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Testimony of Commerce Secretary Pat George
Responses to Economic Development Questions

Senate Commerce Committee

8:30 a.m., Tuesday, Jan. 31, 2012
548-S The Statehouse

Good morning, Madam Chairwoman, and members of the Committee. Per your request, I am submitting written responses to questions resulting from testimony I gave on Jan. 17 about economic development activities at the Department of Commerce. The questions and responses follow:

1. Can you expand on the new job creation evaluation process/common score card?

Upon the transfer of the Kansas Technology Enterprise Corporation (KTEC) into the Department last year, and the implementation of the Keeping Kansas Competitive engineering grants, our staff began to develop a series of performance metrics in order to track the effectiveness of these programs. This process has since evolved into the "Common Scorecard." The scorecard represents a select group of key economic indicators that can be applied across various organizations, such as the Department's partners in the Innovation Growth Network, the Centers of Excellence and Entrepreneurship, NetWork Kansas, the Kansas Small Business Development Center (KSBDC), and to the various grant programs the Department administers at the university level. The scorecard can even be used to evaluate the Department itself.

The goal is to report and track these initiatives with key drivers such as revenue earned, capital attracted, research dollars and grants raised, employment statistics and value of equities, which are all indicators of wealth creation and sustained growth. Furthermore, the measures selected for the scorecard are in alignment with the Gov. Brownback's Economic Development Roadmap, which calls for increasing net personal income, increasing private sector employment and leveraging university assets as engines of economic growth for the benefit of Kansans.

Department staff has been meeting with the leadership of these institutions over the past several months to craft a scorecard that can reflect their unique missions, while appropriately benchmarking across specific indicators. To supplement the scorecard, each organization will produce a summary of their particular strategy and how it relates to the overall economic development environment in Kansas.

The next page shows a draft of what the scorecard might look like:

Senate Commerce Committee
Date: January 31, 2012

Attachment 1

ECONOMIC GROWTH DRIVERS	RESULTS				TARGETS		
Category	Baseline CY 2010	Current YTD 2011	Forecast CY 2011	Baseline to Date	CY 2014	CY 2017	CY 2019
REVENUE EARNED							
Revenue from Partnerships							
Licensing Revenue							
Company Revenue Growth							
Other Earned Revenue							
CAPITAL ATTRACTED							
Industry/Private Sector Sources							
Philanthropic Sources							
RESEARCH DOLLARS/GRANTS RAISED							
Research Expenditures							
Industry Funding							
Federal Awards							
Philanthropic Awards							
EMPLOYMENT							
Companies Attracted/Formed							
Employment							
Payroll							
Average Annual Wage							
VALUE OF EQUITIES							
Market Value of Equities							
Cost of Equities							
Profit from Exits							
CUMULATIVE STATE INVESTMENT							
TOTAL UNFACTORED RETURN							
CUMULATIVE RETURN ON INVESTMENT							

I welcome the Committee's input on the approach to the scorecard, and I intend to keep the Legislature updated throughout the scorecard's development and implementation process.

2. What do other states' "economic development tool boxes" look like?

Kansas competes regularly with Arkansas, Iowa, Missouri, Oklahoma and Texas. Colorado, Florida, Georgia, North Carolina, South Carolina and Tennessee also compete to some degree with Kansas on projects. In addition, Colorado has more green energy incentives that have helped the state win more alternative energy projects.

I have highlighted some of main features of the economic development programs of the states most competitive with Kansas:

<u>Arkansas</u>

- The industrial revenue bonds loan guarantee program has been cited by companies as a reason for locating projects in Arkansas over Kansas.

- The Create Rebate Program provides annual cash payments based on a company's payroll for new full-time permanent employees. Kansas lost companies to Arkansas because of this program before the Promoting Employment Across Kansas (PEAK) incentive was implemented.

Iowa

- Iowa has a single-factor, non-unitary tax, which is based only on the percentage of total sales income within the state versus a three-factor tax on property, payroll and sales.

- The state allows a 50 percent deductibility of federal taxes from corporate income.

- The purchase of computers assessed as real property and used to process data by insurance companies, financial institutions, or certain commercial enterprises, is exempt from Iowa sales or use tax. This has been effective in the recruitment of data centers and has been mentioned by companies for choosing Iowa over other states. In Kansas, this is only possible if projects qualify for the High Performance Incentive Program (HPIP) and stay HPIP-certified. Companies have to pay the sales tax upfront and get reimbursed in Kansas, which is a great deal of output initially for companies, as data centers have a typically large capital investment.

Missouri

- Missouri is a lower tax state than Kansas, as cited in a recent tax study completed by Ernst & Young for Arkansas.

- The state's Quality Jobs Program is similar to the state's PEAK program. Missouri's program allows for a combination of withholding tax retention over a period of years, and tax credits can be sold, transferred or assigned.

- The ability to sell or transfer tax credits in Missouri has been an advantage for companies in that state for many years, as not all tax credits can be used (companies may have more tax credits than liability), so the ability to sell or transfer adds more value to them for competitiveness.

- Chapter 353 Bonds allow for the reduction of real property tax for a period of 25 years. Kansas is limited by law to 10 years of property tax abatement on projects.

- The Federal Income Tax Credit allows a 50 percent deduction of federal income tax payments before computing taxable income. This deduction is not available in Kansas.

- The Manufacturing Jobs Act was passed specifically for the Ford plant in Missouri, which is generating more than $1 billion in new investment. The act allows a qualified manufacturing company, beginning Jan. 1, 2012, to retain 100 percent of the withholding taxes from full-time jobs at the facility for 10 years if it manufactures a new product, or to retain 50 percent of withholding taxes from full-time jobs for seven years if it modifies or expands the manufacture of an existing product. In addition, the law allows a qualified supplier to retain 100 percent of the withholding taxes from new jobs for three years. If the qualified supplier pays wages for the new jobs that are equal to or greater than 120 percent of the county average wage for Missouri it can retain the withholding taxes for five years.

Oklahoma

- Oklahoma Quality Jobs program is a withholding tax retention program similar to the Kansas PEAK program and allows retention for up to 10 years. Oklahoma was one of the first states to create this program, and companies frequently comment on how much they like its value.

- Oklahoma has an abundance of Native American land, and there is special federal tax credit allowed for employing Native Americans on such land (quoted as $4,500 per job). This credit has been cited by companies that are considering Oklahoma for projects.

- The cost of labor in Oklahoma is typically lower than in Kansas, according to companies considering projects in metropolitan areas.

- Oklahoma is considered an overall low cost state for business when considering various tax factors.

Texas

- The Texas Enterprise Fund is a deal closing cash fund. The state has awarded more than $300 million from this fund since 2004. This incentive can be very effective, and Kansas has lost projects to Texas when this cash fund was used.

- The state has no corporate income or personal income tax.

- The availability of labor, along with low labor rates in Texas, especially in San Antonio, has caused the state problems in winning projects, especially when that community competes with the Kansas City area. The availability of all types of skilled labor also has been an issue when Kansas competes with Dallas, given its population and growth.

- On the local level, Texas communities can participate in a sales tax program that allows them to collect the locally generated sales tax revenues and provide that as cash to companies. This is similar to what Topeka and some other communities in Kansas can do, but it seems more widely used in Texas.

As a final comment on state incentive programs, my business development staff has reported that the major emphasis in state incentive programs has been to create or increase funding for "deal closing" funds. For example, Wisconsin will establish such a fund with $68 million, and Florida is increasing the budget for its deal closing fund.

3. What is the Commerce Department doing to promote the five main target industries for Kansas, and does the Department have a calling program?

The Brownback Administration has targeted agriculture, aviation, renewable energy, life and animal sciences and professional services (such as engineering firms, etc.). Also note that the Department's business development activity is not limited exclusively to these sectors.

The Department is represented annually at trade shows in these target markets, including the BIO show in Boston, Wind Power show in Atlanta, National Business Aviation Association show in Orlando and the Solar Power International conference and trade show in Dallas, as well as the Warehouse Education Research Council show for distribution services. The Department follows up with a direct mailing to contacts in these target industries.

The Department's Innovation Growth Program, launching statewide in Fiscal Year 2013, has a growing outbound component. This program focuses on growing and attracting companies by using universities and other natural Kansas advantages as assets. As this program's pilot organization, Kansas State University's Institute for Commercialization (KSUIC) has been identifying intellectual property and other university capabilities as the basis for partnerships with companies around the world. KSUIC researches and contacts companies that are likely to be interested in working with the university for purposes of creating wealth. For example, the university's agreement with one company is built around KSU's animal testing expertise and is bringing more than $1 million in licensing and service agreement revenue to the university in 2013 alone. Jobs are being created for clinicians and administrative personnel as a result.

4. Is the Kansas economic tool box more focused on manufacturing?

The Department's incentives tend to support more projects in the manufacturing industry as opposed to, for example, office projects. High-level manufacturing projects are a good fit for the Kansas workforce, and when combined with the state's "right-to-work' status, provides a competitive edge.

Office based companies have more requirements they have to meet in order to qualify for programs. For example, companies typically have to meet an out of state revenue requirement for HPIP. If they do not meet those requirements, then they can no longer get the sales tax exemption on machinery and equipment, as the Enterprise Zone sales tax exemption was eliminated at the end of 2011. In addition, manufacturers benefit more from the personal property tax exemption since they tend to have more machinery and equipment. Their machinery is exempt from sales tax by state statute, and they benefit from the integrated plant standard that offers other sales tax exemptions for pre- and post-production activities.

Overall, however, it is to Kansas' advantage to allow its incentives to be available for a wide variety of companies to balance out the state's economy and strong manufacturing base. Office and professional service companies typically pay fairly high salaries to their workforces, especially in Johnson County.

A new initiative under development is a statewide manufacturing strategy, through the National Governors Association's Manufacturing Policy Academy. In partnership with the Wichita State University College of Engineering and the Mid-America Manufacturing Technology Center (MAMTC), the Department is convening a series of roundtable discussions throughout the state to bring together manufacturers, suppliers, and community and university representatives to discuss the issues faced by this sector.

The Policy Academy will give participating states a deeper understanding of their states' manufacturing-related industries and fast-growing industry clusters by helping to evaluate and address the major policy and implementation challenges, as well as the opportunities in each state for world-class manufacturing and future success in the global economy.

The Policy Academy also will help each state develop a plan and overcome barriers to improving the general environment for innovation, as well as align state research and development investments, workforce development, and education systems with the current and future needs of the state's advanced manufacturing industries.

5. What types of companies does the state have tools to compete for, and what areas would the state be weak?

The state's incentive programs cover a variety of industry types, but mostly exclude retail and non-profits. Some of the state's programs can be offered to non-profit organizations if they involve an expansion or relocation of the national headquarters of those organizations.

In an environment where there are fewer tax credits and incentives, by virtue of the proposed reduction in individual income tax rates, Kansas must use other resources to expand the economy. The Innovation Growth program is designed for this purpose.

A "Strategic Opportunities Team" is being organized to proactively identify companies that would benefit from existing state strengths and assets. These companies are a mix of existing Kansas companies seeking to expand and out-of-state companies that would gain an advantage by establishing a presence in Kansas. This team includes members of the Department and select university centers of excellence and centers for entrepreneurship.

The Department also is developing ways to coordinate and utilize existing programs around the state that are designed to help existing companies grow and add new jobs. These programs are currently funded through the Department's budget – KSBDC, MAMTC, NetWork Kansas, University Centers of Excellence and Centers for Entrepreneurship – but they are not always working together as part of a larger economic development strategy for Kansas.

In addition, there are other areas of economic development that deserve focus and discussion:

- The state should build up the Job Creation Fund to put more cash into projects, including those related to small businesses with the potential to grow.
- Kansas should do more to help small businesses, such as manufacturers and professional services companies. Many professional services companies, like law firms, cannot be offered incentives even though they pay high wages and have a national client base because of the recent changes in HPIP to a minimum capital investment to $1 million. If a professional services company

cannot qualify for HPIP, it no longer qualifies for a sales tax exemption for build out or office furniture since the Enterprise Zone exemption has ended.

- The state has the limited ability to offer incentives for some companies that pay decent wages but miss the PEAK standard in a higher wage county.

- Incentive packages from Kansas can be weak for projects with large, upfront investments but few employees, like data centers or automated distribution facilities, if the HPIP tax credits are not all usable by the company (because the credits cannot be sold or transferred). The Department is currently facing this situation with a project that can only use $1 million of a $9 million HPIP tax credit offer. The company in question is looking to the Department for other incentives to make up the remaining $8 million.

- Limited funds available for workforce training. Kansas Industrial Training (KIT) and Kansas Industrial Retraining (KIR) funds have been reduced because of budget cuts in recent years and the Investments in Major Projects and Comprehensive Training (IMPACT) program was eliminated.

- Limited incentives for nonprofit organizations. PEAK is only available to nonprofits if the project involves a national headquarters. The Department's training programs, as currently structured, cannot be offered to nonprofit organizations.

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