103

INNOVATIVE FINANCING OF INFRASTRUCTURE INVESTMENT: THE USE OF TAX-EXEMPT BONDS

(103–70)

Y 4. P 96/11: 103-70

Innovative Financing of Infrastruct...

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC DEVELOPMENT

OF THE

COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

JUNE 30, 1994

Printed for the use of the
Committee on Public Works and Transportation

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COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

SUITE 2165 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225-4472

June 28, 1994

MEMORANDUM

TO: Members, Subcommittee on Economic Development

FROM: Economic Development Subcommittee Staff

SUBJECT: **SUMMARY OF SUBJECT MATTER** for June 30, 1994 hearing on "Innovative Financing of Infrastructure Investment: The Use of Tax-exempt Bonds"

On Thursday, June 30, 1994, at 10:15 a.m., the Subcommittee will hold a hearing on the use of tax-exempt bonds to finance infrastructure investment. This hearing will enable Members to examine how tax-exempt bonds may be used to improve our infrastructure, create jobs, and enhance our competitive position in the global economy. This summary of subject matter provides background information on state and local governments' financing of infrastructure investment with tax-exempt bonds, current federal income tax code provisions regarding tax-exempt bonds, and proposed changes to these provisions.

Tax-Exempt Financing

State and local governments have three means of financing infrastructure investment: pay-as-you-go financing, intergovernmental revenues such as federal grants, and borrowing. Borrowing, or debt financing, is accomplished by issuing bonds to pay for

specific projects or services. A bond is a debt instrument bearing a stated rate of interest that matures on a certain date, at which time a fixed sum of money plus interest is payable to the bondholder.

Unlike corporate debt issues, the interest received by holders of state and local governmental bonds, also known as municipal bonds, is exempt from federal income taxes and may also by exempt from state and local income taxes. Consequently, investors will accept a lower interest rate on tax-exempt issues because they will not have to pay taxes on them. This lower rate reduces borrowing costs for state and local governments which use tax-exempt bonds to raise capital to build roads, bridges, airports, mass transit facilities, public power facilities, and schools.

Tax-exempt bonds may be issued by state and local governments and special authorities established by these governments including nonprofit organizations such as hospitals and universities. In 1992, $275 billion worth of municipal bonds were issued, 85 percent of which were long-term bonds. Fifty percent of these bonds were new issuances and 50 percent represented reissuances of previously issued bonds to take advantage of lower interest rates. Historically, commercial banks purchased the largest proportion of these bonds. Today, most tax-exempt bonds are purchased by individuals through household, mutual fund, or money market fund purchases.

The federal income tax code specifies the rules for determining if a bond may be used on a tax-exempt basis and restricts the issuance procedures. Furthermore, state and local governments place additional controls on the use of tax-exempt financing.

Types of Tax-Exempt Bonds

There are two general types of tax-exempt bonds: general obligation bonds and revenue bonds. General obligation bonds are backed by the "full faith and credit" of the state and local government that issues the bonds. Revenue bonds are issued for a specific project, such as an airport, and are paid for from the revenues received from the project.

Tax Code Classification of Tax-Exempt Bonds

For the purposes of the federal income tax code, tax-exempt bonds are divided into two major categories: governmental bonds and private-activity bonds.

Governmental Bonds

Generally, bonds issued to finance facilities that are owned, controlled, and operated by a state or local government are categorized as governmental bonds. Governmental bonds are used to finance the construction of public facilities such as schools, roads, water and sewer systems, gas and electric power systems, and other government-owned capital projects. However, there is no specific definition of a governmental bond in the tax code. Rather, it is the definition of a private-activity bond and the application of two private business-use tests that determine whether a bond is governmental or private activity.

Private-Activity Bonds

A private-activity bond must meet two private business-use tests. First, a private-activity bond is a bond of which more than 10 percent of the proceeds is to be used in a nongovernmental trade or business (except for nonprofit tax-exempt organizations). Second, a private-activity bond is a bond which is to be directly or indirectly repaid from, or secured by, revenues from a private trade or business. If a bond "fails" either of these two tests, it is a governmental bond and the interest on the bond is tax exempt. If a bond "meets" these two tests, it is a private-activity bond and interest on the bond is taxable.

However, the federal tax code provides certain exceptions that permit interest on bonds issued from certain facilities to be tax-exempt even though the bonds "meet" the private-activity bond tests. These "exempt facilities" include airports, wastewater treatment facilities, and solid waste disposal facilities. Various conditions and limitations apply to the use of tax-exempt bonds for each of these exempt facilities.

Moreover, the tax code contains an additional group of programs for which private-activity bonds may be issued on a tax-exempt basis provided that the programs meet specific tax code conditions and limitations. This exception includes programs which issue small-issue industrial development bonds, redevelopment bonds, and sec. 501(c)(3) (nonprofit) organization bonds.

Limitations on Tax-Exempt Private-Activity Bonds

Tax-exempt private-activity bonds are subject to the following tax code provisions that do not apply to governmental bonds:

- **Statewide volume cap.** The statewide volume cap is a ceiling on the aggregate amount of tax-exempt private-activity bonds that may be issued in a state in any given year. The ceiling, unchanged since 1987, is the greater of $50 per capita or $150 million. Exceptions to the volume cap include exempt facility bonds for airports, docks, and government-owned solid waste facilities. All other tax-exempt private-activity bond programs must compete with each other for volume cap allocations.

- **Alternative minimum tax (AMT).** Interest earned on tax-exempt private-activity bonds must be included in an individual's or corporation's calculation of the AMT. While interest on governmental bonds is not taxed to the individual, corporations must include all tax-exempt bond interest in their adjusted current earnings (ACE). The ACE is a preference item included in the AMT calculation.

- **Limitations on advance refundings.** An advance refunding is the refunding of an outstanding issue of bonds prior to the date on which the bonds become due or are callable. Since 1986, tax-exempt private-activity bonds may not be advance refunded while governmental bonds may be advance refunded once.

- **Other restrictions and requirements.** A number of other restrictions and requirements apply to tax-exempt private-activity bonds including: who may hold such bonds (no substantial user or related person), the length of maturity of bonds (may not exceed 120 percent of economic life of facility), restrictions on their use for land acquisition (no more than 25 percent of proceeds), prohibitions on use of proceeds to acquire existing property, public approval requirements, and limitations on the use of proceeds to pay bond issuance costs (no more than 2 percent). Mortgage revenue bonds, student loan bonds, and nonprofit organization bonds are exempted from some of these requirements.

Proposed Changes to Tax-Exempt Bond Laws

Over the past several years, Congress has made a number of changes to tax-exempt bond laws. In the 1980's alone, Congress modified tax-exempt bond laws six times. In particular, the Tax Reform Act of 1986 rewrote the Internal Revenue Code of 1954 and made substantial changes to tax-exempt bond laws. A major objective of many of these legislative changes has been to reduce the benefits of tax exemption. Thus, many types of facilities are no longer eligible for tax-exempt financing, while others are eligible but subject to limitations such as the statewide volume caps.

In response to complaints from state and local government officials about the restrictions placed on tax-exempt bonds by the 1986 Tax Reform Act, then Congressman Beryl Anthony established the Anthony Commission on Public Finance, comprised of a panel of governors, mayors, government officials, and other experts, and asked it to make specific recommendations to revise tax-exempt bond provisions of the federal income tax code. In 1989, the Anthony Commission published its report and recommendations, entitled *Preserving the Federal-State-Local Partnership: The Role of Tax-Exempt Financing*. Among the major proposals contained in that report and offered by others, including hearing witness Congressman William J. Coyne sponsor of H.R. 3630, are:

- **Changes in arbitrage restrictions.** Unspent municipal bond proceeds are often invested in higher-yielding securities until the monies are needed for the facilities being financed by the bonds. The earnings on these investments that exceed the municipal bond yield are called arbitrage. Current federal law limits the amount of arbitrage that can be earned and requires that arbitrage earnings be rebated to the federal government. This limitation is an onerous requirement because it imposes complex bookkeeping and other compliance costs on issuers regardless of

whether a rebate is owed and because it prevents issuers from generating additional funds that could be used to reduce the costs of bond-financed projects.

- **Restoration of the bank interest deduction.** Prior to 1986, banks were permitted to deduct all or most of the interest costs they incurred to invest in municipal bonds. The 1986 Tax Reform Act eliminated this deduction except for the bonds of certain small issuers. An exception to the law permits banks to deduct 80 percent of the costs of purchasing and carrying bonds of issuers that do not issue more than $10 million of bonds annually. The $10 million figure has not been changed since 1986. Restoration of the pre-1986 bank interest deduction level would restore bank demand and provide some stability by bringing this group of institutional investors back into the municipal bond market.

- **Repeal of the Alternative Minimum Tax (AMT) on tax-exempt bonds.** Interest on tax-exempt bonds is subject to the individual and corporate AMT. The AMT is designed to ensure that taxpayers cannot avoid paying income taxes entirely. The 1986 Tax Reform Act provisions subjecting tax-exempt interest to the AMT have contributed to both increased costs for issues and to a reduced demand for municipal bonds by some investors. Purchasers of municipal bonds already pay an indirect tax by earning a lower rate of return because of the tax-exempt status of the interest on investments. In addition, municipal bonds are purchased with after-tax monies; they are not a tax shelter. Repeal of the AMT on municipal bonds would result in lower borrowing costs for issuers and restore demand for those bonds.

- **New rules distinguishing governmental bonds and private-activity bonds.** Bonds for certain governmental facilities are inappropriately categorized as private-activity bonds. Changes should be made to the present rules that arbitrarily limit the amount of private use of a facility (the 10 percent limit) without taking into account whether or not the facility is fulfilling a public purpose. Such changes would lead to the more efficient and less costly provision of public-purpose facilities and permit more public-private partnerships in the building and operation of such facilities.

- **Modifications to statewide volume caps.** The statewide volume cap is a ceiling on the aggregate amount of tax-exempt private-activity bonds that may be issued in a state in any given year. The ceiling, unchanged since 1987, is the greater of $50 per capita or $150 million. In addition, if the private-use portion of a governmental bond exceeds $15 million, the excess over $15 million is subject to the volume cap even though the private use portion of the bond does not exceed the 10 percent private use and security tests. The administrative requirements of complying with the volume cap provisions are costly and burdensome to states. Recommended changes to the tax laws regarding the volume cap are: (1) remove the private-use portion of governmental bonds subject to the volume cap; (2) increase volume cap amounts to keep pace with increased costs of providing facilities and services for tax-exempt financing; (3) eliminate certain bonds from the volume cap; and (4) index the volume cap for inflation.

- **Authority for more advance refundings.** An advance refunding occurs when issuers refinance outstanding bonds before the original bonds mature or are callable. Borrowers advance refund their outstanding debt when long-term interest rates drop, thus reducing their borrowing costs and freeing up resources for new projects. Since 1986, private-activity bonds may not be advance refunded, and governmental bonds may be advance refunded once. Propose easing restrictions on advance refundings so state and local governments can lower the costs of their borrowing.

- **Reclassification of tax-exempt organization bonds as "public purpose" where bond proceeds provide facilities used exclusively in charitable activities for public benefit.** Nonprofit organizations engaged in charitable activities for public benefit and exempt from taxation under sec. 501(c)(3) of the code are permitted to issue tax-exempt bonds used exclusively for facilities that benefit the public. Under the 1986 Tax Reform Act, these bonds are treated as private-activity bonds. While they are exempt from some of the more onerous provisions affecting private-activity bonds, including the statewide volume cap, the prohibition against advance refundings and the alternative minimum tax, they are subject to other provisions that unnecessarily restrict the use of bond proceeds to finance facilities that would otherwise have to be provided by governmental entities.

An agenda for the hearing is attached for your review. If you would like a copy of the Anthony Commission Report, please contact the Subcommittee staff at 225-6151.

INNOVATIVE FINANCING OF INFRASTRUCTURE: THE USE OF TAX-EXEMPT BONDS

THURSDAY, JUNE 30, 1994

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ECONOMIC DEVELOPMENT,
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION,
Washington, DC.

The subcommittee met, pursuant to call, at 11:32 a.m., in room 2167, Rayburn House Office Building, Hon. Robert E. Wise, Jr. (chairman of the subcommittee) presiding.

Mr. WISE. This hearing of the Economic Development Subcommittee will come to order.

I apologize for being slightly tardy. It is always nice to able to put on the record that I was in meeting with the President in the White House. Let the record show it was a very intimate meeting: Myself and 300 others under a big tent. At any rate, I appreciate those of you who have made an effort to be here. I am going to ask that my statement be made a part of the record.

I would simply say that there is a lot of talk about economic growth and you can talk about different programs, direct Federal funding such as the highway bill, such as aviation trust, funds, CDBGs, and so on. There is a more arcane way that Beryl Anthony and Bill Coyne and others have raised but is equally as important. It is arbitrage. It is grant credit back programs. It is interest. It is private activity tax-exempt status.

And in many ways, I suspect that as the Federal deficit is a major issue for all of us, and direct Federal expenditures are more and more difficult to make, that there is a need to look more closely at many of these initiatives such as Congressman Coyne has introduced and such as was written about in the Anthony Commission a few years ago.

Beryl, let me say I think your time is coming in that regard. And I appreciate very much you and the others who are here.

In closing, let me note that while the economic figures seem to be fairly good, and the Budget Committee heard just recently from Chairman Greenspan who says that he feels that this is a strong economy and as strong as it has been for a while, I happen to believe that there is a need for an economic growth package. It may not be that which was proposed last year, but I do believe that there is a need to focus on growth policies, particularly those that build infrastructure and that is the purpose of today's hearing and to lay the groundwork for what Ways and Means may have to do in later months and what other committees besides this one will be doing.

I greatly appreciate Mr. Hutchinson being here. The Congress got out early last night and there was a race to airport, speaking of infrastructure, but I welcome him and any remarks he may wish to make.

[Mr. Wise's prepared statement follows:]

OPENING STATEMENT
BOB WISE, CHAIRMAN
SUBCOMMITTEE ON ECONOMIC DEVELOPMENT
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

June 30, 1994
Innovative Financing of Infrastructure Investment:
Tax-Exempt Municipal Bonds

The need to invest in our nation's infrastructure is critical and enormous. The demand for improved highways, bridges, airports and water systems has stressed our communities to their limits. Given the constraints placed on budgets, both at the state and local level, it is clear that some relief needs to be granted in order to allow for increased investment in infrastructure.

I believe that today's hearing will provide a valuable forum for an open discussion on tax-exempt financing. With the many modifications in tax-exempt bond laws in the 1980's, the ability of state and local governments to use tax-exempt municipal bonds to finance infrastructure projects was seriously restricted. In today's session we will hear about the problems facing the state and local governments and the bond community, as well as the recommendations of the Anthony Commission and proposed legislation to provide relief to distressed communities.

One of the primary financing vehicles for infrastructure projects is the tax-exempt municipal bond. States and localities have relied heavily on this financing tool to build and maintain roads and bridges, water and sewage treatment projects, hospitals, schools, prisons, and other public facilities. Given the scarcity of federal resources, the state and local role in financing public works projects will continue to increase and there will be greater reliance on tax-exempt bonds to finance those projects.

With the use of tax-exempt municipal bonds we can not only improve our nation's infrastructure but we can also expect increased investment and economic development in communities of all sizes. We must seize every opportunity we can to stimulate growth through the use of tax-exempt bonds to meet the long-term needs of America's state and local governments.

America's financing needs are increasing while the relative share of public works spending at all levels of government has decreased by over 50% in the past forty years. At the present time demands on repairing infrastructure are overwhelming, over 41% of the nations bridges are deficient or obsolete and 11% of the nation's highways are in need of repair. Since much of the cost of building and renovating the nation's public infrastructure will be borne by state and local governments, continued use of tax-exempt financing will be vital if they are to meet these needs in an efficient and economic manner.

Mr. HUTCHINSON. Thank you, Mr. Chairman, and I want to hear this panel, so I will be very brief. I ask that my comments be entered into the record and I also commend the subcommittee for holding the hearing. I think that it is a very important and very timely subject and the Nation's infrastructure needs, I think, are very well-documented, and what it is going to cost State and local governments to comply with the clean water requirements as well as the cost of bringing our Nation's roads and bridges up to standards is enormous.

And so I think this subject is very important and I especially want to give my greeting and my welcome to my fellow Arkansan, Beryl Anthony, and we appreciate you being with us today and appreciate all the years of service you gave the State of the Arkansas.

[Mr. Hutchinson's prepared statement follows:]

STATEMENT OF HONORABLE TIM HUTCHINSON
HEARING ON TAX-EXEMPT BONDS
SUBCOMMITTEE ON ECONOMIC DEVELOPMENT
JUNE 30, 1994, 11:15 A.M.
2167 RAYBURN H.O.B.

o I CONGRATULATE THIS SUBCOMMITTEE AND ITS LEADERSHIP -- BOB WISE AND SUSAN MOLINARI -- FOR HOLDING THIS HEARING TODAY.

o THIS NATION'S INFRASTRUCTURE NEEDS ARE WELL DOCUMENTED: IT WILL COST STATE AND LOCAL GOVERNMENTS OVER $100 BILLION TO COMPLY WITH CLEAN WATER REQUIREMENTS. THE COST OF BRINGING THIS NATION'S ROADS AND BRIDGES UP TO STANDARDS WILL COST OVER $200 BILLION.

o WITH THE ONGOING DISCRETIONARY SPENDING CAPS, THE FEDERAL GOVERNMENT HAS BEEN UNABLE TO SIGNIFICANTLY INCREASE ITS INFRASTRUCTURE ASSISTANCE TO STATE AND LOCAL GOVERNMENTS. THE USE OF TAX EXEMPT BONDS OFFERS ANOTHER AVENUE FOR THESE GOVERNMENTS TO PAY FOR NEEDED IMPROVEMENTS.

o IN 1992 ALONE, OVER $35 BILLION IN MUNICIPAL BONDS WERE ISSUED TO PAY FOR TRANSPORTATION AND ENVIRONMENTAL INFRASTRUCTURE.

o THE PUBLIC WORKS COMMITTEE HAS HISTORICALLY VIEWED TAX-EXEMPT BONDS AS AN IMPORTANT COMPONENT OF THE SOLUTION TO INFRASTRUCTURE NEEDS. IN 1988, FOR EXAMPLE, ~~I JOINED WITH~~ THE PUBLIC WORKS COMMITTEE LEADERSHIP ~~IN~~ SUPPORT~~ING~~ LEGISLATION DEALING WITH MANY OF THE ISSUES OF TODAY'S HEARING.

o AGAIN, I BELIEVE THIS IS A TIMELY AND IMPORTANT HEARING AND I LOOK FORWARD TO RECEIVING THE TESTIMONY OF TODAY'S WITNESSES.

Mr. HUTCHINSON. I would also like to ask consent to have entered into the record the statements of Ms. Molinari and Mr. Shuster.

Mr. WISE. Without objection.

[The prepared statements of Ms. Molinari and Mr. Shuster follow:]

REP. SUSAN MOLINARI
OPENING STATEMENT
ECONOMIC DEVELOPMENT SUBCOMMITTEE HEARING ON INFRASTRUCTURE FINANCE: USE OF TAX-FREE BONDS
JUNE 30, 1994

Thank you, Mr. Chairman. I want to join you in welcoming our panelists today. I think the subject of this hearing is timely and important. I am especially pleased to see Mr. Scott Reznick here today. I was first introduced to Mr. Reznick and his ideas by our colleague Rick Santorum last year when he testified before this committee and I welcome Mr. Reznick's testimony today.

As we seek ways to make badly needed improvments in our highways, transit systems, drinking water and solid waste disposal facilities and other infrastructure--at a time when the federal dollars are not there to spend and our state and local governments are also constrained by tight budgets--it is important that we look at creative alternatives.

We must find new ways to fund infrastructure without resorting to new taxes. Tax-exempt municipal bonds are obviously one vehicle we should look to.

Our colleague William Coyne has introduced the Public Finance and Infrastructure Investment Act, H.R. 3630, which brings forth several innovative tools for infrastructure finance.

For example, this bill would raise the cap on the Private Loan Test, which would be of enormous benefit to cities like New York. The Private Loan Test is one way in which a municipal bond may be classified as a taxable rather than tax-exempt bond.

The Private Loan Test requires that a bond be classified as a Private Loan Bond--and thus taxable--if the amount of the bond proceeds that are loaned to an entity other than a state or local government exceeds the lesser of 5 percent of the proceeds or $5 million. HR 3630 raises that cap to $15 million.

The practical effect of being a taxable bond is that the issuer must pay higher interest costs. A bond failing the Private Loan Test may still be tax-exempt but can only be used in narrowly defined ways, such as low income multifamily housing.

According to New York city officials, raising this cap to $15 million, or removing it entirely, would give cities much more flexibility and make tax-exempt bonds a more effective tool for infrastructure finance. So this is certainly a proposal that merits careful consideration.

I look forward to further discussion of this and other ideas today and again I welcome our witnesses and thank them for being here today.

STATEMENT OF HONORABLE BUD SHUSTER
HEARING ON TAX-EXEMPT BONDS
SUBCOMMITTEE ON ECONOMIC DEVELOPMENT
JUNE 30, 1994, 11:15 A.M.
2167 RAYBURN H.O.B.

o I CONGRATULATE THIS SUBCOMMITTEE AND ITS LEADERSHIP -- BOB WISE AND SUSAN MOLINARI -- FOR HOLDING THIS HEARING TODAY.

o THIS NATION'S INFRASTRUCTURE NEEDS ARE WELL DOCUMENTED: IT WILL COST STATE AND LOCAL GOVERNMENTS OVER $100 BILLION TO COMPLY WITH CLEAN WATER REQUIREMENTS. THE COST OF BRINGING THIS NATION'S ROADS AND BRIDGES UP TO STANDARDS WILL COST OVER $200 BILLION.

o WITH THE ONGOING DISCRETIONARY SPENDING CAPS, THE FEDERAL GOVERNMENT HAS BEEN UNABLE TO SIGNIFICANTLY INCREASE ITS INFRASTRUCTURE ASSISTANCE TO STATE AND LOCAL GOVERNMENTS. THE USE OF TAX EXEMPT BONDS OFFERS ANOTHER AVENUE FOR THESE GOVERNMENTS TO PAY FOR NEEDED IMPROVEMENTS.

- IN 1992 ALONE, OVER $35 BILLION IN MUNICIPAL BONDS WERE ISSUED TO PAY FOR TRANSPORTATION AND ENVIRONMENTAL INFRASTRUCTURE.

- THE PUBLIC WORKS COMMITTEE HAS HISTORICALLY VIEWED TAX-EXEMPT BONDS AS AN IMPORTANT COMPONENT OF THE SOLUTION TO INFRASTRUCTURE NEEDS. IN 1988, FOR EXAMPLE, I JOINED WITH THE PUBLIC WORKS COMMITTEE LEADERSHIP IN SUPPORTING LEGISLATION DEALING WITH MANY OF THE ISSUES OF TODAY'S HEARING.

- AGAIN, I BELIEVE THIS IS A TIMELY AND IMPORTANT HEARING AND I LOOK FORWARD TO RECEIVING THE TESTIMONY OF TODAY'S WITNESSES.

Mr. WISE. I would also ask unanimous consent to introduce the statements of Chair Mineta and Mr. Blackwell into the record as well.

[The prepared statements of Mr. Mineta and Mr. Blackwell follow:]

OPENING STATEMENT
NORMAN Y. MINETA, CHAIR
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
BEFORE THE SUBCOMMITTEE ON ECONOMIC DEVELOPMENT
June 30, 1994

INNOVATIVE FINANCING OF INFRASTRUCTURE INVESTMENT: THE USE OF TAX-EXEMPT BONDS

I would like to thank the Chairman of the Subcommittee on Economic Development, Mr. Wise, and the Ranking Member, Ms. Molinari, for holding this important hearing to explore proposals to increase the use of tax-exempt bonds to provide a funding source to improve the Nation's highways, transit systems, airports, wastewater treatment systems, and other public infrastructure. As a former mayor, I am well aware of the important role which tax-exempt bonds play in state and local governments' ability to finance necessary infrastructure investment.

Today, many states and local governments are putting the finishing touches on their annual budgets which are due tomorrow. As these different state and local officials review their budgets, several points consistently appear. First, these communities face enormous public infrastructure challenges. For instance, consider our wastewater treatment needs -- the Environmental Protection Agency has identified municipal wastewater treatment needs of **$137 billion** over the next two decades. Although this is only one element of our physical infrastructure, the number is daunting.

Second, the federal government, faced with tight budgetary constraints, is unable to help these communities finance their infrastructure investments the way it once did. Compared to 30 years ago, the federal investment in infrastructure has dropped by one-half.

Finally, while we have asked state and local governments to assume a greater part of the infrastructure financing burden, we have also taken away many of the incentives which make it possible for these governments to invest in our Nation's infrastructure. Today, the Subcommittee will examine how the federal government can encourage state and local governments to use tax-exempt bonds to finance infrastructure investment.

As the Subcommittee's hearing indicates, Members of the Public Works Committee accept the challenge to help communities find ways to invest in our infrastructure and help our Nation better compete in the global economy.

STATEMENT OF THE HONORABLE LUCIEN E. BLACKWELL
BEFORE THE SUBCOMMITTEE ON ECONOMIC DEVELOPMENT
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

HEARING OF JUNE 30, 1994

INNOVATIVE FINANCING OF INFRASTRUCTURE INVESTMENT:
THE USE OF TAX-EXEMPT BONDS

Thank you, Mr. Chairman. It is indeed a pleasure to be here, and I welcome all of our witnesses.

Our objective today is clear. It should be to secure the repair, improvement and expansion of the transportation infrastructure system as needed to improve the nation's economic productivity, international competitiveness, and quality of life. There is some agreement in the United States transportation community on the nature and scope of the problem, but little consensus on solutions.

The root problems come down to a shortage of supply: too few roads and railways, and to a lesser extent air and water facilities; too few opportunities to change between modes easily and efficiently; and too little combination of the strengths of different systems and services. The problem, as I see it, is that insufficient investment in transportation infrastructure and the inadequate management of these limited funds have damaged national competitiveness in the global marketplace.

Accordingly, several related problem areas must be sorted through before real progress can be achieved. I understand that these areas comprise several factors among which are the following: the role of the private sector, environmental considerations, mass transit initiatives, the trust fund issue (the fact that taxes collected for specific infrastructure-related purposes are being used to offset the federal budget deficit),

research and development, national security implications, regulations, and defense integration and reinvestment (the need to shift a portion of the defense industry and its personnel to a more non-military focus).

Perhaps our examination today of the use of tax-exempt bonds might provide a greater impetus to counteract some political and social goals whose unintended effect has been the further undermining of the viability of the transportation network. In today's world, the ability to exchange goods and services in an efficient and cost-effective manner is intrinsically linked to international competitiveness, economic productivity, and quality of life. Yet while the United States debates the merits of a sophisticated infrastructure network, some of its competitors are already implementing their own.

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Therefore, transportation policy should ensure continued soundness in the nation's infrastructure by emphasizing both short and long-term solutions that provide both funding and incentive for repair, while at the same time encouraging judicious investment for improvements and new technologies. Today, as we listen to the testimony about more innovative financing techniques, we should weigh the use of tax-exempt bonds with the soundness of the approach. Indeed, any policy we adopt regarding this measure should, at the very least, emphasize cooperation between local, state, federal and private entities in regard to responsibility for funding and implementing programs.

The fact that tax-exempt bonds typically have a lower interest rate is encouraging. The fact that their use may improve our infrastucture, provide greater economic stability, heighten international competitiveness, create new jobs, establish new technologies and derivative industries as well as enhance quality of life is extremely heartening.

Once again, Mr. Chairman, I welcome all of the panelists who have come to enlighten us today and anxiously await their testimony.

Thank you, Mr. Chairman.

Mr. WISE. Mr. Kim, any opening remarks, the gentleman from California?

Mr. KIM. No, Mr. Chairman.

[Mr. Costello's prepared statement follows:]

JERRY F. COSTELLO
12TH DISTRICT ILLINOIS

PLEASE RESPOND TO THE OFFICE CHECKED BELOW

COMMITTEES
BUDGET
PUBLIC WORKS AND TRANSPORTATION
SCIENCE SPACE AND TECHNOLOGY
(ON LEAVE)

Congress of the United States
House of Representatives
Washington, DC 20515-1312

OPENING STATEMENT OF

CONGRESSMAN JERRY F. COSTELLO

SUBCOMMITTEE ON ECONOMIC DEVELOPMENT

HEARING ON INNOVATIVE FINANCING OF INFRASTRUCTURE INVESTMENT:
THE USE OF TAX-EXEMPT BONDS

June 30, 1994

Mr. Chairman, I would like to thank you for calling today's hearing on innovative financing options for infrastructure projects. State and local governments need to have a variety of options available to finance local transportation projects and the use of bonds is very important.

A number of proposals are currently before the Congress to make changes to the 1986 Tax Reform legislation. These proposals include a change to arbitrage restrictions, restoration of the bank interest deduction, repeal of the Alternative Minimum Tax and new rules to distinguish governmental bonds and private-activity bonds. Other ideas are modifications to statewide volume caps, authority for more advance refundings and reclassification of tax-exempt organization bonds as "public purpose".

I look forward to hearing testimony from the witnesses who will speak today on the importance of these provisions to state and local governments. I would also like to hear any estimates available on the revenue impact of these proposed modifications.

Again, Mr. Chairman, thank you for your leadership. Given

☐ 119 Cannon Building
Washington DC 20515
Tel (202) 225-5661
Fax (202) 225-0285

☐ 327 W Main St
Belleville IL 62220
Tel (618) 233-8026
Fax (618) 233-8765

☐ 1363 Niedringhaus Ave
Granite City IL 62040
Tel (618) 451-7065
Fax (618) 451-2126

☐ 250 W Cherry St
Carbondale IL 62901
Tel (618) 529-3791
Fax (618) 549-3768

☐ 8787 State St
East St Louis IL 62203
Tel (618) 397-8833

☐ 1330 Swanwick St
Chester IL 62233
Tel (618) 826-3043

the importance of infrastructure investment to the economic development of communities across our nation, it is certainly appropriate for our Subcommittee to review the use of tax-exempt bonds as well as other public financing options.

Mr. WISE. At this point, we will turn to our first panel, and by mutual consent, Mr. Coyne has a markup in Ways and Means and will go first.

TESTIMONY OF HON. WILLIAM J. COYNE, A REPRESENTATIVE IN CONGRESS FROM PENNSYLVANIA

Mr. COYNE. Thank you, Mr. Chairman, Mr. Hutchinson, Mr. Kim, for the opportunity to testify here today on the role of tax-exempt financing in infrastructure investment. I must say, it is a great pleasure for me to testify with Beryl Anthony, who served on the Ways and Means Committee with me for several years. I know of his longstanding interest in this subject and his long leadership as a Member of that committee.

As a Member of Congress serving on the House Ways and Means Committee, and as a former member of the Pittsburgh City Council, I have had considerable opportunity to experience the benefits of tax-exempt financing as a tool for economic development and job creation.

My experiences in this area led me to introduce legislation providing for the permanent extension of the Industrial Development Bond Program. This proposal was included in the 1993 Budget Reconciliation Act. Nationwide, between 1987 and 1992, IDBs have created an estimated 182,000 new manufacturing jobs and facilitated the retention of 169,000 jobs through the financing of roughly 3,800 projects.

My own State of Pennsylvania, for example, financed 224 projects between 1987 and 1992, which created 8,975 new jobs and helped to retain 17,700 jobs that might otherwise have been lost.

The point here is that tax-exempt bond programs promote economic development and job creation. There is, however, a need for the Federal Government to do more to create employment and jobs. Congress should provide State and local governments with much-needed Federal assistance in financing investments in infrastructure and economic development.

This is especially true since business often makes decisions on the location of new facilities based on the availability and quality of the community's infrastructure. That is why I introduced H.R. 3630, the Public Finance and Infrastructure Investment Act of 1993.

H.R. 3630 is supported by 19 of my colleagues on the House Ways and Means Committee, and a total of 34 cosponsors. This legislation would create a new tax-exempt bond, the distressed community economic development bond, that would be targeted at communities that have been hard hit by job loss, population loss, slow growth, or military base closings.

This bill also makes changes in the Internal Revenue Code that will facilitate the use of tax-exempt bonds in meeting pressing State and local government capital financing needs.

I will direct my comments primarily to the proposal for the distressed Community Economic Development Bond Program. The need for this legislation reflects the fact that while the demands on State and local governments have increased substantially, the resources at their disposal have declined. In the last 14 years, the Federal Government has eliminated general revenue sharing and

urban development action grants, and it has limited funding for programs like the economic development administration and community development block grants.

At the same time, the Federal Government has imposed a number of unfunded mandates on State and local governments that require expensive new investments in infrastructure, like water and sewage treatment facilities.

Such investments clearly improve Americans' quality of life but they also consume large portions of State and local governments' scarce capital budgets, which might otherwise be used to foster economic development.

Tax-exempt bonds are important tools in financing activities that promote economic development and create significant job opportunities. In many cases, Federal tax-exempt bond programs provide some of the few remaining sources of significant Federal economic development assistance. Tax-exempt financing is especially important because it is not affected by shortfalls in the availability of discretionary funds.

If the communities of America are to realize the full economic development potential of tax-exempt financing, however, Congress must act to streamline the current restrictions on tax-exempt bonds. H.R. 3630 would do just that. The Public Finance and Infrastructure Investment Act of 1993 would streamline the definition of tax-exempt private activity bonds, simplify existing arbitrage rebate requirements, increase the smaller issue exception for bank deductibility of interest, and index the private activity bond volume cap to inflation.

In addition, H.R. 3630 would establish a new type of tax-exempt private activity bond, the distressed community economic development bond. The distressed community economic development bond would provide an important job creating tool for communities hurt the most by changing local economic conditions. The distressed community economic development bond would be targeted at communities that have been hard hit by population loss, job loss, slow growth, or military base closings.

Communities which meet the bill's criteria for designation as distressed communities could issue private activity bonds to promote a wide range of economic development projects within their jurisdictions. I believe that the distressed community economic development bonds will provide economically hard hit communities—whether they are large or small, urban or rural—with the necessary means to foster economic growth and job creation.

At the same time, the bond reform provisions of the Public Finance and Infrastructure Investment Act of 1993 would increase the usefulness of tax-exempt bonds in meeting pressing State and local infrastructure needs. Enactment of this legislation would provide significant resources for economic development and job creation. It has been shown that 20,000 new jobs are created for every additional $1 billion in public investment.

Mr. Chairman, I want to thank you and the Members of the committee for your leadership in exploring economic development options available to communities across the country.

While H.R. 3630 addresses issues related to the Internal Revenue Code, which are within the jurisdiction of the Ways and Means

Committee, I want to thank the Public Works Subcommittee on Economic Development for providing this opportunity to discuss how this legislation could help American communities create new jobs and expand their local economies.

It is my intent to work for the final approval of this proposal within the House Ways and Means Committee at the earliest appropriate opportunity.

I would, of course, welcome the support of the Members of the Public Works Committee in this effort. And I want to thank you and the Members of the panel for your holding this hearing here today.

Thank you.

[Mr. Coyne's prepared statement follows:]

THE HONORABLE WILLIAM J. COYNE
TESTIMONY FOR
THE HOUSE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
SUBCOMMITTEE ON ECONOMIC DEVELOPMENT
JUNE 30, 1994

Mr. Chairman, thank you for this opportunity to testify on the role of tax-exempt financing for infrastructure investment.

As a Member of Congress serving on the House Ways and Means Committee and as a former Member of the Pittsburgh City Council, I have had considerable opportunity to examine the benefits of tax-exempt financing as a tool for economic development and job creation.

My experiences in this area led me to introduce legislation providing for the permanent extension of the Industrial Development Bond program. This proposal was included in the 1993 Budget Reconciliation Act. Nationwide, between 1987 and 1992, IDBs have created an estimated 182,000 new manufacturing jobs and facilitated the retention of 169,000 jobs through the financing of roughly 3800 projects. My own state of Pennsylvania, for example, financed 224 projects between 1987 and 1992 which created 8,975 new jobs and helped retain 17,724 jobs that might have otherwise been lost.

There is, however, a need for the Federal Government to do more to create jobs. Congress should provide state and local governments with much-needed federal assistance in financing investments in infrastructure and economic development. This is especially true since businesses often make decisions on the location of new facilities based on the availability and quality of a community's infrastructure.

That is why I introduced H.R.3630, the Public Finance and Infrastructure Investment Act of 1993. H.R.3630 is supported by 19 of my colleagues on the House Ways and Means Committee with a total of 34 cosponsors currently. This legislation would create a new tax-exempt bond program, the Distressed Community Economic Development Bond, that would be targeted at communities that have been hard-hit by job loss, population loss, slow growth, or military base closings. This bill also makes changes in the Internal Revenue Code that will increase the usefulness of tax-exempt bonds in meeting pressing state and local government capital financing needs.

The need for this legislation reflects the fact that while the demands on state and local governments have increased substantially, the resources at their disposal have declined. In the last 14 years, the Federal Government has eliminated General Revenue Sharing and Urban Development Action Grants, and it has limited funding for programs like the Economic Development Administration and Community Development Block Grants.

At the same time, the Federal Government has imposed a number of unfunded mandates on state and local governments that require expensive new investments in infrastructure like water and sewage treatment facilities. Such investments clearly improve Americans' quality of life, but they also consume large portions of state and local governments' scarce capital budgets, which might otherwise be used to foster economic development.

Tax-exempt bonds are important tools in financing activities that promote economic development and create significant job opportunities. In many cases, federal tax-exempt bond programs provide some of the few remaining sources of significant federal economic development assistance. Tax-exempt financing is especially important because it is not affected by shortfalls in the availability of discretionary funds.

In short, tax-exempt financing provides an attractive source of funding for important and meritorious economic development projects in communities across America. At the same time, these financing tools are not without their restrictions, some of which impose unnecessary administrative or financial burdens.

If the communities of America are to realize the full economic development potential of tax-exempt financing, then Congress must act to streamline the current restrictions on tax-exempt bonds. H.R.3630 would do just that.

The Public Finance and Infrastructure Investment Act of 1993 would streamline the definition of tax-exempt private activity bonds, simplify existing arbitrage rebate requirements, increase the small-issuer exception for bank deductibility of interest, and index the private activity bond volume cap to inflation.

Most significantly, H.R.3630 would also establish a new type of tax-exempt private activity bond, the Distressed Community Economic Development Bond.

The Distressed Community Economic Development Bond would provide an important job creating tool for communities hurt the most by changing local economic conditions. The distressed community economic development bond would be targeted at communities that have been hard-hit by population loss, job loss, slow growth, or military base closings.

Communities which meet the bill's criteria for designation as distressed communities could issue private activity bonds to promote a wide range of economic development projects within their jurisdictions. In light of the sharp decline in federal support for state and local governments in recent years -- and the concurrent growth in federally imposed mandates on those same governments -- Congressional action to encourage economic development is long overdue.

The Federal Government's financial support for community and economic development activities has declined markedly over the last 12 years. At the same time,

other government policies and changes around the world have adversely affected particular communities and regions of our country. For example, U.S. efforts to open up global trade markets benefit domestic manufacturers of export products, but they have at times had adverse impacts on other domestic industries and specific regions of the country. Another informative example is defense spending. Defense production and military activities encouraged the growth of many communities over the last fifty years. With the end of the Cold War, these same communities face shrinking economic opportunities and a surplus of operational infrastructure assets.

In addition, national infrastructure programs have had inadvertent secondary effects which have placed many hard-hit communities at a disadvantage in attracting new sources of employment. For example, in the past, Federal funding for new highway construction often encouraged the location of business facilities in suburban or rural "green field" sites, to the detriment of existing communities with the necessary infrastructure already in place.

As a result, many communities have experienced unprecedented job loss and economic dislocation. These communities are in desperate need of economic development activities that will provide new jobs and tax revenues.

There have been other adverse effects as a result of certain federal policies as well. Certain federal policies increase the overall cost of providing public services by encouraging under-utilization of existing infrastructure in some areas and shifting demand for such services to areas where new infrastructure must be built. Moreover, many of these same policies produce insidious side-effects like excessive energy consumption and increased air pollution. The Federal policies described above, however, provide important benefits to society. Such policies should also not necessarily be eliminated; rather, additional Federal action is needed to offset their adverse effects on communities that have been hard-hit by major changes in the economy, and to recognize the value of existing infrastructure like housing, roads, schools, and water and sewage treatment facilities.

H.R.3630 addresses these problems through the economic development bond program. The proceeds of such bonds could be used to finance economic development projects in areas which qualify as "distressed communities."

The eligibility criteria consist of (1) population loss equal to or greater than 5 percent, (2) an average five-year unemployment rate of not less than 8 percent, (3) slow job growth, or (4) a military base closing resulting in the loss of not less than 500 jobs.

Only 50 percent of any economic development bond will be counted toward the issuing authority's volume cap allocation, and banks could deduct the interest costs of purchasing economic development bonds issued by qualified small local governments.

These bonds will provide economically hard-hit communities -- whether they are large or small, urban or rural -- with the necessary means to foster economic growth and create new jobs. In short, these bonds will help communities that have been hit by the recent recession at a time when local and state governments find themselves without sufficient resources to make important long-term investments.

I believe that the proposed Distressed Community Economic Development Bond would advance the significant public goal of expanding job opportunities where they are most needed. At the same time, H.R.3630 would provide a number of essential reforms to current bond provisions of the Internal Revenue Code.

Tax-exempt bonds were last addressed in a comprehensive fashion in the Tax Reform Act of 1986. The Tax Reform Act of 1986 was a monumental piece of legislation that dramatically reformed many provisions in the Federal tax code. This law made significant positive changes in the Code with regard to tax-exempt bonds. Some of these changes need to be revisited, however. In addition, a broad consensus has developed in Congress since 1986, primarily as a result of the work of the Anthony Commission on Public Finance, that a number of additional reforms in our tax-exempt bond laws are necessary. Lastly, subsequent events unrelated to, or only indirectly related to, the Tax Reform Act of 1986 have had an impact on States and local governments, and on the market for tax-exempt bonds, and these changes need to be addressed as well.

Over the past several years, a number of bills have been introduced to correct some of the problems associated with bond provisions within the Tax Reform Act of 1986. Many of the provisions in H.R.3630 were included in H.R. 11, the Revenue Act of 1992, which was passed by Congress last year but subsequently vetoed by President Bush. Many of them were also included in H.R. 13, the Tax Simplification Act of 1993, as originally introduced by Ways and Means Committee Chairman Dan Rostenkowski last year. In fact, with the exception of the distressed community economic development bond, which is a new proposal, most of these provisions have enjoyed a long history of strong support from the public finance community.

Over the years, Congress has modified the definition of tax-exempt private activity bonds, adding different provisions to prevent issuers from abusing the federal interest subsidies provided through tax-exempt financing. Today, however, a cap on the total annual volume of private activity bonds that can be issued effectively forces state and local governments to choose their investment initiatives from among many needed projects. As a result of this change to the tax code, several older provisions of the Internal Revenue Code today increase the system's administrative complexity without contributing significantly to reducing abuse or federal revenue loss. Consequently, this legislation repeals the 5 percent unrelated and disproportionate private use test and the lower private business test for certain output facilities, and it increases the nominal limit on the private loan financing test from $5 million to $15 million.

The Public Finance and Infrastructure Investment Act of 1993 also contains a number of provisions that simplify the tax-exempt bond arbitrage provisions in the Internal Revenue Code. A number of arbitrage restrictions in the tax code pre-date the adoption of the arbitrage rebate requirement. Now, in light of the comprehensive rebate requirement, these provisions add little to the code but administrative complexity. In addition, the bill expands the small issuer arbitrage rebate exception to cover issuers that issue up to $10 million in a given calendar year. The current limit of $5 million exempted more than half of the issuers of tax-exempt bonds from the arbitrage rebate requirement in 1992. The bonds issued by these small issuers made up less than 5 percent of the volume of long-term municipal new issues that year. Increasing the exception to issuers issuing $10 million or less in any given year would exclude over 70 percent of municipal issuers from the requirement to track, calculate, and rebate arbitrage profits. Those issuers combined produced less than 10 percent of the long-term municipal issues in 1992.

Banks and other financial institutions are, for the most part, denied a deduction for the portions of their interest expenses attributable to investment in tax-exempt bonds acquired after August 7, 1986. An exception to this disallowance is permitted for tax-exempt bonds issued by governments that issue no more than $10 million of such bonds during a calendar year. This provision is known as the "small-issuer exception."

Six thousand of the 8,500 issuers of tax-exempt municipal bonds each issued less than $10 million in bonds in 1992. These issuers were responsible for only $19 billion of the $235 billion in long-term municipal new issues that year.

The bill increases the small issuer exception from $10 million to $25 million. This change substantially increases the number of tax-exempt bond issuers eligible for coverage under this provision without a proportionate impact on federal revenue loss. Increasing the limit from $10 million to $25 million would provide over 1,000 more issuers the benefits of the bank deductibility of interest exception; such issuers were responsible for only $17 billion in long-term municipal new issues in 1992. In addition, this change addresses the impact of inflation in the years since the Tax Reform Act of 1986 was enacted; due to inflation, the $10 million volume limit now affects small issuers that the Congress never intended to exclude from coverage under this provision.

The bill also indexes annual state volume cap allocations for inflation in calendar year 1994 and each year thereafter. This change would address the impact of inflation on the cap in subsequent years. Due to the decrease in the purchasing power of the dollar since 1987, the volume cap now allows a smaller volume of private activity bond issuance than the Congress intended in 1986. Moreover, the volume cap level was set with the understanding that mortgage revenue bonds and small-issue industrial development bonds would expire at the end of 1987. These tax-exempt bond provisions were subsequently extended and have now been made permanent, reducing the volume of private activity bonds available under the cap for other purposes to a level less than

that Congress intended in 1986. Consequently, indexation of the private activity bond volume cap is advisable.

In conclusion, the Public Finance and Infrastructure Investment Act of 1993 would increase the usefulness of tax-exempt bonds in meeting pressing state and local infrastructure needs. Enactment of this legislation would provide significant resources for economic development and job creation. It has been shown that 20,000 new jobs are created for every additional $1 billion in public investment.

Mr. Chairman, I want to thank you for your leadership in exploring economic development options available to U.S. communities. While H.R.3630 addresses issues related to the Internal Revenue Code, which are within the jurisdiction of the Ways and Means Committee, I want to thank the Public Works Subcommittee on Economic Development for providing this opportunity to discuss how this legislation could help American communities create new jobs and expand their local economies.

It is my intent to work for the approval of this proposal within the House Ways and Means Committee at the earliest appropriate opportunity. I would, of course, welcome the support of the Members of the Public Works Committee in this effort. Thank you, Mr. Chairman.

# # # #

Mr. WISE. I thank the gentleman from Pennsylvania. And indeed this of course is within the jurisdiction of the Ways and Means Committee and it is our hope that we can begin building and understanding in various committees and particularly this is part of an ongoing analysis of infrastructure and what needs to be done in infrastructure and ways that Public Works Committee can assist.

So we look forward to working with you in promoting this case, and one interest I have is trying to show the opportunities that can be gained as well as what we may have lost by failure to enact some of these measures.

I was interested, if it would be all right with the committee since Mr. Coyne has to go, why don't we quickly see if there are any questions for him and then permit him to go on about his markup that he needs to be at. At this point, I will pass and see if there are any other questions.

The gentleman from Arkansas, Mr. Hutchinson.

Mr. HUTCHINSON. Yes. Thank you for your testimony. And thank you, Mr. Chairman. While your legislation is not specific to infrastructure bonds, how do you see H.R. 3630 helping communities to meet the infrastructure needs that they have?

Mr. COYNE. Well, as I pointed out in the testimony, many of the programs that heretofore had helped local communities develop or improve their infrastructure are not available to them now. Tax-exempt bond financing would help communities provide the necessary infrastructure components for local communities.

Mr. HUTCHINSON. I think earlier this year, the President stated that next year he plans on unveiling a major infrastructure bill. Do you see your bill and the components of that as playing a part in that kind of infrastructure proposal of the administration?

Mr. COYNE. Well, I do, particularly when you look at the situation last year when the President and the administration wanted to do something in the economic stimulus package that would have provided enormous resources for local communities. The administration and the President were stymied in the Senate from getting that accomplished.

I know my own county, Allegheny County in western Pennsylvania, would have received another $93 million a year in local infrastructure funds, so to the extent that we are unwilling or unable here on Capitol Hill to provide those kinds of resources, I think tax-exempt financing would be a welcome alternative.

Mr. HUTCHINSON. Thank you.

Thank you, Mr. Chairman.

Mr. WISE. The gentleman from California, Mr. Kim.

Mr. KIM. No comments, no questions.

Mr. WISE. The gentleman from Georgia, Mr. Collins.

Mr. COLLINS. No questions.

Mr. WISE. If I could follow up quickly. Being on Ways and Means, I know you all crunch the numbers a good deal. You are of course very familiar with the budget act, the cap situation. Is there any estimate of how much revenue is, quote, I put it in quotes, lost should these measures be enacted, particularly versus how much is gained in terms of employment and the taxes that would be generated that way?

Mr. COYNE. I don't know that off the top of my head, but I would be happy to try and find out and get that information for you and the subcommittee.

Mr. WISE. That would be very helpful. I suspect that that is going to be the main issue as we come to grips with CBO. Well I, on behalf of the committee, want to thank you very much for taking the time and your patience.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. WISE. At this point, we turn to someone who is a friend of all of us here and no stranger to the Congress certainly is Beryl Anthony. Among his many achievements, he is the head of the Anthony Commission which in 1988 made many of the recommendations that we are discussing today.

It took a look at some of the changes that had occurred in the 1986 Tax Reform Act and gathered local government officials, Federal officials, State officials together and indeed, Beryl, I think that your document that came from that is still the basic document that guides most of us as we move forward today, and I greatly appreciate the time that you have taken to be here.

As I understand it, you are also joined by J.W. Rayder who is Vice President and counsel to Stephens, Inc., and executive director of the Anthony Commission.

TESTIMONY OF BERYL F. ANTHONY, JR., FORMER CONGRESSMAN FROM ARKANSAS, PARTNER, WINSTON & STRAWN, ACCOMPANIED BY J.W. RAYDER, VICE PRESIDENT AND COUNSEL, STEPHENS, INC. AND EXECUTIVE DIRECTOR OF THE ANTHONY COMMISSION

Mr. ANTHONY. Chairman Wise and Members of the subcommittee, thank you for inviting us. Mr. Rayder covered my tax and legislative work on the Ways and Means Committee the last six years I served in the Congress. He was very instrumental in working with the various components of the public finance community as we tried to find some consensus and common ground as we began to develop the recommendations that are in the commission report. I didn't know if you had a copy of it or if the other Members would like to have a copy. I did find three extra copies. I will leave them here if they can serve a useful purpose for you.

Mr. Chairman, and I quote, "America is falling apart, literally. Federal budget pressures and changes in the Federal tax law in the 1980s have steepened a decline in the Public Works spending that dates to the 1950s. If the downward trend continues, Americans will see increasing evidence of deterioration in our highways, water and sewer systems, bridges and other building blocks of the Nation's infrastructure.

"Whatever strategy our President uses to spur our economic growth, one thing is for certain: Our infrastructure is just barely adequate to support our current level of economic activity, and our current rate of infrastructure improvement and investment falls vastly short of tomorrow's needs.

"Declining Public Works investment will inevitably undercut the benefits of private capital investment. If our basic transportation, water supply and waste disposal systems continue to deteriorate,

more money will come out of the private sector's bottom line, thus eroding American productivity."

Mr. Chairman, while these words ring true, they are not mine. These are quotes taken from an article published on June the 24th, 1988, by then-Governor Bill Clinton in The New York Times. A copy of the article is attached to this testimony.

As a firm believer in benefits of infrastructure investment, I commend you for holding these hearings. For years I have sought a national partnership to improve our Nation's infrastructure. The Clinton administration plans to introduce an infrastructure initiative in 1995. With bipartisan input from State and local officials, Members of Congress and the administration, I am confident a sensible infrastructure policy can be enacted that will take us well into the next century.

Mr. Chairman, I basically responded to concerns expressed not only by then-Governor Clinton but Governor Campbell of South Carolina and others to talk about the possibility of going outside the normal committee structure and formulating a special commission to try to bring together the experts and basically put together an educational document.

I did that in 1988, and I must tell you that I did it with some amount of trepidation because Chairmen of committees and subcommittees don't particularly like their junior Members to go outside the normal cycle. And Chairman Rostenkowski then and still does have a strong reputation of ruling a committee with a strict hand. But I thought the need was there so we set up some criteria and we decided to move forward.

Fortunately, the community that I worked with was energized, educated, bright and articulate and I realized that they wanted to make a meaningful input, and I think that is the reason this particular document that was printed in October 1989 has withstood the test of time and scrutiny since then. And as a result of other commissions and other groups that have been formed, I have been asked to either join them or testify before them as have many members of the commission.

And other groups have actually reached in and taken our recommendations as a group as a whole and put them in some of their recommendations. Rebuild America is one that comes to mind. As a result of a piece of legislation that the Congress passed to hold infrastructure hearings, there was a congressional commission that was formed. I testified there. Some of the recommendations that the Anthony Commission found its way into that public-authorized commission that was reported back to the Congress. So you have them as a result of the legislation you enacted.

Over the last five years, the Commission's report has withstood intensive scrutiny and the recommendations have proved broadly acceptable to the public and private groups most affected. The soundness of the commissions recommendations have been further evidenced by the enactment of the several into law and by the inclusion of a substantial number in the Revenue Act of 1992 which was H.R. 11, passed by the Congress, but vetoed by President Bush.

The provisions of H.R. 11 were reintroduced in the current session of Congress and are contained in H.R. 13. And I am also

pleased that my former colleague on the Ways and Means Committee Bill Coyne's piece of legislation also contains many of the recommendations that were outlined in the Anthony Commission's report.

The recommendations of the Commission offer cost-effective mechanisms that can help to sustain the near-term economic recovery and the permanent investment in infrastructure which is essential for long-term growth. These recommendations can be rapidly implemented through modest changes in the Federal tax law.

Such changes will immediately stimulate the flow of private capital into public projects. They will complement and enhance other infrastructure-related initiatives. They can and should play an important role in the Clinton administration's program for rebuilding the Nation's infrastructure and providing a sound basis for economic growth. No other approach can match this one in terms of quickly unlocking private capital for investment in public facilities of lasting benefit.

Any national infrastructure program will achieve maximum effectiveness only if it recognizes the importance of tax-exempt bonds and implements tax law changes that will make local government finance more efficient, accessible, and therefore better able to supplement and leverage Federal support.

The Commission recommends an improved tax code definition of public activity bonds that would permit tax-exempt financing for indisputably public purposes most efficiently undertaken with substantial private participation. The Commission's recommendation protects against past abuses while encouraging the kinds of public-private partnerships particularly needed to ensure prompt application of new technologies to public services in such areas as pollution control, hazardous and solid waste disposal, recycling, and transportation management. Current tax code restrictions on management contracts and over private participation effectively have precluded needed private expertise in many areas.

Private entities cannot prudently commit necessary funds and other resources if their long-term participation is not assured. Absence of private expertise often decreases the economic viability of important public projects and in turn discourages the flow of private capital to such projects. Implementation of this recommendation will open the door for immediate and significant inflow of private expertise in capital entities, public facilities that most need them.

Despite the harsh restrictions imposed by the 1986 Tax Act, the municipal bond market has remained a remarkable efficient source of capital funding. Changes made in 1986, however, have made the market vulnerable to severe volatility and discouraged community investment. These changes have driven traditional buyers, such as banks and certain insurance companies away from the market. Otherwise, these financial institutions are willing and able to invest billions of dollars in long-term public projects.

The recommendation of the Anthony Commission to expand the use of bank eligible bonds and eliminate inefficient alternative minimum tax provisions offer a simple and effective way to help localities serve their citizens and encourage economic growth.

Other proposals can similarly produce prompt and significant results. The Commission was very pleased when permanent extensions of the mortgage revenue and small industrial development bond provisions were enacted last year. Although the Treasury Department has made great strides in simplifying the arbitrage rebate rules, I notice the Chairman mentioned arbitrage rebate. That is the reason J.W. is here, he understands it.

The reforms contained in the Commission report can immediately facilitate local projects and generate savings for State and local governments. The Commission's proposal to ease over restrictive and unnecessary requirements such as the 5 percent unrelated and disproportionate use test can promptly eliminate burdens that regularly delay or make important public projects more expensive.

Tax code relief for State and local governments offer an extraordinarily effective way of opening the offensive to address this Nation's deficient infrastructure. The project selection process and the funding mechanism are already in place and functioning. The municipal bond market, local political accountability and the need to commit the locality's own credit create powerful incentives for selecting the most beneficial projects and financing them in the soundest manner.

Capital will come not from Federal appropriations but from an existing, well-developed private market that repeatedly has demonstrated its ability to provide low cost funding. If the Clinton administration had utilized this approach, its ill-fated economic stimulus package might be having a favorable impact on the Nation's economy as we speak. Instead, it failed because opponents were able to attack it as a wasteful "pork" rather than legitimate economic stimulus.

In recent years, the Federal Government has mandated multitudinous and expensive projects for local governments in areas such as water quality. These projects alone already identified as pressing needs for public expenditure could provide a major infusion of economic stimulation and public improvement. Small changes in tax law and Federal regulations will greatly facilitate an efficient and cost-effective flow of funds to these public capital projects.

Improvement of tax rules to encourage public purpose borrowing will permit the Clinton administration to stimulate maximum economic growth with a minimum of delay and minimum of Federal dollars. It offers a proven method to generate employment and promote long-term public investment, providing immediate relief where most needed and enhancing Federal dollars as they are made available over time through grants, revolving loans and other direct programs.

The Commission report—the Commission supports the development of these programs. Their cost-effectiveness will be multiplied if tax-exempt financing can be used to leverage the Federal investment by attracting private capital to the projects such programs support.

The Clinton administration has an important opportunity to promote sound decision-making in Federal tax policy. In recent years, the concept of Federal revenue neutrality rooted in legitimate concerns about the deficit have obscured the relationship between Fed-

eral tax law and national economic development. Short-term revenue concerns have sometimes clouded decision-making about long-term economic growth.

Mr. Chairman, your own question right out of the box to Congressman Coyne highlights exactly what I am talking about. In promoting economic growth and supporting infrastructure formation, the Congress and administration should consider many combinations of direct expenditures and tax code changes to purchase economic growth. Unfortunately, the Federal legislative process sometimes discourages the use of appropriately broad cost-benefit analysis.

Tax law changes are addressed in committees primarily concerned with the narrow question of Federal revenues, while direct expenditures are considered by committees focused primarily on the programmatic and economic results of such expenditures.

The Anthony Commission urges the Congress and the administration to ensure these institutional predispositions do not impede the process of choosing the best combination of direct expenditures and tax expenditures. Important proposals for economic growth should be judged by their overall effect on the economy and not primarily by their Federal revenue neutrality as determined by the often mysterious revenue estimating process.

I guess the short line is, cut the shackles from OMB and CBO and do what you know is proper for the long term. If that means amending the current budget process, then that is where the fight will have to occur. If you don't do that, the question will always be, how much does the provision cost and then you will have to raise revenue from somebody else in order to pay for it. You will never get the infrastructure program the country needs.

The Anthony Commission endorses a new Federalism under which the Federal Government encourages State and local governments to promote economic vitality. The Commission's recommendations reflect thoughtful consideration by a broad range of participants and a recognition of the need to ensure that the Federal tax law encourages responsible behavior by State and local governments.

The process of producing the Anthony Commission report has brought together diverse interests about expertise and experience in public finance, including representatives of the States, cities and counties, special authorities, nonprofit providers of public services, and the private sector entities that finance public improvements.

The work of the Commission has demonstrated the ability of these groups to build effective coalitions to promote legislative changes.

The Commission and the groups that have supported it stand ready to assist this committee and the Clinton administration in promoting these recommendations and in marshaling the broad support for them that exists throughout the country. We can make available the extraordinary range of expertise and experience that our members and their supporting organizations have in State and local governments, finance and related Federal tax law questions. We also recognize our obligations to promote the kind of thoughtful reform in this important area that President Clinton has always endorsed.

The Members of the committee are listed in an attachment at the end of the testimony. Mr. Chairman, I would just like to mention a couple of things about the membership. William Jefferson Clinton was the Democratic Governor, and Carroll Campbell, Jr. was the governor of the State of South Carolina, the Republican to make it bipartisan. Now our Governor is in the White House.

Kay Bailey Hutchinson was the treasurer of the State of Texas, a Republican. Now she is the Senator from Texas. Kathleen Brown is the treasurer of the State of the California. And now she is running for governor of the State of California. So our members have grown and they expanded and they have even placed themselves in more areas of responsibility. So I think you can count on the fact that you will have some broad bipartisan support on both sides of the Capitol.

Thank you.

Mr. WISE. We thank you, Mr. Anthony. I might note you had a long and distinguished service on the Ways and Means Committee, but your remarks on growth could mark you very well as a senior Member of the Public Works Committee and the need to focus on the long term and to look at the, as you termed them, shackles that are imposed by the budget act and by our own Federal budgeting procedure, and I promise and I want to reassure the audience some of you have been at previous hearings with us that I will not engage in my 45 minute diatribe about the need for capital budgeting, but it is another part of this total package.

You talked about the subject that the budget act problems. And you and as the commission went through and made its recommendations, was there an attempt to try to determine how much revenue would be foregone to the Federal Treasury should these measures be enacted?

Mr. ANTHONY. Yes, and we even went one better than that, Mr. Chairman. One of the first things we did was to solicit some outside funds and we hired an outside firm that had expertise in estimating that had actually—these personnel had actually worked at Treasury and they at one time had been government employees to do estimating for the Congress, and we prepared a very detailed report outlining all of the frailties of the current estimating model because the model does not take into consideration dynamics that take place in the marketplace.

And I know the gentleman from Georgia understands that if you do something of a positive nature, that there is going to be some positive things done in the marketplace. The model that is used is a static model and it does not reflect what we know in real life takes place. So you have to legislate off of a revenue number that is not real so, yes, we took a look at it.

The revenue measure that I introduced, I guess the tax—Joint Tax Committee estimated one cost as much as $350 million in foregone revenue which meant that as I introduced that amendment, I had to offer a B amendment that raised $350 million from somebody. And it made no sense, it makes no sense today, and it will make no sense when you start marking up your bill, but it will be the thing that will handicap the President and the Congress in terms of putting together meaningful infrastructure legislation.

Mr. WISE. Actually——

Mr. ANTHONY. Everybody can figure out what to do. Nobody can figure out how to pay for it because you have got to basically gouge somebody else in order to do what is going to benefit everybody. So unless you really go back into the budget process, and the estimating process, you and every other Member of Congress will always be impaled on the horns of a dilemma.

Mr. WISE. That is compounded because this Federal Government does not have a form of capital expenditure that recognizes capital investment so, therefore, while some would argue this is an investment you can amortize over the life of the asset, that is not the way CBO scores it and so you are quite correct on that.

Mr. ANTHONY. And actually, many States do have capital budgeting and, therefore, they are able to balance their budgets on an ongoing revenue basis. If the Federal Government had a capital budget, we would be in balance. We would be in surplus.

Mr. WISE. The theory of the 1986 Tax Act was you level the field for everybody, tax implications aren't to be the consideration but economic considerations are. Are your proposals, the Anthony Commission proposal essentially restoring what was already in the previous tax code or did you alter those?

Mr. ANTHONY. No, we altered them significantly. The main thing that we did not want to do was, first of all, be perceived as trying to go back to what some people thought were abusive techniques used prior to the 1986 Tax Act.

So what we did is we really looked at all of those areas very, very closely and tried to make what we considered to be reasonable, sensible, meritorious recommendations to amend those areas. What happened in 1986 was done with no policy thought implication. Every time the committee needed revenue to make up for flattening the tax to 28 percent and eliminating loopholes, they basically reached over into two areas. They reached over into pensions and they reached over into tax-exempt bonds because there is a lot of money foregone under tax expenditures in both of those areas.

As a result, the 1986 Tax Act created enormous disparities in pensions and then tax-exempt bonds. We went too far but we went too far because nobody backed off and said what is the long-term investment policy and what is the long-term savings policy. Well since then, pension funds or pension plans, have been eliminated by the millions and we are woefully short on infrastructure.

So the reason I was so pleased that you are looking at this is that, for the first time, the Congress can sit down and say let's plan a long-term economic policy for the country. And then if you run into some legislative hurdles, work your way through them because the first hurdle you are going to run into is the question you asked Mr. Coyne, what does it cost?

And that is always the answer—I mean, if that is always the question, and no regard given to the true market reaction and where the economic activity is going to come, neither you nor the President is going to be successful in 1995 in putting the infrastructure bill together. You can't do it through all direct expenditures because the money is short and you have got a lot of needs scattered out throughout the discretionary budget functions. So you have got scarce dollars there.

So if you can find your way through this OMB, CBO joint tax mysterious estimating process, then you will be well on your way to putting a piece of legislation together.

Mr. WISE. I greatly appreciate your thoughts and the time you have taken, and you are absolutely correct.

I now turn to Mr. Hutchinson.

Mr. HUTCHINSON. Beryl, thank you for your testimony today.

Mr. ANTHONY. Thank you.

Mr. HUTCHINSON. I especially appreciate the emphasis upon the need for a dynamic model when we come to infrastructure investments and have been learning a lot this past year about the problems we have in the budget process and the rules by which we operate, whether it is NAFTA or GATT or whether it is the infrastructure and the way we handle that in the Capital budgeting.

The President, then-Governor Bill Clinton, wrote The New York Times article in 1988 entitled America is Buckling and Leaking. Your Commission issued its report in 1989. It has been almost five years. Give me a kind of a comparative analysis of how bad it is now compared to then.

How much worse are we off in the infrastructure and the need to do what you are doing? And you mentioned the direct expenditures as well as the tax law changes as means of financing. What kind of ratio do we get? How big a part of the solution are tax law changes in financing?

Mr. ANTHONY. Well, there has been an enormous amount of money spent on infrastructure, a lot by States and local governments and a lot by corporations, because they have been forced to by Federal mandates and they were subject to heavy fines and penalties or withdrawal of Federal funds if they did not do that.

But that has also been done at a huge political cost because now you have a huge backlash that has occurred on unfunded mandates that you have to deal with on a day-to-day basis. So I would say that we are holding our own.

Every day, though, you can read a horror story about a bridge or a highway or some local community needing more money to do something on their solid waste or their water. The demand is definitely there.

I guess the best way to say it for you, Mr. Hutchinson, would be to put us in comparison with what other countries are doing. We rank around 50th in the world in the percent of our wealth that we put back into our infrastructure versus our competitors. Would it shock you if I told you that Japan and Germany rank one and two and they are the ones that are beating us every day because they are more competitive because their productivity is higher because their infrastructure is in better shape than ours is?

Mr. HUTCHINSON. Beryl, before I let you finish, is there a danger in the unfunded mandates where we place mandates on state and local governments, whether it is Clean Water Act or whatever?

While you say we are holding our own but that we are misdirecting some of our funds that some other areas where there is great infrastructure, needs are left undone because of what our mandates are requiring.

Mr. ANTHONY. Without question, when you force State and local governments to do clean air and clean water, then they have no—

they have small resources left to leverage into the other areas. We haven't even gotten into the need for airports, but there was a major piece of legislation that was passed by the Congress recently. It is a matter of getting those monies out there and getting them spent.

In terms of the balance, I am not so sure that I can answer that question. Maybe you can ask that same question of some of the panelists because they may have a better feel of the market in terms of where that balance is, but it is an efficient, proven technique to leverage whatever loans and grants and direct expenditures you make by allowing these State and local governments to use the tax expenditures. So I guess from a policy standpoint you could draw those numbers anyplace you want to, 50/50, that would be something that you could decide as a policymaker.

Mr. HUTCHINSON. Thank you.

Mr. ANTHONY. All I am here to tell you is that it is there. It is in place. It can help you. It is fast, efficient. It is proven they just need a few adjustments made to unlock them and unleash them.

Mr. HUTCHINSON. Thank you for your testimony. Thanks for being here. It is good to see you.

Mr. ANTHONY. Thank you.

Mr. WISE. The gentleman from Georgia, Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. Anthony, I thoroughly enjoyed your comments and followed you through with your testimony there. The question on the amount of savings to the taxpayers for reinvestment into our infrastructure, whether it be the infrastructure of private sector or infrastructure of the public, was that 350 million or billion?

Mr. ANTHONY. Well, the one provision, I don't have the total for all of them. I can provide that for you. We did receive joint tax estimation revenue losses on all of them. I would be happy to provide that to you if we can dig out that document from our files. But it was million. 350 million just for one provision.

Mr. COLLINS. And which provision was that one.

Mr. RAYDER. It was a combination of provisions that were included in H.R. 13.—H.R. 11. Bank deductible, arbitrage rebate reform, eliminating of some of the more technical provisions that are in the cost benefit analysis cost State and local governments far more than they benefit the Federal Government.

Mr. COLLINS. OK.

Mr. ANTHONY. Mr. Collins, we will go back and see if we can find some of those past estimates and provide them for the record.

Mr. COLLINS. I appreciate that. I am one who fully believes that any time we can make an adjustment in the tax code, we are not costing the Federal Government, we are reinvesting in the private sector because those dollars will revolve themselves time and time again in the private sector and that is where we generate our revenue. It comes from that private sector, from the expenditures and the investments.

You mentioned the 1986 tax reform, the 1990 budget deal also had a tremendous impact on—that is where we actually established the rules if you are going to cut any type of reform or any type of tax, you have to offset it with a cut in reduction in expendi-

tures. That is where you are getting to the reform of the budget process.

Mr. ANTHONY. Yes. That was the pay-as-you-go 1990 Act. And as I understand it, the Congress in 1993 adopted those caps for five years that were established in the 1990 Budget Act, so you have got to live with them or you have got to figure out a way to amend it.

Mr. COLLINS. I could not agree with you any more and I really appreciate your testimony.

Mr. ANTHONY. It will be the anvil around your neck that will kill your infrastructure bill next year.

Mr. COLLINS. I still think if we are going to promote productivity in the private sector, either through rebuilding infrastructure or reestablishing assembly lines or whatever, we have got to put the investment back into the private sector. We have got to change the budget process. We have got to change the tax codes. You can't just keep bleeding that private sector and not giving them incentive and encouragement to invest and reinvest. That is how we create jobs.

Mr. ANTHONY. We look forward to working with you.

Mr. COLLINS. I look forward to it. I hope I can follow your pattern and in your freshman year, then you were able to land that seat on Ways and Means on second term because that is a coveted idea of mine, too. I would love to be on that committee.

Mr. ANTHONY. Could you happen to represent Washington, Georgia?

Mr. COLLINS. I have from the Hartsfield Airport area, southwest to Columbus, southeast to the Bibb County line, and due south to Peach County.

Mr. ANTHONY. The reason I asked is my family has expanded into your State, building a facility.

Mr. COLLINS. In Washington?

Mr. ANTHONY. So you are one of my Congressmen.

Mr. COLLINS. Thank you very much.

Mr. WISE. Mr. Anthony, I greatly appreciate your help, your willingness. The additional copies of the Anthony Commission report and which we will make sure are distributed to Members.

And, Beryl, I just want to say, I think this might be the year to move this in this session, and we need to talk to Bill Coyne and see how things go, if there is life after health care, but in this session, but certainly in building the momentum for 1995.

So thank you very much, and we look forward to working with you in the future.

Mr. ANTHONY. Thank you.

Mr. WISE. Our next panel will be Liane Levetan, the Chief Executive Officer of DeKalb County, Georgia, chairing the Tax-Exempt Bond and Capital Financing Subcommittee on Taxation and the Finance Steering Committee of the National Association of Counties.

One of our witnesses, Mr. Sam Shapiro, the State Treasurer of Maine, has been fogged in in Maine and so happily we are delighted that Lucille Maurer, the Treasurer of the State of Maryland and representing the National Association of State Treasurers has, on short notice, agreed to fill in. Thank you, Ms. Maurer.

And as well we have Scott Reznick, President of Commonwealth Development Associates of Philadelphia, Pennsylvania. Mr. Reznick, I want you to know that you have given me an education. I have struggled for years to understand some of the terms in the Anthony Commission report and just as I was getting there, you introduced a whole new set to me that I look forward to exploring with you, probably not in as much detail in this hearing but possibly upcoming discussions.

If there is no objection, as I understand it, Mr. Reznick has a train to catch, and I would ask him to go first.

You, Ms. Maurer, you have a meeting?

Ms. LEVETAN. I have a plane to catch.

Mr. WISE. Could I ask what is the lineup? Who is leaving when?

Mr. REZNICK. I am afraid I have to be on a 1 o'clock train.

Mr. WISE. You have a 1 o'clock train at Union Station?

Ms. LEVETAN. I have a 2 o'clock plane.

Mr. WISE. Could the committee strike this deal with you? We will let Mr. Reznick go first and you go and we won't ask you questions unless you have time. I promise you that, Mr. Reznick, I will get you out of here right away. And Ms. Maurer, you are going to be right behind them—Ms. Levetan.

Ms. LEVETAN. Thank you very much.

Mr. WISE. I am sorry. The nameplates are backwards, as I understand it.

Ms. MAURER. Yes. I have a conference call. Could I ask to be excused while these other panel members testify and that will meet their needs.

Mr. WISE. We will be glad to steer you towards a telephone back here if someone would assist you.

Mr. Reznick.

TESTIMONY OF SCOTT M. REZNICK, PRESIDENT, COMMONWEALTH DEVELOPMENT ASSOCIATES, PHILADELPHIA, PA

Mr. REZNICK. Thank you. Thank you for the opportunity to come and share a few ideas today. I need to get out to Arizona for a family function and the matriarch of our family, Aunt Paula, is out there, so on her behalf, I would like to thank you for accommodating this schedule as well.

I would like to thank you again for the opportunity to talk today. I would like to add a disclaimer in that as some Members of the committee know, we have been doing a lot of work with Department of Transportation and other Federal agencies, but my comments today are mine alone and don't reflect the official position of any of these agencies.

Mr. WISE. Mr. Reznick, in order to expedite things, your written statement is already made a part of the record. If there is some point you would like to hit on and summarize, we would be glad to let you do it that way.

Mr. REZNICK. Perhaps with a few statistics.

We began this policy development process about three years ago. And the approach that we took actually was to start with an understanding of how we were actually paying for infrastructure in the United States, what kinds of cash flows and revenues would be available to help finance infrastructure development.

We use 1991 statistics for highways as the best and most recent representation of our current method of paying for infrastructure. We are talking about municipal bonds and debt financing today. In 1991, of the $81 billion that were spent on capital on operating expenses for service transportation in the United States, only 8 percent of it was actually financed through municipal bonds. Ordinarily, we use a pay-as-you-go system.

Roughly 56 percent of our infrastructure financing came from current revenues, ordinarily motor fuel and motor vehicle tax revenues. So that is dollar in-dollar out in the year in which the investment is made.

These are 30-year capital assets and have a useful life of 30 years. Virtually every other circumstance you can think about, these would be paid for using debt financing that would better match the term of payment and the use of the facilities, the benefits from those uses to the useful life of the facility.

By the way, only 4 percent of that financing in 1991 came from tolls, so we have got about 8 percent debt, 4 percent tolls, 56 percent current revenues.

Also I talk in here about grant-backed credit enhancement. This is a vehicle for accelerating the availability of future grant flows from the Federal Government. We have been working particularly on the Highway Trust Fund, but this would be applicable in other arenas as well.

We are working with the rating agencies, particularly Standard & Poor's, and they indicate to us preliminarily because we are actually crossing all the Ts and dotting the Is on the research now, but preliminarily they indicate to us that somewhere between 50 and 60 percent of future Federal grant flows—this is beyond the current year of appropriation—could be used for the current financing of infrastructure development projects. We reduce that cash flow to its current value, its present value.

On a national basis, if we were to look only at the unobligated balances remaining in the Highway Trust Fund, that comes to approximately $10 billion as of the close of last Federal fiscal year. Using structured municipal bonds for the kind of leveraging effects we can create by bringing securitization into the municipal bond market, we should be able to leverage that 10 billion into about 30 billion.

By the way, the best leveraging we have seen so far, for example, on the Clean Water Act of 1987 capitalization grants was out of New York State, their Environmental Facilities Corporation. They were able to raise four bond dollars for each $1 of Federal funding.

When we go to structured municipal bond approach taking the technology that has created the mortgage-backed markets and asset-backed markets bring them into the municipal bond markets, we should be able to increase that leverage factor from four to one to six to one. So we would be able to raise about 50 percent more money using these techniques than is currently the case.

In any event, if we took the $10 billion in the unobligated balance following the Standard & Poors dictum, we take about 50 percent of it and then leverage it six to one, we are talking about turning $10 billion in future revenues into $30 billion. That is nationally, $30 billion in current best rate financing, that means AAA fi-

nancing for infrastructure facilities. There are no new Federal revenues involved.

We do not create new contingent liabilities for the Federal Government. We believe that this will be budget scored as an outlay in the year of appropriation and so many of the problems that you were discussing earlier should be solved by using this kind of procedure, a combination of structured municipal bonds, bringing securitization to the municipal bond market and grant-backed credit enhancement.

I have run some numbers for a few selected States. In West Virginia, your current unobligated is a little over $191 million. Using these tools, we should be able to create about $574 million worth of funding. The savings—these are estimates now—but the saving to the State over current municipal bond structures, in other words, doing it the way we currently do it as compared to the approaches I am describing, we not only raise the 574 million, but we should save the State approximately 85 basis points over its current interest costs.

Over the life of these kinds of bonds, 20 and 30 years, the savings—well, I am in Washington, let me say even that Everett Dirksen would think of this as real money. Pennsylvania, my own home State, we are talking about a little over billion 675 in financing, again with about 85 basis points in interest savings. We have a representative from Arkansas. It is about 353 million, saving 75 basis points.

Georgia is a little over a billion one, saving about 50 basis points. New York, about a billion three. They would save a full percentage point. These are very, very powerful ways to make infrastructure investment more efficient. You asked some questions earlier about revenue loss.

We have had some discussions over at Treasury on this issue and one of their revenue analysts raised an interesting point. If we do use these tools, we will make the municipal bond market more efficient, and that will increase the volume of municipal bonds. That means revenue loss to the Federal Government. We will also, however, be reducing the interest costs for those bonds, thus reducing revenue loss to the Federal Government.

Now, where exactly these two curves will cross, we don't know that yet, but the benefits of this kind of approach by using stuctured finance and grant-backing really is to make the market considerably more efficient. That is where these savings come from and that means that the revenue loss and the budget issues associated with that would be substantially reduced.

At some point, the curves cross, we could actually zero out the revenue loss, we would be in the same place we are now, but nevertheless be generating a fair amount of additional infrastructure investment.

Mr. WISE. I appreciate your testimony. I want to make sure you make that train. I would ask, Mr. Reznick, if you have not already, if the additional information you imparted particularly the impact on several States and, of course, you got the magic one.

Mr. REZNICK. They were not randomly selected, Congressman.

Mr. WISE. I noticed. What I would like to do is get back to you by telephone at some later point and discuss this further.

Mr. REZNICK. I would be delighted.

Mr. WISE. I greatly appreciate it. Also, if you have not got a ride, we are going to assist to get to Union Station. So if you would check, somebody would help you.

Mr. REZNICK. I appreciate it and I do apologize.

Mr. WISE. No, we are all running late, so thank you.

At this point, Ms. Levetan, we are going to get you to the airport on time, too. So I thank you very much for making the effort to be here. You are here today representing NACo, as I understand it, and I know you have been very active in the past and your name is quite familiar to the subcommittee.

We look forward to hearing you.

TESTIMONY OF LIANE LEVETAN, CHIEF EXECUTIVE OFFICER, DeKALB COUNTY, GA, CHAIR, TAX-EXEMPT BOND AND CAPITAL FINANCING SUBCOMMITTEE OF THE TAXATION AND FINANCE STEERING COMMITTEE, ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES

Ms. LEVETAN. Thank you. I would like to say hello to our Georgia Congressman, Mr. Collins. It is good to be here. I am sorry Representative Kim had to leave, but he sat at my table in DeKalb County just a few weeks ago in an event we had, but please tell him that he will be hearing from me on this issue. Thank you.

Mr. Chairman, I am Liane Levetan, the elected chief executive officer—Mr. Kim, I just spoke about you. I said that we had the pleasure of sitting together in DeKalb County. So I am glad that you are here.

Mr. Chairman, I am Liane Levetan, the chief elected executive officer of DeKalb County. I am pleased to have the opportunity to testify on behalf of the National Association of Counties where I serve as the Chair of the tax-exempt bond and capital financing subcommittee.

I want to commend you and the subcommittee for this hearing today. The use of tax-exempt bonds for financing Public Works and infrastructure projects is more critical than ever to States, counties, and cities.

NACo strongly supports tax-exempt bond legislation proposed by Representative William Coyne and Representative John Lewis. We have worked closely with Mr. Coyne in successfully getting a majority of the Ways and Means Committee to be cosponsors of H.R. 3630, the Public Finance Infrastructure Act of 1993.

The bill makes a number of needed changes in the Federal tax code. Legislation introduced by Mr. Lewis, H.R. 2171, would help many smaller jurisdictions that issue less than $25 million in bonds each year. His bill would allow banks to deduct part of the interest costs in holding bonds of these smaller jurisdictions. This provision is also included in Mr. Coyne's bill, H.R. 3630.

We realize that Congress will not restore the pre-1986 conditions for tax-exempt bonds. It appears to be generally agreed, however, that the 1986 Tax Reform Act went too far. That has been mentioned here several times today.

Mr. Coyne's and Mr. Lewis' bills are trying to find a moderate, acceptable compromise. The Public Finance and Infrastructure Investment Act would streamline many of the existing tax code provi-

sions that affect the tax-exempt bonds issued by counties, cities, and States. This legislation would also reduce the administrative and financial burdens placed on many small government issuers, simplify unnecessarily complex regulations governing arbitrage earnings, encourage banks to invest more in their local communities, increase the volume of tax-exempt private activity bonds that may be issued each year, and establish a new type of tax-exempt private activity bond that would facilitate economic development in many distressed communities.

Many of the provisions in this bill were included in H.R. 11, the Revenue Act of 1992, which was passed by Congress but vetoed by President Bush, and have enjoyed a long history of strong support from Congress. The legislation also is supported by over 30 national association of State, county and municipal officials.

The need for local governments to use tax exempt bond financing has grown over the last decade as Federal and State assistance has declined for many infrastructure programs. The only infrastructure programs showing increases are for highways and airports and that has not necessarily helped counties and cities finance local projects. Federal assistance for sewage treatment, stormwater control, drinking water, transit and community development have all declined dramatically. And I say that really dramatically.

At the same time, counties and cities in many regions are still coming out of the last recession. The national economy is picking up steam but that is not true for all areas. NACo did a survey of 63 large urban counties earlier this year and found that these counties are continuing to experience severe financial stress. The financial pressures are causing counties to continue to lay off employees, cut services and raise taxes and service fees. This is the third consecutive year that large urban counties have reported financial distress.

The survey showed that 60 percent of the counties raised fines, fees and charges during fiscal 1993. More than one-third were forced to raise property taxes, postpone capital projects, or freeze hiring. Twenty-five percent of the responding counties laid off employees.

One revenue problem for many counties has been inadequate growth in property tax receipts over the last three years. Even though in many cases rates have gone up, the increases have been offset by decreases in property values or statutory limitations on property tax rates or assessments as we all know.

The survey also found that large counties have been forced to increase spending in a number of areas, especially law enforcement and criminal justice activities, and social service programs. Programs tending to suffer cutbacks included general government, libraries, and parks and recreation.

We have taken the attitude in DeKalb County that the public will support infrastructure improvements if it can be tied to economic development. They have to be shown that infrastructure improvements mean retention of companies and jobs and adding new jobs. We have been successful in getting voter approval for a number of recent bond issues that clearly are linked to economic development.

We passed a $33 million bond issue for park land acquisition and new recreational facilities. As a result, we have been able to greatly expand parks and recreation facilities over the last three to four years. A $29 million bond issue was approved several years ago for libraries.

Almost $30 million was approved in 1992 for acquiring land for new health facilities and for expanding existing facilities. The voters approved a Board of Education bond issue for $98 million in 1989 to improve and expand our schools in the county.

All of these programs are related to retaining and attracting businesses to DeKalb County, which is a large urban county.

In addition, we have had to obtain financing for several other governmental projects that add to our basic infrastructure. $98 million in bonds were approved for building a jail. With $120 million issue, we made major improvements in wastewater treatment plants in our county and shared in the cost of improving two of Atlanta's treatment plants.

A $29 million issue was approved in 1989 for expansion of our drinking water treatment plant. We will start renovations on an office building for additional space for our courtrooms and a morgue with the sale of approximately $9 million of certificates of participation.

While jobs, sewage treatment plants, and courthouses are necessary and important, voters do not necessarily see they affect them. But I believe that they do understand a connection if the projects are linked to economic development. Counties, however, must be accountable and elected officials need to convince citizens that it is imperative, that it is absolutely imperative to maintain all of our infrastructure. This has a long range impact on economic development.

Our biggest unmet needs in infrastructure in DeKalb County are highways. This probably is true for most growing urban counties. We are not able to budget enough funds to keep up with the necessary maintenance, resurfacing, and traffic improvements and signalization that are absolutely necessary, and also resurfacing. Last year we were able to only resurface 15 miles of county roads. We had hoped to get State funding to resurface 59 miles but the funding did not come through.

Despite the large increases in Federal highway funds authorized by ISTEA, we are not benefiting from the additional funding as much as other jurisdictions in our area. The priority list for State projects is based on ability to provide matching funds. And this is the problem, not only in our county, but all over the country.

Unfortunately, we do not have a sales tax dedicated to highway improvements that could be used to pay off a bond issue. I can appreciate and partly sympathize with the problems the State has getting the funds committed and spent. The real problem is that highway needs in Georgia are far greater than available Federal, State, and local funds and this is true all over the country.

I believe it is very important to discuss at this hearing the need to increase private-public partnerships in economic development and also in improving infrastructure. This particularly is an area that needs congressional clarification on what is public purpose and

the type of private participation permitted to have a bond qualify for tax exemption.

We have been successful in my county, DeKalb, in getting the support and participation of businesses, the chambers of commerce and neighborhood organizations in working with us and I want to give you a couple of examples. Only last week, June the 23rd, we had a dedication ceremony for a new swimming pool in a community called Lynwood Park. This is in a low income neighborhood with a per capita income of around $8,500 surrounded by a much higher area.

A local developer, Post Properties, donated $75,000 to build the swimming pool and provided the landscaping. The county allocated $50,000 in community development block grant funds for materials to build the bathhouse. DeKalb County also financed improvements of the water and sewer services and the other things that were necessary, the licenses and all of those things that go with it.

As a result of this public-private partnership, we expect that other improvements will be made in the community. The community is now working with our county on a strategic development plan.

Over the last two years, we have been working with the chambers of commerce, local universities and the Georgia Power Company to develop a small business incubator program. Community development block grant funds along with the State and private funds will be used to finance this project. We have a commitment of $2 million from two banks to establish a revolving loan for some of these areas. The project also is part of DeKalb County's application for being designated as an enterprise community. The small business incubator will be located in a low income neighborhood.

There is evidence that just the anticipated project already has stabilized a nearby shopping center and the whole area. And I am convinced that this is the type of public-private ventures we need if we are to successfully have economic development programs. We also need private partnerships and participation if we are serious about improving our infrastructure.

Mr. Chairman, again, I want to thank you for asking me to testify at this hearing. And I would be more than happy to respond to any questions related to this. I think a good beginning has been made. We in NACo are working collaboratively, as you know, to help you.

I am confident from being here and working on this for some time that the shore is not dimly seen but is clearly seen and I am very confident that the show is on the road and that we are going to see some results and some legislation passed that will allow us in local government to make infrastructure improvements and also benefit our neighborhoods but also be a tremendous asset to the business community, too.

Thank you.

Mr. WISE. Ms. Levetan, we thank you very much for your testimony and giving us some concrete examples of how this legislation could be of assistance on some of the costs really to communities because we have lost some of these financing mechanisms.

I am going to keep my commitment to you and make sure that we are able to get your show on the road as well in the sense of

getting to the airport. I would ask Members of the committee if they have questions for Ms. Levetan, if so, if they could be very brief. She does have a commitment.

Mr. Kim.

Mr. KIM. Yes. Thank you, Mr. Chairman. It is nice to see you again.

Ms. LEVETAN. Good to see you again. Yes.

Mr. KIM. Just a curious question I have. You mentioned that a $33 million bond issue was passed for a recreational facility and $29 million for a library and $730 million for a health facility, $98 million for schools, $98 million for a wastewater plant and jails, et cetera, added up to about $500 million. That is a lot of money you have got to pay back.

My question to you is: How are you going to pay back all those bonds? I understand you say no sales tax has been dedicated to pay off these bonds. Can you tell me how your county intends to pay off those bonds?

Ms. LEVETAN. I will be very candid. That is what makes county government so difficult is the fact that we largely depend on property taxes. That is where we get our revenue from. So, in other words, bond indebtedness is being paid off. We pay about $17 million debt service on these new bonds, that we—which is a tremendous amount which it creates almost $2 million in property taxes and this is the big problem that we are being faced with.

But these things were perceived by the voters as necessary to have maintain a good quality of life. These are not luxuries when you talk about health facilities, when you talk about libraries for educational purposes and DeKalb County is a very diverse county.

Mr. Kim, you visited my county and you know, we are an urban county that has seen tremendous change. We have a 571,000 population, and in order to meet the needs, but to get specific, we pay these through property taxes. And what I have tried to do since taking office as the chief administrator is to bring in the private-public partnerships because government can no longer do all of these things.

So in other words, we are asking Congress to make some of these adjustments so that when I go to Georgia Power or when I go to Hewlett-Packard that is coming to my area, and I ask for money, that we can clearly define what are some of the benefits that they are going to get for building part of the partnership to make our local governments more effective and more efficient.

Thank you.

Mr. KIM. Thank you.

Mr. WISE. And we thank you very much, Ms. Levetan. And are you able—do you have a ride to the airport?

Ms. LEVETAN. Yes, I do. Thank you very, very much.

I would also like to leave with you, NACo would be more than glad to make these things available to you, but we are partners in this tax-exempt financing primer and I know if you don't have this, we would be more than glad to share it with you.

Mr. WISE. I was studying it last night. If you could hold just a second for Mr. Collins.

Ms. LEVETAN. Certainly.

Mr. COLLINS. You will have time to get to the airport.

Ms. LEVETAN. Okay, good.

Mr. COLLINS. Your voice is music to my ears. These folks up here all have accents.

Ms. LEVETAN. Oh, okay.

Mr. COLLINS. You mentioned the many bond issues that you passed, Commissioner. When was the latest bond issue passed by the county?

Ms. LEVETAN. It was passed in 1996—I am talking—not 1996. It was passed last election. It was a health bond issue.

Mr. COLLINS. Which one?

Ms. LEVETAN. The health bond issue.

Mr. COLLINS. When was the jail passed? 1989?

Ms. LEVETAN. 1989. That was before I came back into office. You know, it is amazing to me that so many of these things did pass but you have got to understand DeKalb County is a very unique county, and what we try to do is equate it to economic development from the standpoint—the jail is something we have to do, the over-crowded jail.

But when you talk about, you know, the other issues, the libraries, the parks and recreation facilities because DeKalb County really has become a major urban county and you have to address the needs.

Mr. COLLINS. Well, it has and I can just imagine the job that you have in front of you. I don't know if you are familiar with it or not, but I served as chairman of the local Commission back in the late 1970s.

Ms. LEVETAN. I am very familiar with that.

Mr. COLLINS. We are a very small county, but we were faced with some of the same type problems. Property taxes are what you have to rely on for your cash flow, your biggest portion of cash flow, and I think you have made a very good point that a lack of new investments to offset the depreciation of those investments that exist is an important statement because that is one that we have to address in order, to go back to what Mr. Anthony was stating in the tax codes, to encourage that investment in the private sector.

I am not—with all the redistricting, I know you either have two or three Members of Congress that actually represent DeKalb County.

Ms. LEVETAN. We have four, actually.

Mr. COLLINS. Four.

Ms. LEVETAN. We have four, so they hear a lot from me. I don't know if that is an advantage to me, but——

Mr. COLLINS. One other question in the court ruling the other day dealing with private property rights, in Georgia, we have an impact fee. Have you studied that decision to see if that is going to affect impact fee.

Ms. LEVETAN. We have not, per se, implemented the impact fee at this particular time. We have everything in place to do that. But you know here again, we charge people fees. I mean, there are different philosophies and I know what the law is and we can go ahead and implement this, but if you are to go ahead and attract businesses which create jobs, you can overtax.

I mean, you can say you are offsetting it here, but then you charge fees, you charge impact fees, I think this country has got

to look—counties, our country has got to look at where we are going from the standpoint of business. We had home depot in our area. You know, I was just talking recently to Bernie Marcuson. We were pontificating.

What we are really doing is penalizing businesses now for trying to do business and we have got to be more user friendly from the standpoint of businesses because all of this interacts with government, and I think you know we have got to really look at the long-range goals of what we have here in Congress as well as locally and work more closely together and define our ideas together from the standpoint of serving our constituents but also recognizing, if you don't have business, if you don't—if you are not a user-friendly community, if you are going to have higher property taxes and have high fees, how are you going to get the new businesses in? And as a commissioner, I know you know what I am talking about.

Mr. COLLINS. My only other question is, can you take the 4 o'clock flight? I am enjoying your testimony and it is very—you are right on target, and I just wish that more Members of Congress could hear what you are saying from your position and would understand what you are saying because, in my previous 18 months of being here in Washington, I view what has actually happened as 180 degrees from what you are saying.

Thanks for being with us.

Ms. LEVETAN. Maybe I will come back again. How about that?

Mr. COLLINS. I hope so, I really do, and I would request if you do come, and when you do, that the Chairman have the four Members from the DeKalb County area here to listen to what you have to say, and I hope to be able to get a copy of your remarks and send them to them personally.

Thank you so much.

Ms. LEVETAN. Thank you so much. Thank you.

Mr. WISE. Thank you Ms. Levetan.

Mr. WISE. We are now pleased to have join the committee, and I want to thank you very much for on short notice jumping in, representing the National Association of State Treasurers, Lucille Maurer, the Treasurer of the State of the Maryland.

TESTIMONY OF LUCILLE MAURER, STATE TREASURER OF MARYLAND, ON BEHALF OF THE NATIONAL ASSOCIATION OF STATE TREASURERS, ACCOMPANIED BY MILTON WELLS, DIRECTOR, OFFICE OF FEDERAL RELATIONS

Ms. MAURER. Thank you, Mr. Chairman, and I appreciate your graciousness in letting me join the conference call, and I wouldn't have done it except that I had promised to be on that one.

Mr. Chairman, and Members of the subcommittee, thank you for this opportunity to present the views of the National Association of State Treasurers, NAST, our Nation's pressing needs to improve our bridges, highways, airport safety, clean water. They have been enumerated before. The whole panoply of needs we classify under the "I" word, infrastructure.

I am Lucille Maurer, Treasurer of the State of Maryland and the Immediate Past President of NAST. With me is Milton Wells, the Director of Federal Relations of our organization. We have all 50

States plus the District of Columbia, Puerto Rico, Guam, and American Samoa represented in NAST.

State treasurers, as you know, are responsible for such functions as cash management, debt management, public pension fund investment and a variety of other functions in their respective States. We are in the aspect of infrastructure and debt, we are a member of the Steering Committee on the Rebuild America Coalition, as you know, a broad coalition of public and private organizations committed to reversing the decline in America's investment in infrastructure.

We are also serving on the public finance network a coalition united to preserve State and local governments' use of tax-exempt finance to achieve the goals of maintaining the proper kinds of investments in our State.

I first want to compliment you, Mr. Chairman, on your longstanding and outspoken advocacy of capital budgeting for the Federal Government. You have taken the lead on this proposal for a number of years and it continues to be an innovative, common sense plan to contribute to America's economic well-being. Capital budgeting, in my view, is the key to both good management of our tax dollars and the funding for infrastructure which in turn is essential for economic competitiveness in this global economy.

I wanted to cheer after the testimony of Beryl Anthony and Congressman Coyne for their sensitivity to the public finance issues, but I also have been very heartened by the statements of you and Members of the subcommittee which discloses your sensitivity to the need for cross-connections, how public finance relates to the budgeting and all relate to the economic well-being of our State.

I would like to give Maryland as an example, a State that has continued to provide the infrastructure essential for a reasonable quality of life and for economic development while at the same time balancing our operating budget. We have, for example, over the past eight years spent over $600 million on public school construction, that is State funds almost all of it from bonds, tax-exempt bonds.

The State currently is investing in a bioprocessing facility to help move forward our strategy to become one of the biotechnology centers in this Nation. That was a step in the process which was missing and since State funds along with private funds are investing in that kind of thing.

Maryland is viewed by some as having a high debt. We are always near the top when comparing States in the standard criteria, debt per capita and debt outstanding to personal income. At the same time, Maryland has a national reputation as being a forerunner in the field of debt management. Maryland's capital debt affordability committee was established 16 years ago and has been instrumental in managing the State's debt. Testimony to our success is our coveted AAA rating from all three rating agencies on our general obligation bonds.

Tax-exempt financing needless to say is a fundamental component of this process. But I suggest that the experience of the States demonstrates that a capital budget is very important and that the capital budget can be disciplined.

I have brought with me and will present to you the capital budget that was last introduced and the most recent capital debt affordability which indicates the way in which we recommend to the legislature and to the governor, I chair the committee, by statute, by the governor and the legislature have followed the recommendations of the capital debt affordability because we are very interested in keeping our AAA rating.

So there is a tool for management and I understand that many people are concerned about a Federal Government capital budget because they fear that too many items would be put on the capital side rather than the operating side. And so that is what I mean when I refer to discipline. It would obviously have to be different at the Federal level but it can be done.

In going back to the infrastructure needs, Beryl Anthony, former Congressman Anthony referred to the major problems that face us. Every day something is deteriorating, the water pipes underneath the ground as well as the efforts to clean up water. One of the things is outdated leaky pipes are supposed to waste 30 percent of our daily freshwater supplies.

Half the Nation's communities have wastewater treatment facilities at or near capacity. And many don't have it up to the level we should have it. By the year 2000, a million miles of highway will need resurfacing. I can give you an example of how some of these highways things relate to economic development.

We have in Maryland in the western part of the State close to West Virginia in the mountains an important paper mill but they were thinking of closing the paper mill. One of the problems was that their trucks had a difficult transportation route to the urban centers and to the port. So it was essential that we invest in a major highway and that now has, in turn, provided a stimulus for other companies who have transportation issues to look at that area. So all of these things are interrelated.

And why even if the Federal Government had its capital budget so it could sort out what it could do in terms of finance, if indeed the finance bill of Congressman Coyne were to enable the communities, I speak for the States, but there again, you have heard from the counties and the localities, to do their part.

We need to work together to leverage the funds. Our water quality leverages Federal money and State money to make it possible to do more. So the breadth of your views is important to the solution of the problems, not one piece but altogether, and we need to have a partnership not an adversarial role. And together we would like to work with you.

We are working with the other parts of the finance community to—for example, in secondary disclosure we worked with 12 organizations, some of which you will hear today, government finance officers and underwriters and bond counsel to provide testimony and comments to SEC on the primary and secondary disclosure rules. There are many things that have to be addressed but we as State treasurers feel that these are urgent.

We welcome your interest and we welcome your efforts and we say congratulations and we would like to be here to celebrate with you when these are enacted.

Mr. WISE. Thank you very much.

I would like to say that the National Association of State Treasurers has been extremely active and very, very helpful in putting together not only our hearings but also presentations, conferences as we try to get this whole issue of growth and how do we finance it and how do we adequately account for it particularly at the Federal level in front of Congress, and so I just want to thank you and Mr. Wells and your organization.

I notice you have a conference—national conference coming up and I look forward to seeing the lobbying strategy that I know is going to emerge from there.

I have a question. It really goes to capital budgeting, but there were two days of discussion on the Floor of the House of Representatives a couple of months ago on capital budgeting when the balanced budget amendment was up. And one of the objections that was raised to capital budgeting was the concern was expressed there was no way to really rate the bonds or how do you—States have a rating. As you say, the importance of keeping your AAA rating, how do you grade the kind of issuance that the Federal Government is doing? I just wonder if you have any thoughts on that.

Ms. MAURER. Well, of course, that is a problem because you have never had the rating because the U.S. Government stands behind most of the treasuries. There are the agencies which I think the Federal Home Loan Bank Board has rated some of those agencies that don't have full faith in credit.

But I would think, I am certainly no expert, but the definition of what is capital, what do you do about Air Force airplanes. Of course, you could do the Academy. It is a building. But after all, I understand that we are the only western industrialized nation that doesn't have a capital budget.

And we turn ourselves inside out saying we are printing money and we don't know which piece of it is for what assets that normally a State with a capital budget would issue bonds to cover the cost of it, spread the cost more to match the length of the asset. So while I can't answer your question, but I think that we would have some guidance from the United Kingdom, from France how they manage it and I think, what I was trying to say, the discipline is important but you have to have some sense of what the discipline is going to be.

Mr. WISE. That raises another issue and perhaps it might be one that could be addressed in this manner. The debate several months ago on the Floor of the House also brought up that question: Exactly what is in the capital budget? We are not going to probably get a capital budget approach this year as much as I would like to.

I am wondering, though, whether we could get a Commission established that has representatives from across a wide range to say what should be in a Capitol budget and how would you account for it? How, for instance, should defense be—make certain recommendations—the Commission would make recommendations. Would defense expenditures be considered capital and, if so, how would you spread that cost out over the useful life of the asset?

Highways, borrowing upon State experience, for instance, buildings, borrowing on GSA's experience and other items that would seem to be capital expenditures as well as getting into some of those by my mind more intangible items such as job training or at

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least a building that houses the training programs. Myself, the legislation that Mr. Clinger and I on this committee have introduced refers only to physical structure.

I understand the arguments that some would make for extending it further but perhaps we ought to take it out of this realm and put it into a Commission bipartisan with a wide range of people. I would assume that State treasurers association would be part of that and to look fully at what should be in our Federal capital budget.

Ms. MAURER. That would be a splendid idea. You could get representation from the accounting firms, say, should have to audit businesses and what they write off—not write off but treat as a capital expenditure. That is an excellent idea. There was a Commission on the infrastructure, to finance the infrastructure and that report came out two years ago. That would be a way of at least making some progress and to ensure that there were some definitions that could be followed.

Mr. WISE. Some way we have to move this discussion forward. More and more people I think are coming to the concept of a Federal capital budget.

Mr. Wells.

Mr. WELLS. Mr. Chairman, I think also in that context, and going back to your first question, it is my recollection from reviewing the document that one of the major ratings that put out that the bonds of the United States and Mexico and a number of the Canadian provinces are rated and the bond rating agencies might well have some positive input that could answer the question that you asked.

Mr. WISE. That is a very excellent suggestion. Thank you. I appreciate your participation and now turn to Mr. Collins for any questions.

Mr. COLLINS. Thank you, Mr. Chairman, and thank you, Ms. Maurer. In your State, on capital investments, what is the cap or the limit?

Ms. MAURER. Pardon?

Mr. COLLINS. What is the cap or limit of capital investment by your State?

Ms. MAURER. Well, for the State supported tax, we have two criteria. We have the debt outstanding to personal income and we have revenues to debt service. The last one is a—that we go by the committee on affordability is 8 percent and we have not exceeded 6.9 percent on that. That has a lot of room to it. It is the debt outstanding to personal—the total personal income in the State that we have is 3.2 percent and when income figures vary and in the recession, we were at 3.19, so that is the bind, if we have one.

Mr. COLLINS. Thank you. I think that was the one provision that was really lacking in the capital investment bill that was before us when we were debating the balanced budget. Thank you very much.

That is all I have, Mr. Chairman.

Mr. WISE. Thank you very much, once again, for appearing on short notice and coming here.

Ms. MAURER. Thank you very much. I am leaving this with the committee. I am sure it is good bedtime reading.

Mr. WISE. Our third panel, we are fortunate to have with us three witnesses our third and final panel the first is Frederic Ballard, Jr., with the firm of Ballard Spahr Andrews & Ingersoll in Washington. He will be speaking as a former board member on behalf of the National Association of Bond Lawyers.

Our second witness George Butler Pugh, Jr., with Craigie, Inc. of Richmond, Virginia, who is also Chair of the Municipal Securities Division of the Public Securities Association.

And we also have John F. Wenderski, the Finance Director of Prince William County in Virginia. He is speaking on behalf of the Government Finance Officers Association.

At this point, Congressman John Lewis, who is cosponsor of the legislation with Congressman Bill Coyne, had hoped to be here and to speak, but he is unable to attend. And by unanimous consent, I will insert his statement in the record.

[Mr. Lewis' prepared statement follows:]

JOHN LEWIS
5TH DISTRICT GEORGIA
CHIEF DEPUTY MAJORITY WHIP
COMMITTEES
WAYS AND MEANS
SUBCOMMITTEES:
HEALTH
OVERSIGHT
COMMITTEE ON
THE DISTRICT OF COLUMBIA
SUBCOMMITTEES
GOVERNMENT OPERATIONS AND
METROPOLITAN AFFAIRS
JUDICIARY AND EDUCATION

Congress of the United States
House of Representatives
Washington, DC 20515-1005

WASHINGTON OFFICE
329 CANNON HOUSE OFFICE BUILDING
WASHINGTON DC 20515-1005
(202) 225-3801
DISTRICT OFFICE
THE EQUITABLE BUILDING
100 PEACHTREE STREET N W
SUITE #1920
ATLANTA GA 30303
(404) 659-0116

Statement of Congressman John Lewis

before the House Public Works and Transportation Committee
Subcommittee on Economic Development

June 30, 1994

Chairman Wise and Members of the Subcommittee, first, let me commend you for your leadership in having this hearing. It is critically important that we expand our means of financing improvements to our nation's infrastructure. Our infrastructure is crumbling; improvements are much-needed.

Let me also thank you for this opportunity to comment on two bills which I have introduced to help improve the health of our nation's infrastructure, H.R. 2102 and H.R. 2171.

The need for and cost of new schools, new sewer systems, repaired bridges, renovated health clinics, low income housing and updated hospital facilities have increased dramatically. At the same time, resources with which to meet these needs have decreased. These are much-needed public projects, but the money just is not there to support them. H.R. 2102 and H.R. 2171 would reduce the cost to state and local governments of financing these infrastructure improvements.

H.R. 2171 would raise the cap on the amount of bonds a state or local government could issue and still qualify for the "small issuer" exception. Banks and other financial institutions which purchase and hold municipal bonds are allowed a federal tax deduction for up to 80% of the interest paid on those bonds, if the governmental entity issuing the bonds is a "small issuer." Under current law, a small issuer is one that issues less than $10 million in bonds each year.

Smaller communities are better able to address their financing needs because of the "small issuer" or "bank qualified" provision. Municipalities, counties, school districts, hospital authorities and other governmental entities which exceed the $10 million cap have more difficulty borrowing funds. Most banks purchase only those securities which meet the "bank qualified" rules.

In H.R. 2171, I have proposed raising the cap to $25 million. This amount is a more accurate reflection of a "small issuer" today.

A $25 million cap was proposed by the Anthony Commission An increased cap also was called for in H.R. 11, the tax bill which was passed by the 102nd Congress, but vetoed by President Bush.

H.R. 2102 would allow the issuance of municipal bonds in denominations of less that $1,000. With the issuance of these smaller denomination bonds, it will take longer to accumulate or raise enough money to do certain municipal projects. So, H.R. 2102 would also allow these investments to be held in a higher-yielding security for a longer period than current law allows. The arbitrage period would be one year, rather than the 6 months allowed under current law.

Not only would this proposal give states and local governments more flexibility in raising money to finance projects, but it would enable more, and more moderate-income taxpayers to participate in the tax-exempt bond market. Individual savings are likely to increase as a result.

These are good and important bills. They would go a long way toward achieving our shared goal of improving our nation's infrastructure.

Mr. WISE. Gentlemen, thank you very much. The committee appreciates your patience. Your written statements in their entirety have already been made a part of the record, so I would invite you to summarize, to stress any points you think need to be stressed, to proceed any way you see fit.

We will begin with you, Mr. Ballard.

TESTIMONY OF FREDERIC L. BALLARD, JR., BALLARD SPAHR ANDREWS & INGERSOLL, WASHINGTON, DC, ON BEHALF OF THE NATIONAL ASSOCIATION OF BOND LAWYERS, WASHINGTON, DC

Mr. BALLARD. Thank you, Chairman Wise, Mr. Collins. Thank you very much for inviting us all here today. Taking your invitation to summarize, on behalf of the National Association of Bond Lawyers, we have only a couple of points to suggest.

Tax-exempt finance today is dominated by Internal Revenue Code provisions that allow tax-free financing through the use of either governmental bonds for facilities owned and operated by State and local government or else private activity bonds which are bonds issued by State and local governments for the benefit of facilities that are used or operated or involved with businesses or other nongovernmental entities.

Private activity bounds are allowed only for categories of facility specified in the Internal Revenue Code. This list of categories has shifted over time. In 1986, Congress eliminated sports facilities and convention facilities from the categories of facilities that can be financed with tax-exempt private activity bonds.

If there were just one thing which a committee like yours could do in the infrastructure area, it might be to reshape and reformulate the list of exempt facilities that can be financed with tax-exempt bonds.

For example, just to name one possible category that might be added to that list reflective of much of the testimony this morning, it would be to allow tax-exempt private financing bonds for streets and roads. They can be financed with ordinary so-called governmental bonds under the law if they are owned by the government which they normally are. On the other hand, if a street or a road or a turnpike is owned and operated by a private entity, it cannot be financed with tax-exempt bonds. In this respect, the Internal Revenue Code does not afford the same treatment to streets and roads as it does to docks, airports, mass commuting facilities, high-speed intercity rail facilities.

There is a change that perhaps could be made. When the law and its basic structure was created now in 1968 and 1986, the idea of a privately operated road was not common, not relevant. It may be very relevant now. It might be an idea that Congress should consider.

A second point that National Association of Bond Lawyers would suggest for the committee or Congress' consideration would be a general raise in the so-called State volume ceiling for private activity bonds. These are limited per State to $50 per person of population under law set in 1986 as part of the 1986 legislation, with $150 million minimum per State. Any dollar limit that hasn't been changed since 1986 is almost by definition too low.

A third thing that we would consider is liberalization in the rules permitting facilities financed with governmental bonds to be managed by private entities under contract. The present rule is a result of a liberalization in 1986, not a restriction but a liberalization. The present rule limits the contract term to five years.

We suggest that a longer term might be permissible if the greater length was achieved through renewal options in the State or local government. It seems to us that longer than five years could raise no possible harm if the longer term a rose through publicly held renewal options.

The last thing we suggest and the last thing I want to say, to not take your time and the time of my fellow panelists, is as is noted in many of the bills that have been discussed today, the limit on the so-called bank eligible bonds, the $10 million per issuer, that, too, was set in 1986. The bills pending today have generally suggested raising that limit to 25 million.

That change would be helpful, not just to banks, but it would be helpful to infrastructure because many infrastructure projects are the kind that can only be financed by a bank. They simply are too complicated, too uncertain, too unconventional to be financed through the public securities markets with nearly the ease that a local bank could finance them with its willingness, presumptively, to make an investment in the community.

Thank you very much for your time and attention.

Mr. WISE. Thank you. Mr. Ballard, we will have some questions in just a minute.

I now turn to George Pugh, speaking on behalf of the Municipal Securities Division of the Public Securities Association.

TESTIMONY OF GEORGE B. PUGH, JR., EXECUTIVE VICE PRESIDENT AND MANAGING DIRECTOR, CRAIGIE INC., RICHMOND, VA, CHAIR, MUNICIPAL SECURITIES DIVISION, PUBLIC SECURITIES ASSOCIATION, WASHINGTON, DC

Mr. PUGH. Thank you, Chairman Wise and Members of subcommittee. Good afternoon. My name is George Pugh. I am pleased to be here today to discuss the crucial role tax-exempt bonds play in financing improvements to America's infrastructure.

I speak to you this afternoon as Chairman of the Municipal Securities Division of the Public Securities Association and in my capacity as managing director at Craigie Incorporated in Richmond, Virginia. It is a special honor to participate in today's hearing because it gives me the opportunity to thank you, Mr. Chairman, and the other Members of the subcommittee for your leadership in the effort to increase infrastructure investment.

It also gives me an opportunity to thank Congressman Coyne, Congressman Lewis and former Congressman Anthony for their crucial roles in developing legislation to assist State and local governments in meeting public needs.

We at PSA enthusiastically support these efforts. Infrastructure has been a frustrating issue for our Nation's policymakers. As you know, the quality of our national infrastructure is of crucial importance to our citizenry and our global economic competitiveness. The panel is also intimately familiar with the fact that while infrastructure needs have risen dramatically, the quantity of available gov-

ernmental resources to address these needs is on the decline. This is why we believe now more than ever the municipal bond market can help you in financing the many goals for infrastructure and economic development that you are setting for the Nation.

Our organization's membership which includes my firm and others accounts for about 95 percent of the Nation's municipal bond market activity. My comments today, which are substantially less detailed due to time constraints than those in my written statement, will focus on the importance of tax-exempt bonds to the health of our national infrastructure. I will also address the ways that the Federal Government can help States and localities to take even greater advantage of tax exempt financing.

The tax-exempt municipal bond market is the principal means by which State and local governments finance infrastructure investment. In 1993, these governmental entities issued nearly $290 billion in tax-exempt bonds, much of which was used to finance or refinance Public Works investment. Interest earned by investors on most municipal securities is exempt from Federal income taxes.

This feature allows State and local issuers to pay a substantially lower interest rate on their debt than they otherwise would, thereby reducing the cost of financing infrastructure.

Many of the current law restrictions on tax-exempt securities were imposed by the Tax Reform Act of 1986, or TRA. It is widely believed that the restrictions imposed by the TRA went too far in limiting the ability of States and localities to tap the Capitol markets to fund public investment. By enacting several modest changes to the Internal Revenue Code, Congress and the administration could significantly improve State and local government's ability to finance projects to meet the Nation's public investment needs.

The proposals I will now mention would result in increased levels of infrastructure investment at a relatively low cost to the Treasury.

First, and these are detailed in our written statement, Congress should raise the annual issuance limitation on bonds eligible for purchase by commercial banks. Mr. Ballard mentioned this in his testimony as well.

Second, Congress should permit broader tax-exempt financing for infrastructure projects involving private participation.

Third, Congress should encourage the creation of tax-exempt municipal investment conduits, or TEMICs as they are referred to. These are very similar to the recommendations previously suggested and discussed by Mr. Reznick this morning.

Fourth, Congress should define in the code a new type of tax-exempt security called public benefit bonds to encourage additional infrastructure investment.

And then there are two additional tax-related proposals that would significantly improve State and local government finance. We would like to suggest that the Clinton administration should issue new regulatory guidance on advanced refundings and permit States and localities to take greater advantage of current low interest rates by refinancing outstanding debt. Also, Congress should amend the statute on the municipal bond interest under the alternative minimum tax. The reasons for these actions are detailed in our written statement.

While my testimony so far has focused on the Internal Revenue Code, there are also non-tax issues that can positively or negatively affect the ability of State and local governments to invest in public projects. For example, limited Federal funds have been used in the clean water program around the country to establish State revolving funds. In turn, these funds have been responsibly leveraged in the tax-exempt bond market to increase the total amount of revenue available for public investment.

Also, it is important that Federal policy not limit an airport's financial flexibility to the point where potential investors in airport bonds would demand higher rates of return to compensate for uncertainty regarding the airport's ability to respond to changing financial conditions. This issue is particularly relevant today as the House and Senate work out a final version of the airport improvement program legislation. PSA has been working closely with your colleagues on the aviation subcommittee to address this important issue.

These two issues illustrate that tax-exempt bonds can be used as a tool not only in crafting new tax policy but also under existing tax policy to leverage Federal subsidies that, because of deficit concerns, are necessarily more limited. Committees such as Public Works and Transportation can fashion programs that provide opportunities for States and localities to utilize Federal funds as seed money necessary to access efficiencies on the tax-exempt market. We would welcome the opportunity to work with you on this project.

The most expeditious way for Congress to address the Federal public policy issues I have discussed is by enacting the bills proposed last year by Congressman Coyne and Congressman Lewis. Although passing these bills would not solve all the problems I mentioned, it could result in substantial progress toward our shared goals.

Finally, we urge this subcommittee to look at the existing tax-exempt bond market as your partner in helping the Nation meet the many infrastructure challenges that lay ahead. Limited Federal funding does not necessarily have to mean fewer projects receiving needed financing. The tax-exempt market can help to leverage those limited dollars.

Thank you very much, Mr. Chairman. I would be happy to respond to questions.

Mr. WISE. Thank you, Mr. Pugh. I will be right back.

Our final witness is the chief finance officer at Prince William County, Virginia, John Wenderski.

Mr. Wenderski.

TESTIMONY OF JOHN F. WENDERSKI, FINANCE DIRECTOR, PRINCE WILLIAM COUNTY, VA, ON BEHALF OF THE GOVERNMENT FINANCE OFFICERS ASSOCIATION, CHICAGO, IL AND WASHINGTON, DC

Mr. WENDERSKI. Good morning, Mr. Chairman. My name is John Wenderski and I am the chief financial services director for Prince William County. Today I am here representing the Government Finance Officers Association, GFOA, as a member of its Committee on Governmental Debt and Fiscal Policy.

The GFOA is a 12,500 member professional association of State and local government officials who serve as the chief financial officers of our Nation's cities, States, counties, towns, special districts, school districts, and public retirement systems.

The subject of infrastructure has been studied by numerous commissions, task forces, and congressional committees. However, a national solution to infrastructure financing needs has been difficult to define because sufficient Federal funds are not available to attack the problem head on. Grant funding and low interest loans are the traditional means used by the Federal Government in assisting State and local governments to channel more capital into infrastructure development.

Recognizing limitations in Federal resources to assist these governments build new infrastructure facilities and repair and replace existing ones, GFOA has advocated reliance on three Federal policy options. They are: Targeted fiscal assistance for fiscally distressed communities in the form of grants and low interest loans; increased Federal outlays for State revolving funds for all types of infrastructure facilities; and what we are talking about today, selected changes in the Federal tax laws directed at tax-exempt financing.

Tax-exempt financing is often overlooked as a weapon in the Federal arsenal to assist States and localities in financing infrastructure even though it is a proven and reliable tool. Municipal bonds are issued by governments to pay for their projects, to augment funds available through State revolving loan funds by leveraging capital contributions, and to support innovative public-private partnerships.

Unfortunately, certain so-called reforms in the 1986 Tax Act that were meant to curb abuses have proven detrimental to legitimate financings. Instead, the changes increased borrowing costs for traditional government borrowers and imposed restrictions that thwart innovative programs.

It is now widely recognized that the 1986 reforms were overly ambitious and corrections are needed. The 1989 report of the Anthony Commission on Public Finance and the 1993 report of the Commission to Promote Investment in America's Infrastructure call for a review and modifications of Federal restrictions on the use of tax-exempt bonds for infrastructure projects.

Over 30 national organizations representing State and local Governments including the GFOA are supporting legislation introduced by Congressman Coyne that would provide some limited relief. However, Federal resource constraints have stood in the way of important changes in Federal tax policy.

While GFOA believes that all governmental tax-exempt bonds should be eligible for relief from burdensome Federal restrictions, the Association has developed a proposal to focus relief to the most critical projects. It recommends special treatment for a new category of bonds called mandated infrastructure facility (MIF) bonds.

MIF bonds could be issued by a unit of State or local government to finance the construction or acquisition of a new infrastructure facility that is mandated by the Federal Government; or that is part of an existing infrastructure facility that is required to be renovated or rehabilitated in order to comply with a Federal mandate.

The GFOA proposal would give MIF bonds more favorable treatment than governmental bonds under current law. It would do this by addressing State volume caps limitations on refinancing for savings, providing reasonable rules regarding spending bond proceeds, and arbitrage rebate.

Now, I will make a comment here. This last year, the County of Prince William spent $1.2 million in arbitrage rebate to the Federal Government. That equates to this year when we only spent $900,000 to put 10 fully equipped police officers on the street in the county to add to the safety of our citizens. $1.2 million was spent to rebate to the Federal Government for arbitrage.

Expanding incentives for banks to invest in infrastructure facilities in their communities, more importantly, provides flexibility to communities in working with the private sector in providing those public-private partnerships we have found so critical to our ability to meet the needs and demands of our citizens.

To emphasize the importance of reform efforts directed to tax-exempt financing, GFOA offers the following observations: While Federal financial support for State revolving loan funds is highly desirable, the monies are not sufficient to address the vast infrastructure needs. Other tools must be made available and existing ones such as tax-exempt bonds improved.

Revolving loan programs are not a stable source of financing. The Federal authorization and appropriation processes result in program delays and uncertainties from year to year in financing availability. Planning is thereby impaired and the flexibility is limited.

State or local government financial commitments to finance bond projects ensure that only financially viable and worthy projects go forward. Decentralized decision-making for project selection and priority setting at the local level are more efficient and responsive.

Tax-exempt bonds are not a tax avoidance mechanism used by the rich. Bond holders pay an implicit tax because they accept a lower rate of interest than they earn on taxable investments of similar quality and maturity. Internal Revenue Service data confirms that middle income taxpayers are the significant holders of these bonds.

Mr. Chairman, there is a compelling interest in reevaluating the intergovernmental fiscal partnership and improving Federal public policy toward State and local governments. The interest rate savings associated with municipal bonds that inure to State and local taxpayers, who are also Federal taxpayers, stand as a symbol of the partnership of Federal Government and State and local Governments.

Even working together, we will not be able to solve America's infrastructure challenge in the near future. Therefore, I urge you and the Members of Congress and the administration to consider modifications in tax-exempt bond provisions as an important first step in the important work that lies ahead.

I want to thank you for this opportunity to testify and tell you that GFOA is prepared to work with you and your staff in this vital undertaking.

Mr. WISE. Thank you very much, Mr. Wenderski. I thank the whole panel.

Before I begin questions, I would note, Mr. Pugh, you may be one of the best represented people up here. Mr. Hutchinson has noted that at some point you have been in Arkansas. Mr. Collins, before he left, he asked me to express his apologies, but he has an engagement at 1:30, a conference call.

He knows that your wife apparently is from Peach County which he then underlines is in his district. At the point that you go through West Virginia, let me know and we will be glad to establish a close relationship then.

I thank all of you very much.

Part of the purpose of this hearing, I think that this panel may be able to document it as well as any, is to establish not only what needs to be done but perhaps what has been some of the costs to the changes that occurred in 1986 and the Tax Act and the inability to fully leverage for infrastructure.

And I just wonder if there are any specific examples that any of you would like to bring or observations that you make in terms of infrastructure not built, projects that couldn't go forward. One of you, I believe in your testimony and also in the statement of a previous witness, pointed to the low amount of capital investment that this country makes and noted as the statistics clearly indicate that in the industrial world, the United States, in terms of its GDP, invests far less than any other major industrial power.

I just wondered if anybody would like to have some thoughts or comments in that regard, sort of measuring what have we lost and not been able to do.

Mr. PUGH. I will mention a simple example. One of our proposals is doing away with the AMT provision as it applies to municipal bonds. I am not sure what the total cost is, but there are at least a billion dollars worth of bonds being issued by the Washington Metropolitan Airport Authority to finance the renovation of National and Dulles Airports. And I don't think anybody in the room would quibble with the idea that those are bona fide public projects.

However, a good portion of the bonds—don't ask me what the proportion is, but I would say at least half of the bonds that are issued for those projects are subject to the alternative minimum tax provision and, as such, have interest rates probably a quarter of a percent higher than the rates would have been if they had not been subject to AMT.

We do not believe that there is a Federal advantage to the AMT because only individuals who are not subject to AMT will buy these and so that additional cost just goes right through to the users of the airport.

Mr. WISE. Mr. Wenderski.

Mr. WENDERSKI. Yes. I can tell you that projects typically don't hinge on these actions. What happens, though, is that the cumulative impact on any locality says that one project that should have been considered doesn't get considered at all because it is not available for them to do.

I mentioned that we have made in Prince William County $1.2 million in payments in arbitrage in this last year. It is $1.8 million in the last 18 months. That is $100,000 a month. That is a tremendous amount of capital that we are spending and are not investing

in our community. We are not a large community. We are one that is not full of great wealth and we have many needs in our growing community. So as we look down the road, we see that these constraints that were not there before 1986 are now constraining us unreasonably.

Mr. BALLARD. Chairman Wise, I don't have a specific case study or war story. I wish I did because I know it would be useful now if ever. In answer to your question about what has the Tax Reform Act really done, I would point to the State volume ceiling on the private activity bond because, by definition, the whole idea of the State volume ceiling was to force some projects that otherwise qualified in every respect for tax-exempt infrastructure financing, into taxable financing with a higher interest cost, possibly not feasible at the higher interest cost. So the idea of the volume ceiling was to create exactly the thing that your question probes for.

Mr. WISE. On the volume ceiling, each of your statements makes the point that even the amount has not been increased due to inflation since it took effect.

But is anyone suggesting that the volumes cap be lifted entirely or simply that it be raised periodically to reflect inflation and to reflect legitimate concerns and needs?

Mr. BALLARD. I think it would be preferable to define what should be financed with tax free bonds and allow it to be financed. Having this second level hurdle of the volume ceiling adds immensely to the complexity of the projects. With a proper definition, I would think that the proper balance between tax-free financing and taxable financing in the interest of the Federal Government and the interests of State government certainly could be met.

So, I mean, would it be an improvement to eliminate the State volume ceiling? Certainly, provided that the definitions of what could be financed were policed, adhered to, sculpted properly. Certainly it would be an improvement.

Mr. WISE. But what I hear you saying, though, is that also what got the volume caps imposed was perceived abuses. One of the reasons that they were imposed was perceived abuses and that is this was a means to force localities and States to identify their priorities and clearly establish those and not be able to just simply issue at will.

What I think I hear you saying is that while you are going to lift the volume, you need to make sure that we don't go back and repeat those problems that led to the volume cap in the beginning.

Is that a fair statement?

Mr. BALLARD. Certainly.

Mr. WISE. One of your statements raised the question of the new empowerment zones and enterprise communities. The administration is preparing to make its first set of designations most likely this summer, I believe. At least there is a deadline that our State has been following to get those in this week.

I just wonder and you expressed concern about how that was going to be implemented. I wonder if you would like to expand on that further. Do you see progress being made and are there some suggestions that should be passed along to the administration?

Mr. BALLARD. That was my statement. The empowerment zone and enterprise zone facilities bond legislation we appreciate tre-

mendously because it offers a way to create infrastructure in places where by definition it is tremendously needed.

On the other hand, the concern that it has raised is in some respects the complexity in it in questions like the details of annual compliance with, say, the requirement that a qualifying business have 35 percent zone residents as employees. This could be addressed by regulations, I think. Rather than trying to revise the Internal Revenue Code right away, it would be better to hope that regulations dealing with this problem offer ways that we can work with it.

Regulations could say that, for example, if the 35 percent test is met at the outset of a financing and appears to have been met in good faith, that some kinds of subsequent failure to meet the 35 percent level don't have to be cured right away. Because it seems that it may be quite difficult for a business in an enterprise zone which, for whatever reason, suddenly finds that instead of having 40 percent zone employees, it now has 20 percent zone resident employees changing that payroll may not be as easy in practice as it might sound in theory. That—I think that has the largest practical problem that has been identified.

Mr. WISE. It does occur now to me as you elucidate on that, that it probably—that is probably going to be more of a problem in urban areas than in rural areas where people tend to live in the area they work in because you travel a lot further if you don't. So feel free to come invest in West Virginia.

Mr. Wenderski, you make a proposal on mandated infrastructure bonds which is the first I have heard of this proposal. I think you are going right at the heart of the, quote, unfunded mandate issue.

I just wonder if either of the two witnesses would care to comment on that and whether you see that—whether there are any problems with that, is that something that should be receiving serious consideration.

Mr. PUGH. I personally am not that familiar with it. But as an organization, we are very supportive of his suggestion.

Mr. WISE. Mr. Ballard, any thoughts? I guess one concern I had is that in terms of removed from the State volume caps, does it work—is it something that is in the mix and assists the overall mix of financing that we are trying to achieve or is it something that is a little bit outside of the mix and perhaps draws resources away?

Mr. WENDERSKI. I think that you would find that the approach would provide opportunities to try to address some of the limitations that are currently in law that were not there previously to allow facilities like airports which have AMT attached to them. Those are problems that are not being addressed by that. But things like clean air, requirements to renovate or rebuild new sewage treatment plants, waste management facilities, those kinds of clean ups for the Boston Harbor that are required and mandated through Federal regulation or through statute do need relief to be done.

There are not very many vehicles for localities and States to do those projects and every time the Federal Government puts another stricture on tax-exempt financing it strangles our ability to do those projects. This was an attempt to provide some focus on some very, very important projects that are being waylaid by our

inability to finance them and there is a real need to have them done.

Mr. WISE. I am very interested in it. I am just—this is the first I have seen it and I am trying to think it through. You are not suggesting by any chance the wetlands infrastructure mitigation bonds, are you, that wouldn't be a lot of fun? If you can figure a way out of that mess, I would appreciate it.

Mr. Anthony spoke about a large—he felt that the largest revenue loss would be by lifting—revenue loss, I put that in quotation marks, for the Federal Treasury would be by lifting the or addressing the limitations that are presently on banks.

Given some of the changes that have taken place in the past five or six years, commercial banking and other areas, do you think that that would a genuine effect because of the fact he uses or one of you uses startling statistics on how much has been estimated to have been lost on infrastructure investment by banks pulling out of investments that they used to make.

Do you see them coming back at that number should these limitations—should his recommendations be adopted?

Mr. PUGH. As a participant in the market, I can say in an unqualified fashion that, literally, banks beat the doors down—pardon the expression—for bank-qualified bonds. And there is not enough volume out there to satisfy their demands so, yes, I think the availability of more bank qualified bonds will expand that market tremendously.

I don't know if this has been discussed in your committee, but what has happened to the municipal bond market since 1986 is that the departure of the banks from the big market, that is the proportion that is not subject to bank qualification, has led to a concentration of the market in relatively few lands. Before that, there were a lot of investors in municipal bonds, and today the number has been concentrated in relatively few because the banks are not there.

So the ability of the small relatively unknown community to raise funds into the Nation's capital markets has been tremendously impaired by the absence of banks here and having just a $25 million limit instead of a $10 million limit, I think, would go a long way toward addressing the need of those smaller communities.

Mr. WISE. Anyone else?

Mr. WENDERSKI. I would agree with Mr. Pugh that banks are very interested in supporting their local communities by investing in bonds, but there are not very many opportunities for them the way that limitation rolls up through the government requiring it to count almost every arm of its activities. You cannot get a bond to qualify.

Prince William County, literally, cannot get bonds bank qualified because of the level of our normal financing activities. It precludes purchasers of our bonds who would purchase them at good prices at low prices and at low yields and would provide us with the opportunity to do more with less. They are precluded from doing that through the limitations, even though they are interested in doing that. I think it keeps them out of important parts of our markets

like housing and other activities should be accessing and supporting.

Mr. BALLARD. One last point on the banks and the enterprise zone bonds. One of the last changes in that legislation that was made before it was adopted was to eliminate a provision that would have made qualifying enterprise zone bonds bank eligible. By doing that, Congress meant that a community was successful in getting itself classified as either an empowerment zone or an enterprise community cannot turn to its banks to provide the financing for the very purpose of the classification. It was an unfortunate, in my view, an unfortunate development right at the end of the legislation.

Mr. WISE. It is interesting because I have noticed in our communities the ones that are going through the application process, it is often the banks that are providing a lot of the initiative, even though they are not going to be able to participate in it, but they recognize that the value to the community overall. But you make an excellent point, they would be the first ones to line up to make sure that these bond issues are successful.

At this point, I would turn to the gentleman from Wisconsin, Mr. Barca.

Mr. BARCA. I really don't have any further questions to ask, Mr. Chairman, but I appreciate very much your testimony. I am sure it will be very helpful for us in our deliberations, so thank you for being here.

Mr. WISE. I want to thank you. Let me say in closing that I appreciate very much your patience and the information you have imparted. I want you to know that this is part of a systematic effort to build attention and to draw attention to the need for some initiatives in economic growth.

I think that growth is a bipartisan or nonpartisan, better said, area. This committee has tended to operate on a bipartisan approach. It is my observation that there are controversial things that you can put into an economic growth package and certainly the administration sallied forth with that last year which for whatever reasons did not pass, many of them based on direct Federal expenditures.

It seems to me we ought to be looking at a medley of what can be done. You all have brought that to our attention. As Bill Coyne noted, Ways and Means has the jurisdiction and we all recognize that, but there is a need to build a consensus and since this committee deals directly with infrastructure. It seems to me a good place to start.

Thank you very much, and I look forward to working with you in the future. This hearing is adjourned.

[Whereupon, at 1:55 p.m., the subcommittee was adjourned.]

Testimony Before
The House Committee on Public Works and Transportation
Economic Development Subcommittee

by

Beryl F. Anthony, Jr.

June 30, 1994

My name is Beryl Anthony, Jr. I am a partner in the law firm of Winston & Strawn. Prior to entering the private sector, I served as the Congressman from the Fourth District of Arkansas and was a member of the Committee on Ways and Means. I am the founder and Chairman of the Anthony Commission on Public Finance. I am accompanied by J.W. Rayder, Vice President & Counsel to Stephens Inc. and Executive Director of the Anthony Commission.

Mr. Chairman, "America is falling apart, literally. Federal budget pressures and changes in the Federal tax law in the 1980's have steepened a decline in the public works spending that dates to the 1950's. If the downward trend continues, Americans will see increasing evidence of deterioration in our highways, water and sewer systems, bridges and other building blocks of the nation's infrastructure.

Whatever strategy our President uses to spur our economic growth, one thing is for certain: Our infrastructure is just barely adequate to support our current level of economic activity, and our current rate of infrastructure improvement and investment falls vastly short of tomorrow's needs.

Declining public works investment will inevitably undercut the benefits of private capital investment. If our basic transportation, water supply and waste disposal systems continue to deteriorate, more money will come out of the private sector's bottom line, thus eroding American productivity."

Mr. Chairman, while these word ring true, they are not mine. They are quotes taken from an article published on June 24, 1988, by then-Governor Bill Clinton in the *New York Times*. A copy of the article is attached to this testimony.

As a firm believer in benefits of infrastructure investment, I commend you for holding these hearings. For years, I have sought a national partnership to improve our nation's infrastructure. The Clinton Administration plans to introduce an infrastructure initiative in 1995. With bipartisan input from state and local officials, Members of Congress and the Administration, I am confident a sensible infrastructure policy can be enacted that will take us well into the next century.

BACKGROUND. Responding to concerns expressed by then-Governor Clinton and others, I established the Anthony Commission on Public Finance in 1988 as a bipartisan group with representatives of state and local governments and other participants in public finance. A list of the Commission's members is attached. The Commission examined the ways in which tax-exempt financing could be made a more reliable tool for providing the capital improvements necessary for public services. After weighing carefully both federal concerns about abusive transactions and the legitimate needs of state and local governmetn, the Commission in 1989 issued its first report, *Preserving the Federal-State-Local Partnership: The Role of Tax-Exempt Financing.*

Over the last five years the Commission's report has withstood intensive scrutiny and its recommendations have proved broadly acceptable to the public and private groups most affected. The soundness of the Commission's recommendations have been further evidenced by the enactment of several into law and by the inclusion of a substantial number in the Revenue Act of 1992 (H.R. 11) passed by Congress but vetoed by President Bush. The provisions of H.R. 11 were reintroduced in the current session of Congress and are contained in H.R. 13.

RECOMMENDATIONS. The recommendations of the Anthony Commission offer cost-effective mechanisms that can help to sustain the near-term economic recovery and the permanent investment in infrastructure which is essential for long-term growth. These recommendations can be rapidly implemented through modest changes in the federal tax law. Such changes will immediately stimulate the flow of private capital into public projects. They will complement and enhance other infrastructure-related initiatives. They can and should play an important role in the Clinton Administration's program for rebuilding the nation's infrastructure and providing a sound basis for economic growth.

No other approach can match this one in terms of quickly unlocking private capital for investment in public facilities of lasting benefit. Any national infrastructure program will achieve maximum effectiveness only if it recognizes the importance of tax-exempt bonds and implements tax law changes that will make local government finance more efficient, accessible and therefore better able to supplement and leverage federal support.

Defining Public Purpose. The Commission recommends an improved Tax Code definition of "public activity bonds" that would permit tax-exempt financing for indisputably public purposes most efficiently undertaken with substantial private participation. The Commission's recommendation protects against past

abuses while encouraging the kinds of public-private partnerships particularly needed to ensure prompt application of new technologies to public services in such areas as pollution control, hazardous and solid waste disposal, recycling and transportation management. Current Tax Code restrictions on management contracts and other private participation effectively have precluded needed private expertise in many areas. Private entities cannot prudently commit necessary funds and other resources if their long-term participation is not assured. Absence of private expertise often decreases the economic viability of important public projects and in turn discourages the flow of private capital to such projects.

Implementation of this recommendation will open the door for an immediate and significant inflow of private expertise and capital into those public facilities that most need them.

Unlocking Private Capital: Broadening the Market for Bonds. Despite the harsh restrictions imposed by the 1986 Tax Act, the municipal bond market has remained a remarkably efficient source of capital funding. Changes made in 1986, however, have made the market vulnerable to severe volatility and discouraged community investment. These changes have driven traditional buyers, such as banks and certain insurance companies away from the market. Otherwise, these financial institutions are willing and able to invest billions of dollars in long-term public projects. The recommendations of the Anthony Commission to expand the use of "bank eligible bonds" and eliminate inefficient alternative minimum tax provisions offer a simple and effective way to help localities serve their citizens and encourage economic growth.

Other Recommendations. Other proposals can similarly produce prompt and significant results. The Commission was very pleased when permanent extensions of the mortgage revenue and small issue industrial development bond provision were enacted last year. Although the Treasury Department has made great strides in simplifying the arbitrage rebate rules, the reforms contained in the Commision report can immediately facilitate local projects and generate savings for state and local governments. The Commision's proposals to ease overly restrictive and unnecessary requirements such as the 5-percent unrelated and disproportionate use test can promptly eliminate burdens that regularly delay or make important public projects more expensive.

The Efficiency of Public Finance: Getting Quickly What is Most Needed. Tax Code relief for state and local governments offers an extraordinarily effective way of opening the offensive to address this nation's deficient infrastructure. The project selection process and the funding mechanism are already in place and functioning. The municipal bond market, local political

accountability and the need to commit the locality's own credit create powerful incentives for selecting the most beneficial projects and financing them in the soundest manner. Capital will come, not from federal appropriations, but from an existing, well developed private market that repeatedly has demonstrated its ability to provide low-cost funding. If the Clinton Administration had utilized this approach, its ill-fated economic stimulus package might be having a favorable impact on the nation's economy as we speak. Instead, it failed because opponents were able to attack it as wasteful "pork" rather than legitimate economic stimulus.

In recent years the federal government has mandated multitudinous and expensive projects for local governments in areas such as water quality. These projects alone, already identified as pressing needs for public expenditure, could provide a major infusion of economic stimulation and public improvement. Small changes in tax law and federal regulations will greatly facilitate an efficient and cost-effective flow of funds to these public capital projects.

Improvement of tax rules to encourage public purpose borrowing will permit the Clinton Administration to stimulate maximum economic growth with a minimum of delay and a minimum of federal dollars. It offers a proven method to generate employment and promote long-term public investment, providing immediate relief where most needed and enhancing federal dollars as they are made available over time through grants, revolving loans and other direct programs. The Commission supports the development of these programs. Their cost effectiveness will be multiplied if tax-exempt financing can be used to leverage the federal investment by attracting private capital to the projects such programs support.

Making Decisions for the Public Good. The Clinton Administration has an important opportunity to promote sound decision-making in federal tax policy. In recent years the concept of federal revenue neutrality, rooted in legitimate concerns about the deficit, has obscured the relationship between federal tax law and national economic development. Short-term revenue concerns have sometimes clouded decision-making about long-term economic growth.

In promoting economic growth and supporting infrastructure formation, the Congress and Administration should consider many combinations of direct expenditures and Tax Code changes to spur economic growth. Unfortunately, the

federal legislative process sometimes discourages the use of appropriately broad cost-benefit analysis. Tax law changes are addressed in committees primarily concerned with the narrow question of federal revenues, while direct expenditures are considered by committees focused primarily on the programmatic and economic results of such expenditures.

The Anthony Commission urges the Congress and Administration to ensure these institutional predispositions do not impede the process of choosing the best combination of direct expenditures and "tax expenditures." Important proposals for economic growth should be judged by their overall effect on the economy and not primarily by their federal "revenue neutrality" as determined by the often mysterious revenue estimating process.

Cooperation for a New Federalism. The Anthony Commission endorses a New Federalism under which the federal government encourages state and local governments to promote economic vitality. The Commission's recommendations reflect thoughtful consideration by a broad range of participants and a recognition of the need to ensure that the federal tax law encourages responsible behavior by state and local governments.

The process of producing the Anthony Commission Report has brought together diverse interests with expertise and experience in public finance, including representatives of the states, cities and counties, special authorities, non-profit providers of public services and the private sector entities that finance public improvements. The work of the Commission has demonstrated the ability of these groups to build effective coalitions to promote legislative changes.

Conclusion. The Commission and the groups that have supported it stand ready to assist this Committee and the Clinton Administration in promoting these recommendations and in marshalling the broad support for them that exists throughout the country. We can make available the extraordinary range of expertise and experience that our members and their supporting organizations have in state and local government finance and related federal tax law questions. We also recognize our obligation to promote the kind of thoughtful reform in this important area that President Clinton has always endorsed.

Members of the Anthony Commission on Public Finance

William Jefferson Clinton - President of the United States

Kay Bailey Hutchinson - United States Senator

Carroll A. Campbell, Jr. - Governor, State of South Carolina

Mary Ellen Withrow - Treasurer of the United States

Robert Nash - Under Secretary, United States Department of Agriculture

Jerry E. Abramson - Mayor, Louisville, Kentucky

Edward T. Alter - Treasurer, State of Utah

Kathleen Brown - Treasurer, State of California

Janet Rzewnicki - Treasurer, State of Delaware

Barbara Shipnuck - County Supervisor, Monterey County, California

Jeffrey S. Green - Port Authority of New York and New Jersey

Dr. Eamon Kelly - President, Tulane University

David Aschauer - Bates College

Stephen Mahfood - Missouri Department of Environmental Improvements and Energy Resources

Neil P. Moss - Idaho Health Facilities Authority

John E. Chapoton - Vinson & Elkins

Wooten Epes - Kutak, Rock

George D. Friedlander - Smith Barney Shearson

Theodore M. Hester - King & Spaulding

Freda S. Johnson - Government Finance Associates, Inc.

Richard Larkin - Standard & Poor's Corporation

Robert Dean Pope - Hunton & Williams

BERYL F. ANTHONY, JR.

Beryl Franklin Anthony, Jr. is a veteran of 14 years of service in Congress. A native of El Dorado, Arkansas, he was first elected to the U.S. House of Representatives in 1978. Vice President of his freshman class, Anthony was also founding member of the Sunbelt Coalition, a group that monitored the legislative impact upon southern states. After just one term, Anthony won a coveted seat on the Ways and Means Committee, a powerhouse that shapes federal tax policy. He also served on the Oversight and Trade Committees as well as the Select Committee on Children, Youth and Families.

As a member of the Ways and Means Committee, Anthony pursued a variety of important issues. In the 1980's, he played a major role in restructuring the Social Security trust fund. He championed legislation for improved rural health care for which he was given awards by both the Arkansas and American Hospital Association. He completed his tenure with a focus on international trade where he worked on the North American Free Trade Agreement and on legislation for the General Agreement on Tariffs and Trade.

Anthony's dedication to public service and effective government was demonstrated with the 1988 foundation of the Anthony Public Finance Commission. Composed of mayors, governors, local government officials and members of the finance community, this bi-partisan Commission recommends legislation that enables local governments to better finance the building of roads, schools, hospitals and waste water treatment facilities. The Commission's Arbitrage Relief Provision, enacted in 1989, substantially lessened the borrowing costs for infrastructure investments. Anthony and three House colleagues formed the Infrastructure and Public Finance Caucus in order to bring special recognition to these important issues. In 1992, as a result of his legislative contributions, Anthony received awards from the National Association of Bond Attorneys and the Public Securities Industry in Chicago, Illinois.

In 1987, Anthony was honored by his fellow House Democrats by being selected as Chairman of the Democratic Congressional Campaign Committee. As Chairman, Anthony helped Democrats increase their majority in the House, gaining seats in 1988; winning eight of 10 special elections in 1989; and again winning seats in 1990. When Anthony resigned from the DCCC, the Democratic leadership held a 100-seat majority in the House of Representatives.

Previous to his Congressional career, Anthony served as Assistant Attorney General for Arkansas and as Prosecuting Attorney for the 13th Judicial District. He received a B.A./B.S. in 1961 and J.D. in 1963 from the University of Arkansas. In January, 1993, Anthony became a partner in the Washington, D.C. office of Winston & Strawn. He currently serves on the Board of Directors of Beverly Enterprises and on the International Board of Trustees of the Ward Foundation. His wife, the former Sheila Foster of Hope, Arkansas, is a practicing attorney in Washington, D.C. The Anthonys have two daughters, Alison and Lauren.

FREDERIC L. BALLARD, JR.
REPRESENTING THE
NATIONAL ASSOCIATION OF BOND LAWYERS
HOUSE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
ECONOMIC DEVELOPMENT SUBCOMMITTEE

June 30, 1994

My name is Frederic L. Ballard, Jr. I am a partner in the law firm of Ballard Spahr Andrews & Ingersoll in Washington, D.C. I am here to testify on behalf of the National Association of Bond Lawyers ("NABL"). NABL is a non-profit corporation organized for the purposes of educating its members and others concerning the laws relating to state, and local bonds and other obligations, providing a forum for the exchange of ideas as to law and practice, improving the state of the art in the field, providing advice and comment at the federal, state and local levels with respect to legislation, regulations, rulings, other actions, or proposals affecting state and local obligations, and providing advice and comment with regard to state and municipal obligations in proceedings before courts and administrative bodies through briefs and memoranda as friend of the Court. Currently, NABL has over 3,000 members.

I appreciate the opportunity to speak before this Subcommittee today. My testimony addresses the provisions of the Internal Revenue Code bearing on use of tax-exempt bonds to finance infrastructure. Tax-exempt bonds, so-called because the interest on the

bonds is exempt from Federal income tax, provide low-cost financing that is indispensable in the development of the nation's infrastructure.

SUMMARY OF PRESENT LAW

The Tax Code divides tax-exempt bond issues into two general categories: governmental bonds and private activity bonds. Each is important in its own right to today's hearing.

Governmental bonds are state and local government bonds, issued for the basic purposes of government: streets, roads, sewers, public works generally, public schools, courthouses, criminal detention facilities, administrative offices, and so on. Governmental bonds are the financing mechanism for a very large portion of the Nation's infrastructure development today.

Private activity bonds are bonds issued for the benefit of, or with significant involvement by, a "private" entity. Private, in this context, means an entity that is not a state or local government unit. Private entities include corporations, partnerships, trusts, nonprofit charities, and includes the federal government. The Tax Code grants tax-exemption for interest on private activity bonds only if the facilities financed by the bonds fall into various categories specified in the Tax Code. The permitted categories of facilities include the following:

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- Airports
- Docks
- Mass commuting facilities
- Intercity high-speed rail facilities
- Sewage facilities
- Solid waste disposal facilities
- Low income rental housing
- Certain kinds of utility facilities
- Manufacturing facilities in projects that do not exceed $10,000,000
- Facilities owned and operated by nonprofit institutions described in section 501(c)(3) of the Tax Code, such as hospitals and educational institutions

The complete list is set forth in sections 141 and 142 of the Tax Code.

The facilities permitted to be financed with tax-exempt private activity bonds could otherwise be financed with governmental bonds if the facilities were owned and operated by a governmental entity, except for small issue manufacturing facilities. Congress has allowed them to be financed with tax-exempt governmental bonds because the financing serves a governmental purpose. The participation of a "private" entity means that bonds to finance the facilities will be private activity bonds that are generally subject to

a per state ceiling on the aggregate volume that may be issued by all issuers in a state in each calendar year. The volume cap for a state is $50 times the population of the state, subject to a minimum of $150,000,000. Some kinds of private activity bonds, such as bonds for airport facilities or 501(c)(3) organizations, are exempt from volume ceiling. Private activity bonds for intercity rail facilities are subject to volume ceiling only to the extent of 25% of the issue.

The tax exemption for private activity bonds is a partial exemption, exempting the income from personal or corporate Federal income tax but not from the Alternative Minimum Tax. In this respect the tax-exemption for private activity bonds differs from that of governmental bonds, which are generally exempt from both taxes except in special cases involving alternative minimum taxation of corporations. This difference in tax treatment means that governmental bonds usually receive slightly lower interest rates than private activity bonds.

IMPACT OF 1986 LEGISLATION

Infrastructure development was affected in several ways by the Tax Reform Act of 1986 (the "Act"). These can be summarized as follows:

1. Prior to the Act, a municipality could issue tax-exempt governmental bonds and use up to

25% of the proceeds for business purposes or loans. In this context the term "use" includes one or several private entities using, for example, renting, 25% of the governmental facility. The Act reduced the 25% business use authorization to 5%, or 10% for a business use that is related to the governmental purpose of the issue. Similar restrictions were placed on use of proceeds to make loans to private parties.

2. The Act eliminated the ability of a municipality to use tax-exempt private activity bonds to finance convention and sports facilities. Under the Act a municipality must use governmental bonds if it wants to finance these facilities on a tax-exempt basis. In other words, the issuer must plan the financing so that no more than 10% of the facility is used by a private entity in a fashion other than the general public uses the facility. Generally, this is done either by making sure that the use of the facility will not be predominantly a business use, or else by arranging for the debt service on the bonds to be payable from tax revenues with no direct or indirect

payments from business. Financial planning of this type is not always possible or practical.

3. The Act imposed new, complex, and burdensome rules for "qualified redevelopment bonds." These rules apply to transactions in which a municipality issues tax-supported bonds to finance a program in which it buys dilapidated properties, clears or rehabilitates them, and sells the land or rehabilitated structures to private parties. The Act treats these bonds as private activity bonds and then requires them to comply with the qualified redevelopment bond rules, including the state volume ceiling.

4. The Act directed the Internal Revenue Service to liberalize its position allowing private management of facilities financed with governmental bonds. The Service did so in Revenue Procedure 93-13, which allows a private business manager to receive compensation based on either a fixed fee or various formulas based on gross receipts or level of activities. The Revenue Procedure also requires that the term of the management contract cannot exceed five years and that no

part of the manager's compensation can be based on net profits of the facilities.

These amendments have the common theme of attempting to reformulate the dividing line between permissible governmental uses of bond proceeds and impermissible private uses.

One other provision of the Act affected infrastructure financing indirectly, but importantly. The Act made it uneconomic for banks to purchase tax-exempt bonds other than governmental bonds issued by an issuer of not more than $10,000,000 of such bonds in the calendar year, or 501(c)(3) charitable organization bonds under the same limit. Except for cases qualifying under the $10,000,000 limit, the Act made holding the bonds uneconomic by providing a rule that a bank that purchases tax-exempt bonds loses a pro-rata portion of its deduction for interest paid on its borrowings. While not aimed specifically at infrastructure financing, this provision of the Act made it impossible for all but the smallest cities to use banks in their financial planning, including plans for unusual, experimental, or complex financings that are frequently found in infrastructure development. Congressman Lewis' bill, H.R.2171, would improve this situation by increasing the level of bank deductibility from $10 to $25 million for governmental bonds. While

this does not address the needs of private activity bond projects that provide infrastructure financing, it is an important step in the right direction.

There were other technical changes made by the Act that affect how governmental and private activity bonds are issued that I would be happy to describe in a later submission if you are interested in that level of detail.

ENTERPRISE ZONE FACILITY BONDS

The Revenue Reconciliation Act of 1993 enacted extensive provisions for enterprise zone facility bonds, or EZ bonds. Municipalities can use these bonds if they qualify based on specific criteria regarding the economic distress of the community and the communities expressed commitment to coordinated redevelopment, either as one of nine empowerment zones or 95 enterprise communities, both referred to generally as zones. The authorization for EZ bonds is welcome as a recognition that tax-exempt financing can play a constructive role in community development. At the same time, the statutory provisions for EZ bonds are complex and in certain respects are difficult to understand, and impractical.

EZ bonds are tax-exempt private activity bonds that can be used by a qualified enterprise zone business to finance construction or substantial

renovation of up to $3,000,000 of enterprise zone facilities in any one zone. The bonds are subject to an overall per-business limit of $20,000,000 of financing in all zones nationwide. The facilities can generally be either industrial or commercial. Unlike private activity bonds using the regular $10,000,000 limit, EZ bonds are not limited to manufacturing facilities. Unfortunately the qualifications for these bonds are complex and the number to be rewarded very few in comparison to the national need.

The Code provisions for EZ bonds have presented the following problems:

1. At least 35% of the employees of an enterprise zone business must be residents of the zone, and the business must meet various other tests of an ongoing nature as well. If the business fails to comply with these tests after the bonds are issued, it must bring itself back into compliance within a reasonable period. In matters such as the requirement of 35% zone employment, getting back into compliance may present significant practical problems.
2. The enterprise zone business must be the "original user" of the facility. This requirement apparently means that the parties cannot use bond proceeds to finance the purchase of an existing

facility, that is, a building or structure previously in service for some other owner.

3. The proceeds of EZ bonds apparently cannot be used to discharge an existing mortgage of the enterprise zone business, even as part of a transaction with a primary purpose of construction or substantial renovation.

4. These bonds will be issued generally for small and unsophisticated businesses that will be unable to access the capital markets even given the benefit of tax-exemption due to such businesses' creditworthiness and the costs associated with issuing tax-exempt bonds in the public markets. Bank deductibility (as described above) would have allowed these issues to be placed with local banks which are able to evaluate the local business and monitor its progress. The usefulness of this program may be hindered by a failure to recognize the reality of market forces.

To some extent these problems can be alleviated by Treasury regulations. Communities hoping to be designated as zones through applications which, by coincidence are due today, are waiting for the publication of regulations with considerable interest.

H.R.3630

H.R.3630, the Public Finance and Infrastructure Investment Act of 1993, would create a new category of tax-exempt private activity bonds to be known as "distressed community economic development bonds." These bonds could be used for generally the same purposes as EZ bonds, with the notable and commendable addition of working capital. The bonds would be available in any community that meets a definition of economic distress.

H.R.3630 is an excellent starting point. There are a few respects in which it could be strengthened as it moves through the legislative process. These can be noted as follows:

1. Initial qualification under H.R.3630 is triggered by a community's meeting the criteria established in the bill for "distress". The eligibility tests in H.R.3630 rely on statistics for population loss, unemployment, slow job growth, or military base closings causing a loss of 500 jobs or more. The bill needs to specify what statistics are to be used in each context and how they are to be compared.

2. The bill should state explicitly that the bonds are not affected by a post-issuance

change of circumstance that means the community no longer qualifies. Ironically, the success of an economic development program including bonds issued under H.R.3630 could lead to a reversal of the negative economic indicators that qualified the community as economically distressed in the first place.

Other Possible Initiatives

While I have addressed the current law restrictions on tax-exempt financing for public and private infrastructure financing and briefly described proposed legislation, there are other initiatives Congress could pursue to enhance infrastructure financing and thus investment in the Nation's infrastructure. These could include the following:

1. New Categories of Private Activity Bonds

Congress could authorize a new category of bonds for facilities reflecting the goal in modern governmental finance that the private sector share the costs of governmentally approved projects or actually assume responsibility for them. The latter is known as "privatization". There is growing belief that some governmental functions can be better provided with private sector involvement or total control. As described above, private sector involvement limits or

eliminates the use of tax-exempt financing. The changes in tax law have been contrary to the trends in governmental policy to share the burdens and costs of government with its private sector participants. Facilities that are legitimately viewed as infrastructure facilities which provide sufficient community benefit to justify tax-exempt financing and provide the facility and service in the most efficient manner based on appropriate public policy analysis should improve investment in the Nation's infrastructure. The kinds of facilities to be provided under this kind of analysis range from some current private activity bonds to creative partnerships for the provision of education, roads, and emerging technical requirements facing state and local governments. Creation of a public activity bond as described in the Anthony Commission Report can help expand investment in infrastructure.

2. Further Liberalization of Management Contract Rules

In addition to adding additional categories of permitted private activity bonds or creating a "governmental or public activity" bond as described above, another approach to promote infrastructure financing would be further liberalization of the contractual arrangements permitted for private management of facilities financed with governmental

bonds. Under present law, a management contract providing for compensation based on net profits or with a term in excess of five years will cause the financing for a facility to be private activity bonds. Options to renew the contract beyond the five-year limit are treated as violating the limit. It would be helpful if Congress could direct, or clarify, that renewal options had this effect only if they are held by the private manager and not if they are held by the governmental owner of the facility. Giving a renewal right to the governmental owner should not cause bonds to be private activity bonds.

3. Raise the Volume Ceiling

Congress could liberalize the state volume ceiling for private activity bonds. Congress could do so either by exempting additional categories of bonds or by raising the amount of the overall ceiling from the present level of $50 per person and $150,000,000 minimum. These amounts have not been changed since they were adopted in 1986. Inflation of construction costs alone justifies an increase and would stimulate investment in the existing private activity bond categories of infrastructure. Furthermore, there was no increase in 1993 when Congress added the new category of EZ bonds.

4. Buy Side Restrictions

As described above, the 1986 Tax Act placed numerous restrictions on and impediments to tax-exempt financing. Factors affecting purchasers' willingness to buy tax-exempt bonds were added that diminished or virtually eliminated segments of the market's appetite for bonds. Imposition of the bank deductibility restrictions and application of the Alternative Minimum Tax to tax-exempt bond interest has dramatically reduced the holdings of municipal bonds by banks and insurance companies and some corporations. The market has gone from domination by corporate holders to a retail purchasing market. Any initiative this committee can pursue to eliminate or reduce these restrictions will drive interest costs down due to competition and increase the amount issuers will have available to invest in infrastructure projects. Even if these changes were made only for a category of infrastructure bonds, it would be an improvement.

CONCLUSION

I also commend to you the Anthony Commission Report and the Recommendations contained therein. It continues to be a timely analysis and set of recommendations. Your Committee's attention to the importance of municipal infrastructure is greatly appreciated. Much good has been done and is being

done. Much remains to be done. I would be happy to answer questions or give you follow-up information or assistance as requested.

Frederic L. Ballard, Jr.
Ballard Spahr Andrews & Ingersoll
555 13th Street, NW
Washington, D.C. 20004

Rick is a partner in the Washington office of Ballard Spahr Andrews & Ingersoll, the 250 lawyer firm founded by a relative in Philadelphia in the 1880's. He works primarily in the area of Federal income tax exemption of municipal bonds. He is the author of the ABC's of Arbitrage, a text on the tax rules applicable to investment of bond proceeds by municipalities. He is a member and former Board of Directors member of the National Association of Bond Lawyers. He is also a member of the Section of Taxation and the Section of Urban, State and Local Government Law of the American Bar Association. He is a graduate of Harvard College and Harvard Law School. He was born in 1941 and lives in Bethesda, Maryland, with his wife, Marion. They have three grown children between them.

NATIONAL ASSOCIATION *of* COUNTIES

440 First St. NW, Washington, DC 20001
202 393 6226

TESTIMONY OF

THE HONORABLE LIANE LEVETAN
CHIEF EXECUTIVE OFFICER, DE KALB COUNTY, GEORGIA
CHAIR, TAX EXEMPT BOND AND CAPITAL FINANCING SUBCOMMITTEE
OF THE TAXATION AND FINANCE STEERING COMMITTEE

REPRESENTING THE NATIONAL ASSOCIATION OF COUNTIES

ON

TAX EXEMPT BONDS FOR FINANCING
PUBLIC WORKS AND INFRASTRUCTURE

BEFORE THE SUBCOMMITTEE ON ECONOMIC DEVELOPMENT
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

U. S. HOUSE OF REPRESENTATIVES

JUNE 30, 1994
WASHINGTON, DC

MR. CHAIRMAN, I AM LIANE LEVETAN THE ELECTED CHIEF EXECUTIVE OFFICER OF DE KALB COUNTY, GEORGIA. I AM PLEASED TO HAVE THE OPPORTUNITY TO TESTIFY ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES (NACo)* WHERE I SERVE AS THE CHAIR OF THE TAX EXEMPT BOND AND CAPITAL FINANCING SUBCOMMITTEE.

I COMMEND YOU AND THE SUBCOMMITTEE FOR THIS HEARING TODAY. THE USE OF TAX EXEMPT BONDS FOR FINANCING PUBLIC WORKS AND INFRASTRUCTURE PROJECTS IS MORE CRITICAL THAN EVER TO STATES, COUNTIES AND CITIES.

NACo STRONGLY SUPPORTS TAX EXEMPT BOND LEGISLATION PROPOSED BY REPRESENTATIVE WILLIAM COYNE AND REPRESENTATIVE JOHN LEWIS. WE HAVE WORKED CLOSELY WITH MR. COYNE IN SUCCESSFULLY GETTING A MAJORITY OF THE WAYS AND MEANS COMMITTEE TO BE COSPONSORS OF H.R. 3630, THE PUBLIC FINANCE INFRASTRUCTURE ACT OF 1993. THE BILL MAKES A NUMBER OF NEEDED CHANGES IN THE FEDERAL TAX CODE. LEGISLATION INTRODUCED BY MR. LEWIS (H.R. 2171) WOULD HELP MANY SMALLER JURISDICTIONS THAT ISSUE LESS THAN $25 MILLION IN BONDS EACH YEAR. HIS BILL WOULD ALLOW BANKS TO DEDUCT PART OF THE INTEREST COSTS IN HOLDING BONDS OF THESE SMALLER

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* The National Association of Counties is the only national organization representing county government in the United States. Through its membership, urban, suburban and rural counties join together to build effective, responsive county government. The goals of the organization are to: improve county government; serve as the national spokesman for county government; serve as a liaison between the nation's counties and other levels of government; achieve public understanding of the role of counties in the federal system.

JURISDICTIONS. THIS PROVISION ALSO IS INCLUDED IN MR. COYNE'S BILL, H.R. 3630.

WE REALIZE THAT CONGRESS WILL NOT RESTORE THE PRE-1986 CONDITIONS FOR TAX EXEMPT BONDS. IT APPEARS TO BE GENERALLY AGREED, HOWEVER, THAT THE 1986 TAX REFORM ACT WENT TOO FAR. MR. COYNE'S AND MR. LEWIS' BILLS ARE TRYING TO FIND A MODERATE, ACCEPTABLE COMPROMISE. THE PUBLIC FINANCE AND INFRASTRUCTURE INVESTMENT ACT WOULD STREAMLINE MANY OF THE EXISTING TAX CODE PROVISIONS THAT AFFECT THE TAX-EXEMPT BONDS ISSUED BY COUNTIES, CITIES AND STATES. THIS LEGISLATION WOULD ALSO REDUCE THE ADMINISTRATIVE AND FINANCIAL BURDENS PLACED ON MANY SMALL GOVERNMENT ISSUERS, SIMPLIFY UNNECESSARILY COMPLEX REGULATIONS GOVERNING ARBITRAGE EARNINGS, ENCOURAGE BANKS TO INVEST MORE IN THEIR LOCAL COMMUNITIES, INCREASE THE VOLUME OF TAX-EXEMPT PRIVATE ACTIVITY BONDS THAT MAY BE ISSUED EACH YEAR, AND ESTABLISH A NEW TYPE OF TAX-EXEMPT PRIVATE ACTIVITY BOND THAT WOULD FACILITATE ECONOMIC DEVELOPMENT IN MANY DISTRESSED COMMUNITIES.

MANY OF THE PROVISIONS IN THIS BILL WERE INCLUDED IN H.R. 11 (THE REVENUE ACT OF 1992, WHICH WAS PASSED BY CONGRESS BUT VETOED BY PRESIDENT BUSH) AND HAVE ENJOYED A LONG HISTORY OF STRONG SUPPORT FROM CONGRESS. THE LEGISLATION ALSO IS SUPPORTED BY OVER 30 NATIONAL ASSOCIATIONS OF STATE, COUNTY AND MUNICIPAL OFFICIALS.

THE NEED FOR LOCAL GOVERNMENTS TO USE TAX EXEMPT BOND FINANCING HAS GROWN OVER THE LAST DECADE AS FEDERAL AND STATE ASSISTANCE HAS DECLINED FOR MANY INFRASTRUCTURE PROGRAMS. THE ONLY INFRASTRUCTURE PROGRAMS SHOWING INCREASES ARE FOR HIGHWAYS AND AIRPORTS AND THAT HAS NOT NECESSARILY HELPED COUNTIES AND CITIES FINANCE LOCAL PROJECTS. FEDERAL ASSISTANCE FOR SEWAGE TREATMENT, STORM WATER CONTROL, DRINKING WATER, TRANSIT AND COMMUNITY DEVELOPMENT HAVE ALL DECLINED DRAMATICALLY.

AT THE SAME TIME, COUNTIES AND CITIES IN MANY REGIONS ARE STILL COMING OUT OF THE LAST RECESSION. THE NATIONAL ECONOMY IS PICKING UP STEAM BUT THAT IS NOT TRUE FOR ALL AREAS. NACo DID A SURVEY OF 63 LARGE URBAN COUNTIES EARLIER THIS YEAR AND FOUND THAT THESE COUNTIES ARE CONTINUING TO EXPERIENCE SEVERE FINANCIAL STRESS. THE FINANCIAL PRESSURES ARE CAUSING COUNTIES TO CONTINUE TO LAY OFF EMPLOYEES, CUT SERVICES AND RAISE TAXES AND SERVICE FEES. THIS IS THE THIRD CONSECUTIVE YEAR THAT LARGE URBAN COUNTIES HAVE REPORTED FINANCIAL DISTRESS.

THE SURVEY SHOWED THAT 60 PERCENT OF THE COUNTIES RAISED FINES, FEES AND CHARGES DURING FISCAL 1993. MORE THAN ONE-THIRD WERE FORCED TO RAISE PROPERTY TAXES, POSTPONE CAPITAL PROJECTS, OR FREEZE HIRING. 25 PERCENT OF THE RESPONDING COUNTIES LAID OFF EMPLOYEES.

ONE REVENUE PROBLEM FOR MANY COUNTIES HAS BEEN INADEQUATE GROWTH IN PROPERTY TAX RECEIPTS OVER THE LAST THREE YEARS. EVEN THOUGH IN MANY CASES RATES HAVE GONE UP, THE INCREASES HAVE BEEN OFFSET BY DECREASES IN PROPERTY VALUES OR STATUTORY LIMITATIONS ON PROPERTY TAX RATES OR ASSESSMENTS.

THE SURVEY ALSO FOUND THAT LARGE COUNTIES HAVE BEEN FORCED TO INCREASE SPENDING IN A NUMBER OF AREAS, ESPECIALLY LAW ENFORCEMENT AND CRIMINAL JUSTICE ACTIVITIES, AND SOCIAL SERVICE PROGRAMS. PROGRAMS TENDING TO SUFFER CUTBACKS INCLUDED GENERAL GOVERNMENT, LIBRARIES, AND PARKS AND RECREATION.

WE HAVE TAKEN THE ATTITUDE IN DE KALB COUNTY THAT THE PUBLIC WILL SUPPORT INFRASTRUCTURE IMPROVEMENTS IF IT CAN BE TIED TO ECONOMIC DEVELOPMENT. THEY HAVE TO BE SHOWN THAT INFRASTRUCTURE IMPROVEMENTS MEAN RETENTION OF COMPANIES AND JOBS AND ADDING NEW JOBS. WE HAVE BEEN SUCCESSFUL IN GETTING VOTER APPROVAL FOR A NUMBER OF RECENT BOND ISSUES THAT CLEARLY ARE LINKED TO ECONOMIC DEVELOPMENT.

WE PASSED A $33 MILLION BOND ISSUE FOR PARK LAND ACQUISITION AND NEW RECREATIONAL FACILITIES. AS A RESULT WE HAVE BEEN ABLE TO GREATLY EXPAND PARKS AND RECREATION FACILITIES OVER THE LAST THREE TO FOUR YEARS. A $29 MILLION BOND ISSUE WAS APPROVED SEVERAL YEARS AGO FOR LIBRARIES.

ALMOST $30 MILLION WAS APPROVED IN 1992 FOR ACQUIRING LAND FOR NEW HEALTH FACILITIES AND FOR EXPANDING EXISTING FACILITIES. THE VOTERS APPROVED A BOARD OF EDUCATION BOND ISSUE FOR $98 MILLION IN 1989 TO IMPROVE AND EXPAND OUR SCHOOLS IN THE COUNTY.

ALL OF THESE PROGRAMS ARE RELATED TO RETAINING AND ATTRACTING BUSINESSES TO DE KALB COUNTY.

IN ADDITION, WE HAVE HAD TO OBTAIN FINANCING FOR SEVERAL OTHER GOVERNMENTAL PROJECTS THAT ADD TO OUR BASIC INFRASTRUCTURE. $98 MILLION IN BONDS WERE APPROVED FOR BUILDING A NEW JAIL. WITH A $120 MILLION ISSUE, WE MADE MAJOR IMPROVEMENTS IN WASTE TREATMENT PLANTS IN DE KALB COUNTY AND SHARED IN THE COST OF IMPROVING TWO OF ATLANTA'S TREATMENT PLANTS. A $29 MILLION ISSUE WAS APPROVED IN 1989 FOR EXPANSION OF OUR DRINKING WATER TREATMENT PLANT. WE WILL START RENOVATING AN OFFICE BUILDING FOR ADDITIONAL SPACE FOR COURT ROOMS AND A MORGUE WITH THE SALE OF $9 MILLION OF CERTIFICATES OF PARTICIPATION.

WHILE JOBS, SEWAGE TREATMENT PLANS AND COURT HOUSES ARE NECESSARY AND IMPORTANT, VOTERS DO NOT NECESSARILY SEE HOW THEY AFFECT THEM. BUT THEY DO UNDERSTAND A CONNECTION IF THE PROJECTS ARE LINKED TO ECONOMIC DEVELOPMENT. COUNTIES, HOWEVER, MUST BE ACCOUNTABLE AND ELECTED OFFICIALS NEED TO CONVINCE CITIZENS THAT IS IMPERATIVE TO

MAINTAIN ALL OF THEIR INFRASTRUCTURE. THIS HAS A LONG RANGE IMPACT ON ECONOMIC DEVELOPMENT.

OUR BIGGEST UNMET INFRASTRUCTURE NEED IN DE KALB COUNTY ARE HIGHWAYS. THIS PROBABLY IS TRUE FOR MOST GROWING URBAN COUNTIES. WE ARE NOT ABLE TO BUDGET ENOUGH FUNDS TO KEEP UP WITH NECESSARY MAINTENANCE, RESURFACING AND TRAFFIC IMPROVEMENTS. LAST YEAR WE WERE ABLE TO ONLY RESURFACE 15 MILES OF COUNTY ROADS. WE HAD HOPED TO GET STATE FUNDING TO RESURFACE 59 MILES BUT THE FUNDING DID NOT COME THROUGH.

DESPITE THE LARGE INCREASES IN FEDERAL HIGHWAY FUNDS AUTHORIZED BY ISTEA, WE ARE NOT BENEFITING FROM THE ADDITIONAL FUNDING AS MUCH AS OTHER JURISDICTIONS IN OUR AREA. THE PRIORITY LIST FOR STATE PROJECTS IS BASED ON THE ABILITY TO PROVIDE MATCHING FUNDS. UNFORTUNATELY, WE DO NOT HAVE A SALES TAX DEDICATED TO HIGHWAY IMPROVEMENTS THAT COULD BE USED TO PAY OFF A BOND ISSUE. I CAN APPRECIATE AND PARTLY SYMPATHIZE WITH THE PROBLEMS THE STATE HAS IN GETTING THE FUNDS COMMITTED AND SPENT. THE REAL PROBLEM IS THAT HIGHWAY NEEDS IN GEORGIA ARE FAR GREATER THAN AVAILABLE FEDERAL, STATE AND LOCAL FUNDS. THIS IS TRUE ALL OVER THE COUNTRY.

I BELIEVE IT IS VERY IMPORTANT TO DISCUSS AT THIS HEARING THE NEED FOR INCREASED PUBLIC-PRIVATE PARTNERSHIPS IN

ECONOMIC DEVELOPMENT AND IN IMPROVING INFRASTRUCTURE. THIS PARTICULARLY IS AN AREA THAT NEEDS CONGRESSIONAL CLARIFICATION ON WHAT IS PUBLIC PURPOSE AND THE TYPE OF PRIVATE PARTICIPATION PERMITTED TO HAVE A BOND QUALIFY FOR TAX EXEMPTION.

WE HAVE BEEN SUCCESSFUL IN DE KALB COUNTY IN GETTING THE SUPPORT AND PARTICIPATION OF BUSINESSES, THE CHAMBERS OF COMMERCE AND NEIGHBORHOOD ORGANIZATIONS IN WORKING WITH US. LET ME GIVE YOU A COUPLE OF EXAMPLES.

ON JUNE 23, LAST WEEK, WE HAD DEDICATION CEREMONIES FOR A NEW SWIMMING POOL IN A COMMUNITY CALLED LYNWOOD PARK. THIS IS A LOW INCOME NEIGHBORHOOD WITH A PER CAPITA INCOME OF ONLY $8,500 SURROUNDED BY HIGHER INCOME AREAS. A LOCAL DEVELOPER, POST PROPERTIES, DONATED $75,000 TO BUILD THE SWIMMING POOL AND PROVIDED THE LANDSCAPING. THE COUNTY ALLOCATED $50,000 IN COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG) FUNDS FOR MATERIALS TO BUILD THE BATHHOUSE. DE KALB COUNTY ALSO FINANCED IMPROVEMENT OF THE WATER AND SEWER SERVICE.

AS A RESULT OF THIS PUBLIC-PRIVATE PARTNERSHIP, WE EXPECT THAT OTHER IMPROVEMENTS WILL BE MADE IN THE COMMUNITY. THE COMMUNITY IS NOW WORKING WITH DE KALB COUNTY ON A STRATEGIC DEVELOPMENT PLAN.

OVER THE LAST TWO YEARS, WE HAVE BEEN WORKING WITH THE CHAMBERS OF COMMERCE, LOCAL UNIVERSITIES, AND THE GEORGIA POWER COMPANY TO DEVELOP A SMALL BUSINESS INCUBATOR PROGRAM. CDBG FUNDS, ALONG WITH STATE AND PRIVATE FUNDS, WILL BE USED TO FINANCE THE PROJECT. WE HAVE A COMMITMENT OF $2 MILLION FROM TWO BANKS TO ESTABLISH A REVOLVING LOAN FUND. THE PROJECT ALSO IS PART OF DE KALB COUNTY'S APPLICATION FOR BEING DESIGNATED AN ENTERPRISE ZONE. THE SMALL BUSINESS INCUBATOR WILL BE LOCATED IN A LOW INCOME NEIGHBORHOOD. THERE IS EVIDENCE THAT THE ANTICIPATED PROJECT ALREADY HAS STABILIZED A NEARBY SHOPPING CENTER.

I AM CONVINCED THAT THIS IS THE TYPE OF PUBLIC-PRIVATE VENTURES WE NEED IF WE ARE TO HAVE SUCCESSFUL ECONOMIC DEVELOPMENT PROGRAMS. WE ALSO NEED PRIVATE PARTICIPATION IF WE ARE SERIOUS ABOUT IMPROVING INFRASTRUCTURE.

MR. CHAIRMAN, AGAIN I WANT TO THANK YOU FOR ASKING ME TO TESTIFY AT THIS HEARING. I WILL BE HAPPY TO TRY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

LIANE LEVETAN

DeKalb County Chief Executive Officer

Biographical Information

The first woman elected Chief Executive Officer of DeKalb County, Liane Levetan frequently speaks and writes on urban related issues. She is a nationally recognized authority on recycling and waste management issues and recently contributed a chapter to McGraw Hill's recently published **The Recycling Handbook**

Prior to becoming DeKalb County's CEO, Mrs. Levetan served as the first woman elected to the DeKalb County Board of Commissioners. As a Commissioner, she initiated the first curbside recycling in Georgia. Thus far, DeKalb's recycling efforts have brought in over $1.3 million in revenue. She founded and was the first president of DeKalb Clean and Beautiful.

A director of the National Civic League and the immediate past president of the International Women's Forum's Georgia Chapter, she received the 1993 International Women's Forum "Woman That Makes a Difference" Award for her leadership in building a new "Partnership of Cooperation" in DeKalb County and serving as an outstanding role model for women of all ages.

CEO Levetan has also been appointed co-chair of NACo's International Task Force. A former vice-chair of the Metropolitan Atlanta Crime Commission, she has also served on the boards of the American Cancer Society, the DeKalb Rape Crisis Center, the Metropolitan Atlanta Retired Senior Volunteer Program and the Callanwolde Foundation.

In addition to her public service, over the past three decades Mrs. Levetan has been a successful licensed real estate broker and public affairs consultant. A pioneer teacher of and advocate for mentally retarded children, Mrs. Levetan initiated a successful bond issue funding the DeKalb County Mental Retardation Service Center.

A graduate of Grady High School, Liane Levetan attended the University of Georgia and Georgia State University. Married to Phil Levetan for 39 years, they have two grown daughters and two grandchildren.

TESTIMONY OF THE HONORABLE LUCILLE MAURER

TREASURER OF THE STATE OF MARYLAND

ON BEHALF OF

THE NATIONAL ASSOCIATION OF STATE TREASURERS

BEFORE THE

SUBCOMMITTEE ON ECONOMIC DEVELOPMENT

COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

U.S. HOUSE OF REPRESENTATIVES

JUNE 30, 1994

INTRODUCTION

Chairman Wise and members of the Subcommittee, thank you for providing me this opportunity to express the views of the National Association of State Treasurers (NAST) on our nation's pressing need to improve our bridges, highways, airports, clean water - the whole panoply of needs we classify under the dreaded "I" word, infrastructure, and to strengthen the management of the federal budget. I am Lucille Maurer, Treasurer of the State of Maryland, and immediate past President of the National Association of State Treasurers. All 50 states, plus the District of Columbia, Puerto Rico, Guam and American Samoa, are represented in NAST. State treasurers are responsible for the functions of cash management, debt management, public pension fund investment, and a variety of other functions in their respective states.

NAST is a Steering Committee member on the Rebuild America Coalition, a broad coalition of public and private organizations committed to reversing the decline in America's investment in infrastructure. The coalition includes the American Consulting Engineers Council, the AFL-

CIO, the American Institute of Architects, the American Public Works Association, the American Society of Civil Engineers, the Associated General Contractors of America, the Council of State Governments, the National Association of Counties, the National Association of Home Builders, the National Association of Securities Professionals, the National League of Cities, the Public Securities Association, and the United States Conference of Mayors. The Rebuild America participants continue to focus the attention of the public and policy makers on the economic competitiveness challenges linked to the health of our infrastructure. NAST also serves on the Public Finance Network, a coalition united to preserve state and local government use of tax-exempt finance.

CAPITAL BUDGET

I first want to compliment Chairman Wise on his longstanding and outspoken advocacy of capital budgeting for the federal government. You have taken the lead on this proposal for a number of years, Mr. Chairman, and it continues to be an innovative, common-sense plan to

contribute to America's economic well-being.

States like Maryland have successfully implemented a capital budget process, in which a capital improvement budget and an operating budget separate investment from government operations. I appreciate your support for a capital budget, because (1) it is good management of tax dollars, and (2) it helps to provide adequate funding for infrastructure, which is essential for economic competitiveness in a global economy. This hearing is important because it points out a cross-connection in economic policy i.e., how public finance is related to budgeting, and how budgeting is related to the economic well-being of our states.

As you have pointed out before, the federal budget makes no distinction between consumption and investment. However, a dollar invested in a capital project at least spreads the cost over the period of the asset's useful life. The federal government's current budgeting process provides little separation between spending for recurring government operations and long lasting investments.

Your legislation includes ongoing evaluation of investments in the capital account, and of proposed capital investments. It also includes an enforcement mechanism to ensure capital budgeting meets its intended goals. This discipline is essential to the success of the program, or else it is much too easy to balance the operating budget by transferring items to the capital budget. I suggest that the experience of the states demonstrates that a capital budget is very important and that the capital budget process can be a disciplined one.

It is NAST's hope a federal capital budget, with an account for infrastructure investment, will help infrastructure to gain a greater priority in the federal budget process.

INFRASTRUCTURE

Our infrastructure needs can be clearly shown using some real world examples provided by the Rebuild America Coalition:

* outdated leaking pipes waste up to 30 percent of daily fresh water

supplies in some major cities

* half the nation's communities have wastewater treatment facilities at or near capacity, hamstringing further commercial and residential development

* 41 percent of our bridges are rated deficient, including some which are closed and other subject to weight limitations.

* by the year 2000, a million miles of highway will need resurfacing, and three out of four airline passengers will be delayed due to airport congestion.

TAX-EXEMPT FINANCE

Maryland is a good example of a state that has continued to provide the infrastructure essential to a reasonable quality of life while at the same time balancing its operating budget - even duing the past few rocky years. We have, for example, over the past five years spent

over $600 million on public school construction, almost all of that sum from bonds. The state is also investing in a bio-processing facility, to help move Maryland forward and become a biotechnology center.

Maryland is viewed by some as having "high" debt. We are always near the top when comparing states using the standard criteria - debt per capita and debt outstanding to personal income. At the same time, Maryland has a national reputation as being a forerunner in the field of debt management. Maryland's Capital Debt Affordability Committee was established sixteen years ago and has been instrumental in managing the state's debt. Testimony to our success is our coveted triple-A rating from all three rating agencies on our general obligation bonds. Tax-exempt financing, needless to say, is a fundamental component of this process.

NAST ACTIVITIES

Mr. Chairman, NAST will continue to advocate financial policy improvements to boost infrastructure and economic development. NAST

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is also working with the Securities and Exchange Commission on reforms for political contributions to those officials who are involved in the awarding of bond business. In April, the Southern State Treasurers approved a resolution calling on Congress to enact major campaign finance reform applicable to federal, state, and local officials. Such reforms would address constitutional inequities imposed by the Municipal Securities Rulemaking Board's Rule G-37 banning political contributions from municipal securities dealers.

NAST will also take up the matter of enhanced primary and secondary market disclosure at its annual conference in New Orleans, LA on July 9-13. Proposed SEC rules would require additional continuing disclosure from state and local issuers to market participants to ensure investors are receiving adequate information about municipal securities. NAST supports providing effective disclosure to investors without imposing burdensome costs on state and local issuers. NAST will work with other organizations and hopes to ensure disclosure is cost-efficient.

CONCLUSION

Again, I appreciate the opportunity to testify before the Subcommittee on infrastructure policy, as state treasurers have both daily and long-term responsibilities for public finance. NAST looks forward to working with you, and members such as Rep. Coyne, to craft effective public finance policies which will nourish economic growth across the country. Thank you.

Public Securities Association
1445 New York Avenue, NW
8th Floor
Washington, D.C. 20005
(202) 434-8400 Fax (202) 737-4744

Statement of George B. Pugh, Jr.
Chairman, Municipal Securities Division, Public Securities Association
Executive Vice President and Managing Director, Craigie Incorporated

on behalf of the Public Securities Association

before the
House Committee on Public Works and Transportation
Economic Development Subcommittee

Hearing on Infrastructure Improvements

June 30, 1994

Chairman Wise and members of the Subcommittee, good morning. My name in George Pugh. I am pleased to be here today to discuss the crucial role tax-exempt bonds play in financing improvements to America's infrastructure.

I speak to you this morning as Chairman of the Municipal Securities Division of the Public Securities Association (PSA), of which my firm is a member, and in my capacity as Executive Vice President and Managing Director at Craigie Incorporated in Richmond, Virginia. It is a special honor to participate in today's hearing because it gives me the opportunity to thank you, Chairman Wise, and the other members of this subcommittee for your leadership in the effort to increase infrastructure investment. This also is an opportunity for me to thank in person Congressman Bill Coyne, Congressman John Lewis, and former Congressman Beryl Anthony for the crucial role they have played and, in the case of Congressmen Coyne and Lewis, for the role they continue to play, on the Committee on Ways and Means. Both have introduced legislation that would greatly assist state and local governments in meeting public needs, and PSA enthusiastically supports these bills.

Infrastructure has been a frustrating issue for our nation's policy makers. As you know, the quality of our national infrastructure is of crucial importance to our citizenry and our global economic competitiveness. This panel is also intimately familiar with the fact that while infrastructure needs have risen dramatically, the quantity of available governmental resources to

address these needs is on the decline. This is why we believe that now, more than ever, the municipal bond market can help you in financing the many goals for infrastructure and economic development that you are setting for the nation. While I realize that the Internal Revenue Code does not come under this committee's jurisdiction, your support and advocacy for tax-related issues can and will make a difference in Congress and the Administration.

PSA is the international organization of banks, dealers, and brokerages that underwrite, trade, and sell municipal securities, U.S. government and federal agency securities, mortgage and other asset-backed securities, and money market instruments. PSA's membership accounts for about 95 percent of the nation's municipal market activity. My comments today will focus on the importance of tax-exempt bonds to the health of our national infrastructure, and on ways that the federal government can help states and localities to take even greater advantage of tax-exempt financing.

The Tax-Exempt Municipal Securities Market

The tax-exempt municipal securities market is the principal means by which state and local governments finance infrastructure investment. In 1993, states and localities issued nearly $290 billion in tax-exempt bonds, much of which was used to finance or refinance public works investment. Interest earned by investors on most municipal securities is exempt from federal taxation. This feature allows state and local issuers to pay a substantially lower interest rate on their debt than they otherwise would, thereby reducing the cost of financing infrastructure. The interest cost difference for states and localities resulting from tax-exemption can range from one to three percentage points, depending on market conditions.

The federal government regulates the tax status of municipal bonds in two ways. It limits the types of projects that can be financed with tax-exempt bonds when there is a significant element of private participation, and it limits the tax-exemption of interest on municipal securities for certain investors. Many of the current-law restrictions on tax-exempt securities were imposed by the Tax Reform Act of 1986 (TRA). It is widely believed that the restrictions imposed by the TRA went too far in limiting the ability of states and localities to tap the capital markets to fund public investment. By enacting several modest changes to the Internal Revenue Code (the Code), Congress and the Administration could significantly improve state and local governments' abilities to finance projects to meet the nation's public investment needs. The six proposals I will now address would result in increased levels of infrastructure investment at a relatively low cost to the Treasury.

1. Congress should raise the annual issuance limitation on bonds eligible for purchase by commercial banks.

The TRA of 1986 negatively influenced municipal finance by shifting the incentives facing potential investors in bonds. The most immediate effect of the TRA with respect to demand involved commercial banks. Prior to the TRA, commercial banks were allowed to deduct 80

percent of their interest costs associated with holding tax-exempt bonds. The bottom-line earnings attributes of municipal bonds made them an efficient tool for bank asset management. Accordingly, banks were active players in the bond market. By the end of 1985, banks held $231 billion worth of all municipal bonds outstanding, or 35 percent.

The TRA, however, eliminated the ability of banks to deduct interest costs associated with carrying tax-exempt securities for all but a small class of municipal bonds. Congress took this action to ensure that commercial banks could not eliminate their income tax liability. The Public Securities Association does not quarrel with the underlying premise of this policy goal. Rather, we are concerned about the impact that loss of bank deductibility has had on the composition of demand for municipal bonds, and by extension, what these demand changes portend for the future cost of borrowing for state and local issuers.

As a result of the changes in the 1986 Act, banks have steadily reduced their holdings of bonds. As of the second quarter of 1993, banks held just $97 billion worth of bonds, amounting to a reduction of $135 billion since 1985. Consequently, commercial banks (as a group) no longer support the bond market, but weaken it, since by selling bonds they add more supply to the market. In fact, banks undoubtedly would be selling at a greater rate but for the fact that their holdings in 1986 were grandfathered from the loss of bank deductibility.

Although it is difficult to quantify precisely, the loss of bank demand has certainly kept municipal yields higher than they otherwise would have been. One can get an idea of the importance of bank demand by examining the one sector of bonds that banks are allowed to purchase with deductibility. In 1986, Congress decided to support the market for bonds issued by small cities and towns by allowing banks to deduct 80 percent of the cost of carrying public purpose (non-private activity) bonds issued by communities that issue $10 million or less in such bonds annually. Congressional policy goals have been served well by this provision. Although disinvesting in the municipal market as a whole, banks have remained active in the market for bonds issued by small communities (so-called "bank qualified" bonds).

Communities that qualify as issuers of bank-qualified bonds enjoy a yield advantage over similar communities that do not qualify. This advantage varies widely depending on market forces, but is currently somewhere in the neighborhood of 20 to 30 basis points (0.20 to 0.30 percentage points) and has been as high as 40 basis points. In other words, small issuers are able to finance their public needs more economically because the "bank-qualified" provision stimulates bank investment. In 1992 approximately $14.4 billion in bank-qualified securities were issued, resulting in an interest cost savings of between $432 million and $648 million for those issuers over the lives of their issues.

PSA recommends raising the annual issuance limit for bank qualified bonds from $10 million to $25 million. Raising the limit would extend the interest rate benefit of bank deductibility to a wider group of small communities and would provide current small issuers with greater latitude in planning their financing activities. H.R. 3630, the Public Finance and Infrastructure Investment Act of 1993 introduced last year by Congressman Bill Coyne, and H.R. 2171, introduced last year

by Congressman John Lewis, would raise the bank-qualified limit to $25 million. PSA supports both measures and urges Congress to enact them.

2. Congress should permit broader tax-exempt financing for infrastructure projects involving private participation.

The Tax Reform Act of 1986 imposed a number of limitations on the issuance of tax-exempt bonds by states and localities. One of these limitations, known as the unified volume cap, restricted the annual volume of so-called "private-activity" bonds that can be issued by each state.[1] Among the projects financed under the cap are mortgage-revenue bonds (MRBs), small-issue industrial development bonds (IDBs), and a variety of infrastructure projects involving public-private partnerships. In 1986, the cap was set at the greater of $75 *per capita* or $250 million per state. Beginning in 1988, the cap was lowered to the greater of $50 *per capita* or $150 million. In recent years, a number of states have begun to exhaust their annual volume caps and have been forced to postpone or cancel investment projects involving private activity because tax-exempt financing could not be secured.

Since 1988, inflation, although relatively moderate, has eroded the value of states' volume caps. In real terms, the value of volume caps actually decreases each year. In constant 1988 dollars, the current cap is about $39 *per capita* or $117 million, not $50 *per capita* or $150 million. Without any conscious federal policy decision, the value of state volume caps has fallen by 22 percent in just six years. Under current law, inflation will continue to erode their value, and fewer and fewer projects will be able to be financed.

The original decision by Congress in 1986 to reduce the cap beginning in 1988 was based on the assumption that states' authority to issue MRBs and IDBs would expire at the end of 1987. In fact, those programs have been extended several times since then and are now permanent, but the volume cap has not been restored to its 1987 level.

The erosion of states' abilities to issue private-activity bonds has caused a number of states to exhaust their cap. In 1991, the last year for which complete data is available, private-activity issuance in 13 states totaled at least 90 percent of volume cap. In 37 states, private-activity issuance plus allocated volume that makes up the carryforward allowance[2] totaled at least 90 percent of the cap. In 41 states, the volume cap was exhausted completely, with issuance plus carryforward totaling 100 percent of the cap.

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[1]Private-activity bonds are bonds where ten percent or more of the proceeds are used by a private party and ten percent or more of the debt service is secured by a private party. In general, private-activity bonds cannot be tax-exempt. However, private-activity bonds are permitted for certain important uses, subject to volume caps and other restrictions.

[2]If states do not use their entire cap in a given year, they may designate the remaining cap authority for specific uses in future years. This so-called carryforward allowance must be used within three years. It is important to consider carryforward allowance when examining volume cap usage because many states, knowing that planned future projects will require substantial cap allocation, reserve cap allocation as carryforward to be combined with annual volume cap in future years.

Other factors have contributed to increased pressure on state volume caps. For example, passage of the North American Free Trade Agreement and its bilateral side agreements will force states and communities along the U.S.-Mexico border to invest at least several billion in environmental infrastructure in the coming years. Since it is often more efficient for communities to involve the private sector in such projects, the volume caps could prove constraining.

There are several options that Congress and the Administration could undertake to address the issue of volume caps. The most targeted approach would be to permit certain types of projects to be financed with tax-exempt securities outside of state volume caps. Many categories of projects, such as solid and hazardous waste disposal projects, wastewater treatment and collection facilities, community development and certain multifamily rental housing projects, and transportation facilities, represent essentially public uses of tax-exempt securities regardless of whether states or localities solicit private participation in providing the associated services. One means of legislating such a change is to define in the Code a new classification of tax-exempt securities known as "public-activity" bonds, which would encompass the above uses of proceeds. In general, public-activity bonds could be issued without restriction regardless of the level of private participation as their underlying benefit would be directed to the public at large. PSA recommends such an approach in exempting public uses of private-activity bonds from state-wide volume caps. At the very least, the volume caps should be indexed for inflation to ensure the borrowing capacities of states do not erode over time. Congressman Coyne's bill, which PSA supports, would effect such a change.

3. Congress should encourage the creation of tax exempt municipal investment conduits (TEMICs).

The U.S. securities markets, including the market for tax-exempt municipal bonds, have become increasingly sophisticated in recent years. Many new types of securities and derivative products have emerged to accommodate the needs of bond issuers and investors. These new security structures have improved the efficiency of the municipal market and have lowered financing costs for state and local governments. Nevertheless, many state and local issuers remain committed to financing debt using traditional, "plain vanilla" structures for their securities. Reasons for issuers' reluctance to employ novel structures include discomfort with "new" types of debt instruments, state law constraints on debt terms, and requirements to finance debt through an auction-style, competitive bidding processes, which often make it impossible to employ structured transactions.

Unfortunately, constraints on the ability of issuers to take advantage of new security structures prohibit states and localities from tapping the often strong demand among investors for instruments with tailored cash flow or risk characteristics. In the end, issuers in many cases accept higher costs of capital than if they were able to issue structured securities.

There are ways for secondary market participants such as securities firms to create structured instruments on the secondary market by "securitizing" tax-exempt bonds through partnership or grantor trust arrangements. However, such arrangements are cumbersome at best, often

involving legal constraints and hurdles that should not apply to the passive reconfiguration of a tax-exempt cash flow.

The Tax Reform Act of 1986 addressed this problem in the market for single-family mortgages through the creation of a new type of tax entity known as a real estate mortgage investment conduit (REMIC). Under the REMIC structure, the cash flow from mortgage pools can be structured to fit the needs of individual investors, allowing market participants to take advantage of changing market conditions and resulting in a more liquid market for mortgage loans. The results of this legislation have been phenomenal. Mortgage securitization has grown almost exponentially since 1986, resulting in lower borrowing costs for home-buyers.

A similar vehicle for the tax-exempt market, which could be known as a tax-exempt municipal investment conduit (TEMIC), would likely have similar results for state and local issuers. In a TEMIC, tax-exempt bonds issued by state and local governments would be deposited in a trust. Interests in the trust would be sold to investors, backed by the cash flow from the bonds held in the trust. The trust itself would be a tax-exempt entity. All cash flows from the bonds would flow through the trust to investors. Interests in the trust could be structured in a variety of ways, in much the same way that REMIC securities are structured today. The improved market liquidity and efficiency provided by TEMICs would have the effect of lowering borrowing costs for state and local issuers.

TEMIC legislation should:

- Preserve an amount of tax-exempt income for investors that is equal to that on the municipal bonds held within the TEMIC;

- Recognize that the gain realized by investors on their TEMIC investments should be treated similarly to gains from direct holdings of tax-exempt bonds, to the extent that market discount bonds are held in the TEMIC;

- Consolidate the cash flows from two or more separate bonds as part of the available cash flows for the interests in the TEMIC; and

- Enable investors to obtain interests in the TEMIC that:

  a. Are differentiated by priority in time (e.g. "serialization" of a term bond);
  b. Are differentiated by priority in security ("lien");
  c. Would allow for differing methods of determining the amount paid on the interest (i.e., floating versus fixed rates and deferred interest versus current interest, etc.);
  d. Would allow for AMT or non-AMT pass-through status;
  e. Would allow for pass-through of bank deductibility;
  f. Have additional credit enhancement not present on the underlying bonds;
  g. Have a put against a bank or other third party, secured only by the assets in the TEMIC; or
  h. Can receive a pass-through of any state tax-exemption.

To achieve these objectives, it would seem useful to create two types of interests in TEMICs: "regular" interests, which would be treated as tax-exempt bonds for all purposes of the Code, and "special" interests, which may or may not include tax-exempt elements, but which would expressly recognize the gain inherent in market discount and which would be sold only to taxable entities.

Properly structured, the revenue effect to the federal Treasury of a TEMIC proposal would be limited to that associated with the additional issuance of tax-exempt bonds due to lower interest rates for issuers. Because the tax timing and status of all income from assets contained in the TEMIC — both taxable and tax-exempt — would be maintained, there would be no revenue loss to the Treasury attributable directly to TEMIC structures themselves.

TEMIC legislation would improve the liquidity and efficiency of the municipal bond market by allowing market participants to create from pools of "plain vanilla" tax-exempt bonds cash flows tailored specifically to the needs of investors. Improved liquidity and efficiency would, in turn, lower marginal borrowing costs for state and local issuers and could make certain projects more feasible.

4. Congress should define in the Code a new type of tax-exempt security, called public benefit bonds, to encourage additional infrastructure investment.

Established by the Intermodal Surface Transportation Act (ISTEA) of 1991, the Infrastructure Investment Commission (IIC) was mandated by Congress to identify ways in which pension funds could be encouraged to invest in infrastructure projects. Since the Tax Reform Act of 1986 substantially reduced the involvement of banks and insurance companies as investors in tax-exempt bonds, demand from pension funds was sought to restore some of the lost liquidity and depth of the municipal market. However, pension plans currently have no incentive to invest in tax-exempt bonds, since all benefits distributed to plan members are presently taxed as ordinary income. To attract this demand, changing the taxability of either pension funds or municipal bonds would be wholly inadvisable given the effect such action would have on retirees' incomes and the cost of financing needed infrastructure. Such moves would clearly frustrate the goals of any infrastructure policy.

In its report released in February of 1993, the IIC proposed a novel and creative concept — that a new class of bonds be established under the Code called "public benefit bonds." The bonds would finance infrastructure projects benefiting the public at large where there is significant private participation in development, ownership or operation.

A qualified pension plan would be permitted to buy a public benefit bonds, ***or any other tax-exempt bond used to fund infrastructure***, and distribute amounts attributable to the interest earnings on that investment on a tax-free basis to the plan's participants at the time of retirement, either as a lump-sum or a multi-year annuity stream. The interest on public benefit bonds which

otherwise would be taxable would be tax-exempt only if held in a qualified retirement plan or IRA, or paid to a member of such plan pursuant to a distribution.

Public benefit bonds would:

- Create a new class of institutional investors — pension funds — to broaden demand for municipal bonds and reduce dependency for liquidity on a handful of segments;
- Keep user fees down by allowing tax-exempt financing for projects with private participation like toll roads or transit vehicles (which are presently prohibited) and water supply systems and mass commuting facilities (which are presently subject to volume cap), on the same basis as presently permitted for other modes, such as airports, solid waste disposal facilities, docks and wharves;
- Permit members of self-directed accounts to decide the extent to which they wish to receive a portion of their retirement benefits as tax-free income. This would also give employees an opportunity to direct pension funds for various forms of public investments;
- Result in no adverse fiscal impact to U.S. Treasury while the bonds are held by a qualified plan, since the investors are tax-exempt entities. The fiscal impact would only occur upon distribution of the benefits on a tax-free basis to members in 10 to 20 years. Arguably, the proposal may even be revenue-positive, to the extent that a plan's purchase of tax-free bonds displaces their purchase by a taxable investor, who instead will purchase other taxable investments that would have otherwise been bought by the already tax-exempt pension funds.

5. The Clinton Administration should issue new regulatory guidance on advance refundings and permit states and localities to take greater advantage of current low interest rates by refinancing outstanding debt.

Many municipal bonds are issued with a "call" feature which allows an issuer to recall securities from the market in order to issue other bonds at a lower interest rate in much the same way that homeowners, when refinancing home mortgages, pay off older, higher interest rate loans with the proceeds of new, lower rate loans. With municipal bonds, however, call dates are usually scheduled at specific times. In cases where interest rates have fallen but bonds are not yet callable, public issuers are permitted to engage in "advance refundings." In an advance refunding, new refunding bonds are issued before the call date on outstanding debt. Proceeds from the refunding issue are placed in escrow to defease, or pay off, outstanding debt when it becomes callable or comes due, whichever comes first. Advance refundings permit issuers to take advantage of low market interest rates while higher yielding securities are still outstanding.

The Code limits permissible advance refundings on public purpose or 501(c)(3) debt issued after 1985 to one per issue and on public purpose or 501(c)(3) debt issued before 1986 to two per issue. Congress limited the number of permissible advance refundings because of a concern that

unlimited refundings result in too many bond issues outstanding at the same time for a single project.

Interest rates today, though fluctuating considerably, remain at a historic lows. The current environment has provided an opportunity for individuals, businesses and, to some extent, state and local governments to refinance outstanding high-interest debt and reduce interest payments. This opportunity is significantly curtailed for states and localities, however. Unduly conservative interpretation of the statutory restriction on advance refundings prevents issuers from additional refinancing of outstanding bonds even if original issues have been retired and the escrow which defeased them extinguished. This limitation prevents states and localities from realizing substantial interest cost savings, sometimes on the order of two to four percentage points. Interest rate savings of this magnitude were not anticipated when the original advanced refunding bonds were issued. The Clinton Administration has rightly argued that low interest rates are vitally important for a sustained economic recovery. Limiting the ability of states and localities to take advantage of prevailing market conditions, however, dilutes the potential economic benefits of the current climate.

A strong legal argument can be made that Section 149 of the Code allows issuers to undertake additional advance refundings of outstanding bonds once original issues have been retired. Public issuers would be able to take better advantage of the current interest rate environment if the Treasury would clarify its interpretation of the advance refunding provision to that effect. Such an interpretation is consistent with the intent of the 1986 legislation because it would not result in any more bond issues outstanding at the same time than if the original issue were not retired. It would not require any legislative action and would provide relief to a large number of states and communities around the nation, raising debt capacities of communities that would be affected by the proposed change. Regulatory change on advance refundings would be a valuable form of federal assistance to states and localities around the nation.

6. Congress should amend the status of municipal bond interest under the alternative minimum tax.

The alternative minimum tax (AMT) set in place by the TRA of 1986 has greatly decreased demand for certain municipal bonds. This is because under the AMT, interest on tax-exempt private-activity bonds is subject to both individual and corporate AMTs, and because a higher percentage of interest on public purpose tax-exempt bonds and on tax-exempt 501(c)(3) bonds is now subject to corporate taxation. As a result, yields on these AMT bonds must be increased by 25 to 30 basis points over yields on other, similar bonds in order to attract investors. The higher cost to the issuer of AMT bonds does not necessarily correspond with substantial revenue gains to the federal government. Investors subject to the AMT simply avoid such bonds, and they are instead purchased by investors not exposed to the AMT who enjoy a higher tax-free yield. Eliminating the applicability of the interest on private activity bonds to the individual and corporate AMTs, and modifying the treatment of the interest on public purpose tax-exempt bonds and on 501(c)(3) bonds, would lower borrowing costs for states and localities with no practical negative effect on the federal Treasury.

Non-Tax Issues

Financing our nation's infrastructure clearly requires a partnership between federal, state, and local governments, with the private sector playing an important supporting role. While this testimony has focused on the Internal Revenue Code, there are also non-tax issues that can positively or negatively affect the ability of state and local governments to invest in public projects.

For example, limited federal funds have been used in clean water programs around the country to establish state revolving funds. In turn, these funds have been responsibly leveraged in the tax-exempt bond market to increase the total amount of revenue available for public investment. Also serving as an example of federal policy that can encourage or inhibit state and local infrastructure financing is airport regulation. It is important that federal policy not limit an airport's financial flexibility to the point where potential investors in airport bonds will demand higher rates of return to compensate for any uncertainty regarding the airport's ability to respond to changing financial conditions. This issue is particularly relevant today as the House and Senate work out a final version of the Airport Improvement Program legislation. PSA has been working closely with your colleagues on the Aviation Subcommittee to address this important issue.

These two issues illustrate that tax-exempt bonds can be used as a tool not only in crafting new tax policy, but also under existing tax policy to leverage federal subsidies that, because of deficit concerns, are necessarily more limited. Committees such as Public Works and Transportation can fashion programs that provide opportunities for states and localities to utilize federal funds as the seed money necessary to access efficiencies of the tax-exempt market. PSA would welcome the opportunity to work with you on such projects.

Conclusion: Congress should pass the bills introduced by Congressman Coyne and Congressman Lewis.

Today's hearing highlights many of the ways that tax-exempt bonds help state and local governments to build, repair, and maintain public infrastructure projects at the lowest possible cost of borrowing. The hearing also brings attention to many shortcomings in federal tax policy that prevent the tax-exempt municipal bond market from realizing its full potential. The most expeditious way for Congress to address these federal public policy problems is by enacting the bills proposed last year by Congressman Bill Coyne and Congressman John Lewis and co-sponsored by dozens of their colleagues in the House of Representatives. Although passing these bills would not address all of the issues I covered in my testimony today, it would result in substantial progress toward our shared goals.

Congressman Coyne's Public Finance and Infrastructure Investment Act of 1993 (H.R. 3630) would do the following:

- Increase the annual issuance limit for bank-qualified tax-exempt bonds from $10 to $25 million;

- Index the state-wide private-activity bond volume caps for inflation;

- Increase from $5 million to $10 million the amount of tax-exempt debt that an issuer can sell annually and remain eligible for the arbitrage rebate exemption;

- Clarify the definition of investment-type property;

- Create a new category of tax-exempt bonds, known as distressed community economic development bonds, to be used in areas affected by dramatic population loss, slow job growth, major military base closings, and other extreme economic hardships.

One of Congressman Lewis' bills, H.R. 2171, also would expand demand for municipal bonds by raising the annual issuance limit on "bank-qualified" bonds from $10 million to $25 million. The other bill, H.R. 2102, would permit the issuance of so-called "mini-bonds" by altering arbitrage rules and allowing more communities to offer tax-exempt zero-coupon municipal bonds in small denominations designed to appeal to individual investors. H.R. 2102 would provide states and localities with more flexible financing options and greater liquidity for their debt. The new "mini-bonds" would also provide a way for a broader spectrum of individual investors to participate in the process of improving the infrastructure of their communities.

Widespread support for these bills exists among experts on infrastructure investment. As we have heard today, the Anthony Commission, the Rebuild America Coalition, and the Infrastructure Investment Commission have all advocated a number of similar proposals on behalf of America's state and local governments. Several of these legislative measures were included in legislation passed by the 102nd Congress. PSA urges Congress to remove statutory roadblocks to infrastructure investment and to provide valuable federal encouragement to states and localities by enacting these proposals as quickly as possible.

Finally, we would also urge your committee to look to the existing tax-exempt bond market as your partner in helping the nation meet the many infrastructure challenges that lay ahead. Limited federal funding does not necessarily have to mean fewer projects receiving needed financing. The tax-exempt market can help to leverage those limited dollars.

PSA thanks the Subcommittee for the opportunity to participate in today's hearing. We would be happy to respond to any questions.

George Butler Pugh, Jr.
Executive Vice President & Managing Director
Investment Banking Group
Craigie Incorporated

Responsibilities:	Direct management responsibility for corporate finance and public finance
Education:	Georgia Tech, B.S., Industrial Management; University of Virginia, Graduate School of Business Administration, M.B.A.
Professional and Civic Activities.	Member, PSA Board of Directors; 1994 Chairman, Municipal Division; 1993 Municipal Securities Division Vice Chairman; Member, Board of Directors of Craigie Incorporated; Member of Board of Governors and current President, Bond Club of Virginia; Past Chairman, Southern Municipal Finance Society; Member, Board of Governors, National Federation of Municipal Analysts; Member, Richmond Advisory Board of the Virginia Opera
Other Personal Interests:	Running, swimming and snowskiing
Spouse's Name:	Kay

Subcommittee on Economic Development
of the
Committee on Public Works and Transportation
U.S. House of Representatives

Hearing on Innovative Infrastructure Financing

June 30, 1994
Rayburn House Office Building - Room 2167

Testimony of

Scott M. Reznick, President
Commonwealth Development Associates
6420 Sherwood Road
Philadelphia, PA 19151
215/879-6564 fax 215-879-6567

Structured Municipal Bonds & Grant-Backed Credit Enhancement: Innovative, Efficient Financing for Infrastructure

Infrastructure Investment Policy Setting

The United States is under-investing in infrastructure--the highways, bridges, transit systems, airports, and wastewater, drinking water and solid waste disposal facilities essential to our economy's long-term, non-inflationary growth

Increasing our national investment in infrastructure will enhance our mobility, reduce pollution, improve productivity and competitiveness, create jobs and economic growth

Congress and the Administration must, however, fund the needed increase in infrastructure investment without new taxes. The recent 4 3 cent increase in the Federal gas tax funded deficit reduction, not surface transportation. There are no new Federal revenues or loan guarantees to pay for additional infrastructure investment. State and local government budgets, tax and debt capacities are also constrained

Structured municipal bonds (SMBs) and grant-backed credit enhancement (GBCE) are two innovative financial tools, developed by Commonwealth Development Associates (CDA), that will help efficiently fund additional infrastructure investment.

- SMBs will securitize state and local loans and municipal bonds into bond-backed securities. They will aggregate diverse user fee and tax revenues into debt service payments structured to improve bond credit ratings, reduce interest costs, and enhance the liquidity and leveraging capacity of state and local debt financing for infrastructure.
- SMBs securitize state and local debt by pooling infrastructure loans, and structuring (slicing and dicing) principal and interest payments into different classes of securities aimed at different groups of investors, and/or credit enhancing bondholders.
- GBCE will use the authorized flow of Federal formula grants to repay and/or credit enhance state and local loans and bonds, particularly SMBs. It will accelerate the capital availability and investment of future Federal grant dollars to more rapidly reduce infrastructure project backlogs.
- The use of the states' $10 billion in unobligated balances in the Highway Trust Fund as GBCE could, for example, generate as much as $30 billion in current, best interest rate investment in surface transportation facilities.

Structured municipal bonds and grant-backed credit enhancement will help the Federal, state and local governments increase our Nation's investment in transportation and environmental infrastructure by providing the widest range of states, communities and projects with best-rate investment capital.

Policy Proposals

For the past three years CDA has been working with the DOT, other Federal agencies, Congress, the bond rating agencies and financial attorneys exploring the application of securitization to tax-exempt and taxable state and local infrastructure debt.

CDA recommends that Congress and the Administration develop, enact and enforce the statutory and regulatory changes needed to empower state and local governments to use structured municipal bonds and grant-backed credit enhancement to efficiently and cost effectively provide new capital for vital infrastructure investment.

SMBs: First, we must level the legal playing field so that the emerging markets for structured municipal bonds will not be hampered by the out-moded Federal tax and

securities laws that impeded the market development of mortgage-backed securities--and currently mandate financial inefficiency in the municipal bond market. Congress revolutionized the market for mortgage-backed securities--making it more efficient and cost effective--by enacting SMMEA and authorizing REMICs:

- In 1984, through the *Secondary Mortgage Market Efficiency Act of 1984* (SMMEA), Congress clarified certain Federal and state securities law and legal investment issues for investment grade mortgage-backed securities, making securities issuance more certain and efficient and broadening the investor pool for mortgage-backed securities.
- By creating Real Estate Mortgage Investment Conduits (REMICs) in the *Tax Reform Act of 1986,* Congress eliminated the risk of double taxation when mortgage payments are structured to better meet issuer and investor needs. The market for mortgage-backed securities exceeds $1.5 trillion and may be saving homeowners 50 or more basis points in their mortgage interest costs.

S. 1275 is only one of several bills pending in Congress that would extend SMMEA and REMIC treatment, and the financial benefits, accorded mortgages to payments on small business, community development and other loans. Congress' indicated intent in the legislative history of the 1986 *Tax Reform Act* was to extend SMMEA and REMICs to other loans and receivables, if REMICs proved successful.

REMICs have more than doubled the size of the mortgage-backed securities market making it the second largest capital market in the world, trailing only Federal Treasury bonds in the dollar value of securities outstanding.

Properly designed Federal legislation extending SMMEA and REMIC treatment to the loans and bonds of state and local governments must be sensitive to the imperatives of the municipal bond tax exemption and the disclosure, reporting and suitability issues for municipal bonds being addressed by the SEC and Congressional committees.

To bring the full benefits of securitization to state and local infrastructure developers, users and taxpayers, Congress and the Administration should assure state and local officials that Federal law will no longer impede them from garnering the maximum benefits of innovative, structured finance. New legislation should also permit public-private infrastructure developers to use securitization to access best-rate capital.

Federal law should not only facilitate the pooling of outstanding municipal bonds. It should also enable borrowers to structure their loan payments by maturity, flow of funds priorities and other criteria. Borrowers could then divide and distribute investment risks and returns among themselves and their bondholders with more efficiency than typical municipal bonds.

CDA is currently detailing the changes in Federal law that will be needed to remove statutory and regulatory barriers to the efficient use of securitization in the municipal bond market and enable state and local governments to use structured municipal bonds to their greatest financial advantage.

The pending *Clean Water* and *Safe Drinking Water* reauthorization bills should enable state revolving loan funds (SRFs) to use SMBs to securitize portfolios of their loans and issue best-rate bonds. Portfolio securitization will increase capital availability and reduce the capital costs of SRF investment projects. It will enable SRFs to sell some or all of the loans they make to private investors, rapidly recovering the public capital committed to those loans, and recycling that capital into new investments.

CDA is currently working with the legislative sponsors of the California Infrastructure Bank to assure that the Bank is fully authorized to use SMBs, GBCE and portfolio securitization.

GBCE: Second, Congress and the Administration should develop the legal guidelines and administrative tools necessary to implement grant-backed credit enhancement.

Credit enhancement is an additional assurance to investors against borrower default and delinquency. Loan guarantees, bond reserves, bond insurance and letters of credit are forms of credit enhancement

Credit enhancement may also be derived from a state or local pledge of current and future Federal grants as loan repayment, as funding for municipal bond debt service reserves and/or to acquire junior class SMBs.

The "capitalization grants" authorized by the *Clean Water Act of 1987* have been used by state revolving loan funds (SRFs) as credit enhancement for wastewater bonds. Funded with current appropriations, *Clean Water Act* capitalization grants, and state matching dollars, have been used by at least 16 SRFs to fund reserves for their bonds.

State-aid intercepts have been used to credit enhance local infrastructure financing. Advanced construction bonds have been used to cover short-term cash needs. FTA and FAA have issued letters of intent to help repay state and local authority bonds FHWA is reviewing several letter of intent proposals under its new Test and Evaluation Demonstration Project (TE-045). Recommendation DOT05 of the National Performance Review calls for DOT to use its grants as credit enhancement.

Grant-backed credit enhancement will require no new Federal revenues, expenditures or contingent liabilities. GBCE should be scored as a budget outlay only in the year of appropriation. Unlike Federal guarantees or letters of credit, GBCE should not

jeopardize the state or local municipal bond tax exemption. GBCE will not affect Congress' discretion to authorize, obligate or appropriate infrastructure grants.

CDA is investigating the use of the Highway Trust Fund and other current and future state and Federal formula grants to provide grant-backing.

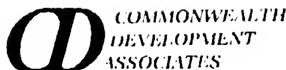
Future capitalization grants to SRFs, funded through the *Clean Water* and *Safe Drinking Water* reauthorization bills, may also serve to credit enhance wastewater treatment and safe drinking water facilities bonds. GBCE will accelerate the investment of Federal and State funding in these needed environmental infrastructure projects.

Conclusion

The municipal bond market is being securitized. Wall Street firms are seeking IRS and SEC approval to pool outstanding tax-exempt bonds into inverse floaters and other derivative securities. This market is emerging under the same Federal statutes and regulations that governed mortgage-backed securities before SMMEA and REMICs.

New ways of applying Federal dollars to support and expand state and local infrastructure investment are being developed and placed in use. Capitalization grants, letters of intent, state-aid intercepts and advanced construction bonds are becoming accepted forms of security for infrastructure debt financing.

New laws for structured municipal bonds and grant-backed credit enhancement should not only capitalize on these trends. They should also bring the financial efficiencies of securitization to our Nation's infrastructure investment and assure state and local governments of the authority to capture those efficiencies for investment in needed transportation and environmental facilities.



6420 Sherwood Road
Philadelphia PA 19151
(215) 879-6561
Fax (215) 879-6567

Scott M. Reznick
President
Commonwealth Development Associates

Scott M Reznick founded Commonwealth Development Associates (CDA) in 1982 to help the Federal, state and local governments invest in economic growth and opportunity, enhanced productivity and competitiveness.

CDA is working with DOT, other agencies of Federal and state government, and the financial community helping to determine how securitization will be used to structure cost effective, tax-exempt financing for infrastructure--structured municipal bonds.

CDA is also helping to determine how the current and future flow of authorized Highway Trust Fund and other Federal and state grants may best be used to pay for needed infrastructure investment--grant-backed credit enhancement.

Mr. Reznick has written extensively on public sector securitization. He has conducted briefings and seminars for Congressmen and their staffs, state legislators, agency and authority administrators and public interest groups; and testified before Congressional and state legislative committees.

His recent reports and publications on innovative infrastructure finance include

- *Innovations in Structuring Public and Public-Private Investment in Infrastructure* a report to the Office of the Secretary of Transportation;
- *Current Financial Structures for Transportation Infrastructure Investment*, a report to the Federal Transit Administration and Volpe National Transportation Systems Center;
- *Public-Private Partnerships in Transportation Infrastructure* for the Federal Transit Administration and American Legislative Exchange Council; and
- *State Revolving Fund and Capital Reserve Programs: Estimates of Financial Impact* for the Federal Highway Administration

He recently participated in the FHWA Policy Discussion reported in *Bond Financing and Transportation Infrastructure: Exploring Concepts and Roles*, February, 1994.

Mr. Reznick received his BA from Brandeis University in 1968 and his JD from the University of Chicago Law School in 1973, where he served on the *Law Review*. Prior to starting CDA, he was a associate professor of law and economics at Rutgers Law School-Camden.

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TESTIMONY

of the

GOVERNMENT FINANCE OFFICERS ASSOCIATION
1750 K Street, NW, Suite 650
Washington, DC 20006
(202) 429-2750

presented to

Subcommittee on Economic Development
Committee on Public Works and Transportation
U.S. House of Representatives

on

Innovative Financing of Infrastructure Investment:
The Use of Tax-Exempt Bonds

presented by

John F. Wenderski
Finance Director
Prince William County, Virginia

June 30, 1994

Introduction

Good morning Mr. Chairman and members of the Subcommittee. My name is John F. Wenderski and I am the Finance Director of Prince William County, Virginia. Today, I am here representing the Government Finance Officers Association (GFOA) as a member of its Committee on Governmental Debt and Fiscal Policy. GFOA is a 12,500-member professional association of state and local government officials who serve as the chief financial officers of our nation's states, cities, counties, towns, special districts, school districts and public retirement systems.

GFOA-Supported Infrastructure Solutions

The subject of infrastructure has been studied by numerous commissions, task forces and congressional committees. However, a national solution to infrastructure financing needs has been difficult to define because sufficient federal funds are not available to attack the problem head on. Grant funding and low-interest loans are the traditional means used by the federal government in assisting state and local governments to channel more capital into infrastructure development.

Recognizing limitations in federal resources to assist these governments build new infrastructure facilities and repair and replace existing ones, GFOA has advocated reliance on three federal policy options. They are

- targeted fiscal assistance for fiscally distressed communities in the form of grants and low-interest loans,

- increased federal outlays for state revolving loan funds for all types of infrastructure facilities, and

- selected changes in federal tax laws directed at tax-exempt financing.

Recognizing the Importance of Tax-Exempt Municipal Bonds

Tax-exempt financing is often overlooked as a weapon in the federal arsenal to assist states and localities finance infrastructure even though it is a proven and reliable tool. Municipal bonds are issued by these governments to pay for their projects, to augment funds available through state revolving loan funds by leveraging federal capital contributions, and to support innovative public-private partnerships. Unfortunately, certain so-called reforms in the 1986 Tax Act that were meant to curb abuses have proven detrimental to legitimate financings. Instead, the changes increased borrowing costs for traditional governmental borrowers and imposed restrictions that thwart innovative programs.

It is now widely recognized that the 1986 reforms were overly ambitious and corrections are needed. The 1989 report of the Anthony Commission on Public Finance and the 1993 report of the Commission to Promote Investment in America's Infrastructure call for a review and modifications of federal restrictions on the use of tax-exempt bonds for infrastructure projects. Over 30 national organizations representing state and local governments, including GFOA, are supporting legislation introduced by Congressman Coyne that would provide some limited relief. However, federal resource constraints have stood in the way of important changes in federal tax policy.

Reforms Targeted to "MIF" Bonds

While GFOA believes that all governmental tax-exempt bonds should be eligible for relief from burdensome federal restrictions, the Association has developed a proposal to focus relief to the most critical projects. It recommends special treatment for a new category of bonds called "Mandated Infrastructure Facility" (MIF) Bonds. MIF bonds could be issued by a unit of state or local government to finance

- the construction or acquisition of a new infrastructure facility that is mandated by the federal government; or
- that part of an existing infrastructure facility that is required to be renovated or rehabilitated in order to comply with a federal mandate.

A federal mandate is defined as a prescription in a federal statute or a federal regulation implementing such a prescription. Infrastructure means any real or tangible personal property, including equipment, that is governmentally owned and that is used to serve the general public.

The GFOA proposal would give MIF bonds more favorable treatment than governmental bonds under current law by

- exempting such bonds entirely from the state volume caps,
- eliminating limitations on refinancings that prevent interest cost savings,
- providing more flexibility to work with private sector partners without jeopardizing the "governmental" status of a project,
- substituting the arbitrage rebate requirement with reasonable rules for spending bond proceeds on a timely basis and using interest earned on the investment of such

proceeds to pay for the project or other infrastructure projects,

- guaranteeing that interest earned on such bonds is completely free from federal income taxation and not potentially subject to the alternative minimum tax, and

- expanding current law incentives to induce banks to return to the municipal bond market and invest in infrastructure facilities and their communities.

Why Municipal Bonds Should Receive Increased Attention

To emphasize the importance of reform efforts directed to tax-exempt financing, GFOA offers the following observations:

- While federal financial support for state revolving loan programs is highly desirable, the monies are not sufficient to address the vast infrastructure needs. Other tools must be made available and existing ones such as tax-exempt bonds improved.

- Revolving loan programs are not a stable source of financing. The federal authorization and appropriation processes result in program delays and uncertainties from year-to-year. Planning is impaired and flexibility is limited.

- A new national corporation, or infrastructure bank, that has limited resources and results in a new bureaucracy will meet the needs of only a few selected projects. Furthermore, it will emphasize providing access to capital rather than making capital more affordable for borrowers who now cannot borrow at even tax-exempt rates.

- State or local government financial commitments to bond-financed projects ensure that only financially viable and worthy projects go forward. Decentralized decision making for project selection and priority setting at the local level are more efficient and responsive.

- Tax-exempt bonds are not a tax avoidance mechanism used by the rich. Bondholders pay an implicit tax because they accept a lower rate of interest than they would earn on a taxable investment of similar quality and maturity. Internal Revenue Service data confirm that middle income taxpayers are the significant holders of these bonds.

- Pension funds are attractive sources of capital for infrastructure, but the necessity for fund managers to earn taxable rates of return on their investments

suggests that this is not a source of financing for projects that need low-cost financing.

- Proposals to subsidize pension funds to induce them to provide low-cost financing and proposals to provide interest subsidies to governments to issue taxable bonds do not provide long-term assurances to recipients that the subsidies will be available over the life of the project and present the possibility of new forms of federal intervention in processes, functions and projects receiving such assistance.

- Pension fund investments in securities issued by a federally chartered infrastructure corporation are likely to displace pension fund investments in securities issued by government sponsored enterprises such as the Government National Mortgage Association and the Small Business Administration rather than result in net new capital investment.

Mr. Chairman and members of the Subcommittee, there is a compelling interest in re-evaluating the intergovernmental fiscal partnership and improving federal public policy toward state and local governments. The interest rate savings associated with municipal bonds that inure to state and local taxpayers--who are also federal taxpayers--stand as a symbol of the partnership of the federal government and state and local governments. Even working together, we will not be able to solve America's infrastructure challenge in the near future. Therefore, I urge you and other members of Congress and the Administration to consider modifications in tax-exempt bond provisions as an important first step in the important work that lies ahead.

Thank you for this opportunity to testify and GFOA is prepared to work with you and your staff on this vital undertaking.

For more information about the Government Finance Officers Association and this testimony, contact Cathy Spain, Director, GFOA Federal Liaison Center, 1750 K Street, Suite 650, Washington, DC 20006 PHONE: (202) 429-2750 FAX: (202) 429-2755.

BIOGRAPHY

JOHN F. WENDERSKI, CPA, CIA

Mr. Wenderski is the Chief Financial Office of Prince William County, Virginia The County covers 355 square miles with a population of 233,000, assets in excess of one billion dollars, and annual revenues of over $440 million. He is responsible for a broad range of activities which include the operations of the Finance, Treasury, Property Assessment, Purchasing and Risk Management offices. His duties at the County include establishing the fair market value of over $14 billion of real estate and personal property, the investment of over $200 million, and the 5-year projection and monthly monitoring of over 50 revenue sources available to the County.

Over the past decade Mr. Wenderski has overseen the issuance of $2.5 billion in tax exempt and taxable securities at the state and local level in over 75 transactions. Mr. Wenderski is a member of the Government Finance Officers Association (GFOA) standing committee on Debt and Fiscal Policy and two sub-committees on Tax Policy and Financial Planning. He is also a member of the Virginia GFOA and the Municipal Treasurers Association of the United States and Canada.

Mr. Wenderski was the Director of Debt Management for the Commonwealth of Virginia from 1987 until joining Prince William County in 1991. He was responsible for the planning, execution, and management of the debt issuing activities of the Commonwealth. This included debt issued by the Commonwealth Treasury Board, the Virginia Public School Authority, the Virginia Public Building Authority, and the Virginia College Building Authority. He also oversaw the delivery of financial advisory services to the institutions of higher education and agencies of Virginia involved in the issuance of debt.

Prior to coming to Virginia he was the Treasurer for the City of Orlando, Florida, where he was responsible for the City's investment program, cash collections, debt management and the City's real Estate and Business licensing.

Mr. Wenderski is a Certified Public Accountant having worked at Deloitte, Haskins & Sells, and is also a Certified Internal Auditor. He has a Master's Degree in Business from Central Michigan University and a Bachelor's Degree from Walsh College. He has taught accounting and business management at the graduate and undergraduate levels in the past at Oakland University and the University of Central Florida.

Mr. Wenderski has also held positions in the private sector as an analyst for mergers and acquisitions at MASCO, a Fortune 500 company, and was the Assistant Treasurer for a regional fine paper manufacturing and wholesaling firm. He has served in a number of other capacities including as the Vice Chairman of the Public Treasurer's Management Foundation.

(2/10/94)

ADDITION TO THE RECORD

TESTIMONY
OF TIMOTHY P. AGNEW
CHIEF EXECUTIVE OFFICER OF THE FINANCE AUTHORITY OF MAINE AND PRESIDENT OF THE COUNCIL OF DEVELOPMENT FINANCE AGENCIES
PRESENTED TO THE SUBCOMMITTEE ON ECONOMIC DEVELOPMENT OF THE HOUSE COMMITTEE ON TRANSPORTATION AND PUBLIC WORKS
JUNE 30, 1994

I appreciate the opportunity to provide testimony on the status of certain tax exempt bonds that assist in the efforts of state and local governmental entities to encourage economic growth and development. The use of tax exempt bonds is a key tool in providing both an incentive for economic development and the necessary infrastructure to support and enhance job creation and this nation 's standard of living.

The Council of Development Finance Agencies (CDFA) is a nationwide organization of state and local governmental entities charged with helping businesses obtain the financing necessary for growth and development determined to be in the public interest. While CDFA's membership represents a diverse array of business finance programs, one common denominator is the issuance of tax exempt, small-issue industrial development bonds to help small manufacturers obtain lower rate financing in order to expand their manufacturing capacity. In most areas, manufacturing jobs are quality jobs that produce a substantial multiplier effect in the local economy. Using these small-issue industrial development bond programs, smaller manufacturers work directly with governmental entities such as the Finance Authority of Maine to construct or expand manufacturing facilities and add machinery and equipment. These projects would not take place or would in many cases be cut back substantially without the reduced rate financing provided by the tax exemption allowed under the Internal Revenue Code.

The small-issue industrial development bond program is a good program to encourage the growth of manufacturing jobs, but it could be enhanced and made more effective with some modest legislative changes. For example:

1. **Capital Expenditure Limitation.** In order to be eligible for tax exempt financing, a small manufacturer must have less than $10,000,000 in total capital expenditures, including the project financed with tax exempt bonds, in the six year period beginning three years before the bonds are issued and ending three years after the bonds are issued. If a business is successful as a result of the project financed with tax exempt bonds and wants to expand within three years after issuing the bond, it may be forced to choose between limiting its expansion to stay within the $10,000,000 capital expenditure limitation or having the tax exempt bonds retroactively become taxable. In other words, the current capital expenditure limitation effectively penalizes the company for success. Limiting the capital expenditure limitation period to the three years prior to bond issuance would solve this problem and allow companies to do what we want them to do: to continue to grow and invest in order to create more jobs and economic growth. In addition, the $10,000,000 limitation has been in effect for over

eight years and does not take inflation into account. Indexing the limitation to inflation would help more businesses take advantage of the program.

2. **Bank Deductibility.** Prior to the 1986 Tax Reform Act, most small-issue industrial development bonds were purchased by commercial banks providing businesses with reduced rate financing approved by governmental issuers in an efficient and cost-effective manner The Tax Reform Act of 1986 repealed a provision that allowed commercial banks to deduct a portion of their interest costs attributable to purchasing small-issue bonds and effectively eliminated banks as a source of tax exempt financing. As a result, governmental issuers and businesses have been forced to sell small-issue tax exempt bonds in the public bond markets, incurring substantial transaction costs for underwriters, credit enhancement, rating agencies and attorneys. These additional costs have deterred many potential borrowers under the program from undertaking manufacturing projects. Particularly on smaller bond issues, the transaction costs of a public bond issue outweigh the benefits of the tax exempt financing I would strongly encourage that consideration be given to restoring bank deductibility for small-issue industrial development bonds of $3,000,000 or less. This change would greatly facilitate the financing process for smaller manufacturers and would have an almost immediate impact in creating new jobs and economic growth.

I would also like to draw your attention to the adverse impact that current proposals by the Securities and Exchange Commission could have on the small-issue industrial development bond program. In an effort to assure an adequate flow of information to purchasers of tax exempt bonds in the public bond markets, the Securities and Exchange Commission has proposed new legislation to require registration of all tax-exempt bonds, and has also proposed new rule amendments that would, among other things, require the businesses benefitting from small-issue industrial development bonds to provide annual audited financial statements to the public. In Maine, and I believe in all other states, the vast majority of the businesses that are eligible for and express interest in using the small-issue industrial development bond program to finance an expansion of manufacturing capacity are small, closely held businesses that guard the confidentiality of their financial information and will refuse to use the program if they must expose that financial information to their competitors. In most cases, small-issue tax exempt bonds are issued with the backing of either a bank letter of credit, a state guaranty or the equivalent. Bondholders are looking to the letter of credit provider or the state guaranty for repayment of the bond, not to the underlying borrower. Rating agencies rate the bond issues based on the credit enhancement provided by the letter of credit or guaranty, not based on a review of the financial statements of the underlying borrower. In the case of bonds that do have this third party credit enhancement, no purpose of bondholder protection is served by requiring the business borrower to disclose financial information. The Council of Development Finance Agencies and its members will be working with the Securities and Exchange Commission to attempt to explain the very real problems created for the small-issue bond program by the proposed legislation and new rules. I would also strongly encourage members of Congress to help assure that there is a reasonable balance between the public interest in protecting investors and the public policy of encouraging job growth and economic development. Imposing additional obligations on state and local issuers of tax exempt debt would have a direct, adverse impact on those issuers and their public missions.

I appreciate the opportunity to provide this testimony on this important issue, and I would welcome the opportunity to work with you in helping to assure that this country maintains and enhances its infrastructure and its ability to encourage responsible business growth and development

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