Small-issue Industrial Revenue Bonds in the Seventh Federal Reserve District

David R. Allardice

On September 3, 1982 the Tax Equity and Fiscal Responsibility Act of 1982 was signed into law. In part, the act repealed the tax exemption that had been available for small-issue industrial revenue bonds (IRBs), effective for obligations issued after 1986. Other provisions of the act were intended to limit the use of IRBs issued prior to 1986.

For years the Congress, the Internal Revenue Service, and others have expressed growing concern over the economic inefficiencies, resource misallocation, and potential loss of tax revenue to the U.S. Treasury that were considered to be the direct result of the rapidly expanding use and growing level of IRB financing. While these concerns have been the basis for the recent legislation limiting the use of IRBs, interest groups with strong views concerning the merits of IRB financing have prevented the passage of legislation that would totally abolish the use of this method of raising capital.

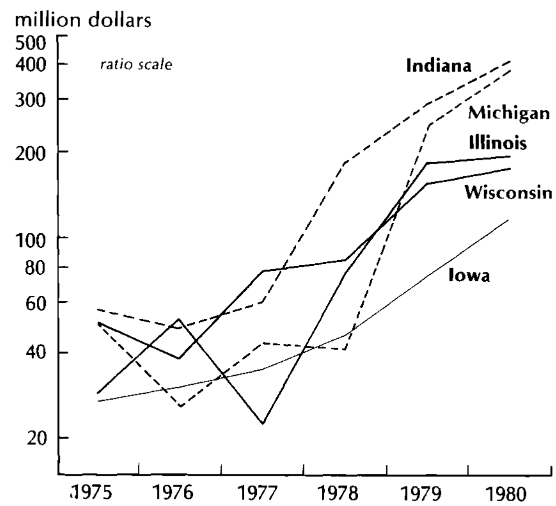
With these legislative changes and public concerns in mind, the Federal Reserve Bank of Chicago examined the background and use of industrial revenue bond financing. The use of these obligations within the five states (Illinois, Indiana, Iowa, Michigan, and Wisconsin) of the Seventh Federal Reserve District may shed some light on the overall national utility and desirability of IRBs.

IRB financing—the background

Forty-seven states currently permit local governmental units to sell tax-exempt revenue bonds and channel the funds derived from such sales into private and quasi-public endeavors. Commonly referred to as industrial revenue bonds, these obligations have become a significant source of nonconventional financing, especially for small businesses. Since small-issue IRBs are tax-exempt, businesses have been able to use the obligations to finance projects at rates below conventional commercial loan rates. Annual sales of IRBs have grown from about $24 million in 1969 to $8.4 billion in 1980. This dramatic growth partly reflects the subsidy that financing through IRBs offers. In recent years IRBs have financed businesses at interest rates between 4 and 7 percentage points below the cost of conventional financing.

Since most IRBs are placed privately with local banks, it is difficult to obtain reliable data at state and local levels. Because of this, the Federal Reserve Bank of Chicago undertook a study to determine the amount of IRB

Figure 1: Annual industrial revenue bond sales in the District States



financing in the District states from 1975 through 1980.[1]

Based on data from various state agencies and surveys of local municipalities, the study found that IRBs issued in the five District states between 1975 and 1980 approximated $3.3 billion.[2] Moreover, the annual amount of IRBs issued in all District states rose rapidly during this period. Indiana issued the largest number and dollar volume of IRBs, amounting to 1,059 obligations worth $1.04 billion.

History of IRB financing

Depletion of certain natural resources, changes in the cotton industry, and the impact of the Depression left southern states with little industry and a surplus of agricultural labor by the mid-1930s. In 1936, the state of Mississippi established the "Balance Agriculture with Industry Program." Launched on the idea that industrial employment and development were in the public interest, this program authorized cities and counties in the state to incur general obligation indebtedness to construct buildings for leasing to private enterprise. In 1938 the city of Durant, Mississippi, issued the first such obligation in the amount of $85,000 for the construction of the Realsilk Hosiery Mill.[3]

The use of local government bonds to finance industrial expansion grew modestly for two decades. Through the mid-1950s the annual volume of new IRB issues never exceeded $10 million. But growth accelerated in the 1960s. In 1962, new IRB issues approximated $84 million, or 0.10 percent of all tax-exempt bonds issued. By 1968 the volume reached $1.6 billion, or 10 percent of all tax-exempt bonds issued.[4] The rapid growth in the 1960s has been attributed to interstate competitive pressures to attract industry and to increases in the cost of raising funds in the capital market.

This growth led to increasing concern about the potential abuses of such financing and the loss of tax revenues resulting from the increased use of IRBs. The Congress responded by passing the Revenue Expenditure and Control Act of 1968. This act removed the tax-exempt status of all IRBs, except those used to finance "exempt activities," "industrial parks," and those sold under a "small-issue" exemption.

This act significantly curtailed the expansion in IRB financing for several years. However, IRB use began to increase again as the small-issue exemption was modified. Initially, the small-issue exemption pertained to IRBs of $1 million or less. Several months later, the act was amended. The amendment permitted IRB issues of $1 to $5 million to retain the tax-exempt status, provided the funds were used to finance a firm that limited its capital expenditures in the local area to no more than $5 million during a six-year period centered on the date the IRBs were issued. Unless the firm complied with the capital expenditure limitation, the small-issue exemption was lost.

A decade later the Congress, responding to arguments that inflation had reduced the value of the ceilings, raised the $5 million small-issue exemption to $10 million. The Tax Reform Act of 1978 also established a special capital expenditure rule for small-issue IRBs used in connection with Urban Development Action Grants. On such issues the six-year capital expenditure limit was increased to $20 million.

The higher small-issue exemption and the rising cost of capital triggered renewed

[1]For a more detailed discussion of the study's findings see: David R. Allardice, *Industrial Revenue Bond Financing in the Seventh Federal Reserve District*, Working Paper 82-2, June 1982, Federal Reserve Bank of Chicago.

[2]This represents the minimum dollar amount of IRBs that have been issued, since not all municipalities were surveyed and not all of those responded.

[3]Olin S. Pugh, *Industrial-Aid Bonds as a Source of Capital for Developing Regions*, (University of South Carolina: Bureau of Business and Economic Research, 1971), p. 1.

[4]Alan Rabinowitz, *Municipal Bond Finance and Administration* (New York: Wiley-Interscience, 1969), p. 103.

growth of IRB financing and heightened concern about alleged IRB abuses. The abuses that attracted the most attention were the use of industrial revenue bonds to finance such nonpublic ventures as massage parlors, country clubs, and race tracks.

The Internal Revenue Service published guidelines in August 1981 for determining whether a pooled offering of IRBs would be treated as a multiple or single bond issue, for purposes of applying the small-issue exemption. In general, the obligations were to be considered a single issue if they were sold under a common plan of marketing, at about the same time and interest rate, and a common or pooled security was available to service the debt. Treatment of the pooled offering as one issue often reduced the availability of tax-exempt IRB financing for many firms and squelched the rapidly building interest shown by many states in using IRB issues backed by pooled real estate assets to finance young farmers.

Congressional concern over IRB financing is reflected in the Tax Equity and Fiscal Responsibility Act of 1982. In addition to eliminating the tax-exempt status of small-issue obligations issued after 1986, the act removes the tax-exempt status of obligations, effective year-end 1982, when more than 25 percent of the bond proceeds are used for a facility primarily providing retail food and beverage services, automobile sales or service, or for the provision of recreation or entertainment. In addition, the small-issue exemption does not apply to about 12 specific types of entertainment and recreation projects, such as country clubs, tennis clubs, racquet sports facilities, and racetracks.

The new law in effect overrides the 1981 Internal Revenue Service ruling with respect to pooled securities. Pooled issues of IRBs will now be treated as separate issues (and thus tax-exempt) unless the obligations are used to finance two or more facilities that are (1) located in more than one state or (2) have the same person or related persons as the principal user.

The new law also establishes requirements for the reporting and public approval of IRB issues. Effective December 31, 1982, IRB sales will be reported quarterly to the Internal Revenue Service and public approval of such financing must be obtained. The public approval requirement may be satisfied by either (1) a public hearing followed by approval by the issuer's elected official or (2) a voter referendum.

IRB financing: pro and con

Studies and opinions vary widely as to the advantages and disadvantages of industrial revenue bond financing. No consensus exists on whether the one outweighs the other.

Advantages

Most studies agree that the bulk of the benefits from IRB financing go to the firms that receive the interest rate subsidy from tax-exempt IRB financing. IRBs aid firms in the construction of plant and equipment by serving as a supplemental source of capital and by lowering the average cost of capital to the firm. The difference between conventional loan rates and rates on IRB financing has been significant, particularly in recent years. The difference has typically ranged from 2 to 3½ percentage points, but widened to a range of 4 to 7 percentage points in the early 1980s.[5]

Local government officials cite numerous advantages in IRB financing. They argue that IRBs can attract new industry, thereby improving—at little cost to the local government—the economic base of the community. This advantage is frequently cited as a useful tool to stimulate development in economically depressed communities. It is also argued that on a dollar-for-dollar basis IRB financing is less costly to local governments than other community development options. If IRBs do attract industry to a local community, then the community may well benefit by increases

[5]*Small Issue Industrial Revenue Bonds*. Congress of the United States, Budget Office, April 1981, p. 18.

in employment, income, and local economic growth. These improvements, in turn, may strengthen the local government by broadening the tax base and by promoting labor use in areas where labor may be relatively immobile, unemployed, or underemployed.

If such benefits to the community are, in fact, produced by IRB financing, then there are obvious political advantages to be gained from these programs. At very little explicit cost to the local community, local government officials can cite newly attracted firms, increased employment, and an expanded tax base as examples of their public management skills.

Bondholders, especially those in upper income tax brackets, benefit from the tax-exempt status of IRBs. And the expanded use of IRBs may drive up interest rates on all tax-exempt securities, thus increasing returns to all holders.

Disadvantages

The expanded use of IRBs has generated an increasing number of arguments and objections against this form of financing. In general, opponents argue that IRB financing results in a misallocation of labor and capital. They contend that a firm requiring a subsidized loan is by that fact shown to be less efficient than those not requiring a subsidy.[6] It is further argued that firms not receiving IRB financing are placed at a cost disadvantage relative to those receiving the subsidy from IRB financing.[7]

Others oppose IRB financing because of the federal tax revenues that are foregone due to the bonds' tax-exempt status. That loss may be substantial. The Congressional Budget Office (CBO) estimated that the federal tax revenue loss due to IRB financing amounted to $700 million in fiscal 1980.[8] However, some contend that the revenue loss was only one-sixth the CBO estimate; still others hold that the economic activity generated by IRBs has produced net increases in tax revenues for all levels of government, including the federal government.[9]

Another possible disadvantage is the impact of IRB financing on cost and the ability of local governments to raise funds for more traditional public purposes. If the demand for tax-exempt securities is downward sloping, an increase in the supply of these obligations will lower the price—raise the interest rate—of the bonds issued. If the higher interest rates on IRBs attract funds that would otherwise have gone into other municipal obligations, it may become more costly to raise funds for public investments that are considered to be of a higher priority and of greater social value.

While IRBs are intended to attract and retain industry in a local community, some observers argue that IRB financing is an ineffective tool. Studies of factors affecting the location decisions of larger firms show that such factors as energy costs and proximity to raw materials, customers, and labor tend to outweigh financing costs in most business location decisions. To the extent that local authorities everywhere use IRBs to compete against one another in attracting or retaining business firms, any regional benefits to private businesses are eliminated and such financing functions simply as a conduit to the tax-exempt market.

Questions about the appropriateness of local governments subsidizing private industry have surfaced since the inception of IRBs. Opponents of IRB financing increasingly raise this issue as the scope of projects that are

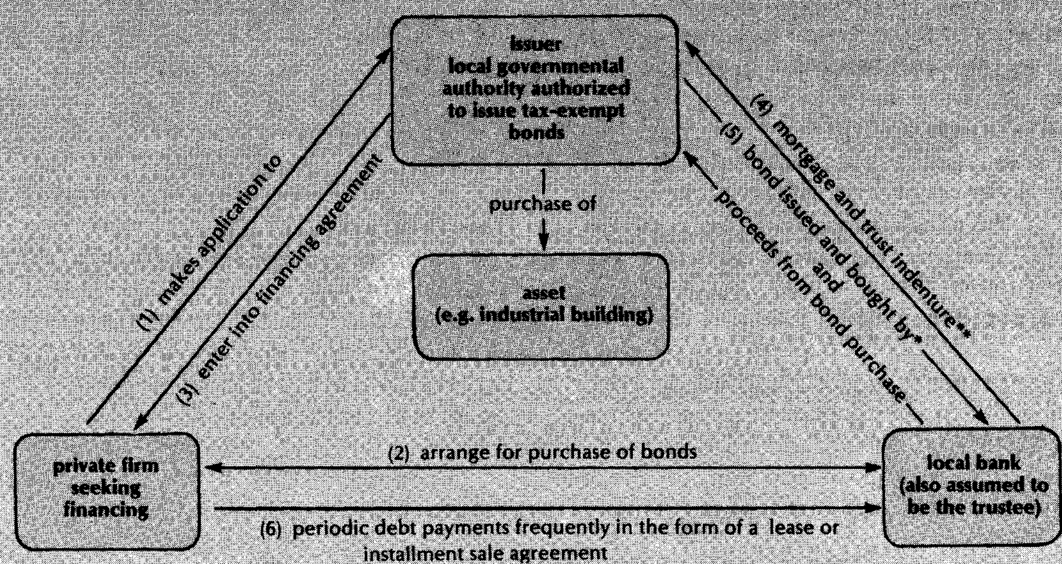
[6]Ralph Gray, "An Economic View of Municipal Subsidies to Industry," *Municipal Finance*, vol. 36 (May 1964), p. 156.

[7]This disadvantage raises questions other than those related to equity. The United States Supreme Court has held that local governments are not automatically exempt from the operation of antitrust laws. *City of Lafayette, Louisiana and City of Plaquemine, Louisiana v. Louisiana Power and Light Company*, 435 U.S. 389, 55 L. Ed.2d 364, 98 S. Ct. 1123 (1978). Thus, refusal to provide IRB financing for a competitor of a municipally owned utility might provide a basis for an antitrust suit.

[8]*Small Issue Industrial Revenue Bonds*, p. 40.

[9]*Report on Tax-Exempt "Small Issue" Industrial Revenue Bonds*, Committee Print WMCP: 97-12, 97 Cong. 1 Sess., July 9, 1981, pp. 5-6.

Figure 2:
Typical industrial revenue bond transaction



*Issuing authority typically assigns to bank all the rights and interest in the financing agreement or other security.

**An agreement between user and corporate trustee to insure adequate administration of the bond issue. Insures that trustee receives payments from company and pays principal and interest on the bonds to the bondholders.

deemed to serve a "public purpose" grows ever wider.[10]

Opponents of IRB financing also point to the issue of "plant pirating." Firms induced to relocate by IRB financing leave behind unemployment, reduced purchasing power, higher costs for certain social services, and a lower tax base. From the perspective of the national economy, the benefits to the acquiring community must be weighed against the costs to the community losing the firm before a conclusion can be reached that the public was better served by the relocation.

[10]A landmark court decision in 1937 addressing the question of public purpose held that "the states, by their constitutions and laws, may set their own limits upon their spending power—but the requirements of due process leave full scope for the exercise of a wide legislative discretion in determining what expenditures will serve the public interest." *Carmichael v. Southern Coal and Coke Co.*, 301 U.S. 495, 81 L.Ed. 1245 (1937).

State enabling acts

Each state must pass enabling legislation before IRBs can be issued. The laws vary, but they frequently specify the type and/or location of business or activity that can be financed by such bonds, the total dollar size (maximum or minimum) of each issue, reporting requirements, controls, and any other provisions desired. All but three states (Hawaii, Idaho, and Washington) have passed legislation authorizing the issuance of industrial revenue bonds.[11]

The states vary greatly in the details of their enabling legislation. In some states, (Rhode Island, for example) the issuance of IRBs is under the control of a state agency. In

[11]*Background Information for Hearings on Tax-exempt "Small Issue" Industrial Revenue Bonds*, Committee Print 97-6, 97 Cong. 1 Sess., April 7, 1981, p. 4.

most states—43—control rests with local levels of government and industrial development authorities. Some states require "proof of net economic benefit" arising out of the issuance of IRBs.

IRBs in the District states

According to recent studies, in 1980 the five Seventh District states accounted for about 12 percent of all small-issue IRB sales in the United States. However, the same data show that from 1975 through 1980 the growth in IRB financing in the District states has been at about a 70 percent annual rate. This was below the national average of almost 90 percent per year. The following reviews the status of IRB financing in each of the District states.

Illinois

Industrial revenue bond sales in Illinois are not reported to any central body, nor does their issuance require the explicit approval of any state agency prior to their sale. The following information on IRB sales in Illinois is therefore based on a survey of all municipalities in the state with a population in excess of 500 persons, based on 1980 census data.

Of the 1,274 municipal governments in Illinois, 881 were surveyed. About 88 percent of those contacted responded to the survey. Of the 779 respondents, only 128 municipalities—16 percent—indicated that they had issued one or more IRBs between 1975 and 1980. Overall, these municipalities issued 340 IRBs between 1975 and 1980 with an aggregate dollar volume of $567 million.

In 1975, only 19 municipalities issued IRBs. By 1980 the number of municipalities that had issued such obligations had risen to 128. The annual dollar volume of IRBs issued in Illinois ranged from less than $29 million in 1975 to a high of $196 million in 1980.

In terms of both dollar volume and number of issues, the city of Chicago has been the largest municipal issuer of IRBs in Illinois since 1975, although Chicago did not begin to issue IRBs in any meaningful amount until 1977. From 1977 through 1980 Chicago issued 39 IRBs worth $66 million.

Municipalities with populations in excess of 5,000 persons were the major issuers of IRBs in Illinois. Of the 128 responding municipalities in Illinois that had issued IRBs, 71 percent had populations exceeding 5,000. These municipalities accounted for 83 percent of the IRBs issued in Illinois from 1977-80. It is noteworthy that only 20 percent of all municipalities in Illinois have populations in excess of 5,000 persons.

IRB sales were concentrated in the major metropolitan areas within Illinois. The 128 municipalities that issued IRBs were located

Population of Illinois municipalities issuing industrial revenue bonds, 1975-1980

Municipal size class	Municipalities issuing IRBs	
	Number	Percent
(number of persons)		
1- 1,000	8	6
1,001- 2,500	14	11
2,501- 5,000	15	12
5,001-15,000	32	25
15,001-25,000	20	16
25,001-50,000	23	18
50,001 and over	16	12
Total	128	100

Dollar volume of industrial revenue bond sales in Illinois by municipal size class

Municipal size class	Dollar volume of reported IRB sales	Percent
(number of persons)	*($ millions)*	
1- 1,000	$ 46.98	8
1,001- 2,500	17.43	3
2,501- 5,000	32.83	6
5,001-15,000	62.26	11
15,001-25,000	73.37	13
25,001-50,000	141.35	25
50,001 and over	192.74	34
Total	$566.96	100

in just 50 of the 102 counties in Illinois. Cook County dominated, with 24 municipalities selling 100 IRBs worth over $170 million.

Of the 50 counties having municipalities that issued IRBs, 36 percent are located in Standard Metropolitan Statistical Areas (SMSAs)—major metropolitan centers within the state. Municipalities located in the state's 18 SMSA counties sold $459.8 million, or 81 percent, of all IRBs reported sold in Illinois from 1975 to 1980.

Indiana

Cities, towns, and counties in Indiana have the authority to establish economic development corporations (EDCs), which can issue industrial revenue bonds to finance industrial, commercial, and manufacturing facilities. Once established, EDCs must report annually to the Indiana Department of Commerce the volume of IRBs issued.

Data from the Department of Commerce show that 133 municipalities and four counties had issued industrial revenue bonds between 1975 and 1980. This represented only about 20 percent of the county and municipal governments in Indiana.

Some 1,060 IRBs were issued in Indiana between 1975 and 1980. The aggregate dollar volume of these bonds amounted to just over $1 billion, making Indiana the largest IRB issuer of the District states. The average dollar size of IRBs issued in Indiana from 1975 through 1980 was slightly less than $1 million ($983,000) per obligation.

Indiana EDCs issuing industrial revenue bonds by municipal size class 1975-1980

Municipal size class	EDCs issuing IRBs	
(number of persons)	Number	Percent*
1- 1,000	6	5
1,001- 2,500	26	20
2,501- 5,000	13	10
5,001-15,000	47	35
15,001-25,000	19	14
25,001-50,000	13	10
50,001 and over	9	7
Total	133	100

*Does not sum due to rounding.

Indiana industrial revenue bond sales by municipal size class 1975-1980

Municipal size class	Dollar volume of IRB sales	Percent*
(number of persons)	*($ millions)*	
1- 1,000	4.616	1
1,001- 2,500	44.084	4
2,501- 5,000	32.772	3
5,001-15,000	184.100	18
15,001-25,000	137.176	13
25,001-50,000	209.696	20
50,001 and over	414.140	40
Total	$1,026.584	100

*Does not sum due to rounding.

The largest issuer of IRBs in Indiana has been South Bend, which issued a total of 136 obligations worth $113.3 million between 1975 and 1980. Other larger issuers include Fort Wayne ($82.2 million), Indianapolis ($71.7 million), Evansville ($75.6 million), and Elkhart ($45.0 million). These five municipalities accounted for 37 percent of the dollar volume of IRBs issued in Indiana from 1975 through 1980.

As in Illinois, municipalities that issued IRBs in Indiana from 1975 through 1980 tended to be the larger municipalities. Of the 563 municipalities in Indiana only 18 percent have populations greater than 5,000. But the 66 percent of IRB-issuing municipalities that were of this size accounted for 91 percent of all IRBs issued by municipalities in Indiana.

IRB issues—in terms of both the number and the dollar volume—were concentrated most heavily in Indiana's urban counties. About 75 percent of the number and the dollar volume of all IRBs issued in Indiana in 1975-80 came from local governments located in the 12 SMSAs in Indiana. Thus, only about one-fourth of the total number and dollar volume of IRBs sold by municipalities in Indiana were issued by municipalities located in rural (non-SMSA) counties, although non-SMSA counties in Indiana account for 33 percent of the population of that state.

Iowa

State law permits incorporated cities and counties to issue industrial revenue bonds. These obligations may be issued to finance manufacturing, processing, or assembling facilities for agricultural and manufactured products. They may also be issued for commercial enterprises engaged in storing, warehousing, or distributing products of agriculture, mining, or industry.

Issuers of IRBs in Iowa are required to report their sales annually to the state of Iowa. These data reveal that from 1975 through 1980 a total of 125 Iowa cities or counties, out of a total of 1,054 cities and counties in the state, had issued IRBs. In the aggregate, these entities issued $330.8 million of IRBs. County entities accounted for $26.3 million of the total.

The largest individual municipal issuer of IRBs in Iowa was the city of Davenport, which issued 11 obligations amounting to $20.0 million. The next largest municipal issuers were Mason City ($16.2 million), Cedar Rapids ($14.8 million), and Des Moines ($13.7 million). Combined, these four cities accounted for approximately one-fifth of the dollar volume of all IRBs sold in Iowa between 1975 and 1980.

Industrial revenue bond sales in Iowa by city size class

City size class	Dollar volume of IRB sales	Percent*
(number of persons)	*($ millions)*	
1- 1,000	14.31	5
1,001- 2,500	42.46	14
2,501- 5,000	43.54	14
5,001-15,000	77.56	25
15,001-25,000	25.24	8
25,001-50,000	30.32	10
50,001 and over	71.10	23
Total	$304.53	100

*Does not sum due to rounding.

Most of the Iowa cities issuing IRBs between 1975 and 1980 were small. About 80 percent of the 115 cities issuing IRBs had populations of less than 15,000 persons. These cities accounted for 58 percent of the IRBs issued. These figures reflect the small size of Iowa municipalities, 92 percent of which have populations of less than 15,000 persons. IRBs were issued—either by cities or county entities—in 77 of Iowa's 99 counties from 1975 through 1980. Three counties (Polk, Scott, and Cerro Gordo) accounted for approximately 28 percent of all the IRBs sold in Iowa.

Iowa is the only District state in which rural (non-SMSA) counties accounted for the majority of IRBs issued. Cities or counties in SMSAs issued only 39 percent of the dollar volume and 41 percent of the number of IRBs.

Population of Iowa cities issuing industrial revenue bonds, 1975-1980

City size class	Cities issuing IRBs: Number	Cities issuing IRBs: Percent*
(number of persons)		
1- 1,000	20	17
1,001- 2,500	23	20
2,501- 5,000	22	19
5,001-15,000	28	24
15,001-25,000	6	5
25,001-50,000	8	7
50,001 and over	8	7
Total	115	100

*Does not sum due to rounding.

Michigan

Analysis of industrial revenue bond sales in Michigan from 1975 through 1980 is complicated by the fact that the IRBs were issued under three separate statutes. Moreover, economic development corporations (EDCs) in Michigan were not required until recently to report their annual sales of IRBs to any state authority. While some data were available, they were not considered complete. As a result, a mail survey of the 312 Michigan EDCs was necessary to determine the dollar volume and number of IRBs sold by the EDCs from 1975 through 1980.

The survey found that IRB sales in Michigan grew very rapidly in 1979 and 1980. From 1975 through 1978, the annual volume of IRBs issued in Michigan averaged about $39 million. Then, IRB issues jumped to $249 million in 1979 and $374 million in 1980, due in part to rising interest rates and a greater reliance on EDCs. The dollar volume of IRBs issued in 1980 was more than seven times the 1975 volume. Over the six-year period under study, some $781 million in IRBs were issued in Michigan.

Most of Michigan's IRBs were issued in the Lower Peninsula and in the state's major metropolitan areas.[12] The largest dollar volume of IRBs was issued in Wayne County ($112.8 million), followed by Kent ($97.5 million), Oakland ($61.0 million), and St. Clair ($56.8 million) Counties. These four counties accounted for 42 percent of the dollar volume of all IRBs issued in Michigan.

Counties in SMSAs accounted for 81 percent of the IRBs issued in Michigan during the six-year period. The Michigan experience provides added evidence that IRB financing in the District states, except for Iowa, is mainly an urban phenomenon.

Wisconsin

Cities, villages, and towns in Wisconsin are authorized to sell industrial revenue bonds.

Issuers of IRBs in Wisconsin must report their sales to the Wisconsin Department of Business Development. The data reveal that 191 municipalities in Wisconsin issued a total of 590 IRB obligations amounting to $571.3 million for industrial, commercial, and recreational purposes from 1975 through 1980.

The largest single municipal issuer of IRBs in Wisconsin, both in number of bonds and dollar volume, was the city of Milwaukee. Milwaukee issued 47 IRBs amounting to $66.8 million. Other major municipal issuers included the cities of Sheboygan ($26.5 million), Janesville ($20.8 million), Appleton ($18.4 million), and Oshkosh ($16.1 million). These five municipalities accounted for 26 percent of the dollar volume and 22 percent of the number of IRBs issued in Wisconsin during the six years under study.

Over half (57 percent) of the municipalities issuing IRBs from 1975 through 1980 had populations of less than 5,000 persons. However, 83 percent of Wisconsin's 576 municipalities have less than 5,000 persons, which indicates that this municipal size class is underrepresented in IRB sales. Large municipalities—those with populations in excess of 50,000 persons—accounted for 6 percent of the municipalities issuing IRBs during the period under study. However, municipalities with over 50,000 persons make up only about 1 percent of all Wisconsin municipalities.

While Wisconsin municipalities with less than 5,000 persons made up the majority of municipalities issuing bonds in terms of number of bonds issued, these same municipalities accounted for only about one-fifth (22

Population of Wisconsin municipalities issuing industrial revenue bonds, 1975-1980

Municipal size class	Municipalities issuing IRBs	
	Number	Percent
(number of persons)		
1- 1,000	22	12
1,001- 2,500	45	24
2,501- 5,000	40	21
5,001-15,000	50	26
15,001-25,000	13	7
25,001-50,000	10	5
50,001 and over	11	6
Total	191	100

*Does not sum due to rounding.

[12]Data on IRB sales by municipal size class are not presented because the sale of IRBs in Michigan is spread across county, township, and municipal governments. As such, the data are not comparable with the four other District states.

Wisconsin industrial revenue bond sales by municipal size class 1975-1980

Municipal size class	Dollar volume of IRB sales	Percent*
(number of persons)	($ millions)	
1- 1,000	$ 24.31	4
1,001- 2,500	44.91	8
2,501- 5,000	56.04	10
5,001-15,000	155.73	27
15,001-25,000	63.61	11
25,001-50,000	64.08	11
50,001 and over	162.58	28
Total	$571.26	100

*Does not sum due to rounding.

percent) of the dollar volume of IRBs sold. Municipalities with over 50,000 persons accounted for 28 percent of the dollar volume of IRBs sold from 1975 through 1980.

From 1975 through 1980 IRBs were issued in 50 of Wisconsin's 72 counties. Eighteen of these 50 counties make up all or part of an SMSA. Municipalities within SMSA counties accounted for 73 percent of the dollar volume of all IRBs sold in the state during this period. IRB financing in Wisconsin is tied more to the urban and less to the rural economy.

Wisconsin's experience

Wisconsin is the only District state in which various state agencies have studied the growth and impact of the state's IRB financing program.[13] These studies found that approximately 86 percent of the dollar amount of IRBs sold in Wisconsin were issued for industrial purposes. The remaining 14 percent were issued to assist the financing of national or regional business headquarters; recreational, hotel, and convention facilities; service, warehouse, and distribution facilities; and commercial enterprises located in redevelopment areas.

Eight out of every 10 dollars in funds generated from IRB sales in Wisconsin were used by firms already located in the state. Only 12 projects using IRB financing attracted out-of-state firms. These findings tend to support other studies that have concluded that financing costs are not one of the primary factors influencing a firm's location decision. They also weaken the argument of those that consider IRBs to be an effective tool in the interstate "pirating" of new industry.

Studies of the Wisconsin IRB program also found that 40 percent of the firms using IRB financing had fewer than 50 employees and only about 26 percent of the firms using such financing were subsidiaries of larger corporations. Thus, there is a basis upon which to conclude—at least in Wisconsin—that IRBs are often used as a tool to finance small, local business in major urban areas.

From the Wisconsin studies it is also known that commercial banks have been the major purchasers of IRBs in Wisconsin. About 75 percent of all the IRBs issued in that state were purchased by banks. Most of these banks were headquartered in Wisconsin.

Conclusion

The dramatic growth in industrial revenue bond financing in the Seventh Federal Reserve District may be attributed to the high cost of conventional business financing and attempts on the part of states and municipalities to attract or retain business.

The study of this financing technique reveals widespread use and diversity within the District states. IRBs are primarily used by municipalities located within major metropolitan areas, except in Iowa where their use is centered in the rural communities. This exception is best explained by Iowa's predominantly rural makeup rather than by any difference in policy.

The study also found a lack of central reporting of IRB sales in certain District states. The lack of adequate data can result in inac-

[13]Richard Kotenbeutel, *Economic Impact of Industrial Revenue Bond Usage in Wisconsin*, (Madison: Wisconsin Department of Business Development, May 1980), and *Industrial Revenue Bonds: An Evaluation by the State of Wisconsin Legislative Audit Bureau*, Madison, May 1981, processed.

curate conclusions being drawn about the use and trends of such financing. Centralized reporting is desirable if lawmakers are to establish sound public policies on the use of such obligations.

The combined effect of the recent decline in interest rates and the passage of the Tax Equity and Fiscal Responsibility Act of 1982, with the provision to eliminate the small-issue exemption after 1986, will be to reduce the future volume of IRB sales in the District and nationwide. However, public financing of private projects remains an option for certain borrowers for certain types of projects. Furthermore, the history of such financing shows that their use tends to ebb and flow with political and economic currents.

ECONOMIC PERSPECTIVES—Index for 1982