

EXECUTIVE REPORT

KANSAS ECONOMIC DEVELOPMENT STUDY: FINDINGS, STRATEGY AND RECOMMENDATIONS

prepared by the

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The University of Kansas

in consultation with

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EXECUTIVE REPORT
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PREFACE

There has been serious concern throughout the state that Kansas could be losing its competitive edge in attracting economic development. As well, there has been a growing awareness of other states' efforts to foster new industry. Recognizing these significant developments, the 1985 Kansas Legislature appropriated funding for a research study of Kansas business conditions and climate and for the development of a state strategy for economic development. Matching funding has been provided by major Kansas organizations (listed at the end of this report), and the University of Kansas provided an equivalent contribution in resources.

The study was undertaken by the Institute for Public Policy and Business Research at The University of Kansas, in close consultation with Wichita State University, Midwest Research Institute (Kansas City), ASLAN (Washington, D.C.), and Counsel for Community Development (Boston). The main elements of the study are:

- 1) An identification of key factors affecting state economic development as perceived by Kansas business, state and community leaders, and by non-Kansans.
- 2) An identification of key factors affecting firm decisions to locate and not to locate in Kansas.
- 3) A delineation of Kansas economic trends, strengths and weaknesses.
- 4) An analysis of other states' incentives and strategies.
- 5) A target industry analysis of the types of industries best suited to Kansas and its regions.
- 6) Recommendations for consideration.

An Interim Report, prepared at mid-point of the study, was submitted in January 1986 to Governor Carlin and the Kansas Legislature. The objectives of the Interim Report were to facilitate discussion among Kansans concerning this important issue, to provide the basic framework for a state strategy, and to provide guidance for legislative action in 1986.

The Legislative Commission on Kansas Economic Development (Representative James Braden, House Majority Leader, Chair), adopted the basic strategy recommended in the Interim Report, and, assisted by Consultant Belden Hull Daniels and the authors, developed ten legislative initiatives based on the 34 recommendations of the report. These were passed by the Legislature in April 1986.

This Final Report includes the following products of extensive research undertaken by the study team:

- Vol. I Executive Report and Recommendations
- Vol. II Kansas Economic Development Study, prepared by the Institute for Public Policy and Business Research.
- Vol. III Innovations in Economic Development: Lessons from Other States, prepared by ASLAN
- Vol. IV Target Industry Analysis, prepared by Midwest Research Institute

A shorter version of the recommendations is included in the Executive Summary, while a more extensive version can be found in Chapter 4 of Volume II.

The authors gratefully acknowledge the splendid cooperation and analysis of the consultant organizations, in particular LaDene Morton of MRI, Bill Hamilton of ASLAN, Belden Daniels of Counsel for Community Development, and Gerry McDougall and Dennis Duell of Wichita State University. We thank the many Kansans who assisted the study with their time and views. As well, particular thanks go to Senator Wint Winter; Secretary Jamie Schwartz and his staff of the Kansas Department of Economic Development; Representative Jim Braden and members of the Legislative Commission on Kansas Economic Development; Chancellor Gene Budig; Vice Chancellor Frances Horowitz; and Dean John Tollefson of the University. Finally this study owes a great deal to the Institute's study team, Shirley Sicilian, Catherine Shenoy, Carolyn Coleman, Gary Albrecht, and Steven Maynard-Moody; also to the Institute's student research assistants, who worked on the project at one time or another, Steve Thomas, Bob Bretz, Bill Mayer, Laurian Casson, Elizabeth Elsey, Ron Riffle, and Adele Richtarik; and to the word processing staff of the Institute.

While the Institute has made extensive use of consultant advice in undertaking this study, the authors are responsible for the specific recommendations of this report.

FINDINGS, STRATEGY, RECOMMENDATIONS

THE KANSAS ECONOMY

This overview of the evolution, current status, and outlook of the economic and demographic environment provides the basis for identification of the problems, issues, and choices associated with the future of the Kansas economy. The bottom line is that the state economy is not well positioned to go forward strongly in the next decade, and repositioning the state economy is the challenge for the state and its communities for the remainder of this century.

The structure of the Kansas economy has changed over this half century from being predominantly agricultural to a mixed form somewhat parallel to the national industrial structure. The trend is clearly one of long transition out of farming to other forms of economic activity, so that today farming produces about 8 percent of the state product and manufacturing, 20 percent. These figures would have been reversed 40 years ago.

Over time Kansas farms have become fewer, larger, and more capital intensive. This has been in response to the imperative to become more efficient in the light of real price decline and increasing costs. Today 1 percent of the state's farms produce nearly 50 percent of the state's agricultural products. Important consequences follow from this. First, the larger capital intensive farms are more vulnerable to the general business cycle; and second, farming employs fewer and fewer people. This labor displacement has been offset, however, by new industry. Employment growth in the non-farming sector has been chronically inadequate to provide sufficient alternative job opportunities for both natural labor force growth and for labor displaced from the farms. Hence employment in key sectors of the economic base, comprised largely of agriculture, manufacturing, and oil and gas, is 24 percent of the state total compare with about 30 percent for the nation.

There have been significant demographic consequences to this great change in the economic structure.

(1) Kansas population has declined from 2.27 percent of the U.S. population in 1890 to 1.04 percent in 1980. It is projected to be 0.93 percent in 2000 and could be 0.75 percent in 2030.

(2) Kansas has had one of the slowest population growth rates in the nation.

(3) The state has experienced net out-migration every census decade since 1890; net outflow was around 130,000 for 1960-70 and 25,000 for 1970-80. For the period 1980-84, net out-migration is estimated to be about 6,000. The predominant groups of out-migrants have been young adults and persons with higher education and skill levels.

(4) The state average age is above the U.S. average and the state has a substantially higher proportion of persons over 65. The state ranks ninth among states in the proportion of population that is 65 years and over. This aging of the Kansas population will continue.

(5) Although the state still has more rural population (33 percent) than the U.S. (26 percent), there has been a significant redistribution within the state to regions of employment opportunity, much of which has been concentrated in the area roughly bounded by Interstates 35, 135, and 70.

Turning to current economic conditions, the state economy fell further, started to recover later, and has grown more slowly than the national economy in relation to the most recent 1980-82 recession. The industrial structure is now such that Kansas can no longer be considered recession proof, and indeed the last recession has illustrated how vulnerable the state economy is to the business cycle.

Total employment in Kansas returned to its 1979 peak level only in the second half of 1984 in contrast to the nation, where the 1979 level had been exceeded significantly by that time. Again the rate of business formation in Kansas in recent years has been well below the national rate; it has been significantly below that of the contiguous states of Oklahoma and Colorado and about the same as Missouri and Nebraska. Furthermore, virtually all sectors of the state economy have been affected, but the primary impact has been in manufacturing, construction, and services.

A number of economic factors underlie this relatively weak economic performance in recent years. These include factors beyond our influence, including the strength of the dollar, the chronic cost-price squeeze in agriculture, and weakening oil prices in world markets. Factors within our influence, however, include inadequate overall employment growth, inadequate growth in education and skill intensive sectors, and inadequate growth in those sectors that are expected to expand strongly in the next decade.

Key considerations affecting the future vitality of the state economy include:

(1) the likelihood of continued depressed agricultural prices due to chronic oversupply;

(2) the likelihood of long-term diminution of the state's mining industry as depletion outstrips discovery, and as world prices erode, also due to oversupply;

(3) the likelihood of modest growth potential for the general aviation industry; and

(4) the secondary impact on the service sector of this expected relative weakness in the above core sectors.

The state economic problem can therefore be summarized as follows. The state economy is highly dependent today on a set of industries that have served us well in the past. While these sectors will remain important in an absolute sense, their future outlook has limits, so that continued reliance on them alone will reinforce the negative trends and erosion now evident in our economic base.

At the same time the U.S. economy is undergoing significant and dynamic change that is technologically based. Kansas does not have a natural comparative advantage in these sectors, as it had for the great industries of the past. Consequently, the state has not been attractive to this “new industry” to the extent necessary to establish a strong economic base from which to grow and provide opportunities for Kansans in the years ahead.

In essence, from an economic perspective, there is a more limited future for our historical major industries relative to the past, the current industrial structure is underrepresented with future growth sectors, and the problem is compounded seemingly by the lack of comparative advantage that would attract industry naturally to the state. From a demographic perspective, if the present economic trends continue, the state population will experience modest growth, a decline in relative size, a further continuation of the “brain drain” and aging, and further redistribution from rural to urban areas.

The state economy is in a state of transition. The objective of economic development is to influence the direction of change toward a future economic structure more favorable to Kansans.

BASIC FINDINGS, IMPLICATIONS AND STRATEGY

The recommendations from this study are based on the following findings and strategic considerations:

1. It would be a mistake to assume that the current weakness in the Kansas economy is a temporary phenomenon, or that some favorable federal action (e.g., better farm policy) will precipitate a rebound in our economic fortunes. The competitive realities of the new international economic order have initiated forces that are harmful to our traditional sectors in their present form.

2. Unabated, a continuation of existing trends will result in an on-going and relative erosion of the state's economic base. This will lead to a relatively lower standard of living for Kansans overall, and to reduced services, lower quality roads and other physical infrastructure, lower quality of education opportunities at all levels, fewer job opportunities, and higher taxes.

3. The state can influence these trends in a positive direction. It is true that the state does not have the capacity or power to conduct a comprehensive industrial policy that makes broad, strategic allocation decisions affecting all aspects of economic development. Nor can it influence world markets, control capital markets, print money, or erect tariff barriers. But the state can play a vital role by establishing an optimum foundation (e.g., tax structure, physical infrastructure) and the key relationships (e.g., private sector-universities-state partnership) that will foster sustained private sector growth and modify existing trends favorably. The task for Kansas state government is to identify those limited but important areas where state involvement is essential for economic success and establish the preconditions for business growth.

4. The objective of an economic strategy is to foster timely adaptation to change and transition. The harsh reality is that those industries that develop and apply new knowledge and technologies the most rapidly and efficiently will be the ones with the competitive edge. For Kansas, this will involve providing support for innovation and the application of science and technology to the existing economic base as well as building upon existing strengths to develop new industry.

5. The central focus of any state economic development policy must be the modernization and expansion of the state's economic base. The Kansas economic base comprises those industries, particularly wheat, beef, food and meat processing, oil and gas, and aviation, in which we have a comparative advantage and around which we have developed clusters of suppliers, institutions, skills, knowledge, and infrastructure. It is not feasible to countenance an abandonment of this base and the development of a substitute economy based on artificial comparative advantage; it would be too expensive and it would leave Kansas too vulnerable to do so. Hence the traditional sectors will remain the foundation

of the state economy and must serve as the gateways or conduits through which new products and new processes emerge.

6. Kansas has a set of important strengths that provide the foundation for progress that would be largely based on internal development. These include the high quality of the education system from top to bottom, a productive work force, state fiscal stability, some elements of the transportation infrastructure, diversity in the economic base, and central location (for some types of industry). These advantages provide Kansas with the capacity and opportunity to compete fully in the modern economy. However, the state does not have a natural comparative advantage. That is, these strengths are not adequate to underpin a strategy largely based on attracting new industry from outside, although this avenue must be pursued vigorously to complement internal development.

7. The economic fundamentals of Kansas are basically sound with respect to business location in the state. That is, the factors that businesses take into account in expansion and location decisions, such as wage levels, energy costs, quality and availability of labor, transportation, services, and tax levels and structure are not “out of line,” and tend on balance to be favorable in comparison with many states. There is a recognized sense of integrity and solidity about the state. Indeed, with exceptions (e.g., liquor laws), the external perception of Kansas is better than Kansans perceive it to be, being more balanced in character or neutral rather than negative. While improvements in the fundamentals and image of the state would be productive and should be made, these factors are not insurmountable handicaps to state development.

8. But a number of significant barriers and gaps do exist that interfere with the development of modern technology-based enterprises, with small business entrepreneurship and innovation, and with the expeditious transfer of technology to Kansas industry. These include inadequate investment in research and development, impediments in the state tax structure, the difficulties new firms experience in obtaining capital in general and non-traditional capital in particular, insufficient links between business and universities, inadequate funding and imbalanced emphases of the current state effort.

9. Consequently, an optimum strategy for the economic development of Kansas should emphasize a balanced approach of supporting the existing economic foundation as well as fostering growth through the expansion of old and the attraction of new industry. Such a strategy would incorporate the following elements:

- a) Enhance and extend the traditional sectors, for example through diversification into new agricultural products and greater value-added in processing.
- b) Sustain existing industry, which is largely small scale, support its modernization and competitiveness, foster its expansion and the birth of new business, and encourage Kansas entrepreneurship.

- c) Develop new industry, but in doing so, recognize:
 - i) that only certain types of industry will find Kansas attractive;
 - ii) that most new jobs will evolve from existing Kansas industry, particularly small business; and
 - iii) that foreign investment is playing an important role in job development in other regions, particularly the eastern, southeastern, and western regions of the United States.
- d) Strengthen the local community basis for development. All business location decisions take both state and local factors into account. Greater success will come from an integrated state-local approach. Further, there needs to be a clear recognition of the geographic diversity of the state in designing development initiatives and support mechanisms.

10. The recommendations to implement this basic strategy are designed to achieve the following objectives:

- 1) Foster competitiveness of Kansas industry through innovation.
- 2) Foster productive interrelationships and linkages among Kansas institutions but particularly the private sector, the state, and the universities.
- 3) Encourage entrepreneurship in Kansas business.
- 4) Establish a favorable business climate and infrastructure.
- 5) Remove barriers to business development.

The interrelated set of recommendations that follow are designed to establish the preconditions for development. The initiative for development itself will need to come from the private sector.

11. It is our firm conviction that the state should not adopt a strategy for development based on tax incentives designed largely to attract industry from outside, but rather should have a tax structure that is consistent with that of competing states with regard to business impact. A strategy based on tax incentives is expensive, and there is not evidence to suggest that it would work. On the other hand, Kansas will lose its attractiveness relative to competing states if its tax structure and levels contain significant anomalies or fail to send the right 'signals' about business climate. In particular, the state must avoid having a tax not generally found in other states that negatively impacts business in any significant way. The Kansas tax structure does contain some impediments to business development, and the tax burden on business is perceived to be slightly high.

12. To achieve a significant long-term improvement in the economic base, the state will need to make a large and sustained funding investment over the next decade to support a well-designed package of economic development initiatives. This will be necessary not only because the economic problem facing Kansas is a difficult one, but also because most other states are already making large investments in economic development and have been doing so for several years. Even so, there is no absolute guarantee of success from a large-scale effort. Patience will be necessary because the specific pay-offs will be long term and uncertain. It is clear, however, that without it, relative erosion of the economic base will continue.

While the challenge facing Kansas is not an insurmountable one, it will be difficult, and it will require substantial investment. A strong commitment will be necessary in funding by the Legislature, in planning by the executive branch, and in cooperation by Kansas organizations. Our survey of Kansas business, state, and community leaders showed a strong majority (78 percent) desiring state and local governments “to take bold, new actions to encourage economic development,” as distinct from adopting a do-nothing (2 percent) or minor change (20 percent) approach.

RECOMMENDATIONS

(*Indicates a new recommendation since the Interim Report of January 1986. Hence both interim Report and new recommendations are listed below. Where the legislative action has already been taken by the Kansas Legislature on the interim recommendations, this is so indicated for each recommendation.)

Traditional Industries

Support for traditional industries that have formed the base of the Kansas economy is an important objective of the state's economic development strategy. Support should not be in the form of subsidies but rather should consist of policies to assist these industries to be more innovative and competitive in national and international markets. Increased support for research, and the redirection of existing research programs, can be important in permitting traditional Kansas industries to maintain and enhance their competitiveness by reducing costs of production, applying new technology to production techniques, and developing new or improved products.

1. Establish a task force on agriculture development and marketing to develop a strategy on:
 - a) the diversification of Kansas agriculture into new products;
 - b) the application of science and technology to the value-added processing of Kansas commodities within Kansas; and
 - c) the provision of technical assistance for production, processing and market development

(In April 1986 the Legislature passed House Bill 3122 which creates an interim task force for agricultural research.)

One mission of the Task Force would be, with consultant support and research studies, to identify new products or crops suitable to Kansas, explore potential markets and cost feasibility, and recommend ways to encourage farm entrepreneurs to develop these opportunities. Kansas agriculture is highly dependent on wheat and beef, and would achieve greater stability with a broader base.

The second task is to devise ways and means of bringing new technology to bear on the processing of Kansas commodities in Kansas. A high proportion of Kansas crops are now processed out-of-state so that the employment and income benefits of adding value to raw materials are lost from rural areas in the state. The greatest benefit would be in the form of employment and income of local persons in the processing facilities, which will in turn benefit local business and increase state revenues.

Finally, the Task Force would recommend permanent organizational and funding arrangements to implement the diversification and value-added strategy over time.

These tasks would be undertaken obviously in close cooperation with the Board of Regents and, in particular, Kansas State University.

- *2. Expand the research program on enhanced oil recovery and increase the transfer of new technology to independent oil well operators.

The oil industry in Kansas is composed of many small independent operators who do not have access to the same technology as the major oil companies. Access to technology that reduces cost and increases production is essential for the Kansas oil industry to be competitive, particularly as falling prices threaten higher cost wells. The state has provided funding for the Tertiary Oil Recovery Project that is developing advanced technology for the recovery of oil in Kansas. Such funding should be continued.

In addition, increased efforts to transfer technology to independent operators are necessary. The major need is for additional field engineers to take procedures developed in the laboratory and work with operators on field tests. The state's role in the transfer of technology is crucial, given the large presence of small, independent operators in the Kansas oil industry.

Taxation

The primary objective of the following tax proposals is to adjust the tax structure by removing several impediments to business location in Kansas. The recommendations will also (a) minimize negative perceptions of the business tax burden in Kansas, (b) bring Kansas into line with competing states, and (c) enhance the business climate for general manufacturing and for research and development. It should be noted that this study has not undertaken an in-depth review of the Kansas tax structure. Such a review is necessary to identify other desirable changes not only from the perspective of the tax burden on the business sector but also for state revenue enhancement.

3. Allow a sales/use tax exemption on all machinery and equipment used in manufacturing and on computers for business use.

The state sales/use tax on machinery and equipment is a serious anomaly in the Kansas tax structure. Kansas is the only state in this region which does not exempt all machinery and equipment used in manufacturing from the sales tax. Missouri, Colorado, Iowa, Nebraska, and Oklahoma have this exemption. By the end of 1984, 39 states exempted machinery and equipment from the sales/use tax. Kansas does allow refunds and exemptions from sales tax on machinery and equipment only in certain limited circumstances. Business leaders across the state noted the sales tax on machinery and equipment as a major disadvantage to economic development within the state. Allowing the exemption to also

apply to computers used in business could lead to more jobs in the service and high-technology sectors. The cost of this exemption to the state would have been approximately \$16 million in fiscal year 1984; this budgetary impact could be minimized by a several year phasing in of the exemption.

4. Allow a reduction in state corporate income tax liability through a tax credit given for research and development expenditures.

(In April 1986 the Legislature passed Senate Bill 754, which targets a research and development tax credit.)

The objective of this measure is to encourage the long run competitiveness of the state's industry by encouraging Kansas firms to lead rather than lag in technological innovation. By the end of 1984, seventeen states offered a tax exemption or tax credit to encourage research and development. Iowa, for example, currently allows up to a 100 percent reduction in corporate income tax through a credit equal to 6.5 percent of a firm's qualifying research expenditures. In addition, the promotion of research and development within Kansas would lead to a higher level of interaction between the business community and universities as well as increase the business community's role in research and development. The cost of this program to Iowa for both fiscal year 1984 and fiscal year 1985 was approximately \$1 million, i.e., about \$15.5 million of research expenditures made by firms qualified for the tax credit. Iowa defines research and development expenditures as stated in section 174 of the Federal Tax Code. A limit on the credit can be imposed (e.g., credit on a percentage of excess expenditure over a base period, limit on the proportion of overall corporate tax liability).

In Volume III, ASLAN consultants identified several limitations to this initiative, namely low incentive effort, diluted effective value due to federal tax deductions, and lack of impact on start-up companies. Consequently if implemented, it should be structured to contain the cost to the state. On the other hand, the initiative does send an important signal concerning the business climate, and it would foster innovation and university-business interaction. Further, the research and development level is relatively low in Kansas because of the small business nature of Kansas industry, so that even a modest impact could be productive.

5. Allow a reduction in state income tax liability through a tax credit for investment in private, state-approved venture capital funds and state chartered venture capital corporations.

(In April 1986, the Legislature passed Senate Bill 756. This bill creates a statewide risk capital system, which includes Kansas Venture Capital, Inc., a state chartered venture capital corporation whose investors are eligible for certain tax credits. The passage of Senate Bill 757 allows credits from income tax liability for investment in private, state certified venture capital companies.)

The objective of this measure is to encourage the formation of private venture capital funds in Kansas to support entrepreneurship and innovation. The lack of seed and venture capital has been clearly identified as a significant weakness in Kansas, if not the greatest impediment to business development, given the small business nature of Kansas industry. State involvement would be limited to certification that the funds are targeted for new technology and innovation orientated business activity in Kansas. Investors would receive a tax credit against Kansas tax liability, and some limits can be imposed on the degree of liability offset.

6. Allow local taxing jurisdictions to give property tax abatements for new and expanding manufacturing facilities, research and development facilities, equipment and machinery, and for a limited scope of non-manufacturing facilities having a potential for job creation. The authority to grant the abatement should be detached from the issuance of industrial revenue bonds.

(A constitutional amendment to allow property tax abatement for economic development was approved by the Legislature with the passage of House Concurrent Resolution 5047 in April of 1986. The proposed amendment will be voted on at the August 1986 primary election.)

There are at least thirty-two states now providing a tax exemption or moratorium on one or more of the above types of property. Iowa currently offers property tax abatement on new research facilities and Missouri provides a twenty-five year property tax incentive for redevelopment of urban areas. Neither state ties the abatement of property taxes to IRBs. Kansas allows a moratorium on land and capital improvements and equipment only if purchased with industrial revenue bonds. The federal income tax exclusion on interest earnings from industrial revenue bonds is being phased out. Thus, the total quantity of industrial revenue bonds issued in Kansas will decline, thereby limiting local jurisdictions' opportunities to offer tax abatements. The detachment of tax abatements for the described properties from the issuance of industrial revenue bonds will provide communities with a continuing capacity to compete on an equal footing with other states' communities.

Allowing local option on tax abatements could encourage unproductive competition among local governments within the state and thus unnecessarily erode the fiscal capacity of these jurisdictions. On the other hand, without this tool, Kansas communities would be disadvantaged relative to competing communities in other states. There are few other tools available. On balance, we recommend the initiative on the basis of allowing Kansas local governments to make the decision in their particular circumstances.

7. Support the 1986 constitutional amendment that would eliminate the property tax on inventories.

Kansas is one of only eight states which does not exempt inventories from property tax. The tax is anomalous and is a disincentive for certain types of industries to develop in Kansas.

Education, Research, and Technology Transfer

Kansas has an excellent higher education system, particularly in relation to competing states. The system overall, and especially the major universities, provides a strong foundation on which to build future progress, and it needs to be harnessed to the state economic development effort by maintaining the existing quality differential relative to competing states and linking university research expertise in many fields, but particularly in science and technology, to Kansas business sectors.

The following recommendations are designed to strengthen the education, research, and technology foundation of Kansas and to systematically link them to the business sector. They recognize that technological innovation is the sustaining force behind the development of new industries, new jobs, and productive improvements in the modern economy. As well, the greatest hope for increasing the rate of productivity, and hence the competitiveness, of older traditional industries also lies in technological innovation.

8. Substantially expand the program and level of funding for centers of excellence in basic research.

(Some progress toward implementation of this recommendation was made with the passage of Senate Bill 755 in April of 1986. Senate Bill 755 creates the Kansas Technology Enterprise Corporation, which is charged with awarding funding to centers of excellence for basic research.)

The Centers of Excellence Program is based on the principle that research universities, operating on the leading edge of science and technology, have the potential to stimulate economic growth by bringing together university-business partnerships to focus on research and “technology transfer.” State funds, matched by the private sector, are devoted to areas of academic excellence in our system that have potential industrial application. The present program is funded at a minimum level, and expanded funding could be devoted to new Centers as well as provide additional support for the current centers. The Kansas Advanced Technology Commission has also recommended the expansion of this program.

Approximately 20 states provide substantially higher levels of funding for similar programs than does Kansas. It is not unusual for state funding to exceed \$5 million for starting such centers; \$501,000 was spent in 1985 to operate the three existing centers in Kansas. This amount should be substantially increased to insure that Kansas will be able to assist its business to be more innovative and technologically competitive. The Kansas Advanced Technology Commission has also recommended the expansion of this program.

9. Substantially expand the level of funding for the Research Matching Grant Program.

(In April 1986 the Legislature passed Senate Bill 755, creating the Kansas Technology Enterprise Corporation, which is charged with awarding the state funds for this program.)

The Research Matching Grant Program is designed to encourage university-industry collaboration and to stimulate the process of technology transfer, for the purpose of fostering the competitiveness of Kansas industry. The program focuses on the applied research phase of the innovation process by supporting university-industry projects that have the clear potential for commercialization. The Kansas Advanced Technology Commission directs investment of state funds in research projects at Regents Institutions, with matching support from the sponsoring industrial firms. Each grant is approved by the KATC on the basis of its job creation potential. The National Conference of State Legislatures held during November 1985, noted that virtually every state is doing as much as possible to enhance this linkage between higher education and business, since private sources of funding are the leading indicators of the concerns that businesses have about future technological developments. Expanding the Research Matching Grant Program would improve Kansas's business image, and encourage business location or expansion in Kansas.

It is essential that this program, and others involving university-state-private sector linkages, be conducted with a minimum of bureaucratic involvement and procedures.

10. Establish Institutes for Applied Science and Technology at the major research universities and centers for technology transfer at educational institutions.

(In April 1986 the Legislature passed Senate Bill 755, creating the Kansas Technology Enterprise Corporation, which is charged with awarding funding to centers of excellence for applied research and development and to centers of excellence for technology transfer.)

The objective of these institutes would be to foster the application of advanced science and technology to Kansas business and industry. Each institute would concentrate on linking its academic strengths to Kansas industry and could enhance existing university programs. The existence of institutes of this nature would provide a campus focus and direction to this objective and a visible focal point for industry/university applied research. The 21st Century Center for Agriculture and Renewable Natural Resources at Oklahoma State University, and similar programs in Rhode Island, Michigan, and Indiana would serve as models for what the proposed institutes for applied science and technology in Kansas would hope to accomplish. The level of funding necessary for a primary institute at the University of Kansas, Kansas State University, and Wichita State University, and a secondary institute at Emporia State University, Pittsburg State University, and Fort Hays State University approaches a minimum of \$10 million. It is estimated that much less money would be required in future years to maintain the programs.

11. Provide resources to the state universities for the purpose of upgrading the quality and increasing the quantity of applied social and economic research.

(In April 1986 the Legislature passed Senate Bill 755, which establishes the Kansas Technology Enterprise Corporation, a body charged with funding educational institutions to create technical information data bases. In April the Legislature also passed House bill 2960, establishing Kansas, Inc., which is to support the state's econometric modeling.)

Applied social and economic research relates directly to both the fiscal stability of the state and the ability of Kansas firms to make sound business decisions. Such research would enhance the fiscal stability of the state by providing a basis for more accurate projections of revenue. Research capabilities provide a resource for industry to turn to in the decision-making process. Applied social and economic research serves to increase cooperation between the business community and the state's educational institutions. Funding for this recommendation would range from \$185,000 for the development of econometric modeling capability to \$385,000 which would include development of a state data base, population projections, small business research, and international import/export related activity.

12. Provide funding for the establishment of an industry liaison function at the state universities.

(In April 1986 the Legislature passed Senate Bill 755, creating the Kansas Technology Enterprise Corporation, which is charged with funding educational institutions to establish industrial liaison offices.)

Present liaison between higher education and the business sector is limited and haphazard. An organized liaison function would improve research and academic ties to business and make both parties more aware of the needs to be filled and the services available. Each university in Kansas would establish an industry liaison office which would focus on developing joint research programs between the university and industry. This office would facilitate technological transfer from the laboratory to the factory. The industry liaison office should be separate from the fund raising arm of the university, but able to work cooperatively with that arm.

- *13. Selectively enhance university programs in management and associated areas crucial to economic development.

Economic development is a long-term exercise. In order to make long-lasting and profound changes in the Kansas economy, future business managers must evolve from a cutting-edge curriculum. To become and remain competitive in the international market place, business schools and other academic units should place additional emphasis on areas such as small business management, international business, advanced production and operations management, and modern information systems. These management areas have been given emphasis in other states. If Kansas does not develop programs in these areas, the quality of management in Kansas will decline and Kansas's firms will not be competitive in the world. Because the major business schools in the state are barely able to support basic quality education with current funding, the addition and enhancement of programs will require the funding of additional faculty and related operating expenses.

14. Endorse strongly a continuation and expansion of the state's commitment to all levels of public education in Kansas. Public education in general and higher education in particular are crucial elements for the future progress of Kansas.

(House Bill 3122, passed by the Legislature in April 1986, provides for the establishment by the Legislative Commission on Kansas Economic Development of an interim task force to analyze funding needs of state universities.)

Kansas has a quality differential in education. It would be catastrophic for economic development if this were to erode. A common theme in the economic development programs of other states is an increased funding commitment to higher education.

In relation to higher education, the Board of Regents has clearly articulated the potential for erosion in their fiscal year 1987 budget issue papers. This Interim Report endorses those urgent concerns and proposed remedies with respect to faculty pay and benefits, instructional equipment and research instrumentation, student resources, library needs, etc.

Finance, Capital Formation, and Innovation

In this section we address two of Kansas's most important economic development goals: (1) The formation and financing of innovative, technology based, new businesses and (2) the encouragement and leverage of private investment capital. Our research revealed that there is a serious lack of financing and venture capital for the start up of new and innovative businesses and the expansion of existing businesses that do not meet standards for traditional financing. Indeed, the lack of venture capital and financing is the main economic development problem for Kansas. Financing is particularly needed for businesses that are applying research to develop new and innovative products. We propose several institutions to provide such financing primarily by leveraging of private sector funds.

15. Establish public/private programs to provide equity or debt financing for new and existing firms that are unable to obtain conventional capital for developing innovative products.

(In April of 1986, the Legislature passed Senate Bill 756, crating a statewide risk capital system, which includes Kansas Venture Capital, Inc.)

Kansas currently has no publicly approved or chartered organizations that provide equity or new equity financing. This represents a serious gap in the state's efforts to attract innovative firms. The program would serve to meet the needs for this type of financing by (1) supplementing private sources of venture capital to start up businesses with innovative products when alternative sources of financing are not available, and (2) providing financing to existing industries that are developing innovative products or applying new technology in order to be more competitive. The program, based on the Indiana model, would have three responsibilities:

1. It would make direct investments in new/innovative businesses. Alternatively, it would make direct investments in private venture capital funds investing in state targeted industries.

2. The program would provide equity and loan financing to established industries to develop new products. This would allow existing firms to harness new technology and meet the changing demands of the competitive environment.

3. The program would invest in newly established Small Business Investment Companies (SBIC) and would induce additional private investment in these SBICs through tax credit mechanisms. This would establish a network of SBICs throughout the state, allowing small businesses to expand. Other states, such as New York, Colorado, and Illinois, to name a few, have contributed between \$1 million and \$2.25 million in state funds to form privately managed, state sponsored venture funds.

16. Establish a Kansas product development program.

(The Kansas Legislature addressed the need for product development when it established a seed capital fund as part of the Kansas Technology Enterprise Corporation with Senate Bill 755 in April of 1986.)

Funds would be invested in viable ideas in order to develop new and innovative products (including but not limited to high technology). Assistance could be given in research and development, prototype development, or process development. The program could structure its investment as a loan, as equity financing, or using royalty agreements. Although initial funds would be provided by the state, the program would become increasingly self-sufficient over time.

A Kansas product development program would differ from the funding programs in Recommendation #15 by providing financing to very high risk ventures: those new businesses that do not yet have fully developed products. It is intended to provide the link between research and the development of marketable products. A separate mechanism is needed because of the risk involved and because of the specialized skills needed in identifying viable ideas very early in the process and in providing assistance to entrepreneurs. Further, because of the risk, direct state funding would be required, at least initially.

The first product development corporation was started in Connecticut. They also exist in Iowa and Arkansas in this region.

17. Establish a state fund to match federal Small Business Innovation Research grants to Kansas small businesses.

(The Kansas Legislature established the small business innovation research matching grant program in April of 1986 as part of the Kansas Technology Enterprise Corporation with Senate Bill 755.)

The purpose of the Kansas Small Business Innovation Research (SBIR) program would be to stimulate technological innovation in small businesses.

The federal SBIR program was established in 1982 to provide funding for research and development by small businesses in order to promote the commercialization of new products and the growth of new technology-based companies. Federal Phase I Awards of \$50,000 or less allow small firms to demonstrate the scientific and technical merit and feasibility of the innovation. Firms that successfully complete Phase I may be selected for Federal Phase II funding of up to \$500,000 to further develop the innovation. Under the Kansas SBIR program, small businesses in the state that receive Phase I awards would also receive a matching grant from the state. Such a state grant is to help innovative small business in Kansas develop products with commercial potential and to increase the probability of their receiving a Phase II award.

Several other states have matching programs in existence to encourage small business innovation. A Kansas SBIR program would encourage Kansas small businesses to compete for research funds and would encourage such firms to stay in Kansas. These small businesses are competitive on a national basis and are exactly the type of innovative small businesses that Kansas needs to keep in order to improve economic growth. Firms that accept state funding must commit to producing the product in Kansas.

18. Establish a Kansas Science and Technology Authority.

(In April 1986 the Legislature passed Senate Bill 755, establishing the Kansas Technology Enterprise Corporation (K-TEC).)

This recommendation originally called for the establishment of a Kansas Science and Technology Authority, which would operate the following programs:

1. the Kansas Corporation of Innovation Development (see recommendation 15),
2. the Kansas Product Development Corporation (see recommendation 16),
3. the Kansas SBIR Program (see recommendation 17),
4. the management of a high technology venture capital fund,
5. the construction and operation of incubators, and
6. the solicitation and facilitation of joint research contracts and grants between state universities, businesses, and government.

After further refinement and development by the Kansas Legislature, in consultation with the Institute for Public Policy and Business Research, this recommendation has reemerged as the Kansas Technology Enterprise Corporation (K-TEC). K-TEC has been

altered to exclude the construction and operation of incubators and to include the financing of the Centers of Excellence program (see recommendation 8).

We believe that various coordinating and financing mechanisms that are to be established need to be organized by a single authority. This would allow the programs to operate more efficiently and would avoid possible duplication of effort and staff. K-TEC will be the umbrella administrative unit for the programs, institutes, and financing corporations set out above. The purpose of the K-TEC is to foster innovation in existing industry and the development of new industry in key exporting areas of special importance to the Kansas economy.

19. Sponsor a program of financial symposia on capital formation.

In other states, high growth companies have presented their business plans and financing requirements to an assembly of investment bankers, venture capitalists, and other investors (such as pension funds, utilities, and insurance companies). After the presentations, investors are given a chance to meet privately with a limited number of companies.

In Oregon this year, at the Fourth Annual symposium, approximately 22 companies made presentations to 59 registered venture capitalists or investment bankers. The companies were solely from the Northwest, but the investors were from as far away as Chicago, California, and Texas. Investors paid \$450 each registration fee.

This would be a low-cost, high impact project that would serve several purposes:

1. Help Kansas companies obtain financing
2. Project a progressive image of Kansas business.
3. Familiarize the investment community within and outside Kansas with opportunities in Kansas.

20. Provide temporary state funding for Certified Development Companies.

(House Bill 2951 authorized the Division of Existing Industry Development within the Department of Commerce to make performance grants available to Certified Development Companies in April 1986.)

The 15 Certified Development Companies (CDCs) in Kansas provide small businesses with an important source of financing when funds are unavailable from a more conventional finance institution. These are especially helpful to firms that would like to expand into new areas of production but cannot get traditional financing. They are also helpful to firms that would like to expand their markets.

These non-profit organizations are certified by the Small Business Administration. Usually, CDC Boards are made up of lenders, local government officials, business leaders and

community organization representatives. The financing package of a CDC always involves a participating bank. A typical loan is:

- 50 percent—participating bank at negotiated term and rate,
- 40 percent—subordinate debt to Small Business Administration,
- 10 percent—small business equity addition.

Such loans can be an important source of financing for Kansas firms that wish to expand.

State funding is necessary to assist the CDCs in their formative years so they can hire sufficient staff to package additional loans and to provide technical assistance for expanding small business. They are financed primarily by a 0.5 percent charge on loans they organize. However, during their early years of existence they do not have sufficient loans outstanding to provide enough income to hire staff and maintain an office. As loan volume increases the CDCs should become self-supporting.

We propose state funding of \$400,000 annually for five years to support CDCs. A pool of funds would be established for which each CDC could compete. Currently the state is funding two CDCs at \$40,000 each.

To be eligible for funding, a CDC would have to (1) demonstrate a need for temporary state funding and (2) demonstrate that its activities are having a positive economic development effect in its area. Of particular importance would be an indication that the CDC is emphasizing financing for small businesses that are creating primary jobs to bring new dollars to a community rather than local service jobs that primarily recycle dollars within that community.

21. Expand the secondary market for the SBA guaranteed portion of bank loans.

Secondary market sales of SBA guaranteed loans have been permitted since 1972. The purpose of such a program is to increase the flow of capital to small businesses by allowing lenders to sell their loans to investors who normally do not lend funds directly to small businesses. The advantages are increased liquidity for a bank and a fiducially sound investment for the organization buying the SBA guaranteed loan. Equally important is that the state's economic development is also advanced. Such a program is expected to have a particularly favorable impact in rural areas where banks are typically less liquid.

One possibility would be to have the state, perhaps through the state pension fund, purchase the SBA guaranteed portion of banks' loans. This would involve KPERS in financing for economic development through a loan that carries a competitive rate of interest and that carries the full faith and credit guarantee of the federal government.

22. Establish an export assistance program to aid small and medium-sized firms in exporting Kansas products to international markets.

Small and medium-sized firms in Kansas have greater difficulty in developing export markets than do larger firms. Smaller companies do not have specialized staffs to assist with export financing, insurance, exchange rates, and cultural differences. Since almost all Kansas businesses are small businesses, the problem of exporting Kansas products is particularly severe.

The Federal Export-Import Bank is encouraging states to develop their own program to assist small businesses that want to increase exports. Nineteen states have passed legislation to assist export financing and seven additional states have legislation pending. We recommend the following Kansas programs to expand state exports:

- (1) export finance counseling services,
- (2) pre-shipment and post-shipment guarantees,
- (3) medium term fixed rate financing assistance,
- (4) post-shipment export credit insurance, and
- (5) an Eximbank delivery system program

*23. Establish a loan guarantee program to facilitate financing of new or expanding businesses in primary industries.

A loan guarantee program would provide new or expanding firms in manufacturing and export related industries with access to capital where adequate financing is not available from traditional sources. The program would guarantee a portion of a loan by a bank or other financial institution, thus reducing the risk to the lender. The intent is to make additional risk capital available in a targeted manner at competitive cost to the borrower.

Such a loan guarantee program would provide an alternative for tax exempt industrial revenue bonds, which are being phased out at the federal level. Loan guarantees are a highly cost effective means for leveraging private investment funds. This would be one of several financing options available to firms in Kansas. It may be necessary to establish an independent financing authority (Kansas Financing Authority) to manage a loan guarantee program.

State Organization for Economic Development

The state's more sustained commitment to economic development needs to be reflected in the Legislature and KDED's organizational structure. Legislative responsibility for economic development needs to be more focused and KDED needs adequate funding and staffing. At present, KDED is underfunded and understaffed. In particular, KDED needs adequate resources to:

1. Foster Kansas international trade,
2. Expand efforts to assist small businesses,
3. Initiate an existing industry program, and
4. Continue industrial recruiting of out-of-state firms.

Our basic conclusion is that economic growth in Kansas will come mainly through the growth of small business and the retention/expansion of existing industries. To be successful additional resources are needed to support KDED activities in these areas.

24. The Legislature should establish a permanent joint House-Senate Committee on Economic Development or, alternatively, separate committees in each house.

(The Legislature created standing committees in each house and a joint committee on economic development with House Bill 3122 in April 1986.)

The Legislature needs a permanent structure for considering legislation on economic development. Such a committee (or committees) would give greater visibility to this area and would focus legislative responsibility for economic development in one committee. The committee(s) would have responsibility for proposing legislation on economic development in the state. Over time, members of this committee would acquire valuable experience on public policies affecting economic growth in Kansas.

A permanent committee(s) is also needed to ensure that momentum on economic development is continued. We believe the state requires a long-term commitment in this area. As a first task the joint committee(s) could have responsibility for considering recommendations in this report that are not acted on during the 1986 legislative session. Appropriate legislation could be prepared for the 1987 Legislature.

25. The Small Business Division of the Kansas Department of Economic Development should be substantially expanded and additional field offices established.

(In April 1986 the Legislature passed House Bill 2951, which created a new Existing Industry Division of the Department of Commerce and included funding for additional Department field offices.)

The Small Business Division was established by the Legislature in 1985. However, its staff of six persons is too small to be effective. The Small Business Division should be adequately staffed and funded so it can effectively coordinate the state's efforts to foster the establishment and expansion of small businesses. For example, the division should

- a. coordinate efforts to increase financing of small business;

- b. coordinate efforts by communities and organizations involved in economic development to provide technical assistance to small business;
- c. assist in the development of incubators for small businesses throughout the state;
- d. work with the Small Business Development Centers at the state universities and colleges which provide technical assistance to small businesses; and
- e. provide assistance to small and medium businesses in securing federal contracts. Staff with expertise in federal procurement policies should be made available to businesses through KDED's field offices.

These responsibilities can best be met by the establishment of additional field offices in the areas of Kansas not currently well served by KDED. Staffing of the field offices should be sufficient. The two field offices of the Small Business Division are not able to serve all parts of a state as large and diverse as Kansas.

26. An existing industry program should be initiated in the Kansas Department of Economic Development.

(In April of 1986 the Legislature passed House Bill 2951, which establishes an Existing Industry Division within the Kansas Department of Commerce.)

The major priority of the Kansas Department of Economic Development has been to attract out-of-state firms to locate in Kansas. While this effort should be continued, more attention should be focused on industries already in Kansas. An existing industry program would work with Kansas industries to

- a. identify problems that prevent Kansas firms from being competitive and expanding, and
- b. propose solutions, to the extent possible, for those problems.

It is essential for the state to pay attention to the needs of business already in Kansas. We need to know if problems exist in such areas as transportation, financing, availability of skilled labor, and taxes. By working with existing industries in a systematic manner, the state would increase the likelihood of retaining existing industries and facilitating their expansion. One part of this state level program would be to assist local communities in establishing their own local industries programs.

27. A new international trade division should be established within the Kansas Department of Economic Development.

(In April of 1986 the Legislature passed House Bill 2951, which establishes a Division of Trade Development within the Kansas Department of Commerce.)

The international trade division (or unit of major status) would have two major functions: (1) assisting international marketing of Kansas products and (2) providing technical assistance to Kansas firms that wish to initiate or expand efforts at exporting. Kansas is increasingly a part of the world economy. International trade is important for many Kansas industries and further efforts must be made to market our products internationally. Efforts at international marketing should all be concentrated in KDED. It is crucial that this area be made more visible by being in a separate division that is adequately funded. The staff should be led by experts in international marketing. Overseas offices in key markets should be established.

The international trade division would also provide assistance to Kansas firms desiring to initiate or expand exports. Small businesses in particular require assistance with export financing, licenses, import requirements, and cultural/language issues. The division would assist with putting a complete package together in order to facilitate increased exports by small businesses.

28. Increased efforts should be made to attract foreign firms to locate in Kansas.

(In April of 1986 the Legislature passed House Bill 2951, which establishes Kansas Department of Commerce offices in Europe and Japan.)

The Industrial Development Division of Kansas Department of Economic Development has responsibility for attracting foreign firms to Kansas. Funding and staffing should be increased for this function. Increased foreign investment is being made in the eastern, southeastern, and western states and is beginning to come to the midwest. Kansas needs to obtain a share of such investment by expanding current efforts. Kansas is one of only ten U.S. states where there are no Japanese-owned plants.

29. The Kansas Department of Economic Development should implement a marketing program aimed at targeted industries.

(In April 1986 the Legislature passed Senate Bill 759, which provides funding for business recruitment advertising aimed at targeted industries.)

Midwest Research Institute's target industry analysis (included in this economic development study) will identify growth industries particularly suited for Kansas. Follow-through is required to identify specific firms in those industries and to market Kansas to them. This requires that KDED take the initiative in "selling" Kansas to this specific set of targeted industries. This will include advertising in particular trade journals and staff contacts with individual firms. Such a targeted market and program is essential if Kansas is to take the initiative in attracting growth firms to the state.

In addition, the targeted industries study begun by Midwest Research Institute should be continued. A second phase of this study would identify target industries for the major regions of Kansas. Funding should be made available for this purpose. The reason for a

targeted marketing program is that only certain industries will find Kansas attractive as a business location. The state's proximity to consumers and suppliers, labor, raw materials, and transportation system will only appeal to certain industries. By knowing which industries Kansas appeals to, the state can spend its scarce marketing resources more efficiently.

30. Kansas should initiate a national promotion campaign aimed at improving the image of Kansas among business leaders with responsibility for making business location decisions.

A major problem identified by Kansas leaders is that the state has a poor image as a place to do business. Yet, there is a strong belief that Kansas is a good state to do business in, and we concur in that judgement. The need, therefore, is to narrow the gap between reality and perceptions of out-of-state business leaders.

We recommend the initiation of a long-term marketing effort, aimed at business leaders, to improve the image of Kansas. The basic message would be that Kansas is a good place to do business, and the state is committed to providing a positive business climate. The return will be high for a reasonable and moderate national promotion campaign.

One part of a national promotion campaign should aim at improving the image and reputation of Kansas products and producers. This could be done, for example, by adopting "KANSAS QUALITY" as a logo for all products made in Kansas. Producers could be encouraged to add this to appropriate products. (This notion was suggested to us by Mr. Bill Tucker of Elkhart, Kansas.)

31. Repeal or amend the constitutional prohibition on internal improvements to permit state economic development initiatives.

(Senate Concurrent Resolution 1635, passed in April of 1986, proposes a constitutional amendment to the internal improvements prohibition. This will be voted on in the August 1986 primary election.)

The purpose of this constitutional amendment is to allow the legislature the option of developing programs that are designed to foster economic development in Kansas and that require some commitment of state funds to private or quasi-public enterprises. In order to allow such investment, the Internal Improvements Prohibition must be amended or removed from the Kansas Constitution. Passage of the proposed constitutional amendment is essential if the state is to play an active leadership role in economic development. The implementation of several recommendations in this report will be limited by the constitutional prohibition on internal improvements.

- *32. Establish an overall travel and tourism strategy for the state. A funding increase is necessary for the following projects:

1. research on travel and tourism,

2. marketing of Kansas attractions in and out of the state, and
3. development of state parks or other major attractions.

Travel and tourism is a growth industry in the United States, but Kansas is not currently competitive in developing this industry. Kansas's spending on travel and tourism has not kept pace with other states, and Kansas currently ranks 44th among the states in funding for its travel and tourism office. We believe Kansas has greater potential in this industry than has previously been recognized.

A necessary starting point for a state strategy is a research program to identify why people travel to Kansas and how such travel can be increased. For example, Kansas historical sites and recreation areas may be a basis for an enhanced state effort to encourage travel and tourism. Particular attention should be devoted to identifying how the state recreation areas can be enhanced and to discover which major attractions should be promoted. A larger marketing effort would be an important part of the travel and tourism strategy.

- *33. Upgrade the Kansas Department of Economic Development data and information systems necessary for economic development.

KDED requires an enhanced computer capacity to handle the information and data bases necessary to carry out its responsibilities. Access to larger data bases are necessary for

- (1) community profiles,
- (2) site profiles,
- (3) directories of Kansas manufacturers and products,
- (4) business services, and
- (5) technology information.

The community profiles would include information about available land sites, wages, taxes, population, labor force, and existing industries.

One option is for KDED to develop a personal computer network system with terminals available for appropriate staff. Currently only one personal computer is available to KDED for purposes other than word processing. This is devoted to the Kansas Directory of Manufacturers. Other programs such as targeted marketing efforts, international marketing, existing industry programs, and travel and tourism would benefit from improved computer resources.

Community Development and Small Business

Firms choose to locate or expand in Kansas based not only on attributes of the state but also on the attractiveness of a specific community. If Kansas is viewed positively as a state, but local communities are not competitive with those in other states, then economic development will lag. A major part of the state's economic development effort, therefore, should be directed toward helping communities to improve their own economic development programs. Several Kansas communities already have well-developed programs that are competitive regionally and nationally. But other communities are just beginning their economic development programs, and they require assistance. We recognize that the state's role is limited, and we propose that state assistance to communities be in the areas of financial and technical assistance.

In this section we also present several recommendations directed to small businesses. These are in addition to other recommendations listed elsewhere, which are intended to facilitate the start-up and expansion of small business. Here we present recommendations that relate to establishing incubators and providing technical assistance to small businesses.

34. Provide low or no-interest matching loans to local governments and nonprofit organizations to facilitate the establishment of incubators.

Incubators help draw out and develop entrepreneurs from within a community. Incubators are highly adaptable, so the needs and resources of highly dissimilar communities can be met creatively; however, low cost funding is essential. Low or no-interest matching loans to local governments can be used to support incubator developments. Funding for initial operating costs should be included. Illinois has allocated \$1 million for its first year of funding for incubators.

The incubator program should be sufficiently flexible to allow private sector operation of incubators even though the state provides initial financing assistance.

35. Establish a revolving loan pool for infrastructure development available for use by communities to promote economic development.

The purpose of the loan pool would be to allow communities to make improvements in infrastructure that would encourage or facilitate economic development. Included would be roads, sewers, water lines, and other improvements with the potential for attracting additional firms, the start up of new firms, or assisting the expansion of existing firms. All funds would be targeted for specific economic development purposes such as improvements associated with an industrial park, improvements associated with an incubator, or the preparation of a site for business use.

The intention is to assist local communities with the financing of infrastructure improvements that would directly improve the communities' prospects for economic development.

All such loans would be repaid to the state at low or no interest. Firms are usually willing to pay for infrastructure improvements that facilitate a new business location or an expansion, particularly if payment can be deferred until the new facility develops a positive cash flow and if interest on payments is low.

36. Substantially expand technical assistance to local communities on how to promote economic development.

(In April of 1986, the Legislature passed House Bill 2951, which expands the small business division of the Department of Commerce by setting up additional field offices.)

Firms considering a site for locating or expanding a business will look at characteristics of the state and the community in making that decision. Many communities have only recently begun economic development programs and are in need of technical assistance. It is important that assistance be given not only on the attraction of firms to a community but also on the retention and expansion of existing industries. Some areas where technical assistance to communities would be important include

- incubator development
- industrial parks
- site development
- financing programs
- existing industry programs
- information for site consultants and firms
- identification and targeting of industrial prospects
- international market development programs

Such technical assistance would best be provided by an expansion of KDED field offices as proposed in Recommendation 25. Kansas is too large and diverse a state to have all communities served by Topeka. Staffing for technical assistance should be sufficient to serve all parts of the state and to allow employment of specialists in key areas such as international trade.

*37. Incentives should be offered to encourage regional coordination and effectiveness of economic development efforts.

An important issue in economic development is how Kansas communities should organize for economic development. Rural communities in particular do not have sufficient resources to hire staff to coordinate economic development. Yet, rural communities must

have staff devoted to economic development (1) to ensure that they participate in state initiatives already passed by the legislature, (2) to actively recruit new firms in their areas, and (3) to assist in developing local strategies for development. To be successful, rural communities must make bold efforts to adjust to economic changes, which suggests that a regional strategy covering a number of counties may be most efficient. Reasons underlying this recommendation are given in the Krider and Houston paper prepared for the Special Commission on a Public Agenda for Kansas.

Several regional institutions already exist that play an important role in rural economies. The Certified Development Corporations (CDCs) are organized in most parts of the state to assist small businesses with financing. They have also, in some cases, assumed additional responsibilities for economic development, such as recruiting firms to their area. Regional planning commissions also perform some functions relating to economic development. In addition, some larger cities and counties in rural areas have hired economic development coordinators. Obviously, overlapping responsibilities and rural communities' working against each other and depleting scarce resources are potential problems. This recommendation is designed to coordinate regional economic development in an effort to minimize overlapping responsibilities in the region and competition among the region's communities.

Although state government should probably not impose a structure for cooperation among rural counties, incentives should be offered to multi-county areas throughout the state if they agree to coordinate strategies and programs for economic development. Such incentives should be temporary. To start this process, the Department of Economic Development should work with interested parties to define viable regions for economic development and to sort out the roles of each participating agency and unit of government. Those regions that establish acceptable business plans would be eligible for temporary state financial assistance.

38. Federal Community Development Block Grants should be used to the fullest extent possible for economic development projects.

Currently 30 percent of the state's CDBGs are being used for economic development. This percentage should be expanded to the fullest extent possible. Infrastructure improvement, incubator financing, and industrial park financing are examples of possible uses of these funds.

39. A state community development block grant program should be established and targeted to economic development.

A state CDBG program could make grants available to local communities for infrastructure improvements, incubators, and industrial parks. Such grants could supplement loans as proposed in recommendations 34 and 35. All such grants would be targeted to specific economic development objectives but would not be limited to low income areas.

A major advantage of a state CDBG program would be its flexibility. It would be used by all communities in Kansas, not just those meeting federal criteria. Further, commitments could be made more quickly to communities and firms, and funds could be used in ways not permitted by the federal program. Most important is that the use of state CDBG funds could be expanded to include loan guarantees to companies instead of being limited to direct loans as under the federal programs.

40. Expand the “Certified Cities” program.

KDED has recently begun a Certified Cities program which deserves to be supported and expanded.

With state-agency support and advice, communities make a comprehensive assessment of all their strengths and weaknesses in regard to economic development. An in-depth study of the community’s labor force, capital availability, existing industries, educational opportunities, infrastructure, etc. would be made. Certified cities would be eligible for priority consideration for loans and grants for incubators, state supported industrial parks, or other state programs. Technical assistance from KDED should be available and targeted to assist communities in areas where weaknesses are discovered.

41. Provide state funding for the Small Business Development Center (SBDC) network to expand technical assistance to small businesses through consulting and training sessions.

(In April 1986, the Legislature passed House Bill 2951, which authorizes the new Department of Commerce to make performance grants available to Small Business Development Centers.)

The basic premise underlying the recommendations in this study is that Kansas is a state of small and medium sized businesses and that the major source of economic growth in Kansas will be from new and expanding small businesses.

The major needs of small businesses are for financing and technical assistance. Financing is covered in other recommendations, some of which have been implemented as elements of the statewide risk capital system. Small businesses do need assistance in such areas as marketing, accounting, finance and personnel. The SBDCs are established at the six Regents’ Institutions plus Johnson County Community College and Washburn University. Universities and colleges are particularly well suited for providing assistance to small businesses. They currently provide technical assistance using their own staffs, university faculty, and students. Expansion of this function would be permitted by state funding. Currently, federal funding for these services is provided through the Small Business Administration, but this funding is not sufficient to serve the need for technical assistance presented by Kansas small businesses.

- *42. Continue and expand the state's commitment to a high quality of life in Kansas communities by encouraging the arts. Funding for the arts should be increased to the mean per capita level of the fifty states.

A central element of Kansas's economic development strategy should be to expand the state's commitment to a high quality of life in Kansas. One important way of improving the quality of life is through increased state support for the arts. Access to the arts—including orchestra, theatre, and other performing arts—is important in making Kansas a more attractive state for economic development. The decisions to locate or expand in Kansas will be influenced by perceptions of quality of life. Such considerations are particularly important for businesses that employ substantial numbers of managers, professionals, and other highly trained persons.

The state government has not adequately supported funding for the arts. State funding is particularly important in Kansas, which has a large rural population and many small towns. Many Kansas communities are too small to develop and fund their own artistic efforts. State support will be necessary if improvements are to occur in the arts. Currently, Kansas is spending only 24.2 cents per capita in the arts which earns a ranking of 45th among the fifty states. Funding for the arts should be increased to the mean per capita level of the 50 states, which for fiscal year 1986 is 83.3 cents.

Economic Development Strategy in State Policy Making: Human Resources, Infrastructure, and Regulation

Economic development is not the sole responsibility of the Department of Economic Development. A wide range of public policies have a direct impact on the state's ability to attract, expand, and retain businesses. To the extent possible, all state agencies, consistent with their mission and responsibilities, should direct their activities to ensure that Kansas has the array of public policies that will encourage and support economic development. We consider specifically policies involving human resources, infrastructure, and regulations.

- *43. Develop a coordinated human resources strategy for the Job Training Partnership Act Program, vocational education, and Kansas Industrial Training that is focused on economic development.

Every effort should be made to utilize Kansas's labor force, which is one of its few competitive advantages. This can best be done by ensuring that the state's training system provides qualified employees with the skills firms need to locate or expand in Kansas. Even though Kansas labor force is highly educated, it too often lacks skills in areas of particular concern to employers, such as electronics. The state has several training programs that can be coordinated and focused on matching labor supply with the demand of employers.

- *44. The major policy goal of the state Job Training Partnership Act Program (JTPA) should be to promote economic development.

The U.S. Congress has mandated that JTPA invest in human capital to increase the earnings and employment of participants. This is entirely compatible with the state's goal of promoting economic development. Indeed, Kansas would best serve JTPA participants by providing training for jobs in new and expanding industries where prospects for job retention and advancement are best.

Kansas can increase JTPA's effectiveness as an agent for economic development in several ways:

- (1) by establishing formal coordination between JTPA, KDED, and the Department of Education through a JTPA job training liaison located in KDED;
- (2) by providing a heavy weight to a job creation standard in the JTPA performance standards for incentive grants; and
- (3) by allocating state funds to supplement JTPA programs to give them more flexibility and increase their impact.

The overall goal of such initiatives would be to establish a coordinated job training program that would provide customized training for employers in the skills and occupations they designated. The funding for such training could be provided by federal JTPA funds, vocational education funds, or state funds as appropriate. An emphasis on customized training would permit the state's job training system to work closely with employers in designing training programs specific to the employers' needs.

- *45. Establish a task force to review the vocational education system with the objective of ensuring responsiveness to changing industry needs for skilled employees.

Vocational education must become more market-driven. The key question is: What kind of skilled employees are needed by current and future employers? The vocational education system has a crucial role in deciding what skills are required and providing training in those areas. A task force would address the following questions:

How can vocational education better coordinate with JTPA and KIT to promote economic development?

How can the private sector have appropriate input in vocational education?

How can vocational education ensure that the quality of training (equipment, instructors, facilities) are at an appropriate competitive level?

- *46. Expand the Kansas Industrial Training Program (KIT) and improve coordination with other training programs.

KIT is the most flexible of the state's job training programs and the only one whose sole objective is economic development. It is important that this program be adequately funded so that KDED can take the initiative in designing customized job training programs for new and expanding businesses. The development of customized training programs for employers can be important in making Kansas more attractive to business, because employers control the content and relevance of such training.

An expanded KIT program is essential because its funds (1) can be committed very quickly, (2) can be used for any kind of training, and (3) can be used to train any employee selected by the employer. Such flexibility is crucial in putting together a coordinated job training program involving vocational education and JTPA. An expanded KIT would permit the state to use job training as a major part of its economic development strategy. Such a strategy is appropriate and important for Kansas.

*47. Review the state's budgeting procedures to determine how the state can expand its investment in public infrastructure to support economic development, particularly highways, airports, water resource development, recreation and wildlife improvements, and state agency facilities.

An adequate public infrastructure is of great importance for economic development. The quality of public services, particularly in such areas as highways, water resources, recreation and wildlife improvements, state agency facilities and airports, is important in attracting business investment, external and internal, to the state. Overall, Kansas has been making an inadequate investment in public infrastructure.

Professor Ed Flentje of Wichita State University has conducted a study on capital finance and public infrastructure for the Special Commission on a Public Agenda for Kansas. He found that:

Relative to construction costs, overall state expenditure, and personal income for Kansas expenditures for capital improvements in 1985 fell 33 percent, or \$148 million, below the average level of the last 25 years. Declining federal assistance, a dominant pay-as-we-go philosophy, and inadequate capital planning and budgeting, among other factors, have contributed to this funding deficit. As a result, new highway projects have reached a virtual standstill, recreation and wildlife improvements have been postponed, action on new correctional facilities has been stalled, preventive maintenance of state facilities has been reduced, and a backlog of unfunded capital improvements for state purposes has occurred.

A continuation of inadequate funding for public infrastructure will impair the state's economic development efforts.

- *48. The allocation of state highway funds should, to the fullest extent possible, be linked to economic development. Priority should be given to projects that promote economic growth in the state.

Kansas's highway system has developed and is designed primarily to transport agricultural products to market. Kansas ranks second in the United States in number of secondary highway miles, most of which were designed to benefit the agricultural industry. Because of a limited population base, Kansas is not able to properly maintain such an extensive highway system. Moreover, the highway system needs to be reorganized to serve the economic development needs of the state. Highways that have the greatest potential for stimulating new industries (or expansion of existing industries) should be given greater priority for maintenance, upgrading, and new construction. Economic development should become an explicit and important factor in highway funding decisions.

One way of ensuring that economic development is a priority in highway decisions is to require that Kansas, Inc. have an opportunity to review and comment on all state highway expenditure plans.

- *49. Conduct feasibility studies to examine the need for major highways in southeast and southwest Kansas.

Four-lane, limited access highways have become the major element in the nation's transportation system. Access to such highways is crucial to an area's economic development. There are sufficient good business locations on or near interstate highways, so that many firms will not consider locating or expanding in "isolated" areas far removed from the interstate highway system.

Southeast Kansas, in particular, is seriously disadvantaged by the lack of an interstate highway and is unlikely to experience significant economic growth until its highway problem is resolved. A feasibility study should address the costs and benefits of a major limited access north-south highway from the Kansas City area to southeast Kansas and also an east-west highway to Wichita.

Similarly the costs and benefits should be determined for a major limited access highway west from Wichita. In southwest Kansas, Highway 54 in particular should be reviewed for a major upgrade. This is a key highway in that part of the state, but it is not currently adequate to handle the heavy trucks that use it.

- *50. The impact of regulations on state economic development should be added to the criteria that regulatory bodies must use in carrying out their regulatory responsibilities, and, where they exist, be given greater emphasis. Existing and proposed regulations should be reviewed by Kansas, Inc. to ensure that they are not unnecessarily impeding economic development.

The impact of state regulatory policies on economic development should be explicitly weighed against other priorities by state agencies. Regulations that impose significant costs on business should not be enacted unless the expected benefits more than offset the costs and can be substantiated. Unnecessary regulations can discourage firms from locating or expanding in Kansas and should be eliminated to the extent possible.

Regulations in the following areas should be reviewed for elimination or modification as appropriate:

1. Transportation
2. Health and Safety
3. Telecommunications
4. Utilities
5. Securities and Banking
6. Environment

Evaluations of significant regulations in these areas should be undertaken by Kansas, Inc. Similarly, Kansas, Inc. should be given an opportunity to provide an evaluation and recommendation on proposed regulations that affect economic development.

INNOVATIONS IN ECONOMIC DEVELOPMENT: LESSONS FROM OTHER STATES-ASLAN, Executive Summary (March 1986)

INTRODUCTION

Forward looking states will anticipate the loss of authority to issue tax-exempt industrial revenue bonds and sharp cutbacks in federal assistance to state and local economic development dictated by the Gramm-Rudman-Hollings Deficit Reduction Act.

Two primary challenges confront the state: First, to provide adequate financing for an expanded economic development program, either from existing revenues or new innovative sources, and second, to implement effective programs and cost-effective tools to achieve the economic development objectives of Kansas. The **Kansas Economic Development Study** provides the Legislature with a propitious opportunity to respond to these challenges.

ECONOMIC DEVELOPMENT FINANCING

States have been looking to and relying upon “new” sources of funds to finance economic development programs. This has involved expanding the permissible use of public pension funds, encouraging participation from private sector firms, using the Community Development Block Grant for economic development purposes, and cultivating previously untapped sources of state funds.

The limited size of state budgets, reluctance to raise taxes, and competition among budget shares have made it imperative that the efficiency of development resources be maximized. In addition, to maintain and/or increase the funding level of existing economic development programs and to implement new approaches, states have looked for new funding sources. To this end, more and more states have successfully attracted funding from non-traditional, non-state sources such as public pension funds and private sector firms.

Public Pension Funds

In recent years, an increasing number of state legislatures have relaxed restrictions on public pension fund investments with the intent of giving the pension fund trustees and managers greater discretion and the opportunity to establish a well-balanced, diversified portfolio. This has enabled public pension funds in a number of states to invest in less traditional, higher-risk ventures. A number of pension funds are, therefore, utilizing a portion of their funds to invest in, or make loans to, businesses.

Private Sector Resources

Increasingly, state economic development programs encourage private sector participation. Many states have come to expect not only cooperation from, but direct participation by these firms in the economic development process.

Development Credit Corporations: In establishing development credit corporations (DCCs), for instance, states typically require a one-shot donation of corporate funds (i.e. stock purchases) to provide a reserve against losses, as was the case in the Kansas Development Credit Corporation. Most of the lending capital is also generated through private sources such as financial institutions that extend lines of credit to the DCCs at below-market interest rates.

Venture Capital Companies: In a somewhat similar fashion, venture capital companies are capitalized by the sale of stock to private corporations. These corporations may be established to make loans, equity investments, and other business transactions to companies with innovative products. To encourage the formation of capital companies, several states have authorized tax credits against state income taxes for investments in these companies.

Matching Requirements: Another technique used by states to involve the private sector is a requirement that in order to receive state financial assistance, eligible firms must raise matching funds from the private sector. These matching funds can generally be provided either by the borrower, a lending institution, or a combination of both.

Community Development Block Grants (CDBG): Since 1982, Federal law has permitted states to set aside a portion of these funds exclusively for economic development purposes. Several states have established a separate pool of discretionary funds that can be allocated quickly on an as-needed basis for economic development purposes.

Unique State Funding Sources

Some states have become innovative not just with utilizing external sources of funding for economic development purposes, but also in making available unusual sources of state funds.

Special sources: In some instances, these sources are peculiar to a particular state. Montana, for example, uses a portion of the revenues from its Coal Trust Fund to finance a number of economic development programs. Each year 25 percent of all new revenues in the Trust Fund are invested in the state as part of the Coal Tax Loan Program.

Industrial Development Pools: Another innovative state resource is the State Investment Fund which is used by West Virginia for economic development loans. In West Virginia, all state reserves are pooled and then invested. Fifty million dollars of this Fund has been set aside for an Industrial Development Pool.

Economic Development Time Deposits: Missouri's Economic Development Time Deposit Program links deposits of state funds to banks which make short-term loans at below-market interest rates for new and expanding industries and community development projects. Each year \$15-20 million of the State Treasurer's Discretionary Deposits are used to finance this program.

Dedicated Tax Revenues: Ohio's Economic Development Financing Act enables the Department of Development to utilize funds generated by profits from state-operated liquor stores to provide financing for public and private facilities for economic development. The act permits the issuance of economic development bonds by the state to raise funds to help finance economic development projects and pledges \$15 million per year from the sale of liquor to be used to retire the bonds.

State Lotteries: Oregon has initiated a major program of economic development using an estimated \$85 million in proceeds from the state lottery. The program encompasses six major thrusts including a Resource and Technology Development Corporation, enhancement of the state's educational institutions, special public works and enterprise zones.

In a similar manner, Iowa has undertaken a major initiative for economic development and education by establishing a lottery. The estimated \$40-60 million revenues will be allocated, among other uses, to a "Jobs Now Capital Account" and a "Community Economic Betterment Account." Approximately \$9 million of the "Jobs" account will be used to establish a World Trade Center. The "Community Economic Betterment Account" provides for principal and interest buy-downs on business loans, grants and loans for economic development, site development or infrastructure costs directly related to projects, and road construction.

CURRENT KANSAS INDUSTRIAL DEVELOPMENT INCENTIVES

Kansas has moved cautiously in establishing economic development programs. The number and diversity of its programs and tools is constrained compared to most other states. This is not necessarily a handicap, but suggests that the state should examine their current programs and tools, their effectiveness in achieving designated development objectives, and new programs and tools which might strengthen the state's competitive position.

Kansas places a singular reliance on Industrial Revenue Bonds and tax concessions in its economic development program.

The primary economic development financing tools in the state are Industrial Revenue Bonds and Umbrella Bonds. In the absence of any compensating action by the Kansas Legislature, the almost certain elimination of the authority to issue tax-free industrial bonds will have a devastating impact on the state's capacity to provide industrial financing.

Tax Concessions

Tax concessions are the second major tool of industrial finance in Kansas. Corporate income tax credits (Job Creation Tax Credit, Investment Tax Credit) and property tax abatements are the most significant tax concessions provided by the State.

While these tax concessions are obviously beneficial to firms operating in Kansas, it is doubtful that the benefits to the State from these incentives exceed their costs in the form of tax expenditures, i.e. the loss of state tax revenues. Further, the utility of these concessions in influencing the site location decisions of firms considering Kansas as one of an array of alternative locations is, at best, questionable.

It is strongly recommended that Kansas evaluate the current system of tax incentives to determine their cost-effectiveness in contributing to the state's economic development objectives.

Customized Industrial Training

Kansas's customized industrial training program is potentially one of the most potent and cost-effective instruments in the state's current array of economic development tools.

These programs tend to have high effective values to firms and to be highly cost-effective. States are finding these programs to be attractive to firms, particularly with foreign firms investing in the U.S.

Enterprise Zones

The Kansas Enterprise Zone program is built almost exclusively around tax concessions. Companies locating or expanding in designated zones are eligible for expanded tax credits under the Job Expansion and Investment Credit Act. In addition, sales taxes on purchase and installation of machinery and equipment and for materials and service used in construction are refunded.

Conclusion

With the eventual elimination of industrial revenue bonds, Kansas will have a relatively weak array of industrial financing tools unless action is taken by the Legislature.

New initiatives will build on the existing edifice of economic development programs in the state. It appears important for the state to undertake some systematic evaluation of these existing programs to determine their effectiveness. At a minimum, a process should be developed for monitoring the costs of current tax concessions to the state, followed by and assessment of the outcomes of these programs and whether their costs are justified by outcomes.

PROPOSED INITIATIVES IN INDUSTRIAL FINANCE

The Interim Report to the Legislature made 34 specific recommendations for strengthening Kansas's economic development programs. Of these, 10 involve some form of industrial development financing. These are identified below, organized by generic types of financing, rather than by function or target.

Tax Incentives

- * Sales/use tax exemption on all machinery and equipment used in manufacturing and on computers for business use.
- * Research and development corporate income tax credit.
- * Income tax credits for investments in state-approved venture capital funds and state chartered innovation corporations.
- * Authorization for local taxing jurisdictions to give property tax abatements for new and expanding manufacturing facilities, research and development facilities, equipment and machinery, and for a limited scope of non-manufacturing facilities with the potential for job creation.

Loans

- * Federal Community Block Grant funds used for economic development

Secondary Markets

- * Secondary market for the Small Business Administration guaranteed portion of bank loans to Kansas small business.

Venture Capital

- * Kansas Corporation for Enterprise Development
- * Kansas Product Development Corporation

Grants

- * Temporary state funding for Certified Development Companies.
- * State funds to match federal Small Business Innovation Research grants to small businesses.

ISSUES IN EVALUATION

Tax Incentives

1. Sales/Use Tax Exemption: This exemption replaces the current refund on manufacturing plant and equipment provisions, which lapses in June. It removed an anomaly in the Kansas tax structure, which appears to place the State at a competitive disadvantage in the region.

It is recommended that Kansas legislate the sales and use tax exemption on manufacturing and equipment and computers.

2. Research and Development Corporate Income Tax Credit: There are three primary limitations to this initiative.

- * There is little evidence to support the contention that R&D tax credits significantly increase expenditures for research and product development.
- * The effective value of these tax credits is significantly diluted by federal income tax deductions.
- * Young start up companies or other enterprises not making profits are not assisted.

It is doubtful, on the basis of existing evidence, that this incentive is a cost effective means of achieving the state's purposes. Further, it would constitute an essentially uncontrollable cost to the state. Support based on the number of other states implementing R&D tax credits is, in the final analysis, unconvincing.

If Kansas decides to establish a research and development tax credit, it is strongly recommended that it be structured to contain the cost to the state, and that systematic evaluations be undertaken to assess its effects on R&D expenditures.

3. Income Tax Credits for Investments in Venture Capital and Innovation

Corporations: These tax credits increase the real rate of return on investments in state approved or chartered corporations by reducing the real rate of income tax on derived investment income; the same function is played by the tax exemption on industrial revenue bonds, with state resources rather than federal providing the subsidy. This form of tax incentive differs generically from direct tax concessions to firms and falls outside the general critique of tax incentives.

Implementation of the recommendations for a Kansas Corporation on Innovation Development and Kansas Product Development Corporation will require initial capitalization of these entities. Similar incentives have proven successful in generating funds for capitalization or venture capital and product development corporations in other states.

It is strongly recommended that the income tax credits for investments in state approved or chartered corporations be legislated as an essential adjunct to the innovation and Product Development Corporations.

4. Expanded Authority for Local Tax Property Tax Abatements:

Property tax abatements are not cost effective economic development incentives. Their effect will be to encourage unproductive competition among local governments within Kansas and to erode the fiscal capacity of these jurisdictions to provide public infrastructure and services which are much more important incentives in economic development.

The intent of the recommendation is to increase the capacity of local governments to promote economic development within their jurisdictions. Other tools would be more effective, particularly land write-downs and loan guarantee funds.

Kansas should move with extreme caution in encouraging costly competition among its local governments though expanding the authority of these jurisdictions to compete through property tax abatements.

Loans

Federal Community Development Block Grants: Since 1982, federal law has permitted states to set aside a portion of these funds exclusively for economic development purposes. Several states have established separate pools of discretionary funds, which can be allocated quickly on an as-needed basis for economic development purposes. A primary use of these funds has been to establish revolving loan funds for assistance to business.

The ability to respond quickly to business financing needs through loans can be important, particularly with the eventual loss of tax-exempt IRB financing. Direct loans, however, are not a particularly cost effective industrial development tool. Preferable instruments from the public perspective are those that leverage private resources, particularly secondary market mechanisms and loan guarantees. There appears to be nothing in current

federal legislation to preclude use of CDBG funds to establish secondary markets and loan guarantee programs.

It is recommended that Kansas permit the flexible use of CDBG funds for economic development. However, administering governments should be encouraged to explore the use of loan guarantees and secondary market mechanisms as a preferred alternative to direct loans.

Secondary Markets

Secondary Markets in SBA Guaranteed Loans: Secondary market sales of SBA guaranteed loans have been permitted since 1972, to help increase the flow of capital to small businesses by allowing lenders to sell their loans to investors who normally do not lend funds directly to small businesses. Several states have passed legislation to permit secondary marketing programs (California, Colorado, Illinois, Minnesota, Mississippi, Montana, New Mexico, Wisconsin, and Wyoming - Pennsylvania and Rhode Island have proposed new programs). Illinois, Montana, New Mexico and Wyoming have active programs.

Secondary market programs are a cost-effective tool for leveraging private investment (loans) to small business. Because the secondary market program purchases only the SBA guaranteed portion of the small business loans, the program is essentially risk free.

All states have not had equal success with secondary market programs. There are important lessons to be learned from these experiences. If Kansas decides to initiate such a program, it should be done only after careful evaluation of the experiences of these states and identification of the appropriate organizational form and operational guidelines for Kansas.

It is strongly recommended that Kansas establish a secondary market program in SBA guaranteed small business loans.

Equity

Kansas Corporation for Enterprise Development and Kansas Product Development Corporation: The state currently has no publicly approved or chartered organizations to provide equity and near-equity financing. Equity and near-equity tools are cost effective.

Equity and near-equity tools are critically important in providing financing to firms for developing and bringing innovative products onto the market, particularly where these firms cannot increase debt financing because of adverse debt/equity ratios. If this need is not being met by private venture capital corporations, the two proposed development corporations

would be an important addition to the state's industrial financing mechanism. Numerous successful examples of similar state-chartered corporations are available.

The Enterprise Development Corporation and Product Development Corporation are strongly recommended as desirable additions to Kansas's economic development programs.

Grants

1. Temporary funding for Certified Development Companies: The business loan programs administered by these SBA certified companies are an important source of small business financing. While the State allocation to such a company constitutes a start-up grant, the primary tool used by such entities in providing small business financing is loans. Again, reservations must be expressed about use of public funds for direct financing, rather than tools that effectively leverage private investment resources.

Temporary funding of Certified Development Companies is highly recommended, with the caveat that they be encouraged to consider a broader and, possibly, more cost-effective array of financing instruments.

2. State matching funds for federal Small Business Innovation Research Grants: Although more common in Western Europe, direct public grants to private enterprise are uncommon in state and local industrial financing programs. They represent a direct, uncompensated cost to the state government. The state will benefit if the innovation is successfully brought to market and the firms expand in Kansas. This, however, by its very nature, is a risky process.

The issue of the relationship of this initiative to the proposed Product Development Corporation should be considered. If implemented, this Corporation could provide equity and near-equity financing, as needed, to Kansas recipients of federal Small Business Innovation Research Grants. Certainly, the firm would view a state grant as preferable to loss of equity. From the State's perspective, however, use of significantly more cost effective equity and near-equity financing is preferable to a direct, uncompensated cost.

This proposed initiative should be carefully evaluated before a decision to implement is made.

EXPANDING THE OPTIONS

Initiatives proposed in the Interim Report respond to many of the industrial development financing needs of the state, with a particularly strong emphasis on technology-based enterprise, innovation and product development, and small business financing. These

proposals, however, include no alternatives to respond to the needs of medium-sized or larger firms that would replace industrial revenue bonds. The state economic development program is likely to require some form of financing authority in the absence of industrial revenue bonds.

State Loan Guarantee Program

A state loan guarantee program could respond to this need. Loan guarantees are highly cost-effective. They are an excellent tool for leveraging private investment resources. Well-managed programs require only initial capitalization and become self-sustaining thereafter.

It is strongly recommended that Kansas consider a cost-effective loan guarantee program as an integral component of its overall economic development program.

Export Finance Program

Approximately 25 states are seriously considering export financing program initiatives. Nineteen states have passed legislation authorizing export finance programs or are about to approve export credits under existing authority (California, Colorado, Illinois, Indiana, Louisiana, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nevada, Ohio, South Carolina, Tennessee, Texas, Utah, Washington, Wisconsin, and West Virginia).

In 1983 Congress renewed Eximbank's legislation to incorporate several changes which would encourage cooperation in export finance between the federal and state governments. The new Eximbank Act creates significant export finance opportunities for the states. (1) For the first time, it mandates that a representative of the state government point of view would sit on Eximbank's Advisory board, (2) it requires Eximbank to provide lines of credit or guarantees to state export finance agencies and other entities, and (3) it stipulates that Eximbank will promote small business exports and its small business export financing programs in cooperation with state agencies.

These changes in Eximbank guidelines provide important opportunities for Kansas to establish an export finance program as an integral component of the proposed trade development initiative.

TARGET INDUSTRY ANALYSIS - MIDWEST RESEARCH INSTITUTE,

Executive Summary (March, 1986)

BACKGROUND AND OBJECTIVES OF STUDY

For some time now economic development leaders across the state have expressed an interest in identifying for Kansas policy makers the state of economic development in Kansas. Economic development practitioners from Kansas cities across the state have watched the decline in some of the state's major economic sectors—agriculture and oil and gas are two obvious examples.

Strong interest on the part of economic developers coupled with legislative interests resulted in the joint public/private funding of a major economic development study for Kansas. Accordingly, in September 1985, Midwest Research Institute (MRI) was retained by the Institute for Public Policy and Business Research (IPPBR), the prime contractor on the proposed study. MRI's role was to conduct a target industry analysis for the state of Kansas and otherwise participate with IPPBR and others in the economic development study.

MRI's approach to the study is a pragmatic one—to provide the best available data to support ongoing economic development efforts. Furthermore, we recognize that our efforts must be part of an integrated implementable plan which will broaden and strengthen the state's current economic base through the expansion and attraction of industry.

The overall objective of MRI's part of the study, which is Volume IV of the Kansas Economic Study, is to provide a list of target industries which the state can use in its marketing efforts to attract new industry as well as retain and foster the growth of existing industries. We have, however, provided considerable information complementary to this primary objective.

Chapter I, Profile of the State of Kansas, is a situation analysis which provides an assessment of the state's economic base, infrastructure, and locational strengths and weaknesses.

Chapter II, Target Industry Analysis, includes not only the list of prime targets but also valuable information on the locational requirements of manufacturing and service industries. This information should be very helpful when marketing to the target industries.

Chapter III, Strategies and Recommendations, includes suggestions and guidance on the overall state economic development plan. The strategies include specific recommendations on legislative action supporting the needs of industry and the overall approach of all players to the implementation of the state's economic development plan.

The original intent of this report was to center on the state of Kansas. However, because the success of the state effort is for the most part dependent on the effectiveness of individual community efforts, MRI is also providing information on the communities' roles as well as specific targets for industrial development at the regional and community levels.

The following sections summarize MRI's findings.

PROFILE OF THE STATE OF KANSAS

In recent years the state economy has felt keenly the impact of declining conditions in several of its economic sectors, most notably the agricultural and oil and gas industries. However, Kansas does have considerable assets on which to build a renewed economic development program statewide. In profiling the state's assets and limitations the following significant observations can be noted:

- Kansas has a dozen cities whose growth in the last 20 years has been in excess of 25 percent. Not surprisingly, the three top cities on this list—Lenexa, Overland Park, and Olathe—are in Johnson County. What is surprising is that many medium- and small-sized communities in Kansas have maintained or expanded their populations in this same period. Cities in the western part of the state—Garden City, Hays, Dodge City, and Goodland—are in the top dozen, as well as cities in the center and eastern part of the state such as Lawrence, Leavenworth, Manhattan, and Emporia.
- Employment has shown modest growth in recent years, in particular in the service, transportation, and mining industries. In addition, Kansas has an outstanding history of good labor relations and work attitudes.
- Transportation in Kansas is generally good, particularly in terms of rail and highway. Air transportation, on the other hand, is reasonable in the eastern part of the state but seriously lacking for many of the medium-sized and smaller communities not located close to Wichita or Kansas City.
- Kansas enjoys a good central location nationally, but there is an indication that Kansas may not be capturing its share of the local and regional market. Many smaller Kansas communities are not receiving the support they require to serve the regional needs of communities surrounding them.
- Kansas has relatively low utility rates, particularly gas and electric rates, which may prove to be a very significant asset in attracting or expanding energy intensive industries.
- Kansas has an excellent educational system for both K-12 and postsecondary levels. However, many of the colleges and universities are concentrated in urban areas; thus, the locational benefits associated with

being in proximity to higher education are not enjoyed by many communities throughout the state.

- Overall tax rate and development incentives offered by Kansas are generally competitive with neighboring states. However, many tax policies such as the sales/use tax exemptions on manufacturing machinery, if modified, would provide added incentive for locating firms. Further, the state has initiated a major research and development program with the universities, but this program is not funded at the levels found in some of the other highly competitive states.
- Per capita expenditures for public services in Kansas is below that of surrounding states. Thus, the state needs to review its policies in this area.

Finally, it should be noted that, while Kansas has a number of strong assets for economic development, it is not distinctly different from its neighboring states. Furthermore, the image of Kansas nationally is neutral—neither good nor bad—which may in fact be an asset since it is often more difficult to overcome a poor image than it is to build an image where none existed before. Obviously, a prime consideration in the attraction of industries is to build on existing assets and further strengthen the Kansas image nationally.

TARGET INDUSTRY ANALYSIS

The MRI target industry analysis centered on identifying both manufacturing and service industries that would find a Kansas location to their advantage. It should be noted that the MRI analysis was not geared only toward the attraction of new industries but also included the expansion or solidification of existing industries, as well as new small companies seeking to establish operation in Kansas.

A key component of the target industry process is the identification of industrial locational factors and then matching that need with the resources in Kansas. During the course of the study, MRI interviewed 82 companies who were asked to rate 39 traditional location factors in terms of their importance to that firm. Their responses were further matched with their perceptions of how Kansas could meet that need.

The locational factors in which Kansas resources matched industry needs relatively closely are:

Community attitude toward business;

Work attitudes;

Proximity to customers;

Labor productivity;
Development incentives;
Highway transportation;
Right-to-work laws; and
Availability of electricity.

Conversely, the areas in which the perception of Kansas resources fell significantly below industry needs are:

Overall tax burden on business;
Local property tax; and
Corporate income tax.

Chapter II contains considerably more detail on MRI's findings related to locational criteria.

The final output of the target industry process is the identification of a select group of prime industry targets which would find a Kansas location attractive. This list for Kansas includes the following statewide and/or short-term targets;

Manufacturing Industries

Biological Products
Medicinals and Botanicals
Steel Investment Foundries
Fabricated Plate Work
Misc. Fabricated Wire Products
Electronic Computing Equipment
Semiconductors and Related Devices
Electrical Equipment for Internal Combustion Engines
Scientific and Research Instruments
Surgical and Medical Instruments

Service Industries

Refrigerated Warehousing

Telephone Communication

Communication Services

Data Processing Services

Computer-Related Services

Research and Development Laboratories

Management, Consulting and Public Relations Services

Medical Laboratories

In addition, industries such as aviation, oil and gas, and agriculture, which have historically comprised a major portion of the Kansas economy but have suffered declines in recent years, must be included in the state's target industry list. While new development in these areas is unlikely for the present, it is important that these industries be supported through the economic development programs of the state, to ensure that the overall economic base is maintained.

STRATEGIES AND RECOMMENDATIONS

During the course of conducting this target industry study, a number of issues surfaced which, if addressed, could help to strengthen the state's current economic base. These issues centered around the following three areas:

1. Legislative action: The state is empowered to position itself strategically for economic development through changes in its tax and regulatory climates, as well as its expenditure policies. Such changes influence not only the state's ability to attract and retain industry, but also to assist local developers in their relative development positions.
2. Industry needs: The state's industrial base has a variety of needs which, if met, will serve to strengthen the overall economy. To keep pace with rapid advancements, industry will require technology development assistance, particularly from universities. In addition, industries will require financing assistance to encourage expansion as well as the start-up of new companies. Finally, as the state begins to market to out-of-state firms and

to encourage relocation, existing industry will serve as the catalyst for determining the most appropriate types of new firms.

3. Long-range, cohesive effort: As programs are implemented, a long-term, unified commitment on the part of all players in the economic development process will be required to ensure success. Communities, industry, government, and education must work closely to foster innovation, support the current economic base, promote the state's strengths, and minimize its weaknesses for many years to come.

SUMMARY

Kansas has many assets on which to build, including its labor environment, utility rates, and educational system. Most importantly, its active interest in forming strong economic development programs represents a favorable image to the industrial sector. However, Kansas has few clear advantages over its neighboring states, and there still remain areas such as tax policies and development incentives which, if improved, might distinguish Kansas as an industrial location site.

By carefully comparing these issues with the needs of the state's current and targeted industries, Kansas can develop an economic development plan that should place it in a strategic position for future growth. It is important to remember, however, that such a plan will require a long-term commitment and the input and support of principal players in the process, including state, government, communities, industry and education, to ensure its success.

APPENDICES

Appendix I

RECOMMENDATIONS

Traditional Industries

1. Establish a task force on agriculture development and marketing to develop a strategy on:
 - a. the diversification of Kansas agriculture into new products;
 - b. the application of science and technology to the value added processing of Kansas commodities within Kansas; and
 - c. the provision of technical assistance for production, processing and market development.
- *2. Expand the research program on enhanced oil recovery and increase the transfer of new technology to independent oil well operators.

Taxation

3. Allow a sales/use tax exemption of all machinery and equipment used in manufacturing and on computers for business use.
4. Allow a reduction in state corporate income tax liability through a tax credit given for research and development expenditures.
5. Allow a reduction in state income tax liability through a tax credit for investment in private, state-approved venture capital funds and state chartered venture capital corporations.
6. Allow local taxing jurisdictions to give property tax abatements for new and expanding manufacturing facilities, research and development facilities, equipment and machinery, and for a limited scope of non-manufacturing facilities having a potential for job creation. The authority to grant the abatement should be detached from the issuance of industrial revenue bonds.
7. Support the 1986 constitutional amendment that would eliminate the property tax on inventories.

Education, Research, and Technology Transfer

8. Substantially expand the program and level of funding for centers of excellence in basic research.
9. Substantially expand the level of funding for the Research Matching Grant Program.
10. Establish Institutes for Applied Science and Technology at the major research universities and center for technology transfer at educational institutions.
11. Provide resources to the state universities for the purpose of upgrading the quality and increasing the quantity of applied social and economic research.
12. Provide funding for the establishment of an industry liaison function at the state universities.
- *13. Selectively enhance university programs in management and associated areas crucial to economic development.
14. Endorse strongly a continuation and expansion of the state's commitment to all levels of public education in Kansas. Public education in general and higher education in particular are crucial elements for the future progress of Kansas.

Finance, Capital Formation and Innovation

15. Establish public/private programs to provide equity or debt financing for new and existing firms that are unable to obtain conventional capital for developing innovative products.
16. Establish a Kansas product development program.
17. Establish a state fund to match federal Small Business Innovation Research grants to Kansas small businesses.
18. Establish a Kansas Science and Technology Authority.
19. Sponsor a program of financial symposia on capital formation.
20. Provide temporary state funding for Certified Development Companies.
21. Expand the secondary market for the SBA guaranteed portion of bank loans.
- *22. Establish an export assistance program to aid small and medium-sized firms in exporting Kansas products to international markets.

*23. Establish a loan guarantee program to facilitate financing of new or expanding businesses in primary industries.

State Organization for Economic Development

24. The Legislature should establish a permanent joint House-Senate Committee on Economic Development or, alternatively, separate committees in each house.

25. The Small Business Division of the Kansas Department of Economic Development should be substantially expanded and additional field offices established.

26. An existing industry program should be initiated in the Kansas Department of Economic Development.

27. A new international trade division should be established within the Kansas Department of Economic Development.

28. Increased efforts should be made to attract foreign firms to locate in Kansas.

29. The Kansas Department of Economic Development should implement a marketing program aimed at targeted industries.

30. Kansas should initiate a national promotion campaign aimed at improving the image of Kansas among business leaders with responsibility for making business location decisions.

31. Repeal or amend the constitutional prohibition on internal improvements to permit state economic development initiatives.

*32. Establish an overall travel and tourism strategy for the state. A funding increase is necessary for the following projects:

1. research on travel and tourism,
2. marketing of Kansas attractions in and out of the state, and
3. development of state parks or other major attractions.

*33. Upgrade the Kansas Department of Economic Development data and information systems necessary for economic development.

Community Development and Small Business

34. Provide low or no-interest matching loans to local governments and nonprofit organizations to facilitate the establishment of incubators.
35. Establish a revolving loan pool for infrastructure development available for use by communities to promote economic development.
36. Substantially expand technical assistance to local communities on how to promote economic development.
- *37. Incentives should be offered to encourage regional coordination of economic development efforts.
38. Federal Community Development Block Grants should be used to the fullest extent possible for economic development projects.
39. A state community development block grant program should be established and targeted to economic development.
40. Expand the "Certified Cities" program.
41. Provide state funding for the Small Business Development Center (SBDC) network to expand technical assistance to small businesses through consulting and training sessions.
- *42. Continue and expand the state's commitment to a high quality of life in Kansas communities by encouraging the arts. Funding for the arts should be increased to the mean per capita level of the fifty states.

Economic Development Strategy in State Policy Making: Human Resources, Infrastructure and Regulation

- *43. Develop a coordinated human resources strategy for the Job Training Partnership Act Program, vocational education, and Kansas Industrial Training that is focused on economic development.
- *44. The major policy goal of the state Job Training Partnership Act Program (JTPA) should be to promote economic development.
- *45. Establish a task force to review the vocational education system with the objective of ensuring responsiveness to changing industry needs for skilled employees.
- *46. Expand the Kansas Industrial Training Program (KIT) and improve coordination with other training programs.

*47. Review the state's capital budgeting procedures to determine how the state can expand its investment in public infrastructure to support economic development, particularly highways, airports, water resource development, recreation and wildlife improvements, and state agency facilities.

*48. The allocation of state highway funds should, to the fullest extent possible, be linked to economic development. Priority should be given to projects that promote economic growth in the state.

*49. Conduct feasibility studies to examine the need for major highways in southeast and southwest Kansas.

*50. The impact of regulations on state economic development should be added to the criteria that regulatory bodies must use in carrying out their regulatory responsibilities, and, where they exist, be given greater emphasis. Existing and proposed regulations should be reviewed by Kansas Inc. to ensure that they are not unnecessarily impeding economic development.

APPENDIX 2

Kansas Economic Development Study Final Report Recommendation Numbers as they correspond to the Interim Report Recommendation Numbers.

Final Report Recommendation Number	Interim Report Recommendation Number
1	1
*2	N/A**
3	2
4	3
5	4
6	5
7	6
8	7
9	8
10	9
11	10
12	11
*13	N/A**
14	12
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21	19
*22	N/A**
*23	N/A**
24	20
25	21
26	22
27	23
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29	25
30	26
31	27
*32	N/A**
*33	N/A**
34	28
35	29

36	30
*37	N/A**
38	31
39	32
40	33
41	34
*42	N/A**
*43	N/A**
*44	N/A**
*45	N/A**
*46	N/A**
*47	N/A**
*48	N/A**
*49	N/A**
*50	N/A**

*This is a new recommendation since the Interim Report

**Not applicable

APPENDIX 3

Funding for this study is being provided by the following organizations:

Kansas Legislature

The University of Kansas

Wichita State University

Kansas Cavalry

Kansas Industrial Developers Association

Southwestern Bell Company

Petroleum Industry of Kansas Inc.

Kansas Turnpike Authority

Kansas Association of Realtors

Kansas Bankers Association

Kansas Farm Bureau

Kansas Chamber of Commerce and Industry

Wichita Chamber of Commerce

Boeing Military Aircraft Corporation