

MINUTES OF THE Senate COMMITTEE ON Assessment and Taxation

The meeting was called to order by Senator Fred A. Kerr at  
Chairperson

11:00 a.m./~~XXX~~ on Wednesday, February 26, 1986 in room 519-S of the Capitol.

All members were present ~~XXXXX~~

Committee staff present:

Tom Severn, Research Department  
Melinda Hanson, Research Department  
Don Hayward, Revisor's Office  
LaVonne Mumert, Secretary to the Committee

Conferees appearing before the committee:

Charles J. (Jamie) Schwartz, Department of Economic Development  
Bud Grant, Kansas Chamber of Commerce and Industry  
James Turner, Kansas League of Savings Institutions

S.C.R. 1635 - Constitutional amendment; repeal of section relating to  
internal improvements

Charles J. (Jamie) Schwartz testified in support of the resolution (Attachment 1). He said that the 1980 amendment to the ban on internal improvements is already inadequate. He stated it is probable that the federal economic development programs will be eliminated or restricted in the near future. One problem is that the Constitution currently requires at least a 50% federal match on projects of internal improvements and such match is becoming less available. Secretary Schwartz said several recommendations made in the Redwood report would not be possible with the current provision for internal improvements. He mentioned that any activity undertaken by his agency will still be reviewed by the Legislature. He noted that other states are already taking steps to replace various federal programs.

The Committee discussed what types of activities in which the state might participate if the internal improvements ban is removed.

Bud Grant told the Committee that his organization recognizes there is a problem, but he cautioned that an outright removal of the ban might result in the state competing with private enterprise.

James Turner urged that the resolution be modified to specifically define what activities the state is allowed to initiate. He mentioned concerns that a state housing authority might be created. His organization would oppose such an authority.

The Committee was advised that the Legislative Economic Development Committee is also studying this issue. Various concerns were expressed by Committee members about the legislation.

Meeting adjourned.



TESTIMONY

SCR 1635

Senate Assessment and Taxation Committee

11:00 a.m., February 26, 1985

Charles J. Schwartz

Secretary, Kansas Department of Economic Development

Attachment 1  
Tax Committee - 2/26/86

**KANSAS DEPARTMENT OF ECONOMIC DEVELOPMENT**

503 Kansas Avenue, Sixth Floor, Topeka, Kansas 66603

Phone (913) 296-3481



JOHN CARLIN  
*Governor*

CHARLES J. "Jamie" SCHWARTZ  
*Secretary*

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear on behalf of the administration in support of SCR 1635, the proposal of the section on internal improvements within the Kansas Constitution.

This prohibition on assistance to private enterprise has had a long history. It has been a part of the Kansas Constitution for over 100 years, but it has also been modified several times. In fact the desire by business interests in Kansas to allow the state to participate in highway construction led to the organization of a group in the mid 1920's to change the constitution and modify the internal improvements ban. This group is still functioning and is known today as the Kansas Chamber of Commerce and Industry.

In 1980, knowing that the state would need flexibility to respond to changing economic times, the administration strongly supported, and you passed and placed on the ballot where it was ratified by the voters, a modification to the internal improvements prohibition which allows the state in conjunction with at least an equal participation by the Federal Government to provide financial assistance to private enterprises. This change enabled the state to guarantee a federal loan that allowed services to be re-established on the northern line of the bankrupt Rock Island Railroad. This line has proved to be an important link in the farm economy of Kansas.

We now feel, however, that this change, barely five years old, is already inadequate to address our rapidly changing economic situation. It is likely that the federal economic development programs that Kansas uses will be severely restricted or eliminated in the near future. The President has proposed the

elimination of the Small Business Administration, the Economic Development Administration, the Export Import Bank, and the reduction of the Community Development Block Grant funds. Many other states are already implementing innovative initiatives that supplement the programs currently available through these federal agencies. They will gain a competitive advantage over Kansas if our economic development efforts continue to be tied to the availability of federal funds.

We need the flexibility to implement economic development initiatives that will make us competitive with other states and which are tailored to Kansas' unique economic strengths and needs. Programs such as those contained and recommended within the Interim Report on the Kansas Economic Development Study may not be possible without a further modification of the state's Constitution. We, therefore strongly urge your support of SCR 1635 which would repeal the prohibition on internal improvements. This action, when approved by the voters, would remove a significant barrier that currently restricts our ability to adopt to the changing needs of a turbulent economy.

It is felt that the following recommendations in the Interim Report on the Kansas Economic Development Study will be impossible to implement without a change in the internal improvements section of the Constitution.

Recommendation #4 - Allow a reduction in income tax liability through a tax credit for investment in private state-approved venture capital funds and state chartered innovation corporations:

The report identifies a relative lack of venture capital in Kansas. Many states, including Indiana, Wisconsin, Maine, Missouri, Montana, and North Dakota, have used income tax credits to develop venture capital funds that invest in enterprises within their state. The report suggests that Kansas develop a similar program, based on the approach used by Indiana, that provides a 20% tax credit to investors who participate in private funds that are targeted for new technology and innovation in Kansas businesses. This recommendation is also the principle tool the report uses to attract private investment in the Kansas Corporation for Innovation Development and the High Tech Venture Capital Fund administered by the Kansas Science and Technology Authority (see Recommendations 13 & 16).

Recommendation #13 - Establish a Kansas Corporation of Innovation Development (KCID).

The KCID would:

- a. Provide much needed "seed capital" to new companies seeking a beginning.
- b. Provide financing for established firms and invest in Small Business Investment Companies.
- c. Encourage private investors to invest in Kansas through the KCID by a tax credit.

Recommendation #14 - Establish a Kansas Product Development Corporation.

This corporation would:

- a. Invest in product ideas brought forth by Kansas companies and individuals for development.
- b. Receive equity, interest, or royalties in return for its funds and aim toward self-sufficiency.
- c. Create jobs and investment through the production of products its funding provides.

Recommendation # 15 - Establish a state fund to match Federal Small Business Innovation Research grants to Kansas small businesses.

The Federal SBIR program has been touted as the government's best program ever to stimulate technological innovation in small firms. Eighteen states provide SBIR matching grants.

The state program would:

- a. Raise the number of applications for the federal program by small Kansas firms.
- b. Bridge the time gap between funding phases of federal grants.
- c. Increase Phase I awardees' chances of obtaining Phase II grants.
- d. Stimulate job creation based on Kansas' best brain power.

Recommendation #16 - Establish a Kansas Science and Technology Authority.

This initiative would:

- a. Directly assist in the development of start-up companies.
- b. Provide matching venture capital to innovative Kansas firms and increase the flow of private venture capital into the state.
- c. Increase the number of industrially-sponsored research grants to Kansas firms.
- d. Operate low cost, high tech incubators on or near university campuses.

Recommendation #27 - Review the constitutional prohibition on internal improvement to determine if it should be modified or repealed.

The implementation of several recommendations in the report may be limited by the constitutional prohibition on internal improvements. In State ex rel. Coleman v. Kelly, 71 Kan. 811 (1905) the Kansas Supreme Court said that the prohibition prevented the state from engaging in private business enterprises.

"This constitutional provision is a limitation placed by the people in their paramount law upon the power of the legislature, preventing it from diverting the energies of the state from public and governmental functions into private and business enterprises. No circumstances can arise which will justify its violation by any governmental department." 71 Kan. at 829.

In light of this provision, recommendations 13, 14, 15 (without a 2/3 vote of the legislature) and 16 in the report are constitutionally questionable.

As the competition for new industry intensifies, other states are taking the lead in providing the necessary ingredients that make their states package the best. For example, the Toyota project (for which Kansas was a serious contender) went to Kentucky. The package put together by the State of Kentucky included \$10 million for the purchase of, and transfer of, land, \$25 million in site improvements, a \$33 million state funded training package, and a \$47 million highway construction package. While these numbers are larger than most projects that states or communities deal with on a regular basis, they do point out the fact that Kansas needs to have the ability to compete with these other states. In many cases, the internal improvements prohibition of our Constitution will not allow us to offer those enhancements and incentives necessary to keep us in a competitive position with our neighbors or our region. We need to do everything we can to be a leader in the development arena.

Recommendation #28 - Provide low or no-interest matching loans to local governments and non-profit organizations to facilitate establishment of the incubators.

A business incubator is a facility which promotes the early stage development of a for-profit enterprise. In most cases they are related to small business and technological innovation. Most are publicly supported as part of a public policy to encourage "home grown" economic development by encouraging entrepreneurship and risk-taking by both business people and government officials. Incubators provide financial and management assistance and business development services in low rent multi-tenant buildings (often rehabilitated older buildings). Usually exit policies provide that within two to four years the new business will leave the incubator to expand its operations or to make room for a new promising entrepreneur.

While much discussion has occurred in recent years about research and development oriented incubators, it is interesting to note developmental activity in this area across the state from Dodge City to Pittsburg, from Lawrence to Pratt as well as Wichita, Kansas City and Johnson County. But it has been difficult to bring these efforts to fruition without additional public support.

Recommendation #29 - A general loan pool for infrastructure development should be available for use by communities to promote economic development.

A state general loan pool for local infrastructure development as a form of support of economic development projects would enable cost sharing by the state for economic growth. The benefit of this growth accrues to the state generally, not just the specific locality. Low or no interest loans would have the effect of small issue bond pooling for smaller communities. It would enable activities which expand the local tax base without furthering stress to local bonded indebtedness limitations.

Repayment of such loans could be structured using a value-added concept for the local tax base--a concept central to tax increment financing now available in Kansas for central business district areas and in Enterprise Zones.

With the gradual demise of such federal funding programs as UDAG, EDA public works, EDA sewer system grants and general revenue sharing, creative efforts must be found to provide initial investment in essential roads, sewer and water lines, and other improvements in order to allow for new economic activity to develop in areas where other competitive advantages are present such as proximity to raw materials and appropriately skilled labor pools.

Recommendation #32 - A state community development block grant program should be established, targeted to economic development.

State funds for economic development project (job-creating) activity would substantially round out the comprehensive state assistance package. Funds to complement loans, CDBG grants, bond issues, private and equity financing would fill financing gaps which exist in many projects. A state grant program without limitations as to target populations, geographic area, or reasonable economic activity is an essential part of a comprehensive public financing support system.