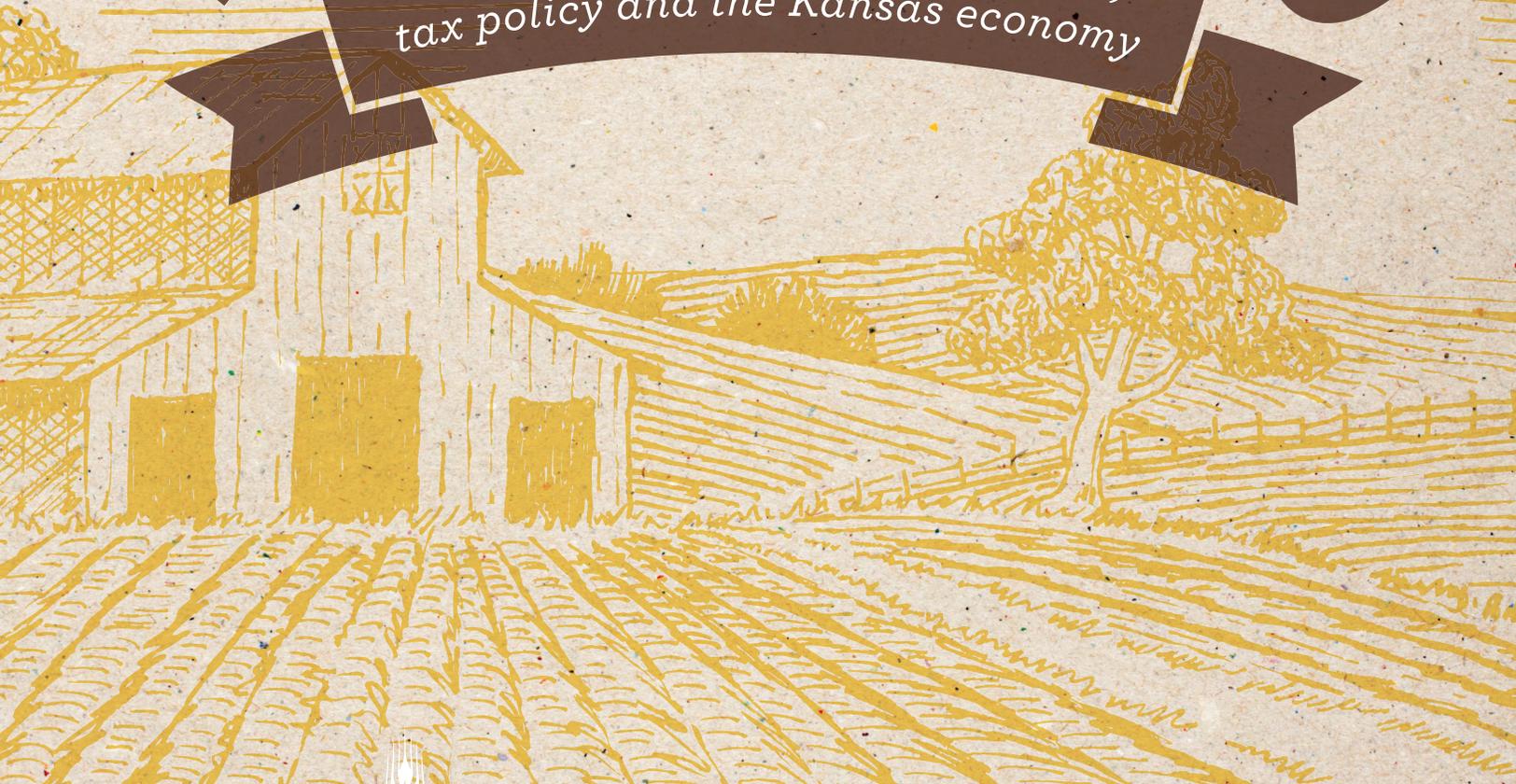


LAY OF THE LAND

Understanding commodity prices,
tax policy and the Kansas economy



Kansas
CENTER FOR ECONOMIC
GROWTH



(785) 783-7370

709 S. Kansas Ave., Suite 200, Topeka, KS 66603

realprosperityks.com



Former Kansas Governor Sam Brownback staked his state's economic future on a tax experiment that led to a drastic reduction of revenue, credit downgrades, and cuts to vital services. When Kansas spiraled into budgetary disaster, the governor said a "rural recession" caused by declining global commodity prices was to blame.

The data, though, tells a different story.

The "rural recession" argument used to explain Kansas' poor economic performance insufficiently and inaccurately tells the state's story. There is no doubt that Kansas felt the effects of dropping commodity prices.

However:

- Other agricultural states were similarly affected and maintained revenue growth.
- Declines in severance taxes were minimal compared with the annual loss of income tax revenue that followed the 2012 tax experiment. Neither the agriculture nor the energy sectors of the Kansas economy are large enough to cause the state's budgetary catastrophe.
- The state's budget was structurally imbalanced before commodity prices were affected. The timeline of the "rural recession" argument misunderstands the sequence of commodity price declines.

The 2012 tax plan, which dramatically reduced recurring revenue, was the main contributor to Kansas' economic troubles.

Put simply, external forces didn't cause the state's economic distress.

Regional agriculture comparison

The commodity price drop did not only affect Kansas. A comparison with other states in the region reveals that Kansas, though negatively affected, was actually less impacted by declining agriculture prices than its neighbors or the nation.

Kansas farm earnings declined 15.8 percent between 2012 and 2016.¹ Neighboring states, and the nation as a whole, generally fared worse, with larger declines in farm earnings than Kansas.²

Further clarification is possible by examining the farm income share of gross state product by state in the surrounding region.³

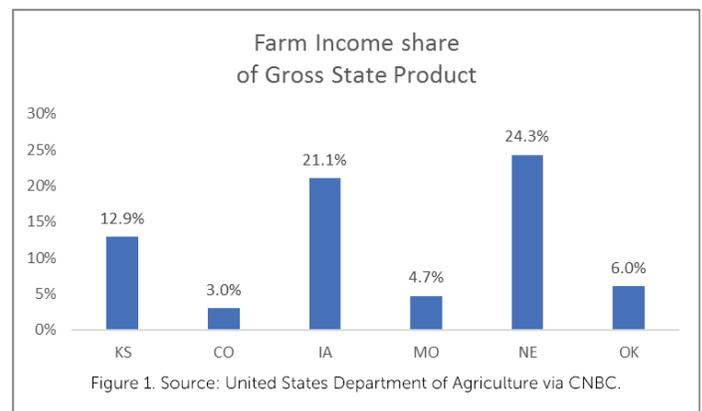


Figure 1 shows Iowa is the regional state most affected by the agricultural downturn. It not only had the second-highest percentage of farm income as a percentage of gross state product (GSP), but also the largest negative percent change in farm earnings.⁴

If Governor Brownback's rural recession argument was accurate, then Iowa's economy should have also been severely affected. However, Iowa's revenue increased every year between 2012 and 2017, with the exception of a decrease between FY 2013 and FY 2014.⁵ The Iowa example proves states can maintain revenue growth despite drops in global agriculture prices.

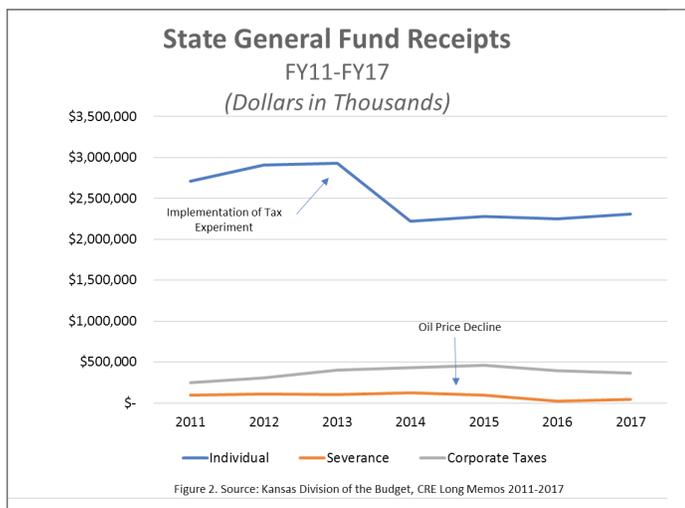
The changes in the agricultural industry are not the primary cause of Kansas' structural imbalance.

Severance and income tax contributions to the state general fund

Kansas' \$700 million revenue shortfall plagued the state's budgets fiscal year 2014 through fiscal year 2017.⁶ The primary decline in revenue came from falling individual income tax receipts. Between 2013 and 2014, the percentage of the state's overall revenue from individual income taxes dropped from 46.2% to 39.2%.⁷

Figure 2⁸ shows that compared with individual income taxes, severance taxes, which are derived from oil and natural gas extraction, make up a comparatively small amount of overall state receipts. Between 2011 and 2017, the percentage of the state's overall revenue from severance taxes dropped from 1.68% to 0.66%.⁹ In 2011, individual income tax receipts totaled \$2.7 billion while severance tax receipts totaled \$98 million.¹⁰ In 2017, individual income tax receipts totaled \$2.3 billion, while severance tax receipts totaled \$42 million.¹¹

It is true that severance tax receipts declined following the collapse of oil prices. However, the overall percentage of severance tax receipts in the Kansas budget, compared with receipts from individual income taxes, reveals the decline of the latter is much more damaging to the state than the former. The decline in oil prices cannot be identified as a leading contributor to Kansas' economic problems and must be considered as an ancillary contributor to the economy's declining health.



Timing and the "rural recession" excuse

Governor Brownback's "rural recession" argument also misunderstands the timing of commodity price drops and the effects of the 2012 tax experiment.

The initial \$700 million decline from the tax experiment began more than a year before commodity prices fell. This revenue loss was higher than the total effect of the Great Recession, and the structural imbalance created between revenues and expenditures led both Moody's and S&P to downgrade Kansas' credit rating in April and August 2014, respectively.¹²

To account for the immediate effects of the tax experiment, Kansas began cutting public services and borrowing money from other funds. In 2014, the state reduced its public employment retirement contributions by \$40.7 million and transferred \$96 million from the state highway fund.¹³ Despite budget cuts and transfers, the legislature relied on short-term solutions to balance the budget.¹⁴

While the \$700 million revenue loss began in 2013, declines in agriculture first began to affect Kansas between 2014 and 2015, and declines in global energy prices hit Kansans in late 2014. The average net income for farms between 2010 and 2014 was between \$130,000 and \$170,000, and the 2015 average was \$6,700.¹⁵

Crop insurance, which protects farmers from natural disasters and commodity price declines, protected many Kansas farmers from feeling this full impact.¹⁶ In 2016 alone, farmers received more than \$74 million from the program.¹⁷

Moreover, the overall industry value of the Kansas oil industry was nearly cut in half between 2014 and 2015.¹⁸

As these declines continued, so did the tax experiment. Towns and cities across Kansas suffered from cuts to state services, as KCEG documented in its 2017 Aid to Locals report.¹⁹ Kansas experienced nine rounds of budget cuts, three credit downgrades, a sales tax increase, and further cuts to the safety net.²⁰

Instead of redirecting its budgetary goals to account for the decline in commodity prices, Kansas doubled-down on its strategy to shoot "adrenaline into the heart of the Kansas economy."²¹

Conclusion

There is no doubt that falling commodity prices hurt rural Kansas. But in commodity-heavy states, the state government should anticipate variability in commodity pricing and provide the financial stability needed to help the economy recover from this variability. Instead, the tax experiment eliminated the financial resources Kansas needed to make it through the rough years.

In June 2017, the Kansas Legislature reversed course and passed Senate Bill 30, a comprehensive income tax plan that ended the most harmful provisions of the Brownback tax experiment.

Now, the Legislature should continue the path to fiscal stability by identifying sustainable and renewable funding sources that can be used to build thriving communities. Kansas should undo previous short-sighted tactics that only serve to deprive Kansas of vital services, develop and contribute to a budget stabilization fund, and bring Kansas' antiquated tax code into the 21st century. Only then will the Sunflower State be able to maintain economic security during future financial fluctuations.



¹ See Bureau of Economic Analysis, "Farm Income and Expenses." Available online: <https://www.bea.gov/itable/>

² See Bureau of Economic Analysis, "Farm Income and Expenses." Available online: <https://www.bea.gov/itable/>

³ See John Schoen, "These states hit hardest by falling farm prices," CNBC 2015. Available online: <https://www.cnbc.com/2015/09/02/these-states-hit-hardest-by-falling-farm-prices.html>

⁴ See Bureau of Economic Analysis, "Farm Income and Expenses." Available online: <https://www.bea.gov/itable/>

⁵ See the Iowa Department of Management, Revenue Estimating Conference's December projections for years 2011-2017. Available online: <https://dom.iowa.gov/rec-projections>

⁶ See Duane Goossen, "Goossen: January Revenue in Perspective," KCEG 2017. Available online: <https://realprosperityks.com/goossen-january-revenue-perspective/>

⁷ See Kansas Division of the Budget, November 2013 CRE Long Memo. Available online: <https://budget.kansas.gov/wp-content/uploads/fy2015-cons-rev-est-long-memo-11-2013.pdf>; See Kansas Division of the Budget, November 2014 CRE long memo. Available online: <https://budget.kansas.gov/wp-content/uploads/fy2016-cons-rev-est-long-memo-11-2014.pdf>

⁸ See Kansas Division of the Budget, November 2011-2017 CRE Long Memos. Available online: <https://budget.kansas.gov/estimates/>

⁹ See Kansas Division of the Budget, November 2011 CRE Long Memo; See Kansas Department of the Budget, November 2017 CRE Long Memo. Available online https://budget.kansas.gov/wp-content/uploads/CRE_Long_Nov2017.pdf

¹⁰ See Kansas Division of the Budget, November 2011 CRE Long Memo

¹¹ See Kansas Division of the Budget, November 2017 CRE Long Memo. Available online: https://budget.kansas.gov/wp-content/uploads/CRE_Long_Nov2017.pdf

¹² See Kansas Center for Economic Growth, "A Guide to Comprehensive Tax Reform in Kansas," 2016. Available online: http://realprosperityks.com/wp-content/uploads/2013/02/KCEG_booklet_FINAL.pdf; See Michael Leachman, "Timeline: 5 years of Kansas' Tax-Cut Disaster," CBPP 2017. Available online: <https://www.cbpp.org/blog/timeline-5-years-of-kansas-tax-cut-disaster>

¹³ See Bryan Lowry and Dion Leffler, "Brownback moves money from highway fund, cuts pension spending to deal with \$279M budget shortfall," The Wichita Eagle 2014. Available online: <http://www.kansas.com/news/politics-government/article4382802.html>

¹⁴ See Duane Goossen, "Goossen: Governor's Budget: Don't Look Here for Structural Balance," KCEG 2017. Available online: <https://realprosperityks.com/goossen-governors-budget-dont-look-structural-balance/>

¹⁵ See Amy Bickel, "Everyone goes hungry' as farm economy suffers," The Hutchinson News 2017. Available online: <http://www.hutchnews.com/news/20170707/everyone-goes-hungry-as-farm-economy-suffers>

¹⁶ See Lindsay Wise and Bryan Lowry, "Trump's budget seen as 'slap in the face' to rural voters who elected him," Kansas City Star 2017. Available online: <http://www.kansascity.com/news/politics-government/article152226172.html>

¹⁷ See Crop Insurance in America, "Kansas," 2018. Available online: <https://cropinsuranceinamerica.org/kansas/>

¹⁸ See Amy Bickel, "Downward flow's ripples: Oil, gas downturn hitting counties on many levels" The Hutchinson News 2016. Available online: http://www.kansasagland.com/news/stateagnews/downward-flow-s-ripples-oil-gas-downturn-hitting-counties-on/article_b928e615-cd5b-570e-b1f6-2618e5164136.html

¹⁹ See Kansas Center for Economic Growth, "Aid to Locals Report: 2017 Update," September 2017. Available online: https://realprosperityks.com/wp-content/uploads/2013/02/KCEG_AidToLocalsReport_v7.pdf

²⁰ See Kansas Center for Economic Growth, "A Guide to Comprehensive Tax Reform in Kansas," 2016. Available online: http://realprosperityks.com/wp-content/uploads/2013/02/KCEG_booklet_FINAL.pdf

²¹ See Sam Brownback, "Gov. Sam Brownback: Tax cuts needed to grow economy," The Wichita Eagle 2012. Available online: <http://www.kansas.com/opinion/opn-columns-blogs/article1096336.html>