

SUMMARY

STATEMENT OF

ALICE M. RIVLIN
Director

CONGRESSIONAL BUDGET OFFICE

Before the
Committee on Finance
United States Senate

March 17, 1982

There should be no release of this
document before its delivery,
scheduled for 9:15 a.m. (EST)
March 17, 1982

In the past ten years, the use of tax-exempt state and local bonds for private purposes has grown sharply, and now accounts for about half of all new long-term, tax-exempt issues. Industrial revenue bonds (IRBs) are the primary mechanism for providing tax-exempt financing for private investment in plant and equipment. IRBs may be used without regard to issue size to finance pollution control equipment, airport and port facilities, sports facilities, convention centers, and industrial parks. Small issue IRBs, which may not exceed \$10 million, may be used to finance plant and equipment for other unspecified private business purposes.

Small issues, which are used to finance a wide variety of facilities from manufacturing plants to country clubs, account for about one-fifth of all tax-exempt bonds floated for private purposes. Estimated sales in 1981 were \$10.5 billion, an increase of 25 percent above the 1980 level. Small issues are particularly advantageous to large, geographically dispersed corporations, since the dollar limit on issue size applies not to the firm, but to facilities within an incorporated county or municipality. Large retail chains are probably in the best position to use IRBs because single stores usually can be financed for less than \$10 million. In the past five years, the largest single user of small issue IRBs was K-Mart, which financed some 100 stores with \$240 million in tax-exempt bonds.

The growth in revenue bond sales has not been limited to small issues. Sales of pollution control bonds increased by 56 percent in 1981, when they reached \$3.9 billion, up from \$2.5 billion in 1980. Tax-exempt hospital bonds increased by 42 percent, from \$3.6 billion in 1980 to \$5.1 billion in 1981.

One issue the Committee should consider is whether subsidies for private-purpose financing are still necessary in light of both the business tax cuts enacted under the Economic Recovery Tax Act of 1981 and changing conditions. It is questionable, for example, whether tax-exempt bonds are necessary to subsidize hospital construction in view of the current national surplus of hospital beds. A second issue is whether the municipal bond market can continue to absorb large increases in private-purpose financing. A third is whether tax-exempt bonds are the most efficient means of providing subsidies, if any are necessary. In the case of pollution control bonds, for example, tax-exempt financing is available only for "end-of-pipe" capital expenditures, which discourages selection of other, possibly more effective solutions to the underlying pollution problem--such as the use of less polluting raw materials or production processes.

The Administration has taken the position that the accelerated cost recovery system (ACRS) included in last year's tax legislation has made other subsidies, such as tax-exempt financing, obsolete. Accordingly, it proposes to prohibit firms from using both IRBs and ACRS. Unless the Congress has a special reason for providing industry with subsidies so deep that they result in a negative tax rate, the idea of trading accelerated depreciation for tax-exempt financing would appear to merit consideration. The Administration has also proposed that small issue IRBs not be allowed for businesses with capital expenditures nationwide of more than \$20 million over a six-year period. This would in most cases make it impossible for Fortune-listed firms to use small issues. The net effect of the Adminis-

tration's proposals would be to target the use of IRBs generally--and small issues, in particular--to smaller firms.

The resulting cutbacks in the use of tax-exempt bonds for private purposes would tend to reduce municipal bond interest rates, which have recently reached record highs. The cost of financing public projects, such as streets, sewers, and schools, would then be lower. If the Congress determines that assistance in some areas is still necessary, it might want to consider direct subsidies, which are more efficient and have no adverse effect on the municipal bond market.

Tax-exempt financing for private purposes has been an issue for several years. Present law warrants reexamination to determine whether the subsidies currently being provided serve a public purpose and continue to be necessary in view of recent developments and changes in tax legislation.

ALICE M. RIVLIN
DIRECTOR

CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE
WASHINGTON, D.C.

✓ CC# 351

CORRESPONDENCE CONTROL FORM

Date of item 3/12 Date Received: 3/16

Sender: Senator Bob Dole

Subject: Requesting AMR testify on 3/17
about private purpose tax-exempt bonds.

ACTION: Verdier

DUE DATE: Interim
3/17 Final

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United States Senate

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March 12, 1982

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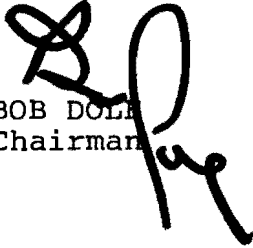
Dear Mrs. Rivlin:

This letter is to request that you testify before the Senate Committee on Finance on Wednesday, March 17, 1982, on the Administration's tax revision proposals regarding private purpose tax-exempt bonds. The hearing begins at 9:00 a.m. in Room 2221, Dirksen Senate Office Building. You are scheduled to testify immediately after several Members testify on the same subject.

One hundred copies of your statement, with an attached summary of the principal points, should be filed with the Committee in Room 2227, Dirksen Senate Office Building by noon on Tuesday, March 16, 1982.

Thank you for your cooperation.

Sincerely yours,


BOB DOLE
Chairman

BD:pmg