Georgia Budget & Policy Institute

Policy Report

Flawed "New Markets" Bill Needs Big Fixes

By Wesley Tharpe, Policy Analyst

The Georgia Senate is now considering House Bill 439, legislation supporters claim will help small businesses in low-income urban and rural areas. But the proposal is poorly designed and is unlikely to help Georgia businesses or the state's economy. It creates an overly complex investment scheme that delivers tax credits solely to insurance companies, rather than Georgia families or businesses generally. It lacks safeguards to ensure taxpayer dollars are properly spent. And quirks in the program's design could undermine its actual goal. If lawmakers are intent on enacting the New Markets initiative, some common sense changes to the bill should be considered to give it a better chance to succeed.

Georgia's "New Markets" Proposal Incorporates Flawed Design Elements

The proposed Georgia New Markets program creates a complicated funding mechanism designed to convert the value of future tax credits for up-front investment in private companies, as described in a recent Georgia Budget and Policy Institute analysis. The credit invokes the name of a federal tax incentive, but it significantly differs from its namesake. It is only available to insurance companies for example, rather than investors and companies with income tax liability. It also hands out state money on a first-come first-served basis, rather than through a competitive bid process.

Several aspects of the New Markets proposal in HB 439 come from a different program entirely, a flawed economic development model called CAPCO that Georgia legislators repeatedly rejected in the past. CAPCO, which is short for Certified Capital Companies, has a long track record of profiting a few out-of-state financial firms, while doing little to generate more capital for in-state businesses.

The tax credit proposed in HB 439 essentially takes some key aspects of CAPCO and embeds them within the broader New Markets framework. Other states including Arkansas, Missouri, and Nevada tried this hybrid model with troubling results. Missouri chose not to renew its New Markets program in 2013 after auditors found the effort created less than half as many jobs as proponents promised.

Options Available to Improve Program's Design

If Georgia lawmakers greenlight HB 439, the new tax credit should be made more effective and more accountable to taxpayers. Legislators can achieve that goal by removing the CAPCO-inspired portions of the bill and more closely mirroring the federal New Markets model.

Here are some suggestions for lawmakers to improve HB 439, so that it is available to more taxpayers and has more potential to help Georgia-grown businesses. These are based on a review of the federal New Markets program, similar state initiatives and conversations with selected industry experts.

1. **Require a competitive bid process managed by Georgians, not federal regulators.**
   HB 439 limits participation in the New Markets program to so-called "community development entities," which are a type of bank certified under federal regulations. So Georgia lacks input into the selection of which banks get to participate. Federally approved lenders gain access to state subsidies on a first-come first-served basis, rather than through a competitive bid process managed by Georgians. The likely result is most of the subsidies flow to a few out-of-state financial firms that specialize in the federal program, rather than to Georgia banks.

   Lawmakers can fix this by revising HB 439 to include a competitive application process led by state officials or independent experts retained by the state. The ideal process gives priority to Georgia-based financial institutions with a proven track record in the state. That prevents a few large, out-of-state firms from monopolizing the program.

2. **Change the financing structure to remove wasteful hidden costs.**
   The inefficient CAPCO model found in Georgia's "New Markets" legislation get a thumbs-down in state audit reports going back more than a decade. Here is the convoluted process: A state creates new credits in its insurance premium tax, which is a levy paid only by insurance companies. In exchange for the credits, insurance companies provide cash to specialized financial companies certified through state rules. The exchange involves a highly complicated financial instrument, unique to the CAPCO process, which ensures insurance companies a guaranteed rate of return over the life of the investment. The capital companies then provide loans to Georgia businesses for a few years until they exit the program. All the profits stay with the capital companies, leaving the state without a cut of the return.

   Most of the complexity is unnecessary. HB 439 could instead allocate tax credits to any qualified investor, company or financial institution that wants to support Georgia businesses in low-income communities, rather than just insurance companies. All participants would have to meet certain criteria and gain certification through a competitive process based on the soundness of the deal in question. The credits could count against an investor's liability on any state tax including personal and corporate income taxes, as opposed to only the insurance premium tax. This could generate a lot more potential investment in Georgia businesses and also grant a wider range of Georgians the chance to participate.

3. **Allow investments in real estate projects, not just small businesses.**
   HB 439 forbids investments in real estate. That is a stark difference from the federal New Markets program, which supports a range of brick and mortar investments including community centers, apartment buildings and commercial strips. This omission might undermine the benefit to low-income communities. Real estate projects are by definition anchored in a specific area, whereas standalone companies are not. New houses and commercial structures cannot pack up and abandon Georgia when acquired or lured by a new batch of incentives. But mobile companies can and often do.

4. **Make sure Georgians know what they are getting in return.**
   HB 439 lacks proper safeguards to ensure participating banks invest public funds effectively. Any program that uses public money to subsidize private companies should require regular reports to both the General Assembly and the public at large. Lawmakers and taxpayers need to know about things like how many jobs the program creates, which businesses receive investments and what rates banks are charging to eligible companies. The 2012 legislation that launched the Invest Georgia program, House Bill 318, includes potential model language for making HB 439 more accountable.

"New Markets" Still an Uncertain Investment, Despite Improvements

Even if lawmakers improve its design, the new tax break outlined in HB 439 is a dubious diversion of state resources at a time when lawmakers struggle to find enough money to pay for schools, roads and other vital needs. Still, these recommended changes are an improvement on the bill as it now stands. If lawmakers are in a hurry to give the New Markets experiment a try, Georgians need some assurance they are getting a decent deal.