SELECT COMMITTEE ON ECONOMIC DEVELOPMENT

HOUSE OF REPRESENTATIVES

48TH LEGISLATURE

ATTENDANCE

DATE: Feb. 16, 1983

ROOM: 224A

	PRESENT	ABSENT	OTHER
VINCENT, John - Chairman	X		
SCHYE, Ted - Vice-Chairman	X		
ASAY, Tom	X		
DARKO, Paula	X		
FABREGA, Jay	X		
FAGG, Harrison	X		
HANSEN, Stella Jean	X		
HARPER, Hal	X		
HARRINGTON, Dan	X		
METCALF, Jerry	X		
NEUMAN, Ted	X		
RAMIREZ, Jack	X		
VINGER, Orren	X		

MINUTES OF THE SELECT
COMMITTEE ON ECONOMIC DEVELOPMENT

February 16, 1983

The sixth meeting of the Select Committee on Economic Development was called to order by Chairman John Vincent at 8:39 p.m. in room 224A in the Capitol Building, Helena, Montana on February 16, 1983.

Roll call was taken and all members were present.

CHAIRMAN VINCENT stated the purpose of this meeting was intended for Ken Peres, the Committee's economist, to explain all the bills so far introduced and inform the committee how all of these bills fit into a larger economic package for the state of Montana.

KEN PERES stated he would like to provide an overview at basically two levels. The one level is development finance perspectives or economic theory, and the second level is business, what are their needs, how can they be analyed etc. Finally, taking a look at the Department of Commerce's scheme up and outline the different bills involved.

He explained Exhibit A, the Overview of Montana Development Finance Perspectives as analytical. He explained the current economic climate that we find ourselves in regarding economic recession and depression in some counties, many people have realized that capital has played a central role. Decisions regarding the investment in capital directly affected people's jobs, incomes and the tax base of specific counties. Everyone agrees there is a problem, but they don't all agree on what the problem is and what should be done. He further explained the Perspective of Classical, Capital Gap, and the Economic Gap, see Exhibit A.

He asked the Committee to view with him Exhibit B, the Overview of Capital Needs of Business & I-95 related proposals. He stated he started with the type of capital business needs, the form of financial capital, the sources of that financial capital, the need in Montana for that capital and the proposal how the I-95 package related to these business needs. He explained that no one proposal satisfies all the individuals, but when taken as a group, it satisfies a broad range of business needs. He explained that when one starts a business, it is necessary to have front end capital. The start up money on projects are optimally equity. Equity is technically a term giving a buyer future income or a piece of the action, from the owner. Opposed to equity is debt. In case of bankruptcy, debt is paid before equity. Debt forms more of a burden to a business than equity. He further explained that sources of capital in Montana were limited and the bill that addressed this was HB 685. He studied the problem of--was there a need for venture capital in the state, and looking at different studies etc. the conclusion was yes, there is a definate need for venture capital. He noted HB 685 was proposed by the committee. He further stated there are other options and models in other states, and if time permits he will address how other states address this need. He further explained Exhibit B, page 1 and page 2.

Ken asked the Committee to review Exhibit C, the Development Finance Proposal submitted by the Department of Commerce. He explained in terms of strategy, these four proposals are basically three different strategies. One strategy is to increase the in-state industrials of public investment funds. This is found in HB 371 and HB 100. He noted there is an issue here on what is market rate. Both of these bills are subject to the prudent person rule. There are different ways of interpreting this rule, and one way is the market rate would be at the conventional private bank rate, for example a mortgage. The mortgage could be put out by the Board of Investments, or the Economic Development Board at commercial rates. The other view, presently taken by Wyoming is that the market rate is established by other type of investment by the Board, basically corporate bonds, and treasury bills, which bring it down from commercial rates.

The second strategy is to increase in-state investments through incentives to in-state investors, and that is the Montana Capital Corporation. $1 million per biennium which if all the tax credit is used, leaves a total of $4 million for the Capital Corporation. This is high risk equity as discussed before.

The third strategy is to increase in-state investments by supporting capital. Of all these programs, this is potentially, the largest. This involves the umbrella revenue bond program, which provides long term debt at the low market rates. They will provide money at the low market rates because of the tax exemption. He asked for questions from the committee regarding specific information they would like answered.

CHAIRMAN VINCENT asked regarding a previously discussed bill, the clause or stipulation in the bill regarding who might qualify, referring to the fact if you can't get money somewhere else you can get it here. He wanted to know what kind of conflicts and tensions are created in the private sector when someone because they qualify in a bonding program, get that preferential rate, where the other businessman has to go a more conventional route.

KEN PERES stated this problem is common to quite a few federal loan programs with the stipulation to come to us if you can't get it elsewhere. There is a Catch 22 on this. Once you prove you can't get it elsewhere, you come to the federal program and they give you a portion of the loan, and you have to go back to the same people who just said you aren't going to make it. This is a classic case where you have to prove you are a failure and a success at the same time and this leads to a lot of problems. The second level is the stipulation addressed to the desire to not displace the private sector. If someone can go to the private sector and get money, they should do it, they don't need government assistance. If they can't get money, then they can go to the federal government and it wouldn't displace money that would have been there anyway. The problem in the past with some of the industrial revenue bond issues have been that companies that have access to capital at competitive rates, instead go to the federal government with the tax exempt programs and get a cheaper rate. In a sense the industrial revenue bond with a federal subsidy has been taken advantage of by some businesses.

The third level, the revenue bond is based on the credit worthiness of the individual corporation of the business. The Revenue Bond Program isn't for new business starting out, they don't have the established track record of older businesses, because the payment on the bond are secured by the company itself. One function of the Economic Development Board with the banks for the bonding authority, would be to look at the particular credit worthiness of particular firms, lump that into one issue and with the credit enhancements mentioned before by Representative Fabrega back this up for a higher rating.

REPRESENTATIVE RAMIREZ asked Ken to explain the future of the tax exempt bonding program. Will there be a shift in Washington regarding these programs.

KEN stated based on the past studies, and the strategies toward Congress to tighten up these programs, regarding the advantages that were taken in the program, try to direct capital where it is needed, because there is a need. Congress has tightened it up with the '82 Tax Act, the Umbrella Bond Revenue Bill. What will happen in the future, he is not sure of. Different studies have conflicted in their conclusions whether the revenue bonds cost the government, or don't cost the government through the increase in income taxes, property taxes etc.

REPRESENTATIVE MILLER commented on things the committee can do, and why it is so important to have a good board. He agreed that what Ken said tonight results in a sound economic policy. He felt the people when they voted 70 to 30 on I-95, want a little bit of risk. He feels the committee is going on too conservative of a turn.

REPRESENTATIVE FABREGA asked regarding HB 700, creating the insurance account. He asked in regard to the general obligation bond, the pledge of income out of HB 100 or borrowing from other state investment funds, what are the options of these three approaches.

KEN PERES stated he had not looked into these, but would.

REPRESENTATIVE FABREGA stated the housing board is in a surplus position of their security account where they can make a loan of $2.5 million to this program. He would like Ken to research the general obligation authority. Also within HB 700 there is a portion to put the program in the position of offering insurance service to the industrial revenue bond issues authorized by local government. If that authority could go high enough through a general obligation bond, that could also provide insurance for the programs. He asked the Insurance Section of HB 700 be further researched and explained.

CHAIRMAN VINCENT asked the committee to let Ken know right away if they wanted any more areas researched in the bills, before executive action would be taken.

There being no further questions, the meeting was adjourned at 9:37 p.m.

John Vincent
REPRESENTATIVE JOHN VINCENT
CHAIRMAN

Mitzie Grover
Mitzie Grover
Secretary

I. OVERVIEW OF MONTANA DEVELOPMENT FINANCE PERSPECTIVES

	CLASSICAL	CAPITAL GAP	ECONOMIC GAP
PROBLEM:			
Context:	All financial opportunities being met through existing financial institutions.	Capital markets are imperfect; capital needs of small firms are going unmet.	Just as there are capital gaps, there are economic gaps; whole sectors, communities, areas and business are either the scene of no investment dis-investment
Problem:	Not enough good investment demand for Montana economy to grow and prosper.	Financial institutions lack adquate info; high transportation costs; unable to pool risk; biased against small business; market imperfections limit capital flows and constrain economic development.	By itself, private sector cannot fill these gaps: short time horizon too much aversion to risk scale of investment is too small narrow view of cost/benefits
RECOMMENDATIONS:			
Goal:	Better business climate to attract business and capital and allow them to grow.	Place small/medium business on equal footing with large corporations in regard to capital terms and access.	Meet MT's economic and development needs through active state policies implemented through local small business people and community groups.
Principles:	De-regulate & no over tax; allow private sector to make economic decisions according to market criteria.	Do not compete with private sector channel and through existing institutions. Target businesses & sectors subject to capital gap.	Do not duplicate private sector efforts when effective Where private sector not effective channel $ through new public financial institutions; judge I via market rate + fiscal + community.
Steps:	Identify impediments to free flow of capital; remove barriers to economic development; send signal to business community; identify resources.	Judge I via market rate; identify capital needs/gaps; passive state regulation/target; remove barriers to economic development; passive intervention/target;	Inventory needs & resources identify opportunities and match entrep.; target I & TA to needy areas; implement state programs at state level & through local groups.

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EXHIBIT A

Steps: Passive intervention cont.

- costs of economic development IRBs;
- risks of economic development insurance
- liquidity of private financial secondary markets
- availability of capital.

II. OVERVIEW OF CAPITAL NEEDS OF BUSINESS & I-95 RELATED PROPOSALS

TYPE OF CAPITAL NEEDED	FORM OF FINANCIAL CAPITAL	SOURCES	NEED IN MT	PROPOSAL
Front End Capital R & D for new product development Start up costs for new enterprise Feasibilitiy studies	Equity, but high risk.	Retained Earnings Personal Savings Family, friends, associates	Intermittent Not reliable, stable or structured	
		Venture capital	- not active in MT	HB 685
Long-term plant, equipment land	Long-term debt 10-40 years	Banks	Most banks do not make 20-yr. loans. Aggressive banks have real estate affiliates but change high commercial rates & floating interest rates; thus, very difficult for business to plan out costs.	HB 100 - - secondary market for mortgages - non-rated bonds HB 371 - same non-rated bonds
		IRB	Over 1,000,000 ok under 1,000,000 becomes difficult because high transaction cost, fees, etc., eat up too much of issue.	HB 700 HB 685 - possibly land, buildings
		LDC	In MT, few & very meagerly funded. Must raise 10-20% of cost. Most in MT have only 25 to 50,000.	

TYPE OF CAPITAL NEEDED	FORM OF FINANCIAL CAPITAL	SOURCES	NEED IN MT	PROPOSAL
Medium Term and Expansion Capital Retooling and replacing equipment Extending market research and testing Expanding staff and operations	Intermediate term debt 5 - 7 years	Banks	High transaction costs for small loans Limited size loans $200,00 - $250,000	HB 100, 371 - Long term CD's -Secondary market for commercial loans - SBA
		SBA	Time and red tape Highly collateralized Commitment of personal assets	HB 685 - Subordinated and/or unsecured debt
Working Capital	Short Term Debt	Banks		Not directly addressed
Acquisition or Buy Out Capital Retain ownership in Montana Finance purchase of out-of-state business if viable plant is faced with shut down	Equity Near Equity Long Term Debt	Retained earnings Personal savings Family friends, associates, banks		Not directly addressed, though could be financed through HB 685

DEVELOPMENT FINANCE PROPOSALS

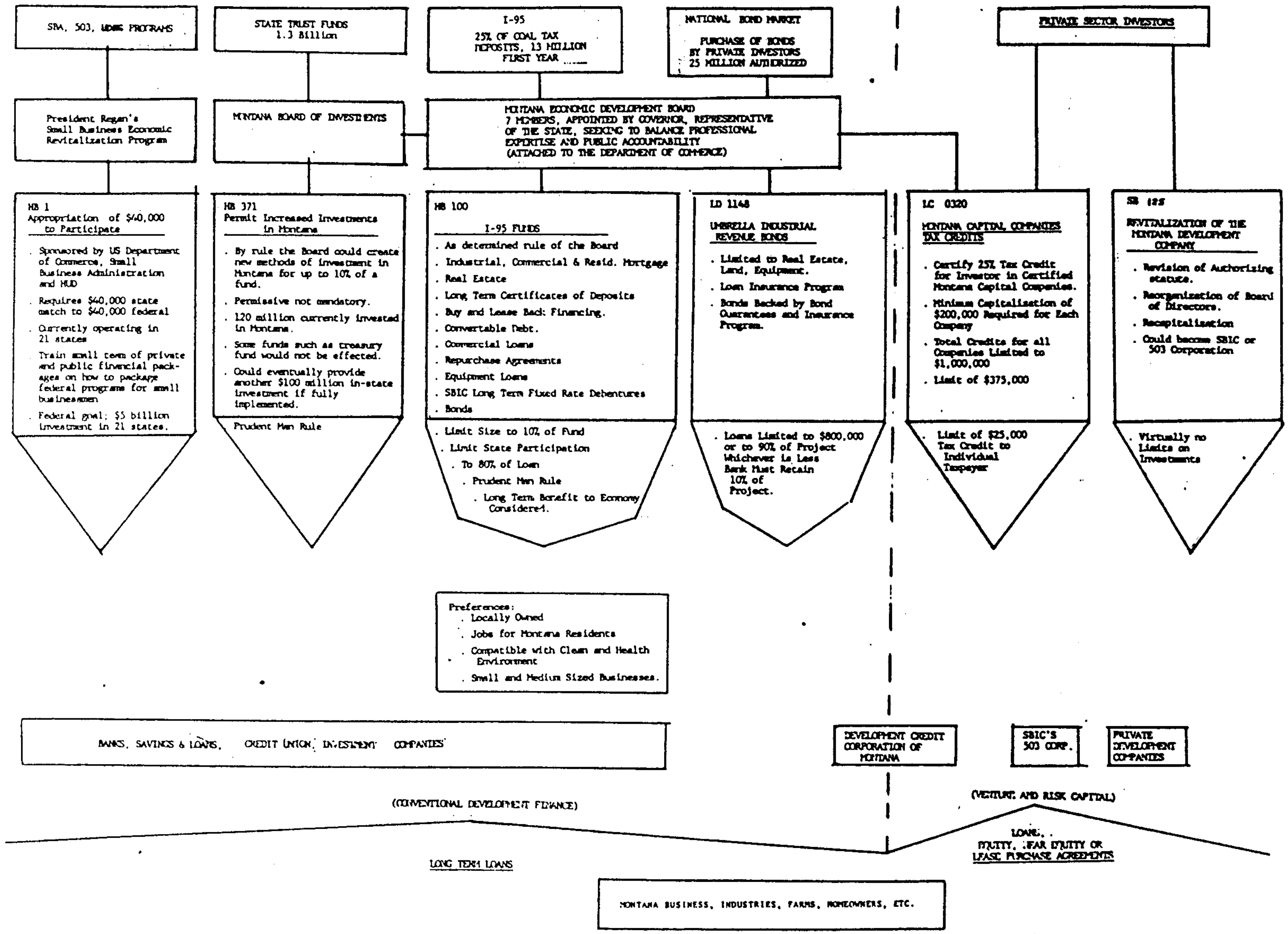

EXHIBIT C