Kansas: Budget problems worsen as tax collections continue to fall short of expectations

TAX AND BENEFITS CHALLENGES | NOV 17, 2016

We have been following the enduring budget crisis in Kansas, having most recently addressed the $348 million decrease in the 2016 and 2017 fiscal year tax revenue estimate in June. At that time, lawmakers were refusing to repeal the exemption on pass through business income, even though the loophole has been one of the key causes of ongoing revenue shortfalls. Repealing the exemption could have generated $61 million of new revenue next fiscal year, more than $200 million in revenue in 2018, and could have prevented painful cuts to services.

The Center For Rural Affairs characterized Kansas' problem as a "self inflicted wound" in an August 2016 report titled "Kansas' Self-inflicted Budget Wound Continues to Bleed Out, Providing a Cautionary Tale For Nebraska" (report). The report addresses the budget shortfall that Nebraska is facing in light of recent suggestions by legislators that they should cut property and income taxes. It warns against such a strategy by pointing to Kansas: "Nebraskans only have to look to their neighbors to the south to see the folly of such imbalanced tax plans."

The report asserts, as many have before, that the Kansas experiment has created budget shortfalls, lowered the state's credit rating, did not produce the promised jobs, and caused an unnecessary and recurring school funding crisis. Further, lawmakers are "shorting services" and borrowing funds to "plug holes." This has affected almost every facet of life, including the Department of Corrections, health services, infrastructure, state pensions, and education, to such an extent that the report's author described Kansas' "[q]uestionable [g]ambling [s]trategy" as follows: "if you keep losing, double-down."

A similarly acerbic observation came from the state's Senate Minority Leader, who noted that Kansas' actual revenue receipts continue to miss the continually-lowered revenue estimates: "They lowered the bar, but continue to trip over it."

The report's bottom line was to warn Nebraska not to follow Kansas' lead: "The problems experienced by Kansas can be avoided in Nebraska by seeking a balanced tax system that relies on income, property and sales taxes to adequately support the schools and services of the state."

SALT IN THE WOUND

In the Kansas Division of the Budget's State General Fund revenue estimate, dated November 10, 2016, economists revised the State General Fund revenue estimate down for fiscal year 2017, and made the first official assessment of fiscal year 2018 and 2019. Highlights include the following:

- For fiscal year 2017, economists decreased the revenue estimate by $345.9 million, or 5.5 percent, below the previous estimate, made in April and subsequently adjusted for legislation enacted during the veto session and special session. The new budget estimate of $5.980 billion is $1.5 billion below final fiscal year 2016 receipts.
- For fiscal year 2018, the initial budget estimate is $5.536 billion, which is $443.7 million, or 7.4 percent, below the newly-revised fiscal 2017 figure. This is based, in part, on the state of the economy, and the net change in transfers out of the state general fund (SGF), based on current statutory requirements for fiscal year 2018. Economists expect the total amount of taxes to increase by 1.4 percent in fiscal year 2018, following a 1.3 percent decrease in fiscal year 2017.
- For fiscal year 2019, the initial budget estimate is $5.575 billion, an increase of 0.7 percent over fiscal year 2018's figure.

In reporting on the budget revisions, KMBC revealed that Gov. Sam Brownback blames the budget problems on "slumps in agriculture and energy production that have also affected other states." Although Kansas' constitution requires a balanced budget, the governor is not prepared to outline proposals to fill the budget gaps until the legislature re-convenes in January. Nor has he opined on the possibility of increasing taxes. A former budget director thinks the budget is out of balance, and laments the current way of thinking: "If tax policy had been left alone, Kansas would have had no problem weathering the ups and downs that have occurred in the oil and [agriculture] economy."

A BETTER WAY TO CREATE JOBS

Like the Center for Rural Affairs, The Platt Institute for Economic Research picked up on Nebraska legislators' discussions to change their tax code to reduce barriers to creating high-paying jobs. However, the report suggested that Nebraska could manage things differently because its tax reform dialogue encompasses a fully-funded plan. This is different from what happened in Kansas, where officials "adopted sweeping tax cuts without offsetting the loss of revenue with revenue increases elsewhere, and did not use triggers to ensure revenue stability. After the tax cuts, Kansas continued to increase spending at rates much higher than inflation, compounding the problem."

Additionally,

> Kansas carved pass-through business income out of the state's individual income tax base entirely, creating a tax loophole that provided substantial opportunities for tax arbitrage for more than 300,000 taxpayers. This growing loophole made it difficult for Kansas to make reliable revenue projections. Tax reform discussions in Nebraska focus on expanding, not shrinking, the state's tax base.

In a blog, the Sunflower State's former budget director bemoaned the Kansas experiment, "which primarily benefitted the wealthiest Kansans, [and] did not 'trickle down' to middle or low-income Kansans. Rather, with the loss of credits like the food sales tax rebate, and increases in sales tax rates, lower-income taxpayers now pay more than before."

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