KEPC UPDATE: Tax bill likely to bring Cali-stye budget crisis

Kansas Economic Progress Council

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One of the most difficult legislative sessions in Kansas history ended Sunday evening with the passage of a $14.3 billion Fiscal Year 2013 budget and a promise by Governor Sam Brownback to sign the "nuclear option" tax cut bill currently on his desk.

Brownback's signature on the bill will force significant budget cuts in future years that could bring California-style budget anguish to Kansas.

The legislative and Congressional redistricting required by the Kansas Constitution was left to the courts.

Budget Agreement

Here are some of the keys to the budget agreement as we understand them.

- The Senate held firm and the budget will NOT take $24.6 million from the state highway fund for general state aid. The money will come from the state general fund.
- The Senate also succeeded in NOT taking $25 million from the state highway fund for K-12 education.
- $40 million from the state general fund is added to the base state aid per pupil. The money was contingent on passage of a bill that increases local option budget authority for school districts.
- Increased funding for technical education and tech ed incentives for secondary schools would come from severance tax receipts that exceed estimates.
- Transfer $5 million from the expanded lottery act revenues fund to the state general fund.
- There will be no LAVTR money (Local Ad Valorem Tax Relief) to mitigate the property tax. There had been discussions about adding $45 million per year, but because the tax conference committee report was not adopted, there is none.

Tax cut bill

Despite some last ditch efforts to propose less dramatic tax cuts by both moderate Republican senators and the Governor, nothing gained traction. The Governor's office says he will sign Senate Substitute for House Bill 2117 in a special ceremony Monday in Wichita.

In the final days of the session, the Kansas Department of Revenue produced a "dynamic scoring" analysis that estimates the State will add 23,000 new jobs by 2020 as the result of the bill.

Here's a very rough calculation. If you divide the 23,000 jobs into the predicted FY 2018 $2.5 billion state deficit under the bill, you get $108,695. That appears to be the minimum each job would need to generate in additional tax revenue (in one year) for the state to get to a zero ending balance in Fiscal Year 2018.

Almost any reasonable calculation indicates that is not possible.

The state budget faces enormous budget cuts in future years that will damage education and other state services. Based on the experience of the past 23 years, the temptation to raid the state highway fund will be irresistible.

Lawmakers were warned in testimony this year about two more immediate problems the measure will cause that have not been addressed.

Kansas credit ratings will be impacted

The financial publication Bloomberg warned recently that cutting income taxes may hurt the state's bond ratings. Kansas has had some of the best ratings in the United States in recent years.

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In November, Moody's Investor Service, one of the biggest bond rating agencies, assigned an Aa2 rating with a negative outlook for Kansas Development Finance Authority (KDFA) bonds to help fund the Capitol renovation project. The rating at that time did not reflect proposals to reduce or eliminate state income taxes.

The Moody's report said:

"The outlook for the state of Kansas is negative, in view of the state's general fund balance depletion, continued reliance on non-recurring measures, and lack of a plan to rebuild reserves, as well as significant future funding pressure from pensions, Medicaid and education."

It's hard to see how the news of the income tax cut will not further affect that outlook.

Because the state is involved in funding local school district budgets, which include capital improvement state aid for new buildings and renovations, many in government fear this will cost local taxpayers more to issue school bonds due to lowered bond ratings.

A financial official with a large local government recently told KEPC, ***"the apparent willingness of the Governor and Legislature to adopt massive reductions of state revenue without identifying corresponding reductions of expenditures could be viewed by credit analysts as a weakness that will make the fiscal management of all local governments more difficult, and by extension, make them more risky investments."***

Economic development program (PEAK) in danger

Lawmakers and the Governor were warned that cutting income taxes will have a dramatic and problematic affect on the PEAK program (Promoting Employment Across Kansas), viewed as one of Kansas' most effective economic development tools.

The alarm came strongly and most often from Salina Area Chamber of Commerce President and CEO Dennis Lauver. Lauver was a member of the Senate Tax Policy Task Force and alerted lawmakers in testimony to both the Senate and House Tax Committees.

However, no action was taken and there will be an immediate problem for PEAK in 2013 as the tax cuts begin.

PEAK is an incentive that allows qualified new or expanding companies to retain 95% of the state payroll withholding tax of eligible jobs that pay at or above the county median wage. The Secretary of Commerce can approve the business retention of the income tax withholding for up to ten years.

The problem is that payroll withholding will automatically drop the first paycheck of January 2013 (when the income tax cut becomes effective) and the cash flow expected by companies in the program will drop dramatically. The trouble will appear almost simultaneously with the start of the 2013 Kansas Legislature on January 14.

There are dozens of Kansas businesses in the PEAK program that will be affected and have built the incentive into their long-range plans. Most are in Johnson and Wyandotte Counties, but there are PEAK incentives also going to companies in Sedgwick, Cherokee, and Harper Counties.

They involve over $125 million in payroll involving over 3,700 newly created jobs and $98 million in capital investment. That's just for 2010 and 2011.

The largest beneficiary is General Motors in Wyandotte County with $107 million in payroll and 1,479 new PEAK jobs.

One troubling piece of information: there is a contract between each business and the State of Kansas. Local economic developers say it was only recently that the Commerce Department started including "fine print" provisions to the effect that the state is not responsible if the revenue stream is altered.

The legislature may have to extend the life of PEAK incentives beyond ten years to fulfill contractual obligations.

Other measures:

- The Legislature extended STAR bonds (Sales Tax Revenue) through 2017. STAR bonds are a key tool for many local governments.
- The Senate did not have enough votes to pass the fix for the "restraint of trade" bill (SB 416). Business groups had sought the legislation after a Kansas Supreme Court decision May 4 in the case of O'Brien v. Leegin Creative Leather Products, Inc. The court ruled that requiring agreements from retailers that they will not discount their products was restraint of trade and illegal vertical price fixing.
- The House failed to pass a bill requiring a KanCare oversight committee