Kansas Health Institute

ISSUE BRIEF

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NEXT KANSAS BUDGET PRESENTS CHALLENGES FOR LAWMAKERS

Introduction

Gov. Sam Brownback and the 2013 Kansas Legislature are beginning to build a state budget for fiscal year 2014 (July 1, 2013, to June 30, 2014) that will be difficult to balance. State revenue is forecasted to drop sharply as a result of tax reductions, but at the same time spending pressures will rise for large items like school finance and Medicaid.

Although the State General Fund (SGF) will likely have a strong bank balance to start FY 2014, the state's official estimate of revenue predicts receipts will fall $733 million below current spending levels, an imbalance that lawmakers must correct.

This issue brief outlines the budget situation that Kansas faces in FY 2014. Lawmakers have the most discretion over the SGF, which is the largest fund within the state budget and receives and spends the majority of state tax revenue.

Overall Outlook

Comparing the estimate of future receipts to the amount state government spends now highlights the key issue for the FY 2014 budget. Estimated revenue of $5.464 billion does not match with current spending levels of $6.197 billion. Table 1 (page 2) provides a profile of the SGF for FY 2014 and the two fiscal years leading up to it.

The FY 2012 column shows the actual experience with revenue collections and expenditures in the most recently completed fiscal year. The next column shows the approved budget for FY 2013 — the fiscal year that will be half-completed when the Legislature begins meeting in January 2013.

The FY 2013 approved budget begins with a bank balance of $502 million. Revenue and expenditures almost balance. In FY 2013 individual income tax receipts begin to go down as income tax cuts adopted by the 2012 Legislature take effect. Spending from FY 2012 to FY 2013 for education remains flat, but Medicaid expenditures go up to accommodate higher enrollments and replace temporary federal funding made available to states during the recession. Total approved spending in FY 2013 is up about $100 million from FY 2012.

FY 2014 starts with an expected bank balance of $474 million, although that number may grow

KEY POINTS

- In fiscal year 2014, estimated State General Fund revenue is expected to be $733 million below current levels of spending.
- Large income tax cuts and a lower sales tax rate will decrease state revenue.
- Pressures to raise spending for Medicaid and school finance will increase.
- Even with a large bank balance, lawmakers must increase revenue or cut spending to balance the FY 2014 budget.

or diminish depending on what actually happens during the remainder of FY 2013. The revenue numbers reflect the consensus revenue estimate completed in November 2012. Expenditures for FY 2014 are assumed to be the same as in FY 2013. The FY 2014 column shows that with total resources available of $5.939 billion, spending the same amount as in FY 2013 leads to a $259 million negative balance. That result does not meet the Kansas law that requires the budget to have an ending balance of at least 7.5 percent of expenditures. For a budget with expenditures of $6.197 billion, the ending balance law requires a minimum balance of $465 million.

FY 2014 Revenue

Receipts drop markedly in FY 2014 for two principal reasons: the expiration of a temporary sales tax and dramatic income tax reductions enacted for 2013.

Sales and use taxes are currently based on a 6.3 percent rate that temporarily was increased from 5.3 percent in FY 2011 to counteract revenue declines caused by the recent recession. On July 1, 2013, the rate will decrease to 5.7 percent, with 0.4 percent newly dedicated to the state's highway fund. If FY 2014 sales and use tax receipts continued to be based on a 6.3 percent rate, SGF collections would be about $425 million higher.

Revenue decline from steep individual income tax reductions began in FY 2013, with the full effect realized in FY 2014. Previous top income tax rates go from 6.45 percent and 6.25 percent to 4.9 percent, while the lower income tax rate of 3.5 percent drops to 3.0 percent. In addition, the incomes of many business owners become completely exempt from state income tax.

FY 2014 Expenditures

Pressure to increase spending comes largely from

Table 1. **State General Fund (Dollars in Millions)**

	FY 2012 Actual (July 1, 2011 to June 30, 2012)		FY 2013 Approved (July 1, 2012 to June 30, 2013)		FY 2014 (July 1, 2013 to June 30, 2014)	
Beginning Balance		**188.3**		**502.9**		**474.2**[A]
Individual Income Tax	2,908.0		2,810.0		2,385.0[B]	
Sales and Use Tax	2,461.7		2,570.0		2,255.0[C]	
All Other Revenue	1,043.0		789.1		824.3	
Total Revenue		6,412.7		6,169.1		5,464.3[D]
Total Available		**6,601.0**		**6,672.0**		**5,938.5**
Department of Education	3,080.5		3,069.4		3,069.4	
Higher Education	740.4		760.2		760.2	
Medicaid	1,094.7		1,203.2		1,203.2	
All Other Expenditures	1,182.5		1,165.0		1,165.0	
Total Expenditures		6,098.1		6,197.8		6,197.8[E,F]
Ending Balance		**502.9**		**474.2**		**(259.3)**[G]

A. Beginning balance will change based on actual experience in FY 2013.
B. Individual income tax drops markedly as a result of tax reductions.
C. Sales and use tax collections decline when the temporary 6.3 percent rate expires.
D. Estimated revenue is $733.5 million below currently approved spending levels.
E. FY 2014 expenditures are shown in the same amount as FY 2013 and do not take into account increases needed for Medicaid or KPERs.
F. If total FY 2014 expenditures are the same as the amount approved for FY 2013, spending will be $733.5 million above estimated revenue.
G. Under the scenario shown, the ending balance would be below zero. Kansas law requires an ending balance of 7.5 percent of expenditures.
Source: KHI analysis of state general fund.

the areas of school finance, Medicaid and payments for public employee retirement benefits.

State payments to public schools constitute half of current SGF spending and have climbed in recent years to replace temporary federal stimulus funds. However, the base amount of state aid per pupil has declined from a high of $4,400 in FY 2009 to $3,838 in FY 2013. An active lawsuit filed by a number of school districts seeks additional state support for public education.

The state portion of Medicaid currently consumes almost 20 percent of the SGF budget. Although Kansas Medicaid is being converted to a full managed care system called KanCare, that conversion is only predicted to slow expenditure growth rather than reduce overall Medicaid expenses.

Finally, the state has struggled to make the Kansas Public Employees Retirement System more financially sound by increasing the state contribution each year. Despite implementing a redesigned retirement system for current and future employees, the state must add approximately $50 million to the budget to cover the required state contribution for FY 2014.

Key Decisions Ahead

The revenue estimated for FY 2014 falls $733 million below current spending. Raising revenue, cutting expenses or doing both constitutes the most direct way to deal with the imbalance. However, the difference is so substantial that simply leaving the temporary 6.3 percent sales tax rate in place or making small cuts to programs would not close the gap. Balancing revenue and expenditures only through reduced spending would require a 12 percent across-the-board cut.

Alternatively, the state could ignore the ending balance law and spend down all or a portion of the available bank balance as a way to get through FY 2014. However, that short-term solution does not solve the imbalance between receipts and expenditures. Other alternatives include cutting spending in what remains of FY 2013 to lower the expenditure base and transferring money from other funds to the SGF.

No matter what solutions lawmakers choose, the FY 2014 budget presents many challenges that could have a direct effect on health programs and other key services.

State General Fund History

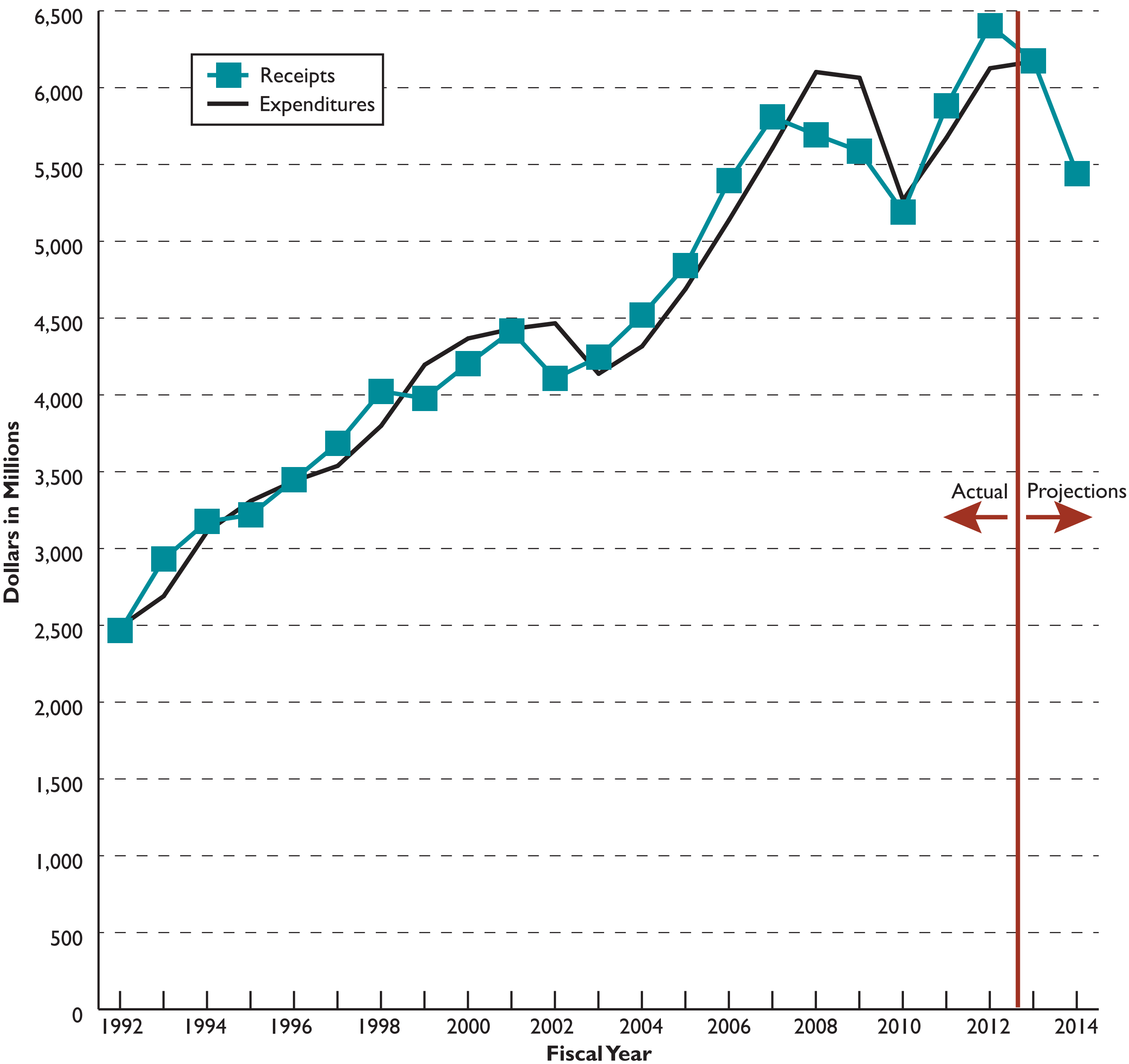
Figure 1 (page 4) depicts a history of State General Fund receipts and expenditures, and shows the expected steep drop in FY 2014 revenue.

The chart begins in FY 1992 when the state implemented a new school finance formula and approved higher spending financed with tax increases. Receipts went down in FY 1999 after a series of tax cuts. In FY 2002 receipts dropped again, this time as a result of a national recession, but an increase in sales and cigarette taxes helped receipts rise again the next year. An expanding economy bolstered receipts from FY 2004 through FY 2007 and allowed expenditures to rise, driven mostly by required increases to school finance and Medicaid.

The "Great Recession" began affecting receipts in FY 2008. For three years in a row, receipts were lower than the year before. The SGF entered that period with a large balance, which allowed spending to exceed revenue in FY 2008 and FY 2009. However, by FY 2010 the balance was depleted and with revenue continuing to decline, the state was forced to make significant spending cuts. Revenue began growing again during FY 2011 on the strength of a recovering economy and collections from a temporary 1-cent sales tax increase. A substantial income tax cut began to take effect in FY 2013.

In FY 2014, the income tax cut takes full effect and the temporary sales tax increase expires. The revenue shown for FY 2014 reflects the recent consensus revenue estimate. Spending for FY 2014 will need to be substantially lower to fit within available revenue.

Figure 1. State General Fund Receipts and Expenditures



Source: 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.

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