S. Hrg. 99-714, Pt. 5

TAX REFORM ACT OF 1986, PART 5

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

MARCH 4, 1986

(MUNICIPAL BONDS AND RETIREMENT SYSTEM FOR FEDERAL EMPLOYEES)

(PART 5 OF 5 PARTS)

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

62-671 O WASHINGTON : 1986

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

5361-85

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TAX REFORM ACT OF 1986, PART 5

TUESDAY, MARCH 4, 1986

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Bob Packwood (chairman) presiding.

Present: Senators Packwood, Chafee, Heinz, Durenberger, Symms, Grassley, Long, Moynihan, Bradley, and Mitchell.

[The press release announcing the hearing and the prepared written statement of Senator Durenberger follows:]

[Press Release No. 86-001]

PRESS RELEASE

(For Immediate Release Monday, Jan. 6, 1985)

COMMITTEE ON FINANCE SETS HEARINGS ON TAX REFORM

Five days of hearings on H.R. 3838, the Tax Reform Act of 1986, have been scheduled for the first two weeks of the second session of the 99th Congress, Chairman Bob Packwood (R-Oregon) announced today.

Senator Packwood said the hearings are set for January 29 and 30, and February 4, 5, and 6 and March 4.

The principal purpose of the hearings is to examine the economic effects of H.R. 3838, on international competitiveness and capital formation. Senator Packwood said the Committee would invite several prominent economists to testify on this topic.

The hearings also will cover certain new subjects included in H.R. 3838, but not proposed by the Reagan Administration last year. Public witnesses will be scheduled to testify on these matters, Senator Packwood said. Senator Packwood chaired 28 hearings addressing tax reform issues between May 9 and October 10, 1985, receiving testimony from over 300 witnesses. He indicated these 1986 hearings would not cover subjects addressed at the 1985 hearings. Public witnesses will be strictly limited.

All of the hearings will begin at 9:30 a.m. in Room SD-215 of the Dirksen Senate Office Building in Washington, with Senator Packwood presiding.

OPENING STATEMENT OF SENATOR DAVE DURENBERGER

Today, the Senate Finance Committee will hear testimony on the tax treatment of municipal bonds. I would like to take this opportunity to announce that I will be offering a comprehensive alternative to the House provisions which deal with tax-exempt bonds. Let me take some time here to explain my reasoning.

Because there has long been controversy over state and local use of these bonds, Congress has taken action in the past to curb abuses.

In the Tax Equity and Fiscal Responsibility Act of 1982—TEFRA—Congress enacted a number of reforms designed to increase public accountability and limit the commercial use of IDB's. In the Deficit Reduction Act of 1984, Congress made additional changes and set a volume cap to restrict the growth of new issuances.

At the same time we were dealing with problems, we were careful to recognize and preserve the use of tax-exempt bonds for appropriate public purposes. Bonds play an essential role in the financing of infrastructure development at the state and local levels—and that role is likely to increase in the coming years.

Just last month, the President proposed cuts ranging from 13 to 100 percent in federal infrastructure programs. These cuts compound a problem that has already begun to threaten our partners in the federal system: massive infrastructure needs.

Before the end of the century, this nation will have to spend well over a trillion dollars to meet its infrastructure requirements. As federal aid drops off state and local governments will have to pick up the bill.

How are they going to do this? Since they can't print money and they can't raise enough tax revenue to cover the bill, they will have to borrow it. That's where tax-exempt financing comes in. State and local governments will rely on bonds to do the things they need to do to meet the needs of their citizens.

That's why I am concerned about the House Tax "Reform" Bill—H.R. 3838. That bill would make it more difficult for states and localities to meet the legitimate needs of their citizens. Though we have yet to see the full effects of DEFRA and TEFRA, H.R. 3838 would go even further. Let me outline some of my concerns with the Ways and Means proposal.

First, it is bad intergovernmental relations. The provisions contained in the bill would distort state and local choices among projects that might merit tax-exempt financing. The size and structure of the proposed volume cap places severe restrictions on many states at a time when two previous tax bills have already limited new issuances. I understand that the volume cap could curtail new issuance by 40% across the nation.

Second, the proposal would run roughshod over nearly all the public/private partnerships that governors and mayors have been working so hard to build. The 10% private use and security tests and the inclusion of the private portion of a General Obligation Bond under the cap would preclude many public/private partnerships—partnerships which have proven to be effective and efficient methods of delivering services and building infrastructure.

Third, H.R. 3838 would sharply curtail the demand for tax-exempt bonds. Under the minimum tax provisions, tax-exempt interest on "non-essential function" bonds would be subject to the alternative minimum tax. Both individuals and corporations would face a decreased incentive to purchase the bonds.

A final criticism is that H.R. 3838 would be extremely difficult to administer. Despite attempts to clarify distinctions between "essential" and "nonessential" uses, many questions remain unresolved. For example, would extended day care in a school be counted in the 10% test?

The terms "essential" and "nonessential" are simply inappropriate. These concepts ignore the fact that public purposes are often served by private users. H.R. 3838 also imposes a major new reporting requirement which increases paperwork and time requirements associated with the issuance of bonds.

If we must reform tax exempt financing to cut down abuse and restrict the rate of issuance, then let it be by principles, not politics. I believe reasoned approach to the tax treatment of bonds must rest on four fundamental principles:

One, comity in the intergovernmental system should be maintained. Any alternative to H.R. 3838 should follow basic principles of comity between the federal government and the states while contributing a fair share to the principle of a revenue neutral tax bill.

Two, tax-exempt financing is vital to state and local governments. The tax code must empower, not impoverish state and local governments, otherwise the renaissance of independent action will be cut short. When we reform tax-exempt bonds we must safeguard the authority of state and local governments to issue bonds for worthy public purposes such as multifamily housing, student loans and hospitals.

Public purposes should be defined according to who receives the benefit rather than who provides the service. Therefore, we must also preserve bonds which stimulate local spending for projects which are important to both the nation and the states but which could not be financed without some sort of private-public partnership. These include pollution control facilities, convention centers, urban redevelopment programs, sewage and waste treatment.

Three, the demand for bonds should not be curtailed arbitrarily. In setting volume caps, we must take into account the rapid and accelerating decline of direct federal assistance for most domestic programs and the continuation of nearly all federal mandates on state and local governments.

Four, there should be reciprocal immunity in tax systems. Like state and local governments—the federal government issues securities to finance debt which is not subject to taxation. In 1985, approximately $80 billion in interest income earned by private investors will be exempt from state and local income taxes, amounting to $4 billion in revenue foregone.

If additional modifications are to be made in the area of tax exempt financing, then those modifications should adhere to the principles I have listed. While I would prefer to let current law remain unchanged in the area of tax-exempt bonds, realistically, I know that is just not an option.

Therefore, I have directed my staff to develop a comprehensive response to H.R. 3838. This proposal has taken a lot of hard work and I think it provides the reasoned alternative to which this Committee can surely agree. Let me cover some of the principle features. The whole proposal will be available later this week.

My alternative eliminates the pejorative terminology of "essential" versus "nonessential." It uses present law concepts which are workable, familiar and not subject to abuse. It redefines bonds to distinguish between governmental and quasi-governmental.

It provides that no portion of a governmental bond shall be subject to a volume cap.

It calls for an effective date after the date of enactment.

It distinguishes between governmental and quasi-governmental bonds when applying restrictions on arbitrage, refunding and reporting requirements.

It permits states and localities to define their own priorities and grants them discretionary authority in determining which quasi-governmental activities merit funding under the cap.

Finally, it imposes a reasonable volume cap on single family housing, student loan bonds, 501(c)(3) organizations, small-issue industrial development bonds, and other IDBs that finance facilities for private parties and industrial parks.

As I said, the details of the proposal will be available later this week. I believe that this alternative is reasonable, fair and fiscally sound and I hope that other members of this Committee will recognize its inherent strength and lend their support to my effort to provide an alternative to the House bill.

The CHAIRMAN. The hearing will come to order, please.

Here comes Senator Domenici. I was just going to start without you.

Senator DOMENICI. You would not have missed much.

The CHAIRMAN. We would have missed the best witness we have had in our 35 days of hearings.

We are all ready to go. Our hearing today covers both municipal bonds and the House proposal on the retirement system for Federal and other Government employees. We will start today with the senior Senator from New Mexico, Senator Pete Domenici, upon whom we rely so heavily for help and advice when we are preparing our bills.

Pete.

STATEMENT OF HON. PETE V. DOMENICI, U.S. SENATE, STATE OF NEW MEXICO

Senator DOMENICI. Thank you very much, Mr. Chairman.

I would be remiss if I did not first congratulate you on the way you are handling this entire tax reform issue.

The CHAIRMAN. Thank you very much.

Senator DOMENICI. I truly believe it is one of the most difficult jobs any chairman could ever have. And I am sure that however tax reform comes out, it is not going to be deficient on the side of your having addressed every issue and having heard witnesses on all of the major issues. That in and of itself is a major undertaking.

I would also want to tell you, Mr. Chairman, and members of the committee, if you permit me, the story that is around today regarding the budget markup—and I have had a number of opportunities to discuss that with you, Mr. Chairman—I hope you understand that the Budget Committee and ultimately the Congress in voting a budget resolution will rely very heavily on what the Finance Committee sees fit to do; not what you read as our laundry list of suggestions.

The CHAIRMAN. I think we both discovered when we read about each other's committees, do not necessarily assume that what we have read is exactly what we are thinking.

Senator DOMENICI. They keep asking me what revenues I would be for, and I try my very best to tell them that I have absolute confidence in the Finance Committee of the U.S. Senate to do what they think is best, and we have to provide some kind of basic information as to how much revenue should be raised. And that is the extent of what we are talking about, in the Budget Committee. I hope you understand that. I think it is important that we start there.

Mr. Chairman, I have a prepared statement. I do not think I will give it. I would ask you to make it a part of the record as if I had given it in full.

Could my statement be made a part of the record, Mr. Chairman?

The CHAIRMAN. Without objection.

[The prepared written statement of Senator Domenici follows:]

TESTIMONY OF

SENATOR PETE V. DOMENICI

BEFORE THE

SENATE FINANCE COMMITTEE

March 4, 1986

Mr. Chairman, I appreciate the opportunity to appear before you today to express my concern that in the rush to tax reform, our country's infrastructure may be shortchanged. Our nation cannot afford to reduce capital investment in infrastructure. In fact, assessments by the Congressional Budget Office and others show our annual infrastructure needs greatly exceeding expenditures. In other words, we are behind the curve and steadily loosing ground.

In 1983, America's total investment in highways, roads, bridges, mass transit, sewage and solid waste disposal, and water supply, was approximately $39 billion dollars. But estimated annual needs for capital financing in these areas runs around $57 billion, leaving an annual short-fall of $18.5 billion. Extrapolated fifteen years to the end of the century, the short-fall adds up to $270 billion, and this does not account for inflation.

This is an alarming and dangerous condition. If allowed to continue, it could adversely effect not only the economic health of America, but the fundamental health and safety of our citizens. Yet at the same time, the realities of the federal budget situation make it difficult, if not impossible, to maintain even current levels of federal support. State and local governments, already stretched to the limits, are unlikely to contribute much more. The needs are unquestionable; we must search for solutions.

To address these concerns the Private Sector Advisory Panel on Infrastructure Financing was created last year by the Senate Budget Committee to advise us on ways to increase infrastructure investment. Soon after the Panel was formed, it became apparent that infrastructrure financing would be affected by the growing tax reform movement, as private investment in infrastructure financing is highly dependent on tax law. The Panel, therefore, took on as part of its duties an evaluation of the implications of tax reform for infrastructure financing.

In July 1985, the Panel issued its first report evaluating the Administration's tax reform proposal. The report found that "the proposed changes would increase the total cost to state and local governments of future investments in public infrastructure and decrease private sector interest in participating in such investments" and that "if left uncoordinated and enacted simultaneously, these changes would have a severe impact upon the level of infrastructure investment." The Panel concluded its report with several recommendations for change in the Administration's tax-exempt bond and capital cost recovery proposals.

Now that the House has passed a tax reform bill, H.R. 3838, the Panel has issued an update discussing the implications for infrastructure financing of the particular provisions of that bill. I would like to submit for this Committee's hearing record, the Advisory Panel's paper, along with their letter to me expressing their deepest concerns.

While H.R. 3838 represents some improvement over the Administration proposal with regard to tax-exempt bonds, it still would have a devastating effect on both public and private investment in infrastructure. The limits on "nongovernmental" use of the proceeds of tax-exempt bonds and the restrictions on arbitrage will create a nightmare of administrative detail for local issuers of bonds for infrastructure projects and will keep the tax exemption of such bonds in continual doubt. The inclusion of sewage, solid waste, and water supply facilities in a very restrictive state volume cap will make it difficult to obtain tax-exempt financing for them. The prohibition on private ownership and management of water supply facilities financed with tax-exempt bonds will virtually end private investment in this area. The requirement that 100% of the proceeds of a "nonessential function" bond be used for the bond's exempt purpose will also hinder private investment.

In the capital cost recovery area, the bill's Incentive Depreciation System scatters property in infrastructure facilities among several classes with recovery lives ranging from 10 to 30 years (most of this property now falls in the 5-year ACRS class). And like the Administration proposal, it completely repeals the investment tax credit. These provisions will deter potential private investors in infrastructure facilities and increase the costs to local governments of building them.

The Panel recommends several changes in the House bill to correct these serious problems. Among them are:

> Remove sewage treatment, solid waste disposal, and water supply facilities from the volume cap;
>
> Allow private ownership and management for water supply facilities financed with tax-exempt bonds;

Retain current law with regard to rules for bond issuance including advance refunding, arbitrage, spending schedules, and the 90-10 rule on spending for the exempt purpose;

Place sewage treatment, solid waste disposal and water supply facilities in one depreciation class with a recovery period not exceeding 10 years;

Retain a 5% credit for investment in sewage treatment, solid waste disposal, and water facilities.

The Advisory Panel's report goes into more detail on these and other issues, and I ask this Committee to give your attention to the report and its recommendations. I urge each of you as members of the Finance Committee to consider the grave implications of passing tax legislation that jeopardizes the infrastructure systems that are a hallmark of our civilized society.

I intend to work this year to ensure that any tax reform bill passed by the Senate does not reduce the availability of capital to finance our basic infrastructure needs. In the rush to reform our tax system, the Congress and the Administration must not undermine the very systems that undergird our economy. Transportation systems, water supply and waste disposal are the foundations of a healthy economy, and we must preserve the access to capital to build and maintain this infrastructure.

Senator DOMENICI. Mr. Chairman, and members of the committee, I know this will sound rather like a strange coincidence, but I do want to tell you that it really is. About 18 months ago, as I told the chairman privately, I began looking at infrastructure and the fiscal policy of the Nation. I told Chairman Packwood that as a result of serving on the Public Works Committee and on the Budget Committee I have seen the huge trends away from Federal funding and aid to build and maintain our infrastructure. I have learned that the next 10 or 15 years there is no way that we can expect a continuation of the high levels of funding that existed for the past 10 years. Observing this dilemma I asked a group of people who have financed infrastructure, governors, public planners, a whole group of Americans, to take a look at infrastructure needs.

This private panel has been conducting hearings around the country. Right in the middle of it, obviously, came the tax reform package. And it is only by coincidence that they are moving through their infrastructure evaluation and they then have an opportunity to look at Treasury I, Treasury II, the House bill that was passed and see what it does for the tremendous needs to infrastructure in the country.

I would just like to give you a couple of numbers that I think are right. The basic essential for this country in the area of water, sewer, highways, solid waste and mass transit—just the big five—are estimated conservatively to be in the neighborhood of $57 billion. There is a shortfall of about $18 to $19 billion a year in terms of maintaining the infrastructure of this nation that this country could hope to fund.

If you put that into a long term—and I assume any tax reform package that you all endorse and pass the Congress would be a long-term haul—we are talking about 15 years, the shortfall would be in the neighborhood of $250 to $270 billion.

Now, frankly, I think a lot of us take for granted what we have been able to build as infrastructure in this country. Until we travel around the world and see how difficult it is to accomplish simple development, Mr. Chairman, like someone wants to build a 40-story building in some city out there in the world, other than America, I mean some of the first things they have to do is find out whether there is water and sewer capacity to service it; what access roads?

Here in our country, obviously, we just take for granted the fact that we have this marvelous infrastructure—water, sewer, water plants, and the like. I am convinced that that is one of the real healthy and strong parts of the American economic system.

Now if we are going to make the change in the direction that all of us hope for a sustained economic growth, that we would experience 3½, 4 percent growth for 10, 15, 20 years, then, obviously, we need more infrastructure; not less. And strange as it may seem, there are a number of people who contend that if we are going to have any preferential treatment in the Tax Code that we ought to move in a couple of directions right up front.

First, there is not going to be enough public money.

Second, if you look through the litany of programmatic curtailments, restraints and reform, there will be less, not more, available at the national level for infrastructure.

Third, about the time we start looking at tax reform, there is a new and exciting thing happening, and that is new ways to attract private investment to the infrastructure needs of this country. Some are merely the investment in their bonds and the like, but there was a growing partnership evolving in terms of private participation in such things as water and water plants, sewage and sewage plants, and a myriad of other combinations of private-public participation.

I regret to tell you that this is typically American in that it is based upon the fact that money can be made by investors who do that.

The House-passed bill, in the opinion of the experts, aside and apart from the problems that they are having, Mr. Chairman, of having to curtail restraint and change their ways because the bill is pending and has not been passed—I think you are all getting plenty of information that there is county bond issues that cannot invest their money as they had planned because they have the 5-percent rule, they have the arbitrage rules, they have all those others—the marketplace is assuming that you have to comply with them long before passage of a law. I would hope that you would help solve that quickly.

But, basically, aside from that, it is assumed by those who have studied it carefully that you should be very, very careful because sewage treatment, solid waste disposal, water supply facilities would be subject to the overall cap. Many people are worried that instead of encouraging more investment, you will encourage less by including those kinds of public infrastructure needs and the bonding that would be used for financing, including them within this broad volume cap that includes many uses that are not nearly as badly needed nor cry out as strongly for preference than private-public sector participation; if we follow the House bill we will be going backward instead of forward.

There are some severe restrictions with reference to private ownership and management of water supply facilities financed with tax-exempt bonds. It appears to me that is moving in the wrong direction, if there are going to be any incentives this Tax Code infrastructure merits a top priority. I have given up that tax reform will result in a totally level investment arena with no preferential incentives. There will be some for many. I submit that we ought not inhibit private ownership and management of water supply. We ought to encourage it just as one example.

Current law should be retained with reference to the rules for advanced funding, arbitrage, spending schedules, the 9010 rule on spending for exempt purposes.

Now I do not want to be in any way on the side of those who are unreasonable out there in the marketplace. I do not think you ought to be investing public money for 3 or 4 years at higher rates than the yield—than the interest than you owe. But, clearly, such short-term rules as those included in the House bill will discourage the evolution of more funding and move in the direction of less.

Sewage treatment, solid waste disposal, water supply facilities are beginning to attract private money. And we immediately look to the House bill and find that the depreciation allowed for those kinds of facilities is scattered throughout the code. That is bad enough, but when you look at the principal motive, it seems to be in goal to dramatically lengthen the depreciation allowed for those kind of facilities just because they are financed with tax-exempt bonds.

In some instances, you go from 5 years to 30 overnight. If you want to encourage investors, you cannot change the rules that quickly. I guarantee you you will dry up the money just as sure as we are here.

Now there are more facts in the statement that I prepared. Suffice it to say that I am not, at this point, prepared to submit a detailed bill that I suggest for this part of the Tax Code. I understand that a number of your members, in particular Senator Durenberger, have taken on this issue as one vital and important in his opinion. I would say that I intend to work with him and any others to see if we can do our very best to maintain this infrastructure which has been our pride in the past; without which we have little chance of continuing an economic growth of the type that we all hope for.

I am reminded that right up the street in Montgomery County—that is not my State—it has similar problems, but, obviously, not as dramatic. But they have experienced dramatic growth, and the biggest shortcoming that they have now are the kind of infrastructure facilities that we are talking about here in this bill. Without the capacity to finance them, the growth that that county has experienced will turn out to be something people do not want instead of something that they desire.

I think that is going to happen around the country unless we encourage rather than discourage investment in public infrastructure of all types.

I would be pleased to answer questions that you might have, but first I would close by thanking you, Mr. Chairman, and members of the committee for your work and for your willingness to hear from me on this subject once again.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator, thank you very much.

Let me ask you one question: What is the definition of a public purpose or a government purpose bond? Is it really anything the local government wants to say it is?

Senator DOMENICI. Frankly, as I came to the U.S. Senate, Mr. Chairman, from a mayor's position in our large city, if I had not seen the last 14 years and what has been done with that definition, my answer would have been unequivocal and very easy. It would have been yes. On the other hand, it does seem to me that if you are going to have any caps and limitations, that clearly one would have to create a definition by a process of elimination.

It would be anything as you described it, and then you would have to decide if there are areas of real abuse. And we would have to take a chance that would become the definition.

I would prefer that it would be your definition. But, clearly, I understand how difficult that is in this area.

The CHAIRMAN. The reason I ask: One of the most intriguing answers we had to this question was from the chairman of the New Jersey Economic Development Commission. He was opting for a very, very broad definition. I asked him if New Jersey had attempted to woo the Saturn plant. He said, oh, yes; of course, most States had. I asked whether they had considered using industrial development bonds. He said, yes, of course, there is a limit on what we could have done, but certainly we offered it as part of the package. I said, do you mean to say you were going to use industrial development bonds to woo General Motors to put the plant there? He said, well, Senator, of course. He said, job creation is a public purpose.

The Federal Government has some misgivings about local governments going around using their industrial development capacity to woo jobs away from other States. Basically, what it amounts to is Albuquerque tries to steal it from Denver who tries to steal it from Butte who tries to steal it from San Antonio.

Senator DOMENICI. Yes.

The CHAIRMAN. Is that all a legitimate government purpose?

Senator DOMENICI. Let me put it this way. I believe it is. On the other hand, if you are asking me within some limitation that may have to be imposed, which of these kind of activities I think is more general to the Nation and more universal and much more needed in terms of overall growth, I would say infrastructure that is directed at water, sewer, pollution control, mass transit, and the like should clearly have a preference over industrial development bonds and the like. As much as I have been an advocate of them, I just think you are going to have to make some choices.

And I submit that those who would choose industrial development bonds over water, sewer and the like are very, very shortsighted because ultimately we cannot have sustained growth if we have industrial bond competition and no incentive for construction of infrastructure of the type I have been describing.

Senator CHAFEE. Mr. Chairman, it is like pornography. It is hard to define, but you know it when you see it.

Senator DOMENICI. You have got it, Senator.

The CHAIRMAN. Senator Mitchell, I apologize. I did not look at the list. You got here before I did, and you should have questioned first. Go ahead. I have finished anyway. I apologize.

Senator MITCHELL. No, no—nothing to apologize for.

Senator Domenici, I commend you for your interest and for your participation in the private sector advisory panel on infrastructure financing. I have had the opportunity to review its report. I think it offers a constructive contribution to the debate. Although candidly I do not agree with everything in it, I think it is a very good report, and a worthwhile endeavor.

Now I would like to ask just one question. We are talking about the need for infrastructure investment. Of course, there are two principal mechanisms for doing so. Here we are describing one alternative which is a subsidy in the form of tax-exempt financing. The other mechanism used by the Government, of course, is direct Government expenditures.

As you know, the administration's budget proposes reductions in direct Government expenditures in the areas that you have identified as the most important.

Senator DOMENICI. That is correct.

Senator MITCHELL. Pollution control facilities, water and other——

Senator DOMENICI. Water and sewer.

Senator MITCHELL. Water and sewer. May I take it that your judgment is that the subsidy method through tax-exempt financing is the preferable alternative? And I would like to ask as part of that: Do you think that is more efficient, more effective, or would direct Government expenditures be the more efficient and effective way to deal with those problems?

Senator DOMENICI. Senator, let me just see if I can answer it as honestly as possible.

I certainly am not suggesting that the maintenance and perhaps increasing of the incentive in the Tax Code is the best or preferable. What I am suggesting is that if you look at the need and the prospect, even if you do not agree with the President in terms of where all these budget restraints should be, that you definitely need both. I do not see any way to meet our needs. And if you all were to adopt the most restrictive investment incentive approach as part of tax reform, I do not think we would come close with water and sewer grant programs.

And you would probably stymie something that could address your question of which is the more efficient way. You would probably stymie the innovativeness of the private sector to get involved. And I think that is one of the most dynamic things that is happening. That they are getting involved and finding new and different ways to finance infrastructure.

You know, I look back at this country and one of the most startling things we did was to permit our cities and counties to build their public buildings with municipal bonds for many, many decades that had the preferential tax treatment on their interest rates. And I ask myself: Would we have the kind of public facilities in our lesser units of government but for that rather significant law?

I do not think we would have. I just do not believe the capital would have been directed there. I do not think we would have been able to afford it. And I am just thinking we are in an era on the dire infrastructure needs, and we ought to encourage new and different private investment by giving some incentives.

I look at it as just an add-on to that in difficult times. And we ought to do it.

Senator MITCHELL. Well, I thank the Senator.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Durenberger.

Senator DURENBERGER. Thank you, Mr. Chairman.

Pete, I am grateful to you for putting the issue in the context of infrastructure. And I have a statement, Mr. Chairman, that I would appreciate being made part of the record.

Let me just say that there is a value in having 6 members of this committee who are also on Environment and Public Works because I think while you have been there longer than many of us, I think it is instructive to look at the issue that George raised with you and the issue that the chairman raised with you in light of the fact that 15 Senators and God knows how many Congressmen sit around here every year filling potholes, building bridges, doing flood control projects, and Lord knows what by way of infrastructure improvement in communities in which we have no idea in a sense of priorities.

Your experience with the water resource division, for example. It seems to me since I have been here it has been your position and that of our colleague here from New York that we ought to block about 80 percent of that water resource money and send it back to the States where decisions could be made back there.

I look at my own State. We have three interstate highways in Minneapolis, St. Paul, and Duluth, three of our bigger cities, that today the cost to finish them is $375 million whereas the cost to do them when they were proposed was approximately $72 million. We could walk through a lot of things.

And I guess in response to both of the questions that were proposed to you, I would suggest to you that the importance of using the marketplace to do the financing is several-fold. No. 1, the market is much more responsive than the political process to where capital into infrastructure relates to the reality of services. I watch the hospital business, in hospital bonding, for example. A lot of sensitivity out there to where the realities are of getting a payback on the investments. So the idea that we are sitting here doing an efficiency trade-off is important to consider.

But if you look at it in the abstract, you could say, well, a direct dollar block grant categorical grant is probably on an efficiency quota of about 85 percent; whereas, tax-exempt bond efficiency was down to about 65 percent, depending on how much we have to pay to sell the bonds by way of revenue foregone. Maybe now it is up to 75 percent.

But that is not the real efficiency. The real efficiency comes in the decisionmaking process, in building the right set of infrastructure under the right economic development program and meeting those needs.

And I think I have taken more than the usual amount of interest in this issue, I think, principally for that reason. And our efforts here, at least those of us on the committee who are trying to give the chairman and the ranking member some help on this issue, is largely to work on the issue that the chairman raised. And, that is, defining governmental purpose.

And so I am very grateful and I think as all of us are to you for your contribution to that effort.

Senator DOMENICI. Thank you very much.

Mr. Chairman, I might just comment that I was pleased that Senator Durenberger mentioned Senator Moynihan. And he and I did start about 9 years ago, 8 years ago, on the water issue. Clearly, the water policy program of the country had become extremely regional. And I must say regionally biased in terms of my part of the country.

I do not think we have succeeded yet in getting a water policy that will put money in the right places. But I have found that if you are saying, Senator, that marketplace is a good needs test for infrastructure, I have included unequivocally that that is the case. Less white elephants are built when there is a marketplace involvement, and the local community has to do part of it; less will be built than we will build under a Corps of Engineer's program any day of the week. There is no question about it.

Senator MOYNIHAN. Senator, if I could comment on that.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. That what Senator Domenici was saying when he said the bias in the water programs was toward his part of the country. It has also ended up with the situation where in consequence nothing was happening. The program had just ceased to—public works and water projects had just stopped in this country 15 years ago.

The CHAIRMAN. Interestingly, we should be starting this on water per se, but the waterway user fees and all the port projects and the cocontributions hopefully will be starting on the floor on it later this week. And that is a long, long, long effort and compromise. And Senator Moynihan was involved in that compromise. And I think we are about there.

Senator DOMENICI. Mr. Chairman, that actually is the first major effort at injecting local sharing of some type as a clearing house for the propriety of the expenditure. And it will be more effective than any of these hearings we have on each and every one of these programs.

The CHAIRMAN. I agree.

Senator DOMENICI. No question about it.

The CHAIRMAN. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman, and Senator Domenici. I want to thank you for coming here and bringing these matters to our attention. Of course, like everything, we have lots of witnesses come in here and tell us how to ease up from the provisions of the House bill, and each one of those cost money. If we are going to make the bill revenue neutral, we have got difficult problems.

You are familiar with this from the Budget Committee. I do not imagine many people come in and tell you how to have some savings before the Budget Committee.

I think that the private sector involvement is extremely important, as you mention.

You mentioned two points I would ask you about. You said something in your remarks about difficult times, that we are in difficult times, and the importance of this. I just do not think that we are ever going to see the demand for the differential between the rate that is paid under these tax-exempts bonds and taxable bonds disappear. In other words, it would not matter that the prime gets down to 5 percent, the cities and towns are going to say, well, that is too expensive and we need these tax-exempt bonds at 3½ percent or whatever it is.

So I think that these demands are going to be with us in perpetuity. Don't you think so?

Senator DOMENICI. Yes, Senator. I did not think that in talking about that that I was talking about real interest rates today or where they will ultimately be. Rather with a Federal deficit of the type it is and the demand for capital pushing up against the interest rates that the market will not allocate enough resources to infrastructure financing unless it has some preferential treatment. That is what I meant. And we will not have enough programmatic money no matter how utopian people are about growth to do it with direct funding.

Senator CHAFEE. The other point you make is on page 5 when you say "retain a 5-percent credit for investment in sewage treatment," et cetera. What you are talking about there is the investment tax credit, I presume. It is currently 10 percent, and you are saying at least retain 5. And as you know, in the House bill, they do away with the ITC totally.

Obviously, we could not single out sewage treatment, et cetera, for a 5-percent tax credit without giving it to everything else. And that really is talking big dollars when we do that.

If we go back to reinstate the investment tax credit even at 5-percent, I think the costs are something like $60 billion over 5 years. Am I correct in that?

It is $120 billion for the 10 percent so it is $60 billion over 5 years for the 5-percent credit. I think we would have a terrible job ever making that up here. How important do you consider that factor in your equations?

Senator DOMENICI. I think it is rather important. I do not want to try to state whether that is more important than a more realistic maintenance of the depreciation schedule, but I think they kind of run hand in hand. When you go from 5 years on depreciation to 30 in this kind of investment, that is a rather singular signal to change your investment patterns. That is important. I do not know if the 5 percent is more important, but, obviously, it is of substantial importance.

And, Senator, you state rather dogmatically that you could not keep the 5 percent tax credit for infrastructure unless you retained it throughout the code. Stranger things than that have happened where you pick a purpose that is significant and retain some good aspect of the law and not make it generally available That would be a clear signal you want investment in this kind of thing. I do not know that you cannot do it. You may not want to, but, obviously, you can do what you can pass.

Senator CHAFEE. Well, I agree with you on that. There is no question that we could do it. I think if we did it, we certainly would have a lot of pressure from everybody else to apply it to everything they are interested in, too.

Well, I think you have performed a great service here in drawing our attention to this matter. We thank you for it.

Senator DOMENICI. Thank you very much.

The CHAIRMAN. Senator Long.

Senator LONG. Let me thank you for coming before the committee to bring this message to us, Senator Domenici.

I have thought many times about some of these things that you are talking about. For example, we can have all the roads we want in the United States just as good as we want. We can have all the airports we want. And we have the very best. We have them as good as we want them to be. Just when it gets to it, you have got to pay for it.

And really if we are not willing to pay for it, we have no right to claim it. But the same thing applies to waterways. If you are willing to pay for it, you can have them.

And sewage now—you know, it is sort of ridiculous to think about—picture all the cities that are operating with septic tanks. You know, those septic tanks will only hold so much. And the outflow—the ground can absorb only so much of that stuff that flows out of those septic tanks. The book, you know, the grass is greenest over the septic tank, and you and I know why.

But here we are with—the program right now is going to eliminate revenue sharing. You are chairman of that Budget Committee. Is that how it is going to be? Are they going to be without revenue sharing in the foreseeable future?

Senator DOMENICI. I presume so.

Senator LONG. I do not like the idea. I voted against it, and I was for revenue sharing. But that is in the cards, it looks like, to cut off the revenue sharing. And the budget we have got out there this year drastically cuts it at the end of this fiscal year.

Then for us to come along with a tax bill behind that to make it a lot more difficult for them to do the job, does not make a lot of sense to me. I think you have got a good point here, Senator.

And, really, most of this is something, I take it, where the communities are going to have to go out here, find somebody to lend them some money, and the tough part—and this is really tough. I know. I have been through some of this. Even before I was elected to public office, I was part of the junior chamber of commerce before they called it the JC, and I would go around and carry petitions and placards and things like that trying to get people to vote for a bond issue to try to improve the community.

But it is tough. It is really tough to get some people who do not like the idea of paying taxes; do not like the idea of paying the assessments, to pay for these things.

I have seen some poor mayor just sweat blood trying to get a bond issue and never succeeded in getting one through.

So when we make it just a lot tougher for them, raise the cost and all that, that fixes it so they appear to be getting less for their money. We are really confronting those mayors out there with a very difficult problem.

You have been a mayor. I believe you were a mayor once. That is my recollection.

Senator DOMENICI. That is correct.

Senator LONG. That is where you got your start, I guess.

Now tell us a little bit about the problem of a mayor trying to improve his community when we make it tougher up here.

Senator DOMENICI. I tell you there is no doubt that if we had in my city, with a great reputation for supporting growth, and—we had not, Senator Long, for some 28 years had a bond election that was turned down by the voters. I mean we worked at it. We had incredible participation by the community. But the point is if those bonds had not been the beneficiaries of the long-standing policy that you have been part of building in of giving those bonds a preferential treatment, you could never have built what you built. You would not take the issues to the public in the same form because you could not afford the debt service. Even with good credit, you would not ask your people to do it. It would be too expensive.

The reason we succeeded is because we had the preferential interest treatment that had the interest rates way down. The people knew that and were willing to say this is a darn good investment for the next 25 years, but you really had to work at it.

I want to say one other thing to the chairman. First, I thank all of you for not being critical of my saying do tax reform but do not do this. You clearly could have said that to me.

But I would like to tell you I am so used to that I would not have minded at all, because everybody tells me, Mr. Chairman, raise revenues but do not raise taxes in that budget resolution. I do not know how you do that. I mean there is some kind of magic, we will try.

They say cut the budget, but do not cut any programs. You know, I do not know how you do that either. There are many who say cut defense, but do not change what we are doing. Well, I do not know how you do that either.

So I just wanted you to share a little of this burden as you prepare a tax reform bill.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Well, I would like to welcome my chairman to this and thank him for what he has done and make a point. If I could get the attention of our chairman of our Budget Committee on this matter, what Senator Domenici has been saying to us is that markets can make good allocations of public resources, and that the public works style of the Congress for the last 50 years has really worked its way out. We are beginning to produce highly uneconomic activities and then, in consequence, none.

Senator DOMENICI. None.

Senator MOYNIHAN. You might want to know that we have just got—the Corps of Engineers has just given us the first annual report on the Tennessee Tombigbee. And traffic came in at exactly 6 percent of the predicted volume.

Senator CHAFEE. Surprise, surprise.

Senator MOYNIHAN. Surprise, surprise.

Senator CHAFEE. If there ever was a dog, that was it. The Tennessee Tombigbee project.

Senator MOYNIHAN. I want to say that when Thomas Jefferson first proposed it, it had—there was a case for it. [Laughter.]

But it really as a mule-drawn canal, may be. It came in at 6 percent. That investment would not have been made if it had been made through bonds. And I think—wouldn't you agree, sir?

Senator DOMENICI. I agree.

Senator MOYNIHAN. And if you—with the investment that will be made through bonds have a market test and we ought to get back to it.

And besides which unless I am mistaken, there is a real constitutional issue that Pollock raises about the Federal taxation of State and local borrowing. I think the Supreme Court has ruled rather strongly on that in the 1890's.

Anyway, thank you very much. And I very much—and while I have another moment, do you think we ought to do something about the way we have got this situation where the House having stated that the new rules take effect January 1, 1986, that all over the country municipalities are just absolutely stuck? They cannot do anything. No bond council can give them advice that they are issuing tax-exempt bonds.

Senator DOMENICI. Well, before you arrived, Senator Moynihan, I indicated to the chairman that that was causing a very serious problem of tremendous magnitude. But to fix that is not to fix the problem. That is to just have a little common sense. And to do something up here to say that it is not so.

The reason for it is the liability, as you know, of those who write legal opinions, and they are not going to write a legal opinion clearing even a triple A bond while that retroactive effective date is still unresolved because in the current atmosphere of liability they could not buy insurance to cover that kind of risk so they are writing the new rules into it for coverage. As a consequence, nothing is getting done. I mean it is all stymied out there.

Senator MOYNIHAN. I mean that may be the only thing we do this year—is to stop municipal construction entirely.

Thank you very much, Senator.

The CHAIRMAN. Senator Bradley.

Senator BRADLEY. Thank you very much, Mr. Chairman.

Let me say to you, Senator Domenici, that I share the concern expressed in your testimony. I think that when we do tax reform we clearly have to take account of the infrastructure effects of tax reform. And so I ask you: Would you include toxic waste disposal facilities in those infrastructure facilities—sewage treatment, solid waste, water supply facilities—that you would like to protect?

Senator DOMENICI. I would surely include them. I think they are on my own handwritten list, and I might not have stated. The reason I did not give them the same amount of emphasis is because in terms of private sector investment with localities and investment in bonds, it is very new. Not to say that it is not needed, but we do not have a lot of experience yet.

But the problem would appear to be so severe that it could not be addressed by the Superfund alone. It will not be. So it is going to have to have some other significant amount of money. And, clearly, there is one that needs some marketplace clearing too because we really are going to have a lot of difficulty in saying where we are ought to put the money. So I would add it to the list. It is on my list here, Senator.

Senator BRADLEY. Well, I want to thank you for your testimony and for your continued thought about this problem of how to finance needed infrastructure improvements. This is both an enormous problem and opportunity, and it really does call for some creative thought.

Senator DOMENICI. Thank you very much, Senator.

The CHAIRMAN. Senator Symms, do you have any questions?

Senator SYMMS. Thank you. Just one question, Mr. Chairman.

And, Senator Domenici, I appreciate your comments about the infrastructure, and I share a lot of your concerns. You pretty well covered all the specifics of it, but just as a more general question: How important in the economy of New Mexico is the whole tax reform question in a general sense, period?

Senator DOMENICI. Well, I came down here thinking that the chairman would be asking me questions about the assumption of revenues in the budget resolution, and I was hoping I did not get totally sidetracked and could address the issue.

If you would like me to tell you what my constituents are saying about it, there is not a great deal of clamor for the overall reform. Most of the enthusiasm comes from those who already have special treatment and are telling us they want to continue it.

Clearly there is an organized effort to maintain the treatment for State and local taxes. People wanting continued preferential treatment for fringe benefits are somewhat organized. On the other hand, I do not perceive that that was the basic essence of tax reform.

I have concluded that there is no clamor for it in its basic essence as described, but rather more for continuation of preferences that they consider terribly important.

I had three or four nice constituents from my State in early on who are women entrepreneurs who own apartments, and they clearly indicated that they wanted tax reform but they did not believe the President was the kind of person who wanted their tenants' rents to go up 30 to 40 percent. I mean there has been just a stream of New Mexicans since then saying, "we do not really think the President has this in mind." And I think in that context I am answering your question.

Senator SYMMS. Do you have a recommendation for us on the point Senator Moynihan just brought up on the prospectivity and the effective date of the law?

Senator DOMENICI. I could not state strong enough what I am hearing everywhere—my own State, everywhere I talk, any kind of group here or across this country—is that while there is concern about the reform, there is genuine amazement that we are operating on some retroactive possibility; that we ought to find some way to clear the air so that we do not further impede investment decisions based upon something that may or may not happen. I cannot urge it strong enough. I did before you came, but I would say it again.

Senator SYMMS. Thank you, Mr. Chairman.

Thank you, Senator.

Senator DOMENICI. Thank you very much.

The CHAIRMAN. Senator, thank you very much for coming and being with us.

Senator DOMENICI. Thank you. I would report—and thank you again, Mr. Chairman, with reference to reconciliation. It is still alive, as you know, and we submitted it yesterday in a package to the House. I thank you and your staff for the marvelous assistance, and I hope we get it done. I would tell you and members of the committee that if we do not, there is a $6 billion outlay that we will have to find elsewhere right off the bat in the budget this year that would otherwise be achieved if it is passed.

The CHAIRMAN. But I hope we get something back that cures not just the $6 billion outlay this year but does not find us in some entitlement programs to future expenditures in outyears.

Senator DOMENICI. You are absolutely right.

Senator BRADLEY. Mr. Chairman, may I ask Senator Domenici one question before he goes, just as a point of information?

The CHAIRMAN. Yes.

Senator BRADLEY. A recent report from the OMB and the CBO says that with no change in current spending or taxes the deficit will drop to $104 billion in 1991.

Senator DOMENICI. Yes, sir.

Senator BRADLEY. I wondered if you could explain for us how the number was arrived at.

Senator DOMENICI. I would be pleased to.

First of all, for the first time in history of the Congressional Budget Office, they have assumed the Gramm-Rudman-Hollings targets as not only on the lawbooks of the land but the first assumption they have made is that that has all been carried out. So the number you saw assumes we have achieved 144, 144 minus 36. In a sense, they have assumed a balanced budget in 1991 for starters. Second, as a result of assuming that, they have some rather optimistic economics and conclude that they come from that assumption. And that would mean that for the next 5 years there is an assumption—for round numbers I will tell you 4 percent real growth for 5 more years. Now that may be off two-tenths, but that is assumed.

The third assumption is a very, very significant one also. It is assumed that there would be no real-growth in defense for 5 years. From this point on, for 5 successive years, that trendline assumes no real growth in defense. The atmosphere seems to indicate that people do not want defense to be increased. But I would assume midstream of a military preparedness buildup that it is rather astonishing to assume 5 years of no growth off the lowest level in the last 6 or 8 percent, down negative 6 percent this year. For those who think defense grew this year, it is negative 6 over the previous year.

They are assuming no real growth on that. They are assuming interest rates commensurate with those set of economics. And I would just say to you if you change any two of them, the trendline is up again. If defense has to grow 1 percent, 1½, and you get 3 percent growth instead of 4, the trendline instead of coming down is going up.

I mean you can mix any of the four and you will have it going up instead of coming down.

Senator BRADLEY. Why did OMB assume zero growth, zero real growth, in defense?

Senator DOMENICI. That is very normal. They assume current policy in their definition. Excuse me, current services. And current services is just a definition. And it is add inflation to the immediate past outlay level—excuse me—budget authority level as appropriated. They do that on domestic. They did it on defense. The President did it on domestic and on defense. He used a baseline that assumes his increase. Therein is a sizable difference, some $24 billion, in budget authority.

Senator BRADLEY. Thank you.
Senator DOMENICI. Thank you very much.
The CHAIRMAN. Thank you, Pete.
Senator DOMENICI. Thank you, Mr. Chairman.
Senator MOYNIHAN. Mr. Chairman, before you go further, could I ask whether it would be possible in the context of Senator Domenici's thoughts—there really is a question of law under Policies Farmers Loan & Trust, which is—the court decided in 1895. There is a question of law about what is the power of Congress to tax in one form or another loans made by State governments and local governments. Could they be included, for example, in the minimum tax? Would it be possible to ask for a legal opinion from the counsel?
The CHAIRMAN. We have had legal opinions from Justice before. And as you know, we have got that case in court right now involving the Social Security where we are including municipal interest.
Senator MOYNIHAN. Yes.
The CHAIRMAN. We can get a legal opinion. I am not sure it is going to settle anything until we finally get another Supreme Court opinion. But we have had opinions from the Justice Department before, and we can get that opinion again.
Senator MOYNIHAN. Why don't we? Could I ask that we do?
The CHAIRMAN. Be happy to.
Now our next witness is the Honorable Joseph Casale, the mayor of Portland, ME. Mr. Mayor, I believe Senator Mitchell might have a few words of introduction.
Senator MITCHELL. Thank you, Mr. Chairman.
I am pleased to introduce to the committee Joseph Casale, the mayor of Portland, ME, which, incidentally, Portland, OR is named after.
The CHAIRMAN. On, however, not merit, but the flip of a coin.
Senator MITCHELL. That is right. Well, you won.
The CHAIRMAN. Well, you won. We had two people, one from Boston and one from Maine, and they each wanted the town named after themselves and they flipped a coin and the fellow from Portland, ME, won.
Senator MITCHELL. Well, Mayor Casale is one of Maine's best known and most able public officials. As mayor, he has successfully continued the resurgence of our State's largest city. One result has been that Portland was recently identified in one national survey as one of the two most attractive cities in America in which to live and work. And while Mayor Casale cannot take all the credit for that, he can take a lot. We are very pleased to welcome him here.
Mayor CASALE. Thank you very much, Senator Mitchell.
Senator CHAFEE. Well, Mr. Chairman, I want to report for the record that I was a resident of his city for a few years at 28 Orchard Street, Portland, ME, when my father was working up there, and it is a lovely city.
Senator MITCHELL. And it is a lot nicer now than when you were there. [Laughter.]
Senator CHAFEE. That may be cause and effect for all we know.
Senator MITCHELL. Well, I did not mean it that way.
Mayor CASALE. Mr. Chafee, we would love to have you come back and visit us sometime.

Senator CHAFEE. Longfellow spoke well of your city.

The CHAIRMAN. Go right ahead, Mr. Mayor.

STATEMENT OF HON. JOSEPH CASALE, MAYOR, PORTLAND, ME

Mayor CASALE. Thank you very much.

Mr. Chairman, Senator Mitchell, and members of the Senate Finance Committee, I am Joseph Casale, mayor of Portland, ME. I thank you for the opportunity to appear before you this morning to present my community's positive experience with the contribution tax-exempt financing has made to our revitalization and my concern over provisions which the Congress is considering.

Portland, a city of 62,000, has been nationally recognized for the revitalization which it has made over the past 15 years. We have shaken the image as a declining seaport city and have emerged as a vibrant city, proud of its historic past and confident of its future.

Throughout the city's years of hard work, the Federal Government has played a vital, if not critical, role in providing assistance. Such programs as general revenue sharing, urban development action grants, community development block grants, economic development administration funds, urban mass transit, housing development funds, and urban parks programs have been successfully utilized in our community.

Perhaps the greatest reason for our renaissance has been the initiative and commitment of the public and private sectors to undertake both large and small scale improvements to the city's commercial, cultural, and physical rebirth. The shared concerns of public agencies and private enterprise evolved into a strong and successful partnership.

While I support tax reform to ease the escalating Federal deficit, I am concerned that the changes in the tax laws may restrict or eliminate the tools which have stimulated this private/public investment and will present local government with a loss in our capacity to continue to revitalize our cities and provide housing opportunities, particularly for low- and moderate-income families. Let me be more specific.

First and most important, I hope the Congress will postpone the effective date for provisions relating to tax-exempt financing until at least January 1, 1987. Without this change, 1986 will be a lost opportunity for cities planning with the private sector to make joint investments in important community-wide projects. One of my goals as mayor has been to see built a conference and convention center in Portland. Such a facility can provide a critical additional market for retail stores, restaurants, and services and is an important part in the preservation of our downtown, not to mention the expanded job opportunities that would follow such a development. The confusion over when provisions of the Tax Act will take effect make it impossible for us to attract a joint venture partner from the private sector to participate in this project.

Similar hesitation exists with investors in a major $40-million waterfront revitalization project and a $10-million downtown housing development. I know from talks with my fellow mayors that other communities are experiencing similar uncertainty. The Congress must make a clear statement soon on this issue.

Second, the proposed volume cap limitation and formula with the inclusion of multifamily housing will unnecessarily result in pitting the need for housing against other uses, particularly small issue industrial development bonds as well as such unique needs for tax-exempt financing as waste to energy systems. A separate issue is whether the cap is at a realistic level for the volume of development activity in a State.

In Maine, our $200-million cap will not even begin to address our needs. During 1985, the Maine State Housing Authority provided $84 million in financing for first-time home buyers with incomes below the State median, which, by the way, for your information is $22,000; and for new apartments, many being rented to families with incomes below 80 percent of that median.

In 1985, our State Finance Authority closed on over $80 million small issue IDB's with $47 million pending. Portland's share alone was more than $30 million. These projects include the expansion of a local dairy, construction of a service building on our fish pier, rehabilitation of a pier for fish boat berthing, printing company expansion and new warehouse and distribution facilities. All these investments have not only created and retained jobs, but are contributing to the rebirth of our maritime heritage, particularly our fishing industry.

I have attached for your perusal a summary of the inducement agreements in our community as well as pending or implemented bond issues as of December 6, 1985 for the State of Maine.

Portland's large issue needs alone for a waste to energy system for trash removal in an environmentally safe manner exceeds $75 million. Our overall State need is in excess of $170 million.

I encourage you to reexamine the formula for the volume cap particularly as it relates to small issue IDB's. I also urge that you consider a separate, combined cap for single and multifamily housing.

Third, with the cutbacks in direct development funding through UDAG, EDA, and CDBG, tax increment financing is becoming an important alternative mechanism for communities undertaking improvement programs. We are looking at it in Portland and know that the other Maine communities are also examining its use. This has proven highly successful in other cities and States; deserves to be continued.

I ask the committee to ensure that this financing mechanism remain as an essential function bond.

Finally, I urge the committee to retain the rehabilitation investment credit. Within our city, these tax incentives have been effective in attracting private investment. By the end of 1985, 156 buildings in Portland had been rehabilitated generating $66 million in private investment. More than 2,700 jobs and $1.5 million annually in local real estate assessment has been created.

I am not familiar with the light system, but I do understand that red light means you are supposed to stop.

The CHAIRMAN. You are almost done. Go ahead and finish up.

Mayor CASALE. Thank you very much, sir.

More than 2,700 jobs and $1.5 million annually in local real estate tax assessment have been created. Without these incentives, many of these buildings would have been abandoned or destroyed, reducing the historic legacy of our community, which we have fought so hard to preserve.

In closing, Mr. Chairman, committee members, it has been an honor and a privilege for me to testify before you today. We in Portland are extremely proud of the partnership that we have forged with you representing the Federal Government. And with that partnership, we have made our country and our cities that much stronger and our citizens thereof more enriched.

Thank you very much for the extra time, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Mayor.

[The prepared written statement of Mayor Casale follows:]

STATEMENT OF

MAYOR JOSEPH P. CASALE

PORTLAND, MAINE

BEFORE THE

SENATE FINANCE COMMITTEE

MARCH 4, 1986

MR. CHAIRMAN, SENATOR MITCHELL AND MEMBERS OF THE SENATE FINANCE COMMITTEE. I AM JOSEPH CASALE, MAYOR OF PORTLAND, MAINE. THANK YOU FOR THE OPPORTUNITY TO APPEAR BEFORE YOU THIS MORNING AND PRESENT MY COMMUNITY'S POSITIVE EXPERIENCE WITH THE CONTRIBUTION TAX EXEMPT FINANCING HAS MADE TO OUR REVITALIZATION AND MY CONCERN OVER PROVISIONS WHICH THE CONGRESS IS CONSIDERING.

PORTLAND, A CITY OF 62,000, HAS BEEN NATIONALLY RECOGNIZED FOR THE REVITALIZATION WHICH IT HAS MADE OVER THE PAST FIFTEEN YEARS. WE HAVE SHAKEN THE IMAGE AS A DECLINING SEAPORT AND HAVE EMERGED AS A VIBRANT CITY, PROUD OF ITS HISTORIC PAST AND CONFIDENT OF ITS FUTURE.

THROUGHOUT THE CITY'S YEARS OF HARD WORK, THE FEDERAL GOVERNMENT HAS PLAYED A VITAL, IF NOT CRITICAL ROLE IN PROVIDING ASSISTANCE. SUCH PROGRAMS AS GENERAL REVENUE SHARING, UDAG, COMMUNITY DEVELOPMENT BLOCK GRANTS, EDA, URBAN MASS TRANSIT, HOUSING DEVELOPMENT FUNDS, AND URBAN PARKS PROGRAMS HAVE BEEN SUCCESSFULLY UTILIZED.

PERHAPS THE GREATEST REASON FOR OUR RENAISSANCE HAS BEEN THE INITIATIVE AND

COMMITMENT OF THE PUBLIC AND PRIVATE SECTORS TO UNDERTAKE BOTH LARGE AND SMALL SCALE IMPROVEMENTS TO THE CITY'S COMMERCIAL, CULTURAL AND PHYSICAL REBIRTH. THE SHARED CONCERNS OF PUBLIC AGENCIES AND PRIVATE ENTERPRISE EVOLVED INTO A STRONG AND SUCCESSFULL PARTNERSHIP.

I AM CONCERNED THAT THE CHANGES IN THE TAX LAWS MAY RESTRICT OR ELIMINATE THE TOOLS WHICH HAVE STIMULATED THIS PUBLIC/PRIVATE INVESTMENT AND WILL PRESENT LOCAL GOVERNMENT WITH A LOSS IN OUR CAPACITY TO CONTINUE TO REVITALIZE OUR CITIES AND PROVIDE HOUSING OPPORTUNITIES PARTICULARLY FOR LOW AND MODERATE INCOME FAMILIES. LET ME BE MORE SPECIFIC.

FIRST, I HOPE THE CONGRESS WILL POSTPONE THE EFFECTIVE DATE FOR PROVISIONS RELATING TO TAX EXEMPT FINANCING UNTIL AT LEAST JANUARY 1, 1987. WITHOUT THIS CHANGE, 1986, WILL BE A LOST OPPORTUNITY FOR CITIES PLANNING WITH THE PRIVATE SECTOR TO MAKE JOINT INVESTMENTS IN IMPORTANT COMMUNITY WIDE PROJECTS. ONE OF MY GOALS AS MAYOR HAS BEEN TO SEE BUILT A CONFERENCE AND CONVENTION CENTER IN PORTLAND. SUCH A FACILITY CAN PROVIDE A CRITICAL ADDITIONAL MARKET FOR RETAIL STORES, RESTAURANTS, AND SERVICES AND IS AN IMPORTANT PART IN THE PRESERVATION OF OUR DOWNTOWN NOT TO MENTION THE EXPANDED JOB OPPORTUNITIES THAT WOULD FOLLOW SUCH A DEVELOPMENT. THE CONFUSION OVER WHEN PROVISIONS OF THE TAX ACT WILL TAKE EFFECT MAKE IT IMPOSSIBLE FOR US TO ATTRACT A JOINT VENTURE PARTNER FROM THE PRIVATE SECTOR TO PARTICIPATE IN THIS PROJECT.

SIMILAR HESITATION EXISTS WITH INVESTORS IN A MAJOR $40 MILLION WATERFRONT

REVITALIZATION PROJECT AND A $10 MILLION DOWNTOWN HOUSING DEVELOPMENT. I KNOW FROM TALKS WITH MY FELLOW MAYORS THAT OTHER COMMUNITIES ARE EXPERIENCING SIMILAR UNCERTAINTY. THE CONGRESS MUST MAKE A CLEAR STATEMENT SOON ON THIS ISSUE.

SECOND, THE PROPOSED VOLUME CAP LIMITATION AND FORMULA WITH THE INCLUSION OF MULTIFAMILY HOUSING WILL UNNECESSARILY RESULT IN PITTING THE NEED FOR HOUSING AGAINST OTHER USES, PARTICULARLY SMALL ISSUE INDUSTRIAL DEVELOPMENT BONDS AS WELL AS SUCH UNIQUE NEEDS FOR TAX EXEMPT FINANCING AS WASTE TO ENERGY SYSTEMS. A SEPARATE ISSUE IS WHETHER THE CAP IS AT A REALISTIC LEVEL FOR THE VOLUME OF DEVELOPMENT ACTIVITY IN A STATE.
IN MAINE OUR $200 MILLION CAP WILL NOT EVEN BEGIN TO ADDRESS OUR NEEDS. DURING 1985 THE MAINE STATE HOUSING AUTHORITY PROVIDED $84 MILLION IN FINANCING FOR FIRST TIME HOME BUYERS WITH INCOMES BELOW THE STATE MEDIAN, AND FOR NEW APARTMENTS, MANY BEING RENTED TO FAMILIES WITH INCOMES BELOW 80% OF MEDIAN.

IN 1985 OUR STATE FINANCE AUTHORITY CLOSED ON OVER $80 MILLION SMALL ISSUE IDB'S WITH $47 MILLION PENDING. PORTLAND'S SHARE ALONE WAS MORE THAN $30 MILLION. THESE PROJECTS INCLUDE THE EXPANSION OF A LOCAL DAIRY, CONSTRUCTION OF SERVICE BUILDINGS ON OUR FISH PIER, REHABILITATION OF A PIER FOR FISH BOAT BERTHING, PRINTING COMPANY EXPANSION AND NEW WAREHOUSE AND DISTRIBUTION FACILITIES. ALL OF THESE INVESTMENTS HAVE NOT ONLY CREATED AND RETAINED JOBS, BUT ARE CONTRIBUTING TO THE REBIRTH OF OUR MARITIME HERITAGE,PARTICULARLY OUR FISHING INDUSTRY.

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PORTLAND'S LARGE ISSUE NEEDS ALONE FOR A WASTE TO ENERGY SYSTEM FOR TRASH REMOVAL IN AN ENVIRONMENTALLY SAFE MANNER EXCEED $75 MILLION. OUR OVERALL STATE NEED IS IN EXCESS OF $170 MILLION.

I ENCOURAGE YOU TO REEXAMINE THE FORMULA FOR THE VOLUME CAP PARTICULARLY AS IT RELATES TO SMALL ISSUE IDB'S. I ALSO URGE THAT YOU CONSIDER A SEPARATE COMBINED CAP FOR SINGLE AND MULTIFAMILY HOUSING.

THIRD, WITH THE CUTBACKS IN DIRECT DEVELOPMENT FUNDING THROUGH UDAG, EDA AND CDBG, TAX INCREMENT FINANCING IS BECOMING AN IMPORTANT ALTERNATIVE MECHANISM FOR COMMUNITIES UNDERTAKING IMPROVEMENT PROGRAMS. WE ARE LOOKING AT IT IN PORTLAND AND KNOW THAT OTHER MAINE COMMUNITIES ARE ALSO EXAMINING ITS USE.

I ASK THE COMMITTEE TO ENSURE THAT THIS FINANCING MECHANISM REMAIN AS AN "ESSENTIAL FUNCTION BOND" AND NOT SUBJECT TO THE VOLUME CAP.

FINALLY, I URGE THE COMMITTEE TO RETAIN THE REHABILITATION INVESTMENT CREDIT. WITHIN OUR CITY THESE TAX INCENTIVES HAVE BEEN EFFECTIVE IN ATTRACTING PRIVATE INVESTMENT. BY THE END OF 1985, 156 BUILDINGS IN PORTLAND HAD BEEN REHABILITATED GENERATING $66 MILLION IN PRIVATE INVESTMENT. MORE THAN 2700 JOBS AND $1.5 MILLION ANNUALLY IN LOCAL REAL ESTATE TAX ASSESSMENT HAVE BEEN CREATED. WITHOUT THESE INCENTIVES MANY OF THESE BUILDINGS WOULD HAVE BEEN ABANDONED OR DESTROYED REDUCING THE HISTORIC LEGACY OF OUR COMMUNITY.

MR. CHAIRMAN, THANK YOU AGAIN FOR THIS OPPORTUNITY TO APPEAR BEFORE YOU TODAY.

IRB INDUCEMENT AGREEMENTS

1. Sunenblick, Reben & Fontaine; originally set at $300,000 per Council Order on 6-18-84, then amended to $340,000 per Council Order on 8-6-84; Howard T. Reben, Stephen P. Sunenblick, and Donald F. Fontaine; acquisition and rehabilitation of the India Street Fire Garage.

2. Moser Cabinet Makers; $320,000; Council meeting of 4-16-84; Thomas Moser; acquisition and renovation of a 120-year old building located on the corner of Cumberland and Forest Avenues.

3. Pearl Street Associates, originally set at $620,000 per Council Order on 12-19-83, amended to $700,000 per Council Order on 5-7-84; Ricardo Quesada; acquisition and rehabilitation to building located at 4 Milk Street.

4. Oakhurst Dairy; $900,000; Council meeting on 11-21-83; Stanley Bennett; expansion at Oakhurst's site on Forest Avenue, and costs for additional equipment and machinery due to expansion.

5. Nappi Distributors; $500,000; Council meeting on 10-17-83; Nick Nappi; acquisition of and improvements to existing building located at 275 Presumpscot Street.

6. Milliken-Tomlinson Co.; $3,500,000; Council meeting on 7-20-81; Epworth Moulton; expansion of firm's facilities on Milliken Road in Riverside Industrial Park.

7. Ventrex Laboratories; $1,600,000; Council meeting on 1-19-81; Robert Foster, Roger Piasio, John Lincoln, Arthur McEvoy and Dr. Hugh Johnston, Dr. Narayan Nayak, and Myron Hames; acquisition and reconstruction of facilities for Ventrex Laboratories on Read Street in Portland.

8. 123 Middle Street Partnership; not to exceed $2,000,000; Council meeting on 5-7-84; sole general partner is the Ram Development Company, whose two general partners are Howard Goldenfarb and Joseph DeFranco; acquisition, reconstruction, remodeling, and rehabilitation of the building situated at 123 Middle Street (Carburs Restaurant location).

9. Montalvo Corporation; $600,000; Council meeting on 5-21-84; Margaret Denham, Edwin J. Montalvo, Jr., Ed Montalvo, Sr.; 7,000 sq. ft. expansion of existing facility on Riverside Industrial Parkway in Portland and to purchase two new large computer-controlled lathes.

10. Woodard and Curran, Inc.; $535,000; Council meeting on 7-16-84; Al Curran; acquisition of land and construction of a 10,000 sq. ft. facility on a new industrial road in Stroudwater Estates that would combine office space plus a small laboratory for this firm. In July 1985, an additional IRB in the amount of $150,000 was requested to supplement the previous one for $535,000 due to unanticipated costs. This Bond was passed at the City Council's meeting on 9-4-85.

11. Teak Associates; $7,000,000; Council meeting on 8-20-84; amount of IRB increased to $8,200,000 at Council meeting of 12-17-84; Eric Cianchette; acquisition and

reconstruction of the Milk Street Armory, bounded by Milk, Market, Fore, and Silver Streets into a hotel to be known as "Portland Regency Hotel".

12. Portland Fish Pier Associates; $1,300,00; Council meeting on 9-24-84; Samuel Davidson and Robert Tetreau; construction of a service building on Fish Pier.

13. Susse Chalet Motor Lodge; $2,500,000; Council meeting on 10-1-84; Susse Chalet Motor Lodge of Portland, Inc. (contact person Charles Wagner); construction of a 106-unit motel on Marston Street, Portland. At Council meeting on 1-15-85, the Council passed an order making two technical corrections: (1) set specific interest rate on bonds; and, (2) corrects name to 1985 Susse Chalet Project.

14. Porteous, Mitchell & Braun Company; originally set at $1,800,000 at Special Council meeting on May 30, 1984, then amended to $2,300,000 per Council Order of September 6, 1984, and further amended to be $2,500,000 at Council meeting of October 1, 1984; Porteous, Mitchell and Braun Company (Earl Ingalls, President); acquisition of land and building facilities for new warehouse and distribution center for Porteous in Stroudwater Estates.

15. Dictar Associates II Project; $6,000,000; Council meeting on March 21, 1983; Dictar Associates, David H. Bateman - Manager; acquisition and rehabilitation of two existing buildings (formerly Hannaford Bros. building, Commercial St.) for use of 55,000 sq. ft. as office and retail facilities, together with construction of a 3-level parking garage to accommodate 200 cars.

16. Dictar Associates II, 335 Forest Avenue, $2,400,000; Council meeting on June 6, 1984; Richard E. Dobson, general partner; reconstruction of existing building at 335 Forest Avenue for 74 residential housing units and for 6,500 sq. ft. of commercial and retail space.

17. Milk Street Associates (1982 project); $850,000; Council meeting on March 8, 1982; Ricardo Quesada; renovations of former Burbank-Douglas building, 36 Pearl Street (on corner of Pearl Street and Milk Street) - retail space on ground floor, offices on 5 upper floors.

18. Free Street Associates (1983); $1,750,000; Council meeting on 8-8-83; acquisition and rehabilitation for general commercial purposes certain buildings located at 18 to24 Free Street (all buildings more than 50 years old) Ricardo Quesada.

19. Barber Foods; $285,000; Council meeting in May of 1981; purchase of equipment.

20. Casco Development Associates; $500,000; Council meeting on 9-21-83; John Higgins; Rehabilitation of building at 474 Congress Street, known as the Loring, Short & Harmon Building.

21. Teak Associates; $800,000; Council meeting on 9-6-83; Eric Cianchette; Construction of a warehouse on Presumpscot Street for State Paper Company.

22. ROMCO, Inc.; $600,000; Council meeting on 9-21-81; Robert Patterson represented ROMCO; acquisition and rehabilitation of former Odd Fellows Hall at 25A Forest Avenue.

23. Congress Street Associates; $1,500,000; Council meeting on 12-7-81; acquisition of 415 Congress Street.

24. Holden Refrigeration Co.; $500,000; Council meetong on 11-5-84; Richard B. Holden, owner; acquisition and rehabilitation of 18,000 sq. ft. garage, 17 Westfield Street for office supply and service area for Holden Refrigeration's operation (building formerly occupied by Henley-Kimball).

25. T. Ricardo Quesada; $1,800,000; T. Richard Quesada; Council meeting on 12-17-84; acquisition and rehabilitation of Roberts Office Supply building located at 44-50 Free Street.

26. Court Square Professional Building; $3,250,000; Council meeting on 12-17-84; Ronald C. Coffin, owner; financing a portion of the costs of acquiring and rehabilitating the Court Square Professional Building located at 145-155 Middle Street and 68-84 Pearl Street.

27. Pine Tree Paper, Inc.; $750,000; Council meeting on 12-17-84; principals are James Tarsetti and Nicholas Alfiero; acquisition of land, construction of a new warehouse and distribution facility - 20,000 sq. ft. in size at 629 Warren Avenue.

28. Dr. J. Michael Taylor and Dr. Mary Morse; $700,000; Council meeting on 1-21-85; acquisition of fire station (1906 Portland Fire Barn) on Park Avenue and convert it to a medical office building.

29. Gowen Marine; $2,500,000; Council meeting on 1-21-85; Joseph Schmader, President, rehabilitate and construct new facilities on Berlin Mills Wharf at 400 Commercial Street.

30. Murray, Plumb & Murray Associates; $2,900,000; primary partners are Peter L. Murray, Peter S. Plumb, E. Stephen Murray, John C. Lightbody, and Ellyn C. Ballou; acquisition and rehabilitation of former Woodman Building (F. O. Bailey) located at the corner of Pear and Middle Streets.

31. 245 Commercial Street Partners; $3,500,000; Council meeting on 2-4-85; Drummond, Woodsum, Plimpton & MacMahon, P.A. (David Batement of Dictar Associtės is the development consultant); acquisition and rehabilitation of two buildings located at 245-251 Commercial Street.

32. Gendron Brothers Associates; $900,000; Council meeting on 3-4-85; John Gendron; acquisition and rehabilitation of the building known as 4 Moulton Street located at the corner of Moulton Street and Commercial Street.

33. Walch Properties, Inc.; $500,000; Council meeting on 3-17-85; J. Weston Walch; expansion of facility on Valley Street.

34. J. E. Goold, Inc.; $750,000; Council meeting of April 1, 1985; William G. Waldron and Dorothy Waldron Fox; expansion of facility at Riverside Industrial Parkway and for acquisition of equipment for such facility.

35. Hobson's WharfCorproation; $1,150,000; Council meeting of 4-17-85; Edward Bradley, Jr., Esq., representing various fishermen; acquisition and rehabilitation of pier for fishing vessel berthing.

36. One Franklin Place Trust; $4,000,000; Council meeting of 4-17-85; Michael Marino, Richard Marino, Norman Reef; acquisition and rehabilitation of the former Galt Block warehouse on the corner of Commercial Street and Franklin Street Arterial.

37. Frye Associates; $900,000; Council meeting in May 1985; James M. Ross, Richard Goduti, Stephen T. Thomas; acquisition and rehabilitation of the Frye Block Building located at 116 Free Street.

38. Splice Tech, Inc.; $400,000; Council meeting of 5-20-85; Keith Barrows; acquisition of lots 8 and 9 in Evergreen Industrial Park in Portland and construct facilities thereon.

39. East Deering Housing Associates; $5,965,00; Council meeting of 5-20-85; General Partner is Foreside Housing Corporation, which is wholly owned subsidiary of Housing Resources Corporation. Housing Resources is owned and controlled by Lyndel J. Wishcamper. Funding for a residential complex containing 115 units of rental housing on Canco Road.

40. St. John Street Realty; $2,200,000; Council meeting of 7-1 85; Joseph Boulos; acquisition, construction, and equipping a warehouse and showroom facility for use by the Westco Corporation (Johnson Supply Co.).

41. Maine Beverage Container Services, Inc.; $1,500,000; Council Meeting of September 18, 1985; Joseph Bourque, Bernard Runser, Joseph Mokarzel, Frank Nappi, and Nicholas Nappi; acquire land and construct a 20,000 sq. ft. recycling facility on Rand Avenue Ext.

42. Two-Twenty-Two Associates; $3,500,000; Council Meeting of October 21, 1985; General Partners are John Menario, Joel Russ, and Michael O'Sullivan; Acquire, Renovate, and Rehabilitate buildings located at 222-242 St. John Street — the former Maine Central Railroad office building.

43. Hangar Associates; $950,000; Council meeting of December 16, 1985; Bar Harbor Airlines — Allyn Caruso; Construction of an airplane hangar and office building and related property at the Portland Jetport.

44. Nappi Distributors; $4,000,000; Council meeting of December 16, 1985; Frank Nappi, Nicholas Nappi; acquisition of land and construction and equipping of a new warehouse and distribution facility in an industrial park off Rand Road being developed by Presumpscot Associates.

45. Young's Furniture; $700,000; Council meeting of December 16, 1985; Jonathan B. Young and Stephen E. Young; acquisition, renovation, and rehabilitation of certain buildings at 525 Forest Avenue in Portland and for the acquisition of certain equipment to be used in connection therewith.

46. Bandon Associates; $1,600,000; Council meeting of December 16, 1985; Roger Kringen, Ronald Nishimura, John Telling, and Pritham Singh; acquisition, construction, and equipping an office condominium unit or units located in the Storer Brothers building, so-called, at 148 Middle Street.

47. Portland Venture Partners; $350,000; Council meeting of December 16, 1985; Michael Mastronardi and Richard McGoldrick; acquisition and rehabilitation of the building located at 148 Middle Street, which building is over 50 years old.

48. Portland Venture Partners; $900,000; Council meeting of December 16, 1985; Michael Mastronardi and Richard McGoldrick; acquisition ahd rehabilitation of the building located at 343 Forest Avenue, which building is over 50 years old.

Enclosure A

1985 INDUSTRIAL DEVELOPMENT BOND

STATUS - DECEMBER 6, 1985

TOTAL STATE CAPACITY $200,000,000

Small Issues By Municipality

Volume		
15	Portland	$ 25,546,000
3	Biddeford	3,250,000
1	Winthrop	325,000
7	Westbrook	4,590,000
7	Auburn	5,160,000
1	Scarborough	600,000
1	Hancock	825,000
1	Easton	5,500,000
3	Bangor	2,586,500
1	So. Portland	1,000,000
1	Boothbay	600,000
1	Winslow	900,000
8	Lewiston	9,475,000
1	Pittsfield	1,200,000
2	Topsham	8,400,000
1	Augusta	900,000
2	FAME	1,014,000
1	York	250,000
1	MHEFA	4,800,000
1	Bridgton	411,365
1	Sanford	820,000
1	Yarmouth	1,100,000
1	Freeport	1,300,000
1	Gorham	600,000
1	Rockland	750,000
61	Total Small Issues Closed (< $10,000,000)	$ 81,902,865

Large Issues

1	Bucksport	$ 65,500,000

Available to December 31, 1985 $ 52,597,135

DSM4/IDBS/dl
120685

Enclosure B

1985 INDUSTRIAL DEVELOPMENT BONDS

PENDING THROUGH DECEMBER 6, 1985

SMALL ISSUES PENDING

Small Issues By Municipality

Volume		
1	FAME	$ 1,900,000
2	Auburn	1,250,000
6	Portland	6,965,000
1	Wells	6,000,000
1	Lyman	700,000
2	Westbrook	4,600,000
1	Poland	1,200,000
1	Brewer	3,000,000
1	Kennebunk	2,000,000
1	Dayton	5,500,000
1	Saco	10,000,000
1	Augusta	500,000
1	Sanford	750,000
2	Scarborough	2,200,000
1	Leeds	800,000
23	Totals	$ 47,365,000

Large Issues

1	RWS	$ 72,000,000
1	PERC	85,200,000
1	Bath/Brunswick	17,000,000
	Subtotal	$174,200,000

Total Pending	$221,365,000

DSM4/IDBP/dl
120685

The CHAIRMAN. Mr. Mayor, would you place any limits on the profits that local governments earn on arbitrage? Because I find a growing resentment on the committee. You are allowed to issue your bonds, and you issue them. You pay less interest on those bonds because they are not taxed. You invest the proceeds in higher yielding bonds earning a profit on it. Many times the bonds are issued long before the money is needed to build the facility. The reason for "early issuance" is for the sole purpose of earning the maximum amount of arbitrage profit. It strikes, I think, many members of the committee that there is a certain unfairness in this.

Mayor CASALE. In some respects, that is true. And although I cannot sit here clearly and articulate all of the provisions of that aspect, I think that my involvement in our community, speaking not from the financial aspect but speaking toward the enrichment or betterment of the communities, is one that—in a public purpose or in a tax-exempt financing plan that has been established by the way that these bonds have been put into effect, I know how it has enriched our community.

Certainly, I am not prepared today to speak to the arbitrage of what you are talking about simply because I am not familiar totally with all the aspects of that provision.

The CHAIRMAN. Thank you.

Senator Mitchell.

Senator MITCHELL. Thank you, Mr. Chairman.

Mayor, thank you for coming down this morning. You mentioned tax increment financing in your statement. Could you give us a little bit more detail on any proposed projects in Portland that may be assisted in that method?

Mayor CASALE. Thank you very much, Mr. Senator. And I certainly will respond to that.

I tried to briefly touch on that in two points. One you picked up on—the tax increment financing. But going back to the specific provision in part of my statement regarding a convention facility in our community, we in Portland—and I am sorry that I did not have time to bring down any pictures today because it is really difficult talking about a part of a city that some of you may not have had the experience of being in. But we have identified an area in our local downtown. We have spent an enormous amount of money with your help trying to rejuvenate and rehabilitate our downtown. And we have identified an area that we feel would be a prime for increment financing that would help build it.

We currently have instituted and negotiated an agreement with a private firm in the city that is willing to consider being a part of that, and that would help us, in fact, build that convention facility. Without this tax increment financing, which by the way we have not ever implemented but we understand through discussions with other cities, States, that they have implemented such structures and conditions as well as contracts and have built a number of facilities in their respective communities, and we feel we can utilize that. However, if it is, indeed, decided by the Congress that they are going to take that provision away, that leaves us excluded. And, quite frankly, with the limitations in the dates that are being talked about, it puts us in a backward position because we just do not know how to step forward because we are stepping back.

Senator MITCHELL. You listed first of the five specific items that you mentioned, the effective date. Do you regard that as the most urgent problem now confronting you?

Mayor CASALE. I do. Sincerely, because what is happening—and I realize—and I want to state quite frankly I realize the tremendous burden that you folks carry. And I know what it is like in my own role on a small scale to be a decisionmaker and how you have to face individuals that you represent in making hard line decisions that are going to benefit, in your opinion, what is going to the betterment of at least 51 percent of the population of the United States.

So I seriously believe that the dates are critically important. I realize the heavy decision that you do have to make, but would hope that somewhere in your thinking that you could find a way to at least phase in those States.

I think that what we need—and I know that it has been talked about for years—that Congress must act on the Federal deficit as it stands right now. However, my feeling is that I believe you folks are going to have to act on it, but I really feel that we need time so that we can use different strategies so that the thinking that I am getting from Washington that we can more or less make it on our own—we have to have time to do that, sir.

Senator MITCHELL. Thank you very much, Mayor, for your testimony.

Mayor CASALE. Thank you.

The CHAIRMAN. Senator Chafee.

Senator CHAFEE. Thank you very much, Mr. Chairman.

And, Mayor, we certainly appreciate you taking the trouble to come down here today.

Obviously, in your city you have used these extensively. The question is: Where do you draw the line?

Now I take it that these that you have listed in your appendix here are all instances of the industrial revenue bonds. That is what the title says.

Mayor CASALE. That is correct, sir.

Senator CHAFEE. And, of course, there is also the opportunity to use the historic tax credits. And I guess that is what you are referring to when you took the rehabilitation investment credit. Is that the historic tax credit that you are referring to?

Mayor CASALE. That is correct.

Senator CHAFEE. But these have specifically used—the ones you have listed, the 150 or whatever it is, 48, are the IRB's, IDB's.

Mayor CASALE. That is correct, sir.

Senator CHAFEE. And in accordance with the 1984 laws, I remember they are sort of mutually exclusive. You cannot use both.

Mayor CASALE. Yes.

Senator CHAFEE. Just take item 28, a couple of doctors who acquired an old fire station and converted it to a medical office building. Is that what you think this is all about? I mean, obviously, if you can have it, that is fine. But would you urge us to continue using tax-exempt bonds for something like that?

Mayor CASALE. Let me state, sir, that you would have to step back and follow the process. And I want to state right now that I am proud of my participation regarding what has been going on in our community and how thorough our process is and how very concerned we are to make sure that we follow all the Federal rules, regulations, and guidelines.

And as far as I know, with all the Federal departments, we have been a model city. In fact, we are utilized in that respect.

Senator CHAFEE. Mayor, I am not suggesting that this was not completely aboveboard or anything like that. We are starting at a point now where we have to examine these; we have chosen to examine them.

And as the chairman said, the problem before us is where do we draw the line. Is this truly a governmental purpose to provide a special funding for a medical office building? I guess that is the question.

I do not want to single out those individuals or even this building, but I am talking of that concept.

Mayor CASALE. Sure. Would it be helpful to you to trace the thinking that we went through in the city?

Senator CHAFEE. Sure.

Mayor CASALE. First of all, what we did was we looked at the municipal buildings in and around the city that were not being utilized for any specific purpose. And we decided that some buildings—to try and take care of some of the tax increases that we were facing in our community, we had to take a look at some of the existing buildings. And we have a heritage in our community and a real proven success that we do not tear good, used buildings down.

We issued are RFP on this. And this particular building happens to be located in an area that is close to the medical complex in our community. And, therefore, we received something like three proposals. And these people were selected to do that, selected to be the ones that we would negotiate with to award it to.

Then they followed step E. And you are absolutely correct. In fact, they did choose to utilize the IRB method of financing their construction, the rehabilitation of the building.

I feel in what the undertone I believe we are coming from is where do you draw the line on what public purpose is and how should these bonds be utilized. I agree that there needs to be some tailoring, if I might use that word. I do not know how that is structured because I really have not thought of it on a local level.

We have been just dealing with the tools that you provide us with to go forward. But I agree that either the Treasury Department or some agency has to come out with clear and articulate rules of how these funds can be appropriated.

Now what that formula is, I do not have a handle on right now. But I certainly would be willing to make myself and my staff available to talk about this issue.

Senator CHAFEE. Well, I can clearly see that if it is available you might as well use it. And I take it that these have been used extensively, obviously, in your community.

I think you would probably agree with me that it would be hard to say that all of these folks would fail to have gone ahead but for IDB's.

Mayor CASALE. That is correct.

Senator CHAFEE. I mean they are there and you might as well use them and get less expensive financing.

Mayor CASALE. That is correct.

Senator CHAFEE. And you have had a well-organized system, obviously, to encourage or assist purchases, and, therefore, this is the result, which is fine.

What is your answer to the question: How many of these people do you think would have not located in your city but for the existence of IRB's?

Mayor CASALE. I believe that a majority of them would not have located. And if you would take a look at it, sir, we have been very careful. Most of these have been used to expand businesses in our community. I think there are relatively very few that have moved from other communities.

Senator CHAFEE. My time is up, but let me ask you one quick question. Do you turn many people down?

Mayor CASALE. Yes, sir. I would not say that we have turned many people down, but there was one specific IRB that came forward that the council did have trouble with, and, in fact, rescinded the IRB application simply because we felt that they had gone beyond the scope of the limits that were given to us with which to issue the bonds.

Senator CHAFEE. Thank you very much.

Mayor CASALE. Thank you.

Senator CHAFEE. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Chafee.

Senator Moynihan.

Senator MOYNIHAN. I have no questions, Mr. Chairman.

But I thank the good mayor for his good testimony, and it registered very well with me.

Mayor CASALE. Thank you. I am delighted to sit in front of all of you. This is the first time that I have had an experience to come to Washington to testify before such a prestigious committee. And I am delighted to be here. And certainly I welcome all of you to come to the city of Portland so that you can see what we have done with the tools that you have given us.

I know Senator Mitchell has been a few times, and has even made it to my joy once or twice.

The CHAIRMAN. I would echo what Senator Chafee said. I have been in your town several times over the past 2 or 3 years, and you have done an extraordinary job.

Mayor CASALE. Thank you very much, sir.

The CHAIRMAN. Any questions, Senator Grassley?

Senator GRASSLEY. No; I have no questions, Mr. Chairman.

The CHAIRMAN. Mr. Mayor, thank you very much for joining us.

Mayor CASALE. Thank you very much, sir.

Senator CHAFEE. Was the railroad station done under these? I know the railroad station has been done over.

Mayor CASALE. The railroad station, Union Station are you talking about?

Senator CHAFEE. Yes.

Mayor CASALE. What has happened is that unfortunately if—how long ago did you live in the community, sir?

Senator CHAFEE. Well, I will not get into that. [Laughter.]

Mayor CASALE. The railroad station is long gone, but what has happened——

Senator CHAFEE. I thought down in that area they redid it in some way.

Mayor CASALE. They have done it in a way that was probably found unfavorable with most of the majority of the citizens in the community.

The CHAIRMAN. Mr. Mayor, thank you very much.

Mayor CASALE. Thank you, Mr. Chairman.

The CHAIRMAN. We will conclude today with Vincent Sombrotto, the chairman of the Fund for Assuring an Independent Retirement and also the president of the National Association of Letter Carriers; and he is accompanied by Tom Griffith, the president of the National Rural Letter Carriers Association.

Gentlemen, good to see you.

STATEMENT OF MR. VINCENT R. SOMBROTTO, CHAIRMAN, FUND FOR ASSURING AN INDEPENDENT RETIREMENT, AND PRESIDENT, NATIONAL ASSOCIATION OF LETTER CARRIERS, WASHINGTON, D.C., ACCOMPANIED BY TOM W. GRIFFITH, PRESIDENT, NATIONAL RURAL LETTER CARRIERS ASSOCIATION, ALEXANDRIA, VA

Mr. SOMBROTTO. Thank you, Mr. Chairman.

I have just a short statment. Mr. Chairman, and members of the committee, my name is Vincent Sombrotto, chairman of FAIR [Fund for Assuring an Independent Retirement].

I am pleased to be here today on behalf of FAIR, a coalition of 28 organizations representing all active and retired Federal and postal employees, a number in excess of 2 million. As was earlier indicated, I am also president of the National Association of Letter Carriers, whose membership totals 277,000 active and retired.

I appreciate this opportunity to appear before the committee to express our views on the proposal to immediately tax Federal annuities. I want to underscore at the outset this immediate taxation not only affects Federal employees but all public employees, including teachers, policemen, firemen, and most private sector employees, who contribute to their own retirement.

FAIR organizations oppose this provision for several reasons. First, these employees have made long-range financial plans based on the assumption of the 3-year recovery rule. Changing the Tax Code would occur at a most difficult time—time of retirement, when income suddenly drops, and they must adjust their plans accordingly.

For instance, we calculate a retiree with a $13,000 annuity would pay over $1,000 in additional unplanned taxes in the first 18 months of retirement under this provision.

Second, Federal employees have been encouraged by the U.S. Government to plan their retirement based on buying Government bonds, which mature during the first 3 years of retirement. As you know, Government employees are the biggest purchasers of Government bonds. And even as the House of Representatives voted to take away the rule of three, the Government was still encouraging employees to buy bonds based on this provision, something that we as leaders in our respective organizations encourage our members to do, and that is to buy Government bonds. There is no better security than to invest in one's own government.

This 3-year recovery rule was originally enacted for tax simplification process. Since the main thrust of tax reform is simplification, eliminating the rule of three will result in tax complications.

Three, a change in the tax status of Federal annuities will cause a significant number of Federal workers in key positions, workers who had not planned to retire but are eligible to retire, to leave Government service.

For example, in surveys of Federal employees such as air traffic controllers, meat inspectors, IRS employees, and foreign service officers, over 55 percent of them eligible to retire said that they would retire if this provision was enacted.

This would have a devastating effect on that vital services that Government provides. In the case of air traffic controllers—and we know what that situation is—for example, if over 57 percent who are eligible to retire, it would be impossible to find qualified, experienced replacements in a short period of time.

In addition, increased retirements would cost the Government more money in retirement outlays, and there will be an increased cost for recruitment and training of new employees.

Last, under current law, the Government gets a very good deal. Taxes are levied on income which employees do not even begin to receive for decades. The Government has full use of these revenues throughout that period, and they immediately are deposited in the general fund. Unlike tax deferred retirement income, which the committee will undoubtedly examine, the current situation for Federal employees and others is immediate taxation on deferred income. While employees willingly accept this immediate taxation on deferred income, we oppose a further deferral on already taxed dollars far beyond retirement.

Therefore, Mr. Chairman, I ask you and the members of this committee to consider this issue carefully and support continuation of the 3-year recovery rule in your tax simplification bill.

I would be delighted to answer and respond to any questions.

[The prepared written statement of Mr. Sombrotto follows:]

FUND FOR ASSURING AN INDEPENDENT RETIREMENT

TESTIMONY

OF

VINCENT R. SOMBROTTO, CHAIR

FUND FOR ASSURING AN INDEPENDENT RETIREMENT

BEFORE THE

SENATE COMMITTEE ON FINANCE

ON

IMMEDIATE TAXATION OF FEDERAL AND POSTAL ANNUITIES

March 4, 1986

100 INDIANA AVENUE, N.W., ROOM 813 • WASHINGTON, D.C. 20001 • (202) 393-4695

Mr. Chairman, Members of the Committee: My name is Vincent Sombrotto, Chairman of FAIR, Fund for Assuring an Independent Retirement. I am pleased to be here today on behalf of FAIR, a coalition of 28 organizations representing all active and retired federal and postal employees.

I appreciate this opportunity to appear before the Committee to express our views on the proposal to immediately tax federal annuities. I want to underscore at the outset this immediate taxation not only affects federal employees but all public employees including teachers, policemen, and firemen and most private sector employees who contribute to their own retirement.

FAIR organizations oppose this provision for several reasons. First, these employees have made long-range financial plans based on the assumption of the three year recovery rule. Changing the tax code would occur at the most difficult time--the time of retirement--when income suddenly drops and they must adjust their plans accordingly. For instance, we calculate a retiree with a $13,000 annuity would pay over $1,000 in additional, unplanned taxes in the first 18 months of retirement under this provision.

Second, federal employees have been encouraged by the U.S. government to plan their retirement based on buying government bonds which mature during the first three years of retirement. As you know, government employees are the biggest purchasers of government bonds and even as the House of Representatives voted to take away the rule of three, the government was still encouraging employees to buy bonds based on this provision. This three year recovery rule orginally was enacted for tax simplification purposes. Since the main thrust of tax reform is simplification eliminating the rule of three will result in tax complication.

Three, a change in the tax status of federal annuities will cause a significant number of federal workers in key positions, workers who have not planned to retire, but who are eligible to retire, to leave government service. For example, in surveys of federal employees such as air traffic controllers, meat inspectors, IRS employees, and foreign service officers over 57% of them eligible to retire said they would retire if this provision was enacted. This would have a devastating effect on the vital services government provides. In the case of air traffic controllers, for example, if over 57% who are eligible retired, it would be impossible to find qualified, experienced replacements in a short period of time. In addition, increased retirements will cost the government more money in retirement outlays and there will be increased costs for recruitment and training of new employees.

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Therefore, Mr. Chairman, I ask you and the Members of this Committee to consider this issue carefully and support continuation of the three year recovery rule in your tax simplification bill. I would be happy to answer any questions.

The CHAIRMAN. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

I want to say that I think Mr. Sombrotto makes a good point here. I have been visited by Federal employees in my State, and they have made plans based on the existing rules, as Mr. Sombrotto says in his first point. In other words, they know that during the first 3 years of their retirement there will be no taxation on their pension, because that is a recovery of what they have contributed. This is unlike the normal plan of somebody who works for General Motors and who is not contributing to his or her plan.

So in that first 3 years when they are not going to be taxed on their pensions because they are just recovering what they have contributed, they have, as Mr. Sombrotto says, planned to cash in various bonds or take capital gains or whatever.

To change the rules arbitrarily so swiftly, it is just plain unfair. I also think his second point about the retirements is a very, very real one. I guess that is his third point.

Because of the effects of this change on an individual, the person may say the heck with it; it is just not worth it and retire early. I think we are going to lose a lot of valuable people because of this.

Now my question, Mr. Sombrotto, is: What if there was a phase-in? In other words, we said this will not take effect for 10 years or some period. What is your answer to that?

Mr. SOMBROTTO. Well, then we could deal with it 10 years from now.

Senator CHAFEE. No, no; in connection with the legislation we would say 10 years from now this goes into effect so that people would not be caught in this unfair trap that you point out.

Mr. SOMBROTTO. Let me say, absent just the complete deletion from this in the House version, in the Senate version, I guess we would take what would be in that case the lesser of two evils.

But let me hasten to add: This particular provision does not really do too much. I mean you are just taking money at the front end. You are front loading the taxes. And then at the back end you are saying you are going to even it out. It drives one to the morbid conclusion that maybe Government does not want people to live too long, and they want to get the money up front before they leave this.

But it goes beyond that too. Federal, and in my case postal employees and in Tom's case, we pride ourselves of being part of this great community called America. And we have made sacrifices and many, many sacrifices over the years. Retirees have given up cost of living increases; they have been frozen. Now in the Gramm-Rudman-Hollings, they have been taken away from them. We have seen Medicare taxes put upon us where there is no real value to us in the immediate sense.

But we have taken this lashing, particularly from some folks in this administration—and I hasten to add not some folks sitting up there now—and we resent it. We believe in fairness. We believe in our great country and making our contributions to it. And then we see heaped upon us time and again legislation that negatively affects us. And, more importantly, unfair legislation that affects us.

And in this case, there is no reason for this to be in tax reform. We think that the rule of 3 years should be retained.

But directly to answer your question, without that happening, of course, we would look at what other alternatives to what is presently in H.R. 3838.

Senator CHAFEE. Let me ask you one other quick question. It is not directly related to this. What percentage of your retirees or your current active members have Social Security, would you say? First, retirees. I know you do not have an exact percentage, but roughly.

Mr. SOMBROTTO. Well, I could say very shortly all postal employees will have some form of Social Security. The present employees, that is, prior to January 1, 1984——

Senator CHAFEE. Yes; that is what I am talking about. First, take the retirees.

Mr. SOMBROTTO. I do not have a number on that. I would be glad to look it up for you and provide you with it and provide the committee with that information.

Senator CHAFEE. Thank you.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, I would like to thank Vince Sombrotto for bringing this forward. I do not know what this is doing in a tax reform bill. I mean this is a retirement measure, and it has been in place for a long time.

And one of the things that is so troubling about the aspects of this legislation is that suddenly, without warning, change in arrangements that people have counted on for 20 and 30 years of public employment.

One of the problems, I think, Vince, you could speak to is that under the Federal system you become eligible for retirement at 30 years and 55, and so when we get—you mentioned the foreign service officers who go to very dangerous parts of the world and do not always come back or when they come back, they come back in a box not infrequently.

At age 55 they are eligible to retire. When they continue to work, they get their regular pay and lose all their retirement so they are working at half pay practically. And now we want to come along and take even something further away.

Do you not agree that we have kind of a strange system that when you reach some of those highly skilled people, when they have made their way through the system and they are right up at the top,-and the moment they really become invaluable, we start charging them for the privilege of working for the Federal Government. And now we want to say when you retire we are going to tax you in the way—we told you in the last 30 years, we are not going to do.

Isn't that basically what postmasters and foreign service officers and people like that go through?

Mr. SOMBROTTO. Sure, sure.

Senator MOYNIHAN. I see Mr. Griffith is agreeing.

Mr. SOMBROTTO. Certainly. I want to respond just briefly and then I am sure Tom has some things to say.

I hope my members hear me at all times. That is a problem that some of us have.

But let me say that another aspect of this—and certainly the credit should go to the President for alerting citizens in our great

Nation about taxes. And he has pontificated about no need for further taxing of middle-income Americans and most Americans. At least that is what he said.

And here we have a situation where our members who have to toil in one job in excess of 30 years—and may I quickly add that most of them do not retire at age 55. The average is 61. However, they see themselves as being taxed twice—taxed at the point where they are drawing a salary and are working, and then at the moment of retirement under this provision being again taxed for the very same moneys that was put into the public coffers and into the Treasury.

So you can imagine as American citizens they are very, very upset and exercised about this kind of treatment. And we think it is not only unfair but it is unnecessary, as you pointed out, to be in what is "a tax reform bill."

Senator MOYNIHAN. I agree.

Mr. Griffith, did you have some comments from the rural carriers?

Mr. GRIFFITH. I think Mr. Sombrotto has expressed my sentiments very well. I might just underline or emphasize the fact that we also feel that it would be very damaging. It is indicated that probably 60 percent of the people that are presently eligible to retire would probably cut and run if this feature was left in. And it would be a significant drain on those that are in the management positions, the leadership positions, on the experienced and government agencies.

Senator MOYNIHAN. I agree, Mr. Chairman.

And I thank you gentlemen.

The CHAIRMAN. Senator Mitchell.

Senator MITCHELL. Thank you, Mr. Chairman.

Mr. Chairman, may I ask if it is possible for the committee to solicit the written views of the postmaster general on the annuity taxation provision?

The CHAIRMAN. Certainly.

Senator MITCHELL. Thank you. I think that would be very helpful.

Mr. Griffith, I was interested in your very last comment in response to Senator Moynihan's question. What percentage did you indicate of those eligible to retire who would do so if this provision is not changed?

Mr. GRIFFITH. We think that probably 55 to 60 percent of those people that are presently eligible but still working would bail out because of the immediate taxation of the funds so they could go ahead with their retirement plans as they have made them over the last several years.

Senator MITCHELL. Mr. Sombrotto, do you have any comparable estimate?

Mr. SOMBROTTO. Yes; we have done some surveys and Tom is absolutely correct. We arrived at the figure 57 percent, which is exactly or almost exactly between 55 and 60 percent.

Senator MITCHELL. Right.

Mr. SOMBROTTO. But if I may——

Senator MITCHELL. Go ahead.

Mr. SOMBROTTO. One of the problems that will be created because of an exodus such as this of that magnitude—and in the postal service, in my craft, in the letter carrier craft but in the postal service, that means there are about 20,000 people that are eligible. And the quick computation would show somewhere in excess of 11,000 to 12,000 would retire on the basis of that 57 percent.

Throughout the entire governmental service and government itself, if those figures were to be extrapolated, you then create the problem of trying to find replacements, replacements who would be starting out in government service replacing people who have had a long experience and valued experience by people that were inexperienced.

The problem that we are seeing—and it is a disgrace—but the constant attack on big Government. And I don't know what that means, big Government. Does it mean there is a lot of people or the people or very tall like Senator Moynihan that aren't Government or does it mean—is that an attack on individuals in Government? Is that attack on your average letter carrier or your average IRS employee, Social Security employee, people that work in all kinds of government jobs? If it is, then it is a sad commentary.

Our Government and our Nation is great because of our people and because of the kind of institutions we have. And if we keep attacking our institutions, don't we denegrate our own society? I think that that is a sad and serious mistake.

I know it was popular and still is popular to attack the Congress as an institution. I think that is unfair and unjust. We might have differences with various legislators, various members of our Government, but you cannot denegrate the whole system. So we think our folks that are in Government, and particularly I can speak to the people that work in the postal service, they feel that they are set upon unjustly over and over again. And they see these attacks as a positive sign that government, the administration, and the people do not care about them.

And I think that is tragic and it is bad. And it is wrong. And so we would hope that we would put an end to it. This is our Rubicon; we do not want to cross it. This is our line of demarkation. And now we are depending on this prestigious committee to right what has been wrong in H.R. 3838.

Senator MITCHELL. One of the real problems with that is, of course, it comes from the head of the Government. I know of no private organization in the country in which the president of the company regularly gets up and denounces the employees and says that his company is not only part of but is the problem in our society. And the difficulty we have is that the head of the Government is the one who is the source of so much condemnation of the Government and of its employees. It is very destructive of morale as would be the case were any private corporate chief executive to do so.

And that kind of denunciation and criticism is so corrosive to the morale and of those within government and to the standing of Government within our society.

We appreciate your testimony and are aware of the problem and hope that we will be able to deal with it.

Thank you.

Senator MITCHELL. Senator Heinz.

Senator HEINZ. Thank you, Mr. Chairman.

I want to welcome Vince Sombrotto here. It is nice to see him again. He and I have shared many platforms together.

And, Vince, although I was not here, I was in the ante room during your testimony. I am aware of it. And one of the points you make which is, I think, quite important and virtually incontestible, is that if some kind of change isn't made in what the House in H.R. 3838 proposed, we would see a retirement of civil servants, Federal employees; you mentioned air traffic controllers in your testimony on or about July 1 of this year, on or before July 1 of this year, that would make the perennial migrations of the lemmings look rather prothetic. It would be a great tragedy for all of us to lose the quality of civil servants and others that you, I think, quite correctly put your finger on. We would lose some of our best and brightest, most able, most experienced people all because of what would be proposed to be inflicted on them.

Let me ask you this regarding the 3-year rule: You make the point that the recovery provisions help to reduce the tax burden and ease the transition into retirement for Government employees. Other employees do not have this kind of 3-year rule. Is there a reason why government employees need this transition more than other employees who don't have contributory plans?

Mr. SOMBROTTO. Well, only because in most cases—and I don't have the numbers before me—in most cases, those that are beneficiaries of retirement systems don't contribute into those systems. And if they don't contribute into their systems, then they are not taxed on those moneys that go into those systems. Beyond that, those that take IRA's, the taxes are deferred. Those that utilize those type of retirement instruments don't have an immediate tax on the moneys. That, in fact, they get a tax deferral.

Now if the proposed tax reform would then say that the 7 percent or 8.3 percent now that Federal and postal employees pay into retirement and Medicare were to be deferred and would not be taxed at the outset, then, of course, there would be some reason why you would tax their annuities when they receive them after retirement.

But, you see, we get it stuck to us both ways, when we are earning and immediately after retirement under this provision. That is why that was enacted back in the mid-1950's. And I might add in order to simplify taxes.

Senator HEINZ. Well, that is why it was proposed originally.

Mr. SOMBROTTO. That is exactly right.

Senator HEINZ. It was tax simplification. And there is some irony that in the name of legislation which is supposed to make taxes fairer and simpler that we are making the tax system with respect at least to this provision a good deal more complicated.

Now you have indicated a potential way out of the woods here. Let me ask you a question that relates to that, which is: Given the rising expenses that people do incur as they get older, people have less in the way of medical bills at age 65 then they do at 75 or 85 at which point they may encounter serious health care problems for home health care or nursing home care that is nonreimbursed care under Medicare or anybody's health plan, why is it better policy to recover the contributions for your members, for example, to recover their contributions early in retirement, as the 3-year rule permits, when retirees are generally in good health and are likely to have some other earnings, possibly from part-time work, than to spread the taxes or the tax benefits more evenly over retirement?

Mr. SOMBROTTO. Well, I don't think that that is the case. I mean I do not think it is beneficial for someone to pay front loaded. That is to say pay taxes immediately and stretch them out.

Senator HEINZ. I understand that it is not beneficial to front load the tax. Current law front loads the benefit free of tax.

Conceptually one could say, well, what you really want is a provision that is relatively neutral over time because people are going to need the most money as they grow older as opposed to at the moment they retire when they are in relatively good health, their expenses are in pretty good shape, most people have their mortgages pretty well satisfied. And I am just asking the question: Why is that a logical policy basis or not?

Mr. SOMBROTTO. Well, I do not know. You are making a case for it and I disagree with it on the basis of the fact that the individuals——

Senator HEINZ. I am not making a case. I am stating an argument and asking you to respond.

Mr. SOMBROTTO. Well, I am glad to hear you are not making a case. Now we can count you as a possibility to support our proposal when it comes up in the committee.

The point is that most employees have planned on that basis. And then there is a question, as I tried to point out earlier, there is a question of perception. And, in fact, people do not like to get beat up by this Government. And that is what happening. The Federal and postal employees have been targeted and have been scapegoats, and they are getting tired of it. And now they see this as almost a final blow where when we are talking in an era of tax reform, of tax fairness, of tax justification, a provision is put in a tax reform bill that creates an opportunity for what we see as double taxation. And they are just outraged by it. And they say enough is enough; we like the present system; we think it serves us better; we think it serves the Nation better; and we think it should not be tinkered with.

Senator HEINZ. My time has expired but if the chairman would give me 30 seconds to make an observation.

It is this: I suspect this is one of those provisions that, in effect, a repeal of the 3-year rule, you can make all kinds of arguments, theoretical ones, for, including the argument that there will be some revenue gain, which is why the House, I assume, put it in, but which on examination prove to be very hollow arguments. The revenue estimate that Treasury, the Joint Tax Committee, makes really do not take into account human behavior. We have had people say, listen, you can write any tax law you want, but there is no way people who do not want to pay taxes and who were not planning on paying taxes because they were sheltered by present law, there is almost no way you can stop them from getting around the law legally.

And I suspect the revenue estimates that everybody expects or is betting on, the $3 billion or whatever it is, would find that the early retirement of all those people that you mentioned would certain neuter those revenue estimates.

And, second, there is an element of fairness here. When people who have been making plans for the last 2, 3, 5, you name it, number of years suddenly find that someone is changing the rules on them just as they are really getting definite about their retirement plans, it is quite unfair.

And we talked about the irony of the complexity that this introduces. There is also an irony in the lack of fairness it could introduce as well.

Thank you very much.

Mr. SOMBROTTO. Thank you.

Senator CHAFEE. Thank you, Senator Heinz.

Mr. Sombrotto, and Mr. Griffith, we appreciate you coming. Let me just say that I heard over the radio coming in that there is some drug task force that has suggested the way we start to eliminate drugs is to subject all Federal employees to some drug testing. Talk about unfairness in singling out a group. I find that ridiculous, if it is as I understood it.

Now this may be a condensation and so in all fairness I want to say I have not read the report, but to suggest we start by testing all Federal employees as though that is a hot bed of drug use is ridiculous. And if we are going to have testing, well, test everybody. That means General Motors and U.S. Army and the Alaskan Police Force and everybody else. Not just the Federal employees.

So we thank you for coming. And on the basis of that barrage, we will let you go.

Mr. SOMBROTTO. If I may gratuitously, if they keep slamming us around, they are going to drive us to the use of drugs. [Laughter.]

Senator CHAFEE. Well, we do not want that to happen.

Mr. SOMBROTTO. But I do want to, on behalf of my colleague here, Tom Griffith, and all of the members of the FAIR coalition, the 28 members, and all of the members we proudly represent, thank this committee for inviting us to testify. We commiserate with you in the works that you will be doing. We know that the deliberations that you will be going through will have a qreat impact on our Nation, and we just want you to know that we support anything that is good for America that makes us a better and fairer society.

We just think that a thorough examination of this particular provision will drive you to the inevitable conclusion that it is not worthy to be in a tax reform package, and that your recommendation will be to take it out.

Thank you very much.

Senator CHAFEE. Thank you very much.

[Whereupon, at 11:11 a.m., the hearing was concluded.]

TESTIMONY OF SENATOR DENNIS DeCONCINI (D-Ariz.)

CHAIRMAN, NATIONAL WATER ALLIANCE

SUBMITTED TO THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

MARCH 17, 1986

The National Water Alliance appreciates the opportunity to share our concerns with the Senate Finance Committee about the impact of federal tax policy on the nation's water resources.

We believe that the current consideration of changes to the federal tax code must include consideration of this nation's ability to maintain and deliver a safe and reliable supply of water. Our belief is founded in our concern for American citizens -- for public health, for economic strength, and for the wise use of the American taxpayers' resources.

Just over two years ago, I founded the National Water Alliance with the assistance of some Congressional colleagues who shared my concern for the nation's most precious natural resource -- water. Senators Durenberger, Dole and Moynihan, and Representatives Roe, Foley, Hammerschmidt and Wright join me on the Executive Committee of the Alliance, representing varying regions, political parties, and perspectives on water issues. They too see the value of a non-governmental forum for the development of integrated water policies and public education in this area. We are joined by twenty-two Board members representing the diverse Alliance membership at large -- from business, labor, state and local government, environmentalists, academia, trade associations, engineers, and concerned individuals.

The National Water Alliance has developed a consensus expressed in National Water Alliance "Policy Statement III" (attached for the record) which is based on the widespread and sincere interests of a broad spectrum of National Water Alliance members, participants in our national public conference in September 1985, and other concerned members of the water community and the public at large. The unique quality of the National Water Alliance -- as a forum for policy deliberations outside of government including this diverse expertise, knowledge, and concern -- presents you with valuable insight and contributions to the current tax policy deliberations.

Senator DeConcini -- Page Two

Early in 1985, we created four Member Task Forces based on member priorities, including the Task Force on Infrastructure Finance and Development. This Task Force focuses on the nation's water-related infrastructure needs, rapidly outpacing the nation's ability to meet those needs. Their focus on federal tax policy evolved from the recognition of this fiscal shortfall: one, the decrease in federal funding capability while federal mandates to provide safe and reliable water remain; and two, the decrease in state and local funding capability while policy shifts limit the options to implement innovative, professional financial solutions.

As federal tax reform proposals develop, we offer a vital perspective on the intimate relationship between federal tax policy and the ability to meet the nation's water needs. It is not always the case that Congressional deliberations successfully integrate such inter-related policy areas -- in this case tax policy with water policy. That integration is critical at this time.

The National Water Alliance Task Force on Infrastructure Finance and Development presented the Board of Directors with a thorough, well-balanced set of recommendations specific to this objective. We extend appreciation to those dedicated members. The breadth of leadership in the Alliance developed a concise, conceptual Policy Statement (see attached) adopted unanimously in January 1986 by the full Board of Directors, including the Executive Committee, outlining the salient points as a valuable skeleton for Congressional considerations.

On behalf of the Board of Directors and entire membership of the National Water Alliance, I thank the members of the Committee for the opportunity to provide testimony, commend you for your leadership, and look forward to your continued wisdom and dedication in the challenges ahead.

/Attached "Policy Statement III" to be inserted for the record./

NATIONAL WATER ALLIANCE

POLICY STATEMENT III

Supporting Provisions of Federal Tax Policy Impacting the Ability of State and Local Governments to Meet Water-Related Infrastructure Needs

PUBLISHED: January, 1986

DENNIS DeCONCINI	DAVE DURENBERGER	ROBERT ROE
U.S. Senator	U.S. Senator	U.S. Representative
Chairman	Co-Chairman	Co-Chairman

James J. Magner
Executive Director

Joan M. Kovalic
Secretary

NATIONAL WATER ALLIANCE

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NATIONAL WATER ALLIANCE

LETTER from the CO-CHAIRS

We believe the current consideration of changes to the federal tax code must include a consideration of this nation's ability to maintain and deliver a safe and reliable supply of water. We are pleased to present the National Water Alliance 'Policy Statement III' in support of federal tax policy provisions impacting the nation's ability to provide needed water-related facilities and structures.

'Policy Statement III' represents one recommendation of the NWA. The Policy Statement is based on the recommendations of the NWA Task Force on Infrastructure Finance and Development, meetings thereof, and relevant sessions of the September 18-20, 1985 NWA Conference, 'Water Policy: 1985'. This Policy Statement supports the positive impact of current federal tax policy provisions on the ability of state and local governments, and their private sector partners in many instances, to meet their responsibilities for adequate water-related infrastructure necessary to the nation's economy and public health.

The additional 'Position Statement' was approved in a 'Sense of the Board' resolution by unanimous vote of the NWA Board of Directors at the October 9, 1985 Board meeting. It includes specific recommendations of the Task Force members. The Position Statement serves as an illustration of representative actions which could be taken in implementation of the Policy Statement.

It is intended that 'Policy Statement III' will encourage full consideration of the policy implications of federal tax provisions for the reasonable and effective financing of needed water-related infrastructure. At a time of restricted federal funding capabilities and looming capital shortfalls, the judicious use of the federal tax code may provide a cost-effective means to direct financial resources to priority water-related infrastructure needs.

On behalf of the Board of Directors, we extend our appreciation to the Task Force on Infrastructure Finance and Development, the Ad Hoc Task Force on Tax Policy, all National Water Alliance members, and the Executive Advisory Committee members who have provided guidance, expertise and support for the development of these Policy and Position statements.

DENNIS DeCONCINI	DAVE DURENBERGER	ROBERT ROE
U.S. Senator	U.S. Senator	U.S. Representative
Chairman	Co-Chairman	Co-Chairman

NATIONAL WATER ALLIANCE

POLICY STATEMENT III

SUPPORTING PROVISIONS of FEDERAL TAX POLICY IMPACTING the ABILITY of STATE and LOCAL GOVERNMENTS to MEET WATER-RELATED INFRASTRUCTURE NEEDS

WHEREAS, THE NATIONAL WATER ALLIANCE recognizes that the development of the nation's water-related infrastructure is not keeping pace with the nation's need for adequate supplies of clean and usable water; and the nation's investment in capital facilities has decreased significantly over the past two decades, while the needs of a growing population and economy have increased; and

WHEREAS, the Alliance further recognizes that while federal involvement in the provision of needed water-related infrastructure has declined, the needs as propounded by federal regulations have increased; and the delegation of responsibility to state and local governments results in serious financial shortfalls in meeting these needs in the areas of water supply, wastewater treatment, solid waste disposal/resource recovery, and other water-related infrastructure; and

WHEREAS, the Alliance further recognizes that federal funds and other resources should be used in the most efficient manner possible to meet water-related infrastructure needs; and the efficiencies of leveraging federal tax incentives can lead to the most positive impact for each dollar spent by all sectors, and in the end by the user; and

WHEREAS, the Alliance further recognizes that federal tax incentives are in effect federal expenditures, and that the use thereof to finance or to encourage the financing of water-related infrastructure should be recognized as such; and policy implications and priorities should be thoroughly assessed in the development of federal tax policy; and

WHEREAS, the Alliance further recognizes that the public sector maintains the ultimate responsibility for these needs to protect public health and promote economic growth; and as a result, this statement does not discount the valid purpose of direct federal grants and other forms of assistance to meet these needs in the many instances where the local tax base is inadequate and the necessary incentive for privatization success does not exist; and rural and low-income areas face particularly severe financial shortfalls in the provision of water-related services; and

WHEREAS, the Alliance further recognizes that of critical impact are several provisions of federal tax policy which are fundamental to the ability of state and local governments to issue tax-exempt bonds for infrastructure financing; and

WHEREAS, the Alliance further recognizes that through long-standing federal tax policy provisions, state and local governments have looked increasingly to the private sector to assist successfully in the provision of needed public services; and the innovative process of privatization is to a great extent reliant upon certain tax incentives provided by the federal government; and

WHEREAS, the Alliance further recognizes that without many current federal tax policy provisions, the ability of the public sector and the private sector to provide essential public services would be weakened if not negated; and

WHEREAS, the Alliance further recognizes that state and local governments, and their private sector partners, require stability and predictability in order to adequately plan for capital needs;

THE NATIONAL WATER ALLIANCE hereby urges increased recognition that several provisions of current federal tax policy are vital to the ability of state and local governments to meet water-related infrastructure needs, and furthermore urges consistency in federal tax policy, and federal water policies.

NATIONAL WATER ALLIANCE

POSITION STATEMENT

IN SUPPORT of NWA POLICY STATEMENT III
SUPPORTING PROVISIONS of FEDERAL TAX POLICY
IMPACTING the ABILITY of STATE and LOCAL GOVERNMENTS
to MEET WATER-RELATED INFRASTRUCTURE NEEDS

Approved as a 'Sense of the Board' resolution
by the Board of Directors on October 9, 1985.

PURPOSE:

This statement of the National Water Alliance Infrastructure Finance and Development Task Force recommends that the Board of Directors adopt a policy position in support of federal tax laws and regulations which allow state and local governments to meet water-related infrastructure needs.

Based on the year's meetings and policy discussions of the Task Force, and on the National Water Alliance September 18-20, 1985 conference sessions on infrastructure finance and development, this statement has been drafted reflecting the general consensus among members and guests during deliberations over the role of the federal government in the provision of needed water-related infrastructure, and particularly over federal tax policy impacting the ability of state and local governments to meet their responsibilities in this area. The consensus is based on an open process incorporating the views and suggestions of a broad spectrum of participants in the Task Force, the recent NWA national conference, and general public debate.

BACKGROUND:

The Infrastructure Finance and Development Task Force and the relevant sessions of the National Water Alliance conference, 'Water Policy: 1985', September 18-20, 1985, have focused on federal tax policy and its impact on the ability of state and local governments to fulfill their responsibilities to meet the serious and increasing infrastructure needs across the country.

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The Need

The development of the nation's water infrastructure is not keeping pace with the nation's need for clean and usable water. Water is required for everyday household use, almost all manufacturing processes, energy development, agricultural production, mineral development, and transportation. All of these uses depend upon well-managed and efficient infrastructure. Even with a sufficient quantity of clean water, the nation's deteriorating supply systems threaten to prevent its use. The need for new and rehabilitated water and wastewater treatment facilities is ever-increasing as the nation grows. The costs to maintain the necessary infrastructure represent more than mere current expenses, but an investment.

The nation's investment in capital facilities has decreased by 30 percent in the last two decades, according to the Private Sector Advisory Panel on Infrastructure Financing. Infrastructure investment was occurring at a rate of 3.5 percent of the gross national product (GNP) twenty years ago, compared to 2 percent today.

Infrastructure needs, including those for water, are vast, serious, and increasing, with significant fiscal implications. The overall infrastructure needs in this country through the year 2000 are estimated as high as $3 trillion. A recent study reported to the Joint Economic Committee (JEC) of Congress found just over $1 trillion in needs for the same period, and a $443 billion shortfall following current policy. Needs directly related to water reported to the JEC amount to $265 billion with a $90 billion shortfall.

State and local governments face these mounting needs from an increasingly precarious position. Traditional federal financial support is dwindling in light of high federal deficits. At the same time, federal requirements for water-related infrastructure remain steady. The resultant fiscal shortfall weakens the ability of state and local governments to meet their responsibilities.

It is recognized that the public sector maintains the ultimate responsibility for these needs to protect public health and promote economic growth. As a result, this statement does not discount the valid purpose of direct federal grants and other forms of assistance to meet these needs in the many instances where the local tax base is inadequate and the necessary incentive for privatization success does not exist. Rural and low-income areas face particularly severe financial shortfalls in the provision of water-related services.

State and Local Options and the Federal Role

In a broad sense, the Task Force focus on tax policy results from this growing awareness that while the federal government role in the provision of needed water infrastructure is reduced, its role as regulator to require that these needs be met is maintained. State and local governments are burdened with increased responsibility in developing water supply and financing infrastructure needs, while federal assistance, both direct and indirect, has decreased.

Given that situation, the preservation of certain tax provisions, as well as privatization, provide options to state and local governments seeking to finance water supply and wastewater treatment needs. In many cases, certain forms of tax-exempt financing and privatization can ameliorate the serious shortfall in financial capabilities at the state and local levels.

Federal Tax Policy

These broad concerns brought the Task Force to focus more specifically on recent policy proposals which would further weaken the federal role in infrastructure development -- tax reform proposals. Contained in these proposals are several provisions impacting the ability of state and local governments to issue tax-exempt bonds for infrastructure financing. In addition, through long-standing federal tax policy provisions, state and local governments have looked increasingly to the private sector to assist in the provision of needed public services. This privatization has proven successful in many instances including water-related facilities. The innovative process, however, is heavily reliant upon certain tax incentives provided by the federal government. Without current tax policy provisions, the ability of the public sector and the private sector to provide essential public services would be weakened if not negated.

Moreover, the tax provisions directly affecting the ability of state and local governments to use tax-exempt financing to meet infrastructure needs are critical. Specifically, these include advance refunding provisions, the retaining of investment earnings (arbitrage), the allowance of bank costs for providing and carrying municipal bonds as deductible expenses, and the redefinition of governmental bonds.

In combination, these provisions of the federal tax code are essential to the ability of state and local governments to provide needed infrastructure. In addition, consistency in federal tax policy is needed. State and local governments require stability and predictability in order to adequately plan for capital needs.

Revenue Impact

The Task Force recognizes that the ultimate bearer of costs is the American user of water-related services, whether by user fees, state and local taxes, or federal income tax. With this in mind, the most efficient and equitable use of this resource must be sought. State and local governments have increased efficiency in their use of available funds, including federal grants, tax-exempt financing, and private sector partnerships. This can continue most effectively through stable federal policy allowing capital planning, and through private sector assistance.

Recent successes with privatization constitute a particular case for the continuation of current federal tax policy. A recent study by deSeve Economics, Inc. surveyed current and currently planned privatization projects in the water-related services of water supply, wastewater treatment, and solid waste disposal/resource recovery. Based on this survey, they concluded that the revenue foregone by the U. S. Treasury by privatization under current tax provisions for the preservation of tax-exempt financing, transitional rules of depreciation, and CCRS Class 4 (as outlined in the President's May 28, 1985 tax proposals) for equipment in water-related facilities would be $100 million over the next five years -- a small amount relative to the billions of dollars in other tax expenditures and in direct federal assistance in these areas.

Furthermore, this impact is incalculably lessened by the positive revenue impact of such projects, by the leveraging impact on state and local government borrowing abilities, and by the efficiencies of the private sector involvement.

In short, the Task Force believes that the current provisions of the federal tax code provide significant efficiency and equity to the American taxpayer.

TASK FORCE RECOMMENDATIONS:

The following Task Force recommendations were included as possible considerations by Congress in the implementation of the Policy Position:

1. Tax-exempt financing, including the use of industrial development bonds (IDBs) for essential public purposes should be continued for facilities, publicly or privately owned or operated, when the specific purpose of such facilities is water supply, sewage and water treatment, hydropower used for financial support for water supply projects, or solid waste disposal/resource recovery.

2. Reasonable transition rules should be provided that recognize the long lead times associated with these facilities, and should include a full investment tax credit for projects where construction has begun or a binding contract has been entered into within six years of January 1, 1986, and a subsequent phase-out period.

3. All equipment in such facilities (other than structures and turbines) should be placed in CCRS Class 4 or equivalent.

4. Existing tax provisions concerning public purpose (i.e., non-IDB) bond refundings, arbitrage earnings, and the deductibility of bank costs for providing and carrying municipal bonds should continue to be applied to bonds issued for public purpose infrastructure facilities.

NWA INFRASTRUCTURE FINANCE & DEVELOPMENT TASK FORCE
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STATEMENT BY

KENNETH T. BLAYLOCK
NATIONAL PRESIDENT

AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES
(AFL-CIO)

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ON

TAX REFORM ACT OF 1986

MARCH 4, 1986

I appreciate this opportunity to appear before the Committee to express AFGE's views on the proposal to eliminate the so-called three-year rule provided by Section 72(d)(1) of the Code.

We recognize that this proposal not only affects federal employees, but all public employees including teachers, policemen and firefighters, as well as other private sector employees who have contributed toward their retirement annuities. But it is particularly inequitable in its applicability to employees under the Civil Service Retirement System. Unlike the contributions toward annuities made by other employees, the contributions made by federal employees are deposited in the general fund of the U.S. Treasury. Thus, the government has the immediate, full use of those revenues as well as receiving the income taxes which are levied each year on the contributions as a part of the employee's gross income. Federal employees, on the other hand, <u>must</u> participate in the retirement system; <u>must</u> pay income tax currently on the required contribution of 7 percent of their salaries; cannot withdraw their contributions prior to retirement unless they resign from government service; and, if they do resign and withdraw their contributions in a lump sum, no interest is paid to them for the period of time the government has held and used their monies. At the very least, the three-year recovery rule negates some of this inequity.

AFGE opposes the elimination of this provision for several other reasons. First, employees have made long-range financial plans based on the provisions of the three-year recovery rule. Eliminating this provision now would impact on those employees at a most critical time--the time of retirement, when income suddenly drops. For instance, a retiree with a $13,000 annuity would have to pay over $1,000 in unplanned taxes in the first year of retirement under this provision. Obviously, in the short run, this produces some revenue. But the amount is relatively small, and its effect will be negated as tax revenues are lost on the return of contributions paid in later years. This temporary shot in the arm is simply not justified.

Second, the proposal would be particularly onerous in the case of survivors. Under S.72(d), if an employee dies before he receives his contributions, then the three-year rule is applicable to his survivors. There are many cases where an employee dies leaving an unemployed surviving spouse, perhaps with college-aged children. The survivor is faced with not only the loss of a loved one, but also with the financial spectre of running the household on approximately 1/4 to 1/3 of the deceased employee's income. The three-year rule provides some relief and permits a period of recovery.

Finally, we think this Committee should recognize the severe personnel implications of this tax change. Many agencies have up to 40 percent of their personnel eligible for retirement. Informal surveys show that if this tax change is enacted, up to about 80 percent of those eligible for retirement will retire. This massive exodus of the most senior personnel within the range of government agencies will leave these agencies virtually dysfunctional. The cost to the government of this exodus would continue to be paid for years.

Before closing, we want to bring to the forefront the larger issue of revenue neutrality. There is a virtual consensus in this country that the massive federal deficit is causing both short-term and long-term disruption to our economy. The budget deficit, which exploded from $40 billion in FY 1979 to over $200 billion in the last two years, has adversely affected interest rates, exchange rates, investment, the trade balance, and threatens the long-term viability of the United States as a world industrial power. Over the past four years, the Administration, with varying degrees of success, has used the budget deficit as a bledgeon to beat down the domestic side of the budget.

In this context, it seems imcomprehensible to undertake a major restructuring of the U.S. tax system without addressing the major failing of the existing tax system--namely, its failure to provide suficient revenue to fund the essential government programs that the American people need, deserve, and want.

The failure of our tax system to meet its fundamental purpose is clear. (In looking at outlays and revenues, the most appropriate economic frame of reference is as a percent of GNP, which is used here.) General revenues (net of Social Security and Medicare) dropped from 16.1 percent of GNP in 1960 to 12.6 percent in 1986. Over the same period, outlays increased only slightly, from 15.9 percent in 1960 to 17.6 percent in 1986. The long-term trends were sharply accelerated by the fiscal policy adopted in 1981. Since 1981, General revenues dropped by a full two percentage points of GNP while defense spending increased 1.2 percent. Because of these two trends, net interest went up an additional 1 percent. Domestic spending, far from being the "cause" of the deficit, actually dropped by 1.3 percent.

Corporate taxes, in paticular, have fallen dramatically. In 1981, the largest corporate tax reduction in history was enacted. By FY 1983, corporate income taxes had fallen to the lowest level in inflation-adjusted dollars since before Pearl Harbor. In FY 1983, the corporate income tax was only 5.9 percent of federal receipts, less than half the level in FY 1980. Although corporate income taxes have rebounded to 8.4 percent in FY 1985, they remain at historically low levels. In the current fiscal year, U.S. "spending" on corporate tax "incentives" is projected to reach $120 billion.

Over this time period, the American public has become outraged as large, profitable U.S. corporations such as ITT, Dow Chemical, W.R. Grace, etc., found sufficient loopholes to pay little or no taxes for many of these years. Often these same corporations relied on federal government contracts as a source of profit.

The underlying forces driving the budget deficit is revealed as falling general revenues and, in particular, falling corporate income taxes and the recent escalation in spending on weapons programs.

Federal employees and the services they deliver will not avoid continual reduction and continual attack until the underlying causes of the deficit are resolved. Congress is not without blame for this situation. Congress voted for the massive tax cuts in 1981. Congress has ratified the expansive spending on military weaponry. Most recently, Congress overwhelmingly passed the irresponsible monstrosity known as Gramm-Rudman.

Given this history of Congressional abdication of its political responsibility, we turn to this Committee to take the lead in redressing the underlying deficit momentum by abandoning revenue neutrality in this tax bill. The message that AFGE, as a union of federal employees, is trying to comunicate to Congress is that the work of government employees is valuable--the services they provide are important and deserve to be funded.

American Postal Workers Union, AFL-CIO

817 14th Street N.W. Washington DC 20005

STATEMENT OF THE

AMERICAN POSTAL WORKERS UNION, AFL-CIO

PRESENTED TO THE

COMMITTEE ON FINANCE CONCERNING TAX REFORM

UNITED STATES SENATE

This statement is being presented by the American Postal Workers Union, AFL-CIO on behalf of our 330,000 active and retired members to the Committee on Finance of the U.S. Senate concerning Tax Reform legislation which is being considered by the Committee. The officers and members of our Union appreciate this opportunity to present our views in this regard.

Of immediate and great concern to our membership is the proposed repeal of Section 72(d) of the Internal Revenue Code, the so-called "three-Year exclusion rule," as provided in Section 1122(c) of H.R. 3838 and approved by the U.S. House of Representatives. Section 72(d) of the IRC presently allows employees who have contributed to their respective retirement trust funds up to a three-year post-retirement tax free period. Such employees previously paid required income taxes through payroll deductions during their pre-retirement working lives.

The controversial and adverse change proposed in the House-passed H.R. 3838 tax bill would be effective for employees retiring on and after July 1, 1986. If enacted into law, this negative proposal would be a financial disaster for approximately 19 million Americans, primarily postal, federal, state, county, municipal and private sector employees who contribute to their retirement plans.

Under current law these loyal and hardworking employees at retirement, as an annuitant are allowed a tax-free period of up to three years to recover through annuity payments an amount equal to the amount he or she contributed from their wages to the retirement system during active employment.

However, the bill passed by the House of Representatives would repeal this three-year rule and make tax-free only a small portion of each employee's contributions in any given year. The balance would be returned over any given year. The balance would be returned over an actuarially determined period (perhaps as long as 20 years), thus assuring that many retirees may never receive full tax-credit amounts they personally contributed into the system and paid taxes on during their working lives.

The net effect is that many employees who have planned for retirement under the current tax laws will not only face an immediate financial loss, but also face a disruption of other plans they may have made to provide for long-term financial security in their retirement years.

APWU has calculated that an average single postal retiree, receiving a $13,00 annuity, would pay an additional $940.00 per year in taxes for each of the first three years under the H.R. 3838 House legislation if the three-year exclusion rule is repealed. A joint-filing postal retiree would pay $360.00 per year for each of the three years under this controversial proposal.

It is important that we address the suggestion that some postal retirees could be better off over their entire retirement life under the House approved measure. The philosophy being that by spreading the employee contribution exemption over (for example) a 12-year retirement period some retirees could benefit more from being in a lower tax bracket for all those years rather than taking the tax break up-front during the first three years.

In the case studies we were able to look at, we discovered that some retirees could pay less in actual dollars, but because of the time value of money, a "real" dollar today would be worth more than an inflated dollar next year and certainly over a 12-15-20 year period these retirees would be worse off over their full retired life span.

Repeal of the three-year rule also raises the obvious question of fairness. Postal and federal retirees will be particularly hard pressed to meet this new tax obligation, considering the reductions they have already had to endure. In the FY '86 Budget, the ax fell particularly heavy on federal & postal workers and retirees, and the Gramm-Rudman legislation appears ready to bury the hatchet even deeper into the backs of these mistreated employees and annuitants.

During the past 10 years, postal & federal workers and retirees have been required to suffer more than $40 billion in lost income from reductions and delays in scheduled pay increases...revisions in the Federal Employees Health Benefits Program...imposition of the Medicare hospital insurance tax...elimination of paid holidays from lump sum annual leave payments upon separation from federal service...revisions in the basis for computing general pay from 2080 to 2087 hours annually...changing the annuity adjustments for federal retirees from semi-annual adjustments...limiting the COLA to 1/2 of the increase in the CPI for retirees under 62...denying any COLA to military retirees employed in the Civil Service... postponing the COLA...covering postal & federal employees hired after January 1, 1984 under Social Security... reducing the so-called "windfall" benefits created by dual entitlement to Civil Service retirement and Social Security...reducing Federal retiree's Social Security spouse's benefit by an amount equal to two-thirds of their government pension...and finally, the suspension of the January 1986 annuity COLA.

These cuts and their accumulated 40 billion dollar savings--calculated by the General Accounting Office and updated by the House Committee on Post Office and Civil Service--have also been accompanied by loss of jobs through reductions-in-force and contracting out.

Mr. Chairman, I believe evidence points out very clearly that the 330,000 active and retired members we represent have suffered more than their fair share. The House H.R. 3838 measure proposal to raise $7.5 billion by repealing the three-year rule is patently unjust and unfair! This large sum could only come from the "pockets" and annuities of retirees.

Another important reason to retain the "three-year exclusion rule" from the standpoint of efficient, cost-effective and essential Government services must be the great concern for a potential mass exodus of the Nation's most senior, qualified and sorely needed postal & federal workers from the lowest to the highest salary positions and who are eligible for immediate retirement prior to the effective date of the tax-reform measure. Such a tremendous personnel loss not only to the Federal government but also, potentially the Congress of the United States and staff persons would be an inexcusable and irretrievable loss to "good government" and the American people.

The American Postal Workers Union desires to express our appreciation and gratitude to your colleagues, Senators

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Paul S. Trible, Jr.; Ted Stevens; Charles Mc C. Mathias, Jr.; Thomas F. Eagleton; Ernest F. Hollings; and Paul S. Sarbanes for their joint sponsorship of Senate Resolution 304 which was referred to your Committee on January 29, 1986 and states:

> "Resolved, That it is the sense of the Senate that section 1122(c)(1) of H.R. 3838 repealing section 72(d) of the Internal Revenue Code of 1954 pertaining to the 3-year basis recovery rule on taxation of retirement annuities will be deleted from the tax reform legislation now pending before the Senate Finance Committee, and that the present 3-year basic recovery rules will be maintained."

Mr. Chairman and Members of the Committee it it our hope that you will concur with the recommendations of your distinguished colleagues who have in an exemplary demonstration of bipartisanship and statesmanship urged rejection of Section 1122(c) of H.R. 3838. We urge you to review the entire text of the Senate Resolution 304 and their well documented explanation for introducing and supporting the resolution on January 29, 1986.

We believe repeal of the basic recovery rule will do irreparable harm to the government, its employees and retirees in a time when they have already suffered more than what any reasonable person would consider fair and equitable. We strongly urge you and the other members of this Committee to delete this controversial proposal from your tax reform package.

Now, a few additional comments concerning the H.R. 3838 tax legislation pending before your Committee. The measure does contribute general equity and fairness to most taxpayers exclusive of the proposed repeal of the IRC Section 72(d).

The average ordinary taxpayer--who has been paying most of the Federal Government's bills while the rich and big corporations exploit special loopholes and avoid paying their fair share of taxes--would benefit from the bill. It appears more than half of the net tax reductions would go to those with incomes between $20,000 and $75,000. Most features of the current tax system which most benefit average Americans would be preserved by the legislation.

For example, the bill retains the deduction for state and local taxes--the most widely uses of all deductions. In fact, a survey commissioned by the American Postal Workers Union last year found that over 59% of our members were entitled to a credit for state and local taxes.

The House Ways and Means Committee was correct in continuing the present treatment of state and local taxes instead of following the Administration's proposal to punish those areas that have done the most to finance public programs and facilities. Again, we recommend the Committee concur in this decision.

The American Postal Workers Union with others in the labor movement, campaigned long and hard to convince

Members of the House of Representatives that the proposal to tax "life-support" benefits was poor tax policy and a backdoor attempt to raise taxes on the backs of the lower and middle-income Americans. We were successful and hope this Committee will not consider such ill-advised taxation further.

While the measure provides badly needed relief for most taxpayers, it also reaffirms the principle that everyone should pay their fair share of taxes! The bill's tough and comprehensive minimum tax would ensure that neither corporations nor wealthy individuals could completely avoid federal income taxes.

H.R. 3838 would put a stop to accounting practices which allow major defense contractors to avoid the taxes that pay for our national defense. Under the measure, foreign tax havens would be curbed, tax breaks for the oil and gas industry would be reduced, large banks would have to pay more than the token amounts required by current law, and limits would be placed on deductions for business meals and entertainment.

Thank you Mr. Chairman and Members of the Committee for giving us this opportunity to express these views concerning tax-reform on behalf of our 330,000 members and retirees. I will be happy to respond to any questions concerning our testimony and provide any related additional information requested.

Statement for the Record
H.R. 3838

The Cellular Telecommunications Division of Telocator Network of America (Telocator) submits this statement in support of an amendment to the effective date for the investment tax credit and depreciation rates proposed in the Tax Reform Act of 1985, H.R. 3838. Telocator represents cellular companies (a new form of mobiletelephone service) that are classified by the Federal Communications Commission (FCC) as "nonwirelines" -- i.e., cellular companies owned by independent entrepreneurs, in contrast to the competing "wirelines" which are owned by telephone companies. The FCC allocated only enough spectrum for two cellular systems in each market -- one set of frequencies for a wireline system and one set for a nonwireline.

The proposed effective date for the repeal of the investment tax credit and the new depreciation rules grandfathers only equipment under binding contract before September 26, 1985 or placed in service by December 31, 1985. As explained below, unless the nonwirelines receive transition relief, this effective date provision would unfairly place a tax burden on many nonwirelines which, due to FCC policies and procedures, almost all of their wireline competitors will not have to bear.

I. Telocator Proposed Transition Rule

In order to relieve nonwirelines of the tax disadvantage they would otherwise suffer in their competition with wireline telephone companies, Telocator proposes broadening the bill's transition relief to include equipment for any cellular system for which the FCC issued a construction permit prior to September 26, 1985. Because the FCC had issued construction permits only with respect to the 90 largest markets as of September 26, 1985, only they would be eligible for this transition relief. In the remaining 215 markets no construction permits were granted prior to September 26 for either wirelines or nonwirelines. Hence no competitive disadvantages would exist in those markets and no transition relief is necessary.

In the event that the generally applicable effective date for the investment tax credit and depreciation amendments is postponed until January 1, 1987, the transitional inequities that the nonwirelines now face would not occur and there would be no need for a special transition rule.

II. Background

Prior to 1983, there was no cellular industry other than two experimental operations in Chicago and Baltimore/Washington. In 1981 the FCC allocated certain frequencies for cellular use and declared that in each of the 305 metropolitan areas, or markets, in the United States one cellular permit would be awarded to a wireline company and one to a nonwireline company. The purpose of the latter policy decision was to ensure a competitive cellular industry. To qualify as a wireline, an applicant had to be owned by a telephone company operating in the same market. The number of eligible wireline applicants in each market was small and sometimes there was only one. A nonwireline applicant, on the other hand, could be any business entity interested in providing cellular service.

The FCC then considered how to process applications for the wireline and nonwireline construction permits in each market. It established a June 7, 1982, deadline for filing applications for the 30 largest markets, a November 8, 1982, deadline for markets 31 through 60 in size, and a March 8, 1983, deadline for markets 61 through 90. The FCC began by using a comparative hearing process to choose among competing applicants but shifted to a lottery procedure for markets 31 through 90. The very restrictive eligibility requirements for wireline applicants and the wide-open eligibility requirements for nonwirelines caused the delay for the nonwirelines which in turn led to the tax inequity at issue here.

III. The Need for Telocator's Proposed Transition Rule

In the top-90 cellular markets, 76 wirelines had completed construction and received their operational licenses before September 26, 1985. As a result, their equipment purchases are not affected by the proposed tax legislation and are eligible for the more advantageous tax benefits that the bill would eliminate. However, only 16 nonwirelines had completed construction and had licenses by September 26, 1985. Therefore, most nonwirelines would not qualify for the tax benefits available to the wirelines and would be placed at a substantial disadvantage in head-on competition with wirelines in their markets if they are not granted transition relief.

The headstart of the wirelines over the nonwirelines is directly attributable to FCC policies. In the top-30 markets wireline applicants avoided the comparative hearing process altogether because there was only one per market or because they were sufficiently limited in number to be able to settle quickly. The larger number of nonwireline applicants in each market made settlement far more difficult. As a result, none of the wireline applications in the top-30 markets went to a comparative hearing but almost all of the nonwirelines were designated for hearing. Thus, although both wirelines and nonwirelines filed their applications in the top-30 markets at the same time, the nonwirelines did not receive their construction permits until an average of 12 months after the wirelines received their permits.

By way of example, in the Atlanta market where five nonwireline applications were filed on June 7, 1982, the applications were designated for hearing on January 21, 1983; the record was closed on December 2, 1983; the Administrative Law Judge issued the initial decision on February 27, 1984; the FCC approved the decision and granted the construction permit on January 29, 1985; an appeal was filed in the federal Court of Appeals on February 27, 1985; oral argument took place on February 14, 1986, and no decision has yet been rendered. By comparison, the wireline received its construction permit on January 21, 1983 and the system went on line in July, 1984.

The FCC switched to a lottery selection process for markets 31 through 60 and 61 through 90, though it did so substantially after applications for these markets had been filed. Cellular Lottery Rulemaking, 98 F.C.C. 2d 175 (1984). Under this new procedure, the nonwirelines still suffered a disadvantage. In almost all cases market-wide settlements were negotiated and agreed to. But these settlements took much longer to arrange among nonwirelines because of their far larger numbers. Thus, in markets 31 through 60, most markets had 12 or more competing nonwireline applicants, and in markets 61 through 90, there was an average of 16 nonwireline applicants. The average number of applicants for wirelines in markets 30 through 90, by contrast, was still a very manageable 2.6 per market.

Because of the far larger number of nonwireline applicants in markets 31 through 90, their settlements took much longer than the wireline settlement process. Thus, the settling nonwireline applicants each had to agree first to take a pro rata interest in the company that would operate in the market in question. Then they swapped interests in the various markets to achieve some measure of consolidation and business rationality. This process was not substantially completed until long after nearly all of the wirelines had reached settlement. For example, in the Salt Lake City market, the wireline received its construction permit on April 26, 1984, and was operational by December, 1984. But the nonwireline did not even receive its construction permit until March, 1985, which was when many other nonwirelines in the 31 through 90 markets received their permits. Compared to the September 26, 1985, date in the House tax bill, the Salt Lake City wireline had 17 months and the nonwireline had only six months to order equipment. Because the process of ordering equipment and launching a cellular system takes a considerable amount of time, the much smaller amount of time left to nonwirelines to complete this process by the deadline established in the House tax bill was simply inadequate in many cases.

Moreover, the various steps to be undertaken before central switches and other equipment could be ordered were made more complicated by the fact that the settlement process resulted in nonwireline permits being held by partnerships with large numbers of partners. In most nonwireline markets, therefore, partnership committees reviewed and authorized the following decisions leading up to orders for appropriate equipment. They had to review the design of the systems which engineers and others had agreed to on the basis of a careful review of the various applications in the market. They had to evaluate and then choose among a changing and sophisticated selection of computer based switching and other equipment in light of their systems' needs. There were numerous difficulties with respect to selecting the location of various towers needed for the operation of the systems and with respect to obtaining zoning approvals for them. The resolution of these difficulties could affect their equipment selection. Consequently, it is entirely understandable that many nonwirelines were unable to order equipment before September 26, 1985 or place it in service by December 31, 1985.

If transition relief is not made available, nonwireline systems that have been delayed by the FCC's processes would be placed at a substantial competitive disadvantage. For example, if a cellular system in a particular market costs $10 million to construct, the wireline would have had the substantial benefit of a $1 million investment tax credit while its nonwireline competitor would have no credit, and for several years the wireline would receive more rapid depreciation than its nonwireline competitor. These discrepancies would enable wirelines to charge lower rates and otherwise have an unfair and undeserved competitive advantage over nonwirelines.

Based on Telocator's survey of a substantial number of nonwireline systems, it believes that the impact on tax revenues of the proposed transition relief, including both investment tax credit and depreciation, would be in the neighborhood of $15 million. Although the effect on tax revenues would be relatively small, the relief would be very significant to the emerging nonwireline industry. It already operates under the handicap of starting later than the wire-line industry; the wireline systems are owned in large part by powerful regional telephone companies with cellular interests that span whole regions of the country; and the nonwirelines incurred far greater hearing and settlement expenses to obtain their FCC permits than did the wirelines. With nonwirelines being the only source of competition to wirelines in the duopolistic cellular market, the FCC and the District Court have recognized the special importance of nonwirelines developing into full competitors of the wirelines. Thus, the requested relief is desirable not only as a matter of tax equity but also to promote the public policy goal of a competitive cellular marketplace.

IV. Relationship of Telocator's Transition Rule to Other Transition Rules

Telocator's proposed transition rule is not unique. A similar transition problem was encountered and remedied by the drafters of H.R. 3838. Section 203(d)(2) of the bill grants transition relief to certain projects if, on or before September 25, 1985, the Federal Energy Regulatory Commission ("FERC") had licensed the project or certified it as a "quali-fying facility" for purposes of the Public Utility Regulatory Policies Act of 1978. In both cases, substantial time and money had been expended in the regulatory process prior to September 26, 1985. In both cases, the necessary regulatory analysis and review entailed significant delay not faced by other taxpayers who made their investment decisions without such extensive federal regulatory review. And in both cases, the initial decisions to pursue the projects were made long before September 26, 1985, in anticipation of the continued availability of the investment tax credit. The case for the nonwirelines is even stronger since relief is needed to provide them with equitable tax treatment vis-a-vis their wireline competitors.

That special transition relief is appropriate for certain taxpayers subject to federal regulatory action is also demonstrated by the transition rules enacted when the investment tax credit was terminated under Section 703 of the Tax Reform Act of 1969. Sections 703(b)(3)(C) and (b)(6)(B) of that Act provide that, in defined circumstances, property described in certificates or orders issued by a federal regulatory agency before termination of the credit would be treated as "pretermination property" (and thus still eligible for the investment credit) even though not satisfying the general definitional requirements. These provisions show a history of Congressional solicitude for taxpayers who, although clearly committed to acquiring or constructing property prior to a statutory deadline, are unable to begin construction or enter into binding contracts in the ordinary course of their businesses as a consequence of the regulatory process.

V. Conclusion

Transition relief for nonwirelines is essential to prevent the creation of a significant tax inequity. Wirelines and nonwirelines constitute two classes of taxpayers that are similarly situated, but FCC procedures have caused one -- the wirelines -- to be eligible for substantially more advantageous tax treatment than the other -- the nonwirelines. That inequity will inhibit the full and fair competition crucial to a competitive industry. Appropriate transition relief would be consistent with similar remedies in the past, would be limited in scope to only those cellular systems authorized prior to September 26, 1985, would involve only a small revenue loss and would rectify an otherwise wholly unjustified discrepancy in the tax treatment accorded to competitive cellular systems in the top-90 markets.

The text of a proposed amendment to the bill is attached as Appendix A.

Appendix A

AMENDMENT to SECTION 203(d):

(14) Certain Cellular Systems -- In the case of property which is part of a system in the Domestic Public Cellular Radio Telecommunications Service covered by an FCC construction permit issued on or before September 25, 1985, such property shall be treated as satisfying the requirements of paragraph (b)(1) of this section.

STATEMENT OF ROBERT J. SCOTT

EXECUTIVE DIRECTOR

COLORADO PUBLIC EMPLOYEES' RETIREMENT ASSOCIATION

BEFORE THE SENATE COMMITTEE ON FINANCE

March 18, 1986

Mr. Chairman and Members of the Committee on Finance, I am Robert J. Scott, Executive Director of the Colorado Public Employees' Retirement Association, which administers four retirement trust funds for state employees, school district employees, municipal employees, and judges in the state of Colorado. I appreciate this opportunity to present the views of our 96,000 active members and 25,000 retired persons and their beneficiaries concerning proposals to eliminate the three-year basis recovery rule as part of tax reform this year.

The three-year rule provides that annuity payments to a retired employee who made taxable contributions to his or her retirement plan and whose annuity payments in the first three years after retirement would equal total contributions are treated as a non-taxable recovery of those contributions until all of his or her contributions have been recovered. As a result, most public employees receive their annuity payments tax-free for the first one to three years following retirement.

The House-passed tax reform bill (H.R. 3838) would repeal this rule, and, effective July 1, 1986, spread the recovered employee contribution over the expected life of the annuity. It is my understanding that the Senate Finance Committee Staff Option For Tax Reform would phase out the three-year basis recovery rule somewhat more gradually; while the details of this proposal have not been released and are accordingly not entirely clear, it appears that individuals who retire in 1987 would pay 50% of the tax imposed by H.R. 3838 in the first three years after retirement, while those retiring in 1988 and thereafter would pay 100% of the tax provided by H.R. 3838. For the reasons set forth below, we urge the Senate Finance Committee to adopt neither proposal, and instead to leave intact the three-year basis recovery rule.

The repeal of the three-year basis recovery rule over a short period of time will, in all likelihood, lead to a mass exodus from government of senior personnel now eligible to retire. These departures could lead to a serious loss of expertise and loss of continuity in critical areas of government. For example, the article appended to this statement reports that under H.R. 3838, the Internal Revenue Service may lose 20% of its top executives this year and is already experiencing a heavy turn over of tax technicians as a result of House Passage of the bill. Although the Senate Finance Committee Staff Option would alleviate this problem somewhat, it would probably only delay the retirement of currently eligible employees by six months, since it would only retain current law an additional six months.

Moreover, an unanticipated increase in the number of retirements could result in a significant increase in costs to the employer governments. For the federal government, it has been estimated that the cost of retirement annuities for those additional employees induced to retire if the rule is repealed would actually exceed the amount of revenues to be gained in the first year by elimination of the rule.

Perhaps most important of all, the repeal of the rule, whether under the House-passed bill or the Staff Option, would unfairly frustrate the legitimate expectations of employees who are approaching the age of retirement. In addition to the increase in tax upon their annuity payments in the first years of retirement, retiring employees would also be taxed at a higher rate on IRAs, accrued leave payments, bonds and other planned retirement funds. To impose this burden with little notice -- whether none at all or 18 months -- upon employees who have long-standing retirement plans and investment strategies is particularly unfair. Accordingly, we urge you not to repeal the three-year basis recovery rule.

Thank you for the opportunity to present the views of the Colorado Public Employees' Retirement Association. We wish you success in your efforts at tax reform.

APPENDIX TO STATEMENT OF ROBERT J. SCOTT

2-24-86 (No. 36) G-1

BNA's Daily Reporter System

DAILY REPORT FOR EXECUTIVES

TAXATION AND ACCOUNTING

IRS: TAX AGENCY SEEN LOSING UP TO 20 PERCENT OF EXECUTIVES DUE TO POSSIBLE PENSION RULE CHANGE

The Internal Revenue Service may lose nearly 20 percent of its top executives later this year if a provision in the House-passed tax overhaul bill (HR 3838) is enacted, an aide to Rep. Frank Wolf (R-Va) said Feb. 21.

Since November, 22 of IRS' 247 executives already have retired and 27 more will be eligible for retirement by the end of October, according to IRS spokesman Wilson Fadely. He could give no reason for the trend, but Wolf's aide said it is because of the House proposal.

The tax code change would require federal workers and others who contribute to their pension plans to begin paying taxes on their annuities as soon as they retire. Current law allows employees to recover the amount they paid into their pension fund and paid taxes on while working. This is done by exempting from income taxes initial monthly annuity payments until workers get all their money back. To be eligible for full retirement benefits, a government worker must have 30 years of service and reached the age of 55.

A survey by the Senior Executive Association seems to support the views of Wolf's office, showing that 91 percent of those government executives eligible to retire will do so if the provision is enacted. The association surveyed more than 1,200 executives, and 43 percent said they were eligible to retire. Nine out of 10 said they would retire if the tax reform provision becomes law, according to the association.

John Rogers, Treasury Department assistant secretary for management, told a Feb. 19 House appropriations subcommittee that he is "very concerned" about the impact the House provision is having on the quality of department management. About 5 percent, or 6,500, of Treasury's employees are eligible for early retirement as of July 1, the effective date of the House tax bill provision, Wolf told the subcommittee hearing.

Deputy IRS Commissioner James Owens told the House panel that all but three of the 22 retirees have been replaced, acknowledging that it will take some time, though, for the new hires to get up to speed. Owens said the replacements are first rate and a group of newly trained executives will soon be available to fill future vacancies.

This is not the first time changes in federal pension rules have prompted career government workers to retire early. A special "use-it-or-lose-it" cost-of-living increase in pension levels led to a similar exodus in 1973, said Donald Alexander, who was IRS commissioner during the Ford Administration. Alexander told BNA it was especially "difficult" managing IRS' field operations because many district directors were among those who left. "They're hard to replace," and it takes time for new managers to learn the job, he said, adding that those who leave usually are at the peak of their experience and young enough to continue working.

Perhaps a greater problem is a current heavy turnover of IRS tax technicians as a result of the House plan, said Alexander. These experienced employees, who are not part of the senior executive service, are particularly hard to replace because of their institutional memory and wide experience, said the former commissioner.

To prevent a flood of retiring workers, Alexander suggested phasing the House provision in over three years or so, which would lessen the cost of working longer and encourage more people to stay. "I think the new [House] plan. . .has much logic behind it but it's going to have an unfortunate result" unless it's modified, he said.

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INFRASTRUCTURE FINANCING

Private Sector Advisory Panel On Infrastructure Financing

The Implications of H.R. 3838 for Infrastructure Financing and Capital Formation

Submitted to

The Committee on the Budget
United States Senate
February, 1986

THE IMPLICATIONS OF H.R. 3838 FOR INFRASTRUCTURE FINANCING AND CAPITAL FORMATION

INTRODUCTION

In July 1985, the Private Sector Advisory Panel on Infrastructure Financing issued its report, "The Implications of Tax Reform for Infrastructure Financing and Capital Formation." That report concluded that "the Tax Proposal would severely decrease infrastructure investment." This projected decline in funds available for infrastructure financing would exacerbate the current shortfall in funds needed to build and maintain our nation's infrastructure facilities. There is a serious gap between funds estimated to be available from traditional public sources and the amount of money needed through the year 2000 for the public works infrastructure to ensure our health, safety, and economic viability.

The overall demand for capital spending on infrastructure between 1984 and the year 2000 has been estimated by the Joint Economic Committee to total $1.1 trillion and by the Congressional Budget Office to total $860 billion. This works out to an annual expenditure of between $57.5 and $73.4 billion. Yet actual federal, state, and local expenditures have been estimated by CBO to total only $39 billion annually.

Investment in infrastructure facilities must be maintained and increased rather than decreased in the next several years. The ability of local governments to efficiently and economically finance public works facilities depends to a large part upon the availability of tax-exempt financing and the tax implications of such an investment for the private investor. The capital cost recovery and tax-exempt bond provisions now in the Internal Revenue Code have provided an important incentive to private investors. This incentive will inevitably be threatened by major changes in the tax code.

Among the most important areas for private investment in infrastructure facilities are environmental facilities—those concerned with sewage treatment, solid waste disposal, and the furnishing of clean water. The projected need for wastewater facilities provides a good example of the funding gap and of the importance of maintaining incentives for private investment. The Environmental Protection Agency in its 1984 needs assessment found that $109 billion of capital investment will be required to build all the wastewater facilities needed between 1984 and 2000. If federal funds remain constant, state and local governments would have to increase their annual outlays for building wastewater facilities, currently totaling some $2.8 billion annually, by more than 50% in order to meet this need.

For water resources and supply, CBO found an estimated annual need for $11 billion and actual annual spending of $5.6 billion. The funding gap for water-related facilities, as for every type of infrastructure facility, will be greatly exacerbated by the federal spending cuts that could occur over the next five years under the Gramm-Rudman provisions. The combination of federal budget cuts and decreased private investment due ~~to changes in the tax code~~ could be devastating to our nation's public facilities.

After the Advisory Panel's report on tax reform was issued, the House Ways and Means Committee reported out a tax reform bill that was passed by the House on December 17, 1985. The House bill, the Tax Reform Act of 1985 (H.R. 3838), also poses significant problems from the standpoint of infrastructure financing. The following is a brief summary of the effect of H.R. 3838 on infrastructure financing and recommendations for change.

TAX EXEMPT BONDS

Nongovernmental Use

The most important difference between the Administration proposal and H.R. 3838 is that the latter allows some nongovernmental activities to receive tax-exempt financing. The provisions of H.R. 3838 follow the general form of the Administration proposal, dividing tax-exempt bonds issued by governmental units into "governmental" and "nongovernmental" bonds, or, in the Committee's terminology, "nonessential function" bonds. "Governmental" bonds correspond to the traditional categories of general obligation bonds and revenue bonds used to provide public services, and may be issued to finance government activities with no volume restrictions (except for incidental nongovernmental use, as discussed below).

A bond is considered governmental under the House bill when no more than the lesser of $10 million or 10% of its proceeds is used for "nongovernmental" purposes, or no more than the lesser of $5 million or 5% of the proceeds is loaned to "nongovernmental" persons. If the bond does not meet both of these tests, it will be denied tax exemption unless a specific exception is provided (see below). In addition, if nongovernmental use of a governmental bond exceeds $1 million but does not exceed the nongovernmental threshold, the portion over $1 million must be counted against the state's volume cap.

The 10% limitation applied to "governmental" bonds, while a substantial improvement over the Administration's proposed 1% limit on nongovernmental use, will pose serious problems for issuers of "governmental" bonds for public projects, especially when combined with the requirement that nongovernmental use exceeding $1 million in governmental bonds be counted against the state's volume cap. In many cases there is a significant private component to public works and buildings. Examples include the state office building which leases space to private vendors, the public school whose cafeteria service is provided by a private contractor, or a public sewage treatment plant which is financed with general obligation or revenue bonds (perhaps because its cost is too high to include it in the state's volume cap for nonessential function bonds) but which has contracted under a "take or pay" contract or on some other basis different from that available to the general public to receive more than 10% of its wastes from one or several commercial users.

It is extremely important to note the point made by the last example: the percentage of nongovernmental use is determined by aggregating the percentages of use of all nongovernmental users. Thus, bonds for a facility will be considered nongovernmental if it has several private users whose aggregate use exceeds 10%, even if none of them reaches that figure separately. This aggregation rule will pose a serious problem for municipal sewer systems, many or most of which are in exactly this situation.

By taking the unprecedented step of making a bond's tax exemption depend solely on the use of the proceeds rather than a predetermined category, H.R. 3838 imposes a tremendous recordkeeping burden and creates enormous uncertainty for issuers of governmental bonds. In order to be sure that bond issues continued to qualify for a tax exemption, and to calculate the state's volume cap, state bond authorities would have to keep detailed records of the exact use of the proceeds of each tax-exempt bond issue throughout the state--a task that would be burdensome, expensive, and extremely difficult, if not impossible. In addition, it would become ~~difficult for bond counsel to issue an unqualified opinion~~ on a bond issue, as their advice on an issue's qualification for tax exemption would necessarily be predicated on other issuances about which they have no control or knowledge.

The Panel shares the concern within the Administration and Congress over past abuses of tax-exempt financing, particularly in the IDB area, and agrees that the availability of such financing be limited to those facilities and functions that truly fulfill a public purpose. The provisions enacted as part of the Deficit Reduction Act of 1984, however, are fully sufficient to curtail abusive uses of IDBs. Furthermore, and most importantly, H.R. 3838, like the Administration proposal, goes far beyond the purpose of eliminating abuses of "private purpose" bonds. As the examples above and the discussion below show, these proposals would have a severe detrimental impact on bonds that are clearly governmental and projects whose purpose is unquestionably public, creating enormous problems for state and municipal capital financing.

The limit on nongovernmental use of facilities financed with governmental bonds should be raised to 25%, as is the case under current law, and the rule requiring inclusion in the volume cap of the nongovernmental portion of governmental bonds that exceeds $1 million should be deleted.

Rules Governing Nonessential Function Bonds

Unlike the Administration proposal, H.R. 3838 allows interest payments on "nonessential function" bonds issued for certain specified activities to continue to receive a tax exemption, subject in most cases to a volume limitation, the current restrictions on IDBs, and some new restrictions. Once the amount of nongovernmental use places these "exempt facility" bonds in the nonessential function category, any further degree of nongovernmental use will not affect their tax exemption, although some exempt facilities are required to be available to "the general "public." This change from the Administration proposal will allow continued use of tax-exempt financing for infrastructure projects. The activities so exempted are:

1. Multifamily rental housing
2. Airports (only including facilities directly related to transportation of passengers and cargo)
3. Ports (only including facilities directly related to transportation of cargo and passengers by water)
4. Mass commuting facilities
5. Sewage and solid waste disposal facilities
6. Facilities for the furnishing of water
7. Small-issue IDBs (no sunset)
8. Qualified student loan bonds
9. Qualified mortgage bonds and veterans' mortgage bonds (with sunset) and veterans' land bonds (without sunset).
10. 501(c)(3) organizations

In addition, H.R. 3838 takes the important step of allowing sewage treatment and solid waste disposal facilities that are privately owned or managed to receive tax-exempt financing, although they receive less favorable depreciation treatment in this event. Bond-financed water facilities, however, must be publicly owned, and can be privately managed only if they are regulated like a public utility. There is no clear reason for this distinction, and when added to the tax changes imposed on these facilities by the new depreciation system (see discussion below), it will seriously reduce further private investment in them.

Another restriction imposed on "nonessential function" bonds is the requirement that 100% of the proceeds be used for the bond's exempt purpose. Under current law, 10% of the proceeds of an IDB may be used for other purposes, such as the building of ancillary facilities which do not fulfill an exempt purpose. This flexibility to use a small portion of the proceeds to meet the various needs that may arise during the construction of a facility is often essential in allowing infrastructure projects to go forward.

H.R. 3838 should be amended in the Senate to allow privately owned or managed facilities for the furnishing of water to be financed with tax-exempt bonds. In addition, the rule allowing 10% of the proceeds of a "nongovernmental" bond to be used for nonexempt purposes should be retained.

Volume Cap

Because it called for the elimination of all nongovernmental bonds, the Administration proposal did not include a volume limitation on tax-exempt financing. H.R. 3838 does impose such a cap. The cap covers all nonessential function bonds except those for airports (other than freight handling facilities) and ports (other than storage facilities), plus that portion of governmental bonds exceeding $1 million in nongovernmental use.

The cap equals the greater of $200 million or $175 per capita for each state ($125 after 1987 to reflect the mortgage subsidy bond sunset). $25 of this is reserved solely for 501(c)(3) organizations (they are not, however, limited to this amount); of the rest, 50% (25% after 1987) is allocated to the various housing bonds--i.e., exempt facility bonds for multifamily housing, qualified mortgage bonds, and qualified veterans' mortgage bonds. The 501 (c)(3) allocation may not be changed at the state level, while the allocation for housing bonds may only be overridden by state statute. As under current law, unused bond authority may be carried over up to three years for specific nonessential function bond projects.

Sewage treatment, solid waste disposal, and water facilities will suffer under these provisions. They will be required to compete for severely limited bond volume with several other uses --among them small-issue IDBs, which are highly popular and typically account for a large portion of states' bond volume. In addition, these facilities are often large and expensive projects whose cost would require most or all of the volume cap.

H.R. 3838 should be amended in the Senate to remove sewage collection and treatment and solid waste disposal facilities and facilities for the furnishing of water from the volume cap.

Arbitrage

H.R. 3838 essentially adopts the Administration proposal with regard to arbitrage, except that it allows a 30-day temporary period for acquisition, repeals the minor portion exception, and expands the general restrictions to include investment in annuity contracts and other property held for investment. The 30-day and 3-year periods within which bond proceeds must be spent may be extended where undue hardship would otherwise result. In addition, the bill contains three troublesome provisions, two of which were not in the Administration proposal.

First and foremost, H.R. 3838 requires that five percent of the proceeds of the bond issue be spent within thirty days of issuance (the Administration proposal required spending of "a significant part" of the proceeds within one month). This provision is already disrupting the market for tax-exempt debt. Issuers who are required to secure financing before taking construction bids cannot sell bonds and cannot enter into contracts for new infrastructure facilities. Such limitations on contracting are imbedded in state statutory and constitutional law, and H.R. 3838 will, in effect, force many states to restructure their procurement provisions, which may require amending their constitutions, to satisfy IRS requirements. In addition, the rule would negatively impact states such as Connecticut which have established leveraged revolving loan funds for infrastructure, combining federal grants and bond proceeds. A substantial number of tax-exempt purchasers have already withdrawn from the new issue market because of the five percent provision. The withdrawal will be permanent unless the provision is altered.

Second, the bill makes changes in the rules regarding reasonably required reserve or replacement ("4R") funds. Although it allows investment in higher-yielding investments which are part of such a fund, it also appears to require that the proceeds eventually be rebated to the United States, as with other types of arbitrage. In addition, the bill requires that a bond's yield be calculated without regard to the costs of issuance. Thus, an issuer maintaining a 4R fund will have to rebate the excess yield to the United States, but because that yield does not include costs, the issuer will have to absorb them. Maintaining a 4R account therefore will actually cost issuers money. This means that issuers will downsize their reserve funds, and this in turn will affect both the marketability and economic viability of the issues, which in many cases are dependent upon the reserve.

Third, the section of the bill extending arbitrage to all bonds, including refunding bonds, seems to indicate that changes in interest rates on variable rate demand bonds will be treated as refundings, thus subjecting them to the arbitrage rules. A colloquy on the House floor regarding this point does not provide sufficient assurance that this would not be the case; at the very least, such assurance should be written into the law.

The Senate should reject the changes in the arbitrage rules made by H.R. 3838, particularly the rule requiring 5% of a bond's proceeds to be spent within 30 days, and should retain current law.

Advance Refunding

Advance refunding provides state and local governments with the ability to reduce interest costs and restructure existing debt to provide necessary financing flexibility. The Administration proposal would have prohibited this pratice.

The bill substantially liberalizes the Administration proposal with regard to advance refunding. The practice will continue to be permitted for "governmental" bonds, with the provisos that 1) each original issue may be refunded no more than twice; 2) the amount of refunding bonds cannot exceed 250% of the amount of the refunded bonds unless the present value of interest savings exceeds the cost of issuance; 3) refunded bonds must be redeemed no later than the earlier of the date they could be redeemed at par or at a premium of 3% or less; 4) any allowable temporary period for arbitrage ends 30 days after the date of issue for the refunding bonds and the date of issue of the refunding bonds for the refunded bonds; and 5) advance refunding bonds are subject to the volume cap to the extent of amounts attributable to any nongovernmental use of the refunded bonds over $1 million. This latter provision, which is a major change in current law with regard to refunding, would result in portions of a single bond issue being counted against a state's volume cap for more than one year if one or more refundings occurred.

The advance refunding rules contain another significant problem: with a limited exception, only "governmental" bonds may be advance refunded, and the bill specifies that advance refundings of bonds issued before the effective date of January 1, 1986 will qualify only if that issue would be "governmental" under the new rules. In order to advance refund pre-1986 bonds, therefore, issuers will have to go back and attempt to trace in detail the exact use of the proceeds in order to determine whether the 5% or 10% threshold has been exceeded. The retroactive nature of this provision is both unfair and excessively burdensome.

No portion of advance refunding bonds should be subject to the volume cap. The Senate should eliminate the look-back provision that pre-

1986 issues must qualify as governmental under the rules established by the bill in order to be eligible for advance refunding.

Minimum Tax

In addition to modifying the Administration proposals on tax-exempt bonds, H.R. 3838 adds a new proposal which could have a significant adverse impact on infrastructure financing. The bill includes as a preference item in both the individual and corporate minimum taxes interest on nongovernmental tax-exempt bonds. Thus, an investor in, say, a nongovernmental issue used to finance a sewage treatment plant whose income and other tax preferences subjected him to the alternative minimum tax would find himself paying tax at a 25% rate on this supposedly tax-exempt income.

It hardly needs saying that this would be a disincentive to the very taxpayers who are most likely to invest in infrastructure facilities. As a result, there would be either an increase in financing costs for these facilities, with bond rates raised to compensate the investor for this disadvantage, or a decrease in the financing available.

H.R. 3838 should be amended in the Senate to remove interest on nongovernmental tax-exempt bonds as a preference item in the individual and corporate minimum taxes.

ACCELERATED COST RECOVERY SYSTEM

Like the Administration proposal, H.R. 3838 would repeal the Accelerated Cost Recovery System (ACRS) and replace it with a system that is closer to economic depreciation. The bill's Incentive Depreciation System (IDS) poses much the same problem for infrastructure financing as does the Administration's Capital Cost Recovery System.

The IDS system divides depreciable property into 10 classes, with assets grouped almost exclusively according to their lives under the old ADR (asset depreciation range) system. The depreciation periods range from 3 to 30 years (see chart). Property in classes 1-9 is depreciated using the 200% declining balance method; property in class 10 using the straight-line method. As under ACRS, the taxpayer may elect to use a nonincentive system. If IDS is used, all gain on disposition of the property is recaptured as ordinary income, to the extent of depreciation deductions, except for low-income housing and 30-year real property.

The bill provides partial basis indexing beginning in 1988, at a rate equal to the sum of one plus 50% of the amount by which the inflation rate exceeds 5%. Thus, in a year in which inflation equaled 7% (i.e., .07) the inflation adjustment would be 1.01 (one plus 50% of .02).

While the doubledeclining balance method and the inflation adjustment may mitigate to some extent the effect of longer depreciation lives, the IDS system nevertheless must be seen as very unfavorable to private investment in infrastructure facilities. Treatment of these facilities under the new system

INCENTIVE DEPRECIATION SYSTEM

Method: Classes 1-9, 200% declining balance, switching to straight-line.

Class 10, straight-line only.

Classification:

Class	ADR Midpoints	Recovery Period* (years)
1	4.5 years and under, plus rental clothing	3
2	5 to 6.5 years, plus all cars and light general purpose trucks, computer-based central station telephone switching, and racehorses	5
3	7 to 9.5 years	7
4	10 to 12.5 years, plus equipment with no ADR midpoint not elsewhere classified, and showhorses	10
5	13 to 15.5 years, plus single-purpose agricultural structures	13
6	16 to 19.5 years	16
7	20 to 24.5 years, plus very low-income housing	20
8	25 to 29.5 years	25
9	30 to 35.5 years, plus moderately low-income housing	30
10	36 years and over, plus structures	30

*Property financed with tax-exempt bonds is depreciated by the straight-line method over the next succeeding recovery period, with Class 10 property depreciated over 40 years.

is not only less favorable than under existing law, but also inconsistent and in some cases unclear. Of the three principal types of facilities where privatization occurs--sewage, solid waste, and water--only one fares even moderately well: some property in solid waste facilities is placed in Class 4, with a 10-year life. Other solid waste property falls into Classes 7 and 8, with 20 and 25 year lives. The treatment of wastewater facilities is unclear, as they do not have a definite ADR life. This could mean that they will be placed in Class 4, the catch-all class, or it could mean that they will eventually be assigned to some less favorable class.

The change in the treatment of water facilities is severe. Property in these facilities, which now is in the 5-year ACRS class, would be placed in Class 10 of IDS, thus resulting in a sextupling of its recovery period and the loss of any acceleration.

The effect of the IDS system is exacerbated by a provision requiring all privately-owned property that is financed with tax-exempt bonds to be depreciated over the next succeeding class life using the straight-line method. Thus, a bond-financed solid waste facility (Class 4) would be depreciated over 13 years rather than 10, while a bond-financed clean water facility (Class 10) would be depreciated over 40 years, both using the straight-line method. Adoption of the IDS system in its current form would severely curtail private investment in facilities for the furnishing of water and discourage investment in other facilities.

The bill should be amended in the Senate to place sewage treatment and solid waste disposal facilities and facilities for the furnishing of water together in Class 4. In addition, language placing such property in the next succeeding class when financed with tax-exempt bonds should be eliminated.

INVESTMENT TAX CREDIT

Like the Administration proposal, H.R. 3838 repeals the investment tax credit, thus removing another important incentive for private investment in infrastructure facilities. In writing the House bill, the Ways and Means Committee recognized that there are certain activities for which private sector investment serves an important national purpose and for which favorable tax incentives are needed to attract investment. It thus preserved the tax credit for rehabilitation of historic structures and extended for three more years the tax credits for solar and geothermal energy investment. Private sector investment in necessary public facilities serves an equally important national purpose.

H.R. 3838 should be amended in the Senate to preserve a 5% tax credit for investment in sewage treatment and solid waste disposal facilities and facilities for the furnishing of water.

OTHER ISSUES AFFECTING INFRASTRUCTURE FINANCING

The Advisory Panel's July report includes a section on other tax reform issues that will have an impact on the infrastructure financing effort, the most important of which are the repeal of state and local tax deductions, elimination of the deduction by financial institutions of interest costs allocable to tax-exempt bonds, and the requirement that property and casualty companies allocate a portion of their tax-exempt income to policyholder reserves. Here H.R. 3838 contains one major change from the Administration proposal and otherwise is about the same.

The important change is the full retention of the deduction for state and local taxes. This was a critical issue in the success or failure of the bill in the House, and many analysts feel that this concession played a major role in its ultimate approval by the Committee and the full House.

H.R. 3838 adopts the Administration's proposal to deny any deduction to financial institutions for interest allocable to the purchasing or carrying of tax-exempt bonds. It does contain one limited exception: for three years, the provision will not apply to bonds issued by a political subdivision to finance projects if the bond issue does not exceed $3 million, with an overall $10 million yearly limit for each subdivision. This is expected to help mainly small communities and does not substantially lessen the impact of the provision.

For property and casualty companies, H.R. 3838 reduces the deduction for losses incurred by 10% (increasing to 15% in 1988) of excludable interest income. This is likely to make tax-exempt bonds a less attractive investment for these companies, which combined with reduced investment by financial institutions is likely to have a negative impact on the bond market.

CONCLUSION

H.R. 3838 in its current form poses significant problems for infrastructure financing. Further changes are needed if investment in infrastructure facilities is to continue unhampered. When the Senate Finance Committee takes up tax reform, it should:

Maintain the current limit of 25% on the nongovernmental use of governmental bond proceeds;

Remove the nongovernmental use portion of governmental bonds from the volume cap;

Remove sewage collection and treatment facilities, solid waste disposal facilities and facilities for the furnishing of water from the volume cap;

Allow private ownership and management for facilities for the furnishing of water financed with tax-exempt bonds;

Retain the rule allowing 10% of the proceeds of a nongovernmental bond to be used for nonexempt purposes;

Retain current law on arbitrage;

Eliminate the provision requiring 5% of bond proceeds to be spent within 30 days;

Remove advance refundings from the volume cap and eliminate the requirement that pre-1986 issues of tax-exempt bonds qualify as governmental under the new rules in order to be eligible for advance refunding;

Exclude interest on nongovernmental tax-exempt bonds from the minimum tax provisions;

Place sewage treatment and solid waste disposal facilities and facilities for the furnishing of water in depreciation class 4, and eliminate the requirement that such property be placed in the next succeeding class when financed with tax-exempt bonds; and

Allow a 5% tax credit for investment in sewage treatment and solid waste disposal facilities and facilities for the furnishing of water.

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TESTIMONY

OF

TOM W. GRIFFITH, PRESIDENT

NATIONAL RURAL LETTER CARRIERS' ASSOCIATION

BEFORE THE

SENATE FINANCE COMMITTEE

TAX REFORM

ON

TAXATION OF ANNUITIES

Dear Mr. Chairman and Members of the Committee:

My name is Tom W. Griffith and I am the President of the 67,000 member National Rural Letter Carriers' Association. Rural Carriers, daily, drive 2,419,160 miles to deliver the mail on 40,434 rural routes to approxmiately 17,444,992 rural americans families. I appreciate this opportunity to appear before the Committee to express our very strong feelings on the proposal to abolish the current law with regard to taxation of a new retiree's annuity.

Both President Reagan and the House Ways & Means Committee called their legislation "tax simplification". In some areas it may be tax simplification, but not in regard to annuities. If we review the current provisions of the law regarding annuities, we find that employees, when they retire, are not taxed on their annuity until they have received an amount equal to the mandatory personal contributions they have made. That period of time usually runs from 1½ to 3 years. Income taxes have been paid on those contributions many years earlier.

In checking the legislative history of how this provision came about, we find that it was adopted to simplify the Internal Revenue Code. To change to the current system as proposed by the House Ways & Means Committee and the President's proposals would not simplify the tax code, but make it more complicated and require bookkeeping by the Office of Personal Management to be much more comprehensive and extensive for twenty or more years on each retiree.

Mr. Chairman and Members of the Committee, why must we always chop at the Federal/Postal Employees? Under Gramm-Rudman, our annuitant's COLA is effectively wiped out through 1991. Rural carriers who retire during this period, or are already retired, will not receive a cost of living adjustment because of the Gramm-Rudman ax. Isn't that enough hurt?

We think you may be creating a very serious government brain drain in this country. It may also create more economic havoc than you had anticipated. The proposed change in this provision affects city, county, state and federal employees who contribute to their own retirement pension.

Many groups are now estimating that up to 60% of those eligible will choose to retire rather than face the consequence of having their grace period wiped out. That will cause serious problems for many important agencies in the Federal Government. It will wipe out the most valuable people in State Governments. These are the people who are experienced and work in management or leadership positions. It could have a serious impact on our teaching core throughout the United States. Additionally, if all of those people retire immediately it could wipe out the reserve that is currently available in the Civil Service Retirement Trust Fund and impact State and Local Trust Funds adversly also.

The most unfair part of it is the fact that many people who are eligible to retire, such as myself, have made plans in their retirement years to utilize this provision. The National Rural Letter Carriers' Association has proudly participated with the U. S. Department of Treasury, for many years, in encouraging our members to buy U. S. Savings Bonds. At our National Convention, speakers from the Treasury Department are always invited and participate in our programs. They persuade our people to participate in buying bonds. They tell them that under the law they could redeem these U. S. Savings Bonds in their grace period of early retirement and lower the tax rate on the interest. Now the Ways & Means Committee and the President are proposing that what the Treasury Department has been telling us is to be repealed without warning.

Mr. Chairman and Members of the Committee, on behalf of all rural letter carriers, I hope that you will give this issue your careful and deliberate consideration. And after looking at it I hope that you will come to the same realization that we have; for tax simplification reasons you should continue the current recovery rule on annuities.

Thank you.

Advisory to The U.S. Senate
Committee on The Budget
Senator Pete V. Domenici, Chairman

Private Sector
Advisory Panel
On
Infrastructure Financing
Joseph M. Giglio, Chairman

February 4, 1986

The Honorable Pete V. Domenici
Chairman
Senate Budget Committee
621 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Domenici:

The Private Sector Advisory Panel on Infrastructure Financing decided at its meeting on January 21 to write you concerning the negative effects of certain tax reform proposals on capital investment and economic activity at the state and local level.

As you know, one of the most essential activities carried out at the state and local level is the construction and maintenance of our country's infrastructure--the basic network of roads, bridges, transportation, water supply facilities, sewage treatment, and waste disposal systems necessary to support economic growth and commerce. A serious problem exists with regard to capital investment in infrastructure projects. Recent studies show a sizeable gap between the amount of capital investment that will be needed between now and the year 2000 and the amount of funding that will be available through federal, state and local government sources. This gap is estimated at $18 billion or more annually.

Since the Advisory Panel was established by the Budget Committee early last year to investigate and advise the Committee on new and innovative financing mechanisms, we have focused on ways to increase funding through traditional means of infrastructure financing, such as bond issues, and on the most promising alternative to these traditional methods: private sector investment. It is our strong belief that the effect of the tax reform proposals on capital formation in the public sector will be devastating to state and local efforts to finance infrastructure through both bond issues and private

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investment. We have prepared a detailed report which is enclosed. Some of the more important points are:

The volume cap imposed by the bill will preclude tax-exempt financing for many if not most sewage collection and treatment, solid waste disposal, and water supply and distribution facilities.

The classification of bonds as governmental or nongovernmental according to the use of their proceeds, the 10% limit on nongovernmental use and the 5% limit on loans to nongovernmental persons, and the inclusion in the volume cap of the nongovernmental portion exceeding $1 million of a governmental bond will impose impossible recordkeeping and administrative requirements on bond issuers at the state and local level.

The early issuance provision which specifies that bonds would be retroactively taxable if 5% of bond proceeds are not spent within 30 days and all proceeds within 3 years is in many instances impossible to comply with. Certain state constitutions require officials to have money in hand before they hire contractors, which makes it difficult, if not impossible, to expend 5% of the proceeds within 30 days.

The new temporary period during which arbitrage may be earned (30 days for bond proceeds used in connection with acquisition and 6 months for construction) will seriously increase the cost to state and local governments of financing infrastructure projects.

Advance refundings provide state and local governments with the ability to reduce interest costs and restructure existing debt to provide necessary financing flexibility. Therefore, the requirement that all pre-1986 bond issues qualify as governmental under the provisions of the legislation in order to qualify for advance refunding is both unfair in its retroactivity and unreasonably burdensome on local issuers who must go back and trace the proceeds. The requirement that any nongovernmental use of refunded bonds exceeding $1 million be counted against the state's volume cap will further reduce the severely limited volume available for new infrastructure facilities.

The inclusion of interest on "nongovernmental" tax-exempt bonds in the minimum tax will raise financing costs by requiring a higher yield to attract investors who might be subject to the tax.

The changes in the depreciation system and the repeal of the investment tax credit will significantly discourage private investment in facilities which serve a clear public purpose, such as sewage, solid waste, and water supply facilities, and lead to higher costs, higher local taxes and increased user fees.

All of these changes will result in higher costs for infrastructure projects. In addition, the changes will severely limit local governments' access to the financial markets and will impose upon state and local bond issuers a new level of complexity with which many issuers are unequipped to deal. As a consequence, many needed projects will never be undertaken.

State and local governments have maintained their fiscal status through several years of tax increases and budget cuts, and it is extremely unlikely that they can ask their citizens to dig much deeper into their pockets. Rather, these governments will postpone or cancel many infrastructure projects, which will adversely affect both public health and safety and economic activity.

In and of themselves, these changes in the tax code will severely constrain the effort to obtain the necessary capital for infrastructure financing. When combined with the cuts that Gramm-Rudman-Hollings will make both in direct funding for infrastructure and in indirect sources of capital such as revenue sharing, the result will be a major setback and a substantial widening of the funding gap.

We urge that you do whatever you can to obtain changes in the tax reform bill that will preserve state and local governments' access to the capital market and protect them from financing restrictions they will find onerous and impossible to comply with. We also urge that you work to obtain a clear public statement from the Finance Committee that no provision in the bill will be effective before

January 1, 1987. We know that your colleagues are concerned about capital formation, and it is essential that they realize that the problems we are raising go to the very heart of that issue.

Sincerely,

Joseph M. Giglio

Joseph M. Giglio
Chairman