

# A LEGISLATOR'S GUIDE

to delivering  
**BETTER SERVICE** at a **BETTER PRICE**



How to reduce government spending and create a better taxpayer experience

by Steve Anderson and Patrick Parkes

July 2014



**KANSAS · POLICY**  
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Kansas Policy Institute is an independent non-profit organization that advocates for free markets and the protection of personal freedom. Our work is focused on state and local economic issues in Kansas with particular emphasis on education, fiscal policy and health care. KPI empowers citizens and legislators with credible research and creative ideas to promote a low-tax, pro-growth environment that preserves the ability to provide high quality services. In addition to publishing issue-specific policy analysis and research KPI also operates several web sites that specialize in investigative journalism, state capital news reporting, transparency in government spending and plain language descriptions of actions taken by the Kansas Legislature.

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## Executive Summary

The recovery from the Great Recession remains a mixed bag for governments at all levels and, more importantly, individual Americans. Its longest lasting impact may be a renewed focus in public policy debates on job creation amid statements of “the new normal” in government finances. These two arguments intersect where states with the lowest tax burdens outpace the highest-burden states in private sector job growth, wage increases, and private sector GDP. It is only because of lower spending levels that states are able to extract less from their citizens in taxes and, in turn, create a more robust economic environment.

The details may differ slightly between states, but the fact remains that states must control spending in order for more jobs to be created. However, cutting spending is never an easy task and interests align in every state to protect spending. The key is to deliver better services to the consumers of public services while doing so at a lower cost to taxpayers. Fortunately, many of the money-saving approaches outlined here have been practiced in the private sector where consumers generally enjoy increasing quality and lower costs. Principles are identified via Kansas-specific examples that hold true across different areas of the country and different levels of government.

While general long-term savings must be found, there are several options available to legislators to “buy time” towards lower spending levels. For instance, state agencies in Kansas have funds with positive cash balances totaling more than \$3.86 billion that could be accessed by agencies or legislative action to spend down these balances as larger state priorities and other cost-saving measures are identified. Revenues should also be reviewed to ensure that agencies with dedicated funding sources receive funding “as needed.” The Kansas Department of Transportation has a dedicated sales tax stream that, pending an efficiency audit could increase General Fund revenue by \$161.9 million for FY 2014 and \$172 million for FY 2015.

Do state agencies need to spend \$5.8 million on Advertising as they did in FY 2012, including \$4.1 million spent by universities? This sort of discretionary spending review should be undertaken by the agencies themselves and the legislature to prioritize spending and trim unnecessary spending. Maurice McTigue is a former member of parliament in New Zealand who

consolidated 34 unemployment programs into four and placed 300 percent more people into work for 30 percent less money in the first year. Bob Williams, a former Washington State legislator, offers a formalized Priority-based budgeting system that views all of state government—all of its agencies and functions—as a single enterprise. Every undertaking is evaluated in the context of all that state government is responsible for doing and the strategies for achieving the best results are developed taking a holistic look at state resources and functions.

Privatization offer another means to force efficiency into government operations by relying on “best value” to deliver core government functions. Oliver Porter of Sandy Springs, Georgia operates a city in which nearly all government functions are undertaken by the private sector—saving money and delivering better municipal services.

Structural debts and obligations also have a tremendous impact on state spending that, at the same time, provide an opportunity to save money if solutions are properly structured. Kansas faces over \$10 billion in defined benefit debt, and moving the system to a 401(k)-style plan for new hires would save the taxpayers \$75 million in the first year while providing a richer, more transportable retirement benefit to government employees. The mechanism invests the spread between contributions to an employees retirement account and existing payments to pay down the \$10 billion debt and remove this burden from state taxpayers.

It is also important to ask policy makers which is more important—giving out selected incentives to individual businesses or lowering the tax burden on everyone in the state. Kansans dish out over \$1 billion in taxpayer-funded incentives annually to a handful of firms while over 74,000 business grow/state or shrink/close each year. Kansans should no longer tolerate attempts by politicians to select the “right” businesses to subsidize while other services are cut or taxes are increased.

None of these approaches are to be undertaken lightly or offered as an easy way to face a state's challenges. But, they must be undertaken as politicians reconcile public demands for economic growth and the unavoidable fact that the states that spend less, and tax less, have more private sector job creation and attract more new residents.



# Introduction

There is no question that states with lower tax burdens have superior economic performance. As shown in Table 1, low-burden states enjoy more than double the amount of private sector job growth experienced in their higher-burdened counterparts. They also enjoy much more robust growth in wage and salary disbursements as well as private sector GDP. Low-burden states gain population from domestic migration (U.S. residents moving from one state to another), whereas the high-burden states lose population. Kansas is not one of the ten highest-burden states but certainly has similar economic performance statistics.

It may be intuitive to assume that access to unusual revenue streams allows some states to have lower tax burdens, but, this is not the case. Florida may have unusual tourism revenue, and Texas may have higher severance tax revenues but these states could still have extremely high tax burdens if they spent more as shown in Table 2. The secret to having a low tax burden is keeping spending under control.

Every state has public schools, social-service programs, highways, prisons, etc. Some just find ways to provide essentially the same basket of services at lower prices. As shown in Table 3, there is great diversity among states that provide essential services at a better price.

States large and small, coastal and land-locked, northern and southern, as well as those with and without plentiful natural resources all find ways to provide high quality essential services at better prices.

So how can legislators lead the transition from being a high-spending state to an efficient service provider and reap the benefits of economic growth and job creation? It obviously takes a great deal of research and planning to intelligently reduce spending in ways that preserve the ability to provide quality services. Independent experts (and hopefully this Legislator’s Guide) can provide valuable guidance and assistance, but the most important element can only come from legislators and others within government: an honest, determined desire to successfully lead the transition.

Leadership is essential. This is hard work, and the resistance from special interests intent upon maintaining their place in the status quo will be considerable. The choice, however, is quite simple. Legislators and administration officials must decide whether to spur the kind of economic growth and job creation that come with having a low-tax environment or to placate the special interests that benefit from high spending.

**Table 1: Economic Performance of States with the Lowest and Highest State and Local Tax Burdens**

Economic Category	10 Lowest Burden States	10 Highest Burden States	Kansas
Private sector jobs ('98-'13)	15.8%	7.9%	3.9%
Wages & Salaries ('98-'13)	87.8%	71.4%	65.8%
Domestic Migration ('00-'13)	4.1%	-4.7%	-3.4%
Private sector GDP ('98-'12)	103.3%	73.9%	76.7%

Source: Tax Foundation, Bureau of Labor Statistics, Census, Bureau of Economic Analysis

**Table 2: 2012 State Spending Per-Resident (actual)**

State Grouping	Amount	Variance
No Income Tax	\$2,491	
Income Tax	\$3,702	49%
10 Lowest States/Local Tax Burden	\$2,781	
10 Highest States/Local Tax Burden	\$3,901	40%
10 Best State Business Tax Climates	\$2,644	
10 Worst State Business Tax Climates	\$3,919	48%

Source: National Association of State Budget Officers, Tax Foundation, Census Bureau; State and Local Tax Burden and Business Tax Climate compares ten best states to the ten worst states as ranked by The Tax Foundation. Spending from federal sources and bond issuance is excluded.

**Table 3: 2012 State Spending Per-Resident (actual)**

States	General Fund	Total
Arizona	\$1,284	\$2,363
Florida	\$1,193	\$1,862
Idaho	\$1,570	\$2,415
Missouri	\$1,318	\$2,627
New Hampshire	\$969	\$2,455
Nevada	\$1,112	\$1,830
South Carolina	\$1,168	\$2,685
South Dakota	\$1,457	\$2,608
Tennessee	\$1,810	\$2,689
Texas	\$1,684	\$2,293

Source: National Association of State Budget Officers (NASBO); total excludes spending from federal money and issuance of bonds.

Results like those listed in Table 1 are the destination, but you cannot get there with arbitrary, across-the-board spending cuts. Customers will not come for low prices and lousy quality. Customers want ‘Better Service, Better Price.’ Whether running a government or a business, the key to getting what you want is doing the best job of giving customers what they want.

Throughout this guide all data are the most recent available, unless otherwise noted. Further, “Agency” is used throughout as a universal term applied to all state entities, including universities.



## Use Multiple Cash Options to ‘Buy Time’

State governments across the country face the constant challenge of devising meaningful spending reduction opportunities that will not impact public service delivery in a negative way. However, few—if any—of these governments have committed to taking a full-scale look at their available cash reserves and other cash resources on hand. This section will outline ways in which Kansas and other states can use such resources to “buy time” while deciding on more permanent, longer-term spending reforms.

Please keep in mind that the suggestions and options set forth throughout the balance of this Guide are presented at a high, overview level. Much more detail is available and should be discussed before venturing into any particular area.

### School District Carryover Cash Balances

In the 2013 legislative session, HB 2261 identified a collection of school funds from which districts are now permitted to transfer carryover cash balances to current operations. Instead of being voluntary, as is the case under HB 2261, the amounts eligible for transfer could be treated as ‘excess local effort’ and qualify for a reduction in state aid to the districts. Such a measure would allow for a one-time reduction in state spending without districts having to reduce their own spending simultaneously. Carryover cash balances in all operating funds (excluding capital and debt) totaled \$888.2 million as of July 1, 2013.<sup>1</sup>

These Carryover Cash Balances operate similarly to a personal checking account—balances only increase when deposits exceed expenditures. In fact, Kansas school districts have increased these balances by \$430 million between 2005 and July 1, 2013. Until recent legislative changes, some of these monies could not be spent or transferred once the money was placed into a specific account (i.e., once a district places money into a specified account for a specific purpose, it cannot spend that money on a different function or transfer it to a different account). Multiple solutions have been signed into law in recent years which waive previous statutory limitations on spending/transferring or encourage the State Department of Education to change regulations to allow local districts more financial flexibility. This was not done to undermine sound financial management, but to remove unneeded regulations.

**ACTION ITEM:** Pass legislation to declare the amounts identified in HB 2261 as Local Effort and deduct from State Financial Aid. In turn, reduce state spending on K-12 by those amounts.

### Agency Carryover Cash Balances

Much like local school districts, many state agencies have built up considerable carryover cash balances that could be used to fund ongoing operations, capital investment, etc. Most people would be surprised to know that the General Fund is only one of over 1,600 active funds operated by the State of Kansas. Data obtained from the Kansas Department of Administration (KDOA) through an Open Records request shows state agencies and universities (hereinafter ‘agencies’) had unencumbered carryover cash balances totaling \$3.25 billion as of June 30, 2013.

The total includes a number of funds with negative balances, balances which KDOA says commonly result from an agency issuing obligations for goods and services in anticipation of appropriations yet to be received. Negative-balance funds totaled more than \$605 million as of June 30, 2013. That means funds with positive cash balances carried a collective total balance of more than \$3.86 billion.<sup>2</sup>

A list of agency balances is available in Appendix A.

Some of the balances are certainly dedicated to the Unemployment Trust Fund, various debt obligations, or federal programs. Funds on deposit with the Pooled Money Investment Board totaled more than \$962 million, some of which belongs to local government. A separate inquiry to PMIB would be required to understand how much belongs to state agencies. Certainly not all of the \$3.86 billion in positive balance funds can be repurposed, and it may be true that the majority cannot be accessed under current federal or state statutory requirements or state agency regulations. However, with the exception of the federal funds and certain debt funds, most of these funds can be made available to state agencies if legislators reword the statute creating the fund and/or the relevant agency removes any regulatory restraints. But, given the fact that there have been no formal legislative reviews of the necessity for these limitations for each fund balance, it is quite likely that legislators might find such a review would create greater budget flexibility for both the state and school administrations. Previously earmarked, restricted funds could be freed for general use in the short term while school districts could begin to enjoy increased longer-term autonomy in planning for and managing their unique needs.

To be clear, nothing here is intended to say or imply that anyone in government is doing anything ‘wrong’ in allowing these funds to grow and/or exist; the point is that other options exist which should be explored.

For example, the Department of Commerce was holding over \$21.6 million on June 30, 2013 in a fund called Impact Program Services. This fund distorts healthy competition among business by “picking winners” arbitrarily and handing out incentives to select businesses choosing to make Kansas home.

In short, agencies may say these carryover cash balances are intended for specific purposes, but why not use this excess cash to reduce spending, avoiding raising taxes, shift money from one agency to another, etc. While perhaps obvious, it is important to emphasize that agencies receive annual appropriations that are intended to allow them to provide necessary services in the coming year. The unencumbered carryover cash balances in many agency funds represent state tax revenue that was not spent as legislators intended (or at least reasonably assumed was necessary) in prior years. Legislators and the administration should conduct rigorous annual reviews of carryover cash balances to ensure that taxpayer money is effectively spent. If more funding than necessary was provided, it should perhaps be put to different, better, and/or more pressing use.

**ACTION ITEM:** Government can reduce spending immediately in agencies where legislators determine some carryover cash balances can be repurposed. Agencies can then spend down those cash balances while planning long term structural spending reductions through various efficiency measures.

#### **Cash Balance Questions for Agencies**

- Have agencies explain how they determine the necessary ending balance in each fund.
- Identify any legislative restrictions or regulatory agency rules that prevent the use of carryover balances in any particular funds and, to the extent that restrictions exist, explain what legislators could do to remove those restrictions and allow cash balances to be spent (similar to the content of HB 2261 in the 2013 legislative session).
- To the extent cash is being accumulated for future purchases, what other options exist that could eliminate the need for those purchases? For example, if cash is being accumulated to purchase a new accounting system or expand an existing one, why not put the entire function out to bid for privatization and require the vendor to provide their own system?
- For agencies with fee funds that are growing or large and static – why not reduce the fees charged since more has been collected than has been needed to fund operations?
- For universities with fee funds – why not use excess student fees collected to reduce tuition or declare fee holidays? Alternatively, consider reducing aid to universities and have them spend down some of the increases in their carryover cash balances.

## **Sales Tax Transfer to the Highway Fund**

The Kansas Department of Transportation (KDOT) has been able to return sales tax money to the General Fund over the last few years and received a significant funding increase in July 2013 that added an additional 0.4 percent. Current law allows for four-tenths of a percent of the sales tax to be directed to KDOT and not allocated through the legislative appropriations process.<sup>3</sup> Legislators could keep the extra four-tenths of a percent in the General Fund until such time as an extensive efficiency study determines what is really needed at KDOT. In the meantime, KDOT can make a request for funding through the regular appropriation process for this extra four-tenths if needed. Sales tax revenues reported for the General Fund are net of transfers out. Therefore, one must ‘gross up’ reported revenues to arrive at actual sales tax revenue to arrive in turn at the true amount being transferred. (From a policy standpoint, these ‘tax expenditures’ should be replaced with transparent accounting and reporting). The increase in the percentage that is transferred to the Highway Fund is how government accounts for the extra four-tenths of a cent that was scheduled to begin on July 1, 2013.

**ACTION ITEM:** End automatic fund transfers to state agencies. Instead, after agencies have demonstrated their true funding needs, address these needs through line-item allocations in the state budget.



## Review Discretionary Spending

Kansas Policy Instituted extracted data from the state's accounting system to show legislators how agencies spend money on travel, memberships, consulting, advertising, etc. so they can ask agencies to explain how services are impacted if some of that spending is eliminated.

For instance;

- State agencies spent \$5.8 million on Advertising in FY 2012, including \$4.1 million spent by universities.
- State agencies spent \$6.6 million on Out-of-State travel in FY 2012, including \$4.5 million spent by universities.
- Overtime continues to be a large item, totaling more than \$15.8 million in 2013.

### PRINCIPLE APPLIED

#### Cutting Spending Doesn't Cause the Sky to Fall

*By Maurice McTigue*

What should legislators hope to accomplish as they deliberate how to fund state governments through another fiscally constrained year?

Any politician who answers, "My goal is to fund the government for another year," would do less damage if he or she immediately went home. If, however, one answers, "This budget will improve the competitiveness of our state. It will encourage more investment, encourage growth, and help that growth create jobs," then please stick around—you are an asset to your state.

Politicians frequently overcomplicate the budget process. As a New Zealand cabinet minister, I encountered many challenges, but a few guiding principles allowed me to increase the impact of government programs, while spending less doing so.

First, legislators should stop funding programs that simply do not work. That may seem easy enough, but it means measuring successes and failures. Budgets should achieve clear benefits for the population, and these benefits should be clearly articulated. The quantity of money spent is no indication of success or failure; it is just a measure of the resources used.

Questions to ask may include: how many people gained jobs as a result of this job training program? Is that more or less than last year? How much did it cost per person? Which provider or program was most effective at placing people into work?

Then legislators should give the ratio of the worst provider's funding to the best, and shut down the worst. Programs are simply tools used to do a job and legislators should only utilize the best.

As Minister for Employment in New Zealand, I inherited 34 programs from my predecessor designed to help the unemployed. Yet an audit that measured how many people they placed back into work showed that 30 of those programs failed that test.

As a result, I closed down those 30 programs and concentrated resources on the four that worked. We placed 300 percent more people into work for 30 percent less money in the first year alone. This is results-based management, and legislators owe that kind of scrutiny to their constituents.

Second, legislators should not buy the same services from a multitude of government agencies. Government agencies have a very strong tendency to sprawl into activities that aren't part of their core business. Appropriators need to take care that they are not using the budget to buy goods and services from organizations that were never designed to provide that service. Legislators should terminate all activities that are not part of an agency's core business or transfer them to the appropriate agency. Agencies should be reduced to a size that is necessary to deliver their core business which, in turn, focuses agencies on accomplishing their missions.

We rigorously applied this criterion to the Department of Transportation in New Zealand and saw results. The department was reduced from 5600 staff to 53. We found that many services previously supplied and paid for by the department should really have been a cost to transport operators and that many of the activities should have been provided by the private sector. Restructuring returned this activity and its cost to where it should be: with the user and consumers, not the taxpayers.

So did the dramatic reduction in the Department of Transportation create chaos on the roads and potholes you could bury the Southern Cross in? No, quite the reverse in fact happened. The same quantity of money was now able to complete 40 percent more projects and that additional activity more than compensated for the workforce reduction at the Department of Transportation. Employment in the transport sector increased by about 20 percent, and road accidents continued to decline. On a wider scale applying the same philosophy across the entire government saw economic growth rates move upwards from one and two percent to between four and five percent while national unemployment fell from a

peak of 11 percent down to four percent. These results show that large, ineffective, and inefficient government can indeed be a barrier to growth and prosperity.

In summary, common sense questioning can ensure a more efficient and effective allocation of budget dollars. If you take nothing else from this guide, remember to diligently ask and insist on answers to these three questions as you consider any budget proposal:

- What will this decision do to improve the competitiveness of any state?

- What will this decision do to the intentions of job creators?
- What will this decision do to the intentions of investors?

If you don't get a positive answer to all 3 questions on each issue don't do it.

*The Honorable Maurice McTigue is a Vice President at George Mason University's Mercatus Center where he is also the director of their Government Accountability Project. Previously, he was an advisor to both the Bush and Clinton White Houses as well as a cabinet member, member of parliament, and ambassador for his native New Zealand.*



## Privatization

Kansas Policy Institute released a study (in conjunction with Reason Foundation) that explains privatization and has many examples of what state and local governments across the nation, including some in Kansas, are already doing are already doing to deliver government service via the private sector.<sup>4</sup> Agencies should be asked to identify anything that cannot be privatized and

explain their rationale. A formal process should be implemented with private sector participation to review all opportunities and begin transitions.

**ACTION ITEM:** Create a Privatization Review Panel and appoint private sector experts to work with agencies to develop and implement privatization options.

## PRINCIPLE APPLIED

### The Sandy Springs Model of Privatization

By *Oliver Porter*

*(This case study is summarized from Reason Foundation's Innovator's in Action 2009)*

In the past one hundred years there has been little change in the model for providing services by local governments. In what other area of life can we say that? In those 100 years we have seen the automobile flourish, air travel, space travel, computers and the Internet. Yet, despite millions of innovations, we plod along with the same old inefficient and unresponsive model for local government services.

In June 2005 my community, Sandy Springs, Georgia, voted with 94 percent approval to incorporate as a new city. The assumption as we began our work was that we would be forming the city in the traditional manner. Because of a very short timeline—five months—and no authority to raise funds it became obvious that it was not possible to implement the city in the traditional manner!

The result? Overwhelming citizen support of a plan that provides all of the city's services—except for police and fire—through a partnership with private industry. After a thorough bid and selection process CH2MHill-OMI, that alphabet soup is an

international firm known for engineering and consulting, was selected to operate the city.

Sandy Springs has been a success story. The city has now been efficiently running for [nine] years. While surrounding traditional cities have experienced severe budget problems during the current recession, Sandy Springs has enjoyed a \$35 million surplus, and roughly 20 percent of operating income has been available for capital improvements. Most notably Sandy Springs has no debt, no bonds and no unfunded pension liabilities. Literally zero long term liabilities. During the [nine] years of operations, Sandy Springs has paved more roads in the community than the county had in the past 20 years, created new parks, established a 125 person police force, and hired 89 firemen with all new equipment. The new city has vastly improved EMS capability, and in conjunction with a neighboring city, has established a state-of-the-art, electronic 911 service. The list of improvements is very extensive and all of these changes have been introduced without tax increases. In fact, the city's taxes are lower than the taxes on the unincorporated areas of the county.

The partnership that looked so risky at first has been an outstanding success.

*Oliver Porter was an architect of Sandy Springs, Georgia, a "start-up" city that primarily relies on privatized services for the delivery of government services.*



# Priority-Based Budgeting

Across-the-board cuts are guaranteed to harm effective services and “bake in” ineffective and/or inefficient spending. Priority-based budgeting requires each agency and the legislature to prioritize every program or service from most to least effective. Those on the bottom of the list can be considered for possible elimination and/or being scaled back. Programs and services at the top of agencies’ lists can still be reviewed for efficiency opportunities.

## PRINCIPLE APPLIED

### Priority-Based Budgeting

By *Bob Williams*

*(This article is summarized from State Budget Solutions Reality-Based Budgeting: How to permanently resolve state budget gaps.)*

Budgets drive all policy, which is why debating, writing, and approving a state budget is the primary task legislators must accomplish. Many state legislators start the budget process by taking existing programs, adjusting costs for inflation, adding case-load increases, splicing in a few new initiatives, and calling this their baseline budget. In this model cost, effectiveness and demand for existing programs is rarely considered.

Legislators should junk the old conventional model and start designing budgets from the ground up based on priorities and performance.

Priorities are determined by well-defined core functions: What is government responsible for achieving? Performance is the measure of how efficiently and effectively those priorities are delivered.

#### How it works

Priority-based budgeting views all of state government—all of its agencies and functions—as a single enterprise. New proposals are evaluated in the context of all that state government is responsible for doing and the strategies for achieving the best results are developed with an eye on all of the state’s resources. Agencies and services are all under one tent where they can be constantly evaluated to ensure they are delivering the highest priorities as efficiently and effectively as possible.

Priority-based budgeting prompts governors and legislators to ask four key questions at the start of each legislative session:

- What must the state accomplish?

**ACTION ITEM:** Issue Executive Order requiring agencies to fully cooperate with priority-based budgeting procedures developed by the Kansas Division of the Budget (DOB) or the legislature. Agencies’ program priorities (with associated costs) should be published in a central location on the state’s web site within thirty days for public inspection.

- How will the state measure its progress and success?
- How much money does the state have available to spend?
- What is the most efficient and effective way to deliver essential services within available funds?

#### Question #1: What must the state accomplish?

The first step in responsible budgeting is to determine the state’s core functions: the essential services it must deliver to citizens, in priority order. We suggest developing a meaningful list of no more than ten core government functions.

Once the core functions are determined, they should serve as a litmus test for the hundreds of agencies, boards, commissions, programs and services currently being funded, as well as all future proposals. Agencies should be asked to submit their budgets based on delivering one or more of the state’s identified core functions. If an agency or program is not advancing one of these functions, it should be abolished.

#### Question #2: How will states measure progress or success?

After identifying the state’s core functions, legislatures must define specific and measurable results to be achieved, as well as benchmarks to measure progress toward those results.

Once the state and agencies have defined what it looks like to successfully achieve government’s core functions, legislators must determine how to measure progress toward those outcomes. Performance indicators are a key tool to make accountability possible by allowing legislators and agencies to answer the question: “Are we making progress toward our goals?”

#### Question #3: How much money does the state have available to spend?

States should not spend or plan to spend more than the forecasted revenue for the next budget period. We recommend forming a non-partisan revenue forecast council to provide a bottom line before budget discussion begins.

**Question #4: What is the most efficient and effective way to deliver essential services within available funds?**

This question is about making sure essential services are delivered as efficiently and effectively as possible without compromising on cost and quality.

Once agencies have submitted a budget, legislative policy committees should carefully review all agency priorities and budget requests under their jurisdiction to determine whether or not they comply with core functions of government that have been adopted.

As lawmakers review agency goals and confirm they are core functions, they should consider whether government must actually deliver the services that accomplish those goals, or whether government's duty is simply to ensure the goals are accomplished. (See privatization section of this guide.)

**Conclusion**

Essentially priorities based budgeting changes the budget submission rules. Agency budgets become less about requesting funding, and more about offering to deliver specific results for a specific price.

Priorities based budgeting serves citizens well by ensuring government delivers essential services as efficiently and effectively as possible. It maximizes the value of each hard-earned tax dollar, which is an important responsibility of legislators. It protects vulnerable programs from election-year rhetoric. It provides a logical place to begin meaningful debate and restructure spending.

*Bob Williams is the president of State Budget Solutions, a former Washington state representative, and formerly a member of the General Accountability Office.*



## KPERS School and State Pension Reform

Currently, the taxpayers of Kansas, a group which includes the beneficiaries of our state's Defined Benefit (DB) pension system, face \$10.253 billion in unfunded liabilities for future retirement benefits.<sup>5</sup> Courts have in general held these unfunded liabilities are an absolute obligation of the state and therefore this is real debt whose future repayment will be made. Failing to pay or reducing the benefits that were guaranteed to teachers and state employees, even if legal, would constitute a breach of trust between Kansans and those in government service. However, the very size of the KPERS debt makes it clear that all Kansans will be paying this debt for generations to come via either increased taxes or reduced funding for other services such as public education or social services.

While the debt itself is staggering, the increased payments from employers (i.e., USD 999 employing an elementary school teacher) to meet this obligation is clear when one considers the potential annual increase in tax dollars being used to pay the debt. For instance, Chart 1 demonstrates that in FY 2019 the legislature would have to find an additional \$750 million dollars to pay for already-accrued debt. By way of reference, \$750 million is approximately 2 ½ times the amount Kansans spent on Public Safety and almost equal to the entire amount spent on Higher Education in FY 2014. By FY 2033, that amount is approaching a staggering \$2 billion, about one third of the amount allocated for K-12 public education in the 2013/2014 academic year. Even those who may not fully appreciate the concept of Unfunded

Actuarial Accrued Liabilities (UAAL), the technical name for this debt, will certainly understand the outflow of cash from the state treasuries at ever increasing rates and the "crowd-out" effect this will certainly have on other state priorities.

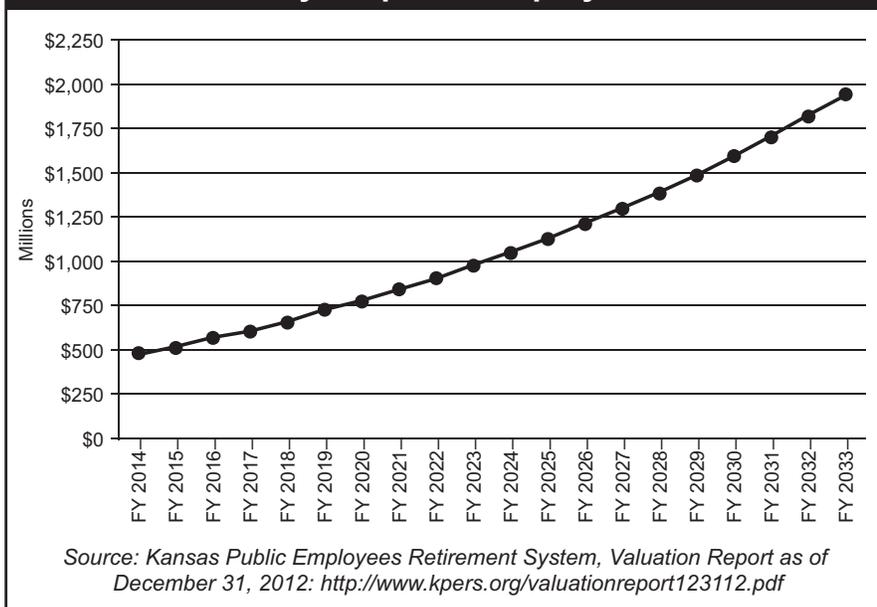
These payments are in addition to the regular employer contributions for each employee and already are approaching a half billion dollars of funds that could be used for other purposes.

### Budgets Considerations

While this problem is not new, or unique to Kansas, recent legislative attempts to address it have not made enough progress. An immediate, long-term solution is needed and more of the same is not the best answer. A recent report from the Kansas Division of the Budget (DOB) offers a clear path towards addressing the long-term needs of both beneficiaries and taxpayers.<sup>6</sup>

The actuarial report commissioned by the DOB outlines a plan in which new members to a KPERS fund will be placed in a Defined Contribution plan (DC) with employer contributions (i.e., USD 999 for a public school teacher) to an individual employee's dedicated retirement account starting, this is similar to a 401(k) in the private sector. Starting at three percent in the first year, this annual retirement contribution would increase one percent per year until reaching eight percent in the sixth year, where it would remain as long as the employee remained in an eligible position, and would be in addition to salary and other benefits. Participants are free

**Chart 1:  
KPERs Statutory Required Employer Contribution**



bonded debt is understandable and any new debt obligation should be undertaken with a great deal of caution. However, explicitly tying the bonding proposal to a DC conversion (i.e., bonding should not be allowed to take place without a conversion) should be viewed primarily as means to refinance pension debt at a lower interest rate. The financial benefits of using tax exempt bonds and the accompanying low interest rate(s) to increase the speed with which the outstanding debt is eliminated. As a tax exempt bond is the key to making the proposal feasible, to work properly the bonds must be financed outside of the pension system. Bond proceeds would directly benefit taxpayers via the retiring of existing pension debt when the funds were handed over to

to make additional contributions, up to the legal pre-tax limit, to increase the value of their retirement savings.

Current non-vested and vested members will be voluntarily allowed to convert the present value of their DB funds to a DC plan. Years of service would be used to determine their DC employer contribution amount (i.e. employees with six years of service would be immediately at the eight percent level).

The conversion of all future hires and voluntary transitions for current members to a DC plan still will require the DB plan to operate for approximately 65 more years; through the life of its remaining beneficiaries but with reduced administrative expenses.

The state can issue bonds to “bridge” the time from inception of the DC to 25 years in the future when an individual retiree’s cash flow reaches its inflection point. The inflection point arrives when the amount of payments to the DB plan starts to decrease as a result of beneficiary deaths and 25 years of no new DB plan members. The revenue flowing from the savings from the DC plan expands over time, building an ever-growing stream of funds to pay off any bonds. Hesitancy in

KPERs as payment towards the UAAL. The savings between the eight percent employer contribution in the DC plan and the current employer contribution to the Defined Benefit Plan is the ideal mechanism to retire these bonds. Those funds should be left in the General Fund, and the bonds must be general obligation debt to accomplish receiving the tax exempt status attached to regular state bond issues. A simplified way to illustrate the idea of bonding pension debt, only upon transition to a DC plan, is to think of refinancing a mortgage at a lower interest rate.

As noted above, the state contracted with an actuarial firm to assess the impact of such a conversion and its impact on unfunded debt and state coffers. The actuarial firm recognized a first-year savings of \$75 million while providing a richer, more transportable retirement benefit to government employees. Note, this \$75 million in first year saving would be in addition to the savings outlined in Table 4.

In addition, Kansas’ bond rating will be free from staggering debt.<sup>7</sup> This freedom will prevent other state priorities from being “crowded out.” Lastly, all Kansans could benefit from lower state taxes in the future.

**Table 4: Savings to Kansas General Fund Budget of KPERs DC Conversion (in millions)**

	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024
Yearly Savings	\$58.6	\$60.9	\$63.4	\$65.9	\$68.5	\$71.3	\$74.1	\$77.1	\$80.2
Cumulative Savings Impact	\$58.6	\$119.5	\$182.9	\$248.7	\$317.3	\$388.5	\$462.7	\$539.7	\$619.9



# Economic Development Incentives

Hillshire Brands boasted a market capitalization of \$4.33 billion in 2011 but received \$57 million in subsidies from Kansas in 2011.<sup>8</sup> Kansas gave Caterpillar \$2.25 million that same year, despite Caterpillar hauling in a profit equal to 84 percent of the Kansas General Fund.<sup>9</sup> Yet, policy makers continue to dish out over \$1 billion in taxpayer-funded incentives annually to these larger, multi-national private sector companies.

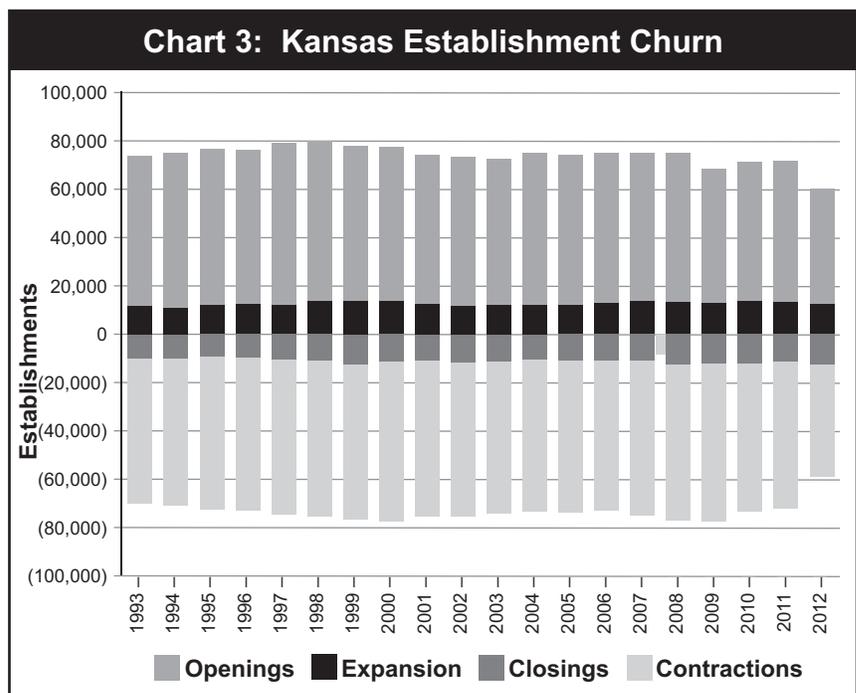
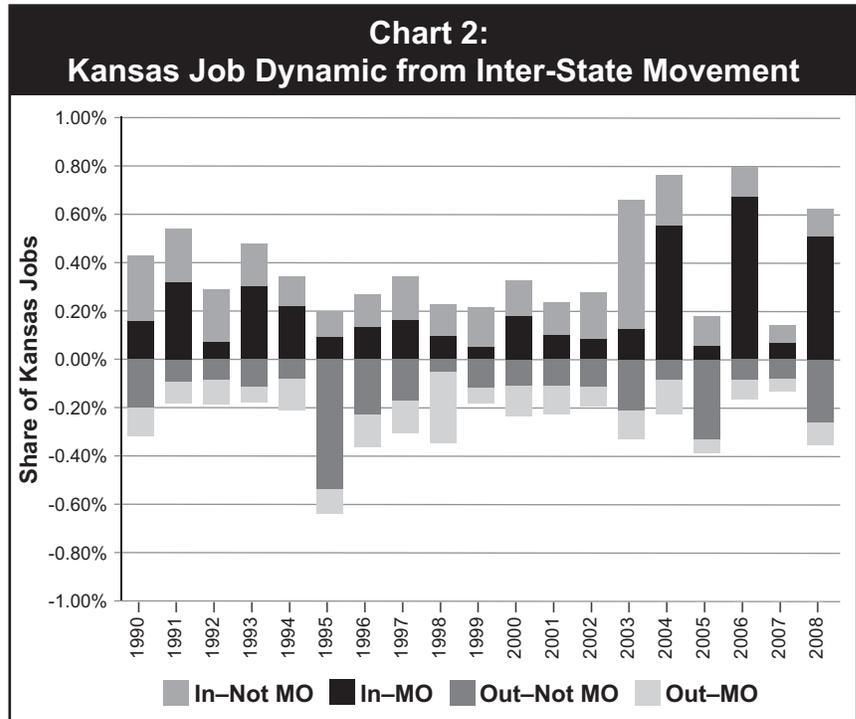
Research by University of Kansas economist Art Hall demonstrates the job gains from incentives are too small to move the needle on aggregate employment in the state. Chart 2, compiled by Dr. Hall, shows that less than 1/2 of one percent of all Kansas jobs are gained or lost due to businesses crossing the Kansas border, meaning over 99.5 percent of new jobs come from existing business expansion or new formation.<sup>10</sup> Between 1993 and 2012, Kansas has averaged 74,267 business expansions and formations each year while the average number of business contractions and closings has been 74,042.<sup>11</sup> The natural churn of the Kansas economy is too large for a few special deals to contribute to overall employment.

These incentives are not only costly and of limited impact; they give select businesses a cost advantage over their competitors.

Taxes on non-favored Kansas' businesses are higher than they otherwise would have been because of these subsidies. Kansans have to pay for the subsidy, the bureaucratic infrastructure, and additional public services used. Few mom and pop shops can foot this increased bill and compete with a subsidized "destination retailer" or other recipient of government largess.

A better economic policy would leave ordinary Kansans—not government—to determine which businesses provide the best product at the best price. In doing so the state would save over \$1 billion annually, helping Kansas implement lower taxes across the board.

**ACTION ITEM:** Government can reduce spending and level the playing field by phasing out the over \$1 billion in business incentives handed out each year.





# General Efficiency Review

Agency programs and functions that are not candidates for privatization should be thoroughly examined to determine how to provide the same, or better, service at a better price to taxpayers.

**ACTION ITEM:** Create a State Efficiency Commission and appoint private sector experts in logistics, communications, purchasing, finance, IT, and other key areas to review agency operations.

## **Operational Issues: Process and Procedures that Can Reduce Costs without Impacting Services**

### **Asset Turnover**

Government agencies tend to use a different approach to the acquisition of assets—ranging from computers to cars—than the private sector. Asset replacement decisions rotate around fixed points in an asset's life. (e.g, the age of a desktop computer or the number of miles on a state car.) This approach is carried on the assumption that agencies avoid unnecessary expenditures and/or untimely asset breakdowns during emergencies.

In making more macro-level determinations about the necessity of each agency as a whole, there are certainly some agencies that are indispensable under the "safe is better than sorry" justification (e.g. Highway Patrol). Taxpayers expect what are typically public safety agencies to operate under this belief and are willing to accept a premium price for these agencies. However, most agencies should be buying and/or replacing assets only when needed instead of on a set schedule.

Yet, there are a few hurdles to clear in order to change the bureaucratic approach to the turnover of assets. The very nature of the state budgeting process reinforces the scheduled approach to asset turnover because agencies can "anticipate" purchases and build them into their budget request. This results in assets that are still fully functioning being disposed of early and unnecessarily. For example, in today's server-based environment, the quality of desktop computers required for workstations no longer requires the continual updates of the past for replacement to stay operable.

Legislators should ask agencies to disclose their approach to asset turnover during the budgeting process and—where appropriate—ask agencies to use as-needed procedures instead of using a fixed schedule.

### **Expose Hidden Costs of Services**

Many agencies perform services for other agencies but do not bill agencies for those services. For example, the

Kansas Public Employees Retirement System is a separate agency with its own appropriation and budget that administers the retirement systems for all state agencies and state school districts. Another example would be the Kansas Department of Revenue, which operates as the "cash register" for all state agencies and schools by collecting and disbursing things such as income and sales taxes. These costs are not reflected in the agencies for which they provide the services and thus understate the true cost of the services those agencies provide.

Secondly, when there is an attempt to outsource or privatize a state function, the agency makes an argument that they can do the function at a lower cost than the private sector, in part, because of these hidden costs. This prevents a true "apples to apples" comparison of the private sector and government service costs.

Legislators should request that all agencies providing services to other agencies begin billing for those services. The end goal should be to remove those supporting agencies, such as KPERS, from appropriations and transfer those appropriations to the agency receiving the service. KPERS and the other supporting agencies would then bill for their services to the respective agency bringing greater transparency to the full cost of government services.

### **Free Agencies from Unnecessary Bureaucratic Controls**

Legislators should allow agencies the freedom to choose whether they contract with the organizations outside of Department of Administration (KDOA) or Office of Information Technology (OITS) for certain activities. These are the two most commonly-utilized agencies for services, but current regulations and internal processes bind many state agencies to these "central service" providers. The services needed range from computer maintenance to human resources to renting meeting space. Every service provided by KDOA and OITS should have the "yellow pages test" applied to it; the "yellow pages test" states that if a service can be found in the local Yellow Pages then a government entity should be forced to justify why they are the best delivery option instead of relying on a presumption that they are, in fact, the best deliver option. Thus, if that service is available in the private sector, agency should be allowed to consider contracting with a private vendor. Legislators should ask KDOA and OITS to substantiate their billings and allow state agencies to look at outsourcing options if they believe they will get lower costs and/or better service.

**Require School Districts to Stop Paying Federal Expenses With State Taxpayer Funds**

There are a number of state employees and school employees who have their salaries paid by federal sources. These salaries include the cost of benefits such as retirement contributions to KPERS. The federal government will also pay their share of unfunded liabilities when the state makes payments on those debts. The state has a dedicated-by-statute funding source for the unfunded liabilities belonging to both state employees and the schools that increases every year

(Note: Last year's payment was \$408.1 million). School districts often do not include this amount in the salary figures of these federal/state employees. The net result of this practice is that state funds are being used to pay for benefits that should be charged to federal government. By requiring the schools to run the funds they receive from the statutorily required KPERS payment through their payroll systems, state monies can be freed up for other purposes or, at the very least, freed up to make additional payments on KPERS' large unfunded liability.



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## Conclusion

A sign hangs in the Kansas Capitol quoting President Dwight Eisenhower, a native son of Kansas, pointing out that politicians think of today while statesmen think of tomorrow. A cliché, perhaps, but one that needs heeding. Most budgetary decisions are made with a short time horizon, often the next election, while long term impacts are considered secondary. Challenges are allowed to grow into problems that ultimately harm the opportunities for economic growth and job creation.

Citizens of every state are often met with ultimatums of, “We must raise taxes or cut services.” This budget guide

outlines clear steps that can be taken to undermine that line of reasoning. Again, not hard and fast rules but principles that should inform legislative intent, bureaucratic action, and citizen education.

None of the approaches outlined are to be undertaken lightly or offered as an easy way to face a state’s challenges. But, they must be undertaken as politicians reconcile public demands for economic growth and the unavoidable fact that the states that spend less, and tax less, have more private sector job creation and attract more, new residents.

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## End Notes

<sup>1</sup> <http://www.kansasopengov.org/SchoolDistricts/CarryoverCashBalance/tabid/1490/Default.aspx>

<sup>2</sup> <http://www.kansasopengov.org/StateGovt/CarryoverCashBalance/tabid/2236/Default.aspx>

<sup>3</sup> K.S.A. 79-3620

<sup>4</sup> <http://www.kansasopengov.org/StateGovt/SpendingCategories/tabid/2074/Default.aspx>

<sup>5</sup> “Kansas Public Employees Retirement System Valuation Report.” Cavanaugh McDonald Consulting (2012): 1-126. Print.

<sup>6</sup> FTI Actuarial and Consulting Inc, report completed for Kansas Division of the Budget on September 1, 2013

<sup>7</sup> [https://www.moodys.com/research/Moodys-downgrades-Kansas-issuer-rating-to-Aa2-from-Aa1-notched—PR\\_298383](https://www.moodys.com/research/Moodys-downgrades-Kansas-issuer-rating-to-Aa2-from-Aa1-notched—PR_298383)

<sup>8</sup> <http://www.kansaspolicy.org/ResearchCenters/BudgetandSpending/BudgetandSpendingStudies/d101605.aspx?type=view>

<sup>9</sup> <http://www.nytimes.com/interactive/2012/12/01/us/government-incentives.html#KS> and WSJ

<sup>10</sup> NY Times, WSJ <http://quotes.wsj.com/CAT/financials/annual/income-statement>, FY 2014 Governor’s Budget Report—Volume 1.

<sup>11</sup> Dr. Art Hall, April 2nd 2013. <http://www.youtube.com/watch?v=rONRjyiFvX8>

## Appendix A: State Carryover Cash by Agency

Agency Name	FY2003 (\$)	FY2013 (\$)	% Change	Agency Name	FY2003 (\$)	FY2013 (\$)	% Change
Abstracters Brd of Examiners	36,426	4,550	-87.51	Lansing Correctional Facility	39,211	160,164	308.47
Board of Accountancy	338,807	420,786	24.20	Larned Corr Mental Hlth Fclty	5,834	10,954	87.76
Adjutant General	4,238,966	(12,709,392)	-399.82	Larned State Hospital	863,753	3,572,574	313.61
KS Dept for Aging & Disab Svs	6,162,401	10,495,822	70.32	Larned Juvenile Correct. Facil.	(1,850,500)	1,649	-100.09
Kansas Dept of Agriculture	6,163,660	7,084,347	14.94	Legislative Coordinating Cncl	-	-	N/A
Kansas Human Rights Commission	149,934	185,224	23.54	Legislature	77,717	122,364	57.45
Attorney General	2,796,508	22,733,122	712.91	State Library	5,907	524,143	8772.73
Kansas Bureau of Investigation	1,118,492	5,168,865	362.13	Lieutenant Governor	-	-	N/A
Bank Commissioner	3,538,778	6,838,350	93.24	The Kansas Lottery	2,279,422	5,852,714	156.76
Board of Barbering	8,557	27,343	219.55	Board of Nursing	741,465	1,214,632	63.81
Behavioral Sciences Reg Board	323,034	794,410	145.92	Optometry Board of Examiners	96,856	408,829	322.10
State Board of Healing Arts	1,135,419	3,630,978	219.79	Osawatomie State Hospital	676,353	2,913,711	330.80
Citizens Utility Ratepayer Bd	148,345	145,443	-1.96	Parsons St Hosp & Trng Center	325,379	1,085,067	233.48
Corporate Commission	9,991,609	20,360,127	103.77	Department of Corrections	52,536	3,319,303	6218.21
Inmate Benefit	2	-	-100.00	KS Correctional Industries	3,542,103	5,491,447	55.03
Board of Cosmetology	396,021	941,737	137.80	Kansas Parole Board	-	-	N/A
Department of Credit Unions	365,590	315,814	-13.62	KS Comm Peace Ofcrs Std & Trng	-	631,534	N/A
Dental Board	278,730	438,023	57.15	Board of Pharmacy	1,337,688	1,721,681	28.71
Intragovernmental Printing Service	2,788,143	-	-100.00	Post Audit Legislative Div	(800,000)	(96,900)	-87.89
Department of Administration	94,249,990	60,822,651	-35.47	Real Estate Appraisal Board	485,957	327,702	-32.57
Kansas Housing Resources Corp	-	1,689,789	N/A	Real Estate Commission	1,259,368	602,140	-52.19
Ks Development Finance Auth.	1,380,728	435,626	-68.45	Kansas Racing & Gaming Comm	2,270,158	4,021,499	77.15
Ellsworth Correctional Fclty	5,151	23,971	365.32	Rainbow Mental Health Facility	394,161	1,606,817	307.66
Office of Administratv Hearings	-	221,578	N/A	Board of Regents	3,623,343	12,586,438	247.37
El Dorado Correctional Fclty	-	1,172	N/A	Court of Tax Appeals	5,071	697,589	13655.33
Board of Mortuary Arts	159,760	250,755	56.96	Department of Revenue	119,318,987	150,768,108	26.36
Emergency Medical Services	703,886	903,761	28.40	Revisor of Statutes	-	-	N/A
Fire Marshal	3,004,476	6,393,642	112.80	Norton Correctional Facility	124,896	20,149	-83.87
Fort Hays State University	11,297,117	51,166,954	352.92	School for the Blind	605,609	135,878	-77.56
KS Gvmtl Ethics Commission	143,375	422,031	194.35	School for the Deaf	929,154	540,044	-41.88
Governor	103,282	1,492,825	1345.38	Secretary of State	5,715,615	7,139,174	24.91
Kansas Guardianship Program	-	-	N/A	Securities Comm of Kansas	272,259	553,323	103.23
Dept of Health & Environment	35,689,058	349,846,811	880.26	Kansas Sentencing Commission	(1,310,722)	1,207,446	-192.12
Bd of Examnrs for Hearing Aids	30,323	41,827	37.94	Dept for Children and Families	(651,846)	17,096,490	-2722.78
Hlth Care Stabilization Fund B	428,214	1,730,588	304.14	Department of Education	2,503,878	1,758,580	-29.77
Department of Transportation	(614,560,682)	(143,636,791)	-76.63	Topeka Correctional Facility	239,466	219,017	-8.54
Highway Patrol	7,841,489	18,053,845	130.23	Technical Professions St Bd	1,151,544	1,534,364	33.24
Kansas Historical Society	3,284,551	3,632,955	10.61	State Treasurer	18,521,852	84,335,591	355.33
KS Home Inspectors Regstrtn Bd	-	62,384	N/A	Pooled Money Investment Board	338,213,838	962,337,749	184.54
Department of Labor	397,640,523	191,463,713	-51.85	Judicial Branch	7,729,114	13,689,891	77.12
Dept of Commerce	21,914,524	34,769,088	58.66	University of Kansas	40,894,856	138,757,013	239.30
Hutchinson Correctional Fclty	118,976	126,797	6.57	University of Ks Med Center	57,516,885	36,580,648	-36.40
Juvenile Corrections	(5,407,456)	2,465	-100.05	Veterans Commission	(1,847,552)	1,056,516	-157.18
Indigents Defense Svcs St Bd	44,533	18,767	-57.86	Board of Veterinary Examiners	279,043	298,754	7.06
Information Network of Kansas	-	421	N/A	Kansas Water Office	2,382,946	3,564,498	49.58
Insurance Department	12,674,098	18,171,613	43.38	KS Wildlife, Parks & Tourism	16,813,776	27,780,993	65.23
Judicial Council	173,490	248,483	43.23	Winfield Correctional Facility	20,492	51,710	152.34
Juvenile Justice Authority	4,566,454	469,804	-89.71	Wichita State University	35,050,225	91,053,886	159.78
Kansas Juvenile Correct. Cmplx	-	7,886	N/A	State General Fund	122,733,886	711,687,602	479.86
Juvenile Corrections	21,805	-	-100.00	Expanded Lottery Act Revised FD	-	1,659,939	N/A
Kansas Arts Commission	8,810	3,125	-64.53	State Water Plan	1,849,500	5,191,064	180.67
Kansas Inc	2,318	-	-100.00	State Economic Development Initiatives	1,403,082	8,139,335	480.10
Kansas Neurological Institute	183,633	173,461	-5.54	Children's Initiatives	2,842,813	4,258,868	49.81
KS Pblc Employees Retiremnt Sys	(5,159,432)	(10,915,832)	111.57	State Budget Stabilization Fund	369,156	-	-100.00
Kansas State University	72,603,247	189,094,132	160.45	Kansas Endowment for Youth	-	3,966,133	N/A
Ks Technology Enterprise Corp	70,576	667	-99.05	Kansas Educational Building	6,602,449	21,076,466	219.22
Kansas State Fair Board	(410,708)	781,938	-290.39	State Institutions Building	15,387,073	12,057,315	-21.64
Emporia State University	13,284,242	20,126,684	51.51	Corrections Institutions Building	1,585,102	2,157,260	36.10
Pittsburg State University	9,807,520	35,489,795	261.86	<b>State Total</b>	<b>918,556,452</b>	<b>3,257,914,788</b>	<b>254.68</b>

Source: <http://www.kansasopengov.org/StateGovt/StateofKansasCarryoverCash/KansasStateAgenciesCarryoverCash/tabid/2237/Default.aspx>

Note: Data obtained via a Kansas Open Records Request (Hard copy in author's possession)





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