Kansas CENTER FOR ECONOMIC GROWTH

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Kansas' Self-Made Fiscal Cliff

At a time when Kansas could be digging itself out of the hole created by the Great Recession, the state is instead on a path to more economic pain and uncertainty because of unaffordable tax cuts and spending cuts that are eroding the foundations of prosperity. Kansas lawmakers have the opportunity to reverse this course in the upcoming legislative session. They can get back to making investments in schools, transportation, health care and other building blocks of a strong workforce and a sound economy.

The recent recession hit Kansans hard. Children, seniors and people living with disabilities saw the services they rely on cut deeply to balance the state budget. Making matters worse, just as Kansas revenues were on the rebound, state lawmakers enacted an unsustainable set of income tax cuts that are highly unlikely to spur job growth, while causing deep cuts in education and other tried and true ingredients of long-term economic growth. Further hampering economic recovery, these tax cuts mostly benefited the wealthiest Kansans, did little for the middle class and were paid for in part by raising taxes on low-income Kansans at a time when they can least afford it.

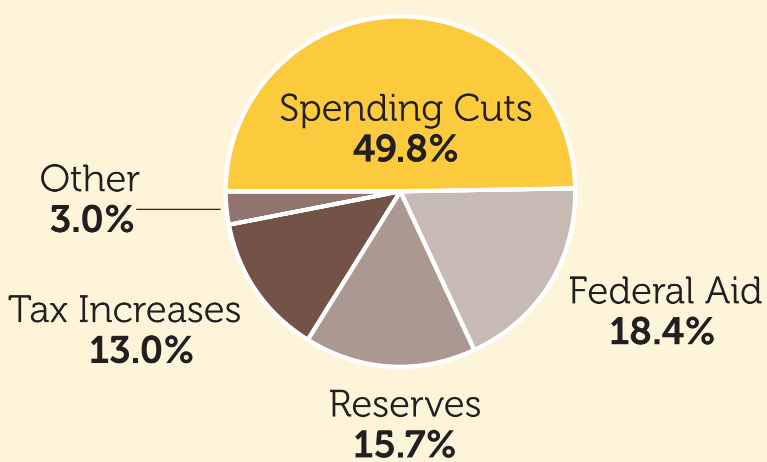
The Recession Dug a Deep Hole

At the depth of the recession, Kansas' revenue fell to 18 percent below pre-recession levels.[1] This meant that just as Kansans' needs were rising as families struggled with reduced incomes and, in many cases, job losses, the state's ability to respond to those needs dropped dramatically.

Kansas lawmakers could have pursued a more balanced approach that included more new revenue. But over the past five years, Kansas relied very heavily on one choice — spending cuts.

Figure 1

KANSAS RELIED HEAVILY ON SPENDING CUTS TO CLOSE BUDGET GAPS, FY08-FY12



Source: Center on Budget and Policy Priorities calculations. For an explanation of the methodology, see Elizabeth McNichol, 2012, "Out of Balance: Cuts in Services Have Been States' Primary Response to Budget Gaps, Harming the Nation's Economy," http://www.cbpp.org/cms/index.cfm?fa=view&id=3747.

[1] Analysis of revenue data from the National Association of State Budget Officers Fiscal Survey of the States, multiple years.

[2] Phil Oliff, Chris Mai and Michael Leachman, 2012, New School Year Brings More Cuts in State Funding for Schools, Center on Budget and Policy Priorities, http://www.cbpp.org/cms/index.cfm?fa=view&id=3825. The governor's budget for the 2014 and 2015 fiscal years would cut schools even more, bringing support to 17 percent below pre-recession levels when adjusted for inflation. See page 116 of Volume I of the Governor's Budget Report.

As a result, the state has seen financial support for some of its most important priorities fall. For example:

- Kansas cut spending for K-12 schools by 13.2 percent between Fiscal Years 2008 and 2013. It now spends $745 less per pupil than before the recession.[2] These cuts have led many Kansas school districts to raise property taxes and cut teaching positions.[3]
- Cuts to higher education contributed to an average increase in annual tuition costs of nearly $1,000 at the state's four-year public colleges between Fiscal Years 2008 and 2013. Kansas cut per-student funding by 24 percent — more than $1,700 — since the start of the recession after adjusting for inflation.[4]
- Kansas has cut funding to community mental health centers that provide services to the uninsured and underinsured by half since 2008.[5]

Now is the time to reverse this harmful trend in reduced support for education and other essential services that threatens to leave Kansas and its economy behind. Unfortunately, during the last legislative session lawmakers made it even harder to regain ground lost during the recession.

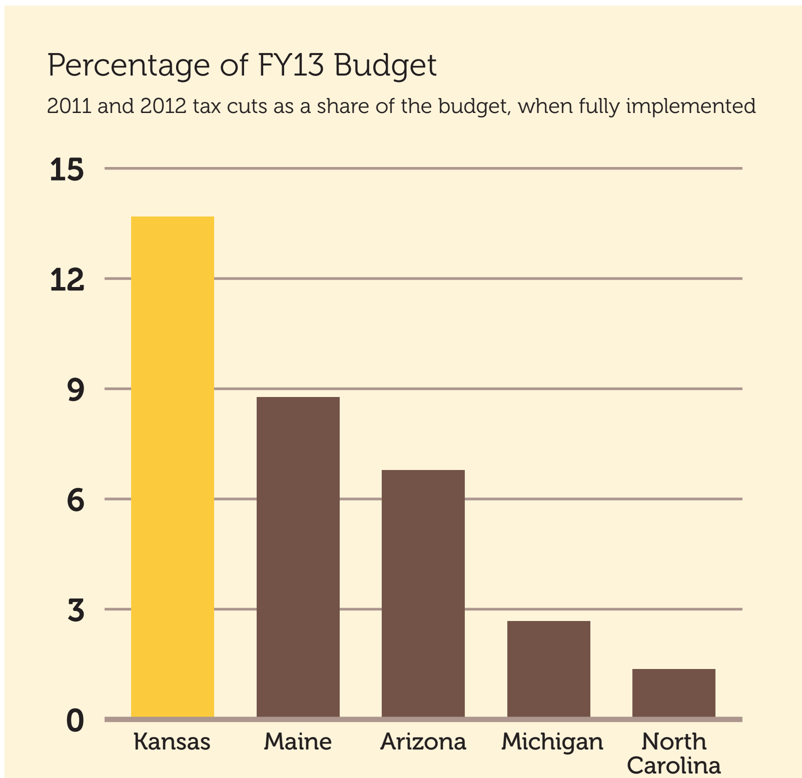
Kansas Lawmakers Chose to Keep Digging

Despite the large hole created by the recession and the harm done from relying on deep cuts to key services like K-12 education, Kansas lawmakers last year enacted massive state income tax cuts.

The tax cuts, which took full effect Jan. 1, 2013, are much larger than those made in other states in recent years (see chart). Most states did not cut taxes at all. The few that did enacted smaller cuts, sometimes phased in over several years.

Figure 2

KANSAS TAX CUTS THE LARGEST ENACTED IN ANY STATE IN 2011 AND 2012



Source: Center on Budget and Policy Priorities.
Note: The tax cuts in Maine, Arizona, Michigan and North Carolina were enacted in during the 2011 legislative session and their full phase-in varies by state. In Kansas, the income tax cuts took full effect January 1, 2013.

[3] See Ken Stephens, "Kansas School Districts Have Tried to Offset State Budget Cuts By Increasing Property Taxes and Reducing Jobs, October 15, 2011, http://www.hutchnews.com/Todaystop/SUN--superintendent-survey .

[4] Preliminary data from a forthcoming report by the Center on Budget and Policy Priorities.

[5] See "Recent History of Community Mental Health Center Funding in Kansas," Association of Community Mental Health Centers, http://acmhck.org/DocumentCenter/View/683. Note: The governor recently announced a new $10 million initiative in response to the Sandy Hook tragedy. But that initiative will redirect money currently used for other mental health services, rather than new funding. See: http://www.khi.org/news/2013/jan/10/governor-announces-new-mental-health-initiative/.

The tax cuts will drain $704 million — more than 11 percent — from the state's general fund revenue starting in the fiscal year that begins July 1, 2013.[6] The general fund is Kansas' primary source of support for schools, health care and other services essential for prosperity and growth.

The tax cut package did two things:

- It exempted from state income tax all business income that is "passed through" to owners, rather than taxed at the corporate level. This means nearly 200,000 profitable businesses will contribute no income tax.

- It reduced income tax rates, particularly for the wealthiest Kansans and at the same time eliminated a rebate for grocery sales taxes and property tax relief relied upon by low-income working families and seniors. The average low-income household earning $20,000 or less will pay an additional $148 per year in taxes. Those earning $20,000 to $35,000 will see no change to their taxes. Meanwhile the wealthiest 1 percent of households — those earning $400,000 or more a year — will receive an average tax cut of $21,087 per year. Income taxes for middle-income families, with earnings between $35,000 and $57,000, taxes will go down by a modest $212 annually.[7]

While sold as a job-creation plan — or, more colorfully, as a "shot of adrenaline to the heart of [Kansas'] economy"[8]— the experiences of other states clearly shows these tax cuts are highly unlikely to create new jobs as promised.[9] Here's why:

- Very little of the business tax break will go to small businesses that create jobs. Most of it will go to large, profitable corporations and other businesses unlikely to create new jobs, like investment funds, law firms and self-employed contractors. Some of those dollars also will end up in the pockets of shareholders who live outside of the state.

- Few taxpayers receiving an income tax rate cut are in a position to hire people. Only 2.7 percent of all personal income taxpayers are owners of small businesses that have any employees other than the owners.

- Some of the money going to wealthy individuals from income tax cuts won't make its way back into the economies of Kansas communities. Those receiving the biggest tax cuts often will save the money or invest it outside Kansas rather than spend it locally. At the same time, low-income Kansans who spend nearly every dime they earn will have less to spend in their communities.

- The massive loss in revenues will make it impossible to maintain a well-educated and healthy workforce, safe roads and bridges, and a good quality of life — the investments Kansas must make to attract and grow businesses.

Kansas now stands at the edge of its own, self-made fiscal cliff. If the state continues on this path and goes over the cliff, it could do permanent damage to the state's future. It would be impossible to make the necessary investment job-creating priorities like education, health, transportation and safe communities.

[6] See Kansas Legislative Research Department's "State General Fund Revenue Estimate for FY2013 and FY2014" http://skyways.lib.ks.us/ksleg/KLRD/Publications/2012_CRE_ShortMemo-11-6-12.pdf

[7] See the Institute on Taxation and Economic Policy's analysis of the Senate proposal in Tax Plans Put Kansas on Road Away from Fair & Adequate Tax Reform http://www.itepnet.org/pdf/KSWrongRoad.pdf.

[8] See Mark Davis, "Brownback: Tax cuts will be 'a shot of adrenaline' to Kansas economy," Kansas City Star, August 18, 2012, http://midwestdemocracy.com/articles/brownback-urges-support-for-his-tax-overhaul/.

[9] For a more detailed explanation, see Nicholas Johnson and Michael Mazerov, 2012, Proposed Kansas Tax Break for "Pass-Through" Profits Is Poorly Targeted and Will Not Create Jobs, http://www.cbpp.org/cms/index.cfm?fa=view&id=3662.