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A Fiscal History of Kansas: The ‘Brownback Experiment’ in Historical Context

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About the Brandmeyer Center for Applied Economics

The KU School of Business established the Center for Applied Economics in February of 2004—renamed the Brandmeyer Center in 2016 to honor a generous gift presented to the School by Joe and Jeanne Brandmeyer. The mission of the Brandmeyer Center for Applied Economics is to help advance the economic development of the state and region by offering economic analysis and economic education relevant for policymakers, community leaders, and other interested citizens. The stakeholders in the Brandmeyer Center want to increase the amount of credible economic analysis available to decision makers in both the state and region. When policymakers, community leaders, and citizens discuss issues that may have an impact on the economic development potential of the state or region, they can benefit from a wide array of perspectives. The Brandmeyer Center focuses on the contributions that markets and economic institutions can make to economic development. Because credibility is, in part, a function of economic literacy, the Brandmeyer Center also promotes economics education.

About the Author

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TABLE OF CONTENTS

A Fiscal History of Kansas: The “Brownback Experiment” in Historical Context

Introduction..........1

A History of Kansas Tax Policy and the “Brownback Experiment”..........4

A Brief Historical Overview of State and Local Taxation in Kansas..........6

Governor Brownback and Kansas Tax Policy, Phase I: An Attempt at Simplification and Improved Uniformity..........9

Governor Brownback and Kansas Tax Policy, Phase II: Elimination of the Income Tax 11

Governor Brownback and Kansas Tax Policy, Phase III: Carry On, Balance the Budget..........16

Governor Brownback and Kansas Tax Policy, Phase IV: Veto Overridden, “March to Zero” Terminated..........19

Kansas State Government Spending, Part I: A Primer on the State Budget and Historical Spending Levels..........22

Modern-Day Drivers of Kansas State Government Spending..........22

The Two Different Kansas Budgets and Long-Run Spending Trends..........24

Brownback-Era Budgets in Long-Run Context..........27

Kansas State Government Spending, Part II: Spending Restraint — The Real “Brownback Experiment”?..........30

Appendix A: Economic Context for the “Brownback Experiment” 37

A Persistent Trend of Slow Economic Growth..........37

A Persistent Trend of Slow Economic Regionalization..........39

A Brief Analysis of Gross Business Starts and Expansions..........41

Appendix B: A Brief History of Property Taxes in Kansas....................44

Property Tax Burdens....................44

A Summary of Kansas Property Tax Law....................46

Appendix C: Medicaid—The Implementation of KanCare....................50

Kansas Medicaid Spending in the Context of Other States....................52

Kansas Medicaid Spending over Time....................54

Appendix D: How State Government Spending Changed during the Brownback Era....................60

A Fiscal History of Kansas: The "Brownback Experiment" in Historical Context

One major theme dominated the fiscal policy story during the era of Governor Sam Brownback: The plan to make Kansas the third state in U.S. history to eliminate its income tax—and the state budget constraints that arose from that plan.[1] Governor Brownback earned infamy among many commentators for calling his plan, on national television, "a real live experiment."[2] The Brownback era animated Justice Louis Brandeis's notion that a "state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."[3]

The "Brownback experiment" originated from candidate-Brownback's quest to initiate policies that promised to improve the performance of the Kansas economy. Two noteworthy features of the Kansas economy help provide a foundation for discussing historical features of the state's fiscal policies. First, Kansas has for decades had a relatively slow-growing economy. Second, Kansas, like most states in the Great Plains, has experienced a slow but persistent trend of economic regionalization, with large geographic areas of the state depopulating while population increasingly concentrates in two primary geographies—the Kansas City and Wichita metro areas. In general—and, sometimes, in the particulars—these two issues help explain the political economy inherited by Governor Sam Brownback and, in part, how he chose to engage them from a policy perspective.

Sam Brownback campaigned for his first gubernatorial term in 2010, using a communication tool he called a "Road Map for Kansas," which emphasized a list of measurable goals related to the improvement of economic conditions and educational outcomes.[4] At the time, the economic effects of the so-called Great Recession remained fresh in the national policy conversations. Kansas happened to enter the recession later than many states. The National Bureau of Economic Research, the arbiter of recession dating, claims the recession lasted from December of 2007 through June of 2009.[5] Yet, in 2008, Kansas experienced one of its fastest inflation-adjusted growth rates of personal income over the past 50 years. However, the negative economic effects of the recession became apparent in Kansas during the time that candidate-Brownback began to consider his preferred policy proposals.

Once elected, Governor Brownback sought to formalize through an Economic Development Strategic Plan the campaign commitments he made via the Road Map for Kansas. That strategic plan highlighted several economic metrics that the Brownback administration wanted to improve (and be held accountable for).[6]

1 Alaska implemented an income tax in 1949 and repealed it in 1980 in connection with a rise in oil prices and completion of the Trans-Alaska Pipeline system. In 2017, the Alaska House of Representatives voted to enact a new income tax but the Senate voted it down. http://www.legis.state.ak.us/basis/get_documents.asp?docid=17151; http://juneauempire.com/news/2017-05-12/senate-kills-income-tax. In 2016, Tennessee voted to eliminate its income tax by 2022. Tennessee's income tax structure is unique and has never taxed wage income. http://www.tennessean.com/story/news/politics/2016/05/20/gov-bill-haslam-signs-hall-income-tax-cut-repeal-into-law/84044810/

2 Scott Rothschild, "Brownback Gets Heat for 'Real Live Experiment' Comment on Tax Cuts," *Lawrence Journal-World*, June 19, 2012.

3 https://en.wikipedia.org/wiki/Laboratories_of_democracy

4 For a discussion of Brownback's first-term Road Map for Kansas that is still available online, see: Katie Stockstill, "Brownback Outlines Road Map for Kansas," *McPherson Sentinel*, August 9, 2010.

5 http://www.nber.org/cycles.html

6 Brownback Administration, "Governor and Lt. Governor Release Strategic Plan," Press Release, February 10, 2011. For a copy of the strategic plan (accessed November 2017), see: http://worldonline.media.clients.ellingtoncms.com/news/documents/2011/02/10/Strategic_Eco_Devo_Plan.pdf

They included the growth of:

- Income
- Private Sector Employment
- Business Productivity
- Population
- Capital Investment
- Gross Business Starts and Expansions

Historically, Kansas has performed poorly in most of these categories when compared with other states. (See Appendix A for greater detail.) Governor Brownback's Economic Development Strategic Plan made it clear that he thought changes in fiscal policy could help remedy the two major issues discussed above: slow economic growth and rural depopulation. The closing paragraphs of the strategic plan said:

> The specific initiatives described in this document represent the beginning—not the end—of a long-term transformation process. Implementation and measurement related to the specific initiatives of this plan will set up the necessary starting points for an on-going process of evaluation and learning.
>
> We have seen in recent years that state budgets decline when economic growth lags. The best way to ensure that our schools are fully funded is to grow the state and local economies. The best way to ensure that there are resources for necessary social services to our most vulnerable citizens is to have a growing economy. To achieve this, Kansas needs to be competitive both nationally and internationally. This can only happen if our state keeps its taxes and regulations down, improves the playing field for all businesses, and maintains world class university programs and transportation infrastructure.

As the fiscal history of the Brownback era unfolded, changes to the state's income tax became the primary fiscal policy tool used to address the list of measurable goals listed in the Governor's strategic plan.[7] The income tax changes subsequently became embroiled in budgetary politics. In brief, the fiscal policy story of the Brownback era unfolded like this:

- In 2012, Governor Brownback, from a budgetary perspective, put forth a fiscally-cautious plan to phase out the individual income tax. Despite the fiscally-cautious approach to achieve a fiscally-aggressive policy goal, the income tax reform plan had a novel feature that attracted immediate political criticism: the exemption of "small business" income from taxation.[8]

- The Legislature destroyed the fiscally-cautious nature of Governor Brownback's original approach by stripping the plan of its revenue-balancing features. As a consequence, the "fiscal note"—the amount of estimated revenue foregone as a result of the tax reduction reforms—increased by a factor of six.

- Governor Brownback deferred to the Legislature as having the "power of the purse," and accepted the Legislature's more aggressive approach.

- In the critical second year of the tax reforms, the official revenue estimating body mis-modeled the income tax changes and underestimated tax revenue receipts by more than $300 million; the largest revenue-estimating error on record (in both absolute and relative terms). This estimation error almost halved the approximately $700 million dollar surplus the Brownback administration had accumulated through efficiency-oriented budget reforms in its first year. (When Governor Brownback took office, the state government of Kansas had $876.05 in the bank.)[9]

- The Legislature would neither replace the revenue-balancing features of Governor Brownback's original plan nor reduce spending to the levels required by the larger fiscal notes it enacted.

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7 The fiscal year *2018 Governor's Budget Report* (Vol. 1, p. 14) said: "The tax cuts that were passed during the 2012 Legislative Session were intended to stimulate economic growth and reverse trends in domestic migration and the outflow of wealth, as well as to spur job growth through the State's small businesses."

8 Technically, the exemption of small business income did not necessarily mean that a small business owner paid zero Kansas income tax. The law listed specific items of income not subject to tax.

9 https://governor.kansas.gov/2011-state-of-the-state-message/

- Once the budget imbalances became manifest, party politics rather than discussions of responsible budgeting began to dominate the debates.[10] Persistent revenue-estimating errors provided a mechanism for news media to fuel the contentious political dynamics by reporting on every missed revenue target.[11]

- In 2016, Kansas voters decided the "Brownback experiment" had gone awry and elected new representatives equal to more than one-third of the legislative seats.

- Early in 2017, the new Legislature passed a bill that essentially reversed income tax policy to its pre-2012 structure, thereby increasing income taxes significantly—and retroactively. Governor Brownback vetoed the bill and the Senate failed to override the veto. However, after about three months of additional political negotiation, the same basic legislation passed again. Governor Brownback vetoed it again, but the Legislature overturned the veto, thereby ending the "Brownback experiment."

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10 See, for example, Brad Cooper, "Fixing Kansas Budget Problems Could Undo No-Tax Promises," *Kansas City Star*, April 13, 2015.

11 For an opinion editorial related to this issue, see: The Capital-Journal Editorial Board, "Editorial: Misdirecting Blame for Kansas' Budget Crisis," *The Topeka Capital-Journal*, October 4, 2016. Governor Brownback convened a working group to understand the revenue estimating errors. See: Governor's Consensus Revenue Estimating Working Group, Final Recommendations, October 4, 2016. http://budget.ks.gov/files/FY2017/cre_workgroup_report.pdf

A History of Kansas Tax Policy and the "Brownback Experiment"

The modern history of tax policy in Kansas arguably began in 1992. That year saw the enactment of the 1992 School District Finance and Quality Performance Act and a constitutional amendment related to property tax assessments. The 1992 Act—a tax increase effort—restructured the individual income tax and raised tax rates on many different tax instruments. It also enacted, for the first time, a state-level property tax levy earmarked for the financing of elementary and secondary public schools. Just prior to this major new law, in 1989, Kansas had finally, after more than three decades of political struggle, implemented a complex reform of the property tax system—a reform that included a constitutional amendment (passed in 1986) and a full reappraisal of all property in the state. The property tax-related constitutional amendment that passed in 1992 modified certain elements of the 1986 constitutional amendment.

In the political wake created by the 1992 Act—particularly the state-level property tax levy dedicated to school funding—Governor Bill Graves, through executive order, established in his first year in office a Tax Equity Task Force to conduct a comprehensive review of the state and local tax structure in Kansas. The Task Force's December 1995 report offered, among others, the following two principles related to tax policy:

- "Tax revision should not unduly erode the tax base. A broad tax base allows the lowest possible rate, while also enhancing compliance, public acceptability, and the stability of the revenue source. But, there is a tendency to grant exemptions from a uniform or general treatment, and once granted they are hard to remove. It is poor public policy to erode the underlying tax base by granting unwarranted, gratuitous exemptions or exclusions. It is important to remove items from taxability, including but not limited to, economic development incentives, only upon meeting rational, economically meritorious criteria. Further, all exemptions and exclusions should be subject to systematic, continuing review." (p. 12)

- "The state and local tax system should be balanced and diversified. A diversified tax system offers a blend of economic tradeoffs. Because all revenue sources have their weaknesses, a balanced tax system will reduce the magnitude of problems caused by over reliance on a single tax source. It will also result in lower rates on each tax and reduce the pressure of competition from other states that have lower rates for a particular tax." (p. 13)

If Kansas has had a prevailing theme to its tax policy since 1992, a general drift away from these recommendations would arguably qualify as that theme. However, the policy makers involved with the decisions creating the drift would probably argue that the decisions were "economically meritorious"—and made primarily with notions of enhanced economic development as the criteria.

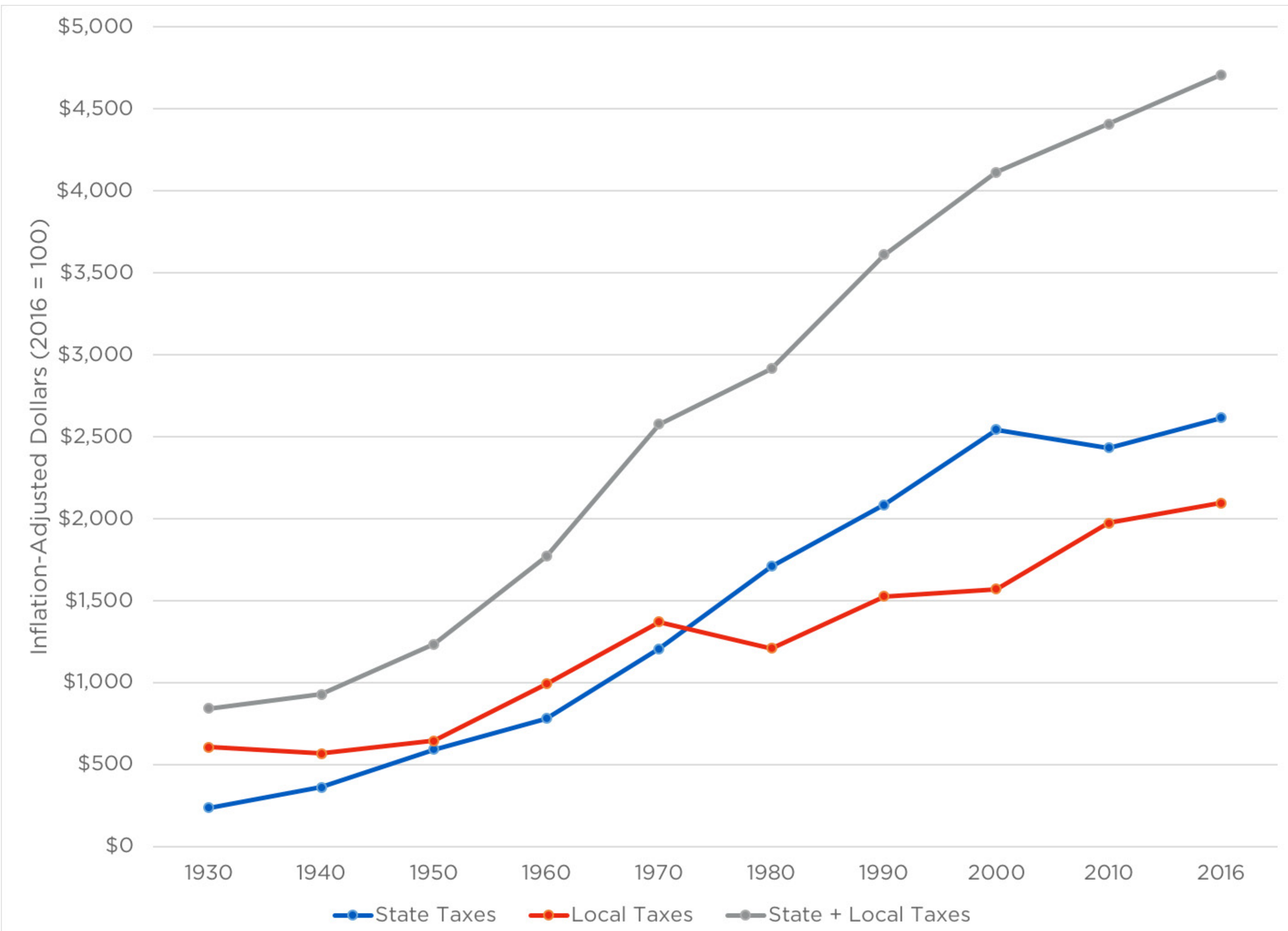
Each year the Kansas Department of Revenue publishes a report on so-called "tax expenditures." The Department compiles "this report to indicate the fiscal impact of exemptions, credits, deductions, modifications, and exclusions relating to the" major tax instruments used by the state government.[12] Although the Department of Revenue's report excludes local governments, state-level policy in Kansas primarily governs the property tax base and sales tax base available to local governments, and hence what analysts might classify as local government "tax expenditures."

12 Kansas Department of Revenue, "Tax Expenditure Report," Calendar Year 2016.

State and local tax revenues derive primarily from income taxes, retail sales taxes, and property taxes—the well-known "three-legged stool" often identified in public finance, and the basis for the Tax Force's comments regarding a "balanced and diversified" tax system. Tax expenditures associated with these three tax instruments often have the largest fiscal impact.[13]

Tax expenditures—or special deals for "special" constituents—work as a persistent force in democracies.[14] Recent Kansas history offers a comical example of this persistent trend. As explained below, the exemption of "small businesses" from Kansas individual income taxation (when they filed as individuals) dominated budget-related debates from 2013 to 2017. Many commentators blamed this exemption for all problems budget related. Yet, within this highly charged political environment, Christmas tree farmers in Kansas somehow convinced lawmakers to grant them their own special exemption from income taxation.[15]

Chart 1:
Kansas State and Local Taxes per Capita (2016$)



Sources: Kansas Legislative Research Department, "Kansas Tax Facts," Various Years; author's calculations.

13 For alternative discussions about tax expenditures (or tax base erosion) in Kansas, see: Glenn W. Fisher, H. Edward Flentje, W. Bartley Hildreth, and John D. Wong, "Sizing up Kansas Public Finance," *Kansas Policy Review*, Vol. 29, No. 1 (Spring 2007), pp. 13-21; and John D. Wong, "Sales Tax Erosion in Kansas," Report prepared for the Kansas Department of Revenue, December 2006.

14 See, for example, Randall G. Holcombe, "Tax Policy from a Public Choice Perspective," *National Tax Journal* Vol. 51, No. 2 (June, 1998), pp. 359-371.

15 2015 HB 2109. This special deal ended with the passage of 2017 SB 30.

A Brief Historical Overview of State and Local Taxation in Kansas

The tax reforms associated with Governor Brownback put Kansas at the center of a national discussion related to tax policy. The substantial reductions in the Kansas individual income taxes (discussed in detail below) dominated the discussion. However, changes to the retail sales tax played an important supporting role. Property taxes played almost no role in the fiscal policy debates of the Brownback era. (However, no fiscal history of Kansas would be complete without a discussion of property taxes, so a few brief remarks place them in the context of other taxes, postponing a more detailed discussion for Appendix B.)

Despite the large individual income tax reductions enacted during the Brownback era, the total state-and-local inflation-adjusted tax burden per capita has persistently increased. Chart 1 shows the trend—and the trends as they related to the state- and local-level components of the total.

The growth of the state-level tax burden clearly decelerated starting in 2000. Indeed, it declined in 2010 relative to 2000. However, this decline—as depicted on the chart—resulted not from noteworthy changes in state-level tax policy but from a decline in Kansas income and commercial activities associated with the aftermath of the 2008 recession. Kansas entered into and emerged from the recession by about one year later than other states. Chart 2 further supports this causation by showing that a general decline occurred across most of the major tax instruments used by the state government. Indeed, the contraction of state-level tax revenue motivated Governor Mark Parkinson to propose a one-percentage point increase in the retail sales tax rate, which became effective July 1, 2010.

Chart 1 shows that the local-level tax burden declined from 1970 to 1980. Chart 3 shows that the property tax—by default—drove the 1970-to-1980 local-level decline.

Chart 2:
Kansas State-Level Taxes per Capita, by Type of Tax (2016$)

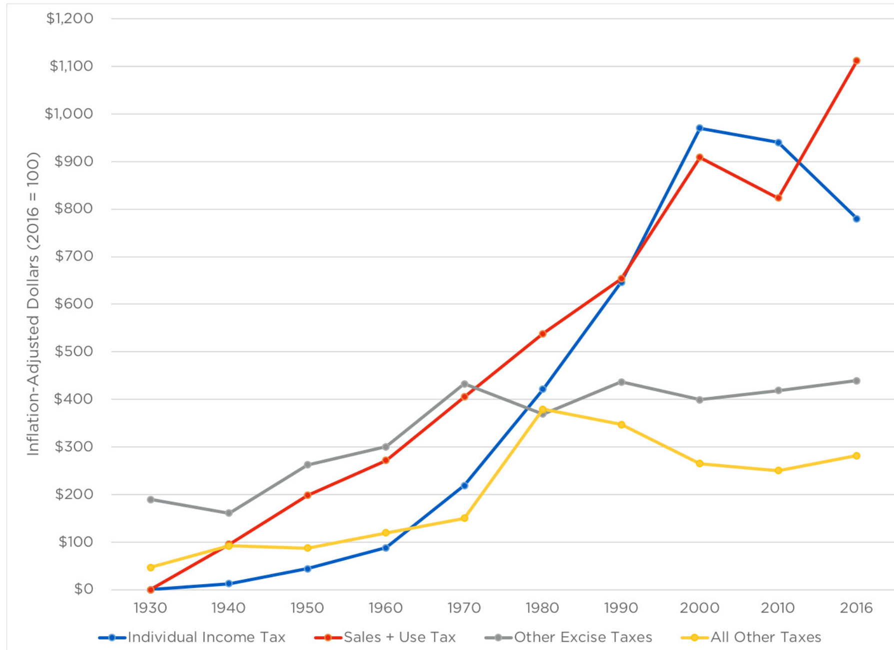
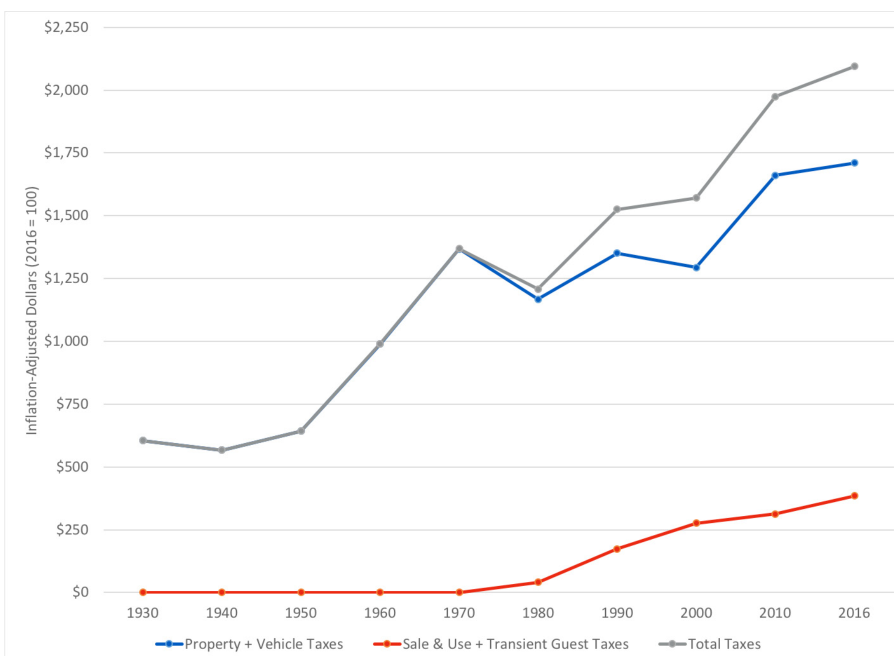


Chart 3:
Kansas Local-Level Taxes per Capita, by Type of Tax (2016$)



Sources: Kansas Legislative Research Department, "Kansas Tax Facts," Various Years; author's calculations.

Complicated political dynamics surrounded the property tax from the 1950s through the 1980s. The driving issue related to the heavy reliance in Kansas on the property tax and the poor administration related to property valuation. From 1970 to 1980, statewide average property tax rates remained relatively stable, but the appraised value relative to market value declined on an average statewide basis: Hence, the decline in inflation-adjusted per capita property tax burdens in a high-inflation decade.[16]

The decline in inflation-adjusted per capita property tax burden from 1990 to 2000 had a primary cause and a secondary cause. The primary cause related to the school funding reforms implemented by the 1992 Act, which lowered overall school-related property tax rates when the state-government explicitly planned to finance a larger portion of the public school budget and reduce the use of property taxes for that purpose. On a per capita, inflation-adjusted basis, only the school-related levy declined; the city, county, and special district levies increased. (See Chart B2 in Appendix B.) The secondary cause was an artifact of the property tax reforms implemented in 1989—reforms directly related to the administrative problems causing the 1970-to-1980 decline. The implementation of the 1980s reforms resulted in a significant shifting of tax burdens, which many taxpayers perceived as a significant tax increase. Consequently, property tax relief became a political theme in the 1990s; indeed, a sequence of statewide-average property tax rate reductions occurred in 1996, 1997, and 1998.[17]

Property tax politics also help explain the rise of the local sales and use tax in the 1970s, as shown in Chart 3. A Kansas Citizens' Tax Review Commission opined, in a 1972 report, that Kansas over-relied on the property tax and recommended a diversification toward other tax instruments.[18]

An examination of Chart 2 and Chart 3 shows another important feature of Kansas tax policy: the "three-legged stool" of public finance referenced above—individual income taxes, retail sales and use taxes, and property taxes.[19] Since 1992, these three tax instruments have accounted for 80 percent to 85 percent of all state and local tax collections in Kansas.
As is common in other states, the state-level government in Kansas lays claim to the income tax. The state-level government also laid claim to the retail sales and use tax until the 1970s; since then, local governments have increasingly shared the sales tax base with the state government. The property tax in Kansas remains primarily reserved for local governments. The state government does levy property taxes for a few specific activities, the most significant of which is a statewide levy (20 mills, since 1998) dedicated to the funding of public schools. The other property tax levies (1.5 mills in total, since 1991) finance the capital budgets for state and educational buildings.

Chart 2 captures the tax reform dynamics associated with Governor Sam Brownback's administration (starting in 2012, from a legislative perspective): the income tax reductions and the sales tax increases.

Kansas enacted an income tax in 1933 and a retail sales tax in 1937. As Chart 2 implies, the retail sales tax generated significantly more tax revenue per capita until the 1990s, when the individual income tax overtook it. From 1990 to 2010, the individual income tax accounted for about 36.5 percent of all

16 Glenn W. Fisher, "State and Local Finance," in H. Edward Flentje, ed., *Kansas Policy Choices: Report on the Special Commission on a Public Agenda for Kansas* (University of Kansas Press, 1986), p. 93. Table 3.9.

17 See, for example, Kansas Department of Revenue, "Statistical Report of Property Assessment and Taxation, 2002," p. 6. This era corresponded with 1997 House Bill 2031 (or SB 41, depending on reference source), which authorized the state-level school district finance mill levy to drop from 35 to 27 in 1997 and from 27 to 20 in 1998. It also exempted $20,000 in the appraised value of a residence from the school district finance mill for tax years 1997 and 1998. Both the 20-mill levy and the $20,000 exemption became permanent.

18 Glenn W. Fisher, *The Worst Tax? A History of the Property Tax in America* (University of Kansas Press, 1996), p. 170.

19 The idea of the three-legged stool is a public finance convention, not necessarily a theory, suggesting it offers a superior tax structure. The technology of tax collection often helps to define preferred qualitative features of a tax system. The pragmatism related to known tax-collection technologies is arguably the basis for the public finance popularity of the three-legged stool. It offers a tax structure using tax collection technologies that permit a broad tax base and "low" tax rates. A full discussion of these issues is beyond the scope of this discussion.

state-level tax revenues. This average was a bit higher than the sales and use tax average of 34.5 percent, but, on a year-to-year basis, these two taxes frequently switched place with one another as the state government's top revenue raising instrument. From 2011 to 2016, as the result of changes to the income tax enacted in 2012 and 2013, the income tax raised an average of 34 percent of the state government's revenue and the retail sales and use tax raised almost 39 percent. (From 1990 to 2016, the corporate income tax has never accounted for more than 6.4 percent of state government revenue, and has averaged 4.7 percent.)

An in-depth discussion of the Brownback-era tax changes takes place below. For the present discussion, Table 1 and Table 2 offer insights into the changes in trend shown in Chart 2 for the individual income and retails sales and use tax.

Table 1 shows the significant individual income tax reductions for virtually all Kansas taxpayers. These tax reductions had two primary components: (1) across-the-board reductions in income tax rates and (2) the elimination of income taxation on "small business" income. Most public finance scholars would unequivocally call item (2) a "tax expenditure" associated with an erosion of the income tax base.

Table 1:
Change in Average Individual Income Tax Liability, 2013-2014 compared to 2010-2012

Kansas AGI Group ($1,000s)	Change in Average Income Tax Liability
$25-50	-18%
$50-75	-17%
$75-100	-17%
$100-250	-20%
$250+	-24%
All	-19%

Source: Kansas Department of Revenue, Annual Reports, various years; author's calculations

Table 2:
State Sales Tax Rate

July 1992	July 2002	July 2010	July 2013	July 2015
4.90%	5.30%	6.30%	6.15%	6.50%

Source: Kansas Department of Revenue, Annual Reports, various years

The exemption allowed qualifying businesses to simply subtract certain income from their total income reported for income tax purposes. As discussed below, Governor Brownback could not convince the Kansas Legislature to offset this erosion of the tax base by eliminating the other income tax exemptions, deductions, and tax credits.

Table 2 shows a slow but steady increase in the state's retail sales tax rate. The per-capita sales tax surge relative to the income tax shown in Chart 1 has two basic explanations: (1) Governor Parkinson's effort to increase taxes in 2010 and (2) the revenue reductions associated with the income tax reductions. The law signed by Governor Parkinson that increased the sales tax rate from 5.3 percent to 6.3 percent contained language that automatically dropped the rate to 5.7 percent in July 2013. That scheduled decrease did not take place because lawmakers, led by Governor Brownback, wanted to use sales tax revenue to offset the reduction in income tax revenue.

As the retail sales tax rate has continued to increase, lawmakers often contemplate the large value of tax expenditures related to the sales tax as a way to counteract the trend. For example, the 2016 Tax Expenditure report published by the Kansas Department of Revenue listed total sales tax-related tax expenditures for fiscal year 2017 as $6.4 billion.[20]

This impressively large dollar figure requires better understanding. About 75 percent of the $6.4 billion arguably qualifies as the sale of intermediate goods or services used to produce other goods or services that will bear the retail sales tax upon final sale. Another 13 percent of the $6.4 billion represents government purchases.

Exempting intermediate goods or services from sales

20 The author often fields questions from lawmakers on this topic. For the 2016 Tax Expenditure Report, see: https://ksrevenue.org/pdf/taxexpreport16.pdf

taxation represents good tax policy, because it prevents what public finance analysts call "tax pyramiding" or "tax cascading." Pyramiding or cascading happens when a tax gets levied on a tax. This outcome would happen if the Kansas government imposed a sales tax on each step in a linked production process.

State and local governments certainly could pay sales tax on the items they purchase. But the public finance-related circularity of doing so seems straightforward. The governments would simply increase the expense of their activity and require higher levels of taxation.

Roughly speaking, then, the state government could capture about 12 percent of the $6.4 billion tax expenditure figure reported for fiscal year 2016, or $767 million. Items removed from the tax-exempt list would include: Prescription Drugs ($108 million), Residential and Agricultural Use Utilities ($217 million), Property and Services Purchased by Religious Organizations and Used Exclusively for Religious Purposes ($27 million), and a large number of smaller exemptions offered for purchases related to Charitable Organizations or Health Care ($32 million). A list of dozens of smaller items would account for the remaining $383 million.

Governor Brownback and Kansas Tax Policy, Phase I: An Attempt at Simplification and Improved Uniformity

> *My plan to create jobs will be paid for by eliminating corporate tax subsidies enjoyed by only a few. These reforms include:*
>
> - *Enhanced Expensing: Allowing Kansas business to immediately deduct a higher percentage of the cost of an investment.*
>
> - *Rural Opportunity Zones, or ROZes, will provide a state income tax waiver for any individual relocating from out-of-state into any participating county that has experienced double digit percentage population decline the last ten years.*
>
> – Governor Sam Brownback,
> 2011 State of the State Address[21]

The 1992 School District Finance and Quality Performance Act increased income taxes, sales taxes, and imposed, for the first time, a state-level property tax levy dedicated to school finance.[22] For the individual income tax, the 1992 Act changed what had been a long-standing, eight-bracket income tax rate schedule into a three-bracket schedule that imposed a net increase in individual income taxes.[23] That rate structure remained in place from 1992 until 2012. (See Exhibit 2 for a summary of all individual income tax brackets and rates during the Brownback era.)

Despite the two decades of stable tax brackets and associated income tax rates, the Kansas tax code accumulated many different tax credit programs as a way certain taxpayers could reduce their total income tax liability.[24] (Exhibit 1 shows the list.) Income tax credits became a favorite approach for incentivizing economic development. Many of the programs had a high value from a taxpayer perspective, but business taxpayers had to qualify for them by seeking permission from the Kansas Department of Commerce.

Governor Brownback supported the idea of creating the type of economic development incentive offered by a tax credit, but making the incentive universally available to any business making investments in Kansas—without first receiving permission from the state government. That idea explains his reference in his State of the State Address to "corporate tax subsidies enjoyed by only a few." The Governor chose a method known as "expensing" to make business investment incentives permission-less and universal.

Expensing is a procedure that allows businesses to capture more value more quickly from the investments they make. This procedure, ideally, would

21 https://governor.kansas.gov/2011-state-of-the-state-message/
22 Senate Substitute for House Bill 2892.
23 Kansas Legislative Research Department, "Kansas Tax Facts, 6th Edition," November 1993, p. 38.
24 To raise revenue, Governor Parkinson, in 2009, signed a law that placed a limit on the tax credit amount for most tax credits. He set the limit to the lesser of 90 percent of the past credit amount or 90 percent of tax liability.

Exhibit 1:
List of Kansas Tax Credit Programs

Credit for taxes paid to other states	Historic preservation tax credit
Credit for child and dependent care expenses	Historic Site Contribution credit
Adoption credit	Individual Development Account credit
Agricultural loan interest reduction credit	Integrated Coal Gasification Power Plant credit
Agritourism liability insurance credit	Law Enforcement Training Center credit
Alternative-fuel tax credit	National Guard Reserve Employer credit
Angel Investor credit	Nitrogen Fertilizer Plant credit
Assistive Technology Contribution credit	Owners Promoting Employment Across Kansas (PEAK) credit
Biomass-to-Energy credit	Petroleum Refinery credit
Business and job development tax credit	Plugging an abandoned oil or gas well credit
Business machinery and equipment tax credit	Qualifying Pipeline credit
Child day care assistance credit	Regional Foundation credit
Community Entrepreneurship credit	Research and development credit
Community service contribution credit	Rural Opportunity Zone credit
Disabled access credit	Single city port authority credit
Earned income credit	Small employer health insurance contribution credit
Electric Cogeneration Facility credit	Storage Blending Equipment credit
Environmental Compliance credit	Swine facility improvement credit
Film Production credit	Telecommunications credit
High performance incentive program credit	Temporary assistance to families contribution credit
Venture and local seed capital credit	Declared Disaster Capital Invest credit
	Higher Education Deferred Maintenance credit

Source: Kansas Department of Revenue, "Tax Expenditure Report," 2016.

replace all investment-related tax credits and thereby reallocate the targeted tax-credit "tax expenditures" toward the universally-available expensing "tax expenditure."

A tax credit works by multiplying the qualifying investment dollar amount by the tax credit percentage. The resulting product defines the amount that a taxpayer can subtract from income tax liability. (Typically, the tax credit cannot create a negative tax liability, unless the tax credit is "refundable.")

The expensing procedure generates a similar economic value, but works as a tax deduction rather than a tax credit, where the deduction amount equals the investment amount. The value of a tax deduction equals the deduction amount times the taxpayer's marginal tax rate. In 2011, Kansas, for most corporate businesses, imposed a tax rate of 7.0 percent and for most non-corporate businesses a tax rate of 6.25 percent or 6.45 percent. So, the expensing procedure would not offer the same value as a 10 percent tax credit (like the so-called High Performance Incentive Program Credit) but it would offer significant value and any business choosing to take the expensing deduction could do so.

A stylized version of the expensing procedure became law in 2011 (via House Substitute for SB 196). Starting in tax year 2012, business taxpayers could "expense" qualifying machinery, equipment, and software purchases. A novel implementation approach allowed the Kansas expensing procedure to capture the difference between the cost of a qualifying investment and the present value of the stream of depreciation deductions allowed under normal federal tax procedures.

Exhibit 2:
Individual Income Tax Rates in the Brownback Era (Joint Return Brackets)

Income Bracket*	Legislation	Tax Years 1992-2012	Tax Year 2013	Tax Year 2014	Tax Year 2015	Tax Year 2016	Tax Year 2017	Tax Year 2018 & After
Not over $30,000	*1992 Act*	3.5%						
	2012 HB 2117		3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
	2013 HB 2059		3.0	2.7	2.7	2.4	2.3	2.3
	2015 HB 2109				2.7	2.7	2.7	2.6
	2017 SB 30						2.9	3.1
$30,001 to $60,000 (or over $30,000)	*1992 Act*	6.25%						
	2012 HB 2117		4.9	4.9	4.9	4.9	4.9	4.9
	2013 HB 2059		4.9	4.8	4.6	4.6	4.6	3.9
	2015 HB 2109				4.6	4.6	4.6	4.6
	2017 SB 30						4.9	5.25
$60,001 and above	*1992 Act*	6.45%						
	2017 SB 30						5.2	5.7

Source: Kansas Statutes or Legislation
*The bracket for taxpayers not filing jointly is half the amounts listed. This changed briefly as part of a 1999 Act that set the brackets for individual filers to the brackets for joint filers.

Although many analysts might categorize expensing as a tax expenditure, it really removes a tax bias rather than creating a tax exception. The Kansas implementation approach sought to retain the economic logic associated with removal of the tax bias.[25] (The legislation authorizing the expensing procedures left intact most of the tax credits listed in Exhibit 1, and gave the taxpayer a choice about which alternative to use.)

Governor Brownback's Rural Opportunity Zones also became law in 2011 (via SB 198).

Governor Brownback and Kansas Tax Policy, Phase II: Elimination of the Income Tax

Last session the Legislature gave our rural communities a new tool to help them reverse their population loss – and they have embraced the Rural Opportunity Zone program, offering no income tax and buying down of student loan debt to new or returning residents.

. . .

Still – the economy remains one of our most pressing issues. While there are certainly factors a state cannot control when it comes to its economy, taxes are one area we do control. And when it comes to taxes, we have some of the highest in the region. This hurts our economic growth and job creation.

To address this, I'm proposing a major step in overhauling our state tax code to make it fairer,

25 See, for example, Arthur P. Hall, "Expensing: A Competitive Leap for Kansas Tax Policy," Center for Applied Economics, University of Kansas School of Business, Technical Brief 07-0903, September 2007.

flatter, and simpler. My tax plan will lower individual income tax rates for all Kansans. It brings the highest tax rate down from 6.45 percent to 4.9 percent, the second lowest in the region – and lowers the bottom tax bracket to 3 percent. My plan also eliminates individual state income tax on most small business income.

As we modernize our tax code and lower everyone's rates, it is also time to level the playing field and simplify state taxes by eliminating income tax credits, deductions, and exemptions — while expanding assistance to low-income Kansans through programs that are more effective and accountable. I firmly believe these reforms will set the stage for strong economic growth in Kansas – and will put more money into the pockets of Kansas families and businesses. Growth that will allow us to further reduce tax rates and increase our competitiveness. Growth that will see people move to Kansas instead of leaving our state.

– Governor Sam Brownback,
2012 State of the State Address[26]

When I started as governor, we had the highest state income tax in the region, now we have the 2nd lowest and I want us to take it to zero. Look out Texas, here comes Kansas!

. . .

Last year the Kansas Legislature passed the largest tax cut in state history. Tonight we are here to take another step on our path to no state income tax. This will create jobs and opportunities in our state that the current generation has left for Texas or Florida to find.

By making government more efficient and growing our economy, we can keep the sales tax flat at its current level and cut income taxes on our lower income working families to 1.9 percent and drop the top rate to 3.5 percent. This glide path to zero will not cut funding for schools, higher education or essential safety net programs.

– Governor Sam Brownback,
2013 State of the State Address[27]

Did Governor Brownback or the Kansas Legislature first propose the idea of eliminating the state income tax? The answer is hard to document. In 2012, the author remembers many legislators (in casual conversation) refer to the idea as the "march to zero" (not the "glide path to zero," as Governor Brownback phrased it). Perhaps the idea grew symbiotically through conversation? Regardless of the answer, Governor Brownback clearly championed the idea, as the above quotations attest.

Whether one thinks of this goal as bold or foolhardy, it certainly qualified as aggressive, given that the individual income tax raised approximately 35 percent to 40 percent of the state government's revenue each year. (The political outcomes culminating in the 2017 legislative session terminated this goal.)

Nevertheless, recognition of the goal to eliminate the Kansas state income tax helps put into context much of the fiscal history recorded in the Brownback era. The widely discussed exemption of small business from income taxation was indeed "revolutionary"—to borrow the term used by tax scholars at the University of Kansas School of Law.[28] However, when placed in context, the exemption represented not isolated policy but a significant step toward a larger policy goal. The small business exemption created a "tax expenditure" in conflict with the purity of popular public finance principles. Yet, it offered a bright-line procedure to advance the "march to zero" and provide a broad, permission-less economic development incentive to the actors in the economy that tend to drive economic development—newly-created businesses and the fast-growing "gazelles" that sometimes emerge from the pool of newly-created businesses.[29]

26 https://governor.kansas.gov/2012-state-of-the-state/

27 https://governor.kansas.gov/2013-state-of-the-state/

28 Martin B. Dickinson, Stephen W. Mazza, and Michael R. Keenan, "The Revolutionary 2012 Kansas Tax Act," *Kansas Law Review*, Vol. 61, 2012, pp. 295-341.

29 Arthur P. Hall, "Economic Development Data Book for Select Regions of Kansas," December 2014; unpublished manuscript available from the author upon request.

The first incarnation of Governor Brownback's tax proposals—the ones originally recommended by him—came in the form of 2012 SB 339.[30] That legislation did not progress. However, it has historical importance because it highlights Governor Brownback's original policy approach. The evolution of legislation propelling the "march to zero" suggests that the Legislature rather than the Governor had the more aggressive timetable; the Governor adopted the Legislature's more aggressive timetable.[31]

The following list of eight items captures the elements of Governor Brownback's original tax reform package, as presented in 2012 SB 339.[32]

1. Eliminate all itemized deductions and tax credits for the individual income tax, except for the High Performance Incentive Program Tax Credit and Community Entrepreneurship Tax Credit;
2. Eliminate the Learning Quest and Long Term Care subtraction modifications;
3. Increase the standard deduction for head-of-household filers from $4,500 to $9,000;
4. Prohibit renters from qualifying for the Homestead Property Tax Refund Program;
5. Eliminate the Food Sales Tax Rebate Program;
6. Maintain the state retail sales and compensating use tax rates at 6.3 percent instead of allowing it to reduce to 5.7 percent on July 1, 2013 as required by current law, and adjust the transfer percentage to allow the same amount to go to the State Highway Fund as under current law;
7. Repeal the current two-year severance tax exemption on new pool oil and gas wells, except for oil wells generating 50 barrels or fewer per day; and
8. Exempt all non-wage business income that businesses would otherwise report from state individual income taxes (as reported by LLCs, S-Corps, and sole proprietorships on lines 12, 17, and 18 of the federal form 1040 individual income tax return).

Notice the fiscally-cautious aspects of SB 339. It recommended revenue offsets to counter-balance the anticipated revenue loss from the increased standard deduction and the exemption of small business income. The proposed elimination of the itemized deductions and the tax credits remained consistent with the policy goal of consolidating past economic development incentives into one broad-based and more uniformly applicable incentive—the complete elimination of the income tax.

Notice, too, that SB 339 did not propose explicit changes to income tax rates. The Governor's remarks in the State of the State passages quoted above make it clear he had rate reductions in mind, but his legislative request captured by the language in SB 339 first defined a mechanism to buy-down income tax rates based on the growth of revenue available to the State General Fund. This mechanism codified the so-called "march to zero." The following language comes from the bill:[33]

- [C]ommencing with fiscal year 2015, in any fiscal year in which the amount of actual state general fund receipts from such fiscal year exceeds the actual state general fund receipts for the immediately preceding fiscal year by more than 2% and the actual ending state general fund balance exceeds the amount of 7.5% of the total amount authorized to be expended or transferred by demand transfer from the state general fund in such fiscal year, . . . the director of budget and the director of legislative research shall jointly certify such excess amount to the secretary of revenue. Upon receipt of such

30 Technically, SB 339 had an earlier lineage in 2011 House Substitute for SB 1, which carried the title the "March to Growth Act." It began its short political life as HB 2381 (see its fiscal note dated March 17, 2011).

31 Political insiders have called the "more aggressive timetable" political gamesmanship meant to obstruct Governor Brownback's tax reform agenda. See, for example, Arthur Laffer and Stephen Moore, "Laffer and Moore: Sweet Supply-Side Revenge for Tax Cutters in Kansas," Investor's Business Daily, February 1, 2016; and Martin A Sullivan, "Economic Analysis: Brownback's Derailed Tax Reform Becomes a Fiscal Train Wreck," Tax Notes, June 4, 2012, p. 1193.

32 The listed items and the wording come from the official fiscal note prepared for DB 339 by the Kansas Division of the Budget, February 14, 2012.

33 SB 339, New Section 45, p. 62, line 35. This language, as modified by HB 2059, became law. The language was twice amended by 2013 HB 2059 and 2015 SB 270. The amendments enacted by SB 270 built in spending considerations for the pension system (KPERS) and Medicaid before the rate reductions could trigger. The bill 2017 SB 30 eliminated this language (as amended), thereby ending the possibility for formula-based income tax rate reductions in tax year 2017 and thereafter.

certified amount, the secretary shall estimate the individual income tax and corporate income tax rate reductions to go into effect for the next tax year that would decrease by such certified amount the estimated individual income tax and corporate income tax receipts during the fiscal year after the next fiscal year. Such rate reductions shall be estimated so that the revenue reductions for individual income tax receipts and corporate income tax receipts will be in the same proportion as individual income tax receipts and corporate income tax receipts are to the total of individual and corporate income tax receipts. Rate reductions for individual and corporate income tax shall be applied to reduce the highest marginal rate applicable. Based on such determination, the secretary shall reduce individual and corporate income tax rates prescribed by [applicable Kansas law].

- In any fiscal year in which the amount of actual state general fund receipts for such fiscal year are less than 102% of the actual state general fund receipts from any prior fiscal year or the actual ending state general fund balance is equal to or less than the amount equal to 7.5% of the total amount authorized to be expended or transferred by demand transfer from the state general fund in such fiscal year, as determined [by applicable Kansas law], the director of budget and the director of legislative research shall jointly certify such amount and fact to the secretary of revenue. Upon receipt of such amount and fact, the secretary shall not make any adjustment to the individual and corporate income tax rates.

The second incarnation of tax proposals associated with Governor Brownback—now with significant input from the Legislature—came in the form of 2012 Senate Substitute for HB 2117 and 2013 HB 2059. Both of these bills became law.

HB 2117 (which began as a simple technical correction bill for elements related to the sales tax) had several legislative iterations. The first iteration essentially embodied Governor Brownback's original vision: tax rate reductions plus the ideas embodied in SB 339.

The final version of HB 2117 destroyed the fiscally-cautious aspects of the initial version. It removed most of the revenue offsets (primarily the elimination of itemized deductions and preservation of the existing sales tax rate that was scheduled to decrease) that Governor Brownback had sought as part of his reform package—a package representing a more logical, systematic phase-out of the income tax. (As explained above, the economic value of a tax deduction equals the deduction times the tax rate. Lower income tax rates make itemized deductions less valuable and eliminating itemized deductions could allow for a faster reduction of income tax rates.)

The major provisions enacted by HB 2117 included:

- A reduction of the three-bracket rate structure (3.5, 6.25, and 6.45 percent) for the individual income tax to two brackets with reduced rates (3.0 and 4.9 percent). See Exhibit 2.
- An exemption for small business income.
- Repeal of a long list of business-related tax credits.
- An increase in the standard deduction to $9,000 for taxpayers filing a joint return or head-of-household return. See Exhibit 3.
- A Change in rules related to the severance tax.

The follow-up legislation, 2013 HB 2059, began life, at the request of the Department of Revenue, as a technical corrections and clarifications bill for certain provisions enacted by HB 2117. However, it evolved to contain many provisions that started in 2013 SB 78, a bill originally requested by Governor Brownback. These provisions consisted, in large part, of the revenue offsets originally included in SB 339 but omitted from HB 2117. It also enacted additional income tax rate reductions. SB 78 proposed larger rate reductions than the ones that finally became law with HB 2059. The significant provisions of HB 2059 included:

- A decrease of the sales tax rate from 6.3% to 6.15% (instead of a decrease to 5.7% as scheduled by earlier law).
- A reduction of the standard deduction levels previously increased by HB 2117. See Exhibit 3.
- A new schedule of declining individual income tax rates. See Exhibit 2.
- A partial restoration of the food sales tax rebate program.
- An expanded number of Rural Opportunity Zones.

Exhibit 3:
Changes to the Kansas Standard Deduction

	1998-2012	2013 (HB 2117)	2013 (HB 2059)
Single Filers	$3,000	$3,000	$3,000
Joint Filers	6,000	9,000	7,500
Head of Household filers	4,500	9,000	5,500

Table 3:
Official "Fiscal Notes" Related to Select Kansas Tax-Related Legislation (Dollars in Millions)

Bill number	FYE 2013	FYE 2014	FYE 2015	FYE 2016	FYE 2017	FYE 2018	FYE 2019	FYE 2020	FYE 2021	FYE 2022
2012 SB 339	-89.9	-99.0	-60.8	-52.6	-49.9	n.a.				
2012 HB 2117										
1st version	-104.5	-147.5	-111.7	-106.1	-106.0	n.a.				
Final version	-231.2	-802.8	-824.3	-854.2	-892.9	-933.7				
2013 HB 2059										
1st version		376.4	290.0	251.2	-58.1	-534.5				
2nd version		2.0	276.5	258.3	27.3	-381.0				
Final version		307.9	217.1	152.6	104.1	-4.6				
HB 2117 + HB 2059		-494.9	-607.2	-701.6	-788.8	-938.3				
2015 HB 2109				384.4	404.8	545.2				
2017 SB 30						591.0	633.0	617.4	584.4	590.3
Source: Kansas Department of Revenue; Kansas Legislative Research Department										

Had the Legislature—and by extension, the Governor—retained the elements of the first version of HB 2117 (income tax rate reductions to 3.0 percent and 4.9 percent plus the tax base elements of SB 339), the budget challenges that plagued the Brownback era may never have arisen. But events evolved differently. The final result became a huge tax reduction instead of an orderly phase-out the income tax.

Table 3 reports the sequence of events using the official "fiscal notes" on each piece of legislation, as calculated by the Kansas Department of Revenue and the Kansas Division of the Budget. This sequence shows how Governor Brownback's fiscally-cautious approach at the outset evaporated as the Kansas Legislature modified his original proposal:

- The first version of 2012 HB 2117 had fiscal notes of about $110 million per year. The final version had fiscal notes of more than $800 million per year, or about 13.5 percent of State General Fund spending.

- The follow-up legislation, 2013 HB 2059, succeeded in enacting some of Governor Brownback's proposed revenue offsets, but further reduced income tax rates. The sequence of three different fiscal notes in Table 3 provides a glimpse into the politics of tax cutting that took place. In retrospect, it seems fair to argue that the orderly phase-out of the income tax originally envisioned by Governor Brownback became forever lost in the politics.

- Combining the final fiscal notes of HB 2117 and HB 2059 is the proper way to compute the fiscal note of what can be defined as Governor Brownback's tax package. Comparing the fiscal note of the first version of 2012 HB 2117 with the combined fiscal notes of the final versions of HB 2117 and HB 2059 shows that the Legislature increased the fiscal note for each fiscal year (2014-2017) by: 121 percent, 236 percent, 444 percent, 561 percent, and 644 percent, respectively.

Governor Brownback and Kansas Tax Policy, Phase III: Carry On, Balance the Budget

Now, even as we celebrate our successes, we must acknowledge that the most recent data regarding state government revenue and expenditures present a clear challenge that must be addressed.

For the past several weeks, we have been in consultation with government, business and industry leaders regarding our shared fiscal concerns. They have been generous with their time and frank with their advice.

Tomorrow I will present to the legislature a proposed two-year budget that is in balance – with revenues exceeding expenditures each year.

And we will continue our march to zero income taxes.

Because the states with no income tax consistently grow faster than those with high income taxes.

There may be some who consider this course too bold . . . well, I'm the sort of guy who would have sent Alex Gordon from third base.

I propose this budget as a starting point to your deliberations. I understand and appreciate that the "power of the purse" is yours and does not belong to any other branch of government.

In my travels around Kansas I've found what I expect most of you have during your visits with the people we serve.

Kansans are sensible, decent, compassionate, thoughtful people.

They prize liberty, celebrate achievement and recognize an obligation to their fellow man.

They want government to focus on its core functions, to perform them well, to provide quality services, good schools, good roads and low taxes.

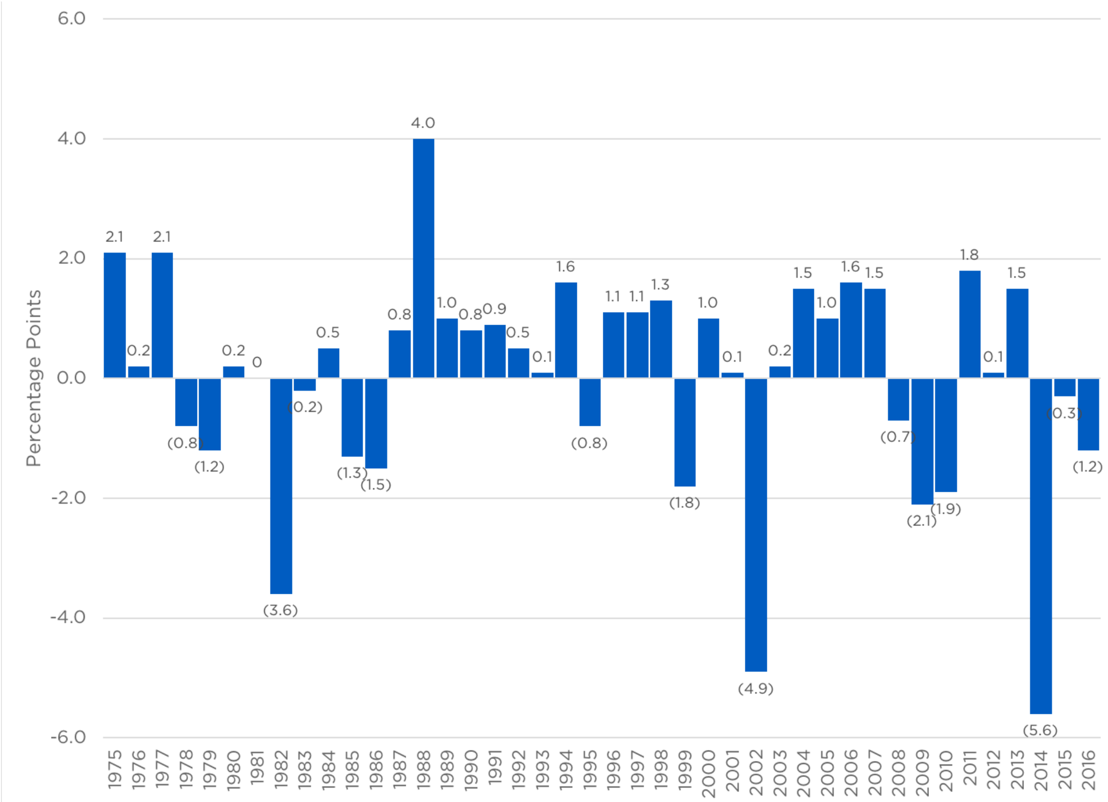
– Governor Sam Brownback,
2015 State of the State Address[34]

From a budgeting perspective, the increasingly large fiscal notes associated with the tax reductions described above happened to coincide with the largest state-budget-revenue-estimating error in history—or, at least, the history for which the Kansas Budget Division publishes records. Unfortunately, that estimating error happened on the high side rather than the low side; that is, the estimates exceeded the actual, so lawmakers thought they had more money to spend than they actually did.

The state government of Kansas uses a long-established process for estimating the revenues available for budgeting purposes. As explained in the Governor's annual Budget Report: "Estimates for the State General Fund are developed using a consensus process that involves the Division of the Budget, the Legislative Research Department, the Department of

34 https://governor.kansas.gov/state-of-the-state-2015/. Alex Gordon played baseball for the Kansas City Royals in the 2014 World Series. He had the potential to score a game-tying run in the bottom of the 9th inning of the 7th game. The third base coach decided to stop Gordon at third base instead of risk that the San Francisco Giants might throw him out at home plate. A news column posted on Yahoo Sports (October 30, 2014) had the following title: "Ninety feet away: The Royals' dream season dies on third base."

Chart 4:
State General Fund Receipts: Actual less Consensus Revenue Estimates (Revised Estimates), as a Percent of Actual



Source: April 2017 Consensus Revenue Estimate, Long Memo, May 10, 2017, p. 10.

Table 4:
State General Fund Revenues: Actual less (Revised) Estimates (Dollars in Thousands)

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Total Recipients	(109,427)	96,922	167,651	90,711	(333,284)	(15,569)	(76,167)
Indiv. Income Tax	(141,792)	132,542	8,029	68,987	(306,761)	(2,459)	(76,064)
Retail Sales Tax	(8,463)	(34,612)	36,353	(5,427)	(7,761)	(17,223)	3,941
Excise Taxes	(26,149)	22,080	14,064	9,518	(2,182)	(3,794)	(182)
All Other Taxes	66,977	(23,088)	109,205	17,633	(16,580)	7,907	(3,862)

Source: Kansas Division of the Budget, *The Governor's Budget Report*, Vol. 1, various years; and Consensus Revenue Estimate memos, various years.

Revenue, and consulting economists from state universities."[35] The group meets a few times per year to compare and revise estimates.

Chart 4 illustrates the over- or under-estimates of revenue as a percentage of the actual revenue received, from 1975 to 2016. It reveals that in the critical second year of the Brownback-era tax reductions, the consensus revenue estimating process over-estimated tax revenues by $333.3 million, or 5.6 percent of the actual tax revenue received.

Table 4 reports, by tax type, the actual revenue received minus the estimated revenue (as revised by the final meeting of the Consensus Revenue Estimating Group). Clearly, the Group incorrectly modeled the legislative changes associated with the individual income tax. If the explanation for the mis-estimates

35 Kansas Division of the Budget, *The Governor's Budget Report*, Vol. 1, Fiscal Year 2018, p. 27.

related to general trends in income or the state's economic performance, the income tax estimates would not represent such a large outlier in the mis-estimates. In fact, a comparison of different versions of the Consensus Revenue estimates show that the income tax estimate became more inaccurate as the revisions progressed.[36]

The missed revenue estimate for fiscal year 2014 marked an important turning point in the overall budgetary aspects of the Brownback-era tax reductions, because it significantly reduced the $709 million ending balance that the Governor's budgets had accrued by fiscal year 2013.[37] By statute, the Kansas State General Fund budget must have an ending balance equal to at least 7.5 percent of authorized expenditures and demand transfers in a budget year. This ending balance amount often has been subject to political gamesmanship, but it remains an important consideration in the overall budgeting process that can either improve or impede budgeting flexibility.

As Governor Brownback acknowledged in his 2015 State of the State Address, projected budget deficits had become a reality that he and Kansas Legislature had to remedy. By the end of the 2015 legislative session, the Governor and the Legislature had reduced fiscal year 2016 State General Fund spending by $86.3 million (relative to Governor Brownback's original budget recommendations) and passed a portfolio of tax increases estimated to generate revenues of at least $400 million per year (see Table 3). *The Topeka Capital-Journal* ran an associated news story with the headline: "Kansas Senate Votes for the Largest Tax Increase in State History."[38]

The tax legislation in question came in the form of 2015 HB 2109. The major provisions of this bill included the following:

- An increase of the sales tax rate to 6.5% from 6.15%.
- A re-classification of so-called "Guaranteed Payments" related to taxable small business income; as of the 2015 tax year, such income would no longer qualify as income exempt from individual income taxation.[39]
- A revision of the individual income tax rate schedule. See Exhibit 2.
- A revision of the treatment of itemized deductions. See Exhibit 4.
- An introduction of a low-income exclusion into the income tax law.
- A restoration of the Individual Development Account Tax Credit.
- An extension of the sunset date for the Rural Opportunity Zone program from 2017 to 2022.
- An increased tax levy on cigarette and a newly-created tax levy on E-Cigs.
- Authorization of a tax amnesty.
- Imposition of a property tax lid on local units of government. See Appendix B.

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36 Compare the version published in the 2015 *Governor's Budget Report* (November 2013 revision) with the June 2014 revision. Related: A significant debate erupted around the missed revenue estimates. Staff economists at the Kansas Department of Revenue pushed a storyline that blamed the timing of capital gains collections—and, in the author's opinion, misled the Secretary of Revenue about the importance of the capital gains issue. That opinion formed while participating in a private meeting with staff, the Secretary, and the Budget Director; a meeting specifically related to and contemporary with the estimating errors. The benefit of hindsight and new data reinforced that opinion. The relevant framework relates to the integrity of the revenue estimates, per se, as they related to the timing of capital gains realizations. Changes in federal law did indeed motivate an "abnormal" amount of capital gains realizations in 2012, but the following year's realizations turned out to be "normal," so staff's argument had no merit. Capital gains realizations for Kansas for tax years 2009-2014 were, respectively (in $billions): 1.5, 3.0, 2.8, 4.2, 3.4, and 4.9. Duane Goossen, a former budget director, correctly framed a rebuttal to staff's argument. See: http://www.kansasbudget.com/2014/07/dont-blame-capital-gains-for-revenue.html. For a news account of the debate see: Bryan Lowry, "Analyst: Kansas Leaders Distorted Research about Tax Revenue Shortfalls," *The Kansas City Star*, June 8, 2014.

37 Kansas Division of the Budget, *The Governor's Budget Report*, Vol. 1, Fiscal Year 2016, p. 22.

38 Tim Carpenter, "Kansas Senate Votes for the Largest Tax Increase in State History," *Topeka Capital-Journal*, June 7, 2015.

39 Per the U.S. Internal Revenue Service: "Guaranteed payments are those made by a partnership to a partner that are determined without regard to the partnership's income. A partnership treats guaranteed payments for services, or for the use of capital, as if they were made to a person who is not a partner." That is, casually speaking, "guaranteed payments" are more like wages, so the Kansas Legislature did not think they should be exempt from income tax as "small business" income. https://www.irs.gov/publications/p541/ar02.html

To a remarkable extent, this legislation—when combined with the tax policy changes of HB 2059—took the Kansas tax code back to what it would have looked like with the first version of HB 2117—that is, back to Governor Brownback's original proposal. Yet, even that statement deserves qualification. Governor Brownback's original proposal had an annual fiscal note about $200 million less than the combined outcome of the final versions of HB 2117, HB 2059, and HB 2109. The Legislature's insistence on maintaining certain itemized deductions explains most of the difference.[40]

Governor Brownback and Kansas Tax Policy, Phase IV: Veto Overridden, "March to Zero" Terminated

> *Since the pioneers moved westward across the country and settled this fertile ground, our state has always held a promise for those who came here—that through dedication and hard work your standing in life can improve. One of my primary goals as Governor is to make it easier for Kansans to thrive and to accomplish their dreams. That is precisely why we cut income taxes on all Kansans several years ago, working to make Kansas the best state in America to raise a family and grow a business.*
>
> *Last week, both chambers of the Kansas legislature voted to raise taxes on Kansans making over $15,000. Not only did they raise taxes on single Kansans earning more than $9.74 an hour, but they did so before even passing a budget. By doing this, legislators said that the hard-working people of Kansas must find savings in their own personal budgets before their elected representatives can be bothered to find savings in the state's budget. This mindset is unacceptable.*
>
> *I am vetoing HB 2178, the punitive tax increase on working Kansans. I am vetoing it because the legislature failed to fulfill my request that they find savings and efficiencies before asking the people of Kansas for more taxes. I am vetoing it because Kansas families deserve to keep more of their hard-earned cash. I am vetoing it because it is retroactive and thus incredibly unfair.*
>
> *Legislators who voted for this largest tax hike in Kansas history will try to persuade you that it is primarily a tax on wealthy business owners. This is false. Rather, this bill is an assault on the pocketbooks of the middle class. These legislators campaigned saying they were going to raise some other guy's taxes. But when the votes were finally cast, they raised yours.*
>
> *Above all else, we must remember that tax dollars do not belong to the government. They belong to the families, individuals, and job-creators who earn a paycheck. It is wrong for government to take more tax dollars than are absolutely necessary to provide for the core functions of the state.*
>
> *Should the legislature override this veto, Kansans are the ones who will pay the price. It doesn't have to be this way; there is another option. My budget proposal does not target Kansas families or the working class, but still achieves structural balance. I urge you to call your legislator and tell them to find savings in government before asking you and your family for more money. After all, it's your money, not the government's. As the stewards of your tax dollars, legislators must be fiscally responsible with your money. It is not too late; the legislature still has time to choose fiscal responsibility over tax increases on Kansas families.*
>
> – Governor Sam Brownback,
> Veto Message on 2017 HB 2178[41]

It took more than three more months of political negotiation after the Governor issued his veto message quote above, but the 2017 Legislature overrode the Governor—and his pro-taxpayer message. The elements of HB 2178 lived on (with slight modifications)

40 This statement relies on the original fiscal notes calculated for HB 2117. Arguments above claim that the analysts associated with the Consensus Revenue Estimating Group mis-modeled the income tax changes, thereby under-estimating the earlier fiscal notes (by over-estimating expected revenue).

41 https://governor.kansas.gov/protecting-kansas-workers-and-families/

to become 2017 SB 30. The Legislature failed to override the Governor's veto on HB 2178 (issued on February 21, 2017), but overrode the Governor's veto of SB 30 (issued on June 6, 2017).

Many commentators viewed the 2016 election for the Kansas Legislature as a referendum on the policies of Governor Brownback. For those who held that view, the election results indicated that many Kansans did not like them. A news story in the *Wichita Eagle*, concisely summed up the results:[42]

> Republicans will retain majorities in the Kansas House and Senate, but Gov. Sam Brownback may face a less cooperative Legislature next session.
>
> Democrats, who ran on a platform of tax fairness and a promise to increase school funding, picked up seats in both chambers after seeing their numbers dwindle in the past six years. That comes on top of victories by moderate Republicans in the August primaries, which saw the ouster of 14 conservative incumbents.

Governor Brownback, in his 2017 State of the State Address, noted that: "Over a third of the members in this chamber tonight are new to the Legislature." That included 14 (of 40) new members in the Senate and 45 (of 125) new members in the House.[43]

The fact that the new Legislature essentially started the 2017 legislative session with a bill to repeal the tax policies enacted in 2012 and 2013 supports the view that the election represented a referendum on those policies. Although Governor Brownback vetoed that effort (HB 2178), the House overrode the veto by two votes. The Senate failed to override the veto by three votes.[44]

Exhibit 4:
Percent of Federal Itemized Deductions Kansas Taxpayers May Claim

	Itemized deduction	1992-2012	2013	2014	2015	2016	2017	2018	2019	2020 & After
2013 HB 2059	Charitable giving	100%	100%	100%	100%	100%	100%	100%	100%	100%
	All other	100	70	65	60	55	50	50	50	50
2015 HB 2109	Charitable giving				100	100	100	100	100	100
	Mortgage interest				50	50	50	50	50	50
	Property tax paid				50	50	50	50	50	50
	All other				0	0	0	0	0	0
2017 SB 30	Charitable giving						100	100	100	100
	Mortgage interest						50	50	75	100
	Property tax paid						50	50	75	100
	Medical expenses						100	100	100	100
	All other						0	0	0	0

42 Bryan Lowry and Dion Lefler, "Democrats make gains in Kansas Legislature," *The Wichita Eagle*, November 8, 2016.
43 https://admin.ks.gov/docs/default-source/osm/astra/kansas-legislature-2016-election-unofficial.pdf?sfvrsn=4
44 http://www.kslegislature.org/li/b2017_18/measures/hb2178/

The ensuing months generated much debate, but ended up close to where it began. The major elements of 2017 SB 30 included:

- Retroactive implementation of higher income tax rates and a return to a three-bracket rate structure.[45] See Exhibit 2.
- Retroactive elimination of the income tax exemption of small business income (and the special exemption for income generated by sales of livestock and Christmas trees).
- A phased-in reinstatement of the itemized deduction for medical expenses, mortgage interest, and property taxes. See Exhibit 4.
- Elimination of all formula-based income tax rate reduction mechanisms.
- A reduction in the threshold level for the low-income income tax exclusion.

Table 3 reports the estimated fiscal note for SB 30. The estimators claimed the changes in law would generate an average of about $600 million per year over a five year period.

This section of the report began by highlighting the tax principles put forward by Governor Grave's Tax Equity Tax Force. It recommended a "balanced" tax structure, one characterized by the so-called three-legged stool of income taxes, sales taxes, and property taxes. That recommendation carried a practical wisdom based on the way tax-collection technology in Kansas had developed over the decades. However, policymakers can achieve—through comprehensive tax reform—the same sound tax policy principles recommended by the Task Force without necessarily retaining the tax structure associated with the three-legged stool.[46]

Perhaps a more well-thought-out structure of comprehensive tax reform could have evolved from Governor Brownback's original, fiscally-cautious approach to phasing out the income tax. However, events unfolded differently. One key point bears repeating: the orderly phase-out of the income tax originally envisioned by Governor Brownback became forever lost in fiscal policy politics. Essentially, Kansas lawmakers reformed nothing; they instead removed a large piece of one leg of the three-legged stool. Not surprisingly, the stool—the state government's "balanced" revenue stream—became unstable. Without considering a more comprehensive approach to tax reform, lawmakers focused on one solution: re-attach the missing piece of the income tax leg of the stool.

45 In an opinion editorial published after the end of the 2017 legislative session, Rep. Don Hineman, the Majority Leader of the Kansas House of Representatives, endeavored to explain to the electorate of Kansas why the Legislature had to increase taxes. Surprisingly, he expressed clear confusion over the retroactive nature of the tax increases. He stated: "Meanwhile, the governor and his surrogates employ the tactics we've sadly come to expect from Washington, D.C., skewering the facts to fit their narrative. They use buzz words like 'retroactive,' although the Legislature ensured the tax plan would not apply retroactively to wage earners." The legislation (SB 30) contains no such provision. However, it did contain language that waived penalties for taxpayers that made insufficient payment of tax withholding or estimated taxes caused by the retroactive tax increase, "so long as such underpayment is rectified on or before April 17, 2018." See: Don Hineman, "Why Tax Reform Was Necessary," *Topeka Capital-Journal* (cjonline.com), July 5, 2017.

46 See, for example, Arthur P. Hall, "A Comprehensive Retail Sales Tax as A Single Tax for the State of Kansas," Technical Brief 09-1218, Center for Applied Economics, University of Kansas School of Business, December 2009.

Kansas State Government Spending, Part I: A Primer on the State Budget and Historical Spending Levels

> *The major drivers in state spending increases are what you think they are: K-12 education, public pensions and Medicaid.*
> . . .
> *Understand though, that the unfunded liability in KPERS vastly exceeds any issues with our year-to-year budget. It dwarfs every other item on the state balance sheet.*
>
> – Governor Sam Brownback,
> 2015 State of the State Address[47]

As with tax policy, the 1992 School District Finance and Quality Performance Act offers a convenient way to date the beginning of the modern era of state government budgeting in Kansas. With that legislation, Kansas lawmakers made a commitment to significantly increase state-level funding of K-12 education. No one could know it at the time, but the 1992 Act also set the stage for what would become (in Governor Brownback's words) the "school finance wars," which played a prominent role in the fiscal-policy history of the Brownback era.[48] The year after the 1992 Act, in 1993, the Kansas Legislature passed the KPERS Omnibus Retirement Bill, which provided "the most comprehensive package of benefit and funding enhancements in the history of the Retirement System."[49] This legislation, by expanding benefits but capping the employer contribution rate, initiated the budgetary dynamics that bear significant responsibility for the underfunded status of KPERS, a status that forces current-day taxpayers to fund KPERS by approximately $450 million more per year than might have been necessary had past lawmakers made a stronger commitment to fully funding the benefit enhancements they enacted.[50]

Modern-Day Drivers of Kansas State Government Spending

Chart 5a and Chart 5b offer a way to see the budget impacts of the three items Governor Brownback enumerated in his 2015 State of the State Address: public education, Medicaid, and KPERS. Chart 5a shows the spending composition of the State General Fund budget. Chart 5b shows the spending composition of the All-Funds budget. Chart 5b includes spending on transportation, a significant item of state spending best accounted for within the context of the All-Funds budget.

Both charts illustrate the step-change in the share of the state budget committed to K-12 education following the 1992 School District Finance and Quality Performance Act. The General Fund's share of K-12 education spending increased almost 15 percentage points from 1992 to 1993; the All-Fund's share increased almost seven percentage points.

Both charts also illustrate the rapid growth of Medicaid spending. Chart 5a shows that the growth of Medicaid has significantly crowded out items of discretionary spending in the State General Fund budget. Chart 5b shows that Medicaid has crowded out transportation spending. (For more details on the history of Kansas Medicaid spending, see Appendix C.)

KPERS contributions represent a relatively small

47 https://governor.kansas.gov/state-of-the-state-2015/

48 See Arthur P. Hall, "The Kansas 'School Finance Wars'," Technical Report 17-1103, Brandmeyer Center for Applied Economics, University of Kansas School of Business, November 2017.

49 Kansas Public Employees Retirement System, 1993 Annual Report, p 3.

50 See Arthur P. Hall, "A Primer on the Underfunding of the Kansas Public Employees Retirement System," Technical Report 17-0901, Brandmeyer Center for Applied Economics, University of Kansas School of Business, September 2017.

Chart 5a: K-12 Education, Medicaid, and KPERS Contributions as a Share of the State General Fund Budget, 1992-2016

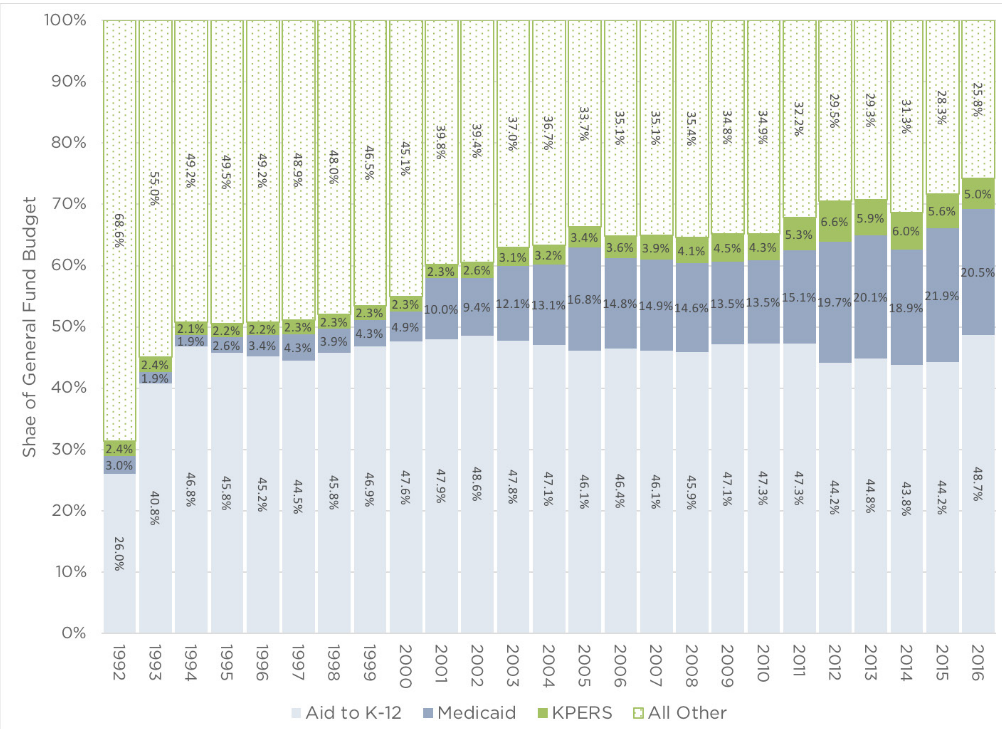
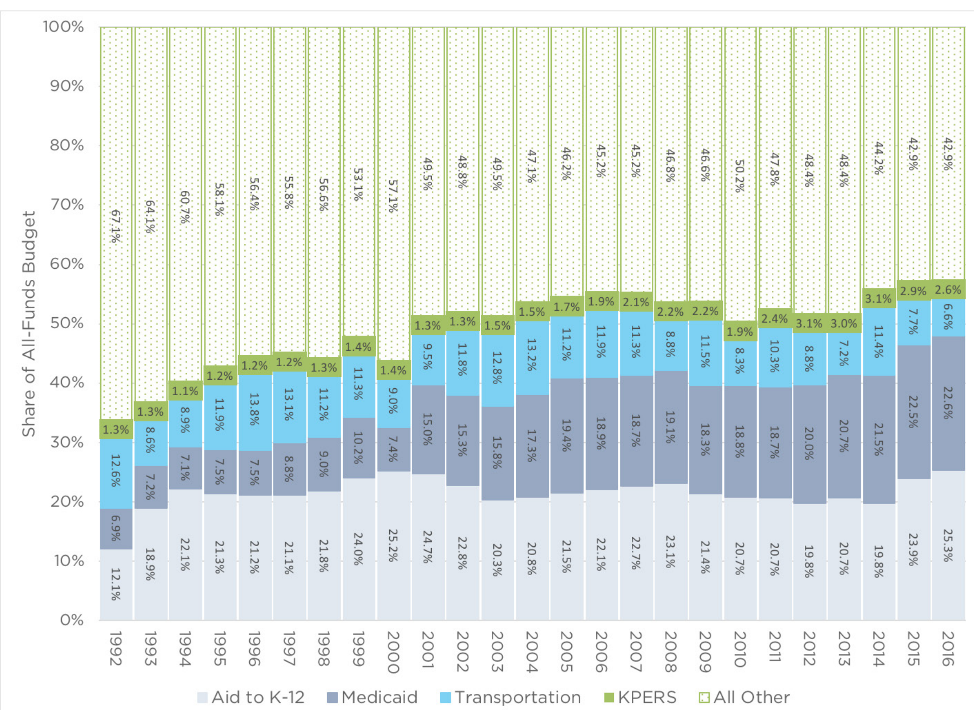


Chart 5b: K-12 Education, Medicaid, and KPERS Contributions as a Share of the All-State Funds Budget, 1992-2016



Sources: Kansas Division of the Budget; Kansas Department of Health and Environment; National Association of State Budget Officers.

share of both budgets. However, note the meaningful increase in the shares beginning in 2011. This increase, which necessarily competed with other state budgeting priorities, illustrates the effects of legislation enacted to improve the fiscal integrity of the public employees retirement system. The underfunded status of KPERS began to accelerate quickly following the recession in 2001—and accelerated even faster following the recession of 2008. In 2014, Kansas lawmakers took a significant step toward increasing the statutory government-employer contribution rate. However, despite fiscal progress initiated by the 2011 legislation, budget-balancing challenges motivated lawmakers to temporarily re-apply a cap on the government-employer contribution rate from 2015 to 2017.

Table 5 offers one more way to evaluate changes in the Kansas budget over time. *The Governor's Budget Report* has consistently used the distinct categories in the table to organize how the Division of the Budget reports state government spending. The pattern of change reported in the table reinforces the pattern of change illustrated in Chart 5a and Chart 5b.

Table 5: The Changing Allocations of Kansas State Government Spending				
	1986	1996	2006	2016
State General Fund Budget				
General Government	10.0%	7.0%	3.9%	4.2%
Human Services	22.5	18.3	22.9	27.2
Dept. of Education (K-12)	41.6	50.7	50.9	49.5
Higher Education (Regents)	18.0	13.6	14.6	12.4
Public Safety	6.5	6.6	7.2	6.3
Ag & Natural Resources	1.4	1.1	0.5	0.2
Transportation	0.0	2.7	0.0	0.2
State All-Funds Budget				
General Government	9.3%	11.3%	5.8%	7.4%
Human Services	27.5	25.3	31.5	33.3
Dept. of Education (K-12)	23.8	26.7	27.1	29.6
Higher Education (Regents)	20.3	16.8	17.2	18.2
Public Safety	3.5	3.8	5.1	3.8
Ag & Natural Resources	1.6	1.9	1.4	1.2
Transportation	14.0	14.2	11.9	6.6

Source: Kansas Division of the Budget, *The Governor's Budget Report*, Vol. 1, various years.

Medicaid (Human Services) and K-12 Education spending have generally increased at the expense of Transportation, Higher Education, General Government, and Ag & Natural Resources.

The Two Different Kansas Budgets and Long-Run Spending Trends

A proper understanding of the issues and claims related to Kansas budget debates requires a recognition that the state government of Kansas manages several different budgets, the two most important ones go by the names: All-Funds budget and State General Fund budget. The All-Funds budget represents the total amount of money spent by the state government. The State General Fund budget operates as a subcomponent of the All-Funds budget. The delineation of spending items reported in the All-Funds budget but not the General Fund budget relates more to political choices established by the Legislature than the reality of how much money the state government spends. Boilerplate language in *The Governor's Budget Report* says:

> The State General Fund receives the most attention in the budget because it is the largest source of the uncommitted revenue available to the state. It is also the fund to which most general tax receipts are credited. The Legislature may spend State General Fund dollars for any governmental purpose.
>
> Special revenue funds, by contrast, are dedicated to a specific purpose. For instance, the Legislature

may not spend monies from the State Highway Fund to build new prisons.

Other examples of special revenue funds are the three state building funds, which are used predominantly for capital improvements; federal funds made available for specific purposes; and agency fee funds, which can generally be used only to support specific functions related to the agency collecting the fee. The Economic Development Initiatives Fund, the Children's Initiatives Fund, the Kansas Endowment for Youth Fund, the Expanded Lottery Act Revenues Fund, and the State Water Plan Fund are appropriated funds that function the same as the State General Fund.[51]

The State Highway Fund offers a good example of how political choices separate expenditures from the State General Fund and special revenue funds. Highway funding could take place in the context of the State General Fund, directly competing with other spending priorities, but Legislatures of long ago chose to make it a dedicated fund. Revenue sources for the State Highway Fund "include a portion of state sales and compensating use taxes, motor fuel taxes, motor vehicle registration taxes, driver's license fees, special vehicle permits, federal funds, and proceeds from the sale of bonds."[52] A common feature of state budget debates involves redirecting state sales tax revenue from the State Highway Fund to the State General Fund, indicating that the Legislature ultimately has political discretion over the definition of these budgetary distinctions, so long as it adheres to the rules related to federal matching funds. (In addition, in times of revenue shortfalls, the Legislature often exercises its prerogative to "sweep" monies from special revenue funds into the State General Fund.)

The design of Chart 6 works to provide a simple primer about long-run trends associated with four budget-related variables. The four variables include: (1) spending from the State All-Funds budget, (2) spending from the State General Fund budget, (3) total state-level tax collections, and (4) total state-level tax collection plus total receipts received by the Kansas state government from the federal government. Chart 6 shows the inflation-adjusted trends in the dollar values of these variables; for added historical context, it also reports the average annual growth rate of the All-Funds budget and the General Fund budget during the terms of each Kansas Governor back to Robert Docking.

For understanding the basic mechanics of the state budget, Chart 6 offers a few noteworthy observations:

- The All-Funds budget represents the total amount of state government spending. The State General Fund typically covers about 45 percent of the All-Funds total. The two funds frequently grow at different rates.

- State-level tax collections always exceed State General Fund spending. The difference accounts for taxes dedicated to special revenue funds, which operate as components of the All-Funds budget.

- Beginning in the early 1990s, federal government funds began to grow significantly as a component of the All-Funds budget. Social services—primarily Medicaid—account significantly for how the state spends the federal funds.

- The gap between All-Funds spending and State Tax Collections + Federal Receipts measures the amount of revenues raised by the state government from non-tax sources. Some of these funds represent borrowed money, some represent revenue generated by gaming and the lottery, and a significant amount of the non-tax revenue comes in the form of specific fees charged by government agencies or entities. Tuition charged by institutions of higher education and fees charged by state hospitals constitute two of the largest sources of fee funds.

51 Kansas Division of the Budget, *The Governor's Budget Report*, Volume 1, Fiscal Year 2018, p. 222.
52 *Ibid*., p. 238.

Chart 6: State of Kansas All-Funds Budget, General Fund Budget, Total Tax Collections, and Receipts from the Federal Government (2016$) 1966-2016

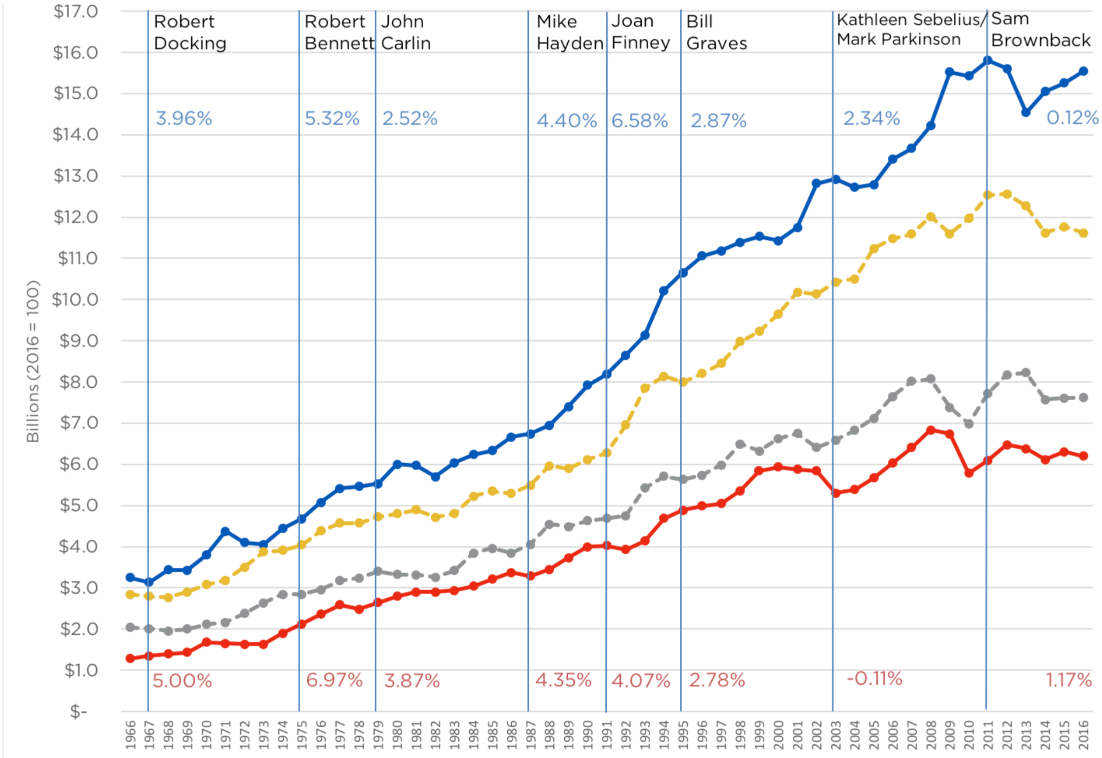
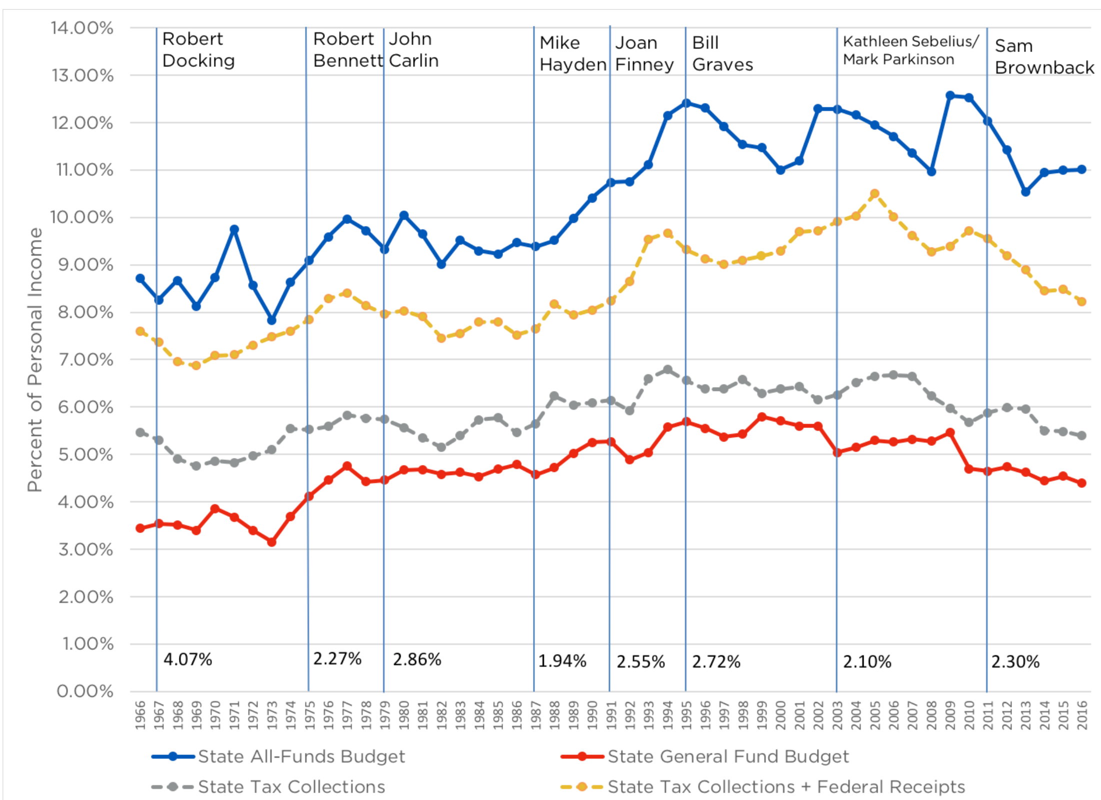


Chart 7: State of Kansas All-Funds Budget, General Fund Budget, Total Tax Collections, and Receipts from the Federal Government, as a Percent of State Personal Income, 1966-2016



Sources: Kansas Division of the Budget, Kansas Legislative Research Department, U.S. Bureau of Economic Analysis.
Chart 6 note: Percentages equal the average annual growth rate of the inflation-adjusted All-Funds budget (blue) and General Fund budget (red) during each Governor's tenure. Governors begin their term in the middle of a fiscal year and the start of a legislative year, so they can influence the rate of change between the fiscal year before they took office and the fiscal year in which they took office.
Chart 7 note: Percentages equal the average annual growth rate of inflation-adjusted personal income during each Governor's tenure.

Brownback-Era Budgets in Long-Run Context

State government spending grew more slowly during Governor Brownback's tenure than during the tenure of any other Governor since (at least) Robert Docking, both in absolute terms and relative to Kansas personal income. (State General Fund spending in the Sebelius-Parkinson era offers a unique exception, as discussed below.) Governor Brownback made this outcome a fiscal policy goal of his administration.[53]

As discussed at the outset of this report, promoting economic growth through fiscal policy reform became a centerpiece of Governor Brownback's legislative agenda. His ideas on these matters developed over a political career that began in 1986. Speaking in political shorthand, few knowledgeable observers would find it controversial to claim that Governor Brownback might self-identify as a "Reagan Republican" sympathetic with the principles of "supply-side" economic policy. Indeed, a news article in the *Kansas City Star*, titled "Reagonomics Guru Arthur Laffer Touts Brownback Tax Plan at Capitol," opened with these two paragraphs:[54]

> Enjoying almost Republican rock star status, the man who designed supply-side economic policies for Ronald Reagan toured the capitol Thursday touting Gov. Sam Brownback's plan to cut taxes.
>
> Art Laffer visited with tax committees in the House and the Senate as he lobbied for the Brownback plan that will slash tax rates and eliminate income taxes for thousands of small businesses.

Both Governor Brownback and Art Laffer would almost certainly respect the teachings of the late, Nobel Prize-winning economist, Milton Friedman. A well-known quotation from Prof. Friedman helps make a conceptual link between tax policy and spending policy, a link that would animate the thinking of supply-side-oriented policy makers:[55]

> I am in favor of cutting taxes under any circumstances and for any excuse, for any reason, whenever it's possible. The reason I am is because I believe the big problem is not taxes, the big problem is spending. The question is, How do you hold down government spending? The only effective way I think to hold it down, is to hold down the amount of income the government has. The way to do that is to cut taxes.

In brief, Friedman would explain his economic logic by arguing that governments can acquire the resources required to execute their functions only by making a claim on the current or future production of the private economy—as measured by income (or the dollar value of economic output). For this reason, Friedman's postulate goes deeper than political slogans. It has received considerable academic attention. One recent academic research paper—a study of studies—began with this statement: "Since the late 1970s, the received wisdom has been that government size (measured as the ratio of total government expenditure to [income]) is detrimental to economic growth."[56]

That received wisdom helps explain why Governor Brownback boasted in his 2014 State of the State Address: "we've reversed a decades-long trend, as finally, the personal income of Kansas families is rising faster than government spending."[57] The following year, in response to critics of his budget proposal, he doubled-down on that message:[58]

> We embarked on a budgetary course that saw State General Fund expenditures grow at a lower rate than throughout the terms of each of the previous

53 See, for example, Governor Brownback's State of the State Addresses for 2011, 2014 and 2015.

54 Brad Cooper, "Reagonomics Guru Arthur Laffer Touts Brownback Tax Plan at Capitol," *Kansas City Star*, January 19, 2012

55 http://www.azquotes.com/author/5181-Milton_Friedman/tag/government-spending

56 Sefa Awaworyi Churchill, Mehmet Ugur, and Siew Ling Yew, "Does Government Size Affect Per-Capita Income Growth? A Hierarchical Meta-Regression Analysis," *Economic Record*, Vol. 93, No. 300, March 2017, pp. 142-171. The authors' analysis generally concludes that "the conventional prior belief is supported by evidence mainly from developed countries but not from less developed countries."

57 https://governor.kansas.gov/2014-state-of-the-state-of-kansas/

58 https://governor.kansas.gov/state-of-the-state-2015/

nine Governors, while continuing to support core government functions and serving Kansans.

. . .

A growing government budget cannot bring lasting prosperity to its citizens by appropriating ever more of their earnings.

If we could spend our way to paradise, we would already be there.

40 Governors held office before the State General Fund Expenditures reached $1 Billion for the first time.

The next 4 Governors saw that number hit $6 Billion.

That government spending growth was not reflective of the trajectory of our population or of the economy. It was government getting too big too fast.

The era of ever expanding government is over, because it has to be.

Chart 7 helps illustrate Governor Brownback's claims. It modifies Chart 6 by dividing each of the four variables by Kansas personal income.[59] Chart 7 also reports the average annual growth rate of inflation-adjusted Kansas personal income during each Governor's term.

Comparing the average annual growth rates of spending reported in Chart 6 and the average annual growth rate of personal income reported in Chart 7 indicates that:

- The Kansas All-Funds budget grew faster than Kansas personal income under each Governor listed except Governors Docking, Carlin, and Brownback.
- The Kansas General Fund budget grew faster than personal income under each Governor listed except Governors Sebelius and Brownback.

The growth rate and dollar levels of federal funding played an important role in this spending-growth story (for all states, not just Kansas). From the perspective of the All-Funds budget, four different episodes of federal receipts growth recorded noteworthy changes: 1991 to 1993 (Finney), 1998 to 2003 (Graves), 2004-2010 (Sebelius/Parkinson), and 2010 to 2016 (Brownback). The average annual growth rate of federal receipts in these episodes was, respectively: 23.87 percent, 7.80 percent, 4.20 percent, and -0.43 percent. In aggregate terms, the growth rate from point to point in each episode was: 51.50 percent, 54.59 percent, 35.48 percent, and -19.66 percent.

Of the Governors listed, only Governor Brownback had to manage a budget in the context of declining federal receipts. Governor Brownback informed the Kansas electorate and the Legislature that federal spending would continue to decline from its 2009 highest-ever level, and that he intended to budget accordingly.[60] The steep decline in the State Tax Collections + Federal Receipts curves in Chart 6 and Chart 7 demonstrate the fact of the persistent decline in federal receipts during the Brownback era.

Federal receipts also help explain the unique case of State General Fund spending in the Sebelius-Parkinson era. Kansas experienced the 2007 economic recession later than other states; Kansas experienced one of its best-ever inflation-adjusted personal income growth rates in 2008 (at 7.6 percent, the highest since the 1973 rate of 8.0 percent). When the economic downturn came, tax revenues dropped significantly, as Chart 6 illustrates, and State General Fund spending dropped with them. However, in conjunction with the federal government's American Recovery and Reinvestment Act of 2009, federal receipts to

59 Despite the academic research related to using the government spending-to-income ratio as a metric for explaining long-run economic growth, the year-to-year movement of the ratio can be quite erratic. This study makes use of the metric as a convenient measuring tool for making comparisons, and makes no claim that some formula captures the "right" government spending-to-income ratio. As Chart 7 shows, there has existed substantial year-to-year variability of the spending-to-income ratio in Kansas. The growth of a state's income can move quite independently from the budgetary decisions of policy makers. Policy makers typically must react to the budget-related realities determined by past income growth.

60 As examples, see his 2011 and 2012 State of the State Addresses.

the state of Kansas experienced the second strongest growth surge in history and the highest level of federal receipts ever. This surge in federal spending, as intended by the policy, offset the decline in state tax revenue, allowing Governors Sebelius and Parkinson to maintain a high spending level in the All-Funds budget while significantly reducing the General Fund component of the All-Funds budget.[61] If not for the decrease in General Fund Education and Medicaid from 2009 to 2010, and using 2009 data as the endpoint, the Sebelius-Parkinson era would have recorded an annual average growth rate in General Fund spending of 2.08 percent. (Compare the 2003 data point with the 2009 datapoint in Chart 7.)

These seemingly arcane budget issues in fiscal year 2009 helped set the stage for meaningful political discord related to spending restraint, a political dynamic hidden underneath the data presented in Chart 6 and Chart 7. Governor Brownback's efforts at spending restraint proved unsustainable. This fact became apparent in the 2016 election and became fiscal reality in the 2017 legislative session.

To foreshadow matters discussed below, the actual spending levels realized in fiscal years 2009 through 2016 came in below expected levels (the levels recommended by the governors). This eight-year streak of missed spending targets helped entrench a broadly-held political perspective that the state budget faced chronic funding shortfalls. The mismatch between expected spending and actual spending materialized primarily because projected revenue levels did not materialize—and this fact became a key part of the political dynamic related to the Brownback era income tax reductions. Spending restraint for the three main categories of spending highlighted above—public education, Medicaid, and KPERS—figured prominently in the public' perception of the budgetary politics—as did spending reductions for Kansas universities.

61 See, for example, Kansas Division of the Budget, *Comparison Report*, Fiscal Year 2010, pp. 21-26.

Kansas State Government Spending, Part II: Spending Restraint — The Real "Brownback Experiment"?

The term "Brownback experiment" gained a potent political currency in Kansas—to assail Governor Brownback's income tax reforms. But what explained its political potency? The simple answer, of course, is to take people's use of the term at face value: discontent with a bold—and novel—income tax reform. That answer seems adequate when considering certain commentary from tax policy pundits, but it seems deficient when considering the Kansas electorate. After all, Governor Brownback won re-election with the "Brownback experiment" in full force. An alternative answer puts the focus on spending restraint. Assailing the novel tax reform offered a convenient way to express discontent with government spending restraint. The explicit government spending restraint of the Brownback era better explains why the term "Brownback experiment" eventually acquired its potency as a political pejorative.

Ironically, the term "Brownback experiment" came from Governor Brownback himself, when he used the phrase "real live experiment" as a summary comment that concluded an approximately 10 minute television interview about his legislative agenda.[62]

Governor Brownback gave his critics an additional, complementary talking point when he wrote in an opinion editorial for the *Wichita Eagle* that: "Our new pro-growth tax policy will be like a shot of adrenaline into the heart of the Kansas economy."[63]

All eyes became focused on the "real live experiment" that would deliver a "shot of adrenaline" to the Kansas economy. And that is what Governor Brownback said he wanted. Lt. Governor Jeff Colyer echoed (in print) what Governor Brownback said in public: "What is different about a Brownback Administration is that we embrace accountability. We are asking the people of Kansas to grade us on our accomplishments for the state of Kansas."[64]

When the shot of adrenaline never kicked-in, but the budget constraints did, Governor Brownback's income tax reforms—the "Brownback experiment"—became the topic of a nationwide debate. Not surprisingly, much of the debate involved the genuinely novel part of Governor Brownback's income tax reforms: the elimination of income tax on small businesses and farms (often called "pass-throughs" in tax policy parlance, because the business income passes through the business to be taxed on the business owner's individual income tax return).

In the spirit of Justice Brandeis's famous quotation about states being laboratories of democracy, many people started to think about whether or not the Kansas experiment might inform national tax policy by granting "pass through" businesses special consideration within the federal government's tax code. However, most commentators ignored one key factor of the Kansas political context: Kansas lawmakers intended to eliminate the income tax. The zero income tax rate on Kansas pass through businesses represented one step toward that larger reform vision, not an isolated policy. For example, without mentioning the income tax-elimination factor, the Editorial Board of the *Wall Street Journal* argued that: "The one relevant Kansas lesson is that Republicans in Washington need

62 Scott Rothschild, "Brownback Gets Heat for 'Real Live Experiment' Comment on Tax Cuts," *Lawrence Journal-World*, June 19, 2012. The full comment was: "On taxes, you need to get your overall rates down, and you need to get your social manipulation out of it, in my estimation, to create growth. We'll see how it works. We'll have a real live experiment." Also see a YouTube clip titled "Kansas Gov. Sam Brownback on MSNBC's Morning Joe," minute mark 8:15 (accessed November 21, 2017): https://www.youtube.com/watch?v=juDv41jovEA

63 "Gov. Sam Brownback: Tax Cuts Needed to Grow Economy," *Wichita Eagle*, July 29, 2012.

64 Katie Stockstill, "Brownback Outlines Road Map for Kansas," *McPherson Sentinel*, August 9, 2010.

to be careful how they write any tax reform for 'pass-through' businesses. One way to do that is to avoid letting pass-through tax rates get too much lower than rates on wage and salary income."[65]

Party politics aside, the *Journal*'s expression of the "one relevant Kansas lesson" may have been too parochial. Public finance economists of all political persuasions would likely applaud it as a sound technical recommendation for income tax policy. However, a much larger lesson suggests itself.

Viewed from a broad perspective of political economy, Governor Brownback arguably relearned a lesson taught 500 years ago by Niccolò Machiavelli:

> It must be remembered that there is nothing more difficult to plan, more doubtful of success, nor more dangerous to manage than the creation of a new system. For the initiator has the enmity of all who would profit by the preservation of the old institution and merely lukewarm defenders in those who gain by the new ones.[66]

The application of Machiavelli's lesson follows directly from the political dynamics familiar to those who follow politics: People like tax cuts; they do not like spending cuts. Even reductions in the growth rate of government spending generates political discontent. In one way or another, the *Wall Street Journal* has editorialized on that topic for decades.

More to the point: Why could Governor Brownback's political opponents—in both political parties—succeed in turning the term "Brownback experiment" into a political pejorative? The reason may have its roots in Governor Brownback's first State of the State Address:[67]

> The days of ever expanding government are over – and under my administration, they will not return. The future demands of us a commitment to deliver core services in innovative and more efficient ways. We will do that, beginning with a structural lowering of the job positions in state government. In my FY2012 budget recommendations, I have eliminated over 2,000 unfilled employee positions.
>
> . . .
>
> The days of ever expanding government are over. My proposed total state spending for the next fiscal year will be more than three quarters of a billion dollars lower than this year. This will be the first time that the total or all-funds state budget has been cut since 1972.

Governor Brownback's goals of spending restraint, not the income tax reforms per se, may have defined the real "Brownback experiment," the one which offers broader lessons. But the novelty—and the boldness—of the tax reform effort allowed the term "Brownback experiment" to become a pejorative. It gave his political opponents a messaging tool to oppose "the creation of a new system" and gave his political proponents the challenge of defending the benefits of the "new ones."

The tax policy section of this report explained how the income tax reforms contributed to revenue estimation errors and subsequent budget-balancing challenges. Charts 6 and 7 establish that state government spending grew more slowly under Governor Brownback than any Governor since the 1960s.

The taxing-versus-spending dynamic had to manifest itself as the inevitable result of the experiment. Every Kansas taxpayer experienced significantly reduced income tax rates under the Brownback reforms. The "new system" promised everyone zero income tax rates, eventually. However, the central and novel feature of the tax experiment—the exemption of small business and farms from income taxation—created a well-defined group that experienced zero income tax rates immediately.

65 Editorial Board, *Wall Street Journal*, "Tax Revenge in Kansas," June 9, 2017.

66 http://www.goodreads.com/quotes/88687-it-must-be-remembered-that-there-is-nothing-more-difficult. This passage comes from Chapter 6 of *The Prince*. Translations of the passage can differ but convey the same thought.

67 https://governor.kansas.gov/2011-state-of-the-state-message/. The Governor's statement about the all-funds budget declining for the first time since 1972 is true in actual-dollar terms but not in real-dollar terms (meaning inflation-adjusted terms).

The beneficiaries of the tax reductions had to become the defenders of the spending reductions required by the lower tax revenues. The beneficiaries of government spending had to become the opponents of the tax reductions. The Brownback experiment ended because the defenders of spending won the debate. And since the beneficiaries of the tax reductions also counted themselves as the beneficiaries of government spending (or other income tax exemptions that Governor Brownback proposed to eliminate), they ultimately became only "lukewarm defenders" of the income-tax-elimination plan.

Anecdotes abound to support this view of the lessons learned from the Brownback experiment, many in conflict with one another, but a news story that compiled a variety of opinions about the tax experiment produced the ones below, by Mr. Fawl. Close observers of Kansas policy could readily articulate corrections or qualifications to his perceptions. But it was Mr. Fawl's perceptions that mattered for the taxing-versus-spending debate—and his perceptions quite closely mirrored the political talking points promulgated by those who "would profit by the preservation" of state government spending. His comments offer a microcosm of the conflicting political forces in play at the time:[68]

> Mike Fawl, 62, put his forklift in reverse, having just stacked another soybean container high in his barn. His family has owned this farm, now some 2,800 acres, since the 1850s, before Kansas was a state.
>
> He shut off the forklift. It rumbled and then fell silent.
>
> Killing Brownback's tax plan and raising taxes "needed to happen," he said. "It needed to happen. Everyone needs to pay their fair share of taxes, and it's been inequitable for a while."
>
> He conceded, "That sounds kind of odd coming from a farmer" who benefited from the tax cuts.
>
> "As a small-business person, you got a tax break, and it was meant to go out and hire people to work for you," he said. But it only ever amounted to about $4,000 or $5,000 for him, he said.
>
> "You can't hire anybody for that. So what you do, you put it in your pocket. … If you live in a community, you have to look out for the people in the community, not just your personal benefit."
>
> Over the years, he said, he has seen schools suffer. He has a son, 36, who is a special education teacher in the Topeka area.
>
> Roads, he said, have deteriorated.
>
> "You drive any road around here, they screw up your tires. So I'm now paying for not doing things correctly. The tires don't last as long."
>
> Fawl voted for Brownback in 2010, when statewide he received 63 percent of the vote, but not the second time, when Brownback edged Democrat Paul Davis by just four points.
>
> "The budget never balancing, we were always at a crisis," Fawl said. "There's not enough money for schools. We don't give raises to state employees. We take money from KPERS [the public pension system]. We take money from the highway fund.
>
> … I was not happy with how he was treating the state at all. I was benefiting from it personally, but it wasn't good for the whole state."

The budget never balancing. Always a crisis. That became the meaning of the "Brownback experiment" to large factions of the Kansas electorate. Persistent news reports helped to reinforce this meaning.

Chart 8a and Chart 8b offer a straightforward way to

68 Eric Adler, "Kansans Consider the Corpse of Sam Brownback's Tax Plan: 'It needed to happen'," *The Kansas City Star*, June 11, 2017. http://www.kansascity.com/news/politics-government/article155431604.html. Also see a YouTube clip titled "Kansans perform postmortem on Brownback tax 'experiment'" (accessed November 17, 2017): https://www.youtube.com/watch?v=-_kf6QuNbu4.

understand the budget situations. For the State General Fund budget and the All-Funds budget, respectively, the charts show the actual budgets approved by the Kansas Legislature (and signed into law by the Governor) minus the budget recommendation first proposed by the Governor. A positive number means a legislatively-approved budget greater than the Governor's original recommendations. A negative number means a legislatively-approved budget less than the Governor's original recommendations—a budget in which the Legislature had to agree to spending reductions relative to initial expectations.

Chart 8a: State General Fund Budget:
Approved Budget less Governor's Recommendations

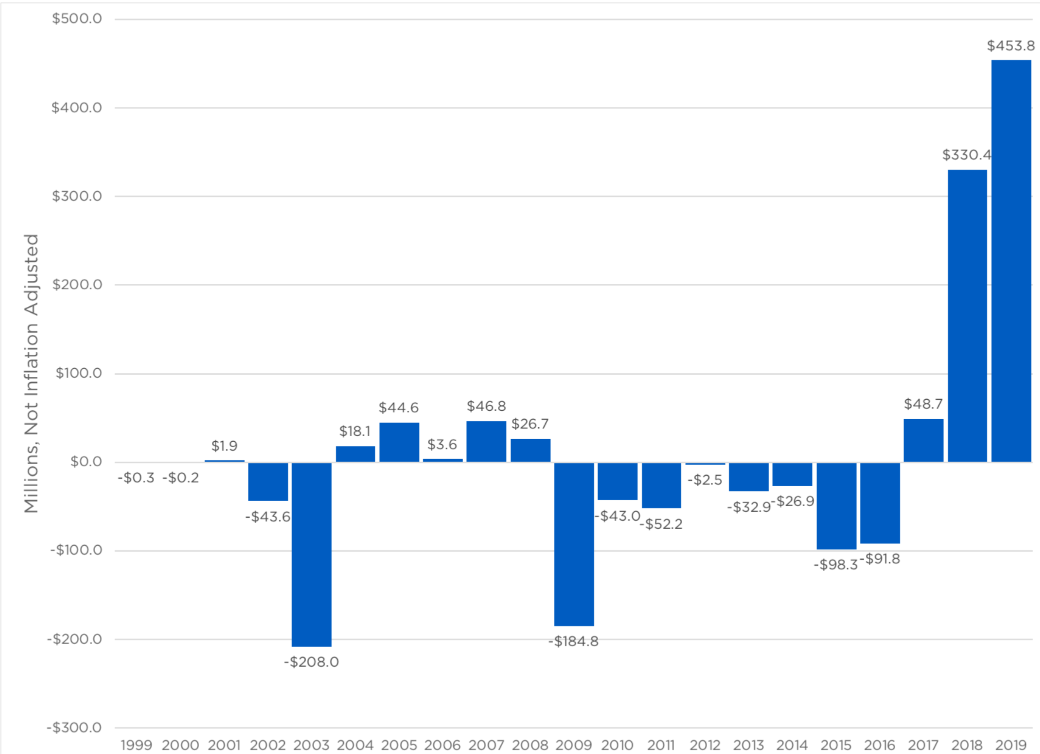
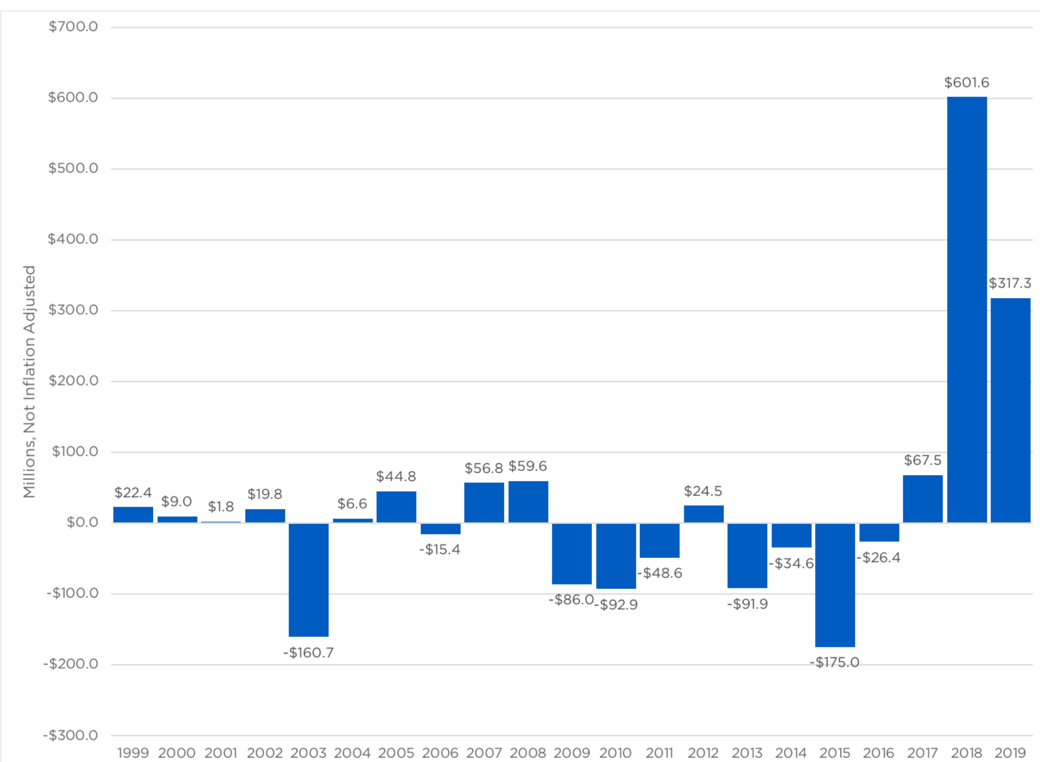


Chart 8b: State All-Funds Budget:
Approved Budget less Governor's Recommendations



Sources: Kansas Division of the Budget, *Comparison Report*, various fiscal years.

From 1999, the second term of Governor Graves, through the time Governor Sebelius left office and passed leadership to Governor Parkinson (2009), legislatively-approved spending almost always exceeded Governor-recommended spending (ignoring some minor cases in the General Fund budget); legislators got to increase spending. Fiscal year 2003, because of the impact of the 2001 recession on the Kansas economy (and particularly the aircraft manufacturing sector), provided the significant exception.

However, the opposite took place from the time of Governor Parkinson through 2016: Governor-recommended spending almost always exceeded legislatively approved spending, meaning legislators had to persistently reduce spending below expectations. Legislators would have had to also reduce spending in fiscal year 2017—had the Legislature not successfully over-ridden Governor Brownback's veto of the Legislature's major tax increase (the veto override that ended the popular interpretation of the "Brownback experiment").

Apparently, the "days of ever expanding government" (to borrow Governor Brownback's phrase) were not over. The voters and their representatives did not want to experience an eighth straight year of having to reduce spending below expectations. Indeed, as Chart 8a and Chart 8b show, they intended to make up for lost time (assuming the legislatively-approved budgets for fiscal years 2018 and 2019 become a fiscal reality).

Party politics and interest-group advocacy took its form in the budgetary dynamics of slow or reduced spending growth. Government spending advocates—"all who would profit by the preservation of the old institution," in Machiavelli's language—had to attack the Brownback tax experiment and use the attack as an indirect political messaging tool to end the spending-restraint experiment. This tactic could work politically because the Legislature never showed the willingness to set spending policy in line with tax policy—and the beneficiaries and supporters of Governor Brownback's tax policies ended up revealing themselves as "lukewarm defenders," because they either benefited from government spending or advocated against the tax policy-related revenue offsets recommended by Governor Brownback to more realistically execute his overall fiscal policy strategy. A news article in the *Wichita Eagle* on March 25, 2015 accurately captured the tax policy part of this political dynamic:[69]

> Lawmakers have been hesitant to take the steps necessary to balance the budget, said Sen. Les Donovan, R-Wichita, who chairs the Senate Taxation Committee.
>
> He voiced frustration that whenever he holds a hearing about closing a tax exemption to secure more revenue, it sparks a backlash.
>
> "Every time I have these meetings, the room is absolutely full of people wearing suits that are lobbying for the entity we're trying to remove the exemption from," Donovan said. "And I don't think the people in here or the people across the way (the Kansas House) have the fortitude, the courage, whatever you want to call it, to take away benefits that we have given to the people of this state over the years. We haven't shown that we have that ability or that fortitude yet, and it remains to be seen if we're going to have it before we're out of here this year."

The Legislature lacked the same "fortitude" on the spending side of the budgetary equation. Duane Goossen served as the budget director for both Governor Graves (a Republican) and Governor Sebelius (a Democrat), and, before those appointments, served many years as a state legislator. Goossen's blog offered him a vehicle by which to express his own opinions about the Brownback-era budget debates. Goossen's personal opinions aside, his blog post of April 9, 2015 offered a compelling look into the politics of spending restraint that took place mid-experiment:[70]

> Stop the talk about Kansas having a spending problem. It's not true, and our lawmakers have just shown how false that claim is.
>
> The Senate Ways and Means Committee has passed a FY 2016 general fund budget with expenditures set at \$6.478 billion and the full Senate adopted that budget. Although the House has not voted on a budget yet, the House Appropriations Committee budget position sets spending at \$6.477 billion.
>
> Compare the spending in the Senate budget—\$6.478 billion—to the FY 2016 official revenue estimate—\$5.811 billion. That's a gap of \$667 million. Wow! If Kansas has a spending problem, why did the Kansas Senate, currently a very conservative body, vote to spend \$667 million more than they expect to receive?

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69 Bryan Lowry, "Kansas Senate Approves Budget that Requires Some Tax Increases," *The Wichita Eagle*, March 25, 2015. In private conversations with the author, Rep. Richard Carlson, chair of the House Committee on Taxation at the time, echoed sentiments similar to those expressed by Senator Donovan in the article.

70 http://realprosperityks.com/duane-goossen-lawmakers-make-it-clear-kansas-has-a-revenue-problem/

> The Senate-passed budget is not lavish. A clear goal of Senate lawmakers was to crank down expenditures to the lowest possible level.
>
> Yet, they still propose spending $667 million more than they take in. The budget puts schools on a block grant, an approach that means cuts and problems for many school districts. University funding goes down. State employees who have foregone salary increases in recent years get nothing again.
>
> If spending is the problem, lawmakers have another $667 million to cut out of the budget in FY 2016. Good luck. Half of general fund spending in the Senate budget goes to school finance, where a cut means reducing the newly passed block grants. Another 22 percent covers the state share of Medicaid, an increasing cost that lawmakers have little choice but to pay. The Senate allocated 12 percent for higher education, 6 percent for public safety, and 6 percent for other human service programs, none of which are easy to cut, and certainly not to the tune of $667 million.

Two years later, near the end of the 2017 legislative session that ended the tax experiment, a virtually identical dynamic took place. The *Lawrence Journal-World* published a news article with the headline: "Senate Passes Spending Plan that Would Need Nearly $800 [Million] in New Taxes Over 2 Years."[71] According to the article:

> Sen. Ty Masterson, R-Andover, tried unsuccessfully to delete all new spending in the bill, other than money to restore the 4 percent cut made last year in Medicaid reimbursement rates to health care providers.
>
> "The general population we serve is not in favor of raising spending and raising taxes," Masterson argued, citing two recent public opinion polls.
>
> But Sen. John Doll, R-Garden City, said the most accurate poll was the 2016 election.
>
> . . .
>
> Masterson's amendment received only 12 votes.
>
> Minutes later, the Senate voted 27-13 to pass the bill and send it to the House.

After the Legislature voted to overturn Governor Brownback's veto, thereby ending the tax experiment, *The Sentinel* published a news article with the headline: "Did Kansas Legislators Actually Read Budget They Adopted?" According to the article:[72]

> The budget Kansas legislators adopted in the waning hours of 113-day session will be busted in two years, despite a $1.2 billion tax increase. It also sweeps all but $5 million from the highway fund and defers payments to the state employee pension program, or KPERS—two things legislators smacked Gov. Sam Brownback for during campaigns last year.
>
> Sen. Carolyn McGinn [chair of the Senate Ways and Means Committee] took to the Kansas Senate to excoriate previous legislatures [of which she was a member].
>
> "This body has had four years to cut this budget. And that didn't happen," McGinn said. "Instead, the way we balanced the budget, the way this body balanced the budget in the last four years, was by stealing from KPERS, stealing from KDOT, stealing from fee funds, stealing from the water fund, and I could go on."
>
> Readers should question whether McGinn actually read the budget she advocated and voted for.
>
> The two-year budget legislators recently approved sweeps virtually all funding from the state highway fund and defers KPERS payments. Without "stealing" (as McGinn calls it) from KDOT and KPERS, the budget would be almost $100 million short.
>
> That potential shortfall is thanks to new spending. ...

71 Peter Hancock, "Senate Passes Spending Plan that Would Need Nearly $800M in New Taxes Over 2 Years," *Lawrence Journal-World*, June 4, 2017.

72 https://sentinelksmo.org/did-kansas-legislators-actually-read-budget-they-adopted/

Finally, in his *Sine Die* statement closing out the 2017 legislative session, Governor Brownback helped reinforce the notion that spending restraint—not his tax reduction policies per se—may have constituted the real "Brownback experiment" the Kansas political system refused to endure further:[73]

> *This legislative session made history, but for all the wrong reasons. Passing the largest tax hike in state history, this legislature passed the biggest budget in state history—and they've already spent every dime.*
>
> *The legislature—despite borrowing and delaying payments—chose to spend over $200 million in new spending on top of increased funding for schools. This budget pays for a legislative wish list on the backs of working Kansans.*
>
> *This session marks a drastic departure from fiscal restraint. I trust that future legislatures will return to a pro-growth orientation that will once again set Kansas on the path toward becoming the best state in America to raise a family and grow a business.*

73 Office of the Governor, "Governor Sam Brownback issues *Sine Die* statement," June 26, 2017. https://governor.kansas.gov/governor-sam-brownback-issues-sine-die-statement/. In a statement to the press, Governor Brownback said: "I am signing the budget, despite my concerns about excessive spending, to avoid a break in core functions of government and to provide state workers with well-deserved pay increases." (Associated Press, "Kansas Gov. Brownback Signs $15.6 Billion State Budget," *The Kansas City Star,* June 25, 2017.)

Appendix A: Economic Context for the "Brownback Experiment"

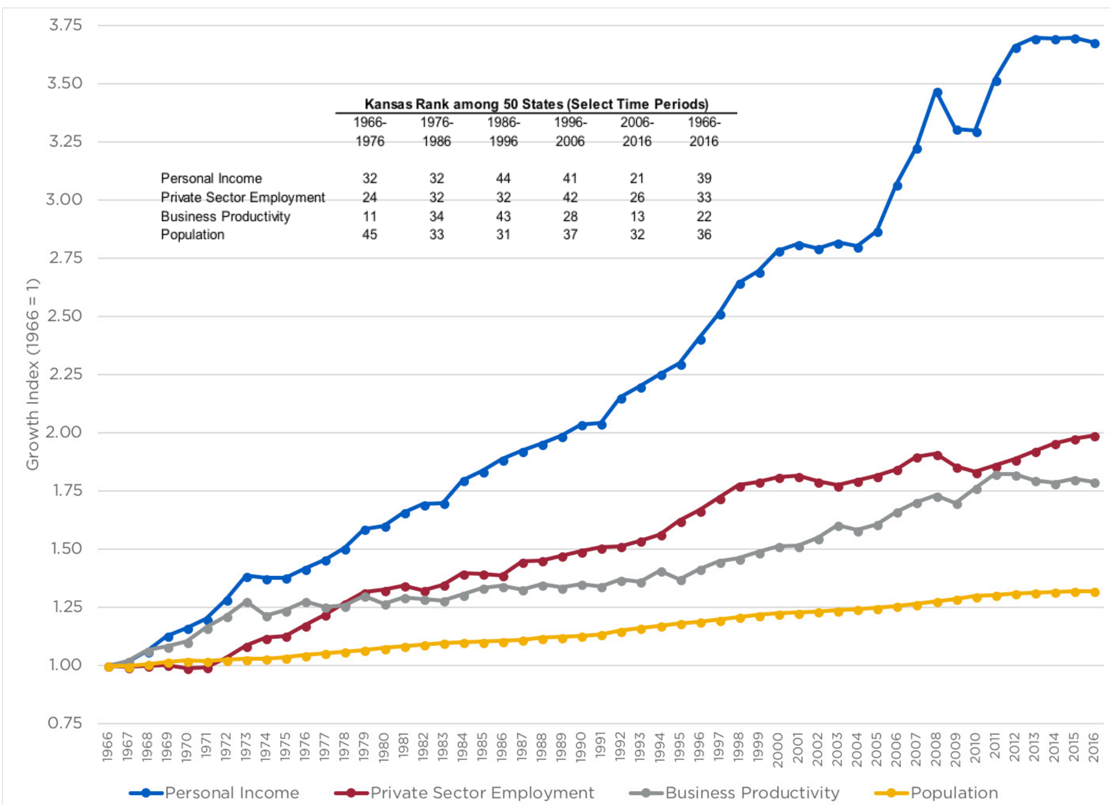
As discussed at the outset of this report, to combat persistent trends of slow economic growth and rural depopulation, Governor Brownback sought to formalize through an Economic Development Strategic Plan the campaign commitments he made via the Road Map for Kansas. That strategic plan highlighted several metrics that the Brownback administration wanted to improve (and be held accountable for).[74] They included growth of:

- Income
- Private Sector Employment
- Business Productivity
- Population
- Capital Investment
- Gross Business Starts and Expansions

A Persistent Trend of Slow Economic Growth

Chart A1 illustrates the relative growth trends in the first four of these metrics—Income, Employment, Business Productivity, and Population—over the past 50 years of available data. Kansas has experienced long-term growth in each metric, but the table embedded in the chart shows that the Kansas growth rates do not rank particularly well when compared with the other 49 states. Over the entire 50-year period, Kansas ranked among the bottom third of states for each

Chart A1: Relative Growth Trends for Select Economic Metrics Related to Governor Brownback's Economic Development Strategic Plan (2016$), 1966-2016

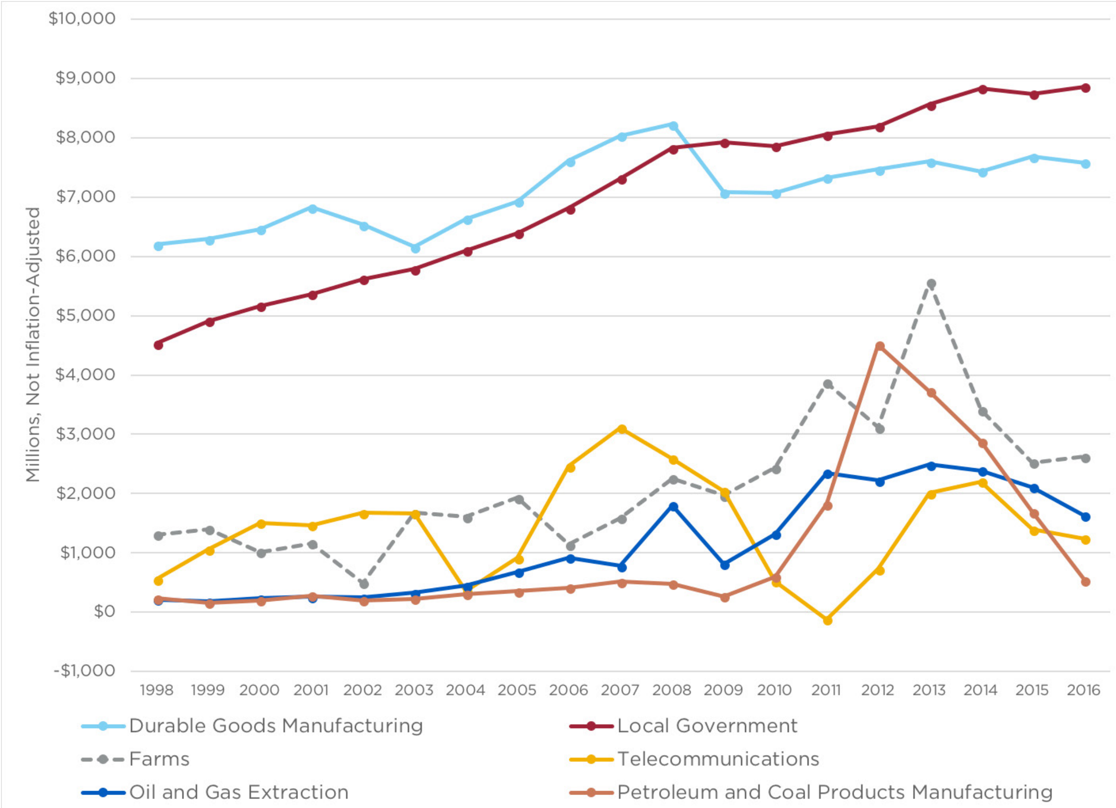


Kansas Rank among 50 States (Select Time Periods)	1966-1976	1976-1986	1986-1996	1996-2006	2006-2016	1966-2016
Personal Income	32	32	44	41	21	39
Private Sector Employment	24	32	32	42	26	33
Business Productivity	11	34	43	28	13	22
Population	45	33	31	37	32	36

Source: U.S. Bureau of Economic Analysis; author's calculations.
Note: Business Productivity = Private Sector GDP ÷ Private Sector Employment

74 Brownback Administration, "Governor and Lt. Governor Release Strategic Plan," Press Release, February 10, 2011. For a copy of the strategic plan (accessed November 2017), see: http://worldonline.media.clients.ellingtoncms.com/news/documents/2011/02/10/Strategic_Eco_Devo_Plan.pdf

Chart A2:
Earnings in Select Industry Sectors, 1998-2016



Source: U.S. Bureau of Economic Analysis.
Note: "Earnings" is the sum of three components of personal income—wages and salaries, supplements to wages and salaries (primarily payroll taxes and fringe benefits), and proprietors' income. The year 1998 marks the date of new data definitions.

metric, except Business Productivity growth. (Capital investment at the state level is extremely difficult to capture in a long-run historical context, so it is not included. Gross business starts and expansions are metrics better dealt with independently; see below.)

The relative growth trend of the Personal Income metric helps support the claim that Kansas has had a relatively slow-growing economy. Using the year 2016 as an end date, Kansas ranked 39th among the states in terms of the growth of personal income over the past 50 years. On a decade-by-decade basis, Kansas ranked among the bottom 20 states for the two decades from 1966 to 1986 and it ranked among the bottom 10 in the two decades from 1986 to 2006. However, Kansas broke into the top half of states (at a rank of 21) for the decade 2006 to 2016. On a year-over-year basis, the growth of Kansas personal income broke into the top-ten of states only seven times. Two of those times occurred around 1980. The other five occurred between 2006 and 2016, three times during the Sebelius Administration and two times during the Brownback Administration. These more recent five examples of unusually rapid annual personal income growth resulted from unique economic events.

Chart A2 captures the time trends that defined the unique events. During the Sebelius Administration, events in four industry sectors help explain the rapid increase in personal income from 2005 to 2008. First, rapid earnings growth in the telecommunications industry from 2004 to 2007. Second, strong year-over-year earnings growth in durable goods manufacturing from 2004 to 2007. Third, strong year-over-year earnings growth in farming from 2006 to 2008. Fourth, a spike in earnings in the oil and gas industry in 2008 (the year average crude oil prices reached almost $100 per barrel and average natural gas prices, at the wellhead, reached almost $8 per million cubic feet).

As Chart A2 illustrates, some of these trends persisted into the Brownback era. Others reversed themselves. And some new anomalies arose.

Two factors offer the primary explanation for the steep decline in personal income from 2008 to 2010. First, a plunge in the earnings in the telecommunications industry from 2007 to 2011.[75] Second, a sharp decline in the earnings in the durable goods manufacturing from 2008 to 2009 (followed by a slow-growth trend that left earnings in that sector below 2008 levels).

During the Brownback administration, four primary factors drove the rapid increase in personal income from 2010 to 2013. First, a major surge in petroleum refining earnings from 2010 to 2012. Second, another major spike in farm earnings from 2010 to 2013. Third, a rapid increase in the earnings of the oil and gas industry from 2010 to 2013. Fourth, a rebound in telecommunications-sector earnings from 2011 to 2014. (Chart A2 includes earnings in the Local Government sector to create a useful reference point for a forthcoming discussion about population and fiscal policy.)

By 2016, the earnings in these various industry sectors had declined from unusually high levels after the episodes of atypical growth—declines that help explain the slow growth of Kansas personal income after 2013. The declines in the earnings of the Farm and Oil and Gas sectors became key talking points in the budget debates of 2016 and 2017. During the years of decline, the state government's revenue estimating group consistently overestimated tax revenue from these sectors, which contributed to mismatches between expected revenues and legislated spending commitments.[76]

The post-2013 slowdown in personal income growth shown on Chart A1 happened even though private sector employment grew; a fact that also helps to explain the slow growth of business productivity during the same time. For the 50 years from 1966 to 2016, private sector employment in Kansas grew at an average annual rate of 1.38 percent. During the Brownback era (2011 to 2016), private sector employment grew at virtually the same 50-year average annual rate, but, for reference, faster than the 2003 to 2007 average of 1.17 percent (the Sebelius era, excluding the periods of recession). From 2003 through 2016, compensation per private sector employee grew at a stable rate (with only a slight decline between 2008 and 2009). However, business profits did not follow a stable growth trend; their growth rate slowed substantially beginning in 2011. From 2003 to 2011, business profits (not adjusted for inflation) per private sector employee grew at an average annual rate of 5.5 percent; from 2011 to 2016, they grew at a rate of 0.07 percent. This fact explains the different business productivity trends during the Sebelius and Brownback eras (as illustrated on Chart A1).

A Persistent Trend of Economic Regionalization

Population trends in Kansas have two important dimensions, time and space. Chart A1 illustrates the time dimension. Map 1 illustrates the space dimension. The space dimension has more relevance for the fiscal history of Kansas.

Kansas has a relatively small population living in a relatively large geographic area. Kansas ranks 34th among the states in population level but 15th among the states in square miles of space. The state's approximately 2.9 million residents represent about 0.9 percent of the nation's population.

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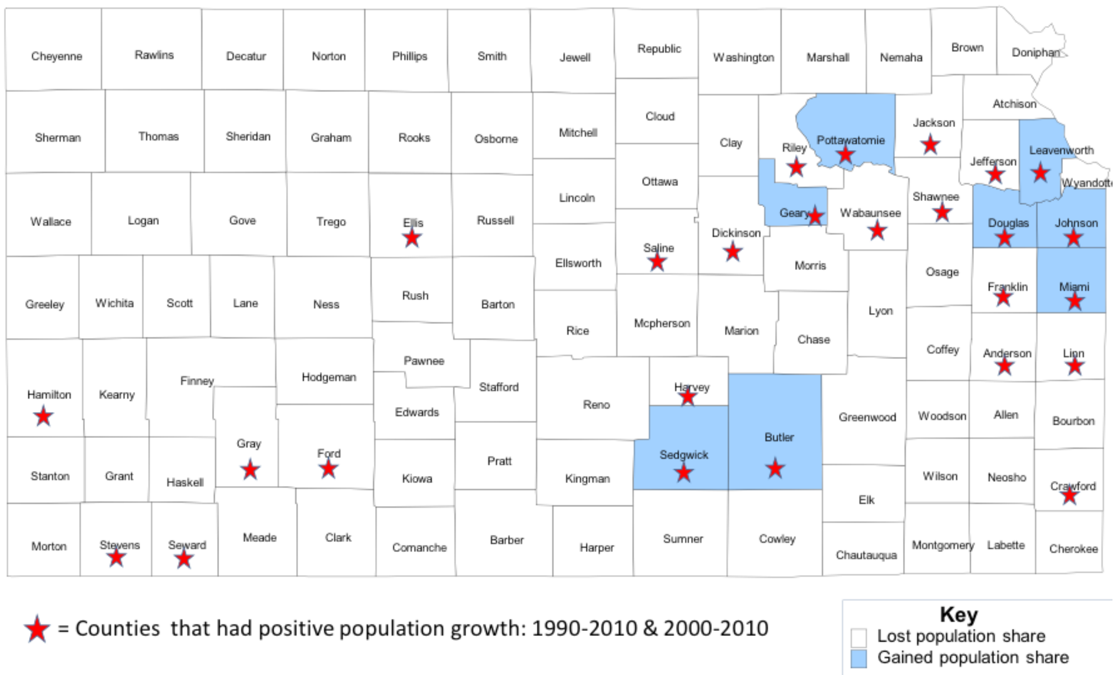
75 Kansas has many firms operating in what the U.S. Bureau of Economic Analysis defines as the Telecommunications sector. However, the Sprint Corporation, with its headquarters in the Kansas City metro area, has a substantial presence in that sector. Sprint initiated layoffs in the range of 15,000 people from 2007 through 2010, but there are no public data quantifying how many of those employees laid off resided in Kansas. See two articles in the *Kansas City Business Journal*: "A Timeline of Sprint's Performance, Layoffs," January 26, 2009; and "Sprint Nextel Isn't Planning More Layoffs, at Least for Now," February 10, 2010.

76 Kansas Division of the Budget, *The Governor's Budget Report, Fiscal Year 2018*, Vol. 1, p. 20.

Map 1:
Kansas Counties that Increased their Share of State Population in each period: 1960-2010, 1990-2010, 2000-2010



Source: U.S. Census Bureau; author's calculations.

Chart A1 illustrates the slow but persistent growth rate of the Kansas population. Despite this persistent growth, Kansas, for at least the past three decades, has also experienced a small but persistent degree of net out-migration.[77] Governor Brownback's strategic economic development plan sought to reverse this long-running trend by generating the conditions that would promote net in-migration.

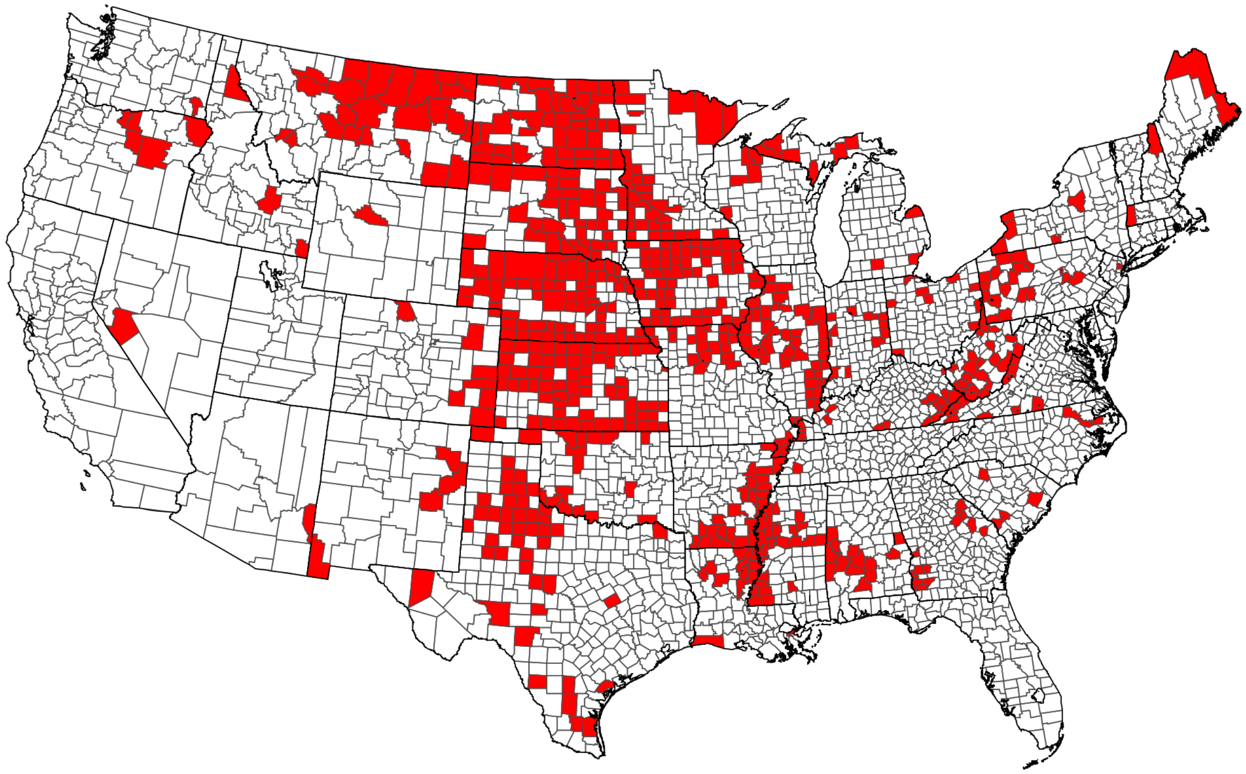
However, Governor Brownback's strategic plan placed a much greater policy emphasis on supporting rural communities that had experienced persistent de-population. The design of Map 1 illustrates the underlying population issue in terms of both time and space. It shows the counties that have experienced persistent increases in the share of the Kansas population (the shaded counties). It also shows the counties that have experienced persistent population growth from the 1990 census through the 2010 census. Only eight of the state's 105 counties have experienced persistent increases in relative population levels over the past five censuses; only 26 counties have experienced population growth over the past two censuses. All of the remaining counties have experienced persistent depopulation—which is a situation characteristic of the Great Plains states in general, as Map 2 illustrates.

The depopulation of communities across the state of Kansas relates to the fiscal history of Kansas in two fundamental ways. First, small population centers widely dispersed across large rural geographies increase the expense of delivering public services like roads, health care, and education. In Kansas, the transportation budget often competes rigorously with other priorities. During the Brownback era, the viability of rural hospitals became a key talking point in the debate over Medicaid expansion and the Kansas Supreme Court ruled that the public education funding formula did not meet the Court's constitutional test for "equity," in part

77 See, for example, Arthur P. Hall, Scott Moody, and Wendy Warcholik, "The County-to-County Migration Patterns of Kansas Taxpayers, 1985-2004," Research Report, Kansas, Inc., October 2006. This report relied on U.S. Internal Revenue Service data. More recent data (through the 2015 tax year) show that the out-migration trend persisted.

Map 2:

Map of All U.S. Counties that Experienced Population Decreases in each period: 1960-2010, 1990-2010, 2000-2010



Source: U.S. Census Bureau; author's calculations.

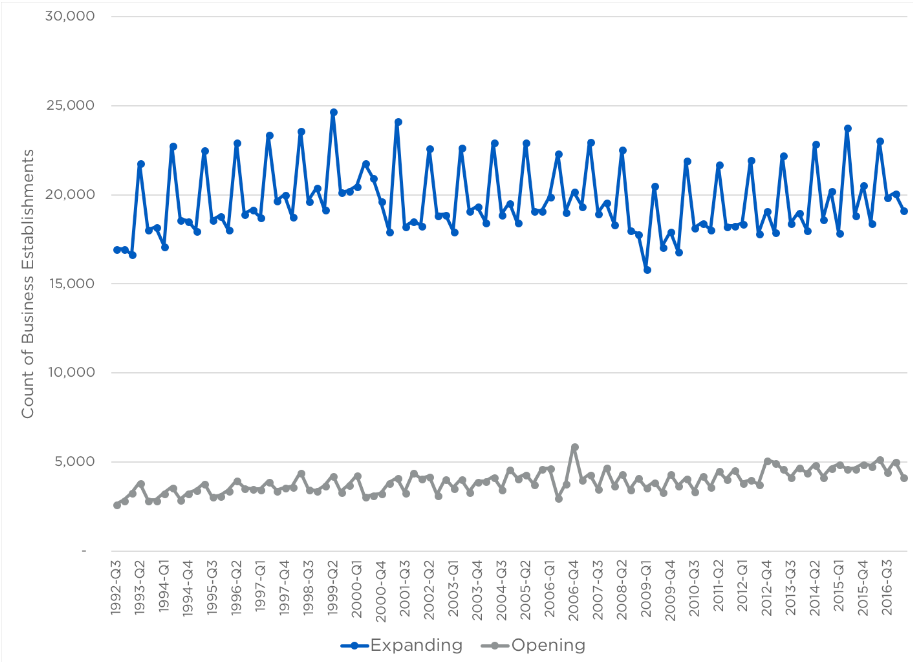
because of the low levels of property wealth among the state's rural areas. Second, after 2009, Local Government became the second largest industry sector in the state of Kansas by earnings (behind the industry sector known as Health Care and Public Assistance). Kansas ranks in the top ten among the states with regard to local government employees per capita—and 60 of the 105 Kansas counties rank in the top quartile of all U.S. counties in terms of local government employees as a share of all wage and salary workers. As a result, many of the rural communities in Kansas also have among the highest property tax rates in the state. (See Appendix B.)

A Brief Analysis of Gross Business Starts and Expansions

Without the opening of brand new business establishments, Kansas (and the United States) would almost always experience negative job growth.[78] That fact explains why Governor Brownback selected gross business openings as a key metric in his Economic Development Strategic Plan. He also included business expansions because employment growth occurs when the number of people employed by brand new businesses and expanding business exceeds the job loss from business closings and business contractions. In any given year, the count of job gains and job losses have a high level of symmetry.

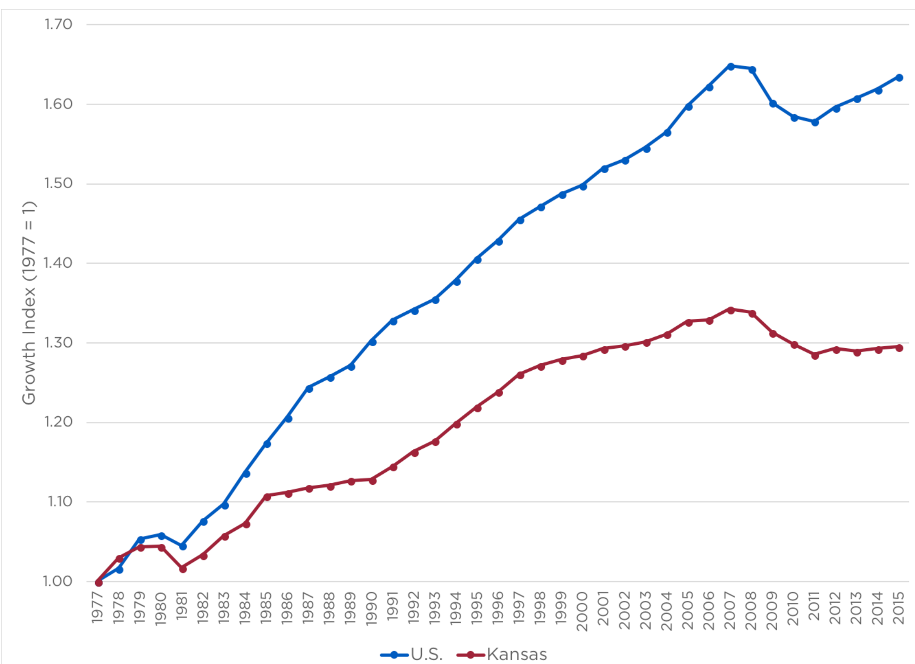
78 See, for example, Arthur P. Hall, "Economic Development Data for Select Regions of Kansas," December 2015. An unpublished manuscript available from the author upon request. More generally, see the Business Dynamics Statistics published by the U.S. Census Bureau. https://www.census.gov/ces/dataproducts/bds/

Chart A3: Count of Kansas Business Establishments Opening and Expanding Employment, 1992-Q3 to 2017-Q1



Source: U.S. Bureau of Labor Statistics; author's calculations

Chart A4: Growth of Business Establishments, Kansas vs. United States, 1977-2015



Source: U.S. Census Bureau; author's calculations.

Chart A3 shows the number of business establishments opening and expanding on a quarterly basis. The pattern of variation during the Brownback era does not look different from the long-term trends (especially when accounting for the effects of the 2008 economic recession, which had its strongest impact on business expansions in the first quarter of 2009). However, the average number of business openings from 2012 forward (the date of Governor Brownback's first round of tax reforms) is noticeably higher—according to the data about 820 businesses per quarter higher when compared to the average of the preceding quarters (and excluding the quarters marked by the economic recession). This timing is suggestive, but it is difficult to know how much the changes to tax policy caused the higher average number of business openings.[79] (The average number of business expansions was also higher by a count of 51.)

The economic development challenge arises from the relatively high statistical correlation between business openings and closings and business expansions and contractions. Not surprisingly, for example, the average number of business closings post-2012 is about 750 businesses higher than the non-recessionary quarters preceding 2012. (The average number of business contractions post-2012 was about 100 businesses higher than the non-recessionary

79 The data in Chart A3 and Chart A4 account for businesses with employees. So-called non-employer business would have benefited from Governor Brownback's zero-income-tax-rate reforms. The U.S. Census Bureau tracks these types of businesses. However, an analysis of the data does not reveal a break in trend in the growth of non-employer businesses. See the data at: https://www.census.gov/programs-surveys/nonemployer-statistics.html

quarters preceding 2012, outnumbering by about 50 the average number of business expansions.)

Chart A4 compares the relative growth rates for Kansas and the United States of the total number of operating business establishments. As with most other economic metrics, the growth rate for Kansas almost always lags the growth rate for the nation. The 2008 recession clearly had a negative impact on the number of business in both Kansas and the nation, but Kansas did not resume a positive growth rate.

Table A1 provides additional perspective. For the entire time period covered by Chart A4, 1977 to 2015, Kansas ranked 45th among the states in the growth rate of business establishments. In certain (arbitrary) time periods, it has performed better than 45th, but it almost always ranks among the bottom-15 states.

Table A1
Rank among the 50 States in the Growth Rate of Kansas Business Establishments, Select TImeframes

Timeframe	Rank
1977-1987	44
1987-1997	37
1997-2007	40
2008-2015	30
2011-2015	37
1997-2015	45

Appendix B: A Brief History of Property Taxes in Kansas

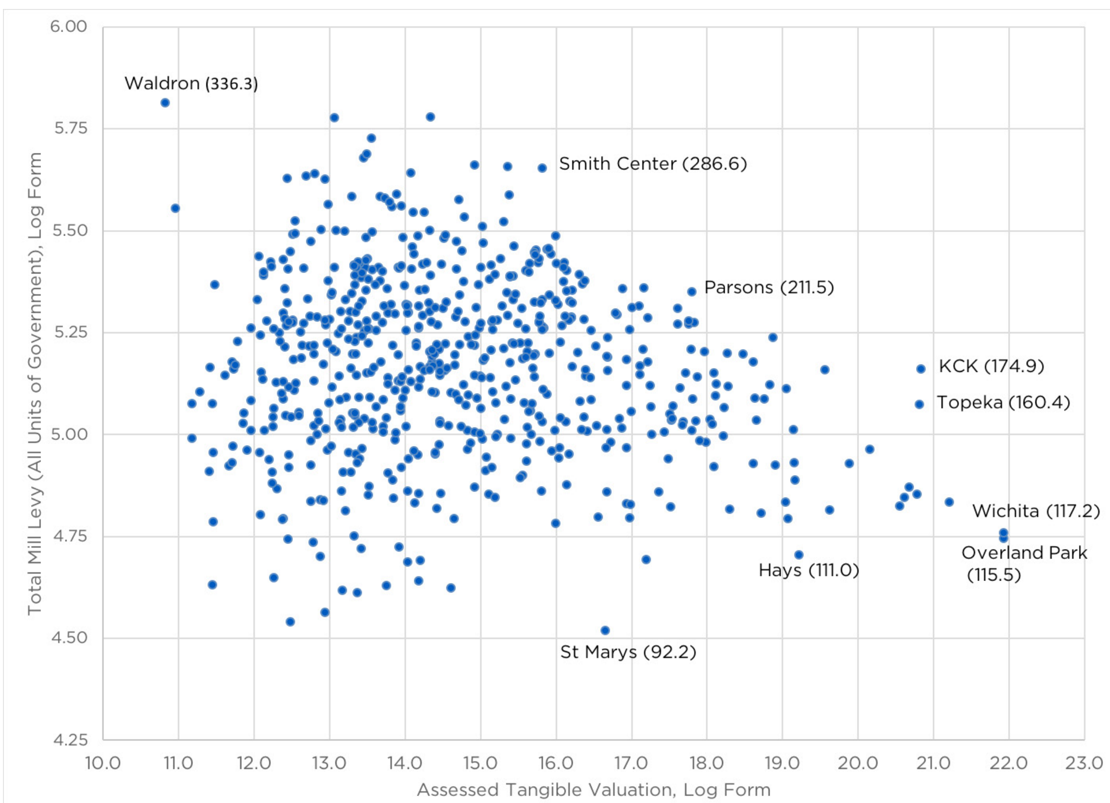
In Kansas, the property tax system has three fundamentally interrelated components: tax rates, assessment rates, and property values. Analysts often refer to property tax rates as millage rates, or mills, because the rate applies to every $1,000 of assessed value. Assessment rates define the assessed value—or the fraction of a property's appraised market value subject to the millage rate. Appraisers must estimate property values; they typically rely on applications and extrapolations of the prices for which comparable properties have sold in the open marketplace.

The Constitution of Kansas specifies the assessment rates that apply for particular classes of property. So, as a practical matter, absent an amendment to the Constitution, appraisals on property and the mills established by various governmental entities determine the variability of property tax burdens among taxpayers in Kansas.

Property Tax Burdens

Chart B1 illustrates the wide variation in total property tax rates levied across the cities of Kansas. St. Marys is a small city in between Topeka and Manhattan, Kansas. Waldron is a tiny city on the Kansas-Oklahoma border. The Constitution of Kansas specifies that homestead property must be assessed at 11.5 percent of appraised value; commercial and industrial properties must be assessed at 25 percent of appraised value. Kansas law provides for an exemption of the

Chart B1:
Property Tax Rates (Mills) and Assessed Tangible Valuations, All Kansas Cities, 2016



Source: League of Kansas Municipalities; author's calculations.
Note: Numerical data presented in natural log form to compare the wide variation in the magnitude of both assessed valuation and millage rates. It creates a more visually convenient picture. For the cities identified, the number in parentheses equals the total mills levied by all units of government. Overland Park and Wichita have assessed tangible valuations of about $3.3 billion; Waldron about $49,000.

first $20,000 of homestead valuation. So, in St Marys, a home worth $100,000 would pay property tax of $848 [($100,000-$20,000) x 0.115 x (92.2/1000)]; a $100,000 business property would pay $2,305. In Waldron, the same properties would pay, respectively, $3,094 and $8,407—or about 265 percent more than the liability in St. Marys. As Chart B1 indicates, those payments represent the extreme low and extreme high, with much variation in between. On a weighted average basis, with assessed tangible valuation used for calculating the weights, Kansans bore total mills of 139.2 in 2016, or 13.9 percent of assessed value.

Kansas has a storied history with the administration of its property tax—most of it related to the property appraisal process. The Constitution of Kansas (Article 11, Section 1) requires the Legislature to provide for a property tax system that has "a uniform and equal rate of assessment and taxation," a requirement that necessarily presumes accurate property appraisals.

Until comprehensive appraisal-related reforms implemented in the late 1980s, Kansas had a poor historical record with regard to the uniform and equal requirement mandated by the Constitution. For example, widespread discontent with the administration of the property tax resulted in a 1953 law that established the Kansas Citizens Commission on Assessment Equalization. Commenting on the November 1954 report from that Commission, John D. Garwood, Professor of Economics at Fort Hays State University, said: "The findings cogently point up the fact that the inequities resulting from faulty assessment throughout all levels of government in the state have completely undermined the property tax structure. The decadence found in the administration of the tax was worse than the critics had alleged."[80] Matters did not improve much following the Commission's 1954 report—until the situation created enough political pressure over the next three decades to culminate in the major reforms built into a 1986 constitutional amendment that the state government implemented in 1989.[81]

From a property tax administration perspective, the uniform-and-equal challenge had two moving parts. First, on a statewide basis, the appraised value of properties fell way below the prices at which similar properties sold on the open market, and a sales price offers the best available metric for identifying "true market value," the baseline tax base related to property taxation. Second, the appraised values varied enormously among similar types of properties. To put the matter in concrete terms, in 1985, the year marking the initiation of long-sought reforms, a residence—in the median case of a large statistical sample of home sales—appraised for 10 percent of its recorded sales prices. Compounding on that administrative deficiency: the appraised values surrounding the median case varied by 51 percent (where the ideal measure of variation equals zero percent).[82] That wide variation meant, for example, that two Kansas families living in a house with a $100,000 market value in different political jurisdictions with identical property tax rates could bear a property tax burden that differed by 51 percent.

Once these basic administrative inadequacies of the appraisal process became a part of taxpayers' expectations, it became politically difficult to change the system, because widespread reappraisals had the practical effect of shifting tax burdens. And shift they did—once the state implemented the reforms in 1989. A comparison of the 1985 and 1990 property tax burdens on hypothetical (but identical) properties revealed homesteads experienced property tax increases of 357 percent; commercial properties experienced increases of 298 percent; and industrial properties experienced increases of 44 percent.[83] Furthermore, the post-reform tax burden increases tended to persist. (Political folklore in Kansas says that the taxpayer jolt associated with these property tax increases made Governor Mike Hayden a one-term governor.[84] Indeed, Governor Joan Finny, who won

80 John D. Garwood, "The Kansas Citizens Examine Their Property Tax," *National Tax Journa*l, Vol. 9(3), 1956, p. 260.
81 Glenn W. Fisher, "The History of the Property Tax in Kansas," in Report of the Governor's Tax Equity Task Force, State of Kansas, December 1995, pp.117-127.
82 Arthur P. Hall, "Property Tax Comparisons among Kansas Localities and Select Cities of the United States," Kansas, Inc. Research Report, May 2006, pp. 9-10.
83 *Ibid.*, Tables 4-6
84 The author has heard this folklore expressed in many different conversations. Also see, Glenn W. Fisher, *The Worst Tax? A History of the Property Tax in America* (University of Kansas Press, 1996), p. 181.

the election against Hayden, had this to say in her first budget document: "The Governor's top budget priority is for meaningful property tax relief."[85])

A Summary of Kansas Property Tax Law

As discussed above, the Constitution of Kansas requires the legislature to "provide for a uniform and equal rate of assessment and taxation." It also provides a list of items that are exempt from property taxation and gives the Kansas legislature the authority to classify separately specific items of property (so long as the items are taxed uniformly by class). The "uniform and equal" requirement applies to the definition of the property tax base; local units of governments within Kansas may set their own tax rates—unless restricted by State statute. Throughout much of Kansas history, such restrictions took the form of so-called property tax lids.

<u>Laws related to the state and local property tax base:</u>

- From January 1964 through 1988, Kansas law said that "all real and tangible personal property which is subject to general property taxes shall be assessed uniformly and equally at thirty percent (30%) of its justifiable value."

- In November 1964, the citizens of Kansas amended the Constitution to exempt "household goods and personal effects not used for the production of income."

- In 1985, a law passed that required the reappraisal of real property. A related amendment to the Constitution of Kansas passed in November 1986 that established a substantial new property classification system. The application of the new classification system and the results of reappraisal took place in January 1989. The new classification system implemented the following schedule of assessment percentages (abbreviated here):
  - Single- and multi-family residential property: 12%
  - Real commercial and industrial property: 30%
  - Commercial and industrial machinery and equipment: 20%
  - Merchant's and manufacturer's inventories: Exempt

- In 1992, an amendment to the Constitution of Kansas modified, effective January 1993, the 1989 schedule of assessment percentages as follows:
  - Single- and multi-family residential property: 11.5%
  - Real commercial and industrial property: 25%
  - Commercial and industrial machinery and equipment: 25%

- In 1997, the Kansas legislature passed a law (K.S.A. 79-201x) to allow for a $20,000 exemption for homesteads from the statewide school levy (20 mills, beginning in 1998).

- In 1998, the Kansas legislature passed a law (K.S.A. 79-32,206) to allow for an income tax credit against property tax paid on commercial and industrial machinery and equipment. Per a 2002 amendment, the credit equaled 20 percent of the property tax paid on this sub-class of personal property. The income tax credit was a "refundable" credit, meaning that a taxpayer received the entire sum due, even if it resulted in a negative income tax liability. This income tax credit expired in 2011 (per 2011 SB 196).

- In 2006, HB 2583 became law. This legislation exempted from property taxation newly acquired business machinery and equipment. According to the public finance principles recited by Governor Graves' Tax Equity Task Force (at the start of the tax policy section of this report), this exemption served to erode the tax base—the first major property tax-related "tax expenditure" for business since the exemption of business inventories in 1989. Yet, the exemption

85 Kansas Division of the Budget, *The Governor's Budget Report*, Vol. 1, Fiscal Year 1992, p. 4.

had a clear, "economically meritorious criteria." As stated in the first paragraph of the bill:

> It is the purpose of this section to promote, stimulate, foster and encourage new investments in commercial and industrial machinery and equipment in the state of Kansas, to contribute to the economic recovery of the state, to enhance business opportunities in the state, to encourage the location of new businesses and industries in the state as well as the retention and expansion of existing businesses and industries and to promote the economic stability of the state by maintaining and providing employment opportunities, thereby contributing to the general welfare of the citizens of the state, by exempting from property taxation all newly purchased or leased commercial and industrial machinery and equipment, including machinery and equipment transferred into this state for the purpose of expanding an existing business or for the creation of a new business.

<u>Laws related to property tax lids:</u>

Legislated limits on property tax levies date back almost to Kansas statehood. The Kansas Legislative Research Department has summarized the early history this way:[86]

> Tax levy limits were adopted as early as 1868 and a graduated scale of levy limits was enacted in 1909. In 1933 the legislature established an overall aggregate levy limitation system for all local units of the state. The limitation laws were rewritten in 1941, and subsequently amended on numerous occasions. Limitations on levies of counties, cities, and townships were recodified in the 1970 Session and further amended in 1973 and 1975.
>
> Legislation enacted in 1970 imposed a temporary "lid" on property tax levies and operating budgets of counties, cities, unified school districts and community colleges in tax years 1970, 1971, and 1972. As reenacted in 1973 with no expiration date, the tax lid law applied to counties, cities, and community colleges; there were no budget controls in the 1973 law, but school districts and community colleges were made subject to budget controls in other laws. Community colleges were exempted from the tax lid in 1977, and their budget controls were eliminated in 1981.
>
> In 1977 the Attorney General issued two opinions which held that, because of nonuniformity of application of the tax lid law, both cities and counties could, by charter ordinance or resolution procedure, exempt themselves from all or part of the tax lid law.
>
> An exemption from the lid sufficient to replace intangibles taxes repealed or reduced by an election was enacted in 1979. The tax lid was further amended in 1983 to prevent a loss of tax authority following the exemption of farm machinery and business aircraft.

In the modern era of Kansas tax policy, the state government has implemented three property tax limitation measures, one in 1989, one in 1999, and one in 2015. A brief summary of each enactment follows:[87]

The 1985 law mandating statewide reappraisal of property also contained a property tax lid provision to prevent localities from reaping a windfall from reappraisal. The law took effect in 1989. As amended in 1990, the law allowed taxing subdivisions to choose a base year of 1988 or 1989. Once a subdivision chose a base year, it could not collect more in aggregate property taxes than it collected in the base year. The law allowed taxing subdivisions to exempt themselves from the lid by passing ordinances or resolutions. The law also provided for specific exceptions:

1. Principal and interest upon state infrastructure loans, bonds, temporary notes, no-fund war-

86 Kansas Legislative Research Department, *Kansas Tax Facts*, 6th Edition, November 1993, p. 83.
87 The summaries draw significantly from: Mike Heim, "Kansas Tax Lids: A Lengthy History," Memorandum, Kansas Revisor of Statutes Office, October 9, 2015.

rants and payments made to a public building commission;
2. Judgments, settlements and expenses for protection against liability to the extent such expenses are authorized by article 61 of chapter 75 of the Kansas Statutes Annotated;
3. Employer contributions for social security, workers compensation, unemployment insurance, health care costs, employee benefit plans and employee retirement and pension programs;
4. Expenses incurred by counties for district court operations and expenses incurred by counties for the detention of juveniles; or
5. Expenses incurred by counties for payment of out-district tuition to community colleges and expenses incurred by counties and townships for payment of out-district tuition to municipal universities.

In 1999, a law passed that replaced the 1989 tax lid (actually the Legislature allowed the 1989 law to sunset).[88] The new law carried the moniker "Truth in Taxation" and suspended all tax limits. In brief, the new law required taxing subdivision—other than school districts or community colleges—to adopt an ordinance or resolution announcing to its taxpayers a budget increase funded by property taxes that increased property taxes by more than the property taxes in the immediately preceding year. The law required no ordinance or resolution if the revenue increase from property taxes was due to any of the following:

1. New improvements to real property;
2. Increased personal property valuation, other than increased valuation of oil and gas leaseholds and mobile homes;
3. Property located within added jurisdictional territory;
4. Property which has changed in use;
5. Tax as levied for the sole purpose of repayment of the principal of and interest upon bonded indebtedness, temporary notes and no-fund warrants.

In 2014, an amendment to the law changed the requirement from one based on the preceding year's tax level to one based on the rate of inflation, as defined by the consumers price index published by the U.S. Bureau of Labor Statistics. That is, if the property tax-funded budget for a specific year exceeded the budget level of the immediately preceding year by more than the rate of inflation, the governing body had to approve of the budget by majority vote and publish the vote in the newspaper. The same five exemptions remained in place and the amendment added a few more.

The 2015 law (modified by 2016 HB 2088) built on the 2014 amendment to the truth-in-taxation regime. Beginning in 2017, cities and counties (but not other taxing subdivisions) must allow a majority of voters to approve the budget rather than leave the matter to a majority vote of the governing body of a city or county. The new procedure compares budgets to the rate of inflation over the preceding five years. Simply stated, the lid says:

- Increases in property tax dollars levied beyond the change in the CPI for the preceding five years require voter approval.

- The inflation measure is a five-year rolling average of the consumer price index, and cannot be less than zero.

As with past property tax lids, the new law provides for a substantial list of exceptions.

Governor Brownback, as part of his 2016 State of the State Address, supported the new property tax lid. He said:[89]

> Since 1999, when the property tax lid was lifted, Kansans have seen those tax rates increased by 24 percent, and property tax revenue increase by 92%.

---

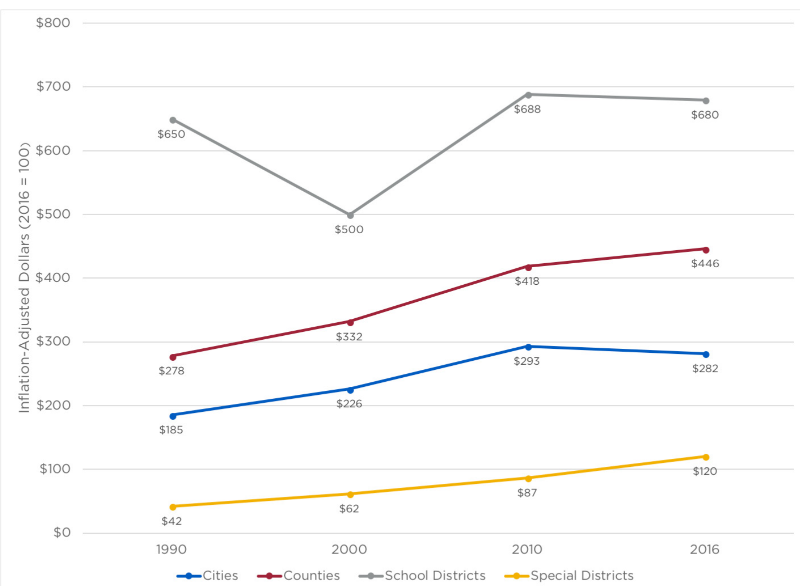
88 Lifting of the lid also affected school funding; the 1992 School District Finance and Quality Performance Act had placed a lid on local property taxes dedicated to capital outlays. Removal of the lid became (a small) part of the "equity" issues adjudicated in the (in)famous *Montoy* case: see the Kansas Supreme Court's *Montoy III* ruling (No. 92,032, January 3, 2005).

89 https://governor.kansas.gov/2016-state-of-the-state-january-12-2016/

> Understandably, people do not like this.
>
> Your property taxes should not grow faster than your paycheck.
>
> They carry heavy burdens on all Kansans, especially those living on fixed incomes. Last year, you [the Legislature] acted to place a lid on property taxes. That was a positive step.
>
> The ability to raise taxes at the local level should not be made without consent and input from local citizens.
>
> Voters should have the ability to make their voices heard with an up or down vote on any proposal that raises property taxes in excess of inflation.

Have the Kansas property tax lids worked? The evidence is mixed.

Chart B2:
Property Taxes Per Capita by Taxing Subdivision (2016$)



Source: Kansas Legislative Research Department, "Kansas Tax Facts," Various Years; author's calculations.

One scholarly study that evaluated property tax changes in the 1990s argued that "when school district property tax rates were reduced [by the 1992 school finance act], cities and counties did raise their rates."[90] Another scholarly study, focused exclusively on county governments, thought the evidence indicated: "that in each successive year under the aggregate levy limit [the 1989 law] per capita property taxes declined by $5.16, . . . while under truth in taxation [the 1999 law], per capita property taxes increased by $5.91 . . ."[91]

Sorting out the effects of such measures can present analytical difficulties. As Chart B1 suggests, the large number of taxing jurisdictions using the property tax creates an enormous amount of variation in both rate-setting and the evolution of the tax bases. In addition to that variation, the significant number of exceptions to the law and the costliness of compliance enforcement created opportunities for the law to operate less effectively than intended. As a story in

> the *Topeka Capital-Journal* reported in January of 2000: "A majority of Kansas counties raised property taxes this year despite a new law requiring them to notify the public of the increases."[92]

Despite uncertainty about the actual effectiveness of the property tax lids, Chart B2 illustrates that inflation-adjusted property taxes per capita did increase over the time periods in question. Under the 1989 regime, county-level per capita property taxes increased at an annual average rate of 1.8 percent while city taxes increased at 2.0 percent. Over the following decade, under the truth in taxation regime (2000-2010), county taxes increased at an average annual rate of 2.3 percent and city taxes increased at the rate of 2.6 percent. Those growth rates declined after 2010.

90 Jocelyn M. Johnston, Justin Marlowe, David S.T. Matkin, Michael Hays, "The Impact of Local School property Tax Reductions on City and County Revenue Decisions: A Natural Experiment in Kansas," *Public Finance and Management*, Vol. 11, No. 2, p. 192.

91 Job D. Springer, Aaron K. Lusby, John C. Leatherman, Allen M. Featherstone, "An Evaluation of Alternative Tax and Expenditure Limitation Policies on Kansas Local Governments," *Public Budgeting and Finance*, Summer 2009, pp. 66-67.

92 Roger Myers, "Report: Mill levies up despite 'truth' law," *Topeka Capital-Journal,* January 13, 2000.

Appendix C: Medicaid—The Implementation of KanCare

We are committed to a strong, effective safety net for our most vulnerable Kansans.

Medicaid spending continues to skyrocket, and it continues to place stress on funding for education, public safety, and other essential services. With additional funding cuts expected from the federal government, Kansas must transform Medicaid into a system that improves services while managing costs. Many states have made the choice to either kick people off Medicaid or pay doctors less. Neither of those choices provides better outcomes. Kansas has a better solution.

The Lt. Governor, Dr. Jeff Colyer, and our cabinet team, with input from legislators and more than 1,800 stakeholders, have produced a measured, innovative and compassionate proposal. Unlike the current one-size-fits-all system, we will offer all Kansans a choice of plans that best fit their needs.

Kansans with long-term disabilities will have an integrated care coordinator. Those with developmental disabilities can keep their case manager if they choose. Many disabled Kansans want to work, but are stuck in government programs that provide neither respect nor independence. I propose Kansas be a national leader in helping the disabled find meaningful jobs. All Kansans should have the opportunity to pursue their dreams. With jobs providing an off ramp from Medicaid, we will be able help those in need of services and reduce our waiting list.

For years Medicaid was spread among several cabinet agencies. This year we will continue to make government smaller and better focused by consolidating multiple agencies into a restructured Department of Aging and Disability Services. By running government more efficiently and effectively, we can save money and provide better service.

— Governor Sam Brownback, 2012 State of the State Address[93]

The Medicaid program in Kansas, like many other states, has grown at the expense of other budget categories. Chart 5a and Chart 5b provide the evidence for that claim. Kansas seems unique, however, in how Medicaid spending has grown. Over the past quarter century, Kansas has (relative to other states) limited the growth of its Medicaid-eligible population but spent more per Medicaid recipient. As Governor Brownback stated, Kansas lawmakers have been "committed to a strong, effective safety net for [the] most vulnerable Kansans."

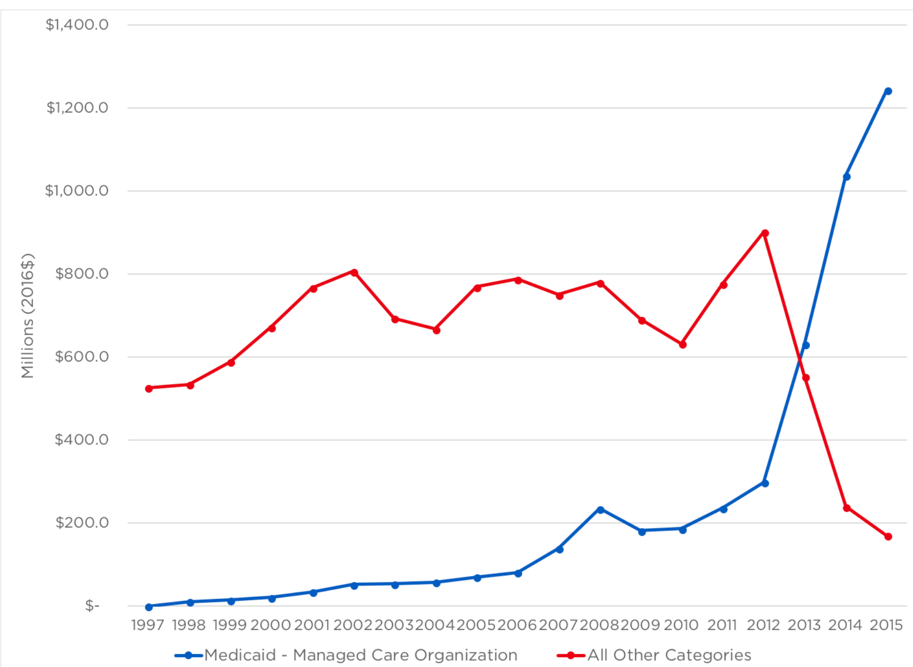
Yet Medicaid-related budgetary expenses continue to rise. The reason seems uncomplicated. The number of Medicaid recipients has continued to increase in absolute terms even though the evidence suggests

93 https://governor.kansas.gov/2012-state-of-the-state/

that, over the past decade, Kansas has managed the growth of expenses per Medicaid recipient (through budget reductions more than reform efforts). Kansas, like other governments and businesses, has searched for solutions to control the growth of health care-related financing. The Brownback administration offered KanCare as its approach to budget control, while striving to maintain and improve the quality of health care services. This appendix discusses the short history of that effort in the context of historical Medicaid spending.

On January 1, 2013, KanCare went live. This program might qualify as another "Brownback experiment"; it defined the first step in the Brownback administration's strategic effort to manage Medicaid outlays comprehensively while simultaneously improving health care outcomes for the Kansas Medicaid population. Lt. Governor Jeff Colyer, an accomplished medical doctor, managed the stakeholder-driven reform process that resulted in KanCare, which moved almost the entire Kansas Medicaid population into one of three different private-sector managed care programs, with strict performance guidelines and a fixed fee per beneficiary.

Chart C1:
State of Kansas Share of Medicaid Spending, Select Categories



Source: Medicaid.gov, Medicaid Budget and Expenditure System/State Children's Health Insurance Program Budget and Expenditure System.
Note: MCO includes Prepaid Ambulatory Health Plan and Prepaid Inpatient Health Plan

The implementation of KanCare required an authorization (known as a Section 1115 demonstration) from the federal government's Centers for Medicare and Medicaid Services. The concept paper describing the KanCare reform, submitted by Kansas in January of 2012, stated that:

> Kansas Medicaid costs have grown at an annual rate of 7.4 percent over the last decade. Long-run trends in Medicaid are driven by widespread increases in enrollment and spending per person. While exacerbated by the economic downturn, Medicaid growth is not just tied to the economy. Kansas is in the midst of a sustained period of accelerated growth as baby boomers reach the age of acquired disability.
>
> Yet the cost drivers in Medicaid are not confined to one service area or population. . . . [T]he projected sources of growth in Kansas Medicaid spending cut across populations. Tackling the structural deficit facing Medicaid cannot be accomplished by excluding or focusing solely on one population or service.[94]

Chart C1 illustrates the practical implication of the KanCare reform program. After 2012, the Medicaid spending category known as Managed Care Organization increased sharply and an aggregated group of 10 other Medicaid spending categories decreased sharply. For the year 2015, the Medicaid spending category Administration accounts for about 37 percent of the Other total; Inpatient Hospital care accounts for another 37 percent. (See Table C1 for additional details.) Notice, too, from Chart C1, that the Kansas Medicaid

94 State of Kansas, Section 1115 Demonstration, "KanCare" Concept Paper, January 26, 2012. Accessed September 2015 at http://www.kancare.ks.gov/download/Kansas_1115_Waiver_Concept_Paper.pdf, p. 1.

program relied to a significant extent on managed care options before the implementation of KanCare. KanCare's intended goal is to shift most persons in the Medicaid program out of fee-for-service operations and into managed care organizations.[95]

Kansas has used managed care throughout the years to help assist many of its Medicaid recipients—just not to the holistic extent offered by KanCare. The federal government's Medicaid.gov website conveniently summarizes the history of Medicaid managed care in Kansas this way: "In 2011, nearly 90 percent of Medicaid beneficiaries were enrolled in managed care. Kansas first introduced managed care in 1985 through HealthConnect, a primary care case management program (PCCM) available statewide on a mandatory basis for all Medicaid beneficiaries, except dual eligibles and foster children. HealthConnect enrollees can receive a variety of services coordinated through a designated primary care provider, including acute, primary, and specialty care, plus behavioral health, pharmacy, dental, and transportation services. In 1995 the state expanded managed care through HealthWave 19, a comprehensive risk-based program, which primarily enrolls low-income children and parents and covers acute, primary, and specialty care, pharmacy, and transportation services. In 2006, the state also began contracting with separate managed care organizations to provide mental health and substance abuse services to most Medicaid eligibility groups on a prepaid basis. In addition, Kansas has operated a Program for All-Inclusive Care for the Elderly (PACE) since 2002, which covers all Medicare and Medicaid acute care and long term services and supports to individuals aged 55 and older who meet a nursing home level of care [but delivers that care in the home or community instead of a nursing home]."[96]

KanCare superseded the former initiatives. The overriding aspiration of the KanCare reform reasoned that a more integrated approach to holistically caring for Kansas Medicaid beneficiaries will reduce long-term costs by focusing on health quality. As the KanCare concept paper stated: "focusing only on costs, to the exclusion of quality and outcomes, would be counterproductive. Kansas Medicaid historically has not been outcomes-oriented. The input the State has received from stakeholders and the public has validated the need for increased accountability in the services the State provides, and for a new level of investment in prevention, care coordination, and evidence-based practice."[97] Lt. Governor Jeff Colyer stated the same theme in a pragmatic way: "The goal is to get [Medicaid beneficiaries] better care, so instead of ending up at the hospital six times a year, maybe they're only in the hospital three or four times, and we can make sure that we are saving money that way, through better outcomes."[98]

Kansas Medicaid Spending in the Context of Other States

States must meet certain federal government guidelines in order to receive Medicaid matching funds from the federal government. However, states also have considerable autonomy with regard to the structure of their Medicaid offerings. As a result, each state has its own intricate details related to the operation of its Medicaid program.

Nevertheless, from the perspective of a state's fiscal history, Chart C2 illustrates one way to synthesize the state-by-state differences—and to understand why Medicaid has generally become a dominate factor in state budget planning. The chart plots the relationship between two different metrics: (1) the percentage point change in a state's Medicaid users, as a fraction of the state's population, in 2011 compared with 1991 and (2) the percentage point change in a state's Medicaid

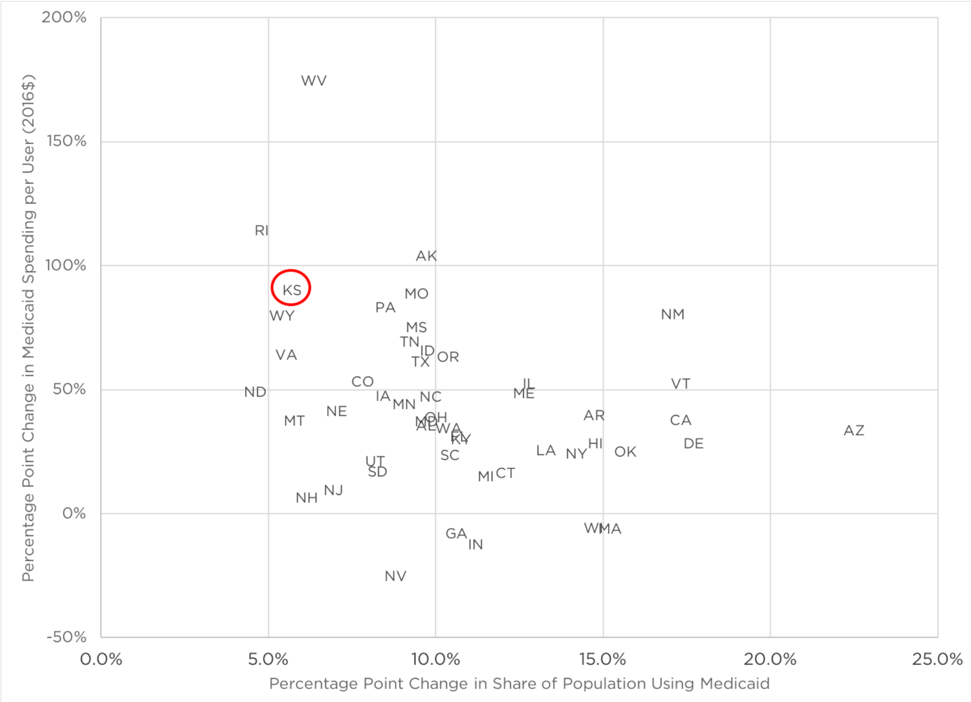
95 For a list of exceptions, see Kansas Health Institute and Kansas Legislative Research Department, "Kansas Medicaid: A Primer," January 2014, p. 23.

96 http://www.medicaid.gov/medicaid-chip-program-information/by-topics/delivery-systems/managed-care/downloads/kansas-mcp.pdf

97 State of Kansas, Section 1115 Demonstration, "KanCare" Concept Paper, January 26, 2012. http://www.kdheks.gov/hcf/medicaid_reform_forum/download/Kansas_1115_Waiver_Concept_Paper.pdf, p. 2.

98 http://khn.org/news/kansas-medicaid-managed-care-brownback-kancare/

Chart C2:
Changes in State-by-State Medicaid Users and Per-User Spending, Fiscal Year 2011 versus 1991



Sources: *Medicaid spending*: National Association of State Budget Officers. These data are proprietary to the National Association of State Budget Officers, and have been modified by the author. *Medicaid users: 1993 Statistical Abstract of the United States*, p. 112; Centers for Medicare and Medicaid Services. *Population:* U.S. Bureau of Economic Analysis.
Note: User is defined as "persons who had payments made on their behalf at any time during the fiscal year."

spending per user, in constant 2016 dollars, in 2011 compared with 1991. (The analysis uses 2011 instead of a more recent year because 2011 seems to mark the termination date of a consistent, long-running state-by-state data series on Medicaid users. After 2011, data reporting shifts to an emphasis on counting eligible persons or enrollees instead of users; Medicaid enrollees may or may not use the service in a given fiscal year and some users may have retroactive access to Medicaid even if not currently enrolled. More generally, with managed care programs like KanCare, the distinction between "users" and "enrollees" becomes outmoded, because the Medicaid system would count all enrolled beneficiaries as "users," regardless of monthly utilization, since the state makes monthly capitation payments to the managed care providers.)

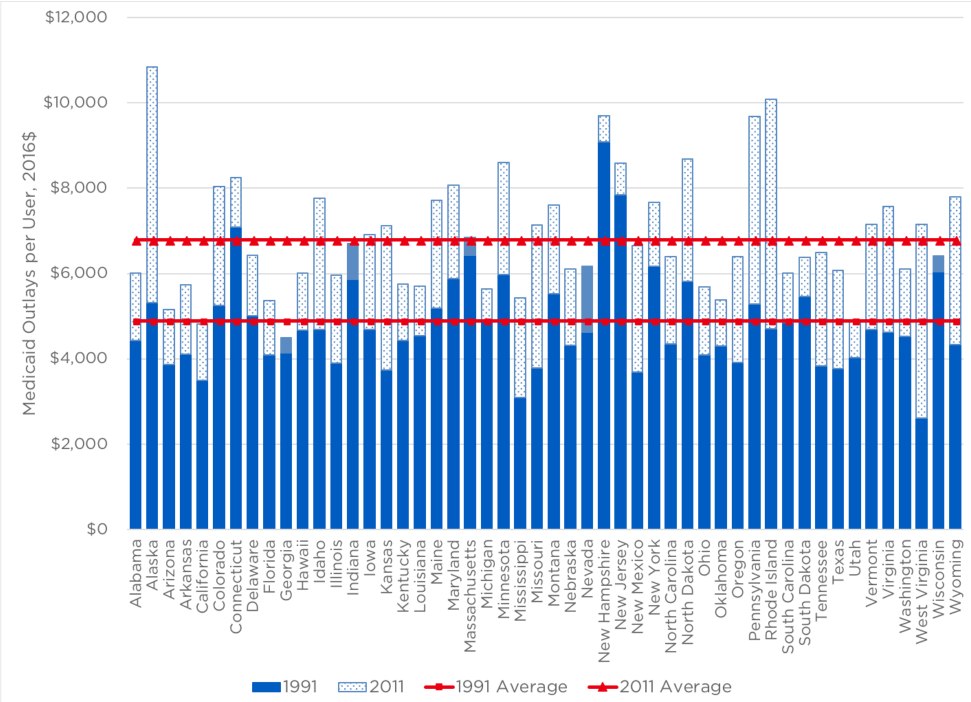
The simple framework shown by Chart C2 indicates that states have, in general, focused on (1) controlling the growth of the Medicaid population, so as to increase the amount spent per user, or (2) expanding the Medicaid population at the expense of spending per user. However, this generalization is not a tidy one; almost all states have experienced both an increase in Medicaid users (as a share of the population) and increased spending per Medicaid user.

Even though Medicaid spending increased from 6.9 percent of the Kansas state government's budget in 1991 to 18.7 percent in 2011,[99] Kansas clearly belongs to the group of states that has tended to control the growth of the Medicaid population and increased its per-user Medicaid spending. Only Rhode Island offers a better example of this combination of growth characteristics. Arizona offers an example of the opposite set of growth characteristics: controlling the growth of Medicaid spending per user but expanding the number of Medicaid users as a percent of the state population.[100] (Note that only five states—Georgia, Indiana, Massachusetts, Nevada, and Wisconsin—reduced per-user Medicaid spending.)

Chart C3 adds important context to the information presented in Chart C2.[101] It compares the level of

99 See Chart 5b.
100 An alternative explanation for the patterns exhibited in Chart C2 could relate to demographics. For example, growth in younger Medicaid users relative to older users might limit per-user spending, while growth in older/disabled populations or the expansion of services for them would have the opposite effect. The author examined Medicaid spending by state and age group and found no compelling patterns related to this alternative theme.

Chart C3:
State-by-State Per-User Medicaid Spending, Fiscal Year 2011 versus 1991



Sources: *Medicaid spending:* National Association of State Budget Officers. These data are proprietary to the National Association of State Budget Officers, and have been modified by the author. Medicaid users: 1993 *Statistical Abstract of the United States*, p. 112; Centers for Medicare and Medicaid Services.
Note: User is defined as "persons who had payments made on their behalf at any time during the fiscal year."

per-user Medicaid spending in 1991 and 2011. The level of per-user Medicaid spending in 1991 matters for interpreting the percentage point increase in spending between 1991 and 2011. For example, Kansas ranked 46th among the states in 1991 per-user Medicaid spending. The growth of 90 percentage points drove its rank to 20th among the states in 2011 per-user Medicaid spending. Rhode Island, by comparison, ranked 21st among the states in 1991. The growth of 114 percentage points in per-user Medicaid spending drove its rank to 2nd among the states in 2011.

The top-five states in terms of 2011 spending level per Medicaid user, in addition to Rhode Island, are: Alaska (1st), New Hampshire (3rd), Pennsylvania (4th), and North Dakota (5th). North Dakota fits the Rhode Island profile. New Hampshire was among the states with the lowest per-population growth of Medicaid users, but it also was among the states with the lowest percentage point change in inflation-adjusted per-user Medicaid spending, indicating it had consistently offered comparatively high per-user benefits. Alaska and Pennsylvania offered comparatively high per-user spending and increased their per-population share of Medicaid users in line with many states. (West Virginia was an outlier; it controlled the growth of per-population Medicaid users, but significantly increased the per-user spending. However, in 2011, West Virginia ranked only 18th among the states in the level of per-user spending, indicating comparatively low per-user spending in 1991; in fact, it ranked 50th.)

The bottom-five states ranked on the basis of the 2011 level of per-user Medicaid spending include: Georgia (50th), Nevada (49th), California (48th), Utah (47th), and Arizona (46th). Note, as mentioned above, that both Georgia and Nevada were two of only five states that decreased the inflation-adjusted per-user Medicaid spending in 2011 when compared with 1991.

Kansas Medicaid Spending over Time

The next three charts—Chart C4, Chart C5, and Chart C6—illustrate useful ways of looking at the change in Kansas Medicaid spending over time. Chart C4 shows total inflation-adjusted Medicaid spending in Kansas. It also shows two different data series that

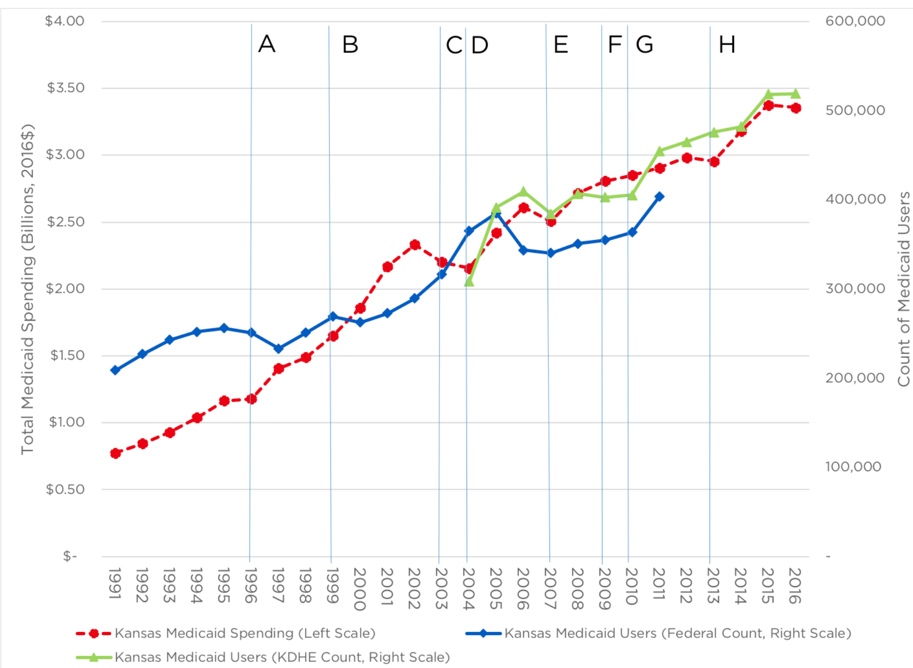
101 Chart C3 is a stacked bar chart. For most states, the states that increased spending in 2011 compared to 1991, the solid-colored bar represents the level of per-user Medicaid spending in 1991. The full height of the bar indicates the level of spending in 2011; the partially-colored bar represents the increase in the level of spending added to the 1991 level of spending. States with solid-colored bars at the top of the stack—like Georgia and Indiana—are the ones that had lower per-user Medicaid spending in 2011 compared with 1991.

count Medicaid users, one series came from the U.S. Centers for Medicare and Medicaid Services (which ends in 2011)[102] and the other came from the Medicaid Data Reports published by the Kansas Department of Health and Environment (which begins in 2004).[103] Chart C5 converts the data in Chart C4 into two different data series for per-user Medicaid spending. The purpose of presenting two different series is to alert the reader to the fact that data issues often arise in public policy analysis that can meaningfully alter an analysis. Chart C6 disaggregates the per-user Medicaid spending trends between the state's share and the federal government's share. It also compares the Kansas trends with the trends for all states. The chart ends in 2011 to preserve data consistency.

State or federal legislation influences the growth in Medicaid users, but so do non-legislative factors, such as demographics and changing income levels among the population. Indeed, as quoted above, the KanCare concept paper emphasized demographic changes in Kansas as the primary driver of Medicaid users—and, therefore, total outlays. Charts C4, C5, and C6 mark years in which meaningful legislative or programmatic changes occurred. The following descriptions of events annotate the years marked.[104] In only a few instances does a change in legislation or program operation have an observable influence on the trends illustrated by the charts.

A: First, in 1996, the federal government enacted the Personal Responsibility and Work Opportunity Act, which separated cash assistance and Medicaid eligibility. This act is the well-known "welfare reform" law signed by President Clinton. Among many other changes, the law allowed states to deny Medicaid coverage to adults who lost cash assistance for failing to comply with the new law's work requirements. Second, in 1997, the federal government enacted the State Children's Health Insurance Program (known as SCHIP or CHIP); it became effective in September of that year, but Kansas did not implement its version of SCHIP until 1999.

Chart C4:
Inflation-Adjusted Total Kansas Medicaid Spending and User Counts, Fiscal Years 1991-2016



Sources: Medicaid spending: Kansas Department of Health and Environment (Medicaid Data Reports; National Association of State Budget Officers, whose data is proprietary to the National Association of State Budget Officers, and has been modified by the author. Medicaid users: Statistical Abstract of the United States, various years; Centers for Medicare and Medicaid Services.

Chart C4 allows the reader to track the change in Medicaid spending separately from the change in Medicaid users. Medicaid spending accelerated between 1996 and 1997, but user growth decelerated, thereby causing a surge in per-user Medicaid spending, as shown in Chart C5. The author found no concrete record of how the two pieces of federal legisla-

102 An agency known as the U.S. Health Care Financing Administration reported this information in earlier years.

103 As mentioned elsewhere in this report, the Health Care Financing Administration defined users as "persons who had payments made on their behalf at any time during the fiscal year." The Kansas Department of Health and Environment reports a metric for Medicaid "customers" and defines it as "those for whom a payment was made . . ." http://www.kdheks.gov/hcf/medicaid_reports/

104 The identification of these items of annotation relied on: Kansas Health Institute and Kansas Legislative Research Department, "Kansas Medicaid: A Primer," January 2014, pp. 20-21.

Chart C5:
Inflation-Adjusted Spending per Kansas Medicaid User, Fiscal Years 1991-2016, All-Funds Budget

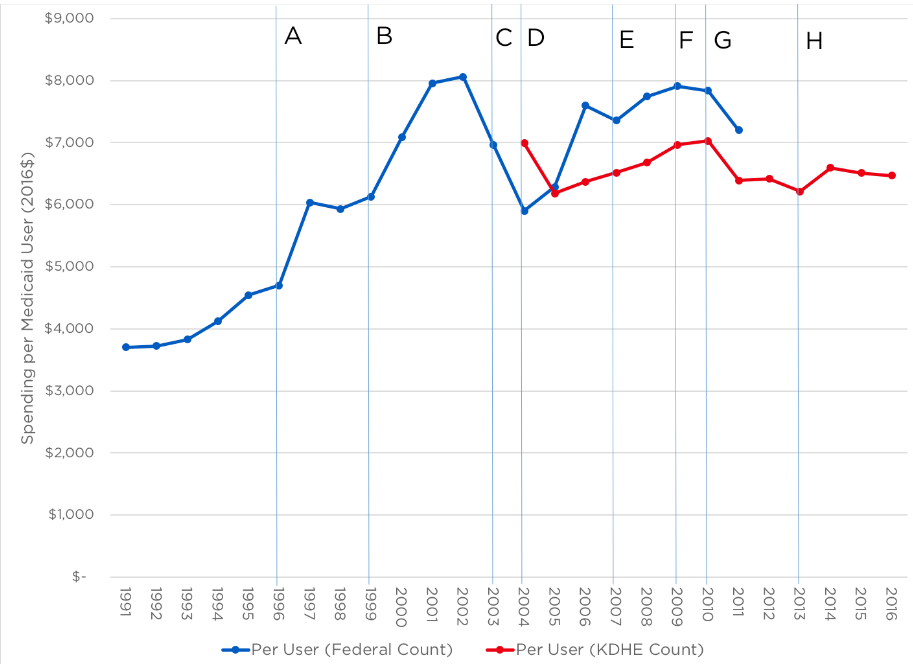
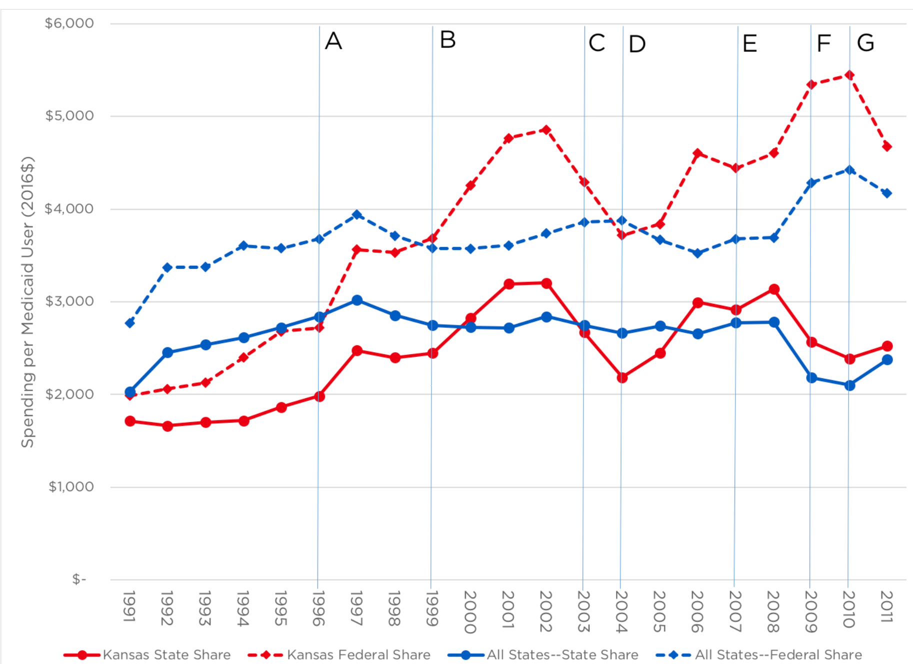


Chart C6:
Inflation-Adjusted Medicaid Spending per User, Kansas Compared to All States, State vs. Federal Levels, 1991-2011



Sources: *Medicaid spending:* Kansas Department of Health and Environment (Medicaid Data Reports; National Association of State Budget Officers, whose data are proprietary to the National Association of State Budget Officers, and have been modified by the author. *Medicaid users: Statistical Abstract of the United States*, various years; Centers for Medicare and Medicaid Services; Kansas Department of Health and Environment (Medicaid Data Reports).

tion may have played into that surge. Instead, an inspection of Table C1 indicates that a growth in Home and Community-Based Services grew rapidly from 1997 through 1999. The decline in Medicaid users may have been related to the change in eligibility requirements associated with the 1996 law, but it may also have been a consequence of the strong period of economic growth that occurred during that time period, thereby reducing the number of income-eligible persons.

B: In 1999, Kansas implemented its version of the State Children's Health Insurance Program (SCHIP). SCHIP provided health care coverage for low-income children in families with incomes up to 200% of the federal poverty level who were not Medicaid-eligible. Total Kansas Medicaid spending grew at an accelerated rate from the 1999 implementation through 2001. Chart C4 illustrates an accelerating growth rate of both Medicaid spending and Medicaid users, with spending growing faster. That combination of relative growth rates explains the surge in per-user Medicaid spending in Chart C5. However, the implementation of SCHIP does not appear to offer the primary explanation for the surge in per-user Medicaid spending from 1999 through 2001. Inspection of Table C1 indicates that the spending on Nursing Home Facilities explains the acceleration in Medicaid spending. Table C1 also shows that spending on prescription drugs escalated from 1997 through 2001.

C: The federal Jobs Growth Tax Relief Reconciliation Act raised all federal government Medicaid matching rates by 2.95 percentage points from April 2003 through June 2004 as a temporary measure to provide fiscal relief to the states. Chart C6 shows no discernible impact from this piece of legislation.

D: In 2004, Kansas passed the Hospital Provider Assessment Program. According to a briefing paper published by the Kansas Legislative Research Department: "The Health Care Access Improvement Program (HCAIP), established by 2004 Senate Sub. for HB 2912, uses an annual assessment on inpatient services provided by hospitals and on non-Medicare premiums collected by health maintenance organizations (HMOs) to improve and expand health care in Kansas for low-income persons. The assessment paid by hospitals and HMOs is used as a state match to acquire additional federal funding."[105] Chart C4 shows an acceleration of Medicaid spending from 2004 to 2006—faster than Medicaid user growth—when using the federal count. The year 2004 happened to coincide with the introduction of the KDHE count of Medicaid users. This count in 2004 was much lower than the federal count, but it grew far more rapidly than the federal count from 2004 to 2006. The discrepancy in both user count and growth rate explains the conflicting per-user trends shown in Chart C5. If the analytical focus remains on the federal count of Medicaid users, per-user spending increased quickly between 2004 and 2006, with the state share growing significantly faster than the federal government share.

E: In 2007, Kansas implemented the Working Healthy program, which allowed people with disabilities to keep Medicaid support services while working.

F: In 2009, two meaningful events occurred. First, Kansas expanded CHIP coverage to children in families with up to 250 percent of the 2008 federal poverty level. Second, the federal American Recovery and Reinvestment Act increased the Medicaid federal matching percentage by 6.2 percent between October 2008 and December 2010.

The influence of the American Recovery and Reinvestment Act on Kansas Medicaid spending is clearly visible in Chart C6. The federal share of spending increases significantly, while the state share declines significantly, until 2011.

G: In 2010, two new meaningful events occurred. First, the federal Affordable Care Act was signed into law, including an expansion of Medicaid to all adults under 138 percent of the federal poverty level. Second, Governor Parkinson reduced Medicaid provider rates by 10 percent to meet budget reductions (allotments). Chart C5 shows the sharp drop in per-user Medicaid spending that resulted from Governor Parkinson's reductions. (For fiscal year 2016, Governor Brownback used Governor Parkinson's precedent as a rationale for reducing Medicaid outlays by an estimated $56 million.[106])

H: Kansas implemented KanCare for most Medicaid and CHIP beneficiaries. Chart C5 illustrates that, after an initial increase, per-user Medicaid spending began to decline. Kari Bruffett, Director of Policy for the Kansas Health Institute and former Director of Medicaid for the State of Kansas, provided three possibilities for why the cost increased from 2013 to 2014. Each possibility primarily relates to transition issues associated with moving to KanCare. In brief, the possibilities include: (1) KanCare capitation payments that were made one month in arrears, by contract, so one-twelfth of calendar year costs may not have been reflected in fiscal year 2013; (2) the Affordable Care Act health insurer's tax was applied to Medicaid plans, and rates had to be adjusted accordingly; (3) mid-year rate adjustments had to be made for calendar year 2013 based on the risk profile of Medicaid members, and those adjust-

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105 Kansas Legislative Research Department, "Kansas Provider Assessments," Section L2, Kansas Legislator Briefing Book, 2014. http://www.kslegresearch.org/Publications/2014Briefs/2014_briefing_book.pdf

106 Jim McLean, "Kansas Health Care Providers to Fight KanCare Cuts," Kansas Health Institute News Service, May 27, 2016.

ments had to be paid in fiscal year 2014; and (4) managed care organizations had a portion of their capitation payments withheld and earned them back based upon performance, and this reconciliation process occurred at some point in calendar year 2014.[107]

KanCare has not operated long enough to assess whether or not it has met its promoters' aspirational goals—from both a cost-management perspective and a health care-quality perspective. It did achieve budget savings in one respect: the final negotiated managed care rates came in below the forecast rates.[108] However, during KanCare implementation, many complaints arose about long waiting times for health care service.[109]

The long waiting times almost jeopardized the state government's request for a one-year extension of the KanCare program.[110] The federal government—via the Centers for Medicare and Medicaid Services—approved KanCare as a five-year demonstration project. December 31, 2017 marked the end of the original five-year demonstration window. However, on October 16, 2017, the federal government granted Kansas a one-year extension. KanCare will operate through December 31, 2018 while the Kansas Department of Health and Environment develops its proposal for KanCare 2.0.[111]

107 Personal correspondence between the author and Kari Bruffett.

108 Kansas Division of the Budget, *Comparison Report*, Fiscal Year 2016, pp. 51, 56.

109 Andy Marso, "Behind the backlog: The problem-plagued rollout of KEES," Kansas Health Institute News Service, April 11, 2016.

110 Jonathan Shorman, "KanCare Extension Denied After Scathing Review Finds Noncompliance with Federal Law," *The Topeka Capital-Journal* (CJOnline.com), January 18, 2017.

111 Office of the Governor, "CMS Approves 12-Month Extension for KanCare," News Release, October 16, 2017. http://www.kancare.ks.gov/docs/default-source/about-kancare/kancare-extension/cms-kancare-extension-approval.pdf?sfvrsn=0

Table C1: Select Items of Medicaid Spending, State of Kansas Share (Millions, $2016)

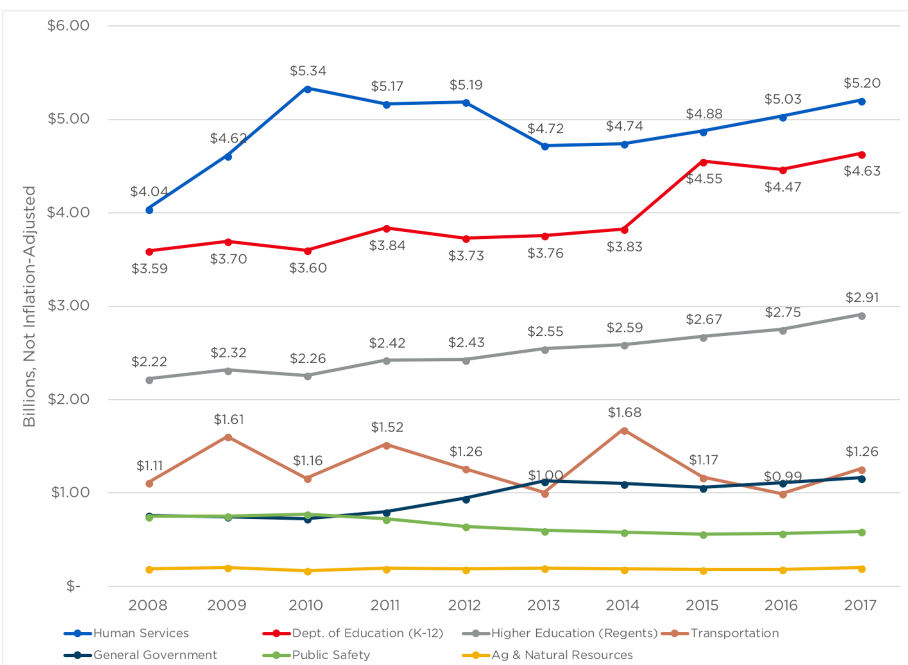
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Inpatient Hospital	$92.0	$81.0	$83.9	$84.8	$86.0	$88.8	$99.2	$109.9	$131.1	$175.2	$130.2	$156.3	$118.3	$104.8	$132.7	$156.7	$130.6	$60.9	$63.5
Mental Health Facility Services	41.9	30.6	28.3	41.8	35.8	22.4	15.3	13.8	15.5	3.1	10.6	15.4	15.5	28.5	31.2	32.2	19.8	11.9	11.4
Nursing Facility Services	132.5	134.6	142.5	181.8	254.4	268.7	173.4	121.2	160.1	147.3	159.0	160.8	135.8	118.1	166.8	200.5	64.9	2.2	2.1
Intermediate Care Facility	59.5	48.2	37.6	36.4	36.7	34.3	31.5	28.4	31.0	30.1	29.2	28.7	23.9	20.6	26.1	29.4	25.0	21.8	21.8
Physician & Surgical Services	21.2	19.1	20.9	24.4	27.5	27.5	32.8	33.1	36.0	41.7	39.6	38.5	35.8	32.2	37.6	43.9	21.2	9.2	5.7
Outpatient Hospital Services	7.4	7.1	7.8	9.7	10.7	10.0	11.5	8.2	11.8	29.4	20.9	21.5	22.5	18.6	21.4	27.2	16.6	2.8	1.2
Prescribed Drugs	59.9	64.8	76.4	89.3	98.2	111.0	112.3	126.7	138.8	89.5	62.9	68.3	59.0	49.9	60.0	72.6	19.3	0.2	0.3
Dental Services	3.9	5.2	5.5	6.0	6.4	7.2	9.7	9.0	11.8	13.5	12.5	12.6	11.0	10.4	13.7	17.5	5.4	0.0	0.0
Medicaid — Managed Care Organization	0.0	10.6	14.3	21.3	34.3	52.0	54.1	57.7	70.3	81.4	138.9	234.6	181.7	186.8	236.5	298.6	631.3	1,038.3	1,243.4
Administration	31.0	31.4	39.8	47.3	50.0	66.1	45.0	62.0	60.4	64.7	85.1	64.3	68.6	62.5	69.5	69.5	63.9	70.5	63.1
Home & Community-Based Services	76.9	112.6	146.1	151.2	161.4	171.2	163.4	155.7	172.9	193.6	200.4	214.1	200.7	186.9	218.4	252.0	187.0	60.4	1.1

Source: Medicaid.gov, Medicaid Budget and Expenditure System/State Children's Health Insurance Program Budget and Expenditure System.
Note: Managed Care Organization includes Prepaid Ambulatory Health Plan and Prepaid Inpatient Health Plan.

Appendix D: How State Government Spending Changed during the Brownback Era

Chart D1:
State General Fund Budget, Select Spending Categories

Chart D2:
State All-Funds Budget, Select Spending Categories



Sources: Kansas Division of the Budget, *The Governor's Budget Report*, Volume 1, various years.
Data for 2017 = approved budgets not actuals (*Comparison Report*, Fiscal Year 2018).
Note: Chart A7.1 omits Transportation and Ag & Natural resources; they are minor SGF categories.

The charts and tables in this appendix document annual state government spending changes from 2008 through 2016 (the tenures of Governors Parkinson and Brownback). Chart D1 illustrates, for the State General Fund, trends in the spending levels of the headline budget categories used by the Kansas Division of the Budget. Chart D2 does the same for the All-Funds budget. Table D1 provides the same information in greater detail (and includes the official spending authorizations enacted by the 2017 Legislature for fiscal years 2017, 2018, and 2019). Table D1 makes use of the so-called *Comparison Reports* compiled by the Division of the Budget to reconcile the Governor's initial recommendations at the beginning of a fiscal year with legislatively "approved" changes made to those recommendations at the close of the fiscal year.

Timing matters for state government budgets that manage an enormous number of specific spending items. The year-to-year variation in spending typically reflects Governors' recommendations (subject to the approval of the Legislature). However, much of the variation in Governors' recommendations relate to the natural ebb and flow of spending drivers—not necessarily specific changes in policy. This natural ebb and flow allows the Governor and Legislature the flexibility to shift monies among spending priorities as dictated by the most urgent demands—and offers explanations for much of the year-to-year spending changes in the Brownback era, especially as it relates to the All-Funds budget in Chart D2.

Transportation and Human Services offer two clear budgetary categories that experience a natural ebb and flow in spending demand. Major highway projects—especially if debt funded—create spending demands based on the different life-cycle stages of the project; Chart D2 shows that the year-to-year spending patterns amount to significant double-digit changes. Caseload estimates drive a significant amount of Human Services spending. As with any estimate, state agencies will typically over-estimate or under-estimate the actual caseload demands. Given the large dollar values in Human Services spending, the difference in actual versus estimated spending can sum to tens or hundreds of millions of dollars in a given fiscal year.

In his 2011 State of the State Address, Governor Brownback boasted that his fiscal year 2013 budget would reduce (nominal) spending in the All-Funds budget for the first time in about four decades. Chart D2 illustrates that reduced spending; Transportation and Human Services accounted for most of the total spending reduction. Almost all of the reduction in spending for Transportation related to the timing of debt funding for T-Works, the state's comprehensive transportation plan. Almost all of the reduction in Human Services spending related to a substantial drop in the demand for unemployment insurance payments. Also notice the fiscal year 2013 line in Table D1 for the All-Funds budget: the reduction of Human Services spending by $96.9 million resulted from lower-than-estimated caseload demands, not a specific policy change.[114] (The reduction of $38.1 million in the State General Fund Human Services spending has the same explanation.)

The increase in All-Funds budget K-12 Education spending by $727 from fiscal year 2014 to fiscal year 2015 is another noteworthy event illustrated on Chart D2. This increase related primarily to a change in accounting policy not education policy. One might call it a political artifact of the "school finance wars." Since 1992, the state government has imposed a property tax levy explicitly for K-12 Education funding. Since 1998, the tax rate has amounted to 20 mills (2.0 percent) on assessed property values. As an accounting matter, most of the money changed hands at the local level, with county tax collectors depositing the funds directly into a school district's general fund. The change in law routed the money through the state treasurer to the state government's "state school district finance fund." As reported by the *Topeka Capital-Journal*: "Sen. Ty Masterson, the bill's author [that changed the accounting procedure], has said the purpose of the change is to clarify the taxes are state aid — not local aid — for schools, because the state mandates them as part of its school finance formula. The money will now flow from county treasurers to the state treasury and then to schools, rather than directly from the county treasurers to the schools."[115]

Fiscal year 2015 marked the beginning of the budget-balancing challenges that arose in connection with Governor Brownback's tax reforms. Table D1 shows, for the General Fund budget, fiscal year 2015 spending increased relative to 2014, but declined in fiscal year 2016 relative to 2015. For fiscal year 2015 and 2016, Governor Brownback established an allotment program to manage General Fund spending.[116] That program explains why most of the spending categories in Chart D1 declined from 2015 to 2016, but many of the same spending categories in Chart D2 did not.

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112 Kansas Division of the Budget, *The Governor's Budget Report*, Fiscal Year 2013, Vol. 1, pp. 157-159. In fiscal year 2013, the T-Works program raised $250 million from the sale of bonds.

113 Compare Vol. 2 of *The Governor's Budget Report* for fiscal years 2014 (p. 225) 2015 (p. 217).

114 Kansas Division of the Budget, *Comparison Report*, Fiscal Year 2014, p. 59

115 Celia Llopis-Jepsen, "Change to School Finance Won't Affect Revenue Tallies," *The Topeka Capital-Journal* (cjonline.com), August 9, 2014. For the law, see: Section 7 of House Substitute for Senate Bill 245 (2014 Legislature) and K.S.A. 2016 Supp. 72-6470.

116 An allotment is a budgeting mechanism available to the Governor under Kansas law. As explained in the *Governor's Budget Report, Fiscal Year 2018*, Vol. 1, p. 223: ". . . the Governor has the authority under a statutory allotment system to limit expenditures of the State General Fund and special revenue funds when it appears that available monies are not sufficient to satisfy expenditure obligations. This authority applies to agencies of the Executive Branch but not the Legislature or the Judiciary. Allotments can be made on a case-by-case basis and do not have to be across the board. Agencies have the right to appeal any allotment amount and the Governor makes the final determination."

Table D1 helps chronicle key policy-related elements of the budget-balancing effort. First, for fiscal year 2015, the $114.1 million (All-Funds) and $35.6 million (General Fund) reduction in spending on Human Services resulted from budget savings associated with Governor Brownback's Medicaid reforms (known as KanCare, see Appendix C), not policy-related reductions in services.[117] Second, for fiscal years 2015 and 2016, almost all of the reductions in K-12 Education spending relate to deferred payments to KPERS, the state employee pension system. These deferred payments came with legislation requiring the repayments that carried an interest rate of 8.0 percent, the assumed investment rate of return used by KPERS. Third, for fiscal years 2015 and 2016, all of the reductions in higher education spending resulted from the allotment program (true spending cuts).

Despite the use of allotments and deferred spending, in the overall context of the natural ebb and flow of state spending demands, one can make the general claim that spending, in current-year dollars, remained relatively stable in the Brownback era—a clear departure from previous administrations, going back to Governor Robert Docking. This relative stability explains why government spending in the Brownback era shrank as a ratio of (growing) Kansas personal income. (See Chart 7.)

117 Kansas Division of the Budget, *Comparison Report*, Fiscal Year 2016, pp. 51, 56.

Table D1: Recommended versus Approved Levels of State Government Spending (and Sources of Change)

	Recommendations and Sources of Change						*Budget Categories Changed*						
Fiscal Year	Governor's Recommended	Governor's Amendment or Allotment	Legislature	Governor's Vetoes	Approved	Approved less Governor's Recommended	General Government	Human Services	Department of Education (K-12)	Higher Education (Regents)	Public Safety	Agriculture and Natural Resources	Transportation
State General Fund Budget													
2008	$6,112,133,303	$19,547,379	$7,186,071	$0	$6,138,866,753	$26,733,450	$-516,223	$18,559,399	$-77,224	$-1,077,224	$10,023,498	$-256,000	$0
2009	6,348,619,689	-130,750,452	-93,541,609	39,475,217	6,163,802,845	-184,816,844	-6,357,443	-139,763,386	-12,654,335	-24,621,420	-8,826,529	-1,210,797	0
2010	5,451,061,567	-44,127,335	1,121,290	0	5,408,055,522	-43,006,045	547,782	-34,158,519	-8,141,515	0	-1,200,918	-39,791	0
2011	5,727,059,007	-2,166,690	-50,061,443	0	5,674,830,874	-52,228,133	0	-2,163,618	-47,579,394	-2,677,771	150,000	59,340	0
2012	6,128,756,855	-4,925,196	1,904,443	564,441	6,126,300,543	-2,456,312	550,000	-3,366,321	0	-238,158	998,167	-400,000	0
2013	6,198,450,033	-34,851,287	-10,864	1,994,355	6,165,582,237	-32,867,796	692,136	-38,074,153	0	3,000,000	1,514,221	0	0
2014	6,025,629,791	0	-27,102,994	189,835	5,998,716,632	-26,913,159	-736,398	-24,050,556	0	169,598	-2,295,903	0	0
2015	6,349,678,468	-81,390,803	-16,864,404	0	6,251,423,261	-98,255,207	1,537,291	-35,595,555	-45,468,001	-15,464,610	-1,205,395	0	-1,279,370
2016	6,294,446,411	-95,060,509	3,211,418	0	6,202,597,320	-91,849,091	111,418	8,321,847	-84,015,709	-17,180,818	-6,085,829	0	0
2017	6,253,014,602	24,613,415	24,071,128	0	6,301,699,145	48,684,543	3,122,034	15,388,501	20,184,044	225,552	2,300,597	33,568	0
2018	6,261,937,495	-23,919,727	354,294,332	0	6,592,312,100	330,374,605	-18,801,838	-19,096,373	352,318,761	96,595	3,334,370	253,206	0
2019	6,154,841,553	42,543,737	411,274,709	0	6,608,659,999	453,818,446	-18,112,759	98,830,312	356,266,257	357,834	3,905,082	307,022	0
State All-Funds Budget													
2008	$13,096,774,388	$18,198,927	$41,378,901	$0	$13,156,352,216	$59,577,828	$-5,279,569	$12,561,925	$-77,224	$-2,562,500	$54,791,196	$144,000	$0
2009	13,600,095,025	-9,053,982	-116,464,031	39,475,217	13,514,052,229	-86,042,796	-22,096,588	-18,569,456	-1,2911,277	-3,1421,328	-579803	-1,096,017	1,066,184
2010	14,497,242,211	-101,419,986	8,475,156	0	14,404,297,381	-92,944,830	247,663	2,301,860	-8,159,272	-39,140	-353750	-153711	-86,772,002
2011	14,777,549,241	-6,723,450	-41,836,273	-71,426	14,728,918,092	-48,631,149	1,431,359	-6,936,209	-47,205,586	3,772,229	264,408	59,340	0
2012	14,734,347,759	2,552,642	21,868,083	43,651	14,758,812,135	24,464,376	19,900,796	5,814,152	0	-238,158	-382,819	-400,000	0
2013	14,404,673,619	-93,957,344	-47,894	2,062,195	14,312,730,576	-91,943,043	406,802	-96,869,235	44,441	3,000,000	1,527,380	-27,431	-25,000
2014	15,050,398,534	0	-34,762,020	189,835	15,015,826,349	-34,572,185	-16,569,218	-12,828,868	1,100,000	169,698	-2,913,797	-30,000	-3,500,000
2015	15,616,177,570	-155,678,012	-19,298,380	0	15,441,201,178	-174,976,392	3,370,539	-114,095,555	-45,468,001	-15,464,610	-2,039,395	0	-1,279,370
2016	15,554,013,616	-29,861,091	3,411,418	0	15,527,563,943	-26,449,673	837,871	77,033,772	-91,280,498	-17,180,818	-2,859,000	-1,000	0
2017	15,896,845,426	35,986,008	31,498,657	0	15,964,330,091	67,484,665	360,429	31,501,113	20,209,981	498,108	6,551,823	558,648	370,829
2018	15,318,557,958	169,710,821	431,895,541	0	15,920,164,320	601,606,362	-18,730,094	214,957,433	373,340,717	1,891,435	11,158,036	4783351	1,819,745
2019	15,831,400,491	48,317,299	268,935,769	0	16,148,653,559	317,253,068	-21,844,174	-58,969,927	371,032,068	2,478,117	9,259,925	1,349,165	1,564,078

Sources: Kansas Division of the Budget, *Comparison Report*, various fiscal years.
Note: Dollars not inflation-adjusted. The table omits some minor budget categories, so the sum of "Budget Categories Changed" may not always match the sum of "Approved less Governor's Recommended."