



DIFFICULT DECISIONS AHEAD: THE KANSAS BUDGET

Introduction

Gov. Sam Brownback and the 2014 Legislature are building a state budget for fiscal year 2015 (FY 2015), which will begin July 1, 2014, and will end June 30, 2015. This proposed budget presents both short- and long-range challenges. Currently, spending exceeds revenue. Projections show that the gap between expenditures and receipts will widen unless difficult decisions are made to bring them into closer balance.

A preliminary budget for FY 2015 was already approved during the 2013 legislative session. However, policymakers will consider extensive revisions during the 2014 legislative session.

This issue brief outlines the State General Fund (SGF) budget situation that Kansas faces. Lawmakers have the most discretion over the SGF, which is the largest fund within the overall state budget and receives and spends the majority of state tax revenue.

Outlook

Lawmakers faced a large gap between SGF revenues and expenditures during the 2013 legislative session as a result of dramatic tax cuts enacted a year earlier. To close the gap, legislators modified some of the tax cuts and tried to reduce

spending. However, even with those changes, approved spending exceeds revenue in FY 2014, lowering the amount available in the SGF bank balance. For FY 2015, the imbalance between the amount of estimated revenue and approved spending grows even larger. The SGF revenue in future years will be limited by the new tax policy. At the same time, the pressure to increase SGF spending will rise, making it even more challenging to build a balanced budget in the future.

Table 1 (page 2) provides a profile of the SGF for FY 2014 and FY 2015. FY 2014 begins with \$680 million in the bank. Expected revenue totals \$5.857 billion, but approved spending equals \$5.964 billion, leaving a balance of \$573 million to start FY 2015. The revenue estimate for FY 2015, completed in November 2013, increases slightly, mainly on the strength of growth in sales and use tax collections. The Legislature approved a preliminary budget of \$6.120 billion for FY 2015. If that expenditure amount remains unchanged, the state would be spending \$203 million more than collected in revenues, and the ending balance would drop to \$370 million.

Revenue

Kansas tax laws, which were changed in 2012 and 2013, significantly lower collections in FY 2014 and

KEY POINTS

- Kansas tax laws, which were changed in 2012 and 2013, significantly lower revenue collections in FY 2014 and FY 2015.
- State spending exceeds revenue in the preliminary FY 2015 budget, which was approved during the 2013 legislative session.
- State law requires a budget that leaves a bank balance equal to 7.5 percent of expenditures. The current bank balance offers some short-term options, but for the longer term, difficult decisions must be made to bring revenue and expenditures into closer balance.

FY 2015 and restrict future revenue. Individual income tax rates drop markedly for calendar year 2013 and go down further over the next five years (Table 2, page 3). Some types of business income have been exempted entirely from state income tax. In addition, if SGF revenue grows by more than 2.0 percent after FY 2018, even deeper income tax rate reductions will be triggered. To offset some of the revenue loss, lawmakers decided to make part of a temporary sales tax permanent, and placed limits on many income tax deductions. The net result of all the changes yields a \$3.7 billion SGF revenue reduction over six years (Table 3, page 3).

Expenditures

As lawmakers revise the preliminary FY 2015 budget, expenditures could easily rise above the amount initially approved. Pressure to increase spending comes primarily from the areas of school finance, Medicaid and payments for public employee retirement benefits.

State aid to public schools constitutes half of all SGF spending in FY 2014. The state’s school finance formula uses a base amount of state aid per pupil of \$3,838, a decline from a high of \$4,400 per pupil in FY 2009. An

active lawsuit, now before the Kansas Supreme Court, could produce a ruling requiring the state to increase school funding to levels established in earlier Supreme Court decisions.

The state portion of Medicaid consumes almost 20.0 percent of the SGF budget. Kansas Medicaid has transitioned to a managed care system (called KanCare) which slowed expenditure growth in the first year, but longer range projections show that the state likely must add \$60–70 million of new spending each year.

The state has struggled to make the Kansas Public Employees Retirement System (KPERs) more financially sound by increasing the state contribution each year. Despite implementing a redesigned retirement plan for current and future employees, the state must still add \$40–50 million each year.

The Legislature approved expenditures in the preliminary FY 2015 budget that are \$156 million higher than FY 2014, and the majority of the increase can be explained by three changes. The Legislature added \$82 million to cover “human service caseloads” which are mostly Medicaid (KanCare) expenses, upped the cost of payments to KPERs by \$39 million, and shifted \$33 million of school

Table 1. State General Fund (Dollars in Millions)

	FY 2014 (July 1, 2013, to June 30, 2014)		FY 2015 (July 1, 2014, to June 30, 2015)		FY 2015 With Potential Spending Additions (July 1, 2014, to June 30, 2015)	
Beginning Balance		680		573		573
Individual Income Tax	2,500		2,525		2,525	
Sales and Use Tax	2,442		2,515		2,515	
All Other Revenue	915		877		877	
Total Revenue		<u>5,857</u>		<u>5,917</u>		<u>5,917</u>
Total Available		6,537		6,490		6,490
					Preliminary Budget	6,120
					School Aid to \$4,492	450
					Restore Higher Ed	25
					Judiciary	8
					Corrections	25
					2% Salary Increase	20
Total Expenditures		<u>5,964</u>		<u>6,120</u>		<u>6,648</u>
Ending Balance		573		370		(158)

Source: Kansas Division of the Budget and KHI analysis of the State General Fund.

transportation costs paid for by the Highway Fund in FY 2014 back to the SGF in FY 2015. The preliminary budget deals with required Medicaid and KPERS increases, but does not add additional SGF funds for general state aid to schools.

Other issues that may lead to spending increases will also be debated. After the Legislature passed the FY 2015 budget, Gov. Sam Brownback line-item vetoed all the funding for the Department of Corrections, saying he considered the funding inadequate. Higher education advocates are seeking to reverse deep cuts that are part of the preliminary FY 2015 budget. The approved budget for the Judicial Branch appears to be \$8 million short of the current need. State employees have not had a general salary increase in many years. Inflation and population growth mean costs will increase in various state programs. Table I (page 2) contains a column showing how the budget may appear if spending increases are approved for some of these items.

Key Decisions Ahead

In the short term, budget writers have the option of using the SGF bank balance to cover the difference

between revenue and expenditures. If expenditures are held to the preliminary FY 2015 amount of \$6.120 billion, the SGF bank balance will drop to \$370 million or 6.0 percent of expenditures. While state law requires a budget that leaves a bank balance equal to 7.5 percent of expenditures, lawmakers could temporarily exempt the state from that requirement, as they have done in the past.

Spending could be raised even more in FY 2015 by taking the bank balance to zero. However, if that happens, the SGF would have expenditures of \$6.428 billion against revenue of \$5.917 billion, creating a large imbalance that would immediately need to be rectified in FY 2016.

The bank balance offers some short-term options, but for the longer term, spending and revenue must be brought closer together while still planning for realistic growth in expenditures. Future budgets need to account for increases each year in Medicaid and for larger contributions to KPERS. The SGF is not on a path now that effectively balances revenues and expenditures, but lawmakers must figure out how to get there.

Table 2. **Kansas Individual Income Tax Rates**

	2012	2013	2014	2015	2016	2017	2018
Top Rate	6.45 & 6.25	4.9	4.8	4.8	4.6	4.6	3.9
Bottom Rate	3.5	3.0	2.7	2.7	2.4	2.3	2.3

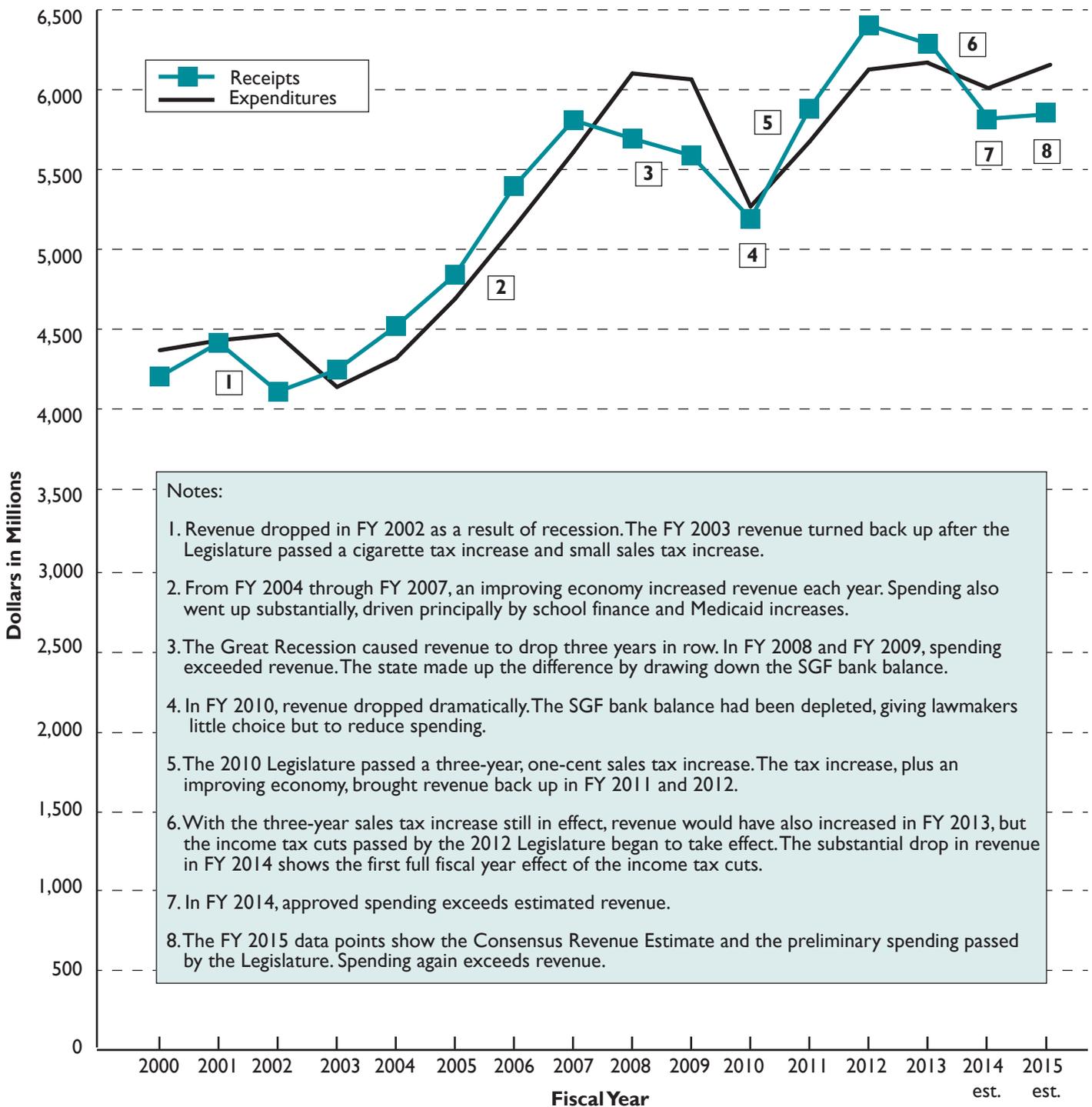
Source: Kansas Legislative Research Department.

Table 3. **Combined Impact on Revenue of 2012 and 2013 Tax Bills (Dollars in Millions)**

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	6-Year Total
2012 Bill							
Income Tax Cuts	-249.2	-847.8	-884.3	-924.2	-967.9	-1,013.7	-4,887.1
Severance Tax Changes	18.0	45.0	60.0	70.0	75.0	80.0	348.0
2013 Bill							
Sales Tax to 6.15%		193.2	218.7	226.9	235.4	244.3	1,118.5
Itemized Deduction Changes		114.6	107.4	127.0	148.3	166.5	663.8
Standard Deduction Changes		56.3	59.1	62.1	65.2	68.4	311.1
Income Tax Rate Changes		-35.2	-145.1	-238.3	-317.4	-459.5	-1,195.5
All Other		-21.0	-23.0	-25.2	-27.4	-24.2	-120.8
Combined Impact	-231.2	-494.9	-607.2	-701.7	-788.8	-938.2	-3,762.0

Source: Kansas Legislative Research Department.

Figure 1. State General Fund Receipts and Expenditures



Source: Kansas Division of the Budget and KHI analysis of State General Fund receipts and expenditures.

About the Issue Brief

This publication is based on work done by Duane Goossen, M.P.A. This publication is available online at www.khi.org.

KANSAS HEALTH INSTITUTE

The Kansas Health Institute is a nonprofit, nonpartisan, independent health policy and research organization based in Topeka, Kansas. Established in 1995 with a multiyear grant from the Kansas Health Foundation, the Kansas Health Institute conducts research and policy analysis on issues that affect the health of Kansans.

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