

MINUTES OF THE SENATE ELECTIONS AND LOCAL GOVERNMENT

The meeting was called to order by Chairman Tim Huelskamp at 1:30 P.M. on January 17<sup>th</sup>, 2006 in Room 423-S of the Capitol.

All members were present.

Committee staff present:

Martha Dorsey, Kansas Legislative Research Department  
Mike Heim, Kansas Legislative Research Department  
Ken Wilke, Revisor of Statutes  
Zoie Kern, Committee Secretary

Conferees appearing before the committee:

Richard Gannon, Director Governmental Affairs for Kansas Press Association  
Art Hall, Center For Applied Economics KU School of Business

Others attending:

Bill Introductions:

Richard Gannon requested introduction of Fiscal Note **SB 328** by Senator Haley - relating to public officials receiving training in the requirements of the Kansas Open Meetings Act and Kansas Records Act (Attachment 1).

It was moved by Senator Wilson to introduce this bill and seconded by Senator Betts. The motion carried.

Doctor Art Hall lectured on Local Government and the Kansas Puzzle (Attachment 2).

Doctor Hall presented research on productivity in Kansas. Addressing statistics to support the issues of, are we getting our dollars worth and looking for answers to keep people in Kansas now and generations to come.

Closing

The next meeting is January 24, 2006

There is no further business, the meeting was adjourned at 2:35pm

Adjournment

Respectfully submitted,

Zoie C. Kern, Senate Secretary

11-106  
January 17, 2006

The Honorable Tim Huelskamp, Chairperson  
Senate Committee on Elections and Local Government  
Statehouse, Room 262E-B  
Topeka, Kansas 66612

Dear Senator Huelskamp:

SUBJECT: Fiscal Note for SB 328 by Senator Haley

In accordance with KSA 75-3715a, the following fiscal note concerning SB 328 is respectfully submitted to your committee.

SB 328 would amend the Kansas Act against Discrimination to prohibit discrimination in homeowners associations' restrictive covenants based on the protected classes of race, religion, color, sex, disability, familial status, national origin, and ancestry. If such a covenant already exists, the homeowners association would be allowed to change the portion of the governing document to delete the restrictive covenant without approval of the property owners. If the association does not delete the covenant within 30 days of receiving written notice requesting that it be deleted, an injunction can be filed against the association by the Kansas Human Rights Commission, the city or county that has a common interest in the property, or any person.

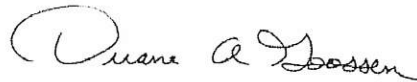
Estimated State Fiscal Effect				
	FY 2006 SGF	FY 2006 All Funds	FY 2007 SGF	FY 2007 All Funds
Revenue	--	--	--	--
Expenditure	--	--	\$1,000	\$1,000
FTE Pos.	--	--	--	--

Elections and Local Government  
1-17-06  
Attachment 1

The Honorable Tim Huelskamp, Chairperson  
January 17, 2006  
Page 2—328

The Kansas Human Rights Commission estimates that enactment of SB 328 would lead to approximately 100 additional inquires and estimates that 11 of the inquires would advance beyond the initial stage of investigation. Negligible additional costs would be incurred for communication costs to answer inquires, the reprinting of housing posters, miscellaneous office supplies, and travel for the filing of injunctions. The Commission estimates that \$1,000 in funding would be needed from the State General Fund. Any fiscal effect resulting from enactment of SB 328 is not included in *The FY 2007 Governor's Budget Report*.

Sincerely,



Duane A. Goossen  
Director of the Budget

---

cc: Marshall Kennedy, Attorney General's Office  
Ruth Glover, Human Rights Commission

# Local Government and the Kansas Productivity Puzzle

By  
Arthur P. Hall, Ph.D.\*

## Introduction

The Kansas economy suffers from an odd anomaly that has direct consequences for the economic well-being of Kansans. For reasons that have no ready explanation, the Kansas economy lags both the nation and the region in terms of per-worker productivity and the growth rate of per-worker productivity. This anomaly began about 20 years ago, and has had direct implications for the growth of per-worker compensation.

Chart 1 illustrates a set of trend lines that embody important information about the implications of the “Kansas Productivity Puzzle.” It depicts relative, inflation-adjusted growth rates—among the U.S., the Plains region, and Kansas—of a metric called Gross State Product (GSP). Like Gross Domestic Product (GDP) at the national level, GSP measures the total dollar value of all goods and services produced within a state’s borders during a given year. Over the 27-year period shown (the years of best data availability), the collection of all U.S. states’ GSP combined has grown 130 percent, the collection of Plains states combined has grown 99 percent, and Kansas GSP has grown 92 percent. (The Plains states include Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota.)

---

\* Art Hall is the executive director of the Center for Applied Economics at the University of Kansas School of Business, a privately-funded research center. This white paper is adapted from testimony that Hall delivered to the House Committee on Taxation, the House Committee on Commerce and Labor, the Senate Committee on Commerce, and the Senate Committee on Elections and Local Government. January 2006.

Productivity differences account for about half of the economic growth difference between Kansas and the U.S. (The other half relates to Kansas' slower employment growth.) Productivity differences account for virtually 100 percent of the growth difference between Kansas and the Plains region.

Economic growth for an economy works just like compound interest for an investment: Small differences in rates make a big difference over time. On an average annual basis, the GSP growth rates illustrated in Chart 1 equal 3.1 percent for the U.S., 2.5 percent for the Plains, and 2.4 percent for Kansas. If Kansas GSP had grown at the U.S. average annual rate of 3.1 percent instead of 2.4 percent (a difference of 0.7 percentage points), the Kansas economy would have been about \$18 billion dollars richer in 2004—or about \$10,000 per worker. If Kansas GSP had grown at the Plains average annual rate of 2.5 percent, the Kansas economy would have been about \$2 billion dollars richer in 2004—or about \$1,300 per worker.

### **Explaining the Kansas Productivity Puzzle**

Productivity is defined as (inflation-adjusted) GSP divided by the total number of full and part-time workers in the economy—a dollar value of output per worker. Productivity, so defined, has a value dimension and a growth-rate dimension, as illustrated by the different levels and slopes of the trend lines in Chart 2. For example, per-worker output for the U.S. is, on average, more valuable than the per-worker output in the Plains and Kansas (as indicated by the height of the trend lines), and that value has grown more quickly (as indicated by the slope of the trend lines).

Chart 2 helps inform the core aspects of the Kansas Productivity Puzzle. At first glance, one can readily perceive the Kansas productivity lag. Over the time period charted, Kansas has experienced productivity growth of 26 percent; the U.S. and Plains region have experienced productivity growth of 38 percent and 30 percent, respectively. Total productivity growth in Kansas ranks 37<sup>th</sup> among the states. The key feature of the puzzle, however, is the fact that the lag shown in Chart 2 persists across *all* industry sectors, with exceptions during certain time periods for durable goods manufacturing and transportation and public utilities. The observer is tempted to focus on the 1995 productivity dip in Kansas, but the lag relative to the Plains begins about 1986. (Small differences over time make a big difference.)

Kansas' lagging productivity matters because productivity drives both business competitiveness and worker compensation. Over the past quarter century, as economic theory predicts, there is a near perfect statistical correlation in Kansas between productivity growth and per-worker compensation (wages plus employer-paid benefits and taxes). Because Kansas lags in productivity, it also lags in terms of per-worker compensation. In fact, a chart illustrating trends in per-worker compensation would look almost identical to the trend lines on Chart 2.

Interestingly, however, the average Kansas worker has appropriated more of each dollar of productivity gain than has the average worker in the U.S. or the Plains. In Kansas, over the past quarter century, every \$1.00 of increased productivity has corresponded to a \$0.75 increase in compensation; the figures for the U.S. and the Plains are \$0.50 and \$0.66, respectively.

Chart 3 illustrates the competitive implications for Kansas of the combination of lagging productivity and better-than-average compensation increases relative to productivity gains: Unit labor costs for Kansas businesses have increased significantly relative to the U.S. average. In fact, over the time period shown, no state other than North Dakota and Iowa had unit labor costs that grew more rapidly. Note, too, that Kansas has lost its unit labor cost advantage despite the fact that average per-worker compensation in the U.S. is about 20 percent higher than it is in Kansas.

The only positive way for Kansas to improve its unit labor cost standing among the states is to increase productivity. The alternatives are wage stagnation, unemployment, job destruction, or business exit.

Productivity improvement, however, occurs on the front-lines of business units. Productivity growth is a process that requires continual trial and error on the part of individual businesses. To the extent that the Kansas Productivity Puzzle has a public policy solution, policy makers must concentrate on creating a business environment that promotes investment, experimentation, and efficient resource mobility.

### **Searching for Solutions to the Kansas Productivity Puzzle**

The preponderance of current evidence suggests that Kansas may offer a less attractive location for capital investment and risk taking than other states. Chart 4 provides some readily available evidence for this argument. It illustrates the rate of new (non-corporate) business formation. The 1987 spike notwithstanding, Kansas begins to significantly diverge from the growth path of the U.S. and Plains at about the same time the productivity lag materializes in 1986. (The only ready explanation for the pronounced 1987 spike in Kansas is the federal Tax Reform Act of 1986; this issue requires more investigation.)

Chart 4 also includes the rate of Kansas new business formation with Johnson County removed from the data sample. Over the past 30 years, Johnson County has constituted one of the fastest growing areas of the U.S. Along almost every economic dimension, Johnson County dramatically improves the Kansas average. This point is important for two reasons. First, the economic performance of most Kansas regions is significantly worse than the Kansas average indicates. Second, any comprehensive solution to the Kansas Productivity Puzzle must also explain the stellar economic performance of Johnson County.

The existence of the Kansas Productivity Puzzle and the data in Chart 4 suggest that Kansans should explore whether the state's overall policy mix—at both the state and local levels—deters capital formation, a key ingredient for productivity growth. A noticeable tendency in Kansas public discourse is to promote jobs above all else. Job growth is important, but a jobs-only focus offers an incomplete perspective. Over time, there exists a strong inverse relationship between productivity growth and unemployment. A policy and business environment that strives to maximize productivity for all businesses offers the best approach for enhancing the prosperity of Kansas' less prosperous areas and perpetuating the economic success of Kansas' most prosperous areas.

From a pure policy perspective, Kansas is unique among the states in terms of the size and growth of its local government sector. Excluding Washington D.C., Kansas ranks third behind Wyoming and New York in terms of the *number* of full-time-equivalent (FTE) local government employees per capita. Kansas ranks fourth over the past 30 years in terms of the *growth rate* of local government FTEs per capita. In many sections of the state, over the past 30 years, the state and local government sector has been among the top three fastest growing sectors of the economy.

A large body of economic research indicates that this growth of the Kansas government sector may play a direct role in the Kansas Productivity Puzzle. Many high-quality academic studies that have investigated cross-country differences in economic growth have shown that, in general, the more the government sector spends as a share of the economy's output (GDP), the slower the economy will grow. Research explicitly related



to the U.S. states found that “state and local policies have a more profound influence on the private capital-to-labor ratio in a region than on private output. Furthermore, the evidence suggests that the growth of government—whether it be in terms of services or infrastructure—appears to discourage growth of the private sector.” Importantly for the Kansas Productivity Puzzle, the private capital-to-labor ratio is a metric directly related to labor productivity.

To the extent that local government growth helps solve the Kansas Productivity Puzzle, the most effective policy change would involve a reduction in investment-related taxes financed by a reduction in local government payroll. The linkage between government growth and economic growth works through both the effects of taxation and the effects of government spending. Taxation and government spending reduce growth by reducing business profits, and thereby the capacity for business investment. New research in a top-ranking economics journal has demonstrated that increased public spending—particularly spending on wages—may stifle investment and growth more than taxation: Among a group of 18 advanced economies, an increase of one percentage point in the ratio of the government wage bill to GDP leads to an immediate decrease in investment as a share of GDP of 0.48 percentage points and a cumulative decrease of 2.56 percentage points after five years.

Taxation stifles investment behavior in two ways. As mentioned, taxation has a direct effect on the level of business profits. Lower profits leave fewer resources for investment. Certain types of taxation stifle investment by effectively increasing the cost of capital. A clear example in the context of this discussion is the Kansas property tax on machinery and equipment. This direct tax on the acquisition of productivity-enhancing capital investment increases the cost of owning the capital, and thereby lowers the expected rate of return from the investment. Lower rates of return shrink the number of potentially worthwhile investments.

Economy wide, government spending on wages has a significant adverse impact on business profitability. When government payrolls grow, the government sector explicitly competes with private businesses for workers. The higher wages that result from the competition reduce business profits, and thereby the capacity to invest. Reduced investment leads to lower productivity and slower economic growth. (In certain regions of Kansas, local government employment accounts for almost 20 percent of the wage-and-salary jobs.)

Charts 5 and 6 illustrate the growth of Government in Kansas from two different perspectives—a financial perspective and an employment perspective. Chart 5 clearly shows that the Kansas government sector has consumed an ever-larger share of private economic output. Over the time period illustrated, Kansas state and local government spending grew (in inflation-adjusted terms) by 116 percent; GSP grew by 81 percent. Note that federal funds are omitted from the spending trends, so the trends result from revenues taxed or collected from Kansas sources. Over the entire time period charted, Kansas has slower state and local government spending growth relative to GSP than does the U.S.; however, Kansas experienced faster growth in this metric than did the U.S. during the 1980s, which is when the productivity lag manifested itself.

Chart 6 reveals that local government employment has closely tracked private employment over the 30-year period covered, 79 percent versus 90 percent aggregate growth. (State and local government employment combined has grown 66 percent.) On average, the Kansas local government sector hires one person each time the private sector hires nine people. These local government employment statistics include public school employees (about 55 percent of the total) as well as those people that work in the many other functions of local government. The overall allocation of local government employees among various functions has been relatively stable over the past three decades.

The key question linking the Kansas Productivity Puzzle to the growth of Kansas government sector employment is: Are the people employed by government providing cost-effective services that Kansans value? In other words, are they contributing to overall productivity? If you imagine the Kansas economy as a business enterprise, it is fair to equate government services with the “overhead” or “shared services” of the enterprise. Different types of enterprises have different operational requirements; however, as most people know, the correct structure of overhead services adds to the productivity of an enterprise, while improperly structured overhead (or excess overhead) acts as a drag on productivity. Many bankruptcies have resulted from too much overhead. General Motors, while not yet bankrupt, represents the current-day poster-child of excess overhead.

Only the citizens of Kansas’ many unique localities can adequately assess whether their government sector is enhancing or stifling the productivity potential of their economies. However, for the state as a whole, Table 1 offers one approach for quantifying the possibility of excess overhead: It records different 2002 dollar costs associated with different levels of local government FTEs per capita. For example, in 2002, Kansas had 4.77 local government FTEs per 100 Kansas residents; the four states that border Kansas (averaged together) had 3.16 local government FTEs per 100 citizens. If you subtract 3.16 from 4.77, the result equals 1.61 FTEs per 100 citizens; multiplying 1.61 by 27,129 (the 2002 Kansas population divided by 100) yields 43,668 Kansas local government FTEs; multiplying 43,668 by \$31,606 (the 2002 estimated average cash compensation per FTE) yields almost \$1.4 billion—per year. (Note, too, that a standard rule-of-thumb for an employer is to increase cash compensation by one-third in order to account for employer-paid benefits and taxes. So, the true cost is probably closer to \$1.8 billion than \$1.4 billion.)

## References

Alesina, Alberto, Silvia Ardagna, Roberto Perotti, and Fabio Schiantarelli. "Fiscal Policy, Profits, and Investment," *American Economic Review*, Vol. 92(3), June 2002, pp. 571-589.

Barro, Robert J. *Determinants of Economic Growth: A Cross-Country Empirical Study*. (Cambridge: MIT Press, 1997).

Brown, Stephen P.A., Kathy J. Hayes and Lori L. Taylor. "State and Local Policy, Factor Markets, and Regional Growth," *The Review of Regional Studies*, Vol. 33(1), Summer 2003, pp. 40-60.