Concept note:

Local Economy Preservation Funds

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An estimated 3.3 million businesses have been forced to close their doors, at least temporarily, during the pandemic, and half of small businesses fear they will close permanently. There are warnings of the worst wave of small business bankruptcies since the Great Depression. Many local businesses could simply disappear, taking with them tens of millions of jobs. Cities could lose their engines of prosperity. FTC commissioner Rohit Chopra warned, “vulture investors” in private equity “are waiting in the wings to scoop up scores of struggling businesses on the cheap.” Close behind will be corporate acquirers. The likely result will be asset stripping, job losses, and a massive increase in wealth and income inequality.

There is a way to save local businesses at scale, while also creating a more equitable, sustainable, and democratic economy. The federal government could support states and cities in establishing Local Economy Preservation Funds (LEPFs), as The Democracy Collaborative terms them. These would enable equity investments in local companies that were viable pre-COVID and will be viable afterward, place them in a holding company, and provide an exit to community ownership in the recovery – with emphasis on **ownership by people of color**, **employee ownership**, or **local ownership that stays local**.

How LEPFs Work: States and cities would receive money to establish LEPFs. If desired, funds could be established to support regions, industries, minority- or woman-owned businesses, or other asset categories important to the local economy. Small businesses would apply to receive equity investments from the LEPF to remain in operation and be held in the LEPF until they are viable and ready to exit.

To ensure firms remain locally owned and in the public interest, LEPFs would only exit small businesses to local owners, prohibiting flipping to absentee investors or corporate acquisitions. Preference could be given to employee owners via worker cooperatives or ESOPs, which enjoy tax advantages. Some firms, especially those providing critical public goods and services, could be retained long-term in public ownership, or passed to community-based non-profits to be run as social enterprises.

If ownership shares are returned to individual local owners, preference should be made for owners who are people of color, women, and veterans. Investors could exit at stabilization via loans to owners, repaid through company cash flow. In some cases, a partial ownership interest can support local owners through the crisis, allowing them to continue operating or reopen later. In other cases, full ownership might be obtained, if, for example, owners are nearing retirement and not interested in starting over.

Proven Concept: A public holding company owning shares in businesses is a proven model worldwide. In the Great Depression the Reconstruction Finance Corporation became the nation's single largest investor, owning thousands of firms. There have been calls for the U.S to establish a federal Coronavirus Finance Corporation. In an October poll by The Democracy Collaborative and YouGov, 70 percent of respondents said the government should help keep small business from shuttering instead of being acquired by big business. Asked about Local Economy Preservation Funds, over half supported such funds administered at the local and state level; a narrower majority supported this at the federal level.

Delivery-Delegating Authority to States and Cities: The most effective approach is for the federal government to support local development finance agencies and CDFIs, which could set up preservation funds at the state and local level, where knowledge of local economies is greatest and financing networks already exist to distribute capital. Similar local autonomy was proven effective in the State Small Business Credit Initiative, where states received federal funds to support small business and were held accountable via reporting on outcomes. Ideally, a LEPF program would be federally administered through the SBA (rather than in Treasury as SSBCI was), which would then delegate funds and authority to individual states. Recommended funding is $1B allocated to the states for program implementation, education, and monitoring – plus additional allocation of multiple billions for capital.

Capital Options-Using Municipal Liquidity Facility: Given the dire straits of state and municipal finances due to the crisis, federal funding will be needed. LEPFs could be capitalized through direct appropriations, the Federal Reserve's Municipal Liquidity Facility (MLF), and through private capital. Through the MLF program, the Fed will purchase up to $500 billion of municipal notes from states, counties, and cities. Robert Hockett of Cornell Law School has said LEPFs could qualify for this program, since, by preserving businesses, they would protect tax revenues and likely be revenue producing. Cities, counties, states would access the MLF by issuing bonds, which they then sell immediately to the Federal Reserve. Given the unfavorable rates currently offered by the MLF (3 years at up to 5.5%), it is recommended that rates be adjusted by the Biden-Harris administration through a stimulus bill. To be the most effective, MLF rates should be changed to 0% for 10 years.

Engaging Private Capital: Private capital could be attracted via credit enhancement techniques, such as loan guarantees or loss reserves. Boosting funding to the SBA Loan Guarantee program by $100B is one additional way that this program should be implemented. Allowing LEPFs to use the credit enhancement to secure more favorable rates would increase the number of small businesses that could be supported. Allocating funding to support program implementation and education would be critical here too, with a suggested $1B as stated above.

Placement of Funds: LEPFs could be created within existing DFAs, or held inside CDFIs. The funds would be managed by experienced finance managers, with expertise in pursuing dual goals of prudent financial management and service to the public good. Both DFAs and CDFIs are smart choices to monitor funds, as they are experienced at managing for both financial and social returns.

Performance Tracking: Clear performance metrics, both financial and social, will be critical to tracking LEPF success. Any enabling legislation should give clear guidance requiring creation of citizen oversight bodies to design and monitor outcome metrics and shape program design overall. Metrics collected should include jobs preserved, percent paying living wage, number of employee owners created, number of people of color and women in jobs and in ownership, etc. If administered through the SBA, the agency should be empowered to create these citizen oversight bodies.