

KANSAS LEGISLATIVE RESEARCH DEPARTMENT

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November 9, 2012

To: Legislative Budget Committee and Governor Sam Brownback

From: Kansas Legislative Research Department and Kansas Division of the Budget

Re: State General Fund Receipts Estimates for FY 2013 and FY 2014

Estimates for the State General Fund (SGF) are developed using a consensus process that involves the Legislative Research Department, Division of the Budget, Department of Revenue, and three consulting economists from state universities. This estimate is the base from which the Governor and the Legislature build the annual budget. The Consensus Group met on November 6, 2012, and revised the estimate for FY 2013 and developed the initial estimate for FY 2014.

For FY 2013, the estimate was decreased by \$5.2 million, or 0.1 percent, below the previous estimate (made in April and subsequently adjusted for legislation enacted during the veto session). The revised estimate of \$6.169 billion represents a reduction of 3.8 percent below final FY 2012 receipts.

The initial estimate for FY 2014 is \$5.464 billion, which is \$704.8 million, or 11.4 percent, below the newly revised FY 2013 figure. Factors influencing this forecast in addition to the state of the economy include the fully annualized impact of the new state income tax law that is effective in tax year 2013; scheduled reductions in the retail sales and compensating use tax rates, as well as the SGF's share of tax receipts from these sources (pursuant to legislation enacted in 2010); and a net change in transfers out of the SGF in compliance with current statutory requirements for FY 2014.

Table 1 compares the new FY 2013 and FY 2014 estimates with actual receipts from FY 2012. Table 2 shows the changes in the FY 2013 estimate.

Economic Forecast for Kansas

Although the U.S. economy, fueled by a rebounding housing market and relatively strong consumer confidence, is continuing its recovery from the Great Recession, the forecast rate of growth remains slow. Uncertainty continues to exist involving the global and US economies as a result of political upheavals in the Middle East, the ongoing European Union debt crisis, and the possibility of a new recession that could arise as a result of dramatic spending cuts and tax increases that will occur in 2013 (the "Fiscal Cliff") in the absence of any additional action by federal policymakers. The current assumption is that modest growth will continue in the national and state economies during the forecast period. Nominal Gross Domestic Product is now expected to grow by 4.0 percent in 2012 (the April estimate had been 3.9 percent) and 4.2 percent in 2013 (the April estimate was 4.3 percent); and nominal Kansas Gross State Product

is now forecast to grow by 3.5 and 3.9 percent for the two years, respectively. Although the Congressional Budget Office suggests the contractionary economic implications of the Fiscal Cliff could lead to another recession, many other forecasts are being made based on the assumption that some kind of action will be taken late in 2012 or early in 2013 to prevent this scenario. The estimates contained in this memo for FY 2013 and FY 2014 are premised on this latter set of forecasts, which are believed to represent the most likely outcome.

Kansas Personal Income

Kansas Personal Income (KPI) in 2012 is now expected to increase by 3.0 percent above the 2011 level, down from the April estimate of 4.3 percent. The 2012 estimate would have been 0.8 percent lower if a Social Security payroll tax cut had not been extended at the federal level for 2012. The new forecast calls for additional KPI growth of 3.2 percent in 2013 (down from the 4.6 percent estimate in April) and 4.0 percent in 2014. The Social Security payroll tax cut is not expected to be extended for 2013.

New Kansas Income Tax Law

Although additions to disposable Kansas personal income as a result of the new state income tax law for tax year 2013 will be expected in the long run to stimulate new economic activity and generate additional revenue streams that could help offset a portion of the revenue loss associated with the new law, there is no evidence that the fiscal notes provided by the Department of Revenue at the time the legislation was enacted should be changed significantly relative to the short run or through the end of the current forecast period in FY 2014. Relative to the individual income tax, those estimates indicated receipts were to be reduced relative to the prior law by \$249.2 million in FY 2013 and by \$847.8 million in FY 2014.

Employment

Data obtained from the Kansas Department of Labor verify that employment has continued to rebound. The most recent monthly data from the Kansas Department of Labor show that total Kansas non-farm private sector employment from September 2011 to September 2012 increased by about 12,400 jobs, with particularly strong growth in the professional and business services sector. Two and a half years after Kansas employment bottomed out as a result of the Great Recession, 36.3 percent of the lost jobs have returned to the state (compared to 48.5 percent for the US as a whole). The current average estimates used by the Department indicate that the overall Kansas unemployment rate, which was 6.7 percent in CY 2011, is expected to be 5.9 percent in CY 2012 before further declining to 5.6 percent in CY 2013. The national unemployment rate is expected to remain well above the Kansas rate, with the US rate now expected to be 8.2 percent in 2012 and 7.8 percent in 2013.

Agriculture

Although net farm income increased significantly in 2011, the outlook for 2012 has been significantly affected by the drought. Subsoil moisture supplies as of late October were rated as short or very short in 84.0 percent of the state; while topsoil moisture was short or very short in 66.0 percent of the state. Corn production has been especially hard hit, with the 2012 yield now

expected to be the lowest since 1975. Of particular significance for livestock, range and pastureland conditions are now rated 79.0 percent poor or very poor, the worst since this metric was developed in 1995. The U.S. All Crops Price Index for October was 239.0 percent of the 1990-92 base, up 17 points from a year earlier. High input prices, especially energy and fertilizer costs, remain an ongoing concern for the agricultural sector.

Oil and Gas

Driven by foreign demand and volatility in the Middle East, the price of oil thus far in FY 2013 has remained at a relatively high level and is expected to continue to for the balance of the forecast period. The average price per taxable barrel of Kansas crude in FY 2013 has been reduced to \$84, or \$8 per barrel lower than the previous forecast of \$92 (and lower than the \$90.29 final average price for FY 2012). The FY 2014 price is expected to increase to \$92 per barrel. Gross oil production in Kansas, which had been declining steadily for more than a decade until FY 2000, reversed that trend about seven years ago and began increasing. Expectations are now that the rate of increase will be accelerating as a result of significant new oil production initiatives already underway in the state. The current forecast of 45.0 million barrels for FY 2013 and 48.0 million barrels for FY 2014 compares favorably to the 33.5 million barrels produced in FY 2005. The repeal of a severance tax exemption for new oil pools in 2012 also has significantly expanded the percentage of Kansas oil subject to taxation.

The price of natural gas is expected to average \$2.80 per 1,000 cubic feet (Mcf) for FY 2013 before increasing to \$3.75 per Mcf for FY 2014, based on an industry source's analysis of futures markets. (The previous price forecast for FY 2013 made in April was \$3.10 per Mcf.) Factors considered for these estimates included the relationship between crude oil and gas prices, a review of rig count data, the current record high storage levels for gas, the overall economic outlook, and the impact of enhanced production from shale formations elsewhere in the United States. Kansas natural gas production in FY 2012 of 305.9 million cubic feet represented a significant decrease from the modern era peak of 735.0 million cubic feet in FY 1996 (largely as a result of depletion of reserves in the Hugoton Field). Production is expected to continue to decrease to 285.0 million cubic feet for FY 2013 and 265.0 million cubic feet for FY 2014.

Inflation Rate

The Consumer Price Index for all Urban consumers (CPI-U) is expected to increase by 2.2 percent in 2012. The latest forecast calls for inflation to remain at very moderate levels of 2.1 percent in 2013 and 2.2 percent in 2014.

Interest Rates

The Pooled Money Investment Board (PMIB) is authorized to make investments in US Treasury and Agency securities, highly rated commercial paper and corporate bonds, repurchase agreements and certificates of deposit in Kansas banks. Extremely low idle-fund balances in recent years have required the PMIB to maintain a highly liquid portfolio, which reduces the amount of return available to the pool. In FY 2012, the state earned only 0.13 percent on its SGF portfolio (compared with a 4.26 percent rate as recently as FY 2008). The

average rates of return forecast for FY 2013 and FY 2014 remain very low (0.16 and 0.15 percent, respectively) and reflect the expected continuation of historically low interest rates and smaller idle-fund balances.

Economic Forecasts

	<u>CY 2012*</u>	<u>CY 2013*</u>	<u>CY 2014*</u>
KPI Growth	3.0%	3.2%	4.0%
Inflation (CPI-U)	2.2%	2.1%	2.2%

	<u>FY 2012</u>	<u>FY 2013*</u>	<u>FY 2014*</u>
SGF Interest	0.13%	0.16%	0.15%
Oil and Gas			
Oil Price per bbl	\$ 90.29	\$ 84.00	\$ 92.00
Gross Production (000)	42,283	45,000	48,000
Gas Price per Mcf	\$ 3.80	\$ 2.80	\$ 3.75
Gas Taxable Value	\$ 1,019,466	\$ 638,400	\$ 913,000

*Estimated

State General Fund Receipts Estimates

FY 2013. The revised estimate of SGF receipts for FY 2013 is \$6.169 billion, a decrease of \$5.2 million below the previous estimate. Preliminary receipts through October from tax sources collected by the Department of Revenue had been running \$21.2 million below that forecast. The overall revised estimate is approximately \$243.7 million, or 3.8 percent, below actual FY 2012 receipts. As noted earlier, the change in income tax law that will be reducing withholding and estimated payments during the final half of FY 2013 is one of the reasons for the overall reduction, as is the significant change in net transfers relative to FY 2012.

Each individual SGF source was reevaluated independently, and consideration was given to revised and updated economic forecasts, collection information from the Departments of Revenue and Insurance, and year-to-date receipts.

The corporation income tax estimate was increased by \$70.0 million. Receipts from this source had exceeded the final FY 2012 estimate by almost \$35.0 million, and the fiscal-year-to-date receipts through October had been running well ahead of the previous estimate. Motor carrier property tax receipts, which also exceeded the final estimate for FY 2012, were increased by \$5.0 million. Fueled by unexpected growth in unclaimed property, the forecast for agency earnings was boosted by nearly \$7.0 million.

Reductions of note include the individual income tax (down by \$60.8 million); the severance tax (down by \$19.7 million); and the corporation franchise tax (down by \$11.0

million). Individual income tax receipts in FY 2012 finished \$47.0 million below the final estimate for that year and had not been keeping pace with the previous fiscal-year-to-date expectations in FY 2013. The forecast prices of both oil and gas for severance tax purposes were reduced relative to the April estimates. Finally, approximately \$11.0 million in corporation franchise tax refunds were paid in September to taxpayers who had not realized the tax has now been fully repealed.

FY 2014. SGF receipts are estimated to be \$5.464 billion in FY 2014, a figure that is 11.4 percent below the revised FY 2013 forecast. This result is heavily influenced by the fully annualized impact of the new income tax law (estimated to be a reduction of more than \$800 million relative to prior law); the reduction in the state retail sales and compensating use tax rates from 6.3 to 5.7 percent; the reduction in the share of sales and use tax receipts earmarked for deposit in the SGF; and an increase of \$54.0 million in net transfers from the SGF which will occur absent any change in current law.

Accuracy of Consensus Revenue Estimates

For 38 years, SGF revenue estimates for Kansas have been developed using the consensus revenue estimating process. Besides the three state agencies identified on the first page, the economists currently involved in the process are Joe Sicilian from the University of Kansas, Tracy Turner from Kansas State University, and Nancy McCarthy Snyder from Wichita State University. Each of the agencies and individuals involved in the process prepared independent estimates and met on November 6, 2012, to discuss estimates and come to a consensus for each fiscal year.

STATE GENERAL FUND ESTIMATES

Fiscal Year	Adjusted Original Estimate*	Adjusted Final Estimate**	Actual Receipts	Difference from Original Estimate*		Difference from Final Estimate**	
				Amount	Percent	Amount	Percent
1975	\$ --	\$ 614.9	\$ 627.6	\$ --	-- %	\$ 12.7	2.1 %
1976	676.3	699.7	701.2	24.9	3.7	1.4	0.2
1977	760.2	760.7	776.5	16.3	2.1	15.8	2.1
1978	830.1	861.2	854.6	24.5	3.0	(6.5)	(0.8)
1979	945.2	1,019.3	1,006.8	61.6	6.5	(12.5)	(1.2)
1980	1,019.3	1,095.9	1,097.8	78.5	7.7	1.9	0.2
1981	1,197.1	1,226.4	1,226.5	29.4	2.5	0.1	--
1982	1,351.3	1,320.0	1,273.0	(78.3)	(5.8)	(47.0)	(3.6)
1983	1,599.2	1,366.9	1,363.6	(235.6)	(14.7)	(3.2)	(0.2)
1984	1,596.7	1,539.0	1,546.9	(49.8)	(3.1)	7.9	0.5
1985	1,697.7	1,679.7	1,658.5	(39.2)	(2.3)	(21.3)	(1.3)
1986	1,731.2	1,666.4	1,641.4	(89.8)	(5.2)	(25.0)	(1.5)
1987	1,903.1	1,764.7	1,778.5	(124.6)	(6.5)	13.8	0.8
1988	1,960.0	2,031.5	2,113.1	153.1	7.8	81.6	4.0

Fiscal Year	Adjusted Original Estimate*	Adjusted Final Estimate**	Actual Receipts	Difference from Original Estimate*		Difference from Final Estimate**	
				Amount	Percent	Amount	Percent
1989	\$ 2,007.8	\$ 2,206.9	\$ 2,228.3	\$ 220.5	11.0 %	\$ 21.4	1.0 %
1990	2,241.2	2,283.3	2,300.5	59.3	2.6	17.2	0.8
1991	2,338.8	2,360.6	2,382.3	43.5	1.9	21.7	0.9
1992	2,478.7	2,454.5	2,465.8	(12.9)	(0.5)	11.3	0.5
1993	2,913.4	2,929.6	2,932.0	18.6	0.6	2.4	0.1
1994	3,040.1	3,126.8	3,175.7	135.6	4.5	48.9	1.6
1995	3,174.4	3,243.9	3,218.8	44.4	1.4	(25.1)	(0.8)
1996	3,428.0	3,409.2	3,448.3	20.3	0.6	39.0	1.1
1997	3,524.8	3,642.4	3,683.8	159.0	4.5	41.4	1.1
1998	3,714.4	3,971.0	4,023.7	309.3	8.3	52.7	1.3
1999	3,844.7	4,051.9	3,978.4	133.7	3.5	(73.4)	(1.8)
2000	4,204.1	4,161.0	4,203.1	(1.0)	--	42.1	1.0
2001	4,420.7	4,408.7	4,415.0	(5.7)	(0.1)	6.4	0.1
2002	4,674.5	4,320.6	4,108.9	(565.6)	(12.1)	(211.7)	(4.9)
2003	4,641.0	4,235.6	4,245.6	(395.4)	-8.5	9.9	0.2
2004	4,605.5	4,450.5	4,518.7	(86.8)	(1.9)	68.2	1.5
2005	4,490.5	4,793.8	4,841.3	350.8	7.8	47.5	1.0
2006	4,834.0	5,308.7	5,394.4	560.4	11.6	85.7	1.6
2007	5,144.0	5,721.3	5,809.0	665.0	12.9	87.8	1.5
2008	5,700.4	5,736.3	5,693.3	(7.1)	(0.1)	(43.0)	(0.7)
2009	6,185.7	5,709.7	5,587.4	(598.3)	(9.7)	(122.3)	(2.1)
2010	5,974.2	5,291.0	5,191.2	(783.0)	(13.1)	(99.8)	(1.9)
2011	5,851.0	5,775.0	5,882.1	31.1	0.5	107.1	1.9
2012	6,098.9	6,404.3	6,412.7	313.8	5.1	8.4	0.1

* The adjusted original estimate is the estimate made in November or December prior to the start of the next fiscal year in July and adjusted to account for legislation enacted, if any, which affected receipts to the SGF.

** The final estimate made in March, April, or June is the adjusted original estimate plus or minus changes subsequently made by the Consensus Estimating Group. It also includes the estimated impact of legislation on receipts.

The table (above) presents estimates compared to actual receipts since FY 1975, the fiscal year for which the current process was initiated. First, the adjusted original estimate is compared to actual collections and then the final estimate is compared to actual receipts.

Concluding Comments

Consensus revenue estimates are based on current federal and state laws and their current interpretation. These estimates will be further adjusted in mid-April prior to the conclusion of the 2013 Legislative Session.

Table 1
State General Fund Receipts
(Dollars in Thousands)

	Consensus Estimate November 6, 2012					
	FY 2012 (Actual)		FY 2013 (Revised)		FY 2014	
	Amount	Percent Change	Amount	Percent Change	Amount	Percent Change
Property Tax/Fee:						
Motor Carrier	\$ 24,814	7.1 %	\$ 26,000	4.8 %	\$ 39,000	50.0 %
Income Taxes:						
Individual	\$ 2,908,029	7.3 %	\$ 2,810,000	(3.4) %	\$ 2,385,000	(15.1) %
Corporation	284,466	26.5	340,000	19.5	360,000	5.9
Financial Inst.	25,849	19.4	29,000	12.2	30,000	3.4
Total	<u>\$ 3,218,344</u>	<u>8.9 %</u>	<u>\$ 3,179,000</u>	<u>(1.2) %</u>	<u>\$ 2,775,000</u>	<u>(12.7) %</u>
Excise Taxes:						
Retail Sales	\$ 2,136,353	8.7 %	\$ 2,225,000	4.1 %	\$ 1,952,000	(12.3) %
Compensating Use	325,339	13.1	345,000	6.0	303,000	(12.2)
Cigarette	96,661	0.8	92,000	(4.8)	92,000	--
Tobacco Products	6,978	6.2	7,000	0.3	7,200	2.9
Cereal Malt Bev.	2,081	9.2	1,900	(8.7)	1,900	--
Liquor Gallonage	18,543	1.5	19,000	2.5	19,200	1.1
Liquor Enforcement	58,862	4.9	60,500	2.8	61,500	1.7
Liquor Drink	9,528	5.8	9,500	(0.3)	9,800	3.2
Corp. Franchise	9,817	(67.6)	(5,000)	(150.9)	6,000	220.0
Severance	107,253	8.7	100,100	(6.7)	137,400	37.3
Gas	40,276	(2.3)	21,200	(47.4)	33,400	57.5
Oil	66,977	16.6	78,900	17.8	104,000	31.8
Total	<u>\$ 2,771,417</u>	<u>7.8 %</u>	<u>\$ 2,855,000</u>	<u>3.0 %</u>	<u>\$ 2,590,000</u>	<u>(9.3) %</u>
Other Taxes:						
Insurance Prem.	143,180	1.0 %	\$ 140,000	(2.2) %	\$ 149,000	6.4 %
Miscellaneous	2,718	34.0	2,500	(8.0)	2,500	--
Total	<u>\$ 145,898</u>	<u>1.5 %</u>	<u>\$ 142,500</u>	<u>(2.3) %</u>	<u>\$ 151,500</u>	<u>6.3 %</u>
Total Taxes	<u>\$ 6,160,474</u>	<u>8.2 %</u>	<u>\$ 6,202,500</u>	<u>0.7 %</u>	<u>\$ 5,555,500</u>	<u>(10.4) %</u>
Other Revenues:						
Interest	\$ 9,677	(51.0) %	\$ 10,000	3.3 %	\$ 9,700	(3.0) %
Net Transfers	180,521	51.9	(101,900)	(156.4)	(155,900)	(53.0)
Agency Earnings	62,079	23.1	58,500	(5.8)	55,000	(6.0)
Total	<u>\$ 252,277</u>	<u>33.4 %</u>	<u>\$ (33,400)</u>	<u>(113.2) %</u>	<u>\$ (91,200)</u>	<u>(173.1) %</u>
Total Receipts	<u><u>\$ 6,412,751</u></u>	<u><u>9.0 %</u></u>	<u><u>\$ 6,169,100</u></u>	<u><u>(3.8) %</u></u>	<u><u>\$ 5,464,300</u></u>	<u><u>(11.4) %</u></u>

Table 2
State General Fund Receipts
FY 2013 Revised
Comparison of November 2012 Estimate to June 2012 Estimate
(Dollars in Thousands)

	FY 2013 CRE Est. as Adj. for Legis.	FY 2013 CRE Estimate	Difference	
			Amount	Pct. Chg.
Property Tax/Fee:				
Motor Carrier	\$ 21,000	\$ 26,000	\$ 5,000	23.8 %
Income Taxes:				
Individual	\$ 2,870,800	\$ 2,810,000	\$ (60,800)	(2.1) %
Corporation	270,000	340,000	70,000	25.9
Financial Inst.	26,000	29,000	3,000	11.5
Total	\$ 3,166,800	\$ 3,179,000	\$ 12,200	0.4 %
Excise Taxes:				
Retail Sales	\$ 2,225,000	\$ 2,225,000	\$ --	-- %
Compensating Use	350,000	345,000	(5,000)	(1.4)
Cigarette	92,000	92,000	--	--
Tobacco Product	6,900	7,000	100	1.4
Cereal Malt Beverage	1,900	1,900	--	--
Liquor Gallonage	19,000	19,000	--	--
Liquor Enforcement	59,500	60,500	1,000	1.7
Liquor Drink	9,300	9,500	200	2.2
Corporate Franchise	6,000	(5,000)	(11,000)	(183.3)
Severance	119,800	100,100	(19,700)	(16.4)
Gas	27,300	21,200	(6,100)	(22.3)
Oil	92,500	78,900	(13,600)	(14.7)
Total	\$ 2,889,400	\$ 2,855,000	\$ (34,400)	(1.2) %
Other Taxes:				
Insurance Premium	\$ 140,000	\$ 140,000	\$ --	-- %
Miscellaneous	2,000	2,500	500	25.0
Total	\$ 142,000	\$ 142,500	\$ 500	0.4 %
Total Taxes	\$ 6,219,200	\$ 6,202,500	\$ (16,700)	(0.3) %
Other Revenues:				
Interest	\$ 7,900	\$ 10,000	\$ 2,100	26.6 %
Net Transfers	(104,290)	(101,900)	2,390	2.3
Agency Earnings	51,510	58,500	6,990	13.6
Total Other Revenue	\$ (44,880)	\$ (33,400)	\$ 11,480	25.6 %
Total Receipts	\$ 6,174,320	\$ 6,169,100	\$ (5,220)	(0.1) %