

Approved February 3, 1992
Date

MINUTES OF THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT

The meeting was called to order by Representative Diane Gjerstad at
Chairperson

3:40 ~~am~~ pm on Monday, January 27, 1992 in room 423-S of the Capitol.

All members were present except:

Representatives Bradford, Chronister, Edlund and Wisdom. Excused.

Committee staff present:

Lynne Holt, Legislative Research
Jim Wilson, Revisor
Betty Manning, Secretary

Conferees appearing before the committee:

Pat Oslund, Research Associate, IPPBR
Lynne Holt, Legislative Research

The meeting was called to order by Chairperson, Representative Diane Gjerstad at 3:45 p.m.

The Chair introduced Pat Oslund, Research Associate for the Institute for Public Policy and Business Research. Ms. Oslund presented background and origin of enterprise zones. She explained enterprise zones were conceived as an attempt to revitalize free enterprise in small, depressed areas. With these zones, taxes and regulations were to be virtually eliminated in order to create an attractive business environment. She also outlined goals and details of the current Kansas program as well as what is happening in other states. Ms. Oslund also delineated several items for the committee's consideration while examining the enterprise zones issue. Included in material submitted to committee members was a sample enterprise zone registration form. Attachment 1.

Ms. Oslund responded to questions from committee members.

The Chair recognized Lynne Holt, Legislative Research, who explained the bill as proposed does not totally reflect the joint committee's intent, and presented an outline of the concept of **HB 2681**. Ms. Holt explained difference between current law and proposed legislation, its purpose, procedures for zone designation, criteria for approval, and tax benefits. She also outlined major changes approached by interim committee to the enterprise program and tax benefits under the proposed new legislation. Attachment 2.

Lynne Holt responded to questions.

Conferees on **HB 2681** will appear tomorrow.

The meeting adjourned at 4:55 p.m.

**Revising the Kansas Enterprise Zone Program:
Assessment and Suggestions for Change**

**Testimony presented to the
House Committee on Economic Development**

**by
Pat Oslund
Research Associate**

**Institute for Public Policy and Business Research
University of Kansas
Anthony Redwood
Professor of Business
Executive Director**

January 27, 1992

*Eco-Devo
Attach #1
01-27-92*

Introduction

Good afternoon. I am happy to address the committee on the subject of Kansas Enterprise Zones. I hope to be able to do four things this afternoon:

1. Present some background information on the origins of Enterprise Zones.
2. Outline some of the problems with the current Kansas program, and argue that the current program needs change.
3. Look briefly at the experience of Enterprise Zone programs in other states.
4. Outline what I see as some "guiding principles" for an enterprise zone program, and comment very briefly on some of the features of the proposed legislation before the Committee.

Background and Origins of Enterprise Zones

In order to understand EZ programs, both as they are implemented in Kansas and in other parts of the US, it is a good idea to look back at their conceptual origins. The Enterprise Zone idea originated in Great Britain in the late 1970s. It was conceived of as an experimental attempt to revitalize free enterprise in small depressed areas of the country. Within such zones, taxes and regulations were to be virtually eliminated in order to create an extremely attractive business environment.

The idea caught on quickly in the US. Both the Reagan and Bush administrations have pressed for federal Enterprise Zone legislation. While to date such federal legislation has been unsuccessful, a majority of the states (37 to date) have adopted some form of an EZ program. Not surprisingly, programs vary widely across states. And they differ substantially from the prototype programs envisioned in Britain. In particular, the major tools of most programs in the U.S. have been tax breaks, with only moderate regulatory relief, often in the form of simplified building permit procedures.

Some, probably the majority, of states adopting EZ programs have seen them as tools to rehabilitate poor urban neighborhoods. However, some states have extended the idea to rural areas (for example, Kansas and Colorado). All this contrasts with the British approach, where the emphasis has been more on developing decaying industrial zones.

There is one key difference between enterprise zone programs and other economic development programs, both as practiced here and abroad. This is the concept of stimulating development in limited geographic areas, bringing jobs and investment to declining or disadvantaged regions. According to an article by Susan B. Hansen ("Comparing Enterprise Zones," in *Enterprise Zones: New Directions in Economic Development*, ed. Roy E. Green):

Enterprise zones are unique in their attempts at geographic targeting and their repudiation of the notion that growth elsewhere will redound to the advantage of depressed regions. In practice, this has meant focussing of state and local resources in areas not favorably regarded by market forces. (p. 23)

One point that I would like to emphasize is that Enterprise Zones are not intended to be general purpose economic development tools, nor general tools for industrial recruitment or retention. Rather, they are intended to be focussed on a specific targeted group of communities. When one looks at the statement of purpose in the Kansas EZ legislation, it is clear that this

geographically targeted assistance was originally a goal of the Kansas program. This prompts the question of whether this targeting has been achieved in practice.

Goals of Current Kansas Program

Let us now turn to the Kansas program. The initial legislation establishing the program was enacted in 1982. The purpose of the Enterprise Zone program as stated in Kansas statutes is to:

expand and renew the local economy and improve the social and economic welfare of residents in economically distressed zone areas located within cities and counties of the state of Kansas, by providing incentives for business and industry to develop new business and expand existing business within economically distressed areas and thereby create new jobs and sources of income, particularly for disadvantaged workers. [K.S.A. 12-17,108]

Notice that the terms distressed and disadvantaged are emphasized in the statement of purpose.

Before going into the details of the Kansas program, I want to make three general comments about development incentives.

1. There is certainly a lot of dispute among academics about the extent to which incentives are determining factors in the location of jobs and investment. I am not going to resolve this dispute today. One viewpoint is that firm location decisions are a two stage process. Incentives become important once a firm has picked a region of the country (say midwestern states) but before it has decided on a particular state or city.

2. There is also a dispute about the whole concept of geographic targeting implicit in the theory of Enterprise Zone programs, if not always in the practice. On a strict cost-benefit basis, the argument could certainly be made that incentives should be available to the fastest growing parts of the state. It is there that they will probably have the greatest impact on jobs and investment.

3. There is some potential for conflict between programs designed as general economic development incentives and programs designed to improve the most distressed areas of the state. The current Kansas program has tried to fill both roles. I will claim that in practice the program has been primarily a general development tool and has not generally succeeded in bringing jobs and investment to depressed parts of the state.

Now let's turn to the details of the Kansas program.

Details of Current Kansas Program

Major Incentives

Incentives apply to qualified new or expanding businesses. Qualified businesses may include those engaged in manufacturing, services, administration, sales, and many other lines of business.

1. \$350 per year income tax credit for new employee who is a Kansas resident. \$500 per new employee if the employee meets federal targeted jobs tax credit qualifications. Credit may be claimed up to 10 years.
2. \$350 per year income tax credit for each \$100,000 in investment. Credit may be claimed up to 10 years.
3. Sales tax exemptions for all sales of tangible personal property or services purchased for the purpose of and in conjunction with constructing, reconstruction, enlarging, or remodeling a qualified business facility. Note that this is broader than the sales tax exemption for manufacturing machinery and equipment applicable elsewhere in the state.
4. Local incentives such as capital improvements, fee waivers, etc.

Qualification Criteria

A zone may be in city or county area. No more than 25% of the land in the city or county can be designated. Beyond that, the zone must qualify in one of two ways:

1. The zone may meet UDAG (Urban Development Action Grant) criteria. A list of cities which meet the criteria is published in the *Federal Register*--the list has not been revised for several years; OR
2. The zone may meet distress criteria, such as showing widespread poverty, unemployment and general distress. Distress must be evidenced by:
 - a. unemployment of at least 1.5 times state average; OR
 - b. at least 70% of residents with income below 80% of median income; OR
 - c. a population decrease of at least 10% for any 10 year period starting with 1970.

In addition to a - c, the governing body of the city (or county) must find substantial deterioration, abandonment, or demolition of commercial or residential structures in the area, OR there must be substantial tax arrearages on commercial or residential structures.

The qualification criteria stress unemployment, poverty, and deterioration. But in fact, the criteria are quite weak. The criteria apply only to the parcel(s) of land on which the zone will be located. For example, depopulation of a particular piece of land might be part of the process of conversion from residential to commercial use. In the process, abandonment or demolition would naturally follow. The parcel would then qualify under method 2.

As a result of the weak qualification criteria, a large majority of the Kansas cities with populations over 1000 have successfully applied for zone designation. (See Table 1). Smaller cities, on the other hand, are much less likely to apply for zone designation. This may in part be due to lack of organized economic development groups to initiate interest in designation status and to sustain the designation process.

At last count, Kansas had designated 206 city zones and 57 county zones. Almost every county in the state contains at least one zone under county or city authority. (See Figure 1)

It should be pointed out that this is indeed a very large number of zones. In contrast, if we look at some of our surrounding states, Colorado currently designates 16 zones, Oklahoma 83, Missouri 37 (plus 18 additional zones just approved this summer). (see Table 13)

Analysis of Kansas Data

Analysis of Geographic Location of Jobs and Firms

One of the major concepts of enterprise zones is geographic targeting. Ideally, we would be able to analyze the Kansas enterprise zone program directly to see if it was reaching its target: distressed areas of the state. This would require that we had some measure of EZ activity for each zone. Unfortunately, there are no data showing the number of firms, number of jobs, or amount of investment claimed in individual zones. Although the Kansas Department of Revenue releases aggregate statistics about the EZ program, information about the individual zones would no doubt violate the confidentiality of the individual taxpayers. Lack of data for adequate evaluation is a major problem with the current Enterprise Zone program.

As a second best alternative, the Institute for Public Policy and Business Research has analyzed some data from the Kansas Department of Commerce publication *New and Expanding Manufacturers* from 1985 - 1989. The approach is similar to that used by the Commerce Department in a 1988 study. Manufacturing firms listed in the publication are designated as to whether they are located in an EZ. There is also some data on the range of employment (for example 1-10 jobs) for the new firms. We reconciled this employment range data with data on jobs by type of industry to produce the final results that you see in Table 2. The employment data should be interpreted as **estimates only**. Another weakness of the data from this analysis is that while they show the level of activity in the zones, they fail to show the number of firms that actually claim incentives.

For the time period considered, we found that fully 73% of new manufacturing jobs in new facilities were located in enterprise zones. On average, manufacturing firms starting up in EZs had 38 employees, in contrast to 16 for those outside of EZs. The data can be interpreted as saying that larger manufacturing firms seek out EZs. But remember that almost every city with population over 2500 has a zone, so a firm which has decided on a particular city can usually arrange an EZ location.

Many of the jobs have gone to a few locations, with Pittsburg leading the list in terms of jobs (a few large manufacturing firms) (see Table 4) and Kansas City leading the list in terms of number of firms. The counties in and around the Kansas City and Wichita metropolitan areas have attracted the bulk of employment and new firms.

If you look at the map in Figure 2, there is one pattern that stands out: EZ development has done almost nothing to bring manufacturing to the western part of the state.

If you look at the location patterns for new firms (Table 5 and Figure 3) you see a similar pattern to that for new jobs. 53% of new manufacturing firms picked EZ locations, mostly in the Eastern half of the state.

If you look at the data for number of manufacturing expansions (Table 6 and Figure 4) you will see that 69% of all reported manufacturing expansions took place within the boundaries of EZs. Wichita lead the group, with 92 reported expansions in EZs, followed by KC. In Wichita, 81% of all expansions took place within EZs.

This might be a good time to summarize some of this data analysis:

1. Between 1/2 and 3/4 of the new and expanding manufacturing activity in the state takes place within the boundaries of EZs.
2. Larger establishments have a greater tendency to seek out EZ locations.
3. Zone activity is concentrated around urban areas and in the eastern part of the state.

Analysis Based on Distress Criteria

Kansas criteria for zone qualification are based on income and population growth criteria. Hence we thought it would be interesting to see if EZ use was concentrated in low income or low growth areas. The results of the analysis are shown in Tables 7-12.

We first grouped cities in the state according to whether per capita income was above or below the state average. When we looked at new manufacturing jobs, we found that cities with income below the state average pulled in 94% of the EZ jobs and 87% of the EZ firms. At first glance this looks like targeting is working. However, many of the higher income areas of the state, such as communities in Johnson County, have just recently attained EZ status, so jobs in these areas are not reflected in our data. Furthermore we would expect the service industries, not included in the data set, would be more likely to locate in these areas.

When we look at expansions, fully 36% of enterprise zone activity occurred in areas with income above the state average. Targeting clearly fails for expanding manufacturing.

We also grouped cities according to population growth-- a similar pattern emerged.

To summarize:

1. Overall, there is not much evidence that the Kansas program targets low income or low growth communities effectively.
2. It appears that the high number of zones and the weak designation criteria mean that in practice, the Kansas EZ program is more of a general industrial recruitment incentive program, and that it has not been able to focus resources on providing development for those most distressed areas of the state.
3. This is not to say that industrial recruitment programs are not needed, or better yet, that some restructuring of the Kansas tax structure is not needed to enhance Kansas ability to attract and retain industry. My point is that this is not the original mission of an EZ program as stated in the statutes. There may still be a need for a truly targeted program.

I would like to look at enterprise zone programs in a few selected states, many of which do have a more targeted program.

Programs in Other States

Colorado

- Focus:
 - Primary focus is development in rural areas. Secondary focus is development in depressed urban areas.
- Number and Scope of Zones:
 - Originally limited to 12 zones (4 urban and 8 rural)
 - 4 additional zones recently authorized
 - No limit on geographic scope--in one case, a zone encompasses 6 counties. Zones currently cover about 70% of Colorado land area, but only about 15% of the population. This makes the program unique among the states.
- Criteria for Designation:
 - Less than 50,000 in population
 - One of the following:
 - Unemployment 25% above state average
 - Per capita income 25% below state average
 - Population growth rate less than 25% of state average
 - Competitive process for zone designation. Decisions based on distress criteria and on the quality of the zone's development plans.
- Administrative:
 - Each zone must have a plan, describing the zones potential for economic development and job creation.
 - There must be concrete measures taken by local govt. and private sector to support zone objectives. For example, local govt. can pledge to offer local incentives.
 - A person or agency must be designated as zone administrator.
 - The state assists in zone marketing. In 1989, \$600,000 was set aside to market zones. It was distributed on a matching basis to local zones.
 - State provides "how to" type of support for local administrators.
- Major Incentives:
 - 3% investment tax credit
 - \$500 job credit
 - \$200 contribution toward employee health insurance
 - 25% credit for expenses to rehab older buildings
 - Special credits for ag processors
 - Local property tax incentive payments (similar to abatements)
 - Exemption of manufacturing equipment and machinery from local sales tax.
- The competitive process and the state-local partnership are very important here. Local government plans must be good or the zone won't get designation.

Indiana

- Focus:
To develop small scale growth centers in urban areas, and to provide benefits for zone residents.
- Number and Scope of Zones:
14 zones.
Growth limited to 2 zones per year.
Zones are small geographic areas.
- Criteria for Designation:
All criteria must be met
 1. 25% of residents below poverty level or unemployment 150% of state average.
 2. Area greater than .75 sq. miles and less than 3 sq. miles with a continuous boundary
 3. Site must be suitable for mixed use: residential, commercial, and industrial
 4. An "Urban Enterprise Zone" association must be formed.Competitive process for zone designation, with decision based on: distress; support from local residents (and businesses); commitment to infrastructure improvement; capacity of Urban Enterprise Association to carry out goals.
- Incentives:
Additions to business income after designation are **exempt** from state income tax.
Property tax credit for taxes on inventories
Loans for investment
Employees who live and work in the zone get 50% deduction on income tax.
- This program has come under criticism lately in an evaluation study done by James Papke at Purdue University. A lesson to be learned from his study is that the property tax credit on inventories seems to have little relationship to stimulating zone employment. Unlike other incentives, it is not tied to increases in a firms level of activities, and in many cases is a windfall for firms which would have held inventories in any case.
- Nevertheless, the program is worth looking at because it is highly targeted and it focusses on local involvement.

New Jersey

- Focus:
Urban rehabilitation, including retail development. Provision of benefits to low income zone residents.
- Number and Scope of Zones:
 - 10 zones in urban areas, designated for 20 years.
 - Additional areas are designated to compete for new zones if and when the New Jersey legislature authorizes additional zones.
 - Zones are generally 30% of a city's land area.

- Designation Criteria:
 - For designation, a zone must meet a set of distress criteria determined administratively.
 - Additionally, the zone must have a development plan authorized by local govt.
 - Included in the plan must be local incentives.
 - Competitive selection process based on based on degree of distress, potential for stimulating new activity, commitment by zone businesses and residents, and demonstrated effort by community to encourage job creation.
- Incentives:
 - \$1500 new employee tax credit for zone residents
 - \$500 credit for other new employees
 - Sales tax exemptions on tangible personal property (machinery, equipment, and supplies) used in zone
 - Sales tax exemption for building materials
 - Reduced sales tax rate (50% reduction) for retail sales in zone
 - Reimbursement for part of employee unemployment insurance
 - Employment and job training programs (not exclusive to zones)
 - Financial assistance for energy conservation measures
- A recent evaluation study by Marilyn Rubin estimates that the program returns \$1.9 to taxpayers for every \$1 spent on tax abatements or other incentives.

Illinois

- Focus:
 - General economic development incentive program. Original purpose was neighborhood revitalization in depressed areas of the state and business and industrial growth in depressed areas.
- Number and Scope of Zones:
 - Originally limited to 48 (8 per year for 48).
 - Now 88 zones.
 - Small to medium sized zones (0.5 sq. mi. to 15 sq. mi.)
- Criteria for Designation
 - Department of Commerce and Community Affairs sets minimum qualification criteria for "depressed areas."
 - Must satisfy **one** of
 - Unemployment: 120% of state average for last 12 months; OR
 - Low income: 70% of households with income less than or equal to 80% of the median for the region in which the zone is located; OR
 - Population loss: Decrease of 20 percent over 10 year period; OR
 - Job creation: Zone must create or retain a minimum of 1000 full time equivalent jobs and stimulate investment of \$100 million or more.

- **Administrative**
 - Zones process initiated by city or county ordinance.
 - Awards are competitive. Zone must first meet minimum criteria. After that, high importance is placed on the local plan for economic growth and on the perceived ability of local officials to implement the plan.
 - Zones are locally administered, and a local administrator must be appointed.
 - Zones responsible for reporting job and investment data, but study reveals that these data have not been very accurate.
- **Major Incentives**
 - Investment credit (against income tax) of 0.5% of total investment.
 - Job credit of \$500 for disadvantaged workers.
 - Sales tax exemption for materials used in construction.
 - Sales tax exemption of materials and machinery for manufacturing for large projects.
 - State utility tax exemption for large projects.
 - Local sales tax exemptions on items state exempts.
 - Other local incentives encouraged. Most common is property tax abatement.
- **Results of Evaluation Study**
 - Major study by Kent D. Redfield and John F. McDonald. *Enterprise Zones in Illinois*. Illinois Tax Foundation: Springfield, August, 1991.
 - Study concludes that zones have been "demand driven." Rules (including # of zones) have changed in response to demand from communities. Zones for specific projects (including a package to keep Sears HQ in the state) have been authorized.
 - No hard data on costs and benefits of program, and no adequate evaluative mechanism.
 - Program has become unclear in its focus. According to study, "enterprise zones are universally considered by local officials and community leaders to be general economic development tools rather than mechanisms for targeting growth in depressed areas and revitalizing neighborhoods."
 - As in Kansas, the flexible criteria for zone designation means that some zones are characterized by relatively high income and/or low unemployment.

Guiding Principles for EZ Programs

Based on my research of programs in other states, as well as on my observations of the current Kansas program, I am going to suggest some general guidelines along which a targeted enterprise zone type program might be developed. I and my colleagues at IPPBR first discussed these principles last September, before any new Kansas legislation had been suggested. One thing that we all agreed on was that the current program was in need of revision. I am going to present our original set of "guiding principles," along with some VERY PRELIMINARY discussion of how the newly suggested legislation relates to these principles.

I should point out that the newly suggested legislation replaces the current enterprise zone program with a two-tiered program with different incentives for metropolitan versus nonmetropolitan areas. In particular, job credits are expanded in nonmetro areas.

Guiding Principles

1. *Enterprise zones are designed to be targeted toward areas of economic distress.*

The expanded credits in the "nonmetropolitan regional business program" proposed in the new Kansas legislation would accomplish this targeting. In Kansas, it is primarily the non-metro areas which have been experiencing slow income and employment growth.

2. *Within that mission (targeting areas of distress), programs should be as efficient as possible, focusing on new job and investment activity.*

Incentives should be chosen to best achieve this objective. Incentives such as the inventory property tax credits in Indiana, which fail to target new activity, should be avoided.

Both the non-metro regional business program and the statewide incentives offered in the new legislation target new activity.

3. *The number of zones should be limited, and chosen through a competitive selection process. Competitive selection is the norm across the states.*

We originally saw this guiding principle as a means to prevent every area of the state from becoming an enterprise zone and hence diluting the purpose of targeting distressed areas. We also questioned whether very small zones in small communities could be successfully administered and marketed.

As a preliminary comment, it appears that limiting special incentives to areas encompassing at least a full county might achieve the same purpose, especially if multi-county cooperation becomes common.

4. *Enterprise zones should be part of an overall development strategy.*

Local development agencies need to be outline how the enterprise zone will involved are important. Overall development strategy needs to be expressed by local development groups.

The nonmetro regional program would be a big step in this direction, because it requires regional cooperation, and would also tie in with existing development organizations and programs.

5. *Incentives should be big enough to make an impact.*

Studies suggest that sales tax exemptions are especially important since they help the firm immediately during its difficult start up phase. With respect to the current Kansas program, the \$350 per year job/investment credit for 10 year approach might be too small an annual incentive for too long a time. Somewhat larger job/investment credits for a shorter time period might do more to help small businesses get off the ground.

The new program gives a large job credit, but for one year only. I suspect that the size and timing of the job credit will be a subject of further discussion.

6. *Benefits should be targeted at basic industries, (for example as defined in KSA 74-8902).*

Basic industries might include manufacturing, mining, agriculture, and a number of other industries, in turn support the retail and personal service establishments.

One of the innovative features of the proposed legislation (both for metro and non-metro areas) is that for the most part it restricts benefits to industries in the "basic" category. These industries are most likely to provide a foundation for the local economy.

7. *The EZ program should have a built-in means for evaluation.*

Table 14 shows an example of the registration form used in Indiana. Data from these forms were used to complete the Indiana EZ evaluation.

I would like to stress the importance of evaluation. It is only with good data that we can see if programs are working as intended and make adjustments if they are not.

Table 1
Number of Enterprize Zones by City Size

City Size	EZ Status		Total
	No EZ	EZ	
	# Cities	# Cities	# Cities
under 500	303	35	338
501-1000	67	24	91
1,001-2,500	40	63	103
2,501-5,000	8	37	45
5,001-7,500	0	9	9
7,501-15,000	1	17	18
15,101-25,000	2	8	10
25,001-50,000	0	7	7
50,001-100,000	0	2	2
100,001-200,000	0	3	3
over 200,000	0	1	1
Total	421	206	627

Table 2
Jobs in New Manufacturing Firms, 1985 - 1989

Year	Enterprise Zone Location?				Total
	In EZ		Not in EZ		
	Jobs		Jobs		Jobs
	Number	% of Total	Number	% of Total	Number
1985	1878	72	722	28	2600
1986	1070	73	404	27	1474
1987	692	47	779	53	1471
1988	2307	94	142	6	2449
1989	1073	68	499	32	1572
1985-1989	7021	73	2545	27	9566

Tables 1-6 are based on data from Kansas Department of Commerce, *New and Expanding Manufacturers*, various years. Employment numbers are estimates based on employment range data.

Table 3
New Manufacturing Firms, 1985 - 1989

Year	Enterprise Zone Location?				Total # Firms Number
	In EZ		Not in EZ		
	Firms		Firms		
	Number	% of Total	Number	% of Total	
1985	52	46	60	54	112
1986	40	55	33	45	73
1987	32	43	42	57	74
1988	36	78	10	22	46
1989	24	62	15	38	39
1985- 1989	184	53	160	47	344

Table 4
The Location of New Manufacturing Employment, 1985-1989
Cities with More Than 100 Jobs in Enterprise Zones

City Name	Jobs	
	85-89	% of Total Jobs
Pittsburg	1598	23
Kansas City	1033	15
Osawatomie	341	5
Wichita	308	4
Hays	294	4
Salina	288	4
Ottawa	262	4
Eudora	204	3
Abilene	198	3
Chanute	178	3
El Dorado	165	2
Tonganoxie	112	2
Augusta	109	2
Columbus	102	1
All Cities	7021	100

Tables 1-6 are based on data from Kansas Department of Commerce, *New and Expanding Manufacturers*, various years. Employment numbers are estimates based on employment range data.

1-14

Table 5
The Location of New Manufacturing Firms, 1985-1989
Cities with 4 or More New Firms in Enterprise Zones

City Name	Firms	
	Number 85-89	% of Total Firms
Kansas City	25	14
Wichita	16	9
Pittsburg	13	7
Ottawa	8	4
Great Bend	7	4
Chanute	5	3
Hutchinson	5	3
McPherson	4	2
Pleasanton	4	2
All Cities	184	100

Table 6
The Location of Expanding Manufacturing Firms, 1985-1989
Cities with 5 or More Expansions in Enterprise Zones

City Name	Total Expansions	EZ Expansions	
	Number	Number	EZ as % Total
Wichita	113	92	81
Kansas City	34	21	62
McPherson	22	19	86
Wellington	15	15	100
Salina	22	14	64
Arkansas City	12	11	92
Topeka	12	11	92
Lawrence	12	10	83
Olathe	20	9	45
Pittsburg	13	9	69
Coffeyville	10	8	80
Fort Scott	9	8	89
Marion	10	7	70
Newton	8	7	88
Emporia	6	6	100
Great Bend	8	6	75
Hesston	6	6	100
Parsons	9	6	67
Dodge City	10	5	50
All Cities	571	396	69

Tables 1-6 are based on data from Kansas Department of Commerce, *New and Expanding Manufacturers*, various years. Employment numbers are estimates based on employment range data.

Table 7
Jobs in New Manufacturing Firms, 1985-1989
By Income Category

Income Category	Jobs	% of All Jobs	Jobs in EZs	% of EZ Jobs
Cities with Income At Least State Average	1621	17	414	6
Cities with Income Below State Average	7945	83	6607	94
All Locations	9566	100	7021	100

Table 8
Number of New Manufacturing Firms, 1985-1989
By Income Category

Income Category	Firms	% of All Firms	Firms in EZs	% of EZ Firms
Cities with Income At Least State Average	85	25	23	13
Cities with Income Below State Average	259	75	161	87
All Locations	344	100	184	100

Table 9
Number of Manufacturing Expansions, 1985-1989
By Income Category

Income Category	Expansions	% of All Expansions	Expansions in EZs	% of EZ Expansions
Cities with Income At Least State Average	193	34	142	36
Cities with Income Below State Average	378	66	254	64
All Locations	571	100	396	100

Tables 7-12 are based on Kansas Department of Commerce, *New and Expanding Manufacturers*, various years. Employment numbers are estimated from employment range data. Income and population data are from the U.S. Bureau of the Census, *Current Population Reports: Local Population Estimates*, and *STF1A 1990*.

Table 10
Jobs in New Manufacturing Firms, 1985-1989
By Population Growth Category

Population Growth Category	Jobs	% of All Jobs	Jobs in EZs	% of EZ Jobs
Cities with Pop. Growth At Least State Average	2613	27	1256	18
Cities with Pop. Growth Below State Average	6953	73	5765	82
All Locations	9566	100	7021	100

Table 11
Number of New Manufacturing Firms, 1985-1989
By Population Growth Category

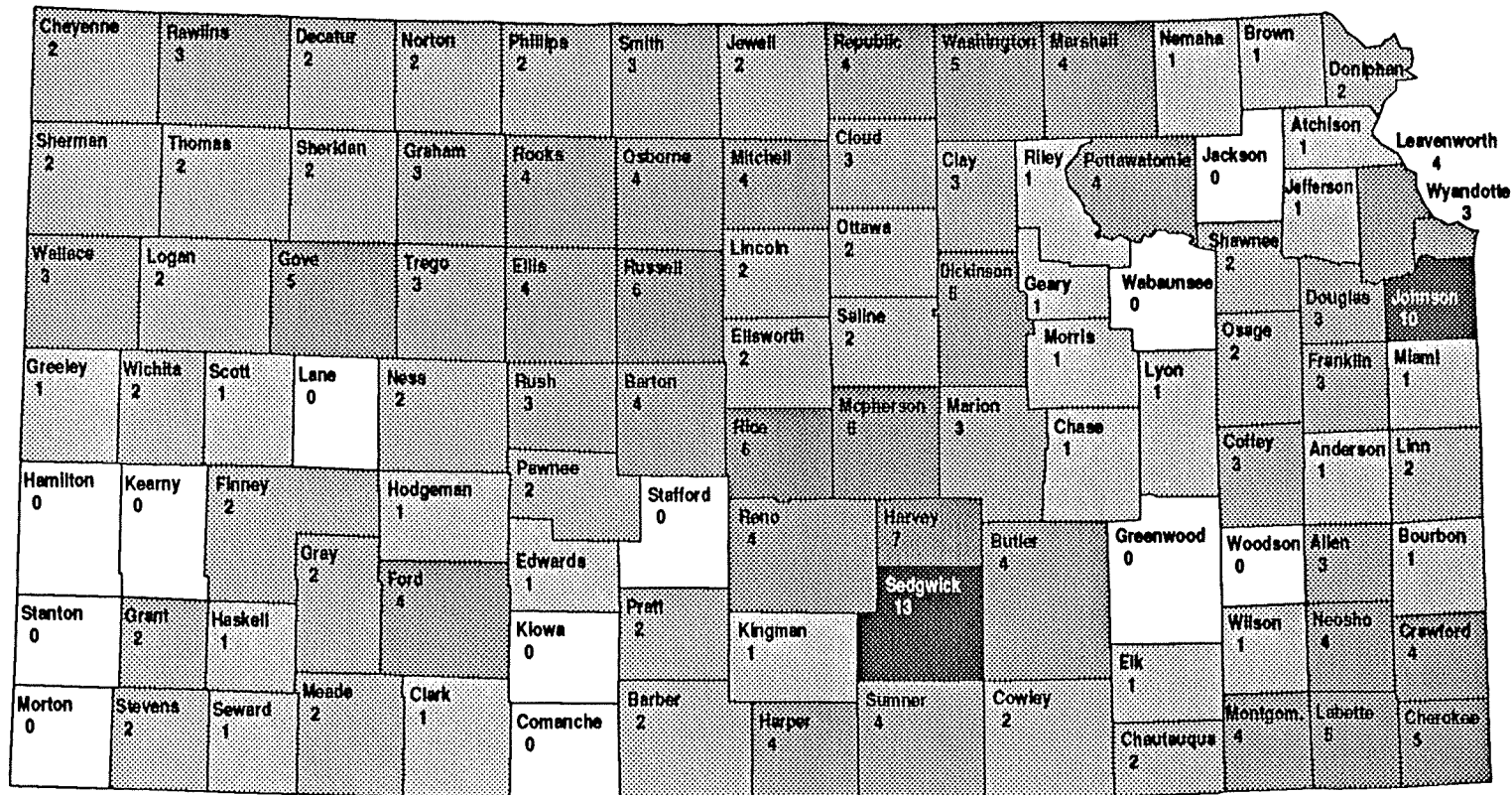
Population Growth Category	Firms	% of All Firms	Firms in EZs	% of EZ Firms
Cities with Pop. Growth At Least State Average	110	32	42	23
Cities with Pop. Growth Below State Average	234	68	142	77
All Locations	344	100	184	100

Table 12
Number of Manufacturing Expansions, 1985-1989
By Population Growth Category

Population Growth Category	Expansions	% of All Expansions	Expansions in EZs	% of EZ Expansions
Cities with Pop. Growth At Least State Average	220	39	152	38
Cities with Pop. Growth Below State Average	351	61	244	62
All Locations	571	100	396	100

Tables 7-12 are based on Kansas Department of Commerce, *New and Expanding Manufacturers*, various years. Employment numbers are estimated from employment range data. Income and population data are from the U.S. Bureau of the Census, *Current Population Reports: Local Population Estimates*, and *STF1A 1990*.

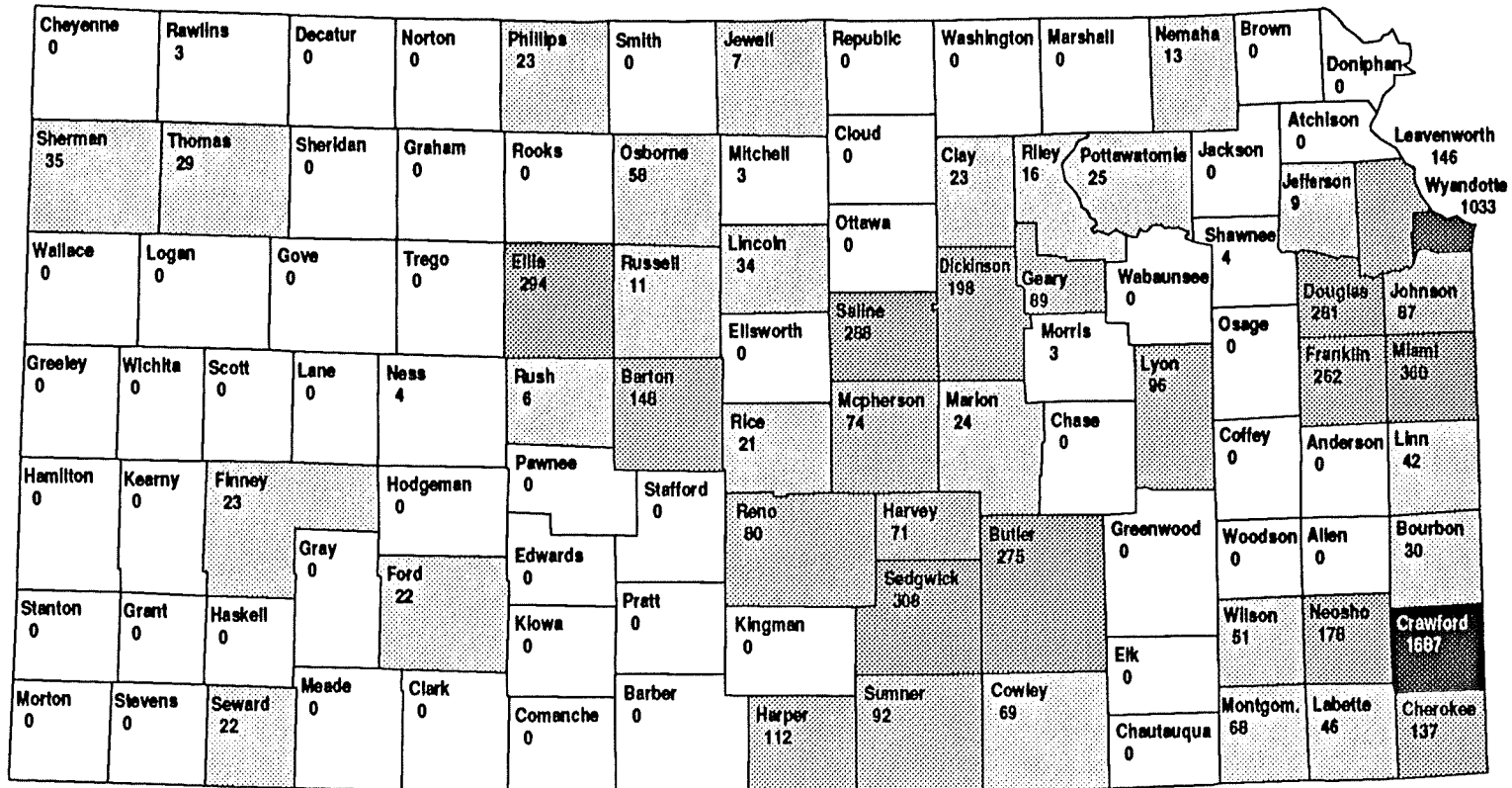
Figure 1
Number of Enterprise Zones, 1991



Includes 206 city zones and 57 county zones.
Data provided by Kansas Department of Commerce.

81-1

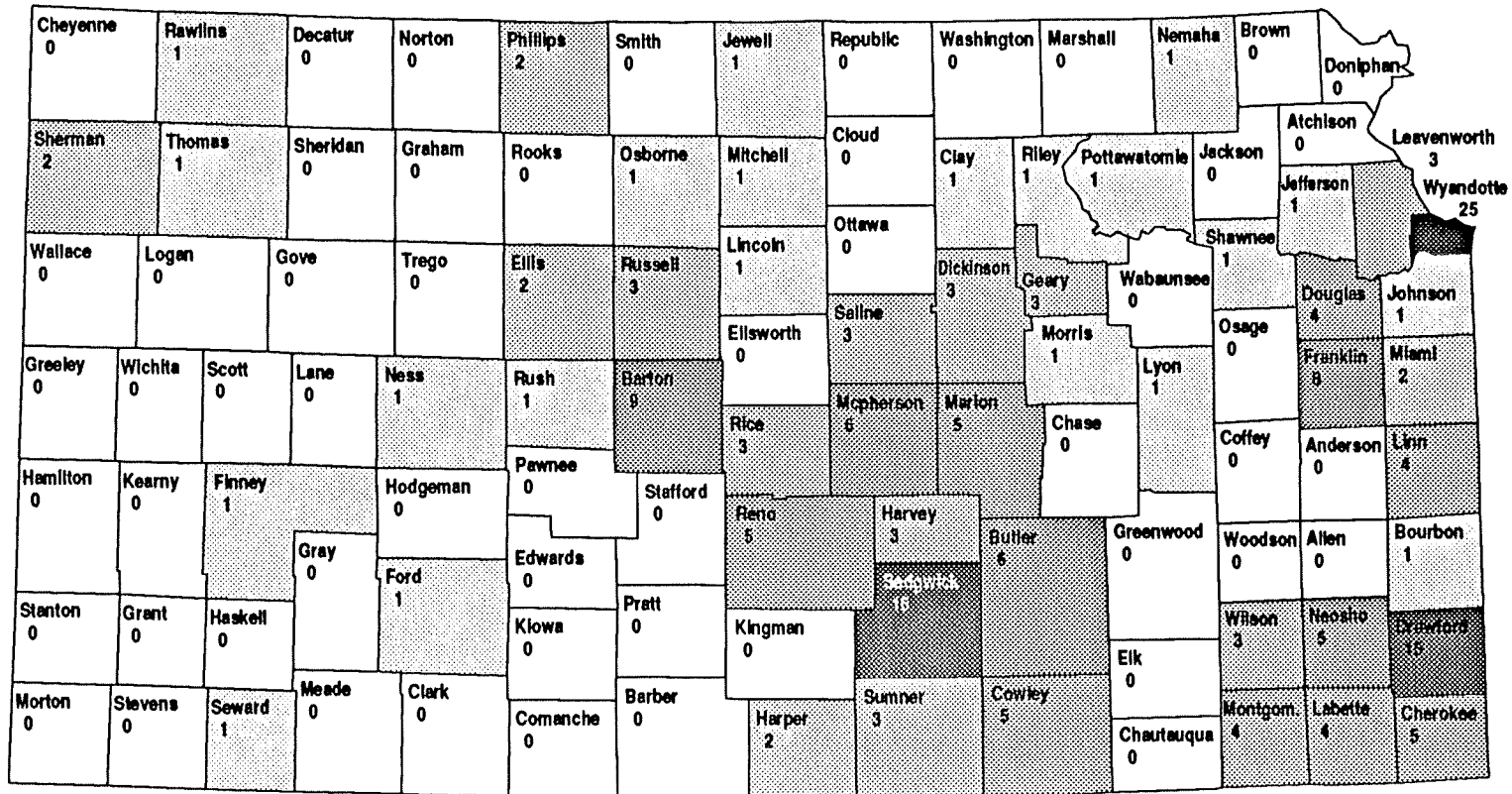
Figure 2
Jobs Created in New Manufacturing Firms Locating in Enterprise Zones
1985-1989



Data from Kansas Department of Commerce, *New and Expanding Manufacturers*, various years.

61-1

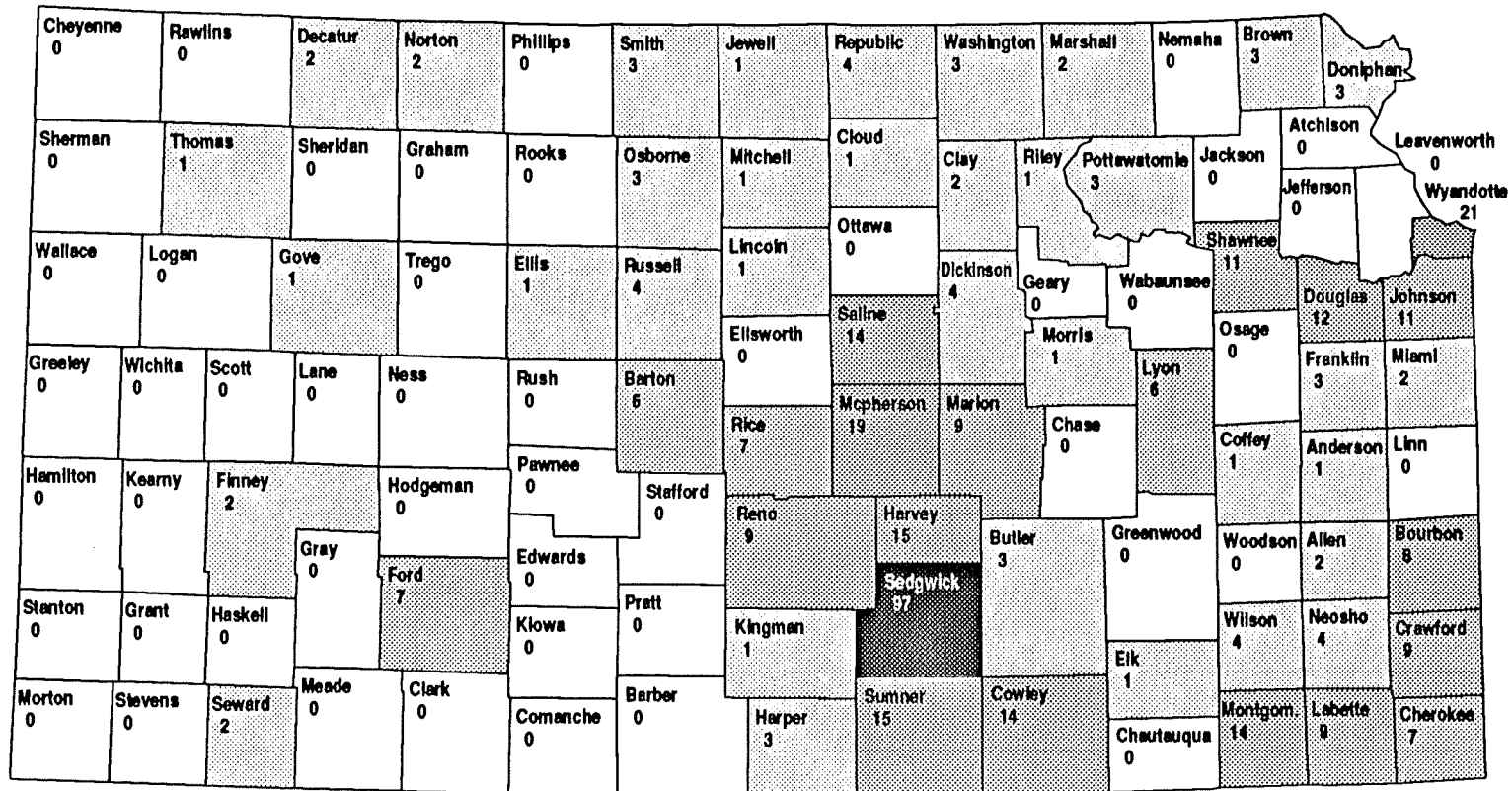
Figure 3
 Number of New Manufacturing Firms Locating in Enterprise Zones
 1985 - 1989



Data from Kansas Department of Commerce, *New and Expanding Manufacturers*, various years.

1-20

Figure 4
 Expansions of Manufacturing Firms Located in Enterprise Zones
 1985 - 1989



Data from Kansas Department of Commerce, *New and Expanding Manufacturers*, various years.

1-21

Table 13

SUMMARY OF STATE ENTERPRISE ZONE INFORMATION

STATE	CURRENT YEAR DATA			CUMULATIVE YEAR DATA			NO. OF EZ AREAS	YEAR EZ ENACTED
	JOBS	FIRMS	INVESTMNT (\$000,000)	JOBS	FIRMS	INVESTMNT (\$000,000)		
AL	1,874	31	\$66	-	-	-	11	1987
AZ	-	-	-	-	-	-	9	1989
AR	-	-	-	16,239	-	\$1,900	448	1983
CA	-	-	-	7,041	-	382	19	1984
CO	-	-	-	9,900	-	758	16	1986
CT	-	-	-	7,341	-	415	10	1982
DE	-	-	-	90	-	42	30	1984
DC	Writing regulations						3	1988
FL	1,482	110	12	-	-	-	30	1984
GA	-	-	-	2,500	-	100	3	1982
HA	Rules not approved yet						0	1986
IL	14,876	1,807	623	54,422	5,207	4,024	82	1982
IN	-	-	-	-	-	-	14	1983
KS	7,146	177	750	-	-	-	255	1982
KY	-	-	-	18,154	1,488	1,700	10	1982
LA	-	-	-	25,361	-	2,200	750	1981
ME	-	-	-	-	-	-	4	1987
MD	-	-	-	-	1,600	43	15	1982
MI	700	84	31	-	-	-	1	1986
MN	-	-	-	6,175	-	-	16	1983
MO	-	-	-	11,702	-	541	37	1982
NV	-	-	-	200	-	-	2	1983
NJ	-	-	-	34,705	-	2,960	10	1983
NY	-	-	-	3,535	-	584	19	1986
OH	-	-	-	34,000	-	12,000	193	1982
OK	-	-	-	-	-	-	83	1983
OR	-	-	-	3,281	-	-	30	1985
PA	-	-	-	9,850	-	-	42	1983
RI	New legislation enacted June 1991						0	1991
SC	-	-	-	500	-	300	46	1987
TN	Designation process occurring this year						1	1984
TX	-	-	-	9,142	-	711	28	1988
UT	-	-	-	798	39	-	14	1988
VT	-	-	-	-	-	-	3	1986
VA	-	-	-	2,230	-	48	18	1982
WV	Tax difficulties						0	1986
WI	-	-	-	1,229	41	49	8	1988
TOT.	26,078	2,209	\$1,482	258,395	8,375	\$28,757	2,260	

Taken from U.S. Department of Housing and Urban Development, State Enterprise Zone Update, 1991

Table 14
Indiana Program: Example of EZ Registration Form

State Form 42626 (4-88)

ENTERPRISE ZONE BOARD
Enterprise Zone Business Registration Form
For Calendar Year 19__

APPROVED BY STATE BOARD OF ACCOUNTS 1988 EZB-R

A zone business that claims any of the incentives available to zone businesses shall, before June 1 of each year, submit to the Enterprise Zone Board a verified summary of the amount of the tax credits and exemptions claimed by the business in the preceding year.

THE INFORMATION ON THIS FORM IS CONFIDENTIAL ACCORDING TO IC 4-4-8.1-2.5

PART I - GENERAL INFORMATION

1. Name of Business _____
2. Mailing Address _____
3. City, State, Zip _____
4. Telephone Number _____
5. Zone Street Address or Location of Inventory (if different from Number 2) _____
6. Social Security Number or Federal Identification Number _____
7. Primary Business Activity (check one)
Manufacturing _____ Warehouse/Distribution _____ Retail _____ Professional Service _____ Other (please specify) _____
8. Standard Industrial Classification (see attached listing) _____
9. Legal Business Form (check one)
"C" Corporation _____ "S" Corporation _____ Partnership _____ Sole Proprietorship _____
10. Total Employees Working at the Zone Location During the Previous Calendar Year _____
11. Total Zone Residents Employed at the Zone Location During the Previous Calendar Year _____
12. Total Wages and Salaries During the Previous Calendar Year _____
13. Total Wages and Salaries at the Zone Location During the Previous Calendar Year _____
14. Total Wages and Salaries of Your Zone Resident Employees During the Previous Calendar Year _____
15. Number of Enterprise Zone Qualified Employee Certificates (IT-40 QEC) Issued During Previous Calendar Year _____
16. Total of Compensation Included on Line 5 of Enterprise Zone Qualified Certificates (IT-40 QEC) Issued During the Previous Calendar Year _____
17. Total New Jobs Created at the Zone Location During the Previous Calendar Year _____
18. Total New Jobs Filled by Zone Residents During the Previous Calendar Year _____
19. Percent of Total Business Income Allocated to Indiana _____ (If the business is headquartered in Indiana and all business is conducted in Indiana, the percentage would be 100%; for businesses having income sources both within and without Indiana, the percentage would be less than 100%; for multi-state corporations, from Schedule EZ, IT-20.)
20. Percent of Total Business Income Allocated to Zone Operation _____ (For corporations, from Schedule EZ; if there is only one business operation and it is located in the zone, the percentage would be 100%; for businesses having income sources both within and without zone location, give zone percentage only.)

PART II - TAX SAVINGS SUMMARY

1. Total Business Personal Property Tax Credit (i.e., the inventory tax credit - the assessed value per Schedule EZ-1, multiplied by the local tax rate, minus the state replacement tax credit) _____
2. Total Gross Income Tax Exemption (gross income exempt from taxation from Schedule EZ, multiplied by .003 (sales) and/or, .012 (services, rent, dividends, interest, other) _____
3. Total Employment Expense Credit (from Part II, Schedule EZ) _____
4. Total Loan Interest Credit (from Schedule LIC) _____
5. Total Tax Savings (total of Lines 1-4) _____

PART III - REGISTRATION FEE AND ELIGIBILITY

In accordance with IC 4-4-6.1-2, 2.5, each enterprise zone business claiming a credit or exemption shall register with the Enterprise Zone Board by June 1 of each year. Furthermore, if an enterprise zone business receives tax-saving incentives in excess of \$1,000 in any year, the business must pay an annual registration of one (1) percent of its tax savings to the State Enterprise Zone Board for the services, administration and promotion of the enterprise zone program, or be disqualified from eligibility for enterprise zone incentives. This registration fee will cover the administration, promotion and technical assistance provided by the enterprise zone program.

1. Registration Fee \$ _____ (If the total on Line 5, Part II, exceeds \$1,000, multiply the total on Line 5 by .01 and remit the registration fee to:
Enterprise Zone Board, State of Indiana, Indiana Commerce Center, One North Capitol, Suite 700, Indianapolis, IN 46204-2288
In the year awarded, a zone business is required by law to use all its tax-saving incentives (except for the amount of the registration fee) for capital investment, an increase in zone resident employee compensation, and to assist the zone Urban Enterprise Association, or be disqualified from eligibility for enterprise zone incentives.
2. Total New Capital Investment in Enterprise Zone During Previous Calendar Year \$ _____ (Please list if the investment is building renovations or improvements, new equipment, inventories, etc.) _____
3. Total Zone Resident Employee Wages and Salaries or Other Compensation During Previous Calendar Year \$ _____
4. Total Cash and/or In-Kind Assistance to the Urban Enterprise Association \$ _____
5. Total: (Part III, Lines 2-4) \$ _____
(The sum of Lines 2-4 must equal or exceed the amount in Part III, Line 1, to avoid disqualification from eligibility for enterprise zone incentives.)

I certify that I have examined this form and to the best of my knowledge and belief, it is true, correct, and complete.

Signature _____

Title _____

Date _____

MEMORANDUM

Kansas Legislative Research Department

Room 545-N -- Statehouse
Topeka, Kansas 66612-1586
(913) 296-3181

January 27, 1992

To: House Committee on Economic Development
Re: H.B. 2681 -- Tax Incentives for Businesses

Existing Law

As of January 10, 1992: 264 enterprise zones
(206 city zones; 58 county zones)

- I. Purpose: expand and renew the local economy

improve the social and economic welfare of residents in economically distressed zone areas
- II. Procedure for zone designation:
 - A. local governmental unit to submit to Kansas Department of Commerce (KDOC) a resolution requesting area for zone designation and a plan (map, narrative describing how zone will eliminate economic distress, at least one local incentive)
 - B. resolution either approved or disapproved by KDOC
 - C. zones effective for five years
- III. Criteria for approval:
 - A. city zone to be within corporate limits of city; county zone wholly within unincorporated portion of county
 - B. city zone not to exceed 25 percent of city's population and 25 percent of land area of city and must meet certain "distressed" criteria (K.S.A. 12-17,110 (a)(3)); county zone not to exceed 25 percent of county's population and 25 percent of land area of county and must meet certain "distressed" criteria (K.S.A.12-17,110 (b)(3))

*Eco. Devo
Attach. #2
01-27-92*

- C. more than one noncontiguous area within enterprise zone allowed

IV. Annual report:

- A. enterprise zones to report annually to KDOC on local incentives for economic development; usage and revenue impact of local incentives associated with zones; and other information as determined by the Secretary of Commerce.
- B. annual report required by Secretary to Governor and Legislature

Associated Tax Benefits -- Enterprise Zones

Tax benefits triggered by facility location within enterprise zone; for facilities located outside zones, unenhanced job, and investment credits available

- I. Job credit (K.S.A. 79-32,153(c)(1))
 - A. a net addition of two employees per year
 - B. \$350 per employee per year; subject to 50 percent maximum; up to ten years
 - C. \$500 per employee per year (targeted credit for low-income employees); subject to 50 percent maximum; up to ten years
- II. Investment credit (K.S.A. 79-32,153(c)(3))
 - A. \$350/\$100,000 per year; subject to 50 percent maximum; up to ten years
- III. Sales tax exemption (K.S.A. 79-3606 (ee))
 - A. contingent on enterprise zone designation
 - B. exemption on sales of tangible personal property or services associated with construction, reconstruction, enlarging, or remodeling, including purchase of materials, equipment, machinery

Proposal Under H.B. 2681 Legislative Intent

- I. Reasons by Joint Committee for major changes to Enterprise Zone Program:
 - A. unawareness on part of businesses of enterprise zone benefits
 - B. little demonstrable commitment by local government
 - C. benefits provided to all types of businesses regardless of their contributions to long-term economic growth and prosperity of a community or region
 - D. enterprise zones generally used as recruitment tool; question of program intent given criteria for designation based on economic distress factors
 - E. greater need to provide incentives to revitalize nonmetropolitan areas of state

- II. Major provisions of bill:
 - A. Elimination of enterprise zones; replacement of zones with "nonmetropolitan regions" (New Sec.1 (d)), to exclude Douglas, Johnson, Leavenworth, Sedgwick, Shawnee, and Wyandotte counties
 - B. Procedure to establish region (New Sec. 3 (a)(b)):
 - 1. KDOC to establish nonmetropolitan regions comprised of one or more counties
 - 2. city with population of at least 2,500 to consent to participation in region
 - 3. city and county to apply to KDOC for designation of region
 - C. Qualifications for region establishment (New Sec. 3 (c)):
 - 1. regional economic development organization
 - 2. regional strategic plan
 - 3. demonstrated commitment to offering local incentives
 - D. Reporting required on annual basis to KDOC by nonmetropolitan region (New Sec. 5 (a)):
 - 1. list of local incentives
 - 2. usage and revenue impact of local incentives
 - 3. other information required by the Secretary of Commerce

- E. Secretary of Commerce to report annually to Governor and Legislature on information from nonmetropolitan regions (New Sec. 5 (b))

Associated Tax Benefits -- HLB. 2681

Tax benefits triggered primarily by type of business; "basic industry" (manufacturing; business services; warehousing; and research and development) targeted by program, as defined in New Sec.1

Benefits of sales tax exemption (K.S.A. 79-3606 (ee)) and job and investment credits are most enhanced for "basic industry" in nonmetropolitan regions, somewhat less enhanced for "basic industry" in other parts of the state, and job and investment credits are available at an unenhanced level (existing law) for all qualified businesses regardless of type. Retail businesses may also be eligible for sales tax exemptions under specified conditions.

I. Nonmetropolitan region

- A. sales tax exemption (basic industry) (New Sec. 2 (a))
- B. sales tax exemption (retail in cities under 1,500) (New Sec. 2(b)(1))
- C. sales tax exemption (retail in downtown area of Kansas Main Street City) (New Sec. 2 (b)(2))
- D. job credit (basic industry) (\$2,000 per year per employee; one time credit; can carry forward; subject to up to 50 percent; net increase of minimum of two employees) (New Sec. 7(b)(1))
- E. investment credit (basic industry) (\$350 per \$100,000 per year for up to ten years; subject to 50 percent maximum) (New Sec. 7(b))

II. All other parts of state

- A. sales tax exemption (basic industry) (New Sec. 2 (a))
- B. sales tax exemption (retail in cities under 1,500) (New Sec. 2(b)(1))
- C. sales tax exemption (retail in downtown area of Kansas Main Street City) (New Sec. 2 (b)(2))
- D. job credit (basic industry) (\$1,000 per year per employee; one time credit; can carry forward; subject to up to 50 percent; net increase of minimum of two employees) (New Sec. 7(c)(1))

- E. investment credit (basic industry) (\$350 per \$100,000 per year for up to ten years; subject to 50 percent maximum) (New Sec. 7(c))

III. All parts of the state, regardless of business type

- A. job credit (\$100 per year per employee; up to ten years; carry forward; subject to 50 percent; net increase of a minimum of two employees) (Sec. 12 which retains existing law)
- B. investment credit (\$100/\$1,000 per year for up to ten years; subject to 50 percent maximum) (Sec. 12 which retains existing law)

IV. Sales tax exemption conditioned upon business:

- A. being "basic industry," pursuant to New Sec. 1 (a)
- B. being retail business subject to criteria in New Sec. 2 (b)(1-2)
- C. having documentation on at least two additional employees
- D. receiving approval from KDOC, if business moves from one city or county to another in Kansas (See Sec. 2(a))

V. Transition language included in the bill to authorize receipt of credits and sales tax exemptions claimed by taxpayers prior to date of bill enactment (New Sec. 8)

VI. Language pertaining to enhanced job and investment credits in existing law stricken (Sec. 12 (c))

VII. Sales tax exemption in K.S.A. 79-3606 (ee) which was incorporated into H.B. 2681 to be decoupled from enterprise zones which are eliminated in this bill (Sec 13)

TOPIC II*

BUSINESS INCENTIVES

Policy Questions

1. Should the state adopt different policies concerning enterprise zones and other select business incentives?
2. Are existing policies directed to most effectively increasing state resources and promoting economic development?
3. Alternatively, should other objectives, such as the rehabilitation of depressed areas or the stimulation of certain types of industry, be targeted by these incentives?

Background

Since their creation, the Economic Development committees have been actively involved in monitoring and evaluating state incentives to businesses. In particular, enterprise zones, private activity bonds, and property tax abatements have been subject to their continued scrutiny. Outlined below is a review of past Economic Development committee actions pertaining to each incentive.

I. Enterprise Zones

The 1987 Joint Committee on Economic Development recommended the introduction of S.B. 470, which would have amended various statutes including those related to the Job Expansion and Investment Credit Act to make that Act subject to the definition of "Kansas basic enterprise." This definition would have excluded retail and support services in favor of primary and export goods and services. The bill died in the House Taxation Committee but its provisions, with amendments, were incorporated into a conference committee report on 1988 H.B. 2909 pertaining to the Kansas Basic Enterprises Loan Program. The definition of "revenue producing enterprise" (Job Expansion and Investment Credit Act) in the report was amended to exclude "services associated with the sale of products at retail and those services provided by attorneys, architects, engineers, accountants, insurance agents, dentists, real estate brokers or individuals licensed by the Board of Healing Arts." Taxpayers must qualify for investment credits as a precondition for qualifying for sales tax exemptions pursuant to K.S.A. 79-3606(ee). These exemptions apply to sales for tangible personal property or services purchased in conjunction with the construction, enlarging, or remodeling of a qualified business facility within an enterprise zone and the sale and installation of machinery and equipment purchased for installation at such a facility. Therefore, the amended definition contained in H.B. 2909 would have affected a taxpayer's eligibility for receipt of both the job credit and the sales tax exemption. The bill was vetoed by Governor Hayden.

The 1988 Joint Committee on Economic Development revisited the subject of the Kansas Enterprise Zones program and recommended introduction of H.B. 2021, which would have made the Job Expansion and

* H.B. 2681 is included in the Appendix at the end of this report.

Investment Credit Act subject to the definition of "Kansas basic enterprise," thus making the sales tax exemption dependent on taxpayer eligibility for the credit subject to such definition. Among other provisions, a reporting requirement was included in this legislation; local units of government which designated enterprise zones must submit reports, with specified information, to the Kansas Department of Commerce on or before February 15 of each year. For its part, the Department must submit to the Governor and the Legislature by March 1 of each year a report containing the information furnished by the governmental units. House Sub. for Sub. H.B. 2021 was enacted and approved by the Governor in 1989. That bill essentially removed all provisions of the introduced version of the bill with the exception of the reporting requirements. The date the Department of Commerce was required to submit an annual report to the Governor and Legislature was changed from March 1 to April 1. The approved bill also contained a procedure governing the transmittal of information from the claimant of the job credit to the Department of Revenue and from the Department of Revenue to the Department of Commerce. The provision concerning that transmittal procedure is scheduled to expire on July 1, 1992.

The most recent bill to be considered by the Legislature is 1991 S.B. 29, sponsored by Senators Winter, Moran, and Rock. This bill would amend K.S.A. 79-32,153 (a) and (b) and repeal K.S.A. 79-32,153 (c) to reduce the enhanced job credits for a qualified business facility within an enterprise zone from \$350 to the standard amount of \$100 for each new employee and \$100 for each investment of \$100,000. In addition, K.S.A. 79-3606(ee) related to the sales tax exemption would be repealed. The bill was referred to the Senate Committee on Economic Development which held hearings on it. A Subcommittee was subsequently appointed to review the bill and make recommendations to the entire Committee, which it did. The Subcommittee report recommends a greater commitment from communities in providing local assistance to recipients of sales tax incentives pursuant to K.S.A. 79-3606(ee). It also recommends, consistent with provisions in previously considered but not implemented legislation, linkage of the definition of "Kansas basic industry" with qualified businesses in enterprise zones whose investors would be eligible for job credits and sales tax exemptions under K.S.A. 79-3606(ee). The Subcommittee report acknowledges the possibility that different criteria for incentives might be appropriate for businesses (also retail businesses) located in enterprise zones within downtown business districts but indicates that time constraints precluded further exploration of that option. Finally, the Subcommittee report recommends an interim review of the criteria for enterprise zone designation, including the option of different criteria for businesses located in downtown business districts.

II. Private Activity Bonds

The 1987 Joint Committee on Economic Development recommended the introduction of H.B. 2645 (subsequently enacted in 1988), which codified an executive order governing the bond allocation practices of the Kansas Department of Commerce. This bill was precipitated by a federal requirement that states take one of the following actions:

1. adhere to the federal formula governing allocation of the state ceiling (now \$150 million);
2. adopt an alternative formula to be proclaimed by the Governor; or
3. enact legislation specifying the allocation formula to be used by the state.

As the executive order governing the state's formula was scheduled to expire on December 31, 1987 and the federal bond allocation formula was considered to be complex and unworkable, the Committee opted for state legislation. The state's allocation formula called for the reservation of \$5 million for qualified student loan bonds, \$5 million for the private activity use of a portion of the proceeds of bonds issued by governmental issuers, and \$25 million for qualified small issue bonds.

The Economic Development committees addressed the Private Activity Bond Allocation Act once again in 1990, when S.B. 667 was referred to them for their deliberations. That bill, which also was enacted in

1990, accelerated the date in that year for the reservation of the amounts to be allocated for specific types of private activity bonds, as based on the state's allocation formula.

III. Economic Development Exemptions

The 1989 Joint Committee on Economic Development studied the issue of economic development exemptions and recommended introduction of S.B. 440. This bill, which was enacted in 1990, prescribed limitations upon the authority of a county or city to grant certain property tax exemptions for economic development purposes under provisions of Article 11, Section 13 of the *Kansas Constitution*; imposed certain requirements upon owners of exempt property; authorized the exemption of certain rented or leased property from property or ad valorem taxation; and required the written notification of unified school district boards prior to approval of agreements for property tax abatements to be financed by issuance of industrial revenue bonds.

Committee Activity

The Committee heard presentations on enterprise zones, industrial revenue bonds/private activity bonds, and economic development exemptions. In addition, the Committee heard a presentation by Professor Jarvin Emerson, Kansas State University, on "The Dynamics of Industry and Firm Change." That presentation focused on the formation of new firms and the retention of existing firms, and examined how net business formation compares with the expansion and contraction of ongoing firms. A staff memorandum explored the strategies used by states in recruiting firms, comparing a competitive approach to a regional cooperative approach. The memorandum also examined the merits of targeting incentives to particular industrial sectors and regions in the state. As with the background information, the discussion on Committee activities is divided into distinct categories.

Enterprise Zones

A report by the Institute for Public Policy and Business Research (IPPBR) disclosed the following findings:

1. between one-half and three-fourths of the new and expanding manufacturing activity in the state occurs within the boundaries of enterprise zones;
2. larger establishments are more inclined to seek out enterprise zone locations;
3. zone activities are concentrated around urban areas and in the eastern part of the state;
4. overall, there is not much evidence that the Kansas program targets low-income or low-growth communities effectively; and
5. the Kansas Enterprise Zone program is more of a general industrial recruitment incentive than an incentive for development in the most distressed areas of the state.

The IPPBR report also outlined the salient characteristics of three state enterprise zone programs offered in Colorado, Indiana, and New Jersey. It concluded with the identification of guiding principles for enterprise zone programs:

1. zones should be designed to be targeted toward distressed areas;
2. they should focus on new jobs and investment;
3. the number of zones should be limited and selected on a competitive basis;
4. an enterprise zone should fit into an area's overall economic development strategy;
5. incentives should be big enough to make an impact (for example, one study noted that sales tax exemptions were important to firms in the start-up phase);
6. enterprise zone benefits should be targeted to basic industries; and
7. an enterprise zone program should have a built-in means for evaluation.

The Secretary of Commerce reported that confidentiality of tax return data makes it difficult for the Department to glean the true cost of the Kansas Enterprise Zone program to the state and thus to incorporate meaningful data into the annual report required for submittal to the Legislature and Governor. In addition, the Secretary observed that the statement of legislative intent attributable to the Kansas Enterprise Zone program was vague and, therefore, raised questions about the intended meaning of "economically distressed," as those words modify zone areas, and the method of evaluating success in meeting program intent. Finally, the Secretary questioned the contention that there are too many zones designated within the state. The Secretary justified the program as an important component of state and local economic development efforts, but recognized the existence of deficiencies in the program. These deficiencies were reflected in:

1. the ability of a city or county to continuously amend the zone designation, the variety of ways in which existing designations may be changed, and the flexibility a city or county has to "compose" zones to meet the required criteria;
2. out-of-date criteria governing zone designation (the lists of criteria established by HUD's Urban Development Action Grant program were last published in October, 1987) and problems with criteria related to population decreases of 10 percent for any ten-year period after 1970 and limitations of 25 percent of the land area, as well as the nonuniform impact of unemployment and low-income factors on determinations for zone designation;
3. the need for documentation by governing bodies of cities and counties that make determinations about substantial deterioration, abandonment, or demolition of commercial or residential structures in the area;
4. the questionable meaningfulness of local incentives; and
5. questions about legislative intent concerning the establishment of swine confinement facilities in enterprise zones after the zone has been approved.

After raising the above concerns, the Secretary made 11 specific recommendations to address those concerns.

Staff reviewed the actions of the Joint Committee on Special Claims Against the State as they have related to claims presented to the Committee for return of sales tax paid on projects completed in enterprise zones. One conclusion from staff's examination of the claimants was that both large and small businesses had failed to comply with the law and had cited the same rationale in support of their refunds -- inaccurate information provided to them at the outset of their projects. A staff memorandum on recent legislative activity on enterprise

zones recounted the actions of the 1987 and 1988 Joint Committees on Economic Development and the 1991 Senate Committee on Economic Development to restructure the Enterprise Zone programs. (See background section on Enterprise Zones.)

Representatives from the Kansas Chamber of Commerce and Industry, the Kansas Association for Small Business, and the Kansas Industrial Development Association responded to questions submitted to them prior to the meeting. The consensus of conferees was that the Kansas Enterprise Zone program and associated benefits have been instrumental in ensuring the competitiveness of Kansas firms with out-of-state firms. Conferees opposed exclusion of zone designation from the wealthiest parts of the state. The representative from the Kansas Association for Small Business did not oppose restricting the program to Kansas basic industries, a position which was not shared by the Kansas Chamber of Commerce and Industry. The representative from the Kansas Industrial Development Association took the position that enterprise zone incentives should be extended to all basic industries, regardless of location.

Fiscal information presented by the General Counsel, Kansas Department of Revenue, disclosed that in CY 1990, the total amount processed and allowed for credits associated specifically with investments in enterprise zones was \$557,483, and for sales tax exemption certificates, \$8,604,526. The total for processed and allowed credits and exemption certificates in CY 1990 was \$9,162,009.

A subcommittee was appointed during the 1991 interim to suggest changes to the existing laws governing the Kansas Enterprise Zone program and associated tax benefits.

Industrial Revenue Bonds/Private Activity Bonds

As part of its review of business incentives, the Committee heard a presentation by Joe Norton, Gilmore and Bell, on federal and state laws concerning Internal Revenue Bond financing in Kansas. The Committee was informed that the Tax Reform Act of 1984 and the Internal Revenue Code of 1986, as amended by the Revenue Reconciliation Act of 1990, have severely limited the types of IRBs that may be exempt from federal taxation. In order to receive a federally tax-exempt issue, the issuer must obtain an allocation of the state's "Private Activity Volume Cap," \$150 million annually for Kansas. The Private Activity Bond Allocation program is administered by the Kansas Department of Commerce.

A Legislative Post Audit report on *Reviewing the Department of Commerce's 1991 Bond Allocations* (March, 1991) was presented to the Committee. That report disclosed that there are seven types of private activity bonds defined by federal law, but only three types have been used in Kansas in recent years: qualified mortgage bonds, qualified small issue bonds, and exempt facility bonds. Aggregate allocations from these bonds cannot exceed \$150 million annually.

Qualified mortgage bonds include: mortgage revenue bonds, mortgage credit certificates, and qualified veterans' mortgage bonds. For this type of bond, the issuer does not have to make an informational filing with the Board of Tax Appeals. Qualified small issue bonds are issued for manufacturing facilities and are industrial revenue bonds. Authority to issue tax-exempt IRBs for this type of facility expires on December 30, 1991. Such authority may be renewed but will require an affirmative act of Congress. For this type of bond, the issuer has to make an information filing with the Board of Tax Appeals. Exempt facility bonds are, for the most part, industrial revenue bonds which can be used for the following projects: airports, mass commuting facilities, sewage and solid waste disposal facilities, and qualified residential rental projects. For those exempt facility bonds which are IRBs, the issuer has to make an informational filing with the Board of Tax Appeals.

The Legislative Post Audit report on bond allocations recommended several procedures for increasing accountability on the part of the Kansas Department of Commerce. The agency was informed of the following:

1. It should provide general notice about the program and about the deadlines for making applications to all potential applicants.
2. It should develop standard criteria for evaluating applications and authorizing localities to issue tax-exempt bonds. These criteria could include such items as who is eligible to apply; the documentation required to support an application; and the priority factors to be considered in approving applications. The criteria that will be used should be communicated to all those who apply under the program.
3. It should develop formal policies and procedures for processing applications. At a minimum, these policies and procedures should fully describe how the Department will carry out the allocation process, and should specify the types of records that will be maintained to document the Department's actions and decisions related to the program.
4. If the Department plans to use an advisory committee to help evaluate applications, the membership on that committee should include locally elected officials.

The Secretary of Commerce provided an update of the Department's activities related to private activity bond allocations. She also explained the new administrative policy of the Department to impose a cap on single-family housing projects at \$75 million. Over the past several years, approximately \$100 million has been designated for single-family housing in the early part of the allocation year. The Secretary justified this policy change by noting that industrial development bonds (bonds for manufacturing purposes) should be the state's first priority for usage of the Private Activity Bond authority which would enable the Department to use these bonds as business recruitment tools. In addition, the Secretary informed the Committee of the Department's intent to impose a fee on applications for bond allocations.

Property Tax Abatements/Economic Development Exemptions

An issuer (city or county) may exempt from ad valorem property taxes any facility owned by that issuer to the extent that the facility is purchased or improved with the proceeds of the issuer's IRBs. (Exceptions to the exemption apply to poultry confinement and rabbit confinement facilities.) The maximum period for property tax exemptions under the statute is ten calendar years. Property tax exemptions associated with IRB issues are not subject to the restrictions accompanying Article 11, Section 13 of the *Kansas Constitution* (economic development exemptions).

Economic development exemptions are authorized by the 1986 amendment to the *Kansas Constitution*. These exemptions are applied to real or personal property that are used exclusively for:

1. manufacturing articles of commerce;
2. conducting research and development; and
3. storing goods or commodities which are sold or traded in interstate commerce.

The provisions of 1990 S.B. 440 (discussed in the background section) have the effect of limiting the exemption amendment. The State Board of Tax Appeals must approve the exemption but, according to Jack Shriver, Chairman of the Board of Tax Appeals, the Board's consideration is limited to determining whether the business meets the constitutional or statutory guides for exemption. An Attorney General's opinion established that the Board may not determine whether economic development will occur as a result of the exemption.

Mr. Shriver noted several problems he had experienced with authorization by cities of economic development exemptions. According to Mr. Shriver, a city resolution (a precondition for exemptions) often contains no description of the property or the specific dollar amount exempted. On some applications, the property will be replacement equipment, and there will be no evidence that employment increased due to the new acquisition. Other problems involve failure by the city to: conduct public hearings; adopt written policies implementing economic development exemptions; compile a cost-benefit analysis; and file an application for exemption with the Board of Tax Appeals. A city might recommend that any business, regardless of use (e.g., retailers), be given an economic development exemption. In some cases, applicants for exemptions cannot link purchases made over a period of time with projects and increases in employment.

Statutory problems were addressed in an article from the *Washburn Law Journal*, titled "Spurring Economic Development in Kansas Through Property Tax Exemptions -- Are We Getting the Results We Want?" (Vol. 30, No. 1, 1990). The article also raises concerns specific to 1990 S.B. 440. First, the legislation attempted to prevent pirating by local officials of businesses between taxing districts. However, this only applies to pirating of personal property. A business can still move across county lines to obtain an exemption for real property and improvements without a requirement of factual determination. Second, although there is a requirement for local governing bodies to develop and conduct a cost-benefit analysis, this does not mean that analyses developed and implemented will be accurate. Local governments may lack the objectivity and an accurate statistical model to make such determinations. Nor does the law require the denial of an exemption if the related costs outweigh benefits.

Broader Context for Business Incentives

The policy question about whether state resources most effectively increase state resources and promote economic growth must be considered within the context of industry and firm change. If incentives are designed to target to strengths or weaknesses in the economy, one must be able to identify those economic and geographic areas of growth and contraction. A study by M. Jarvin Emerson (presumably, the first of several) provides a profile of the types of Kansas businesses which start up or leave the state, in addition to the salaries, the employment, and the location of such firms, for a five-year period from 1985 through 1989. Based on the data collected, Emerson was able to conclude the following (not an exhaustive list of conclusions):

1. metropolitan areas experienced significant gains from net business formation, while nonmetropolitan counties as a group had substantial losses from net business formation;
2. compared with the growth of ongoing firms, the net effect of employment growth of firms starting and quitting was small; however, for most service and manufacturing sectors, the contribution to employment growth was significant;
3. small firms dominated the number of starts, but larger firms were the major employers;
4. the service sectors of business services, health services, engineering, and accounting services experienced the largest net gains in employment and wages from firms starting and quitting;
5. the largest manufacturing sectors which experienced net gains were machinery and computer equipment manufacturing, fabricated metal products manufacturing, and transportation equipment manufacturing, while the largest net loss was food and kindred products manufacturing; and
6. the largest net losses of employment and wages from starting and quitting firms was in crude petroleum and natural gas, oil and gas field services, and motor freight and warehousing.

A staff memorandum examined two approaches used by states and localities to recruit businesses -- cooperation and competition -- and analyzed the implications of each strategy. This memorandum further identified activities of other states in promoting a cooperative strategy on a regional basis. These activities included:

1. identifying policy areas in which cooperation and joint efforts among states within a region would be mutually beneficial;
2. once a multi-state council or regional organization has been established, identifying policy areas in which pooled state resources could be used to leverage federal or private funds;
3. identifying the key industries in a state and capitalizing on those industries; and
4. identifying areas for technology transfers and a mechanism for accomplishing such transfer.

Committee Conclusions and Recommendations

The Joint Committee on Economic Development focused its recommendations on significantly restructuring the Kansas Enterprise Zone program and amending the associated tax benefits of job expansion and investment credits pursuant to K.S.A. 32,1521 *et seq.* and sales tax exemptions pursuant to K.S.A. 79-3606(ee).

The Committee adopted, with several modifications, a report drafted by a subcommittee which was assigned by the Chairperson during the 1991 interim to examine options for the Kansas Enterprise Zone program and offer recommendations for change. This report necessitated the introduction of legislation to realize its provisions.

The Committee notes that major changes to the program are needed because: (1) the existing Enterprise Zone program provides state incentives to businesses which have expanded or located in zones and were, in many cases, unaware of the availability of such incentives; (2) there is very little commitment exacted from local units of government to complement state tax benefits; (3) state tax benefits are provided to all types of businesses whether or not such businesses actually contribute to the long-term economic growth and prosperity of a community or region; and (4) the existing Enterprise Zone program sets forth criteria for zone designation based on factors related to poverty, unemployment, and economic distress but has generally been used as a recruitment tool, thus raising the question of actual program intent.

The Committee's proposal for a replacement program would generally be used for purposes of business recruitment, although certain components of the program would be targeted to revitalization of nonmetropolitan areas of the state.

The major conceptual difference between the existing Enterprise Zone program and the proposed program is that in the existing program enhanced job credits, investment credits, and the sales tax exemption (K.S.A. 79-3606(ee)) are dependent upon the location of qualified businesses within designated enterprise zones, whereas in the proposed program the type of business (if it meets expansion and investment criteria) is the overriding factor in determining a business' eligibility for enhanced job and investment credits, and it is a major factor in determining eligibility for the sales tax exemption. It should be noted, however, that the unenhanced level of job and investment credits pursuant to K.S.A. 79-32,153(b) still would be available to those businesses eligible for such credits under existing law.

Essentially, sales tax exemptions pursuant to K.S.A. 79-3606(ee) are available to all businesses, regardless of their location in the state, provided that these businesses are manufacturing, warehousing, business services, and research and development enterprises. All these businesses would be identified by standard industrial classification (SIC) codes, specified in statute. In order to receive sales tax exemptions, businesses would have to provide documented evidence of job expansion involving, at a minimum, the addition of two full-time employees.

If such businesses come from out-of-state or move from one site to another within a city, such businesses would apply directly to the Kansas Department of Revenue (KDOR) for exemptions. For all other eligible businesses, the approval of the Kansas Department of Commerce (KDOC) is a necessary precondition for receipt of the exemptions.

Although sales tax exemptions pursuant to the provisions of K.S.A. 79-3606(ee) would be generally restricted to "basic" enterprises which comply with specified SIC codes, retail businesses could also qualify if they (1) locate and expand in communities of 1,500 or less, as determined by the latest U.S. Federal census, or (2) if such businesses locate or expand in a downtown area of a Kansas Main Street Program administered by KDOC. Therefore, geographic restrictions govern eligibility of retail businesses for sales tax exemptions.

Businesses may also receive job expansion and investment credits if they are manufacturing, warehousing, business services, and research and development enterprises identifiable by the same SIC codes as businesses eligible for sales tax exemptions pursuant to K.S.A. 79-3606(ee). However, retail businesses may not receive these credits under any circumstances.

Investment credits pursuant to K.S.A. 79-32,153(c)(3) would be available to "basic" enterprises regardless of their location in the state. A one-time jobs credit equal to \$1,000 per certified full-time employee (a net increase of a minimum of two employees is required) would be available to qualified "basic" enterprises regardless of that enterprise's location in the state. However, an enhanced job credit (\$2,000 per certified employee) would also be available to those qualified enterprises which are located within nonmetropolitan regions of the state designated as such by KDOC. (For both types of job credit, an eligible business would be subject to restrictions governing the percentage of income tax for which a credit may be claimed in any taxable year, as well as recertification requirements.) These regions, which would replace existing enterprise zones, must be composed of one or more nonmetropolitan counties, as prescribed by statute, and each region must satisfy the criteria of having a regional economic development organization and a regional strategic plan (both approved by KDOC) and demonstrated local support. Each region also would be required to submit an annual report to the Secretary of Commerce which includes certain statutorily prescribed items.

Under all circumstances, businesses would apply directly to KDOR for sales tax exemptions and job and investment credits, as KDOR would have all the necessary information on: SIC codes; updated lists of communities with populations of 1,500 or less and communities participating in the Kansas Main Street Program (to determine eligible retail businesses for the sales tax exemption); and lists of designated regions (to determine eligibility for the enhanced jobs credit). However, as noted above, businesses applying for sales tax exemptions which move from one city or county within the state to another city or county within the state also would require KDOC's approval.

To conclude, the Committee believes that the proposed program might accomplish the following: (1) serve as part of a recruitment package; (2) encourage more planning and regional cooperation as well as local commitment by extending incentives to businesses within communities which participate in the Main Street program and to those located in communities which participate in designated regions; and (3) support nonmetropolitan business development at an enhanced level while, at the same time, encouraging metropolitan business development.