NORTH CAROLINA CENTER FOR
PUBLIC POLICY RESEARCH INC.

NEWS RELEASE

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N.C. CENTER EXAMINES INDUSTRIAL REVENUE BOND PROGRAM AND RECOMMENDS CHANGES

The federal Tax Reform Act of 1986 allows North Carolina to continue issuing industrial revenue bonds (IRBs), but a new ceiling on the amount of bonds issued will force the state to be far more selective in approving projects, reports the N.C. Center for Public Policy Research.

Ten years ago, North Carolina voters amended the state Constitution to allow IRBs to be issued here. In theory, these bonds are supposed to attract new industrial plants, create jobs, help raise wages, and assist depressed areas of the state. But the Center has found that:

* IRBs in many cases have helped keep wages low in an already low-wage state;

* IRBs have not been issued in the poorest -- and thus neediest -- areas of the state; and

* IRBs often have been used as cheap sources of capital for already profitable companies.

In the latest issue of its quarterly magazine, North Carolina Insight, the Center recommends three changes in the industrial revenue bond program. The recommendations are the result of a six-month study by the Center into the way IRBs have functioned over the last decade.

"Supporters of industrial revenue bonds claim these bonds are the best thing since pit-cooked barbecue," says Insight Editor Bill Finger, principal author of the IRB study. "Unemployed workers in Gaston County and struggling farmers in Duplin county might agree. In 1985, Gaston County used IRBs to help Combustion Engineering Inc. to expand its operations, while Duplin County used IRBs to help persuade a new poultry processing plant to locate there. 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."

Finger and Donald E. Horton Jr., a UNC law student who assisted in the research, examined how IRBs have performed in the state since their adoption in the form of a constitutional amendment in 1976 (Article 5, Section 9). They also analyzed how the federal Tax Reform Act -- enacted by Congress on September 27 -- will affect the IRB program in North Carolina in the future.

Since 1976, more than $1.8 billion worth of IRBs have been issued for industrial facilities and another $904 million for pollution control bonds. Under the new tax act, industrial revenue bonds can still be issued in North

Carolina through December 31, 1989, but in 1987, the state will be limited to issuing about $484 million in tax-exempt bonds, including IRBs, housing bonds, and others. Obviously, says the Center, the state will have to be more selective about which projects it chooses to back.

Industrial revenue bonds are a form of tax-exempt financing designed to promote industrial expansion. The income on such bonds is tax-exempt, and in North Carolina, IRBs are restricted to a face value of $10 million or less. Currently, both state and local officials determine whether an IRB may be issued to finance a manufacturing plant. If a county industrial authority and a board of county commissioners approve an IRB proposal, three state agencies -- the Departments of Commerce, Natural Resources and Community Development, and State Treasurer -- review the proposal. If they also approve the bond proposal, the county authority issues the bond, which is typically purchased by a bank or insurance company. The proceeds go to the manufacturer to finance the plant.

The Center examined three main areas of concern -- whether IRBs (1) raise wages, (2) help economically depressed areas, or (3) induce investment.

Waivers From State Law Undermine Goal of Using IRBs To Attract High-Wage Industry

First, in examining whether IRBs help raise wage levels in North Carolina, the Center uncovered a little-known consequence: often, IRBs help finance plants that pay below-average wages. Although North Carolina law [G.S. 159C-7(1) and (3)] requires a company seeking an IRB to offer wages either above the county average wage or 10% above the state average manufacturing wage, the firm may get a "wage waiver" from the state Department of Commerce. Department of Commerce data show that since 1979, wage waivers have been issued for 94 IRB projects in 12 different industrial sectors.

For example, textile firms received nearly half of the wage waivers, followed by the apparel industry and the food and kindred products industry. Yet all three industries pay below-average wages. While the statewide average manufacturing wage, as of June 1986, was $7.50 an hour, for textiles it was $6.54; for apparel, it was $5.26; and for food and kindred products, $6.82. The issuing of wage waivers for an IRB project thus does little to alleviate North Carolina's status as a low-wage state -- currently 49th in the country.

IRB Program Not Helping Poor Rural Counties

Second, the Center found that IRBs have generally helped prosperous areas of the state. Using data from the State Treasurer's office, the Center reports that two of the state's most populous and prosperous counties -- Wake and Mecklenburg -- were among the top three counties in terms of the number of IRBs and pollution control bonds issued between January 1, 1976 and June 30, 1985. Other large counties ranking in the top 15 were such industrial centers as Guilford, Gaston, and Buncombe counties. On the other hand, few of the state's most rural, least populated, and poorest counties ranked high. Some depressed counties of North Carolina do not even have local industrial authorities to issue IRBs. Furthermore, as of 1985, 20 counties -- one fifth of the state's counties -- have never issued an IRB, and more than half of those 20 counties had 1985 unemployment rates exceeding the statewide average.

IRBs Are A Cheap Source of Capital For Already Profitable Companies

Third, the Center reports that the state has approved IRBs for some of the country's biggest firms. From 1976-82, for instance, 68 firms listed among *Fortune* magazine'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," says

Finger. "Thus, more than 40 percent of the IRBs went to well-established businesses instead of to struggling firms that might not have been able to expand or create new jobs on their own. It is unlikely that IRB financing alone persuaded such large, financially sound companies to make an investment they weren't already planning to make," he adds.

"Our findings in these three areas raise questions about whether IRBs have actually done what they were supposed to do," says Finger. "Since IRBs are sold in the open market, they tend to support already profitable firms. Ironically, they have also gone to firms paying low wages, but not to the most depressed counties. With the changes from the federal Tax Reform Act of 1986, North Carolina will have to be more selective in approving IRBs."

In order for the IRB program to adjust to the new federal tax law and better serve the purposes for which it was enacted, the Center recommends:

° The Department of Commerce should use the wage waiver provision more conservatively, so that the taxpayers do not subsidize companies paying wages below the statewide average. The General Assembly should consider amending state law to limit the discretion of the Department of Commerce to approve IRBs for low-wage industries, or the department could amend its own rules to accomplish the same goal.

° The Department of Commerce should target IRBs to counties of greatest need, possibly through a technical assistance effort in conjunction with its new Blueprint for Economic Development. In the past, the department has played a passive and reactive role regarding IRBs. A more direct role in targeting areas for use of IRB bonds could measurably improve the economy of depressed counties.

° And, the county commissioners of Camden and Gates counties in the severely depressed northeast section of the state should set up industrial financing authorities. The 20 counties which have never issued an IRB (through 1985)* should consider using IRBs as an incentive to industry to build plants in those counties. Despite their rural character, these counties can attract some types of industries, and IRBs would help them meet the goal of bringing in new plants and creating new jobs.

The N.C. Center for Public Policy Research is an independent, nonpartisan, nonprofit corporation created to examine significant public policy issues in North Carolina. The Center is supported in part by grants from the Mary Reynolds Babcock and Z. Smith Reynolds Foundations, both in Winston-Salem. Past studies have examined the Department of Commerce's policies in announcing new jobs, all the boards and commissions in the executive branch of state government, and for-profit hospitals in the state. The Center has also published a list of the 20 most influential lobbyists in the N.C. General Assembly, as ranked by the legislators, registered lobbyists, and capital news correspondents.

Copies of the research on industrial revenue bonds, as contained in Vol. 9, No. 2 of North Carolina Insight magazine, are available for $6.00, plus $1.00 postage if mailed, from the N.C. Center for Public Policy Research, P.O. Box 430, Raleigh, NC 27602.

For more information, call Bill Finger at (919) 832-2839.

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* 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.