

Testimony to the House Ways & Means Committee on House Bill 511

Zach Schiller, Research Director

Good morning, Chairman Beck, Ranking Member Letson and members of the committee. Thank you for the opportunity to testify today about House Bill 511. Policy Matters Ohio is a nonprofit, nonpartisan research institute with offices in Cleveland and Columbus.

I believe that this legislation needs serious, detailed consideration and that it is premature to vote on it today. That is because there are key questions related to this bill that have not yet been answered. Specifically, is the venture-capital program as structured the best vehicle for accomplishing economic development and creating more good jobs in Ohio? And is it structured in a way that as much benefit as possible flows to Ohio, and not to investors and companies in other states?

As you know, this program depends on state tax credits, which support the issuance of debt that is then provided to various venture-capital funds. The state has not yet had to issue tax credits and will only do so if the investments that are made do not generate a sufficient return to pay off the bonds. The bill calls for an increase in the annual tax-credit limit from \$20 million to \$26.5 million. Based on the current program, the state can be liable for a total of up to \$380 million. My understanding is that in its final form, the bill will allow that liability to grow to \$550 million. This is a very significant liability, and the program should be carefully analyzed before the General Assembly approves such an increase.

Proponents of the program will argue that tax credits have not been issued, that that won't happen, and that this program is "free." I certainly hope that the state never has to issue any tax credits. Investment returns have improved over the past year. However, it is not plausible that this is a cost-free program. There is no free lunch here. Just because this is an off-balance sheet liability does not mean it is *not* a liability. If this were a free program, why would we limit it to \$550 million? Why not make it \$1 billion, or more? I think we know the answer. This is a call on the resources of the state, even if we have avoided an out-of-pocket expense.

Since the Ohio Venture Capital Authority was created by the General Assembly in 2003 and the first funds were invested in Fiscal 2006, a total of 766 new jobs have been created. That does not constitute a large number in relation to the more than \$100 million committed to venture funds under the program and its six years of operation. Fund supporters argue that the investments also help retain jobs by allowing companies to meet payroll. However, in light of the job performance, we believe the program needs evaluation, not immediate expansion.

As you know, Ohio law requires that those venture-capital funds that receive money must invest half of the proceeds in Ohio-based companies. Program proponents note that for each dollar invested, \$6 has been invested in Ohio companies. However, this program is not making good on its promise that firms receiving the money invest most of it in Ohio. Of the 25 venture funds that have gotten funding, 11 have not invested 50 percent of the funds in Ohio. A number of those have not invested a single dollar in Ohio. The state of Ohio, through the contingent tax credits that allowed this money to be raised, is supporting venture firms that take the money and invest it outside Ohio.

The program aims to bring funds from national venture-capital firms into Ohio. It has done some of that, and the venture-capital industry argues that a prohibition on investment of program funds outside the state would keep the program from being able to operate successfully. But three of the four non-Ohio firms that have received funds through the program have not invested in Ohio at all. While their investments may contribute to the financial success of the overall fund, this does not create jobs and prosperity for Ohioans.

In short, this program needs to be tightened up so that firms invest more of the funds they receive in Ohio. Every firm that receives funds should invest in Ohio. A clawback mechanism should be installed so that, after a reasonable period of time to invest the money, venture funds that do not invest the bulk of it in Ohio repay it, with interest. We recommend that the committee postpone action on this bill, or at least amend it to ensure the maximum benefit to Ohio. Thank you for the opportunity to testify.