SUBJECT: Reforming economic incentives, eliminating Emerging Technology Fund

COMMITTEE: Economic and Small Business Development — committee substitute recommended

VOTE: 9 ayes — Button, Johnson, C. Anderson, Faircloth, Isaac, Metcalf, E. Rodriguez, Villalba, Vo

0 nays

WITNESSES: For — (*Registered, but did not testify*: Jay Barksdale, Dallas Regional Chamber; Bill Hammond, Texas Association of Business; Carlton Schwab, Texas Economic Development Council; Max Jones, The Greater Houston Partnership)

Against — None

On — Ed Heimlich; (*Registered, but did not testify*: Phillip Ashley, Comptroller of Public Accounts; Jose Romano, Office of the Governor; Paul Ballard, Marianne Dwight, and Corinne Hall, Texas Treasury Safekeeping Trust Co.)

BACKGROUND: Government Code, ch. 490 established the Emerging Technology Fund as a trusteed program within the Office of the Governor. Created in 2005, the fund provides grants, equity stakes, and other forms of investment to fund technology research at companies and higher education institutions with the intention of stimulating job growth and helping technology start-ups bring their products to market.

Government Code, ch. 489 established the Texas Economic Development Bank. Created in 2003, the bank houses a number of financing and other economic development programs to provide competitive, cost-effective state incentives to expanding businesses operating or relocating to Texas. The bank also has programs designed to increase small, medium, and historically underutilized businesses’ access to credit.

DIGEST:

CSHB 27 would modify the state's two main economic development programs. The changes would include:

- abolishing the Emerging Technology Fund and transferring that program's unexpended balances and authority over its existing investments; and
- expanding the Texas Enterprise Fund's authority to approve certain higher education research commercialization grants and shortening the fund's standard approval period for grants.

Emerging Technology Fund. The bill would amend Government Code, ch. 490 to abolish the Emerging Technology Fund on September 1, 2015. The state's current equity position in companies that have already received awards from the Emerging Technology Fund would be transferred to the Texas Treasury Safekeeping Trust Company. The trust company would be required to manage the equity portfolio under the prudent investor standard of care. Any proceeds earned from the sale of investments would go to general revenue. Money deposited in the Emerging Technology Fund as a gift, grant, or donation would be spent or distributed in accordance with the terms of the gift, grant or donation.

Any unencumbered balance that remained in the Emerging Technology Fund could be appropriated only to:

- the Texas Research Incentive Program;
- the Texas Research University Fund; and
- the comptroller's office to cover expenses associated with managing the state's portfolio of equity positions and investments in projects funded under the former Emerging Technology Fund.

The trust company would be required to perform to the maximum extent practicable an annual valuation of the equity shares from projects that received funding from the former Emerging Technology Fund in its portfolio. The trust company also would be required to submit an annual report to the lieutenant governor, House speaker, and legislative standing committees with primary jurisdiction on economic development and post on the trust company's website a report on any valuation performed during the previous fiscal year.

The bill also would continue through 2030 a requirement that the governor create an annual report detailing the number of jobs created and the outcomes of all projects that received Emerging Technology Fund investments. The governor would be required to exclude from the report information that is confidential by law.

Texas Enterprise Fund authority. The bill would amend Government Code, ch. 481 to allow the Texas Enterprise Fund to provide grants for commercialization of intellectual property derived from research developed at Texas public or private universities. To be eligible for funding, a research project would have to be supported by funding from one or more private entities in addition to any funding from the university. The state's investment could not be more than 50 percent of the project's funding.

The bill also would reduce from 91 days to 31 days the amount of time that the lieutenant governor and House speaker were provided to approve a grant from the Texas Enterprise Fund.

The governor's office would be required to make grants to encourage development and location of small businesses in the state.

Rules for the operation of the Texas Enterprise Fund would be adopted by the governor's office and would have to include:

- forms and procedures for applications and award of grants;
- procedures for evaluating grant applications;
- provisions governing the grant agreement process;
- methods and procedures for monitoring grant recipients, projects, or activities to determine whether and to what extent the grant recipients comply with job creation performance targets, capital investment commitments, or other specified performance targets;

- document retention requirements consistent with state law; and
- conflict of interest provisions to ensure that individuals involved in the operation of the program do not have a substantial interest in any grant recipient or grant awarded from the fund.

This bill would take effect September 1, 2015.

SUPPORTERS SAY:

CSHB 27 would provide comprehensive, common-sense reforms for Texas' economic development incentive programs while balancing the state's need to compete for economic growth with a commitment to transparency and accountability.

The bill would address concerns about the Texas Enterprise Fund raised in a September 2014 report by the State Auditor's Office. The report said it was not always possible to determine whether award decisions were supported or to determine the number of jobs that recipients of awards from the fund created. The report said the governor's office should strengthen its control structure for administration of the Texas Enterprise Fund. The bill would require the governor's office to develop procedures to determine grant recipients' success in meeting job creation targets and capital investment commitments.

The governor's office also would be required to develop strong conflict of interest provisions to ensure that those involved in awarding grants and monitoring compliance do not have a substantial interest in any grant recipient.

Small businesses and rural communities often have been left out of the state's economic development efforts. The bill would explicitly require that the governor make grants to encourage development and location of small businesses in Texas.

Eliminating the Emerging Technology Fund would ensure that Texas was not in the business of picking winners and losers. Even sophisticated private firms that specialize in early-stage funding can make errors of judgment, as evidenced by the dot-com bubble of the 1990s. It is important that the state end the use of taxpayer money for something as speculative and volatile as venture capital.

The bill could free up $90.6 million in unexpended balances in the Emerging Technology Fund for appropriation to university research programs. Texas has some of the most advanced research universities in the world, and the state supports these institutions with billions of dollars every year. However, a significant percentage of research that emerges from Texas universities is commercialized in other parts of the country. By allowing the Texas Enterprise Fund to provide commercialization grants in certain circumstances, this bill would provide an incentive for research to stay in Texas. As an added benefit, the grants would go to public universities and not private corporations as had been the case with the Emerging Technology Fund.

OPPONENTS SAY:

CSHB 27 could fail to take the long view of economic development in the state. Texas cannot take its economic growth for granted. Other states are performing better economically than they were a few years ago, which, combined with the uncertainty surrounding oil prices, could erode Texas's competitive edge in job creation.

Maintaining an environment with strong job creation requires a commitment to innovation and research. By eliminating the Emerging Technology Fund, the bill could handicap Texas startups. Startups, especially in biomedical research, are highly regulated and extremely complex, and these businesses typically take about seven years to establish themselves before they can begin hiring employees on a large scale.

California and New York both have a venture capital industry that is significantly larger than the venture capital industry in Texas, and these states also have an extensive commitment to early-stage funding. Without a similar willingness to make long-term commitments to early-stage funding, Texas may not be able to compete with these other states.

Focusing on grants for research commercialization would not signal a long-term commitment to research in the same way as taking equity in a startup. A well-managed, early-stage funding program should pay for itself and when done correctly, can be stable and profitable. A portfolio of early-stage funding investments would pay for itself, whereas research commercialization grants would not show the state any direct return.

The bill would not do enough to help the state's small businesses and rural communities. The bill should include requirements that a certain percentage of grants from the Texas Enterprise Fund go to small businesses or businesses that locate in less populous counties.