rating:



Outlook:

 **Negative**

Overview

Strong social trust and the expectation of respect for the private property of others are foundational features of any free market economy. Before the pandemic Arizona was a leader in criminal justice reform and responding to the burgeoning opioid crisis. Between 2014 and 2020, the state's incarceration rate was falling and crime rates were going down.

In June 2017, then-Gov. Ducey declared opioid abuse a statewide emergency, and in 2018 Arizona enacted the Opioid Epidemic Act, intended to address easy access to opioids via pharmaceutical grey markets.

SECTOR SNAPSHOT

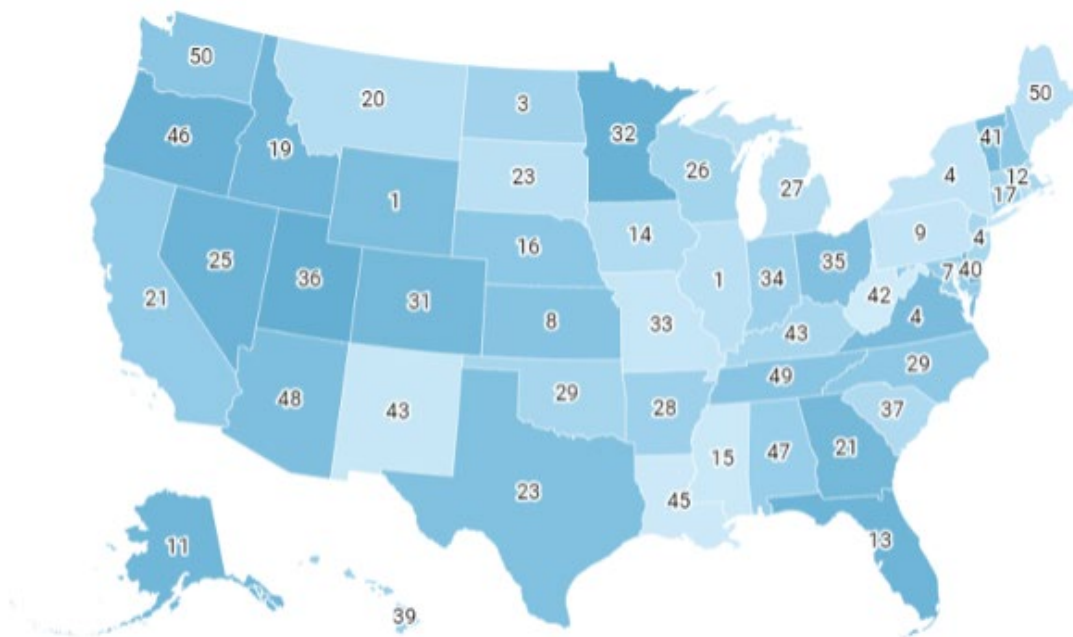
Fatal Drug Overdoses:
2,768

Violent and Property Crime rate:
3,185 per 100,000ⁱⁱⁱ

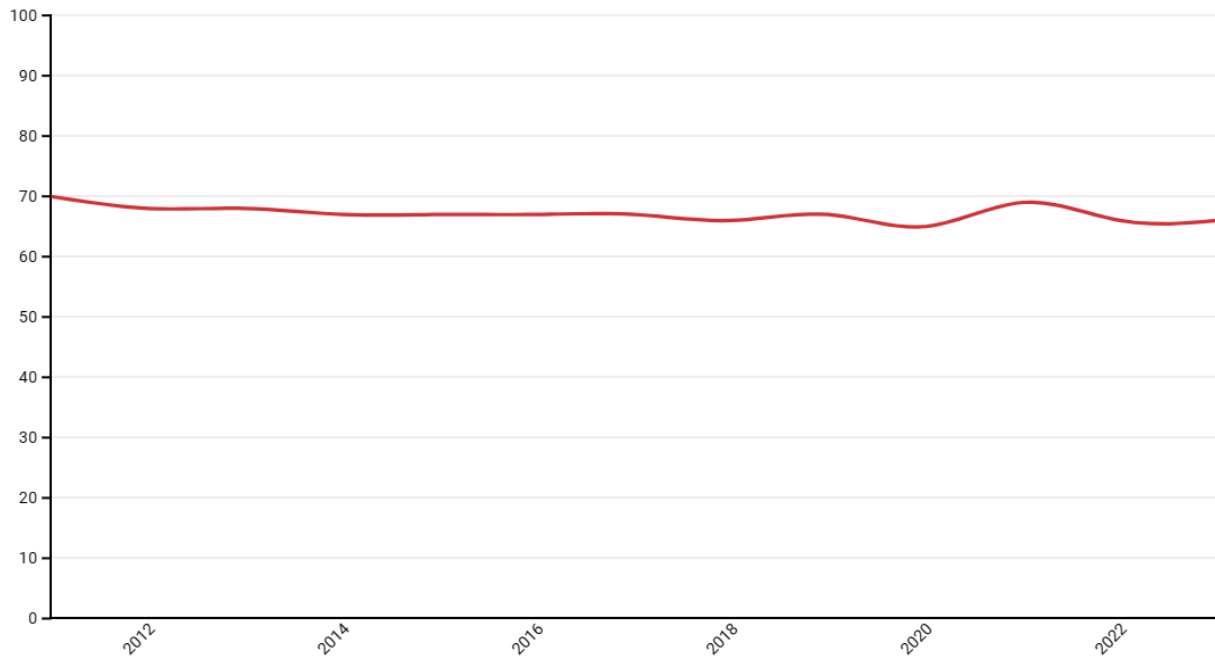
Homelessness:
13,553 homeless people

Unfortunately, since 2020, the combination of the pandemic, a national movement towards less aggressive policing, and an open southern border enabling the free flow of fentanyl as a substitute source of opioids has reversed many of these gains.

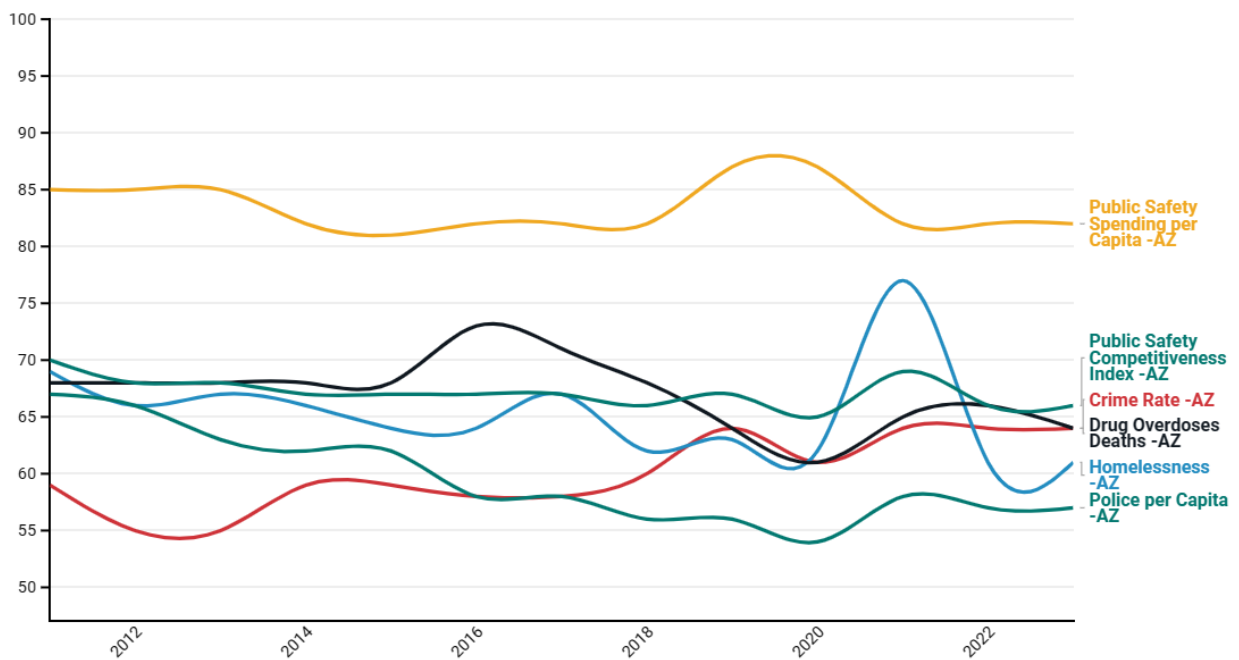
2023 Public Safety Competitiveness Index Ranking



Public Safety Competitive Index - Arizona



Public Safety Competitive Index Components - Arizona



Performance

Arizona has a drug addiction problem. Fatal and non-fatal overdoses remain at or near all-time highs reached during the pandemic, and the vast majority of these are linked to opioid abuse (and, in turn, fentanyl abuse). Well-intentioned policies intended to reduce abuse of prescription opioids interacted with an open southern border and 2020's national trend towards less aggressive policing of many crimes to move many addicts into dependence on illegal street fentanyl. CSI's research last year put the cost of fentanyl abuse in Arizona at more than \$53 billion every year.

At the same time, the state's police resources have not kept pace. Arizona's public safety spending has not seen the same rapid growth as other areas of its state and local budgets since 2020, and today the state has one of the lowest police-per-capita rates in the country.

Drug addiction and permissive policing may in turn be probable contributors to Arizona's homelessness and property crime problems.

ISSUES TO WATCH

- **When will crime rates reverse their recent trends and start falling again?**
- **How does Arizona address its ongoing opioid crisis, given the abundant supply of cheap fentanyl from illicit sources?**
- **How does Arizona address its growing homelessness problems, and in a cost-effective manner?**

Outlook

Ultimately, drug addiction is linked with higher rates of homelessness and criminality. And today, Arizona's drug problem is a problem with opioids generally, and fentanyl specifically. America's uncontrolled southern border is the perfect conduit for the flow of cheap fentanyl into the United States, and as a border state, Arizona is unfortunately well positioned to be disproportionately impacted by this flow.

September numbers from the Department of Homeland Security reported an all-time-high number of illegal crossings by undocumented migrants. As CSI found in its research last year, illegal migrant crossings are correlated with the opioid crisis and cross-border drug smuggling; it is probable, then, that the flow of fentanyl across the southern border is also at an all-time high.

One of Arizona's largest law enforcement agencies – Maricopa County Sheriff's Department – has been under federal supervision for 15 years. The state's largest municipal law enforcement agency, Phoenix Police Department, has been under federal investigation for over two years. This federal intervention in state and local law enforcement effort diverts time, money, and other resources away from policing and is ongoing.

Finally and alarmingly, according to the latest FBI data, after declining in 2021 violent crime rates in Arizona again rose last year.

America's uncontrolled southern border is the perfect conduit for the flow of cheap fentanyl into the United States, and as a border state, Arizona is unfortunately well positioned to be disproportionately impacted by this flow.

Recent Policy

H.B. 2001 – 2018: Controlled Substances; Regulation; Appropriation^{iv}

- “Prohibits specified medical professionals from dispensing schedule II drugs that are opioids. Permits specified medical professionals to dispense schedule II drugs that are opioids for medication-assisted treatment. Limits an initial prescription of a schedule II drug that is an opioid to a 5-day supply, except that a prescription following a surgical procedure is capped at a 14-day supply.”
- “Prohibits a person from being charged or prosecuted with possession or use of a controlled substance, drug paraphernalia or a preparatory offense if the individual, in good faith, seeks medical assistance for themselves or a person experiencing a drug-related overdose.”

H.B. 2814 – 2023: Criminal Justice

- “Establishes the Fentanyl Prosecution, Diversion and Testing Fund (Fentanyl Fund), administered by the Department of Public Safety (DPS), and consisting of legislative appropriation.”
- “Establishes the Antihuman Trafficking Grant Fund (Trafficking Fund), administered by the Arizona Department of Homeland Security (AZDOHS), and consisting of legislative appropriations. Trafficking Fund monies must be distributed to eligible programs that reduce human trafficking in Arizona by providing assistance and analytical services to law enforcement agencies or services to victims and training to law enforcement and prosecutorial agencies and the public.”

S.B. 1055- 2023: Funding; Full-service Crime Labs

- “Modifies Department of Public Safety (DPS) Forensics Fund distributions by removing the current distributions and reallocating the monies to all full-service crime labs in Arizona based on the proportion of crimes reported to DPS in relation to the total number of crimes reported in all jurisdictions.”

CSI Research

Fentanyl, Crime, and Arizona’s Southern Border: August 2022

State Budget

Performance Rating:



Outlook:

 **Negative**

Overview

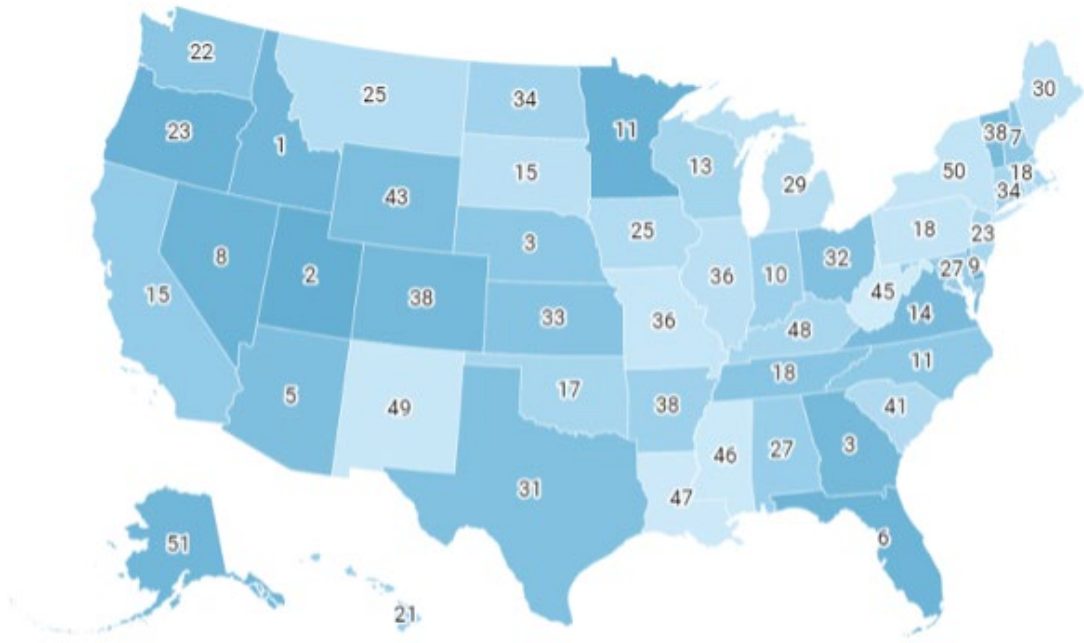
At the state and local levels, where government must operate on a cash-balanced basis, the free enterprise system depends on an efficient government at sustainable levels. If government budgets grow too large, they can crowd out private spending and investment, and reduce private opportunities. If too small, local public infrastructure and public goods suffer and economic activity moves elsewhere.

State and local government in Arizona has broad authority to spend incoming revenue and issue debt, subject at the local level to voter approval and aggregate budget controls. However, rapid growth in the state’s economy and a general reluctance at the state level to issue debt, means Arizona

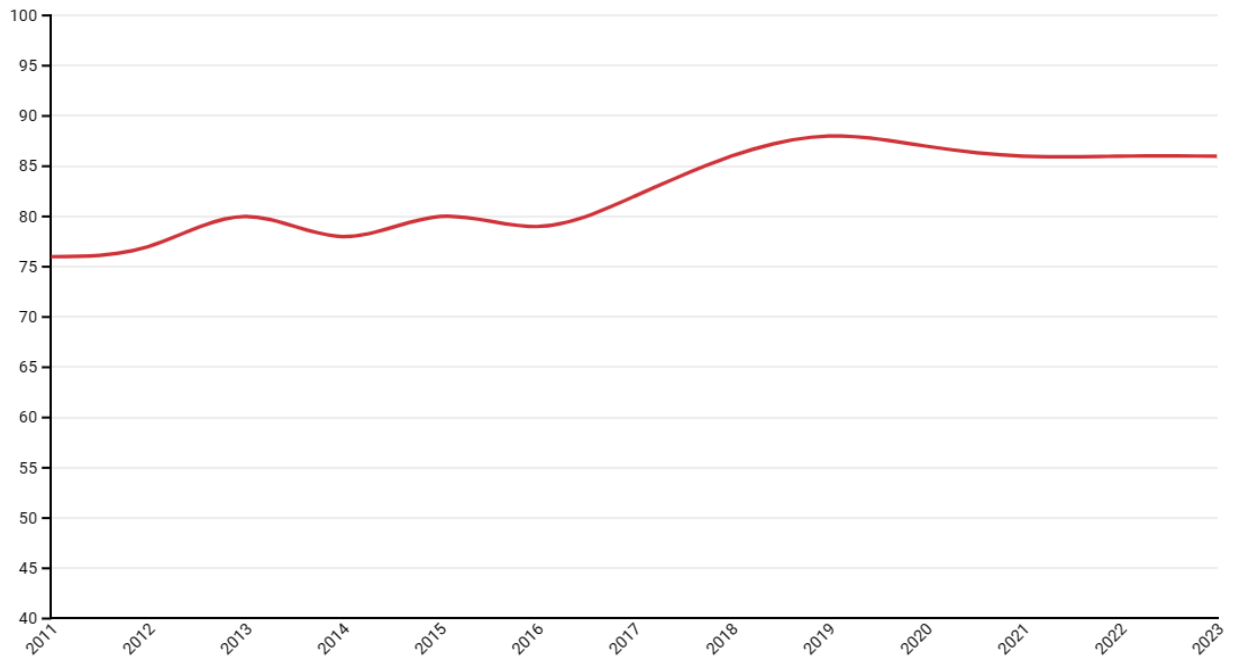
today has a relatively small debt-to-income ratio, and a lower level of state and local government spending relative to the size of its economy, than most other states.

While government budgets have grown significantly in recent years due to rapid revenue growth since 2017, this has been offset somewhat by similar-paced growth in the state’s economy. Between 2017 and 2022, the state built record levels of reserve balances, and because state and local governments operate on a cash-balanced basis, projections of lower revenue growth in the future will constrain future spending growth.

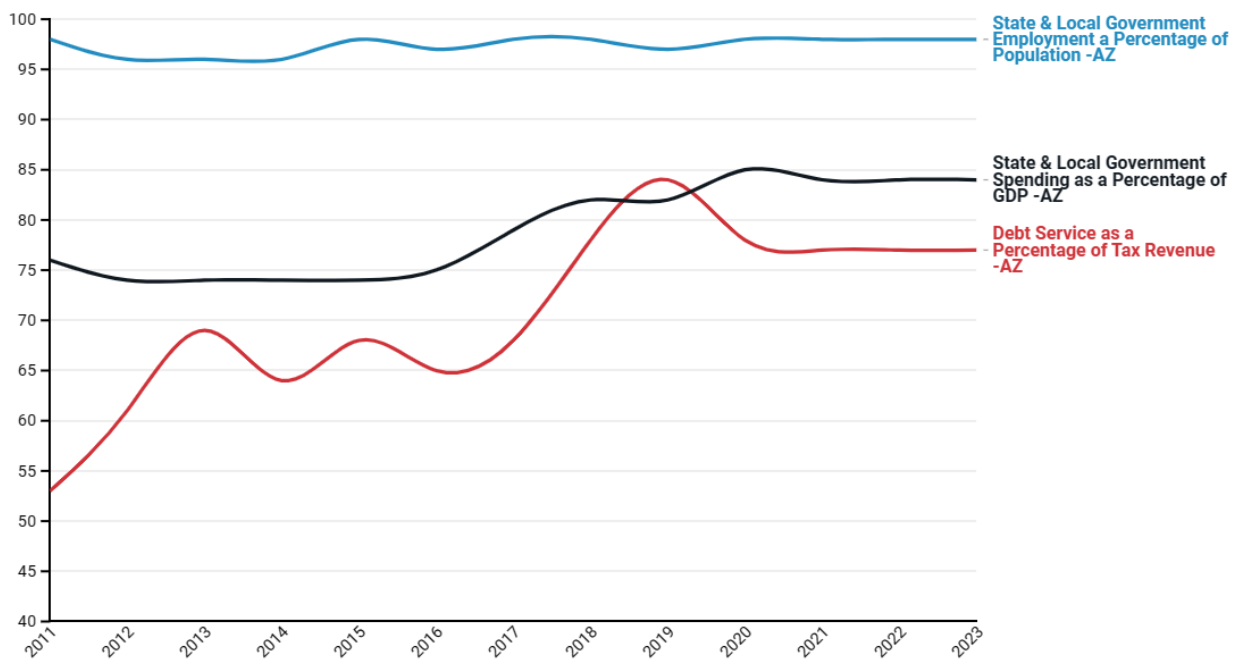
2023 State Budget Competitiveness Index Ranking



State Budget Competitive Index - Arizona



State Budget Competitive Index Components - Arizona



Performance

At \$12.8 billion, the State of Arizona's FY 2023 General Fund budget was its largest ever. But despite record spending, the state had a checking account cash balance of over \$4.5 billion and another \$1.4 billion in its rainy-day account, the Budget Stabilization Fund.

State debt is at one of its lowest levels in history – the State of Arizona today owes only about \$750 per person, and total debt service as a percentage of tax revenue is just 5%.

And despite rapid growth in state and local government spending over the past five years, this state is one of the most payroll-efficient in the country – just 3.8% of its population works for state and local government.

SECTOR SNAPSHOT

State and local spending % of GDP:
12.5%

FY24 Estimated Ending Cash Balance:
(-\$401 million)^v

Spending Growth since FY 2019:
+\$24.2 billion (+60%)^{vi}

ISSUES TO WATCH

- How do state and local policymakers manage the imminent loss of emergency federal funds?
- Assuming the state's record budget surpluses are gone permanently, what does this mean for state budgets going forward?
- If the revenue slowdown continues, how do policymakers respond? What spending programs are at risk, and which taxes might go up?

Outlook

This year's enacted state budget increased spending another \$2.2 billion, and over just the past two budget years State General Fund spending has grown a combined \$5 billion (+40%). The large cash reserves built up over several years are gone – the state's legislative budget officers originally projected a \$10 million checking account balance this year, and in October revised that down to a negative \$400 million cash shortfall.

At the local level, a concerning number of reports highlight the commitment of one-time federal emergency money received over the past three years to ongoing commitments, like payroll and new programs and services. It remains to be seen how local budgets will manage the loss of this money in the coming months.

And finally, a slowing economy and inflationary pressures will likely squeeze both state and local budgets in the coming years in ways they haven't experienced in a decade.

Recent Policy

S.B. 1720 – 2023: General Appropriations Act

- “Effective May 11, 2023, the FY 2024 budget includes spending in the total amount of \$17.8 billion and a cash balance of \$6 million. The adopted budget includes ongoing and one-time revenues of \$17.8 billion.”

S.B. 1729 – 2022: General Appropriations Act

- “Effective June 28, 2022, the FY 2023 budget includes spending in the total amount of \$15.8 billion, a cash balance of \$1 billion and a structural balance of \$506 million. The adopted budget includes ongoing and one-time revenues of \$16.8 billion.”

CSI Research

The Arizona Budget: Then & Now 2023

The Arizona Budget: Then & Now 2022

Taxes & Fees

Performance Rating:



Outlook:

 **Neutral**

Overview

In general, a tax regime characterized by low marginal rates and a wide, efficient base is critical to protecting and growing a jurisdiction's economy. Arizona's tax regime features relatively low and consistent income taxes; relatively low property taxes; and relatively high sales taxes. It is no surprise, then, that it scores so well.

Arizona has no statewide property tax and no local income tax. Since 2018, it has adopted a simplified and fair sales tax regime that treats all businesses the same – brick-and-mortar or online.

In 2021 and in response to years of rapid revenue growth, the state enacted the lowest-in-the-nation single rate individual income tax at a flat 2.50%.

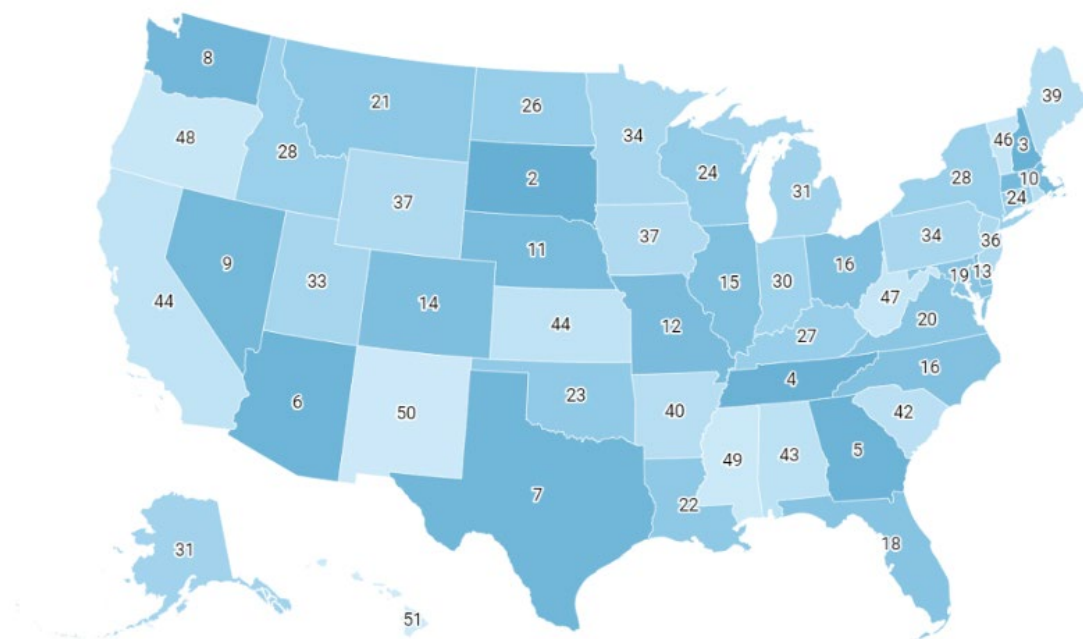
SECTOR SNAPSHOT

Tax & Fee revenue % of GDP:
10.8%

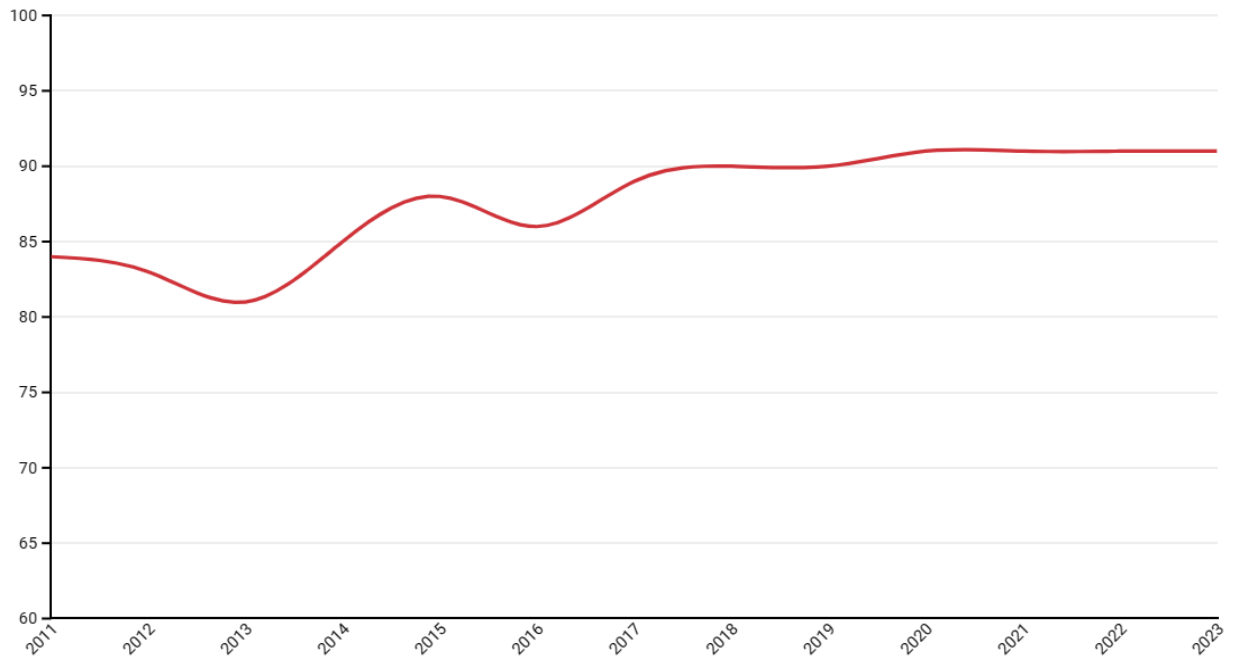
Tax Foundation State and Local Individual Income Tax Collections Per Capita:
\$4,136

Tax Foundation Rank for State and Local Tax Burden:
15th lowest state and local tax burden^{vii}

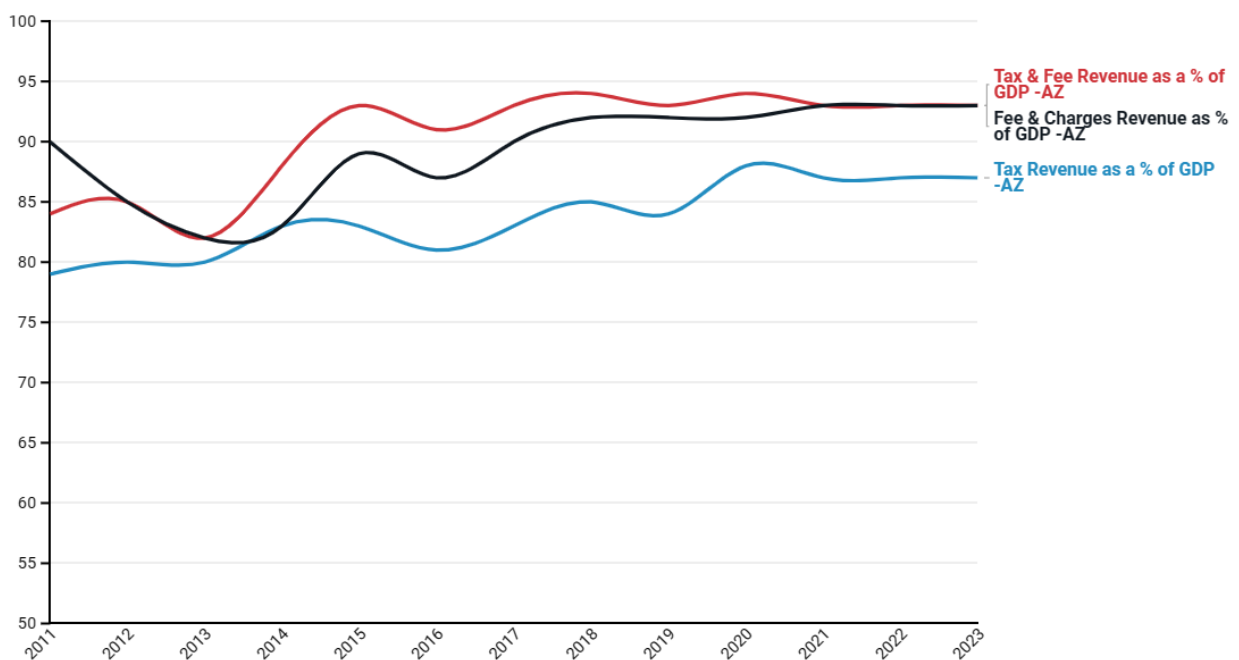
2023 Taxes & Fees Competitiveness Index Ranking



Taxes & Fees Competitive Index - Arizona



Taxes & Fees Competitive Index Components - Arizona



Performance

Arizona ranks very highly for its state and local tax regime, and in recent years its performance has improved. The state has responded to rapid economic growth, and corresponding rapid revenue growth, by aggressively modernizing its tax structure and lowering rates.

In 2021, the state eliminated its graduated statewide individual income tax – phasing into a 2.50% flat tax regime over three years. This mirrors the change made to its corporate income tax a decade earlier (which has a single 4.50% rate).

Since 2018, the state Transaction Privilege Tax has taxed most online (remote) sales the same as local sales, which creates parity for local businesses and incentivizes locating activity inside the state.

In 2022, the state largely eliminated its personal property taxes on businesses prospectively, by adopting instant depreciation on most of these purchases. Going forward, new capital investment in Arizona will be valued at just 2.5% of the market price beginning from the first year of purchase for property tax purposes.

And this year, the state (finally) repealed its regressive municipal sales tax on rental housing – a regressive local tax that raised very little revenue, disproportionately impacted its poorest residents, and contributed to the high cost of rental housing in the state.

ISSUES TO WATCH

- Will the state continue its history of tax cutting in the face of a changing budget picture?
- Will the state's new flat income tax and property tax reforms produce the expected economic growth?

Outlook

While the state's aggressive tax reforms since the end of the Great Recession and culminating in the past five years' reforms have positioned it very well, the prospects for continued improvement in the short term are less optimistic. Spending has grown rapidly, and legislative budget forecasters are seeing slowing revenue growth, which limits the opportunity for significant tax reform soon.

On the other hand, statutory and constitutional protections at the state and local level will limit the ability of policymakers to increase taxes rapidly or significantly, too. State law requires a three-fourths legislative majority or two-thirds of voters to approve any statewide tax increase. Local taxes are subject to statutory limits as well, and typically require voter approval.

Recent Policy

H.B. 2900 – 2021: Omnibus; Taxation^{viii}

- “Establishes new individual income tax brackets for tax year (TY) 2022 and state General Fund (state GF) revenue thresholds that must be met for further modification to the individual income tax rates in future taxable years. The Arizona Department of Revenue (ADOR) must use a single 2.5 percent tax rate following receipt of the notice that the previous fiscal year’s state GF revenue was at least \$12,976,300,000.”

H.B. 2822 – 2022: Personal Property; Additional Depreciation^{ix}

- “Requires the county assessor to adjust the depreciation schedule prescribed by the Arizona Department of Revenue by using a valuation factor of 2.5 percent to determine the valuation of certain subclasses of: 1) class 1 and class 2 personal property initially classified during or after TY 2022; and 2) class 6 personal property acquired and initially classified during or after TY 2022.”

S.B. 1131 – 2023: Residential Leases; Municipal Tax Exemption^x

- “Beginning January 1, 2025, prohibits a city, town or other taxing jurisdiction from levying a tax or fee on the business of renting or leasing real property for residential purposes.”

CSI Research

HB 2822 & The Taxation of Business Personal Property

Arizona’s New Tax Structure

The Economic Impact of Prop 310, A Sales Tax for Fire District Funding Measure

Accelerating Arizona’s New Tax Structure: Economic Impacts of Implementing the 2.50% Flat Tax in 2023

Data and Methodology



The Free Enterprise Competitive index is an equally weighted aggregate measure of eight indices that align with CSI's policy areas: Education, Energy, Healthcare, Housing, Infrastructure, Public Safety, State Budget & Finances, and Taxes & Fees.

Arizona's competitiveness in each of the policy areas is evaluated through metrics that are publicly available each year for all fifty states and D.C., and measure performance. For example, in education, the relevant metrics are standardized testing results for reading and math for 4th and 8th grade, percent of total spending on instruction per pupil, high school graduation rate, and percent of total enrollment in Charter schools.

- 1) Each metric is ranked for fifty states and D.C. in every state by year.
- 2) An aggregated measure is calculated by equally weighting each metric and summing as shown in the following equation.

$$\sum_{1}^{n} Mys_i/n$$

Where: M=metric,y=year,s=state,i=metric number,n=# of metrics

For example, the Aggregate Education Competitiveness Index has seven metrics, so the equation for the aggregate index is calculated as follows:

Aggregate Education Competitiveness Index per year,per state
=(NAEP4Rys+NAEP4Mys+NAEP8Rys+NAEP8Mys+PSOIys+GRys+PECS)/(7)

Where y,s = the year and state

NAEP4R_{state,year} = 4th grade NAEP reading test = 74

NAEP4M_{state,year} = 4th grade NAEP math test = 66

NAEP8R_{state,year} = 8th grade NAEP reading test = 85

NAEP8M_{state,year} = 8th grade NAEP math test = 69

PSOI_{state,year} = Percent of total spending on instruction per pupil = 70

GR_{state,year} = High school graduation rate = 59

PECS_{state,year} = Percent of students enrolled in Charter schools = 95

Entering the metric values into the equation produces the following result:

Aggregate Education Competitiveness Index per year,per state
=(74+66+85+69+70+59+95)/(7) = 74

- 3) Ranking each of the Aggregate Competitiveness Indices for all fifty states and D.C. determines order of competitiveness. 1st is most competitive, 51st is least competitive.
- 4) Follow steps 2 and 3 for all of the policy areas Education, Energy, Healthcare, Housing, Infrastructure, Public Safety, State Budget & Finances, and Taxes & Fees.
- 5) The Free Enterprise Competitiveness Index is the equally weighted average of the policy area Aggregate Competitiveness Indices as shown in the following equation.

$$\sum_{i=1}^n Mys_i/n$$

Where: PAI=Policy Area Index,y=year,s=state,i=PAI number,n=8

For example, the Free Enterprise Competitiveness Index has eight policy areas, so the equation for the index is calculated as follows:

**Aggregate Education Competitiveness Index per year,per state
=(EDys+ENys+HCys+HOys+INys+PSys+SBFys+TFys)/(8)**

Where y,s = the year and state

ED_{state, year} = Education Index = 74

EN_{state, year} = Energy Index = 87

HC_{state, year} = Healthcare Index = 90

HO_{state, year} = Housing Index = 68

IN_{state, year} = Infrastructure Index = 62

PS_{state, year} = Public Safety Index = 59

SBF_{state, year} = State Budget & Finances Index = 79

TF_{state, year} = Taxes & Fees Policy Index = 80

**Free Enterprise Competitiveness Index per year,per state
=(74+87+90+68+62+59+79+80)/(8) = 74.88**

- 6) Ranking each of the Aggregate Competitiveness Indices for all fifty states and D.C. determines order of competitiveness. 1st is the most competitive, 51st is the least competitive.

Appendix: Sources of Index Metrics

Policy Area	Stat	Years	Source(s)
Education	NAEP 4th Grade Testing Reading -	2011-2022	National Assessment of Educational Progress (NAEP)
Education	NAEP 4th Grade Testing Math -	2011-2022	National Assessment of Educational Progress (NAEP)
Education	NAEP 8th Grade Testing Reading -	2011-2022	National Assessment of Educational Progress (NAEP)
Education	NAEP 8th Grade Testing Math -	2011-2022	National Assessment of Educational Progress (NAEP)
Education	Spending on Instruction as Percent of Total Spending per Pupil -	2011-2020	U.S. Census
Education	High School Graduation Rate -	2011-2020	U.S. Dept. of Education
Education	% Of Total Enrollment in Charter Schools -	2011-2022	U.S. Dept. of Education
Education	Funding Per Student	FY 2023	Arizona Joint Legislative Budget Committee
Energy	Nameplate Capacity (Megawatts) per 100,000 Residents -	2011-2023	U.S. Energy Information Administration
Energy	Reliability -CAIDI (minutes per interruption) W/O MED per Capacity -	2011-2022	U.S. Energy Information Administration
Energy	Reliability - CAIDI (minutes per interruption) With MED Capacity -	2011-2022	U.S. Energy Information Administration
Energy	Electricity Price (cents/kWh) - Residential -	2011-2023	U.S. Energy Information Administration
Energy	Electricity Price (cents/kWh) - Commercial -	2011-2023	U.S. Energy Information Administration
Energy	Electricity Price (cents/kWh) - Industrial -	2011-2023	U.S. Energy Information Administration

Policy Area	Stat	Years	Source(s)
Energy	Residential Natural Gas Price -	2011-2023	U.S. Energy Information Administration
Energy	Commercial Natural Gas Price -	2011-2023	U.S. Energy Information Administration
Energy	Industrial Natural Gas Price -	2011-2023	U.S. Energy Information Administration
Energy	Share of Electricity Produced by Clean Energy -	2011-2022	U.S. Energy Information Administration
Healthcare	% Employer Provided Insurance	2011-2022	U.S. Census
Healthcare	% Private Insurance	2011-2022	U.S. Census
Healthcare	Active Physicians per 100,000	2011-2021	Center for Disease Control & Prevention
Healthcare	Spending per Capita on Medicare & Medicaid	2011-2020	U.S. Census, CMS.GOV
Healthcare	Hospitals in Arizona	2021	Kaiser Family Foundation
Healthcare	Population on AHCCCS and Removed Since end of MOE	2023	AHCCCS
Healthcare	Healthcare Professional Shortage	2022	Arizona Board of Regents
Housing	Hours to Pay Mortgage	2011-2023	Zillow, U.S. Bureau of Labor Statistics, CSI Calculations
Housing	Hours to Pay Rent	2011-2023	Zillow, U.S. Bureau of Labor Statistics, CSI Calculations
Housing	Housing Shortage - Surplus / Population	2011-2022	U.S. Census, CSI Calculations
Housing	% Permits as a Share of Housing Deficit/Surplus	2011-2022	U.S. Dept. of Housing and Urban Development, U.S. Census, CSI Calculations
Infrastructure	Acceptable Road Condition	2011-2020	U.S. Dept. of Transportation

Policy Area	Stat	Years	Source(s)
Infrastructure	Structurally Deficient Bridges	2011-2023	Federal Highway Administration (FHWA)
Infrastructure	Average Commute Time to Work	2011-2022	U.S. Census
Infrastructure	% of Households With Broadband Internet Subscription	2011-2022	U.S. Census
Infrastructure	State Spending per Functional Mile of Roads	2011-2021	Federal Highway Administration (FHWA), U.S. Census
Public Safety	Crime Rate	2011-2020	U.S. Dept. of Justice (FBI)
Public Safety	Homelessness	2011-202	U.S. Dept. of Housing and Urban Development
Public Safety	Drug Overdoses Deaths	2011-202	Center for Disease Control & Prevention
Public Safety	Police per Capita	2011-202	U.S. Dept. of Justice (FBI)
Public Safety	Public Safety Spending per Capita	2011-202	U.S. Census
State Budget & Finances	Debt Service as a Percentage of Tax Revenue	2011-2021	U.S. Census
State Budget & Finances	State & Local Government Employment a Percentage of Population	2011-2021	U.S. Census
State Budget & Finances	State & Local Government Spending as a Percentage of GDP	2011-2021	U.S. Census
State Budget & Finances	FY 2024 Cash Balance as of October 2023	2023	Arizona Financial Advisory Committee
State Budget & Finances	Spending Growth Since 2019 All funds	2019-2023	Arizona Joint Legislative Budget Committee

Policy Area	Stat	Years	Source(s)
Taxes & Fees	Tax & Fee Revenue as a % of GDP	2011-2021	U.S. Census
Taxes & Fees	Tax Revenue as a % of GDP	2011-2021	U.S. Census
Taxes & Fees	Fee & Charges Revenue as % of GDP	2011-2021	U.S. Census
Taxes & Fees	Tax Foundation Collections per Capita and Rank Among States	2023	Tax Foundation

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- ^{iv} “State of Arizona House of Representatives Summary of Legislation 2018”, Majority Research Staff, 2018.
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- ^{vi} “FY 2024 Appropriations Report”, Joint Legislative Budget Committee, July 2023.
FY 2019 and FY 2024 Appropriations report total spending all sources
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