Congressional Action Sharpens Debate

# *Tax-Exempt Bonds for Manufacturers: How Effective in North Carolina?*

by Bill Finger and Donald E. Horton Jr.

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*For 10 years, North Carolina manufacturers have been able to use industrial* **development** *bonds (IDBs)—a tax-exempt financing tool—to reduce the cost of capital expenses. Advocates claim that these bonds, called industrial* **revenue** *bonds in North Carolina, have boosted the state's economy. Skeptics question whether these bonds have enhanced development, helped increase wages, and met the needs of depressed counties. From 1976 through fiscal year 1986, industrial revenue bonds provided $1.8* **billion** *in capital to manufacturers for construction and modernization of plants and equipment. Another $904 million went for pollution control bonds.*

*In the fall of 1986, Congress is expected to pass a sweeping tax-reform bill, which affects tax-exempt financing. The new tax law will limit the use of industrial revenue bonds in the future, but it will not eliminate these bonds immediately, as some analysts once anticipated. How will these limitations affect the state's economic development efforts? What does a decade of experience show about how these bonds are used in North Carolina?*

In 1985, Combustion Engineering Inc. in Gaston County needed $3.3 million to expand its operation. To get the capital, the company normally would have had to borrow at 100 percent of the prevailing prime lending rate. Instead, it got the $3.3 million at 57 percent of the prime rate by using an industrial development bond. The company, which assembles industrial wire screens for sorting gravel, planned to hire 245 new employees and has 30 years to pay off the loan.

One hundred and seventy miles to the east, other corporate executives were seeking ways to cut capital expenses for their new venture, Carolina Turkeys. Duplin and Wayne counties wanted the new poultry processing facility, which announced it would create up to 1000 new jobs in three years.[1] Duplin County won the competition by piecing together a financial package that included a $10 million industrial development bond at 66 percent of the prime rate. Carolina Turkeys has 12 years to pay off the bond.

Supporters of such bonds, usually called industrial *revenue* bonds (or IRBs) in North Carolina, claim these bonds are the best thing since pit-cooked barbecue. Unemployed textile workers in Gaston County and struggling hog farmers in Duplin County might agree. But critics make convincing arguments that IRBs subsidize the private sector at the expense of taxpayers and may not improve the overall economy in the process.

The importance of industrial revenue bonds to North Carolina has come under increased scrutiny recently because of the 1985-86 tax-reform efforts by Congress. In the fall of 1986, Congress is expected to pass a major tax-reform bill, and President Reagan is expected to sign the bill into law.[2] The new tax bill still allows industrial revenue bonds to be issued, but with some new restraints. "Despite the new tax bill, industrial revenue bonds will still be sold," says N.C. State Treasurer Harlan Boyles. "But with the implications of the bill, we may not see as many requests to use IRBs."

Bruce Strickland, director of the industrial financing group in the N.C. Department of Commerce, also sees the IRB program as alive and well. "We will still be able to do an IRB issue, but we'll have to seek new methods of marketing the program."

The new tax bill reduces the tax incentives for buying tax-exempt bonds, including IRBs. That is, the new law might have the effect of reducing the *demand* for tax-exempt bonds. The law also puts constraints on the *supply* of tax-exempt bonds, through such provisions as placing a limit on the amount that can be issued in a state. "Thus the use of industrial development bonds might decline in North Carolina, as well as throughout the nation—an admitted objective of the proponents of the new tax-reform law," says Boyles.

For the first time in the 10-year-old North Carolina IRB program, officials now are preparing to cope with a major new federal tax law. If fewer manufacturers like Combustion Engineering and Carolina Turkeys can obtain below-market financing through IRBs, what will the state stand to lose in its economic development efforts?

## North Carolina—Down the IRB Road

Industrial revenue bonds are part of a larger tax-exempt financing system affected by the new tax bill. *To get capital* for everything from school buildings and roads to hospitals and manufacturing facilities, government agencies traditionally have sold tax-exempt bonds on their own behalf or on behalf of a private company. Individual and institutional investors supply the capital by buying the tax-exempt bonds. Before the new bill, the interest on the bonds paid to the investors was exempt from federal income tax. The interest income is also exempt from state income tax, when the bond is issued by a North Carolina unit of government. Because the interest was tax-exempt, the investors were willing to accept a lower rate of return than they received from taxable investments. Hence, companies *borrowing* capital via tax-exempt bonds have been able to obtain financing well below the prevailing market rates, thus cutting their capital costs.

Over the years, tax-exempt bonds have provided financing "typically 30 percent below standard commercial rates," explains policy analyst Neal Peirce, who has studied the impact these bonds have on local economic development efforts.[3]

Analysts often refer to tax-exempt bonds as either "public purpose" or "private purpose" bonds. **Public purpose bonds** help finance schools, roads, and other capital projects benefiting the general population. When such bonds carry the full faith and credit, and the full taxing power, of a governmental unit behind them, they are called *gener-*

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*al obligation bonds.* **Private purpose bonds** provide funds for industrial plants, commercial ventures, pollution control, owner-occupied and multifamily housing, private hospitals, and convention centers, among other activities. (Some analysts object to the "private purpose" label, contending that if a tax-exempt bond is allowed under the law, by definition it serves a public purpose.)[4]

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>
> *—Harlan Boyles*
> *State Treasurer*

Bonds which finance community development projects, commercial ventures, manufacturing facilities, and other projects are called *industrial development bonds* under the federal tax code. Those IDBs with a face value of less than $10 million are called "small-issue" IDBs. In North Carolina, small-issue IDBs are usually referred to as industrial *revenue* bonds.

Mississippi issued the first industrial development bonds in 1936. For nearly 30 years, southern states used these bonds more than other states, but the volume remained relatively low. By 1963, a total of only $88 million in IDBs had been issued nationally. In the late Sixties and early Seventies, IDB volume increased dramatically as more and more states searched for new ways to enhance economic development.

In 1967, the N.C. General Assembly authorized industrial revenue bonds, but in 1968 the N.C. Supreme Court found the act unconstitutional.[5] In 1973, the Court struck down a reformulation of the 1967 law.[6] "Both cases were decided on the ground that the financing schemes were not within the constitutional definition of 'public purpose' because the benefits of the financing went directly to private industry and only indirectly to the public," wrote William H. McBride and David Dreifus in a legal analysis of the issue.[7]

In 1975, the General Assembly addressed the constitutional question. The lawmakers passed a new act authorizing IRBs but made it contingent on voter approval of a constitutional amendment. In 1976, the amendment passed by a 55 to 45 percent margin, a typical margin for an amendment involving money matters, says Alex Brock, longtime executive director of the State Board of Elections. Hence, the North Carolina Industrial and Pollution Control Facilities Financing Act became law, codified as Chapter 159C in the N.C. General Statutes. North Carolina was the last southern state to authorize IDBs.

Some of the objections that were raised in 1976 to the constitutional amendment remain 10 years later. For example, John Sanders, director of the Institute of Government at the University of North Carolina at Chapel Hill (UNC-CH), explains that government involvement in bonds for private purposes may have set a dangerous precedent. "The more heavily we use the municipal revenue bond tax exemption for a wide variety of purposes, the greater we jeopardize its original function of financing essential government facilities—schools, water and sewer facilities, and other capital outlays," says Sanders.

By 1981, 48 states had IDB programs, and 24 of them allowed their use for almost any activity, from fast-food chains to nightclubs. Such uses prompted wide-scale criticisms, especially of the IDBs used for non-manufacturing purposes. "A prominent basis of criticism was the growing use of small-issue IDBs for the construction of such well-publicized projects as ski slopes, golf courses, and in one case a topless 'go-go' bar in a large eastern metropolis," reported a recent issue of *Cross Sections*, a publication of the Federal Reserve Bank.[8] Such abuses became widely publicized and gave federal opponents of tax-exempt financing schemes the leverage they needed to get restrictions passed by Congress, first in 1982 and again in 1984.

In 1984, Congress made major adjustments to tax-exempt financing, limiting the volume of IDBs that an individual state could issue, among many other changes. The 1982 law established a Dec. 31, 1986 "sunset provision" for small-issue industrial development bonds; the 1984 law moved

the sunset provision for small-issue IDBs for *manufacturing facilities to Dec. 31, 1988.*[9] This set the stage for the 1986 bill..

North Carolina differs from many states in its IRB law. In many states, small-issue IDBs have helped finance rest homes, office buildings, restaurants, and other nonmanufacturing facilities. But the North Carolina law, more restrictive than the federal law, allows IRBs to finance only pollution control and manufacturing projects.[10] In North Carolina, IRBs are theoretically designed to attract industry, create and save jobs, raise wages, and protect the environment.

To qualify for an IRB in North Carolina, a manufacturer must meet three requirements: 1) create *new* jobs or maintain *existing* jobs (and not abandon another site); 2) pay wages above average for the county or at least 10 percent higher than the statewide average; *and* 3) not create any adverse environmental effects.[11] A manufacturer applies for the bond through an industrial financing authority in the county where the jobs are to be located.

The county board of commissioners must approve each bond issue, together with three state agencies — the departments of Commerce, Natural Resources and Community Development, and State Treasurer (see graphic on page 6). No voter approval is required. No state or county funds are involved (aside from staff time spent on the projects), but projects financed by industrial revenue bonds are subject to property tax. Neither the state nor the county is obligated for any defaulted bonds.[12]

Despite such restrictions, IRB's can be used by manufacturers in many different circumstances. Hence, critics question the extent to which these bonds 1) induce a company to invest in a specific area; 2) increase the wages of an area; and 3) meet the needs of depressed areas. An analysis of these three criticisms shows the pitfalls and payoffs of IRBs in North Carolina.

## Do IRBs Induce Investment?

Proponents of IRBs call them one of the most important inducements for getting an industry to build or expand a facility. The N.C. Department of Commerce claims that from 1976-85, industrial projects using IRBs created 65,070 jobs and saved another 27,345. Some studies in other states reinforce this viewpoint. In 1981, for example, the Massachusetts Industrial Finance Agency surveyed the 768 projects it had financed with IDBs. One-third of those surveyed responded, and only 7 percent said they would have made the same investment without IDB financing.

Other studies have found, however, that industrial development bonds do not induce substantial investment. The Federal Reserve Bank of Philadelphia examined data from 3,000 counties throughout the country and found that "a 10 percent increase in the value of IDBs outstanding resulted in only a 0.2 percent increase in a county's total employment. This lack of response to IDBs might be explained by the fact that since so many states offered them, they were of little relative advantage to firms."[13]

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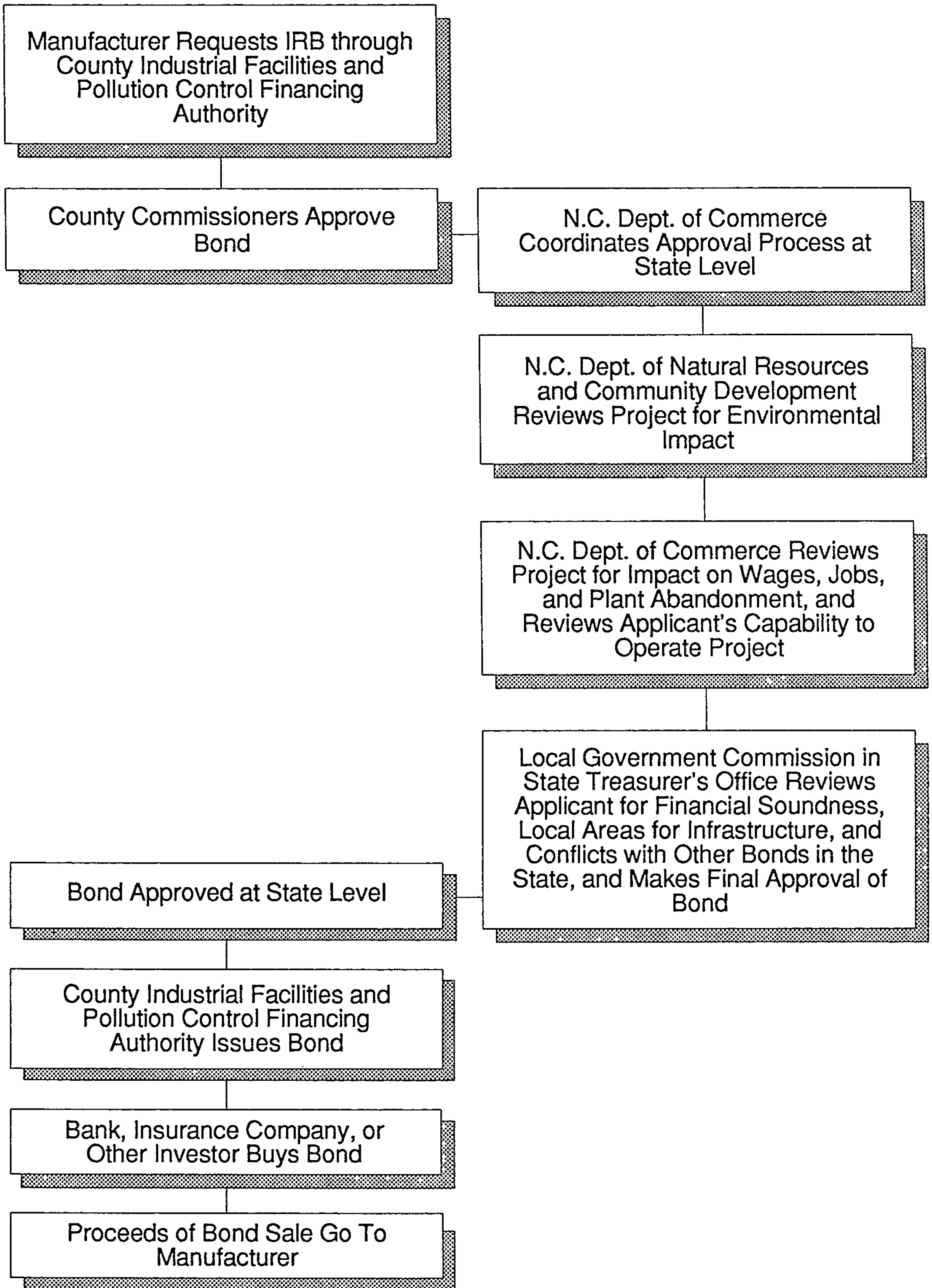
*— John Sanders*
*Director, Institute of Government*

Charles D. Liner of the UNC-CH Institute of Government questions the value of IRBs as an inducement for new investment. "The evidence from numerous studies suggests that taxes and financial inducements don't have much effect on companies' location decisions," says Liner.[14] "Government's role is to provide to new industries the services it normally provides to individuals and businesses. Schools and roads are obviously going to be important to a company."

Companies must have sound credit ratings to qualify for IRBs. To get such a

## How Manufacturers Get Capital from Industrial Revenue Bonds



credit rating, a company must be reasonably prosperous. Hence, the companies approved for IRBs are often those that need tax-exempt financing the least, argue some economists. Dr. Thomas J. Leary, economist at the University of North Carolina at Greensboro, for example, found that such blue-chip manufacturers as Weyerhaeuser, Monsanto, International Paper, Georgia Pacific, and International Telephone & Telegraph made extensive use of industrial revenue bonds in the early years of the North Carolina program.

From 1976-82, reported Leary, 68 firms listed among Fortune's 1000 largest companies used 160 industrial revenue bonds in North Carolina. These 160 bonds had a total value of $383 million, which was 42 percent of all IRBs sold for manufacturing firms during that period.[15] It is unlikely that IRB financing alone would persuade such large, financially sound companies to make an investment they weren't already planning to make.

"The mechanism [for selling tax-exempt bonds] relies on the marketplace," says Richard Geltman, staff director of the committee on economic development and technological innovation for the National Governors' Association. "If a firm is marginal, it is less likely to be able to sell its bonds. The system is inherently structured toward profitable firms."

As large corporations took advantage of small-issue industrial development bonds nationwide, analysts became concerned about controlling this trend. Thus, in 1984, Congress established a $40 million limit on the total amount of industrial development bonds a single corporation could have outstanding. This limit did not apply to pollution control bonds (see sidebar on page 8).

These new rules resulted in smaller companies becoming the predominant users of small-issue industrial development bonds nationwide, according to the Council of Industrial Development Bond Issuers, a consortium of 117 member agencies nationwide. "About 78 percent of the users of small issues are small and medium-sized businesses (i.e., with less than $50 million in annual sales)," the council concluded in a report issued early in 1986.[16]

The report explains that, nationwide, these small-issue bonds are used primarily for in-state expansions, *not* in recruiting an industry from another state. Companies "rarely use small issues to finance interstate relocations from one labor market to another," the report found. "Almost 75 percent of all SIDB [small-issue industrial development bond] financings support expansion or improvements *at existing company sites*, and 20 percent of the bonds help finance activities at new locations within the same state" (emphasis added).[17] The other 5 percent of the bonds involve an interstate expansion, the traditional economic development strategy of industrial recruitment. The council based its report on data from 1,401 businesses that have used small-issue industrial development bonds, issuing agencies in 40 states, and 50 institutional purchasers of these bonds.

## Do IRBs Increase Wages?

North Carolina law requires a company applying for an IRB to offer wages above the county average or 10 percent above the state's average manufacturing wage. If a company does not meet these minimum wage standards, it must get what is known as a "wage waiver" from the N.C. Secretary of Commerce. When a low-paying company gets a wage waiver, the role of IRBs in raising wages becomes questionable.

A wage-waiver controversy in Alamance County erupted into the press on April 5, 1985. "County reiterates support for low-paying industry," read the headline that day in the Burlington *Daily Times News*. The story explained how NCA Inc., a Burlington auto parts manufacturer, had asked the county commissioners for a wage waiver for a $1.5 million industrial revenue bond issue. The company, which planned to use the financing for acquisition and renovation of an old hosiery mill site, paid a top hourly wage of only $4.80, according to the news reports, far below the county's average manufacturing wage of $7.72 and the statewide average of $7.29. Nevertheless, the county commissioners, on a 3 to 2 vote, approved a request for a wage waiver. The request then went to the Secretary of Commerce for approval.

To get a waiver from the statutory wage guidelines, a company must first get the county commissioners to request the waiver. The Secretary of Commerce may then grant the waiver on a discretionary basis, if unemployment in the county is especially severe.[18] The key phrase in the statutes is "especially severe," which is defined in the North Carolina Administrative Code.[19] The current rules allow a wage waiver through one of two routes, high unemployment rates or plant closings.

For the first route, a county must have an *average* unemployment rate of either 10 percent or 110 percent of the statewide rate (and at least 6

percent). The comparison is based on the most recent six months for which data is available from the Employment Security Commission. The Burlington auto parts manufacturer did not qualify here since the Alamance County unemployment rate in 1985 was only 5.1 percent, below the statewide rate of 5.2 percent.

The second route allows a wage waiver if a plant in the county has permanently closed in the last 12 months (or will close in the near future), and this closing resulted in the loss of either 300 jobs or 5 percent of the total labor force in the county. This rule opened the door for the Burlington company, because there had been several plant closings in Alamance County. The Department of Commerce has issued four different sets of rules regarding the waiver process—in February 1980, March 1983, November 1984, and March 1985. The November 1984 changes added the provision for plant closings "in reaction to the horrible number of plant closings," explains Bruce Strickland of the Department of Commerce.

Because the administrative rules defining "especially severe" are so flexible, the Secretary of Commerce can exercise some discretion in awarding wage waivers. Moreover, the *statutes* give the secretary the power to collect data regarding the waiver request and to call for a public hearing on the proposed project.[20]

"If the local county commissioners ask for the waiver, we take a close look at that," says Strickland. "We value the local decision process." The department began considering the waiver for the Burlington auto parts manufacturer after receiving the request from the Alamance County commissioners. "But the application got involved in local controversy and, technically, it was withdrawn," says Strickland.

Data available from the Department of Commerce show that 94 wage waivers have been granted since 1979. Textile firms had nearly half of these wage waivers (45 of 94, or 48 percent).

## *Pollution Control Bonds*

Pollution control bonds are generally designed for environmental, rather than economic development, purposes. Utility companies are by far the largest user of pollution control bonds. Chemical firms and other companies that must meet environmental standards may also apply for pollution control bonds. In 1985, for example, Carolina Turkeys in Duplin County, obtained $3 million from a pollution control bond, as well as $10 million through an industrial revenue bond (see the beginning of the main article).

Carolina Power and Light (CP&L) has obtained $603.8 million in capital through tax-exempt bonds issued under the 10-year-old N.C. Industrial and Pollution Control Facilities Financing Act. This is 22 percent of all the bonds issued under this act, far more than any other company.[1] All the CP&L bonds are pollution control bonds, which differ in many ways from small-issue IDBs for a manufacturer. One significant difference is that the federal $40 million limit on the amount of industrial development bonds a single company may have outstanding does *not* apply to pollution control bonds.

Under the federal tax code, pollution control bonds are considered a type of industrial development bonds, but fall under a different section than do small-issue industrial development bonds.[2] The new tax law expected to pass Congress will no longer allow tax-exempt pollution control bonds to be issued (except for solid wastes). The same chapter of the North Carolina General Statutes covers pollution control and industrial revenue bonds (Chapter 159C). Since pollution control and revenue bonds are different types of bonds, various sections of NCGS 159C apply only to pollution control bonds.

—*Bill Finger*

FOOTNOTES

[1]According to records in the State Treasurer's office, CP&L has obtained $603.8 million from nine pollution control bonds. The amounts of each bond, with the date of issue, are: $63 million (12/12/79), $6 million (3/30/83), $48.5 million (3/30/83), $6.4 million (6/29/84) $262.6 million (6/29/84), $2.6 million (7/2/84), $67.3 million (5/21/85), $50 million (9/5/85), and $97.4 million (10/10/85).

[2]Pollution control bonds fall under Section 103(b)(4)(F) of the Internal Revenue Code. Small-issue industrial development bonds come under Section 103(b)(6) of the Code; the industrial revenue bonds issued in North Carolina fall under this section.

## Table 1. Number of Waivers Granted to N.C. Manufacturers from Wage Requirements in N.C. Industrial Revenue Bond Law, by Industry, 1979-85*

| Industry Sector | Average Hourly Earnings, N.C. June, 1986 | Number of Wage Waivers |
|---|---|---|
| All Manufacturing Sectors | $ 7.50 | |
| Textile mill products | 6.54 | 45 |
| Apparel and other finished goods | 5.26 | 9 |
| Food and kindred products | 6.82 | 7 |
| Lumber and wood products | 6.56 | 6 |
| Transportation equipment | 8.37 | 4 |
| Machinery, except electrical | 8.43 | 4 |
| Furniture and fixtures | 6.87 | 4 |
| Rubber and plastics products | 9.27 | 4 |
| Primary metal industries | 8.89 | 3 |
| Miscellaneous manufacturing industries | – | 2 |
| Electrical machinery, equipment, and supplies | 8.53 | 2 |
| Printing and publishing | 8.59 | 2 |
| Unclassified in data | – | 2 |
| Total Wage Waivers | | 94 |

*Source*: Business Assistance Division, Department of Commerce.

*The North Carolina statutes require that manufacturers using industrial revenue bonds pay wages above average for the county where the project is located or at least 10 percent above the statewide average wage; see NCGS 159C-7(1)a.

The apparel sector, in second place, had nine waivers (or 10 percent), and the food and kindred products sector had seven waivers (see Table 1). By far, then, the major portion of the waivers went to manufacturers in the lowest paying job sectors. As of June 1986, the textile sector paid $6.54 an hour compared to a statewide average of $7.50. The apparel sector was even lower, at $5.26 an hour. Food and kindred products averaged $6.82.

"Most of the waivers were granted when unemployment conditions were especially severe," says Strickland. "At that point in time, it's [more] important [just] to have a job rather than a high-paying job." Strickland says that the large portion of the waivers going to textile companies reflects the needs of that industry. Several wage waivers helped textile companies take over plants that were in the process of closing down, he adds. "So many of the textile employees displaced are older and have some severe trauma in going to other industries. I wish we could help them more," he adds.

Comparing the 94 wage waivers shown in the Department of Commerce data with county unemployment rates suggests that some waivers—while they might have met the administrative guidelines—went to areas where unemployment was not severe. In 1979, a firm in Lenoir County was approved for a wage waiver when the county had an unemployment rate of 5.2 percent (the lowest rate among the 94 waiver cases). This met the 1979 guidelines because the administrative rules then called for a comparison over five quarters; the waiver would not meet the current standards.

"Without that wage waiver, 175 people would have lost their jobs," explains Strickland. "A company was going to have to close because of [low] profitability due to competition from imports. A [second] company came forward and said, 'We will buy and operate this company if we can get financing.'" This waiver, contends Strickland, thus helped to save jobs—a valid purpose for the program.

In 1983, discretion was again important.

With the statewide unemployment rate at 8.9 percent, wage waivers went to companies in Catawba County (which had an 8.0 percent unemployment rate), Stanly County (8.6 percent), Randolph County (8.5 percent), and Granville County (8.4 percent). Again, these waivers appear to have satisfied administrative rules *then in effect*, but none was over the current 10 percent minimum or 110 percent of the statewide average.

The discretion is important, says Strickland, because of the cyclical nature of unemployment. "I do believe that our safeguards are sufficient and effective," says Strickland. With so many waivers going to the textile industry, Strickland and others contend that IRBs can be used to help traditional industries facing problems with imports and displaced workers. But were IRBs designed for that purpose? Is this what the voters had in mind in passing a constitutional amendment 10 years ago?

The legislation establishing IRBs in North Carolina defines the act's purposes in general—not specific—language. "[T]here exists in the State a critical condition of unemployment and a scarcity of employment opportunities," begins the statute. After several paragraphs about the "safety, morals and general welfare of the entire State," the section concludes with the call for industrial revenue bonds to help finance manufacturing facilities "which provide job opportunities or pay better wages than those prevalent in the area . . . ."[21]

To Strickland, the legislative purpose is "to save and create jobs." The wage waiver helps promote that purpose, he says.

The statutes do not define clearly *which* jobs IRBs should help to save or create. Therein lies the rub. Should IRBs, which are subsidized by taxpayers, be used for *any* manufacturing jobs, even when assisting a low-paying manufacturer? Or should IRBs be used only to boost the overall wage rate in this low-wage state? After a decade of IRB experience, the legislature should now clarify the purpose of IRBs regarding wage rates. There is now enough experience with IRBs in the state to refine the purposes of the law.

## Do IRBs Help Depressed Areas?

In 1982, the U.S. Advisory Commission on Intergovernmental Relations found that 12 states have special vehicles for targeting small-issue IDBs to depressed areas. Connecticut, for example, gives businesses seeking an IDB the choice of locating in a more restricted area and receiving a tax rebate. Tennessee uses tax relief in addition to IDB financing as an inducement for companies to locate in central business improvement districts.[22]

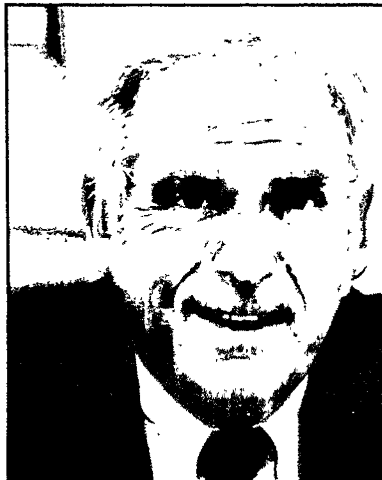
The Council of Industrial Development Bond Issuers reported in 1986 that "at least 16 states have developed area revitalization programs which target the issuances of SIDBs to economically depressed areas." Of these 16 states, most "require recipients of bonds for commercial purposes to locate in designated depressed areas; bond recipients with *manufacturing projects*, however, are not required to locate in target areas" (emphasis added).[23]

North Carolina law does not target IRBs to areas of special need. By the end of 1985, 20 counties—mostly in the far east and far west—had never issued an IRB.[24] Of those 20 counties, 11 had 1985 unemployment rates exceeding the statewide average of 5.4 percent.[25] Three of the 20—Camden, Currituck, and Gates counties (adjacent and sparsely populated)—had not formed the local industrial financing authority necessary to issue an IRB. The Currituck County Commissioners voted in February 1986 to establish the required financing authority, although the authority is not yet functioning. County commissioners appoint the members to this authority.

"Once our move is publicized, I feel that the other two counties will follow suit," says Frances Walker, a Currituck County Commissioner. "We're the last frontier [in North Carolina]

*"Without that wage waiver, 175 people would have lost their jobs."*

*—Bruce Strickland*
*Department of Commerce*



## Table 2. Industrial Revenue Bonds Issued, Jan. 1, 1976 - June 30, 1985 Top Ten Counties (By Number Issued)

| | Industrial Revenue Bonds | | Pollution Control Bonds | | Total | |
|---|---|---|---|---|---|---|
| County | No. | Amount (in 1000s) | No. | Amount (in 1000s) | No. | Amount (in 1000s) |
| 1. Wake | 37 | $106,978 | 6 | $434,950 | 43 | $541,928 |
| 2. Catawba (tie) | 30 | 94,670 | 1 | 4,270 | 31 | 98,940 |
| Mecklenburg (tie) | 30 | 90,730 | 1 | 3,000 | 31 | 93,730 |
| 4. Alamance | 22 | 58,800 | | | 22 | 58,800 |
| 5. Iredell (tie) | 21 | 72,075 | | | 21 | 72,075 |
| Guilford (tie) | 21 | 49,580 | | | 21 | 49,580 |
| 7. Gaston | 17 | 41,500 | | | 17 | 41,500 |
| 8. New Hanover | 9 | 34,700 | 7 | 37,555 | 16 | 72,255 |
| 9. Rutherford | 14 | 32,300 | | | 14 | 32,300 |
| 10. Buncombe (tie) | 13 | 43,775 | | | 13 | 43,755 |
| Wayne (tie) | 13 | 35,777 | | | 13 | 35,777 |
| Stanly (tie) | 13 | 35,300 | | | 13 | 35,300 |
| Granville (tie) | 13 | 32,250 | | | 13 | 32,250 |
| Robeson (tie) | 13 | 27,850 | | | 13 | 27,850 |
| Total (Top 14 Counties) | 266 | $756,285 | 15 | $479,775 | 281 | $1,236,040 |
| Total for all Counties | 589 | $1,584,188 | 29 | $689,275 | 618 | $2,273,463 |
| Top 14 Counties — Percent of Total | 45% | 48% | 52% | 70% | 45% | 54% |

*Source:* "Industrial and Pollution Control Facilities County Summary," State and Local Government Finance Division, Department of State Treasurer, June 30, 1985.

in regards to industrial growth. Industrial growth will come if we encourage it."

From 1976 through June 1985, Wake County had issued more bonds—IRBs plus pollution control bonds—than any other county (43); Catawba and Mecklenburg counties tied for second (31). In ranking the top 10 counties, five counties tied for 10th place, resulting in a "top 14." Among these 14, the Piedmont had nine counties, the mountains had two, and the coastal plain had three (see Table 2).

To concentrate on areas in great need, the Department of Commerce could mount an IRB promotion program to counties with high unemployment. "Rural development is tough," says Strickland. "Everyone involved has to work harder to achieve meaningful results in remote areas."

Such a development campaign might be enhanced by issuing IRBs through a statewide—rather than a county—agency. Statutory authority exists for such an effort (NCGS 159D), but this vehicle has never been used. This section of the law authorizes bond issues that would affect more than one county.

Currently, Department of Commerce officials view NCGS 159D primarily as a potential means for what they call an "umbrella issue." Under such a bond issue, businesses with relatively small capital needs, of say $350,000 each, join together for a single bond issue large enough to make the IRB process feasible. "We see it as a tool to help small businesses," explains Strickland. To qualify

under NCGS 159D, these small businesses would have to be located in more than one county.

The statute authorizes any two counties to form a political subdivision called "The *North Carolina* Industrial Facilities and Pollution Control Financing Authority" (emphasis added), which has the power to issue tax-exempt bonds in a manner similar to that used by a single-county financing authority. After the statewide financing authority has been formed, any other county may become a member through a process specified in the statute.[26]

## Conclusion and Recommendations

The industrial revenue bond program has left an important mark on North Carolina. From its beginning in 1976 through fiscal year 1986, industrial revenue bonds provided $1.8 *billion* in capital to manufacturers for construction and modernization of plants and equipment. Another $904 million went for pollution control bonds. These bonds have helped to save and create jobs.

National studies have found, however, that IDBs do not make much difference as to whether a firm relocates to a new state. As pointed out earlier, the Council of Industrial Development Bond Issuers, a major trade association, found that only 5 percent of small-issue IDBs nationwide go toward interstate investments. In addition, the analysis of the North Carolina experience shows that IRBs have not helped many areas of special need because no targeting of such areas has taken place. Finally, the wage waiver provision allows state assistance to companies that pay wages *below* the state average, which is still one of the lowest hourly rates in the country.[27]

Despite these findings, Bruce Strickland of the Department of Commerce says that industrial revenue bonds have been a very important economic development tool for the state. Maryland, South Carolina, Tennessee, Virginia, and other states use public credit for the benefit of private companies, where North Carolina does not, explains Strickland. "In Maryland, for example, local and state governments have guaranteed loans made by private lenders to help employees buy out a company that was going to close," he says.

The IRB program in North Carolina now has a 10-year track record. Enough time has elapsed for state officials to take stock of strengths and weaknesses of its operation. Moreover, state officials are preparing to cope with a major new federal tax law that will affect both the supply and the demand for the IRBs that can be issued (see article on page 14). The constraints of the new tax law will probably limit the uses of IRBs in the future. "North Carolina has used IRBs to compete with other states," says Strickland. "If we can't use revenue bonds as effectively, we face a sharp competitive disadvantage, because these other states have programs that offer subsidies with state funds."

Nevertheless, the small-issue IDB program will continue under the new federal tax law. The legislature, the State Treasurer's office, and the Department of Commerce should consider fine-tuning the way that industrial revenue bonds will operate in the state. The analysis in this article of the first 10 years of IRBs in North Carolina leads to three specific recommendations.

*1. The N.C. Department of Commerce should use the wage waiver provision more conservatively.* Currently, the statute gives the Secretary of Commerce extensive flexibility in granting a waiver from the statutory requirement that a company pay above-average wages. With this flexibility, the Department of Commerce has used the wage waiver, in effect, to subsidize low-paying companies. But the General Assembly designed the statute to use IRBs to attract companies paying *above-average* wages. Through its use of the wage waiver, the Department of Commerce has put a high priority on saving jobs, even low-paying ones. The department has thus used its wage-waiver rules to undercut the statute.

To alleviate this problem, the General Assembly should consider altering the statutory language to limit the Secretary of Commerce's discretion to approve an IRB project that involves a low-wage company (NCGS 159C-7, paragraphs 3-5). Alternatively, the Department of Commerce should consider amending its rules to limit more seriously those situations where an IRB can be approved for a low-wage company (see 4 NCAC 1E .0303). Finally, the department should articulate how wage waivers—now made on a case-by-case method, with no apparent larger purpose—are tied to a broader economic development policy for the state. For example, the wage waiver might be tied explicitly to a rural development policy, a priority area for the administration of Gov. James G. Martin.[28]

*2. The N.C. Department of Commerce should target IRBs to areas of high need.* This could be done through a technical assistance effort from the Department of Commerce, seeking out areas where IRBs might allow the expansion of an existing firm or even bring in a new company. Currently,

the department plays too passive and reactive a role regarding IRBs, approving what comes to them from the counties. The county economic development officers now play the lead in using IRBs. "High need" might be defined as counties with an unemployment rate exceeding 10 percent, or 4 percent higher than the statewide unemployment rate.

*3. The county commissioners in Camden and Gates counties should form the financing authority necessary to issue an industrial revenue bond.* All other counties in the state either have, or have begun to form, these financing authorities. These agricultural counties can attract some types of industry and need to use all the economic development tools at their disposal. But no firm could use an IRB in these two counties until the commissioners approve the formation of the financing authority.

Industrial revenue bonds may have been the deciding factor for some companies in expanding or building a new facility in North Carolina, especially for those companies at the lower end of the wage structure. However, at the present time, IRBs in North Carolina seem to function more like a subsidy to these industries, making construction costs lower, than as a way to enhance high-wage industry in a low-wage state. Is that what the voters wanted when they approved IRBs in 1976?

## FOOTNOTES

[1]For more discussion on the number of *announced* jobs and *actual* jobs that come to North Carolina in a given year, see "Phantom Jobs: Studies Find State Data Misleading," in *North Carolina Insight*, April 1986, p. 50.

[2]As of September 10, Congress had not yet passed the bill, but a conference committee had reached agreement.

[3]Neal R. Peirce, "Industrial Revenue Bonds: A Big Mac Attack on the Taxpayers," *Southern City*, March 30, 1981, p. 12.

[4]The tax bill establishes new categories for tax-exempt bonds, dividing them into bonds for "essential" and "non-essential" purposes. The definitions are extremely complicated. Generally, "essential" function bonds are for traditional public purposes (schools, roads, etc.). Bonds for "non-essential" functions help finance privately owned facilities, including housing, airports, water and sewer facilities, industrial facilities, and other projects.

[5]*Mitchell v. North Carolina Industrial Development Financing Authority*, 273 N.C. 137, 159 S.E.2d 745 (1968).

[6]*Stanley v. Department of Conservation and Development*, 284 N.C. 15, 199 S.E.2d 641 (1973).

[7]William H. McBride and David Dreifus, "Industrial Development and Pollution Control Financing in North Carolina," 61 *North Carolina Law Review*, March 1983, p. 420.

[8]James F. Tucker, "A Perspective on Industrial Development Bond Financing," *Cross Sections*, Spring 1985, p. 9.

[9]For more on these Congressional actions, see J. Allen Adams and R. William Ide III, "Industrial Development Bonds—Still Alive and Relatively Well in North Carolina," *Popular Government*, Fall 1985, pp. 2-5, and "Private Purpose Tax-Exempt Bonds," *State Policy Reports*, Vol. 2, Issue 22, Nov. 29, 1984, pp. 13-22.

[10]NCGS 159C-2(c).

[11]NCGS 159C-7(1) and (3).

[12]For more on how a bond issuance actually works, step by step, see "North Carolina Business Climate," Industrial Development Division, N.C. Department of Commerce, undated, pp. S-29 to S-31. This also explains some exceptions to the three conditions listed in the text.

[13]Gerald Carlino and Edwin S. Mills, "Do Public Policies Affect County Growth?", *Business Review*, Federal Reserve Bank of Philadelphia, July-August 1985, p. 12.

[14]For a review of studies on this topic, see Michael Kieschnick, *Taxes and Growth: Business Incentives and Economic Development*, Chapter 3, The Council of State Planning Agencies, 1981; and Roger J. Vaughan, *State Taxation and Economic Development*, bibliography (p. 140), The Council of State Planning Agencies, 1979.

[15]Thomas J. Leary, "Industrial Revenue Bonds in North Carolina 1976-1982," *tread softly: Carolina Conservation Quarterly*, Vol. 1, No. 1, Winter 1983, pp. 27-32.

[16]*Small Issue Industrial Development Bonds and the U.S. Economy*, prepared by the Developing Systems, Limited (DSL) Consortium for the Council of Industrial Development Bond Issuers, March 1986, p. 5.

[17]*Ibid.*, p. 8 and pp. 32-34.

[18]NCGS 159C-7. See especially the last sentence in the first paragraph after section (3): " . . . the Secretary may, in his discretion, approve the proposed project if he shall have received (i) a resolution of the governing body of the county requesting that the proposed project be approved notwithstanding that the operator will not pay an average weekly manufacturing wage above the average weekly manufacturing wage in the county and (ii) a letter from an appropriate State official, selected by the Secretary, to the effect that unemployment in the county is especially severe."

[19]4 NCAC 1E .0303(2).

[20]NCGS 159C-7, fourth paragraph.

[21]NCGS 159C-2(a) and (c).

[22]Neal M. Cohen, "Community Assistance: The States' Challenge," *Intergovernmental Perspective*, Vol. 8, No. 3, Summer 1982, pp. 14-21. This article summarizes a 1982 report, *States and the Distressed Communities*, by Cohen and others, published by the U.S. Advisory Commission on Intergovernmental Relations.

[23]*Small Issue Industrial Development Bonds and the U.S. Economy*, p. 28.

[24]The 20 counties are: Alleghany, Anson, Avery, Camden, Clay, Currituck, Dare, Gates, Graham, Hyde, Jones, Madison, Pamlico, Pender, Perquimans, Polk, Transylvania, Tyrrell, Washington, and Watauga.

[25]The 11 counties are: Alleghany, Anson, Avery, Clay, Graham, Hyde, Madison, Pender, Transylvania, Tyrrell, and Washington.

[26]NCGS 159D-4(a) and (b).

[27]In April 1986, the North Carolina average manufacturing wage of $7.48 ranked 49th among the 50 states (Mississippi ranked 50th). The national average was $9.70.

[28]For more on economic development, see "North Carolina: An Economy in Transition," *North Carolina Insight*, April 1986, especially pp. 29-32, regarding the Martin administration, and pp. 42-82, regarding economic development strategies in general.