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Third Frontier Ballot Initiative Broadens State Bond Issuance Authority

Policy Matters Ohio Report Explores Fiscal and Legal Implications

State Issue 1, a constitutional amendment on the November 4th ballot, would broaden the ability of the state, universities, and local governments to issue bonds for research, development and technology commercialization. A new report issued today by Policy Matters Ohio, a non-partisan policy research institute, outlines how the amendment will mean important changes in public sector ability to help private economic development. Policy Matters Ohio does not take a stance for or against Issue 1.

The report argues that approval of State Issue 1 would open a new era in Ohio's economic development policy. Both state and local governments would be empowered to devote more resources to research and product commercialization efforts and to engage in partnerships with the private sector that are far closer than those that exist today.

A "yes" vote will allow the legislature to authorize the state to issue up to $500 million in general obligation bonds over the next decade to support the development of technology-based industry. The white paper, *Exploring the Third Frontier: Constitutional and Fiscal Implications of Issue 1*, explains that the amendment will accomplish a good deal more than authorize the bond issue:

- The amendment permits state and local governments to use other forms of revenue, not just bond proceeds, to assist private companies with research and commercialization. This authority is permanent. Permitted support could include grants, loans, loan guarantees, advances, direct investments, or in-kind contributions of personnel or property.
- The bonds will be backed by the state's "full faith and credit" and the state will be obligated to pay such debts regardless of state fiscal conditions. This could result in the state making long-term financial commitments it cannot modify during a financial crisis. Meeting these obligations may come at the expense of social services, education, and other discretionary programs. Currently, the state, but not local governments, can issue general obligation bonds to finance research that increases the use of Ohio coal. Otherwise, the Ohio Constitution only permits the state to take on debt to finance direct aid to the private sector by using "revenue

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bonds." Revenue bonds use non-tax receipts, such as the state's profits from its liquor monopoly, to repay bondholders.

- ♦ State universities and local governments also may issue bonds, subject to the rules established by the General Assembly in implementing legislation. The General Assembly will have the task of deciding what types of bonds may be issued (revenue or general obligation), in what amounts, and for which specific purposes.
- ♦ In recent years the state has made grants to venture and seed capital firms without becoming a stockholder or requiring a financial return from firms' investments. The amendment creates an exception to constitutional provisions that prohibit the public sector from becoming a stockholder in a private business. These prohibitions have been in the state constitution for over 150 years. As an investor, the public sector could share in any gains that result from its investments, and would be better able to ensure that companies' actions conform to the public interest. These positive outcomes must be balanced against the risk that public funds are wasted and do not produce economic returns for the state.
- ♦ For decades, public sector economic development programs have focused on facilities and equipment. The amendment clarifies the public sector's constitutional authority to support operating expenses and to finance projects designed to create or acquire intellectual property. Although some state programs support these activities, current constitutional sections are not explicit, and the state's authority rests primarily on Attorney General opinions that have not been tested in court.
- ♦ Bond payments likely will be subject to federal income tax because some of the proceeds will benefit private industry. Therefore, the state will pay a somewhat higher rate of interest than with other general obligation bonds. Using Office of Budget and Management estimates made for the most recent state operating budget, the state would pay $190 million in interest over a twenty-year period if it issued $50 million in bonds each year for ten years at a 6.5% interest rate.

"Given the state's economic climate, and the perception that the state is falling behind, Ohioans may be ready to support this policy approach," said Zach Schiller, Policy Matters research director. "On the other hand, such broad-based expansion comes with risks that must be weighed carefully."

The proposed amendment removes long-standing constitutional barriers that prevent the public sector from becoming a stockholder in private businesses. If the amendment is approved, Policy Matters says, it is vital that state and local governments work hard to ensure that programs to support research, venture capital, and product development achieve their intended results.

Exploring the Third Frontier summarizes the proposed amendment, explains how bond proceeds might be used, examines trends in the state's debt service levels, and explores how the amendment will change the state constitution. The report is available online at www.policymattersohio.org.

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