Arizona's 2022 Public Election and Free Enterprise

December 12th, 2022

The 2022 election cycle in Arizona officially concluded on November 28th, after unofficially concluding on November 17th (ten days after election day) following media calls on the closest outstanding races. Ultimately, voters approved 7 of the 10 initiatives, and declined to approve three. Of those, the Common Sense Institute specifically analyzed two propositions prior to the election (Propositions 209 relating to interest on medical debt, and Prop 310 relating to a new a sales tax for fire district funding, which respectively passed and failed). Additionally, two other propositions of interest to the state's free enterprise system passed: Propositions 130 – relating to the application of the state's property tax – and 132 – requiring 60% of voters approve of future ballot measures that increase taxes.

This report provides an updated analysis of implications for the state economy, the state budget, and individual liberty and general freedom to engage in private enterprise of the passage (or failure) of these items.

Issue	Initiative	CSI Analysis	Outcome	Economic Impact	Budget Impact	Free Enterprise Impact
Application of Property Taxes	Prop 130		Passed	No	No	Yes
60% Threshold For Approval of Taxes	Prop 132		Passed	No	No	Yes
Limits on Medical Debt Collection	Prop 209	The Economic Impact of Prop 209	Passed	Yes	No	Yes
Fire District Sales Tax	Prop 310	The Economic Impact of Prop 310	Failed	Yes	Yes	Yes

Summary of Ballot Issues

Prop 130: Application of Property Taxes

Unique among the state's major tax types, *ad valorem* taxes on real and personal property are constitutionally – versus statutorily – authorized and applied. This limits the authority of policymakers to, for example, exempt certain properties from taxation or treat like properties differently based on a desired public outcome. The 'uniformity clause' of the Arizona Constitution requires all taxes to be *uniform* on like property. While the Legislature has been creative in finding solutions to the policy constraints this imposes, practically speaking, this makes it difficult to exempt property from taxation outright. Given that the Constitution explicitly subjects *personal property* - things like machinery, office equipment, and other tangible things - to tax, the Legislature is constrained in its ability to limit or eliminate this economically destructive tax despite a clear record of high compliance costs, low economic efficiency, and little net revenue impact. An April 2022 CSI study of just-passed HB 2822 found only about 9% of statewide property tax payments are attributable to business personal property[i], and of that a much smaller share – only about $230 million statewide or fewer than 3% of total payments – is associated with traditional local business investment in machinery, equipment, and other general commercial activity.

HB 2822 addressed this issue by setting the *valuation factor* – a factor under generally broad legislative control – to 2.5% on newly purchased, *locally-assessed* business personal property beginning in 2023. While this minimizes the property tax burden on these new investments (eliminating about 90% of the property taxes owed on qualified property over its taxable life), the proposal stopped short of outright eliminating the tax on new property due to constitutional constraints.

Under the new authority granted it by Prop 130, the Legislature now "may exempt" "personal property that is used in a trade or business" from tax. By itself, the proposition merely makes conforming technical changes to Constitutional provisions and grants greater authority to the Legislature to implement the state's property tax. There is no direct economic or fiscal impact. However, there is substantial future opportunity for the Legislature to address outstanding issues – particularly with the state's personal property tax.

Building on the framework established by this-years HB 2822, the Legislature could outright exempt newly added centrally assessed business personal property from tax. **This would have minimal new fiscal impact (perhaps $20 million statewide when fully phased in) but would generate substantial compliance and administerial savings for both taxpayers and local governments.**

While there is (unfortunately) scant evidence available that quantifies personal property tax compliance costs for businesses, there is consensus that they are substantial – *perhaps on the order of 100% or more of revenue collected for most taxpayers* (see, for example, a 2015 study of the Connecticut business personal property tax system[ii]). Given these two facts, this author sees little justification for the continued retention of locally-assessed business personal property taxes following enactment of Prop 130, and looks forward to policymakers using the increased flexibility Prop 130 accords them to devise a fairer and more pro-growth property tax system.

Prop 132: 60% Threshold For Approval of Taxes

Since 1993, Arizona's Legislature has been constrained by Prop 108 – which requires a two-thirds majority of both chambers to approve any new tax increase. Consequently, **every major tax increase since then has been approved by voters and not at the Legislature**. And excluding a temporary measure overwhelmingly enacted by voters during the Great Recession, none of them passed with a threshold even approaching 60% - **a $700 million dollar sales tax increase in 2000 secured 53% of the vote, and an $800 million income tax hike (later struck down as unconstitutional) secured less than 52% of the vote**. Neither would have been enacted under Prop 132, which creates a 60% threshold for voter enactment of new tax increases.

Despite these slim majorities and one-time election events, once approved, it is virtually impossible to change or repeal a voter-approved tax increase, due to 1998's *Voter Protection Act*. CSI was unable to identify any instance of a voter-approved tax increase being later amended or changed in accordance with the Act's mechanisms. Worse, the differing thresholds (two-thirds when traditionally enacted at the Legislature, versus simple majority at the ballot box) has led the Legislature to increasingly rely on ballot referrals or budget gimmicks to address their budget responsibility when it comes to revenue increases. During the Great Recession, the Legislature referred rather than enacting outright the temporary 1-cent sales tax and relied on a dubious "administratively set fee" to expand Medicaid rather than directly levying a new tax under the plain language of Prop 108.

CSI's analysis of the Proposition 208 income tax surcharge found that it would have reduced state GDP by over $5 billion annually, through increased costs of capital and a decreased incentive to work and invest in Arizona. Because the language of the proposition lacked any sunset date and due to the *Voter Protection Act*, however, once enacted by a bare majority it would have been the permanent and virtually immutable policy of this state. Similarly, an attempted referral of the state's 2.5% flat tax – had it made it to the ballot and again passed by a slim majority in one election – could have reduced the state's economy by another $6 billion. Case law on the interactions between a *repeal* of legislation by voters and the *Voter Protection Act* is scant, but there would likely be practical and legal consequences if this had occurred.

The combination of a two-thirds majority requirement to raise taxes legislatively, 1998's *Voter Protection Act*, and a relatively easy path to the ballot in Arizona has created an unworkable public policy framework. Increasingly large swathes of state statute are immutable and outside the bounds of the normal policymaking framework of annual regular legislative session. This is especially problematic when the policymaking is as impactful as levying taxes and raising revenue, and the electoral majorities too slim to infer clear public intent or mandates.

Passage of Prop 132 ensures that going forward only the most critical revenue measures with clear popular mandates – like 2008's emergency and temporary 1-cent sales tax – will pass by referendum and with the added protections of the *Voter Protection Act*.

Prop 209: Limits on Medical (and Other) Debt Collection

Proposition 209 proports to address a legitimate problem not just in Arizona but in the United States: rapidly and unsustainably increasing healthcare costs[iii] and declining quality of healthcare insurance coverage when it is truly needed (costly emergencies) even as premiums keep climbing[iv]. The result is high costs borne directly by consumers when unexpected and costly medical events occur even when the patient has insurance coverage. This often takes the patient by surprise precisely because consumers have been conditioned to believe that insurance exists to protect them during these unanticipated events. Unfortunately, since 2010 the U.S health insurance system has increasingly provided the reverse: increasing coverage for regular and routine *expected* costs, like primary care and recurring prescriptions, 'paid for' by insurance companies with significantly higher co-pays and deductibles which reduce coverage during the costly and the unexpected.

Compounding the problem, hospitals and other emergency providers are required to provide care without regard for ability to pay – leading to over $40 billion in uncompensated expenditures by U.S. hospitals alone[v]. Uncompensated care isn't just medical debt – its bad medical debt that hospitals have written off as a loss. These expenses must be passed on to other payers, and since large payers like the government don't want to cover them, invariably they are passed on to consumers and out-of-pocket payers with the least advance negotiating opportunity or choice of care. The result: surprise billings in the tens of thousands of dollars for patients with sudden, unexpected medical events.

Ironically, much of this outcome is attributable to just a handful of well-intentioned federal policy interventions that had unintended consequences: the 1986 *Emergency Medical Treatment & Labor Act*; the 1996 *Health Insurance Portability & Accountability Act*; and the 2010 *Patient Protection and Affordable Care Act*. Other actions – including state and local responses to these sweeping federal changes – have added to the issue by trying to address second-order effects without addressing the underlying structural problems created by the three major overhauls.

Prop 209 – despite again being well intentioned – is an example of the latter. The crisis in healthcare isn't predatory debt collection practices, per se, but the institutional failures that drive up out-of-pocket costs for patients and reduce the value of insurance as emergency coverage. The propositions broad language and poorly understood scope are likely to make this issue worse rather than better.

By making it harder for providers to collect on balances due, Prop 209 will increase the value of bad debts in Arizona for healthcare practitioners at all levels. Those costs may end up passed on as higher fees and service prices.

By further confusing an already highly regulated landscape, defensive healthcare and financial service providers may be more reluctant to take on anything that could be construed as "medical debt". This can limit patient options in meeting their increasing out-of-pocket costs from deductibles, co-pays, and other cost sharing provisions relied on by their insurance companies.

Finally, because the asset protections under the proposition apply to all collectors and not just medical debt collectors, there may be unintended implications for lenders, banks, landlords and credit card companies across Arizona. Consumers may be surprised to discover that it is harder to rent an apartment or buy a car in Arizona due to a proposition they had been led to believe was about predatory *medical* debt collection practices. It is too early to assess with confidence what the permanent implications of Prop 209 will be, given the scope of its changes and the uncertainty surrounding how impacted providers will respond. **An early model run based on very general assumptions about the impact on the state's financial services and consumer lending markets suggests the industry could reduce employment by 1,500 jobs and state GDP could fall by $500 million/year due to this law.** Like our pre-election report, this analysis remains speculative[vi]. But CSI will monitor the implementation of the law and its effects on the state's economy beginning next year and update the analysis as more about the economic consequences becomes known.

Prop 310: Fire District Sales Tax

Emergency fire services in Arizona are provided by a combination of state, county, and municipal sources. For the vast majority of the state's residents, fire service is provided exclusively by a municipal fire department. However, for approximately 21% of Arizona's more rural residents, fire service is provided by a fire district – a county-created special taxing district with a dedicated property tax revenue source. There are 144 fire districts in Arizona. For perspective, Yavapai County (population 236,000) hosts *14* separate fire districts; Phoenix (population 1.6 million) receives fire services largely from a single entity (the Phoenix Fire Department).

For years, districts have asserted that they are in a revenue crisis. In large part this is because there is insufficient property tax base to support 144 separate districts spread across the states vast swathes of sparsely developed rural land. Though the average fire district in 2020 collected only about $3.4 million/year in revenue, the state's 12 largest fire districts accounted for more than half of statewide district receipts[vii]. **Meaning the 132 'smallest' districts probably have an average annual revenue of less than $1.9 million.** This is insufficient to run even a small professional fire department. CSI believes it is probably true that the model for creating and running fire districts requires review. Need for fire services should be objectively determined and resources allocated accordingly. The current system seems more interested in dotting the state with a hodgepodge of overlapping districts that in practice often provide few actual services.

Unfortunately, Prop 310 would not have attempted to resolve any of these structural issues. Instead, the act proposed a statewide 0.1-cent sales tax generating about $190 million annually for distribution to the state's 144 fire districts in proportion to their share of district property tax base. Ironically, this formula would have concentrated new revenue in the state's largest and already best-funded (more urban) districts, while likely doing little to improve to capacity or financial sustainability of the state's smallest districts. To CSI's knowledge there was no basis for selection of the amount of the tax or the revenue distribution mechanism beyond a belief that this was a level voters could be expected to approve. And – contrary to numerous assertions made in arguments for the Proposition – CSI's analysis found that statewide fire district revenues have not been 'relatively flat' over time; despite the Great Recession and the Prop 117 valuation caps, **district revenues have grown at an average annual rate of over 9% since 2003 (nearly twice as fast as state personal incomes have grown)**. The problem appears again to be resource *allocation* rather than resource *availability*.

Ultimately, had it been approved, **CSI estimated that the sales tax would increase the average Arizona households annual tax bill by $52, and reduced state GDP by a cumulative $7.4 billion over 20 years**. The blank-check manner of distribution made it difficult for us to estimate the offsetting benefits (if any) of this tax increase through increased emergency service provision, and districts have historically struggled with general fiscal governance and out-of-control benefit expenditures (like spending on public pensions and long-term disability programs). There is at least a possibility the money would have been used to fill these spaces and generated no measurable benefit in terms of emergency response. In some fire districts public pension costs for retired firefighters can exceed 20% of its total budget.

Failure of this tax increase at the ballot provides an opportunity for the Legislature to consider structural reform to state rural firefighting service that makes more responsible use of tax resources in a way that is targeted toward reorganization, need and efficacy.

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[i] "HB 2822 & The Taxation of Business Personal Property". *Common Sense Institute*. April 19, 2022.

[ii] Walters, Lawrence. "The business personal property tax in Connecticut". *Romney Institute of Public Management*. November 6, 2015.

[iii] Kurani, Nisha and Ortaliza, Jared. "How has U.S. spending on healthcare changed over time?". *Health System Tracker*. February 25, 2022.

[iv] Miller, Stephen. "Average Worker Paid $5,588 Out of Pocket for Family Health Coverage This Year". *Society for Human Resource Management*. October 13, 2020.

[v] "Fact Sheet: Uncompensated Hospital Care Cost". *American Hospitals Association*. February 2022.

[vi] For purposes of this analysis, CSI used the REMI, Inc. regional economic simulation model. We assumed that revenue (industry sales) to the Arizona credit and financial services industry would fall by 2.94% due to the changes in Proposition 209. We made no assumptions about changes elsewhere – either offsetting savings to consumers from reduced debt coverage costs or additional economic costs borne by healthcare providers.

[vii] Stielow, Jennifer. "PSPRS COSTS PLAGUE CITY & FIRE DISTRICT BUDGETS". *Arizona Tax Research Association*. October 2019.