

State Budget: Eliminating Progressive Income Tax Yields Structural Deficit

As Gov. Katie Hobbs presents her State of the State address today in the background are the results of the largest individual income tax cuts enacted during the pandemic in the country. The [Center for Budget and Policy Priorities estimates](#) that the elimination of the progressive income tax in Arizona will cost the state \$2.25 billion in revenue in FY 2024, the highest per capita loss in the country, and has created a structural deficit.

In October, the Joint Legislative Budget Committee [identified structural deficits](#) for Arizona's future state budgets. Given the flush budgets of the last few years, Arizonans should wonder where the revenue went. Figure 1 is often mischaracterized to suggest the state does not have a revenue problem—except the expenditures in FY25-FY27 in Figure 1 represent the so-called skinny budget.

Figure 1

Projected Shortfall of \$(401) M in FY 24 & \$(449) M in FY 25 - Assumes Each Year's Shortfall is Resolved and Not Carried Into the Following Year

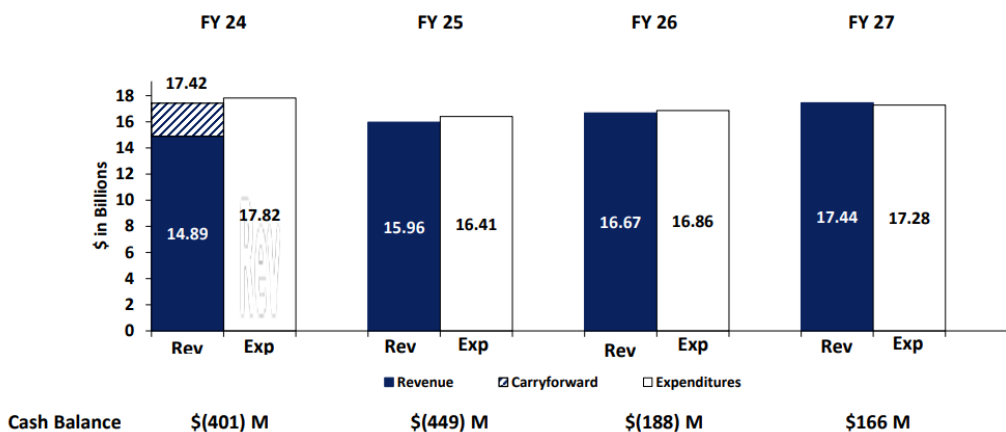
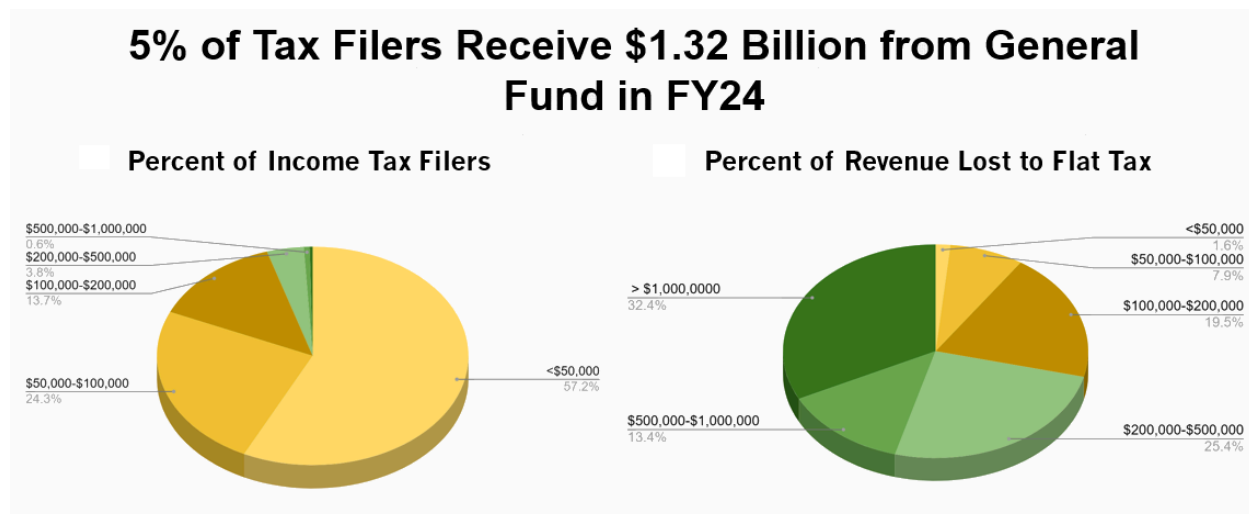


Figure 1 shows a deep drop in expenses after FY24. This is because FY24 is an actual enacted budget that includes added funds for both one-time needs as well as ongoing needs that the legislature has treated as a one-time expenditures. FY25-FY27 are so-called skinny budgets that just meet statutory requirements, nothing more.

Where the revenue has a simple answer: lawmakers in their 2021 session during the Ducey Administration decided to dramatically lower income tax rates for wealthy people. The Grand Canyon Institute has referred to this as [pizzas and Porsches](#)—most tax filers will save enough to buy a pizza—so may not even realize their income taxes changed, while the most wealthy will save enough to buy a Porsche. Seventy percent of the total value of the tax cut enacted with Arizona's 2.5% flat tax rate benefitted those with incomes of more than \$200,000. Less than 10% of the total value of the tax cut went to the vast majority of Arizonans who earn less than \$100,000. This is the impact of replacing a progressive income tax rate structure ranging from 2.59% to 4.5% with one tax rate for all Arizonans. See Figure 2.

Figure 2



Source: Joint Legislative Budget Committee and calculations by Grand Canyon Institute.

The structural deficit would disappear if the tax revenue from families with incomes exceeding \$200,000 were not foregone. Instead we will likely see pushes for a series of budget cuts because for FY25 \$1.4 billion has already been allocated to filers with an income exceeding \$200,000. Ideally, the legislature would at least refer that issue back to voters as the state continues to have real fiscal needs. See Figure 3.

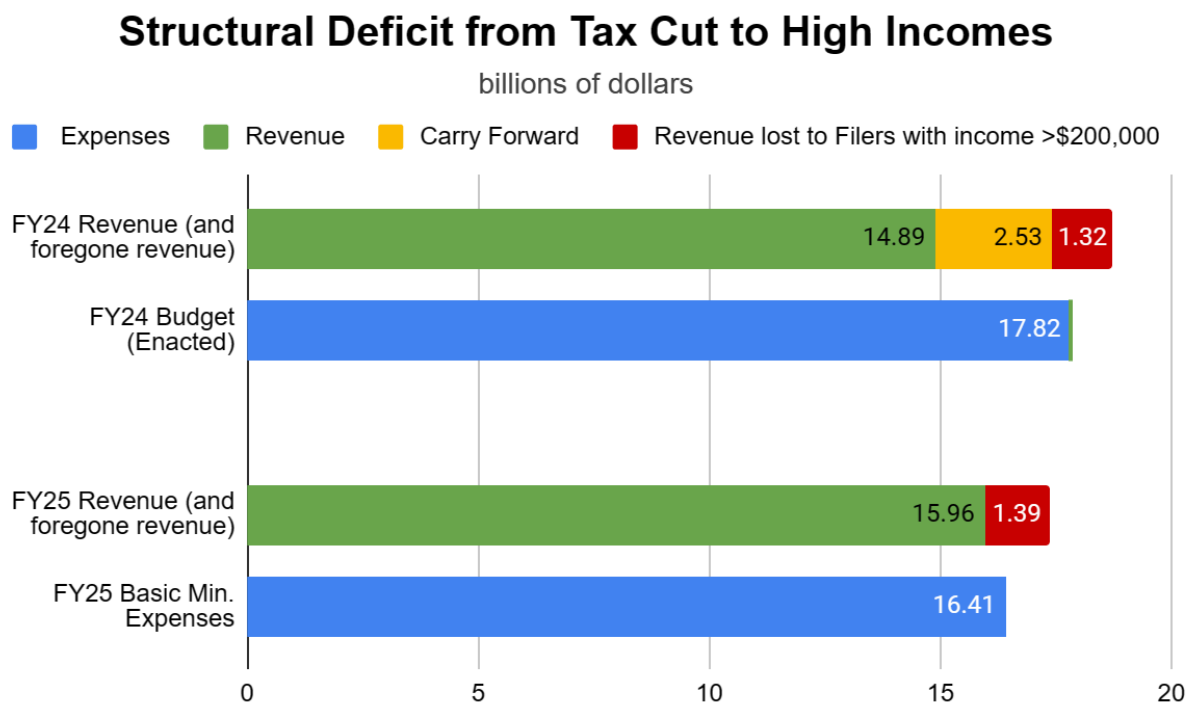
Arizona continues to have a crisis in K-12 education with [one in six teaching positions vacant](#) entering this school year and almost all filled by nonstandard means—from increasing class sizes, teachers with emergency credentials, and long-term substitutes. And more than 2,000 remain unfilled. Yet with a deficit in the coming year, lawmakers might instead cut K-12 base funding.

Arizona has a series of other issues from affordable housing (with COVID rent relief disappearing), summer shelter for the homeless (paid for by COVID funds that will be gone for next summer), and childcare (another COVID funding source disappearing).

Arizona continues to only provide an [emergency dental benefit](#) for adults on AHCCCS (Medicaid), which means you can get an abscessed tooth pulled, but basic preventative care is not covered.

Most Arizonans would likely prioritize these state investments over massive tax breaks for the well-off, but they certainly should not face service cuts due to [reckless fiscal policy](#) from the wealthy-favored flat tax.

Figure 3



About

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