

KANSAS LEGISLATIVE RESEARCH DEPARTMENT

010-West-Statehouse, 300 SW 10th Ave.
Topeka, Kansas 66612-1504
(785) 296-3181 ♦ FAX (785) 296-3824

kslegres@kird.state.ks.us

<http://www.kslegislature.org/kird>

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To: Governor Kathleen Sebelius and Legislative Budget Committee

From: Kansas Legislative Research Department
Kansas Division of the Budget

Re: State General Fund Receipts Estimates for FY 2009 and FY 2010

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 4, 2008, and decreased the estimate for FY 2009 and developed the first estimate for FY 2010.

For FY 2009, the estimate was decreased by \$211.4 million, or 3.5 percent, below the previous estimate (made in April and subsequently adjusted for legislation enacted during the veto session). The revised estimate of \$5.781 billion represents 1.5 percent growth above final FY 2008 receipts.

The initial estimate for FY 2010 is \$5.782 billion, which is virtually unchanged from the newly revised FY 2009 figure. Various factors influencing this growth rate in addition to the state of the economy include several pieces of legislation enacted in 2005-2007 that are continuing to reduce relative to prior law the amount of severance, estate, corporation franchise, and motor carrier property tax receipts deposited into the SGF.

Table 1 compares the new FY 2009 and FY 2010 estimates with actual receipts from FY 2008. Table 2 shows the changes in the FY 2009 estimates.

Economic Forecast for Kansas

The slowing of the national and state economies that began in 2007 has taken a significant turn for the worse this fall. Recent measures of consumer spending and confidence indicate that the economy is sliding deeper into a major downturn, the depth and severity of which remains unclear as of early November. The accelerating financial crisis engulfing the housing, credit, and stock markets makes the level of uncertainty regarding this Consensus estimate much higher than normal. Although forecasts of virtually all major income-related economic variables for the nation and the state have been lowered since April, the possibility remains that the relative health of certain key sectors of the state's economy, including aviation manufacturing and energy, could enable Kansas to experience a milder contraction than the country as a whole. These estimates in fact are based on the assumption that Kansas Gross State Product will grow by 3.5 percent in 2008 and 2009 before accelerating to 5.0 percent in 2010.

Kansas Personal Income

Kansas Personal Income (KPI) in 2007 grew by 6.3 percent over the 2006 level. The growth rate for KPI is expected to decelerate significantly for 2008 and remain much weaker throughout the forecast period. Current estimates are now set at 4.2 percent for 2008; 3.2 percent for 2009; and 4.3 percent for 2010. Overall US Personal Income growth is not expected to differ significantly from the pattern in Kansas, with national estimates currently at 4.0 percent, 3.0 percent, and 4.8 percent for the same three years, respectively.

Employment

Data obtained from the Kansas Department of Labor indicate that the private-sector economy has been slowing throughout 2008. The most recent monthly data show that total Kansas private (non-farm) employment from September 2007 to September 2008 had decreased by 2.3 percent. Modest growth in professional and business services was more than offset by reductions in manufacturing and financial sector employment. Current unemployment estimates by the Department, which were generally developed prior to much of the economic turmoil beginning to be seen in October, are that the overall Kansas jobless rate, which was 4.1 percent in CY 2007, is expected to jump to 4.4 percent in CY 2008; 4.7 percent in CY 2009; and remain at 4.7 percent for 2010. These figures do compare favorably to current national unemployment forecasts of 5.6 percent for 2008; 6.2 percent for 2009; and 6.1 percent for 2010.

Agriculture

Although net farm income in 2007 was significantly higher than 2006, the outlook for 2008 is much more uncertain as a result of higher input prices, especially energy and fertilizer costs, and the recent collapse in commodity prices tied to problems with the national economy. The All Farm Products Index of Prices received by Kansas farmers was 158 in September, up from 147 a year earlier. Although the 2008 Kansas wheat crop forecast of 356 million bushels represents significant growth over the previous year, it is worth remembering that the crop in 2007 was only 284 million bushels and reflected abandonment of 1.8 million acres, the largest such abandonment in 11 years.

Oil and Gas

Notwithstanding the historic levels of volatility thus far in FY 2009 in the price of oil, the estimate for the average price per taxable barrel of Kansas crude remains at \$80, unchanged from the April forecast. The estimated average price of \$70 per barrel for FY 2010 takes into account the recent collapse in world oil prices and anticipated weakening of demand relative to the economic slowdown. As always, significant political tensions in the Middle East and elsewhere provide a great deal of uncertainty about forecasting the price of this commodity. Gross oil production in Kansas, which had been declining steadily for more than a decade until FY 2000, has recently reversed that trend and been increasing slightly since FY 2005. The current forecast of 40 million barrels for FY 2009 represents a level not seen since FY 1997. Approximately half of all Kansas oil produced is not subject to severance taxation because of various exemptions in that law.

The price of natural gas is expected to average \$6.25 per mcf for FY 2009 before decreasing to \$5.75 per mcf for FY 2010, based on an industry source's analysis of futures markets. Factors considered for these estimates included the relationship between crude oil and gas prices, the current relatively high storage levels for gas, weakening of the economy, and the impact of enhanced

production from shale formations elsewhere in the United States. Kansas natural gas production in FY 2008 of 379 million cubic feet represented a significant decrease from the modern era peak of 730 million cubic feet in FY 1996 (largely as a result of depletion of reserves in the Hugoton Field). Production has nevertheless rebounded slightly in recent years and is expected to stabilize at 390 million cubic feet for both FY 2009 and FY 2010.

Inflation Rate

The Consumer Price Index for all Urban consumers (CPI-U) increased by 2.9 percent in 2007, matching the final November forecast. Higher energy prices have contributed to the current 2008 CPI-U forecast being increased to 4.3 percent (relative to the 2.9 percent estimate used in April). The latest forecasts for 2009 and 2010 are for inflation to return to more moderate levels, 2.4 percent and 1.9 percent, respectively.

Interest Rates

The Pooled Money Investment Board is authorized to make investments in US Treasury and Agency securities, highly rated commercial paper, repurchase agreements and certificates of deposit in Kansas banks. In FY 2008, the state earned 4.26 percent on its SGF portfolio (compared with a 5.27 percent rate in FY 2007). The average rate of return forecasted for FY 2009 is 2.55 percent. For FY 2010, the forecasted rate is 2.70 percent.

Economic Forecasts

	<u>CY 2008*</u>	<u>CY 2009*</u>	<u>CY 2010*</u>
KPI Growth	4.2%	3.2%	4.3%
Inflation (CPI-U)	4.3%	2.4%	1.9%
	<u>FY 2008</u>	<u>FY 2009*</u>	<u>FY 2010*</u>
SGF Interest	4.26%	2.55%	2.70%
Oil and Gas			
Oil Price per bbl	\$80.71	\$80.00	\$70.00
Gross Prod. (000)	38,008	40,000	38,000
Gas Price per mcf	\$6.13	\$6.25	\$5.75
Gas Taxable Value	2,188,973	2,291,250	2,107,950

* Estimated

State General Fund Receipts Estimates

FY 2009. The revised estimate of SGF receipts for FY 2009 is \$5.781 billion, a decrease of \$211.4 million from the previous estimate. The revised estimate is \$87.8 million or 1.5 percent above actual FY 2008 receipts.

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 estimate of total taxes was decreased by \$230.7 million, while the estimate of other revenue was increased by \$19.3 million.

The estimate for individual income taxes was decreased by \$179.4 million. Stock market upheavals, especially during the fall, likely will result in far less tax year 2008 income tax receipts attributable to capital gains and dividend income than the state has been receiving in recent years. Final FY 2008 receipts from this source were more than \$50 million below the final estimate for that year, a downturn in receipts that had occurred well before this fall's economic news.

The compensating use tax forecast was decreased by \$48.0 million. This result is largely attributable to refunds of approximately \$30 million for one taxpayer, as well the impact of the weakening economy on certain business purchases and selected motor vehicle sales.

The sales tax estimate, although slightly ahead of the previous forecast through October, was reduced by \$10.7 million in anticipation of much weaker consumer spending and confidence for the balance of the fiscal year.

The interest forecast was reduced by \$10.0 million as a result of lower SGF balances throughout the fiscal year and a reduced interest rate.

On the positive side, the corporation income tax estimate was increased by \$7.8 million as a result of a previously unanticipated assessment of more than \$10.0 million.

The oil severance tax estimate also was increased by \$5.7 million because of an increased production forecast; and new information about the timing of the diversion of certain revenues to a special trust fund.

The agency earnings estimate was increased by \$27.9 million because of the infusion of one-time money relative to a settlement with the federal government over deferred medical assistance payments from FY 2005 and FY 2006.

Details of the current year's revised estimate are reflected in Table 2.

FY 2010. SGF receipts are estimated to be \$5.782 billion in FY 2009, a figure that is virtually unchanged from the new FY 2009 forecast. The growth rate for total taxes is expected to be 1.9 percent.

Factors taken into account for FY 2010 include continued phasing out of the estate and corporation franchise taxes; the expectation that very modest growth will be returning to the major tax sources; the removal of the one-time federal drawdown from agency earnings; and a significant increase in net transfers from the SGF scheduled under current law.

FY 2011 and thereafter. Although the Consensus Group will not make its initial estimate for FY 2011 until next fall, worthy of note is the fact that a number of provisions in previously enacted legislation will further reduce SGF receipts beginning in FY 2011:

- Legislation enacted in 2006 that decoupled the Kansas estate tax from the federal law beginning in 2007 and eliminates the Kansas tax altogether in 2010 will reduce receipts relative to the prior law by \$47 million in FY 2011; and \$52 million in FY 2012.
- Legislation enacted in 2007 that phases out the corporation franchise tax will reduce receipts relative to the prior law by an estimated \$37.0 million in FY 2011; and \$48.0 million in FY 2012.
- Legislation enacted in 2006 relative to a property tax exemption for business machinery and equipment is expected to further reduce motor carrier property tax receipts to the SGF by \$5.6 million in FY 2011; and \$7.4 million in FY 2012.
- Additional legislation enacted in 2005 will reduce severance tax receipts to the SGF by \$10.9 million in FY 2011; and \$14.4 million in FY 2012; and \$18.0 million in FY 2013.

Accuracy of Consensus Revenue Estimates

For 34 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, Ed Olson from Kansas State University, and John Wong from Wichita State University. Each of the agencies and individuals involved in the process prepared independent estimates and met on November 4, 2008, 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	0.0
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
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)	0.0	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)	(9.3)	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	5,694.9	(5.5)	(0.1)	(41.4)	(0.7)

* 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 2009 Legislative Session.

Table 1
State General Fund Receipts
(Dollars in Thousands)

	Consensus Estimate November 4, 2008					
	FY 2008 (Actual)		FY 2009 (Revised)		FY 2010	
	Amount	Percent Change	Amount	Percent Change	Amount	Percent Change
Property Tax:						
Motor Carrier	\$ 29,032	12.5 %	\$ 30,500	5.1 %	\$ 28,500	(6.6) %
Income Taxes:						
Individual	\$ 2,896,653	6.9 %	\$ 2,890,000	(0.2) %	\$ 2,990,000	3.5 %
Corporation	432,078	(2.3)	340,000	(21.3)	365,000	7.4
Financial Inst.	33,160	0.2	32,000	(3.5)	32,000	--
Total	<u>\$ 3,361,891</u>	<u>5.6 %</u>	<u>\$ 3,262,000</u>	<u>(3.0) %</u>	<u>\$ 3,387,000</u>	<u>3.8 %</u>
Estate Tax	\$ 44,247	(20.4) %	\$ 32,000	(27.7) %	\$ 15,000	(53.1) %
Excise Taxes:						
Retail Sales	\$ 1,711,398	(3.1) %	\$ 1,715,000	0.2 %	\$ 1,750,000	2.0 %
Compensating Use	246,277	(13.6)	220,000	(10.7)	225,000	2.3
Cigarette	112,705	(2.2)	111,000	(1.5)	110,000	(0.9)
Tobacco Products	5,548	4.6	5,600	0.9	5,800	3.6
Cereal Malt Bev.	2,228	6.6	2,200	(1.3)	2,200	--
Liquor Gallonage	17,579	3.1	18,000	2.4	18,400	2.2
Liquor Enforcement	49,983	6.0	52,000	4.0	54,000	3.8
Liquor Drink	8,903	3.9	9,500	6.7	9,700	2.1
Corp. Franchise	46,659	(2.6)	32,000	(31.4)	20,000	(37.5)
Severance	148,172	27.7	156,700	5.8	130,200	(16.9)
Gas	91,511	14.9	92,300	0.9	80,000	(13.3)
Oil	56,662	55.7	64,400	13.7	50,200	(22.0)
Total	<u>\$ 2,349,452</u>	<u>(2.6) %</u>	<u>\$ 2,322,000</u>	<u>(1.2) %</u>	<u>\$ 2,325,300</u>	<u>0.1 %</u>
Other Taxes:						
Insurance Prem.	117,588	3.3 %	\$ 118,000	0.4 %	\$ 119,000	0.8 %
Miscellaneous	5,233	(4.7)	2,500	(52.2)	2,500	--
Total	<u>\$ 122,821</u>	<u>3.0 %</u>	<u>\$ 120,500</u>	<u>(1.9) %</u>	<u>\$ 121,500</u>	<u>0.8 %</u>
Total Taxes	\$ 5,907,443	1.9 %	\$ 5,767,000	(2.4) %	\$ 5,877,300	1.9 %
Other Revenues:						
Interest	\$ 111,258	20.6 %	\$ 51,000	(54.2) %	\$ 50,000	(2.0) %
Net Transfers	(377,653)	(172.0)	(118,200)	(68.7)	(199,500)	(68.8)
Agency Earnings	53,875	(16.4)	81,400	51.1	54,600	(32.9)
Total	<u>\$ (212,519)</u>	<u>---</u> %	<u>\$ 14,200</u>	<u>(106.7) %</u>	<u>\$ (94,900)</u>	<u>(768.3) %</u>
Total Receipts	<u><u>\$ 5,694,924</u></u>	<u><u>(2.0) %</u></u>	<u><u>\$ 5,781,200</u></u>	<u><u>1.5 %</u></u>	<u><u>\$ 5,782,400</u></u>	<u><u>0.0 %</u></u>

Table 2
State General Fund Receipts
FY 2009 Revised
Comparison of November 2008 Estimate to June 2008 Estimate
(Dollars in Thousands)

	FY 2009 CRE Est. as Adj. for Legis.	FY 2009 CRE Estimate	Difference	
			Amount	Pct. Chg.
Property Tax:				
Motor Carrier	\$ 29,500	\$ 30,500	\$ 1,000	3.4 %
Income Taxes:				
Individual	\$ 3,069,420	\$ 2,890,000	\$ (179,420)	(5.8) %
Corporation	332,200	340,000	7,800	2.3
Financial Inst.	40,000	32,000	(8,000)	(20.0)
Total	\$ 3,441,620	\$ 3,262,000	\$ (179,620)	(5.2) %
Estate Tax	\$ 32,000	\$ 32,000	\$ --	-- %
Excise Taxes:				
Retail Sales	\$ 1,725,702	\$ 1,715,000	\$ (10,702)	(0.6) %
Compensating Use	268,000	220,000	(48,000)	(17.9)
Cigarette	108,000	111,000	3,000	2.8
Tobacco Product	5,600	5,600	--	--
Cereal Malt Beverage	2,200	2,200	--	--
Liquor Gallonage	17,800	18,000	200	1.1
Liquor Enforcement	52,000	52,000	--	--
Liquor Drink	9,500	9,500	--	--
Corporate Franchise	32,000	32,000	--	--
Severance	151,300	156,700	5,400	3.6
Gas	92,600	92,300	(300)	(0.3)
Oil	58,700	64,400	5,700	9.7
Total	\$ 2,372,102	\$ 2,322,000	\$ (50,102)	(2.1) %
Other Taxes:				
Insurance Premium	\$ 119,000	\$ 118,000	\$ (1,000)	(0.8) %
Miscellaneous	3,500	2,500	(1,000)	(28.6)
Total	\$ 122,500	\$ 120,500	\$ (2,000)	(1.6) %
Total Taxes	\$ 5,997,722	\$ 5,767,000	\$ (230,722)	(3.8) %
Other Revenues:				
Interest	\$ 61,000	\$ 51,000	\$ (10,000)	(16.4) %
Net Transfers	(119,610)	(118,200)	1,410	(1.2)
Agency Earnings	53,510	81,400	27,890	52.1
Total Other Revenue	\$ (5,100)	\$ 14,200	\$ 19,300	(378.4) %
Total Receipts	\$ 5,992,622	\$ 5,781,200	\$ (211,422)	(3.5) %