GAO

**United States**
**General Accounting Office**
**Washington, D.C. 20548**

**Resources, Community, and**
**Economic Development Division**

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B-249447

July 24, 1992

The Honorable Ted Weiss
Chairman, Human Resources and
Intergovernmental Relations Subcommittee
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

In a July 16, 1992, meeting with your office, we were asked to provide the preliminary results of certain aspects of our ongoing work, performed at your request, on small issue industrial development bonds (IDB). Under the Internal Revenue Code (IRC), the authorization to issue IDBs expired on June 30, 1992. Because the Congress is now considering whether to extend the IDB provision, your office requested that we provide you with the information currently available to us on (1) whether federal, state, and local requirements for approving the issuance of IDBs are targeted to specific objectives and (2) what public benefits are achieved from the use of IDBs.

IDBs are bonds exempt from federal taxes that are issued by states and localities to help private companies finance the construction or expansion of small manufacturing projects. According to the Department of the Treasury and the Joint Committee on Taxation, the federal government forgoes tax revenue of $2 billion annually for all cumulative outstanding IDB issues. State and local issuers approve projects for IDB financing, and they facilitate the sale of the bonds to private investors. Proceeds from the bond sale are provided to the developer undertaking the project, and the developer is obligated to repay the investors with interest. The total amount of tax-exempt bonds that state and local authorities can issue--including IDBs--is determined each year by a per capita formula. In 1991, the 50 states issued about $1.2 billion in IDBs.

Under the IRC, the interest on these bonds is exempt from federal taxes because the IDB-financed projects are considered to be serving a public purpose. Proponents of extending the IDB provision claim that IDBs achieve





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specific public benefits by providing aid to economically distressed areas, creating jobs, assisting start-up companies, and keeping manufacturing concerns from moving their operations to foreign countries. Opponents of extending the provision question whether IDBs provide these kinds of benefits.

In summary, on the basis of our preliminary work, we found that the IDB provision in the IRC does not target IDBs to specific objectives and, in addition, that the majority of states and localities do not have requirements targeting IDBs. Furthermore, on the basis of our work in Ohio--the largest IDB issuer in 1991 and the first of three states we will be reviewing in detail--we found that it is unclear whether the purported public benefits of IDBs are being achieved.

## IDBS ARE GENERALLY NOT TARGETED

The major federal requirements for the use of small issue IDBs, contained in section 144 of the IRC, are that IDBs are (1) generally to be used to finance manufacturing projects and (2) to be issued for amounts not exceeding $10 million. These requirements reflect the congressional intent that IDBs should be limited to manufacturing and that the projects financed with IDBs should be small. The IRC does not require that states and local IDB issuers establish further criteria to target IDBs for specific objectives.

The majority of states, in turn, have not imposed any specific criteria for the approval of IDB projects beyond the basic IRC requirements. In a survey of all 50 states, we found that 37 states approve IDB projects on a first-come, first-served basis, without consideration of any specific objectives that may be derived from the manufacturing project. Thirteen states, which account for about 30 percent of total IDB issuances in 1991, have some additional criteria that target IDB use for specific objectives. For example, 12 states have job creation as a factor in their approval criteria, and 5 states factor assistance to economically distressed areas into their approval criteria. (The 13 states generally have more than one factor in their approval criteria.) The enclosure provides details on the states' criteria for approving manufacturing projects for IDB financing.

In our survey of the 50 states, the state officials responsible for administering the IDB provision in 29 states said their states allow local authorities to issue IDBs. According to the state officials in 7 of these 29 states, local issuers have additional criteria for approving projects for IDB financing. However, in 9 of these states, local issuers have no additional criteria; in 13 states, the officials did not know whether local issuers had any additional criteria.

In the seven states where officials reported that local issuers have approval criteria, only two states mentioned local criteria that target specific objectives. In one state, local issuers are reported to have criteria relating to economically distressed areas; in another state, the local issuers are reported to give priority to publicly funded job training providers.

Because federal requirements for IDB financing are not targeted on specific objectives and the majority of states and localities do not have criteria that target IDBs, the public sector generally does not direct this tax-exempt financing toward achieving the public benefits purported by proponents of the IDB provision.

## WORK IN OHIO INDICATES THAT ACHIEVEMENT OF PURPORTED PUBLIC BENEFITS IS UNCLEAR

Despite the fact that IDBs are generally not targeted, proponents of extending the provision claim that IDBs are achieving several specific public benefits. IDBs are credited with fostering economic development in economically distressed areas, creating jobs, assisting start-up companies, and keeping manufacturing companies from moving their operations to foreign countries. However, our detailed work in the state of Ohio--the largest issuer of IDBs in 1991 and the first of three states that we will be reviewing in depth--suggests that these claims are not being achieved in the majority of cases.

The state of Ohio does not target IDBs to achieve specific objectives; rather, it approves IDB projects on a first-come, first-served basis--provided the project meets the basic federal requirements. As a result, for the 32 projects Ohio approved in 1991 for which information was available (out of 33 total projects approved), we found the following:

-- Ten, or 31 percent, of the projects were located in urban areas or counties that the U.S. Department of

Labor has designated as labor surplus areas--jurisdictions with an unemployment rate that has been at least 20 percent above the national unemployment rate for the past 2 years.

-- Developers estimated that without IDB financing for their projects, 1,084 fewer jobs would have been created. However, these job creation estimates may not represent net job creation because they ignore the alternative use of IDB financing, which includes investor funds and a federal tax subsidy. That is, if IDB financing were not invested in IDB projects, the money would be used elsewhere in the economy, which would also create jobs. Whether IDB financing would create more or fewer jobs than the alternative use depends on the specific nature of the spending or investment. As a result, the federal government's involvement and subsidy may accomplish little that would not have been achieved through the alternative.

-- In Ohio, companies that received IDB financing in 1991 had been in business, on average, for 35 years. Five of the 32 companies were start-up companies.

-- Our interviews with developers provided no support for the claim that without IDB financing, companies would move their operations to a foreign country. However, one developer said that his company would have moved operations to another state if he had not received IDB financing.

OBSERVATIONS

Federal, state, and local requirements for the approval of IDB issuance generally do not target the use of IDBs for specific objectives. While proponents of the IDB provision credit the bonds with providing public benefits--such as fostering economic development in economically distressed areas, creating jobs, assisting start-up companies, and keeping manufacturing operations in the United States--our work to date indicates that it is unclear whether these benefits are being achieved as a result of IDB financing.

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In performing our work, we discussed the IDB provision of the IRC with officials at the Internal Revenue Service, the Department of the Treasury, and the state of Ohio. To determine what criteria states and localities use to approve projects for IDB financing, we conducted a 50-state telephone survey and interviewed state officials responsible for administering the IDB provision. To determine what benefits were being achieved, we performed a detailed review of 32 out of the 33 projects approved for IDB financing in 1991 in the state of Ohio--the largest issuer of IDBs that year. (Information was not available on one project.) We interviewed state and local officials responsible for IDBs and all developers who used IDBs to finance manufacturing projects. We obtained information on Ohio jurisdictions with high unemployment rates from the Department of Labor's July 1992 issue of Area Trends in Employment and Unemployment.

Our final report, which we plan to issue to you in the spring of 1993, will provide a much more in-depth analysis of these and other issues related to the use of IDB financing.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this correspondence until 30 days from the date of this letter. At that time, we will send copies to the Secretary of the Treasury; the Director, Office of Management and Budget; and other interested parties. We will make copies available to others upon request. Should you require any additional information, please contact me at (202) 275-5525.

Sincerely yours,

Judy England-Joseph

Judy A. England-Joseph
Director, Housing and Community
Development Issues

## STATES' CRITERIA FOR APPROVING MANUFACTURING PROJECTS FOR IDB FINANCING

| State | Criteria |
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| California | California requires job creation at a ratio of one job created for every $50,000 spent; it also takes into consideration the project's public benefits, such as hiring displaced workers, locating in an enterprise zone, and maintaining pollution control. |
| Colorado | Colorado ranks projects on the basis of all the following criteria taken as a whole: job creation/retention, existing or projected community needs, priorities of local government, feasibility of the project, availability of alternative financing, local government's capacity to accommodate the project's impact, previous performance of the developer with private activity bonds, and competition with other bond issues. |
| Georgia | Georgia requires job creation at a ratio of one job created for every $125,000 spent. |
| Maine | Maine requires that the project have no detrimental impact on industry competitors located within the state and that all necessary licenses be granted by the Environmental Protection Agency. The project must also provide public benefits, such as job creation or an augmented tax base. |
| Massachusetts | Massachusetts requires a project to provide job creation/retention at a ratio of either one job per 1,300 square feet of building space developed or one job for every $65,000 spent on purchases of equipment. In addition, the state requires that the developer retain ownership of all land and project facilities for at least 3 years, that annual sales of the company not exceed $30 million, and that if the company is relocating, accommodations be made for existing employees. If none of these criteria are met, the project must serve a public purpose, such as being located in a community where unemployment is high, or the project must have above-average |

growth potential. Also, the project can be involved in emerging technologies, a minority-owned business, or a child care facility.

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| Minnesota | Minnesota uses a work sheet to score public purpose, assigning point values to the project on the basis of its proposed public benefits, such as job creation/retention, augmentation of the tax base, and location in areas of high unemployment. |
| Missouri | Missouri requires a project to create jobs. |
| New York | New York considers the impact the project will have on areas that are already economically developed, the contribution it will make toward revitalizing distressed regions, the assistance that will be provided to targeted groups and industries, the amount of job creation/retention, the amount of state dollars needed to invest to create jobs, and the issue of whether the project is in a growth industry that will contribute to the state's long-term economic development. |
| North Carolina | North Carolina requires that a developer pay above-the-average manufacturing wage, not relocate the new facility in a different county, and be able to repay the bond. The state also requires that the project not harm the environment, and it considers job creation/retention, impact of the bond on the community, and competition with other bond issues. |
| Oregon | Oregon requires that the project have a national or international market. Oregon also considers the state's estimated loss of tax revenue compared with the estimated payroll and profit taxes available after the project is completed. |
| Pennsylvania | Pennsylvania requires job creation/retention at a ratio of one job created for every $50,000 spent. |
| Vermont | Vermont ranks projects on the basis of all the following criteria taken as a whole: overall feasibility of the project, protections afforded to bondholders, and job creation. |

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| Washington | Washington considers whether a project is located in a county affected by problems in the timber industry or high unemployment and requires job creation at a ratio of one job for every $200,000 spent. |

Note: All other states use no criteria other than federal requirements. Bonds are issued on a first-come, first-served basis.

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