



## A Legislator's Guide to Delivering Better Service at a Better Price: how to reduce government spending and create a better taxpayer experience.

### **Introduction**

There's no question that states with lower tax burdens have superior economic performance. As shown in Table 1, low-burden states have three times the rate of private sector job growth and much more robust growth in wage and salary disbursements and private sector GDP. Low-burden states gain population from domestic migration (U.S. residents moving in and out of states) whereas the high-burden states lose population. Kansas is not one of the ten highest-burden states but certainly has similar economic performance.

**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-'12)	12.2%	4.1%	1.6%
Wages & Salaries ('98-'11)	70.7%	58.7%	52.1%
Domestic Migration ('98-'12)	3.8%	-4.6%	-2.9%
Private sector GDP ('98-'11)	92.5%	66.9%	65.6%

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

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

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

State Grouping	Amount	Variance
No Income Tax	\$2,604	
Income Tax	\$3,764	45%
Lowest State/Local Tax Burden	\$2,784	
Highest State/Local Tax Burden	\$4,022	44%
Best Business Tax Climate	\$2,639	
Worst Business Tax Climate	\$3,896	48%

*Source: National Association of State Budget Officers, Tax Foundation, Census Bureau; State & 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.*

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.

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

States	General Fund	Total
Alabama	\$1,467	\$2,494
Arizona	\$1,285	\$2,402
Florida	\$1,199	\$2,238
Idaho	\$1,597	\$2,635
Missouri	\$1,318	\$2,628
New Hampshire	\$969	\$2,555
Nevada	\$1,125	\$2,019
South Carolina	\$1,155	\$2,663
South Dakota	\$1,458	\$2,610
Tennessee	\$1,869	\$2,715
Texas	\$1,695	\$2,310

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

States large and small... coastal and land-locked... northern and southern...with and without plentiful natural resources...they all find ways to provide essential services at a better price.

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 it is more important to have the economic growth and job creation that comes with having a low-tax environment...or placate the special interests that benefit from high spending.

Results like those listed in Table 1 are the destination, but you can't get there with arbitrary, across-the-board spending cuts. Customers won't 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.

## **Use Multiple Cash Options to 'Buy Time'**

Kansas legislators face a unique challenge in having to adjust spending in a short period of time in order to implement the 2012 tax reform. Across-the-board spending reductions are expedient but almost assuredly result in unnecessary negative impacts on services. Thoughtful, effective spending reduction takes time but legislators only have 90 days (and even less now) to produce a budget.

This conundrum has prompted a number of legislators to consider raising the sales tax and eliminating some income tax deductions because they don't believe there is time to properly reduce spending. Fortunately, there are ways for the 2013 Legislature to 'eat their cake and have it, too.'

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.

### **Agency Carryover Cash Balances**

Much like local school districts, many state agencies have built up considerable carryover cash balances that could be used. Most people would be surprised to know that the General Fund is only one of 1,461 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 \$2.5 billion as of June 30, 2012.

The total includes a number of funds with negative balances, which KDOA says commonly results from an agency issuing obligations for goods and services in anticipation of appropriations yet to be received. Negative-balance funds totaled \$899 million as of June 30, 2012; that means funds with positive cash balance totaled \$3.4 billion.

A list of agency balances is attached. A complete list of funds by agency for FY 2005 through FY 2012 is available for download at [KansasOpenGov.org](http://KansasOpenGov.org).<sup>i</sup>

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 \$835 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 \$3.4 billion in positive balance funds can be repurposed and it may well be that the majority cannot. But given the fact that there are no formal legislative reviews of the necessity for each fund balance, it's quite likely that legislators might find enough that could have a significant impact on efforts to balance the budget.

To be clear, nothing here is intended to say or imply that anyone in government is doing anything 'wrong;' the point is that other options exist which should be explored.

For example, Department of Commerce was holding over \$100 million on June 30, 2012 in a fund called Impact Program Services; that's money given to select businesses as 'economic development'. Commerce also has another \$24 million in a collection of other economic development funds.

Department of Revenue has \$1.7 million in a collection of funds set aside to pay tax refunds, even though refunds are not paid out as an expense; instead they are deducted from gross revenue, which means there is no accounting need for expense reserves.

KDOR also has a number of other funds which may hold considerable balances that could be repurposed, including:

- ✓ \$1.9 million Photo Fee Fund
- ✓ \$2.6 million Ethyl Alcohol Production Incentive
- ✓ \$2.3 million Electronic Databases Fee

Agencies may say these carryover cash balances are intended for specific purposes, but Legislators can and should question whether it is better to use this excess cash to avoid raising sales tax, eliminating mortgage deductions or reducing spending elsewhere. 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 annually conduct rigorous reviews of carryover cash balances to ensure that taxpayer money is effectively spent; if more than was necessary was provided, it should be put to different and better use.

**Action item: Government can reduce spending immediately in agencies where legislators determine some carryover cash balances can be repurposed and force agencies to 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 that prevent the use of carryover balances in any particular funds and, to the extent that restrictions exits, explain what legislators could do to remove those restrictions and allow you to spend down cash balances.
- 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 you charge since you have collected more 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.
- Have the Pooled Money Investment Board identify balances invested by entity (agency and local governments) to determine whether any state agency money is available for repurposing.

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

KDOT has been able to return sales tax money to the General Fund over the last few years and now is scheduled to receive a significant funding increase in July. Secretary King continues to find more ways to reduce costs. Instead of raising the sales tax to 6.3%, 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.

Sales Tax Transfer to Highway Fund (dollars in thousands)		
States	FY 2013	FY 2014
Retail Sales Tax (net of transfer)	\$2,225,000	\$1,952,000
Compensating Use Tax (net of transfer)	\$345,000	\$303,000
total net of transfer (1)	\$2,570,000	\$2,255,000
% transferred to Highway Fund	11.233%	18.421%
Gross Sales & Use Tax (2)	\$2,895,220	\$2,764,192
Tax transferred to Highway Fund (2) minus (1)	\$325,220	\$509,192
Time lag effect built in to Consensus Revenue Estimates		-\$22,060
Tax transferred to Highway Fund		\$487,132
Increased sales tax allocation to Highway Fund for FY 2014		\$161,912

*Source: KLRD; Consensus Revenue Report, November 2012; Kansas Division of the Budget. Sales tax is remitted a month in arrears and Budget estimates that 'time lag' to reduce the transfer by \$22.1 million.*

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 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 is scheduled beginning July 1. (The increase will actually amount to 0.34 cents instead of 0.40 cents because the allocation was increased slightly over the last two years to provide a fixed dollar amount of tax revenue to the Highway Fund.)

Sales Tax Allocation		
States	FY 2013	FY 2014
State sales tax rate	6.300%	5.700%
Percent allocated to Highway Fund	11.233%	18.471%
Percent allocated to General Fund	88.767%	81.529%
	100.000%	100.000%
Portion of tax rate for Highway Fund	0.71%	1.05%
Portion of tax rate for General Fund	5.59%	4.65%
	6.300%	5.700%

**Action Item: Keep the sales tax allocation to Highways at 11.233% until an efficiency / needs audit of the Kansas Department of Transportation is completed to determine how much sales tax revenue is actually required. Doing so would increase General Fund revenue by \$161.9 million for FY 2014 and \$172 million for FY 2015.**

### **School District Carryover Cash Balances**

HB 2261 identifies a collection of school funds from which districts are permitted to transfer carryover cash balances to current operations. The amount eligible to be transferred is \$114 million as calculated by KSDE.

Instead of being voluntary, the amounts eligible for transfer could be treated as 'excess local effort' and qualify for a reduction in state aid. That would allow state spending to be reduced (one time) by \$114 million without districts having to reduce spending. Carryover cash balances in all operating funds (excluding capital and debt) totaled \$889 million as of July 1, 2102.

**Action Item: Pass legislation to declare the amounts identified in HB 2261 as Local Effort and deduct from State Financial Aid. Reduce state spending on K-12 by \$114 million.**

### **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.<sup>ii</sup>

- State agencies spent \$5.8 million on Advertising, including \$4.1 million spent by universities. The Department of Transportation spent \$336,000.
- State agencies spent \$6.6 million on Out-of-State travel, including \$4.5 million spent by universities.

- Overtime continues to be a large item, totaling \$10.3 million in 2011 (calendar year 2012 data is still being processed).

### **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 are already doing.<sup>iii</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.***

### **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 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.

***Action Item: Issue Executive Order requiring agencies to fully cooperate with priority-based budgeting procedures developed by the Kansas Division of the Budget. 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.***

### **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.***

Note: 'Agency' is used throughout this Guide as a universal term and is intended to apply to all state entities, including universities.

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<sup>i</sup> <http://www.kansasopengov.org/StateGovt/CarryoverCashBalance/tabcid/2236/Default.aspx>

<sup>ii</sup> <http://www.kansasopengov.org/StateGovt/SpendingCategories/tabcid/2074/Default.aspx>

<sup>iii</sup> <http://www.kansaspolicy.org/researchcenters/budgetandspending/budgetandspendingstudies/101605.aspx>