

FISCAL FOCUS



Budget and Tax Policy in Perspective

IMRPOVING THE
ECONOMIC DEVELOPMENT SYSTEM
IN KANSAS

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Introduction

As a society, we have a responsibility to lay the foundation for a prosperous future. That responsibility is two-fold:

- Making sure that children have access to tools - like a good education and health care - that will prepare them to be contributing citizens and a successful part of our future workforce, and
- Encouraging economic development that will help supply quality job opportunities for our future workforce.

Because a thriving business community is a key component of the state's overall prosperity, policymakers are often called on to enact legislation that will promote economic development. While Kansas invests substantial resources in economic development, it is not clear that taxpayers are getting a good return on those investments.

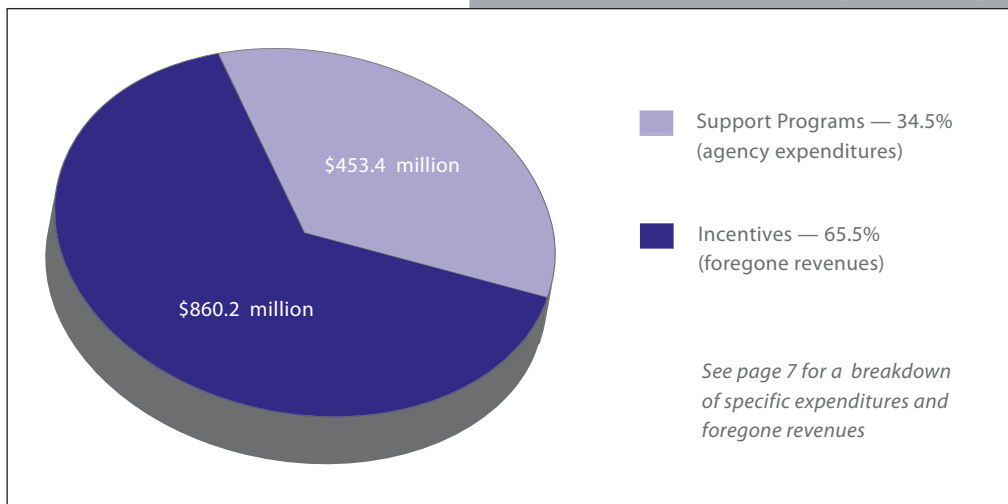
Policymakers should continue to seek ways to invest in the health of the business community in the same way that we make investments in essential state infrastructure. But in order to ensure we are making wise investments in economic development, we need greater transparency and accountability for results. Kansas can set itself apart as a leader in business and economic opportunity by offering smarter incentives that are streamlined, focus on key industries and quality jobs, and offer the most benefit for the state in a return on its investment.

Investing in Economic Development

ECONOMIC DEVELOPMENT SPENDING IS SIMILAR ACROSS THE COUNTRY

Economic development spending takes on a number of forms and generally involves support programs, direct incentives or tax incentives. Economic development spending tends to be fairly similar in states across the country and can typically be divided into funding for either support programs or incentives. Support programs include services offered to any businesses in the state or those considering relocation to the state, while incentives are provided directly to a business for a specific purpose (i.e. job expansion or retention).¹ Traditional incentives involve payments or benefits given directly to businesses. Tax incentives work differently in that they represent foregone revenues to the state as opposed to direct payments. Tax incentives have become an increasingly large part of the economic development total.

Kansas Economic Development Spending
FY 2003-2007 (in millions)



VALUE OF ECONOMIC DEVELOPMENT SPENDING IS DIFFICULT TO MEASURE

Research shows that the value of state spending to attract and retain businesses is difficult to measure and often plays a small role, if any, in actual business decisions. A recent audit of Kansas economic development spending included a review of research and findings on the effectiveness of economic development incentives. The review showed that a majority of the research was either inconclusive or found that the incentives offered did not create significant intended outcomes, such as job creation or longevity of business entities.²

Further research shows that economic development incentives do not play a large role in decisions about where to locate or relocate a business. Instead factors such as transportation, labor quality and markets tend to be the most important issues in business location decisions.³

In Kansas, several audits have been performed in this decade to determine the effectiveness of various economic development tools. A 2004 audit of job expansion programs found there were far fewer jobs created by businesses receiving funding from the Kansas Economic Opportunities Initiative Fund than had been promised. In this case, the businesses had committed to create almost 2,200 jobs, but in reality had created only 589 jobs, just over a quarter of the jobs promised.⁴

A 2003 audit showed a negative return on investment for high-risk capital investments made by the state. Investments in Ad Astra I and Ad Astra II, venture capital funds intended to provide risk capital to businesses, resulted in a loss of \$3.5 million in state dollars.⁵ While the purpose of these funds is to keep businesses in the state by providing capital that would otherwise be difficult to obtain in Kansas, it is difficult to justify the use of taxpayer dollars in such a high-risk manner.

UNCLEAR WHETHER KANSAS APPROACH IS WORKING

Kansas invests a large amount of money in a wide array of economic development functions, but it is unclear whether the state's current approach to economic development is working. A recent audit conducted by the Kansas Legislative Division of Post Audit (LPA), found that the current system of economic development incentives in Kansas has not been proven to be effective. However, the report also found there is an expectation in the business community that incentives will be provided, and that state and local governments are pressured to provide incentives regardless of whether they make a measurable difference in business location and retention decisions.

Kansas investment in economic development between 2003-2007

The state's investments in economic development fall into two main categories: direct expenditures by state agencies and forgone revenues due to tax incentives. In all, the state is estimated to have spent more than \$1.3 billion during the five-year period between state fiscal years 2003 and 2007.⁶ This equates to about \$477 per person spent on economic development in Kansas during that five-year period.⁷

Difficult to track resulting economic activity

It is difficult to track economic activity resulting from Kansas investments in economic development. One of the major shortcomings of the Kansas approach to economic development incentives is that there is not enough accountability built into the system. For example, while requirements for job creation might be in place for some programs, the mechanism to monitor and enforce actual job creation is weak. Therefore, it is difficult to ascertain how much economic activity has resulted from the sizeable investments Kansas has made in economic development in recent years.

Kansas agencies working on economic development report that more than 80,000 jobs were created as a result of economic development spending between fiscal years 2003 and 2007. However, the Kansas Department of Labor reports that the total increase in non-farm jobs in Kansas between 2003 and 2007 was significantly less at 47,000. Using the official data from the Department of Labor, it is clear that the number of jobs reported by state agencies as a result of economic development investments is inaccurate. Even if all of the new jobs in Kansas during that five-year period were attributable to economic development spending, there would still be a disparity of more than 33,000 jobs.

Kansas Investment in Economic Development
Between 2003-2007

AGENCY EXPENDITURES AS REPORTED TO LEGISLATIVE DIVISION OF POST AUDIT

Kansas Department of Commerce	\$367.1 million
Kansas Technology Enterprise Corporation (KTEC)	70.0 million
Kansas Small Business Development Center	8.7 million
Kansas Bioscience Authority	5.8 million
Kansas, Inc.	1.8 million
Subtotal of State Agency Expenditures	\$453.4 million

FOREGONE REVENUES IDENTIFIED BY LEGISLATIVE DIVISION OF POST AUDIT

Industrial Revenue Bond Exemptions	\$349.7 million
State Income Tax Credits	137.6 million
Sales Tax and Revenue (STAR) Bonds	131.2 million
Property Tax Abatements	113.7 million
“Pay As You Go” Projects	43.2 million
Neighborhood Revitalization Act	38.7 million
General Obligation and Special Revenue Bond Projects	21.6 million
State Bond and Rebate Projects	20.1 million
Transportation Development District Act	4.5 million
Subtotal of State Agency Expenditures	\$860.2 million

TOTAL	\$1,313.6 million
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Measuring Economic Development Results

The trend in economic development is to move toward higher levels of standards and accountability. Many state and local governments have recognized that mere job creation is not enough to stimulate economic growth in the community. In fact, jobs paying at or below the poverty level can actually increase the government's cost of providing social services. Instead, it is the quality of the jobs created that makes a measureable difference in the prosperity of a community. As a result, a trend has started toward imposing job quality standards as a condition of receiving economic development incentives. By late 2003, at least 43 states - including Kansas - had attached job quality standards to at least one development subsidy.⁹

Standards for job quality

There are many approaches to job quality standards. However, the primary goal of these measures is to ensure that new jobs created with the assistance of public investments are high quality jobs that provide good wages and benefits to employees. Wage standards are the most common requirement, but some states are also requiring that participating employers provide benefits, such as health insurance.

The typical wage-based approach to job quality standards is to base employee wages on levels set by the local labor market. For instance, in order to qualify for federal job training funds in Montana, a business must pay 110 percent of the state median wage.¹⁰

Kansas has participated in this trend toward job quality standards. In order to receive Kansas Industrial Training (KIT) and Kansas Industrial Retraining (KIR) funding, businesses must pay a wage of at least \$11 per hour in Johnson, Wyandotte, Leavenworth, Douglas, Shawnee and Sedgwick counties or \$9.50 per hour for jobs in other Kansas counties.¹¹ However, this requirement is not imposed on all Kansas economic development incentives. Furthermore, the level of wages required for KIT and KIR falls short of a "quality" job standard in that \$9.50 per hour equates to \$15,200 per year, which is significantly below the 2009 poverty line of \$22,050 for a family of four.¹²

Economic Development budget reporting

Several states have moved toward requiring more accountability in economic development incentives. Some states require the release of a tax expenditure report detailing forgone tax revenues resulting from tax credits and exemptions. Other states focus on direct spending for economic development. A few states require that information be published annually on both foregone tax revenues and direct expenditures for economic development. These reports are known as Economic Development Budgets or Unified Development Budgets.

The state of Texas is one of the leaders in this movement. Texas law requires that an annual Unified Development Budget document be presented to its Legislature. This document must contain a broad range of data on economic development spending including state government expenditures supporting economic development, Texas Growth Fund investments, information on local economic development corporations, state tax exemptions and tax incidence, franchise tax credit claims, and impacts of tax exemptions.¹³

Recommendations

Research acknowledges that economic development incentives have not proven effective in impacting business decisions. However, they have come to be expected by businesses across the country. In order to maximize their ability to attract and retain businesses, states must be smarter about how they spend their economic development dollars. Kansas has an opportunity to be a leader in economic development by streamlining and tailoring investments that will attract and retain quality jobs and will encourage the development of innovative industries.

Invest in education

Most business location and retention experts agree that the availability of a well-educated work force is one of the top factors in deciding where to locate a business. Investments in education at every level are essential to developing the kind of workforce that employers are seeking. This includes a high-quality public school system, as well as improved access to post-secondary education and job training in scientific and technical professions. This may be in the form of funding for research in state universities, subsidies of student costs, or support for institutions of higher learning that provide technical job training. By investing in the education and training of Kansas workers, and providing economic opportunities within the state, we can also improve retention of our population.

Invest in “quality of life” infrastructure

A thriving community attracts strong businesses. Investments in infrastructure that impacts the quality of life in a community – such as public safety, high-quality public schools, parks and recreational spaces, and the arts – are proven to draw people and businesses. A study of Colorado’s success, along with several other states in attracting high technology industries, found that quality of life was one of the top three factors contributing to businesses locating or relocating in Colorado.¹⁴ Based on Colorado’s experience, placing a priority on developing and maintaining infrastructure that improves the quality of life is an economic development tool that will attract businesses.

Invest in physical infrastructure

Quality infrastructure can set a state apart for purposes of economic development. Traditional infrastructure - such as roads, bridges and transportation facilities - remain a key component of business success in the United States. However, new infrastructure, such as high-speed internet, green energy and other technologies can also be a significant factor in economic development.

Invest in businesses that create quality jobs

Kansas has made a start in requiring job quality standards for businesses receiving economic development incentives. However, this policy should apply to all incentives for job creation. Job creation at sub-poverty wage levels does not merit the investment of taxpayer dollars. To this end, job quality standards should be integrated into all economic development incentives offered in Kansas.

Invest in industries that are growing

In order to maximize the impact of economic development spending, investments should be tailored to attract industries with high growth potential. Forecasts show that the aviation industry alone is likely to need more than 20,000 new workers by 2028. Other technical occupations with anticipated employee shortfalls include engineering technicians, mechanical drafters, chemical technicians, avionics technicians, and architectural and civil drafters.¹⁵ By streamlining incentives to areas that are specifically in demand and growing, the state can ensure that its investments will continue to reap returns.

Require accountability with investments

Kansas is unable to determine the return on a number of current economic development investments. In some cases, this is because the state does not have the authority to compel recipients of economic development incentives to provide documentation that they have met promised outcomes. In other cases, state agencies tasked with ensuring that these outcomes have been met have inadequate systems in place to track compliance. One way to improve the accountability of these investments is to make them more transparent by requiring the release of an annual Economic Development Budget. This will make it easier for both policymakers and the public to track state economic development investments, including direct expenditures and foregone tax revenues, and to ensure that these investments benefit the state in the long run.

Conclusion

The State of Kansas makes significant investments in economic development with the purpose of generating economic activity in the state. Studies show that these investments are not particularly effective, but have come to be expected by businesses across the country. The key to effective investments in economic development is not increasing the amount of business subsidies, but instead ensuring that current investments are producing measurable results. It is not necessary for Kansas to spend more for economic development, rather, it is necessary for economic development dollars to be spent smarter. This includes investing in the most important factors for business location and relocation decisions, streamlining expenditures to attract growing industries, ensuring that all incentives include job quality standards, and increasing accountability for economic development investments.

Ensuring the health of the business community is important for Kansas families. A strong business community creates good jobs and an opportunity for parents to provide financial stability for their children. Wise investments in economic development can strengthen the business community in ways that are effective, ultimately ensuring the prosperity of the state.

Endnotes

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