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PROFESSIONAL SPORTS STADIUMS: DO THEY DIVERT PUBLIC FUNDS FROM CRITICAL PUBLIC INFRASTRUCTURE?

HEARING

BEFORE THE

SUBCOMMITTEE ON DOMESTIC POLICY

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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PROFESSIONAL SPORTS STADIUMS: DO THEY DIVERT PUBLIC FUNDS FROM CRITICAL PUBLIC INFRASTRUCTURE?

WEDNESDAY, OCTOBER 10, 2007

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC POLICY,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m. in room 2154, Rayburn House Office Building, Hon. Dennis J. Kucinich (chairman of the subcommittee) presiding.

Present: Representatives Kucinich, Cummings, Davis of Illinois, Tierney, and Issa.

Staff present: Jaron R. Bourke, staff director; Charles Honig, counsel; Jean Gosa, clerk; Chris Mertens, intern; Natalie Laber, press secretary, Office of Congressman Dennis J. Kucinich; Leneal Scott, information systems manager; Alex Cooper, minority professional staff member; and Larry Brady, minority senior investigator and policy advisor.

Mr. KUCINICH. The committee will come to order.

I have been informed by the minority staff that Mr. Issa will be here, but he has asked if we could begin in his absence. He has assented to that.

We have also been asked by Mr. Solomon if we could expedite his testimony, as he has other pressing time commitments, and we shall do that, as well.

The committee will come to order. The Subcommittee on Domestic Policy of the Committee on Oversight and Government Reform is in order. Today's hearing will examine whether professional sports stadiums divert public funds from critical public infrastructure.

Without objection, the Chair and the ranking minority member—who, again, has asked us to proceed in his absence, but he is on his way—will have 5 minutes to make opening statements, followed by any opening statements, not to exceed 3 minutes, by any other Member who seeks recognition.

Without objection, Members and witnesses may have 5 legislative days to submit a written statement or extraneous materials for the record.

The Department of Transportation says there are 12,176 structurally deficient urban bridges in America today. I can tell you, coming from Cleveland, OH, we have quite a few in our city, as well. One of those bridges collapsed in Minneapolis, MN, last Au-

gust killing 13 people. Our bridges, roads, schools, and water purification systems are all aging. Many are in need of repair and replacement. Assessing the whole picture, the American Society of Civil Engineers has concluded America's infrastructure is "crumbling."

For those who are in the audience, every county engineer in America has to keep a list of the conditions of critical infrastructure and particular bridges and to grade those bridges as to their structural stability. I have seen lists in quite a few communities, and I can tell you there is a great concern across America about the structural stability of a lot of our infrastructure.

But even though we have our infrastructure crumbling, the Minnesota Twins got public funding approved for a new stadium just a year before the I–35 West bridge collapsed. The Yankees are getting a new stadium valued at over $1 billion, even though New York City, alone, has 50 structural deficient bridges. In Cleveland, local and State government gave the Browns and the Indians and the Cavaliers new stadiums, yet we have five structurally deficient bridges in the county.

As an aside, while we are, in Cleveland, very proud of our Cleveland Indians and want to see them go to the World Series, we also know that in the city of Cleveland there was a great debate about the funding for these stadiums and that, while the public provides the funds, the people who are living in the city aren't getting any free tickets to these games. They are paying, if they can get a ticket, for the ticket. They paid for the stadium. They don't get any of the profits.

Now, this story of crumbling infrastructure around the Nation is pretty much the same everywhere, in light of publicly funded and financed sports stadiums. Baltimore has two publicly financed sports stadiums, while the county has eight structurally deficient bridges. Philadelphia has three publicly financed sports stadiums, while the county has 42 structurally deficient bridges. Chicago has two publicly financed sports stadiums while it has a whopping 82 structurally deficient bridges.

Keep in mind this isn't about whether we love our teams in our towns; we all have a great and passionate love for our home team. But this is a separate issue as to where do we put our infrastructure money. Does public funding of professional sports stadiums divert funds and attention from infrastructure maintenance?

Let's look at the case in Minnesota. Since taking office in 2003, Minnesota Governor Tim Pawlenty consistently opposed increases to the gasoline tax, even vetoing them at least once. The gasoline tax increase would have funded bridge and road repair. But he signed a bill allowing Hennepin County to raise its county sales tax without going to the voters, as county law mandates. The county tax increase was dedicated to paying the debt service on the bonds for a new Twins Stadium.

The Minnesota experience is not unique. State and local officials continue to invest public funds in professional sports stadiums, in spite of the persistence of crumbling bridges, roads, and schools. Federal taxpayers continue to subsidize these give-aways by financing new professional sports stadiums with tax-exempt bonds. If

there was ever a topic meriting oversight and government reform, we have one here.

Repairing and maintaining America's roads and bridges is one of the key Government responsibilities, and it is a significant burden on State and local taxpayers. According to the Congressional Budget Office, 63 percent of State and local infrastructure spending is devoted to operations and maintenance. That amounted to $151 billion in 2001. Those funds are diverted from gasoline taxes and general revenues.

Most of the structurally deficient bridges are owned by States and localities. According to the U.S. Department of Transportation, 24,061 of the Nation's 77,793 structurally deficient bridges are owned by States, and 55,390 of them are owned by local governments. Obviously, State and local governments are having a hard time keeping up with the rising cost of bridge maintenance and structural maintenance.

Well, now comes along the professional sports team owners, and to that problem they add another: they want a new stadium. And not just a new stadium, but they ask for parking facilities, a dedicated ramp from the highway, new stadium to have more luxury boxes, even at the expense of fan seating. They want to finance the tax-exempt bonds that the city and State would guarantee because the costs of construction are lower with reduced interest rates on tax-exempt bonds.

So what happens? Cities and States compete with one another to offer the larger package of publicly financed incentives. According to one of our witnesses here today, Professor Judith Grant Long of Harvard, in both absolute and relative terms the public spends a lot on professional sports stadiums. In her written testimony, Professional Long finds that the public will have spent $33 billion on professional sports stadiums by the time the last facility currently scheduled for construction is completed.

Taxpayers also assume a large share of costs for new professional sports facilities. Among new professional sports facilities built since 1990, the average public share of cost is estimated to be between 55 and 85 percent.

Clearly, having a professional sports team in one's city is an expensive item, but it is also not a very good investment. There are few things economists agree on, but the profession is unanimous on this point. At our last hearing on the topic, sports economist Dr. Brad Humphreys of the University of Illinois stated, "I have not found any evidence whatsoever suggesting that professional sports stadiums create jobs, raise income, or raise local tax revenues." Of course, there is a great feeling of pride in having a team, but we also have to recognize that doesn't necessarily create jobs or raise revenues or grow the economy.

One of the things that I said back in Cleveland years ago when the debate was going on over the building of sports facilities is that, instead of building money for a new facility, just issue bonds to buy the team. That way you don't worry about a team leaving, and that way the public owns the team. Then if the team goes to the World Series, then the public shares in that revenue. Then you drive down the price of tickets. There are all kinds of ways you can do this.

But instead what has happened is that the taxpayers get the bill for the stadium. Even worse than that, you have corporations that buy naming rights to make it appear as though they built the stadium. So what you get is the public gets the bills and the owners of the sports team get these huge profits.

It is indisputably clear that public subsidies enrich the private owners of the teams. Look at the Detroit Tigers and Detroit Lions. The value of the Tigers rose from $83 million in 1995 to $290 million in 2001, the year after the team moved into their new stadium. The Lions increased in value after moving into a new stadium even more dramatically from $150 million in 1996 to $839 million in 2006.

Economic benefit to the teams' owners was certainly the case for President Bush, who in 1989 spent about $600,000 to buy a small stake in the Texas Rangers baseball team. During his ownership, Mr. Bush and his co-investors were able to get voters to approve a sales tax increase to pay more than two-thirds of the cost of a new $191 million stadium for the Rangers, as well as the surrounding development.

Mr. Bush and his partners also received a loan from the public authority charged with financing the stadium to cover their private share of construction costs. By 1994, the Rangers, in their new publicly financed stadium, were sold for $250 million, a threefold increase in value in nearly 5 years, and one that was largely attributable to the new taxpayer-subsidized stadium. Mr. Bush personally came away with a profit of $14.9 million. In this case, the tax-exempt financing indisputably benefited the owners of the Texas Rangers.

How is it that critical infrastructure needs go unfunded while luxuries like professional sports stadiums are subsidized heavily?

The first part of the question has been the subject of considerable discussion dating back to the 1980's. For instance, in an article entitled, "Holding Government Officials Accountable for Infrastructure Maintenance," Ned Regan, the long-time Republican Comptroller of the State of New York, wrote: "Maintenance budgets are routinely starved by government at all levels. Neglect, not age, is the root cause of most infrastructure failures in this country. Simply put, deferring maintenance is a handy expedient for public officials faced with problems in balancing their budgets."

Now, Regan identifies two problems that account for that. The first is that politicians like to get credit for what they do, and the credit is more noteworthy when you can cut the ribbon at the opening of a new facility.

He writes: "Maintenance activities, while undeniably in the public interest, tend to be regarded as having low visibility and correspondingly low political payoff. A television news editor, for example, is not likely to be interested in bridge maintenance. Moreover, the consequences of the failure to scrape and paint a bridge in a particular year are not evident at the time. People do not think that the bridge might collapse in the next year."

The second problem is the lack of systematic funding, a lack of a democratic and transparent process in which infrastructure needs are evaluated. There is no process whereby decisionmakers know, based on sound evidence and rigorous analysis, what maintenance

requirements are and what the costs of neglecting maintenance are likely to be. Such information could then be considered in light of available resources when determining maintenance budgets. That is accompanied by a lack of public information. "As long as the public remains uninformed about the extent to which public assets are not being safeguarded, public officials will be encouraged to continue the prevailing pattern of neglect."

This is the second time this subcommittee has examined the merits and costs of public financing of professional sports stadiums. At our March 29, 2007, hearing we examined the effectiveness of Congress' last attempt to curb the use of tax-exempt financing for construction of professional sports stadiums. In 1986, Congress passed the Tax Reform Act, which changed the rules on tax-exempt financing. Basically, the act excluded professional sports stadiums from a list of exceptions to taxable private activity bonds. That should have closed the matter, but sports stadiums continue to be built with more and more public money, according to Professor Long.

When we discussed this specific case in detail with the Chief Counsel of the Internal Revenue Service, who is in charge of enforcing the regulations on tax-exempt financing, we discovered that a significant loophole was being exploited that permitted professional sports teams the benefit of tax-exempt financing for sports stadiums and their exclusive, private use. In that hearing we questioned the Chief Counsel about a private letter ruling that enabled the New York Yankees to benefit from a tax-exempt financing of the new Yankees Stadium and a construction cost saving of $189.9 million, according to New York City's Independent Budget Office.

Obviously, the 1986 act did not have the intended effect of curbing public financing of sports stadiums' construction. As Dennis Zimmerman testified at our previous hearing, "Since local taxpayers were expected to be reluctant to use general obligation debt to pay for stadium debt service, stadium bonds would wither. Unfortunately, the expectation was overwhelmed by the combination of monopoly power to professional sports leagues that maintains excess demand for franchises and stadium proponents' use of pseudo-economic studies showing that stadiums pay for themselves."

Clearly, there is more work to be done. Our bridges should be safe. Our children's school buildings should be safe and conducive to learning. And the owners of professional sports teams should pay for their own stadiums. To the extent that the use of public money to finance professional sports stadiums diverts funds and attention away from maintaining critical public infrastructure, my hope is that these hearings will contribute to fixing the problem, focusing a discussion on the kind of investment that goes into these facilities, asking about the specific economic benefits to the community, especially those that were promised at the beginning of the construction of many of those projects, and asking the question about how do we meet the diverse needs in the community, particularly where there is aging infrastructure.

Middle America, there are bridges that are falling, there are roads that are in ill repair, there are schools that are crumbling; yet, we see this tremendous push being made to try to put hundreds of billions of dollars into sports stadiums.

While we love our local teams and we have a great deal of commitment and pride in our local teams, we also know that the public infrastructure that is needed in order to provide jobs, to increase business activity in a community, has to be maintained, and that infrastructure is crumbling. The money generally comes from local and State governments, the same place where a lot of these funds to build these facilities are coming from.

So with that we are going to go to the first panel.

[The prepared statement of Hon. Dennis J. Kucinich follows:]

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CHAIRMAN,
SUBCOMMITTEE ON DOMESTIC POLICY

COMMITTEE ON OVERSIGHT AND
GOVERNMENT REFORM

COMMITTEE ON EDUCATION AND LABOR

Statement of Dennis J. Kucinich
Chairman, Domestic Policy Subcommittee
Hearing on Public Infrastructure and Professional Sports Stadiums
October 10, 2007

The Department of Transportation says there are 12,176 structurally deficient urban bridges in America today.[1] One of those bridges collapsed in Minneapolis, Minnesota, last August, killing 13 people. Our bridges, roads, schools, and water purification systems are all aging; many are in need of repair and replacement. Assessing the whole picture, the American Society of Civil Engineers has concluded, America's infrastructure is "crumbling."

But the Minnesota Twins got public funding approved for a new stadium just the year before the I-35W bridge collapsed. The Yankees are getting a new stadium valued at over $1 billion, even though New York City alone has 50 structurally deficient bridges. In Cleveland, local and state government gave the Browns, Indians and Cavaliers new stadiums, yet we have 5 structurally deficient bridges in the county. The story is the same around the nation. Look at the slide:

Baltimore has two publicly financed sports stadiums, while the county also has 8 structurally deficient bridges.

Philadelphia has three publicly financed sports stadiums, while the county also has 42 structurally deficient bridges.

And Chicago has two publicly financed sports stadiums, while it has a whopping 82 structurally deficient bridges.

Does public funding of professional sports stadiums divert funds and attention from infrastructure maintenance? Consider the recent case of Minnesota. Since taking office in 2003, Minnesota Governor Tim Pawlenty consistently opposed increases to the gasoline tax, even vetoing them at least once. The gasoline tax increase would have funded bridge and road repair. But he signed a bill allowing Hennepin County to raise its county sales tax without going to the voters as county law mandates. The county tax increase was dedicated to paying the debt service on the bonds for a new Twins stadium.

[1] 2006 Status of the Nation's Highways, Bridges, and Transit: Conditions & Performance, Table "Bridge Deficiencies by Functional System, 2004," p. 3-19 (2006).

The Minnesota experience is not unique. State and local officials continue to invest public funds in professional sports stadiums in spite of the persistence of "crumbling" bridges, roads and schools. Federal taxpayers continue to subsidize these giveaways by financing new professional sports stadiums with tax exempt bonds.

If ever there was a topic meriting "oversight and government reform," we have one here.

Repairing and maintaining America's roads and bridges is one of the key governmental responsibilities, and it is a significant burden on a state and local taxpayers. According to the Congressional Budget Office, 63% of state and local infrastructure spending is devoted to operations and maintenance. That amounted to $151 billion in 2004, and those funds are derived from gasoline taxes and general revenues. Most of the structurally deficient bridges are owned by states and localities. According to the US Department of Transportation, 24,061 of the nation's 77,793 structurally deficient bridges are owned by states, and 55,390 of them are owned by local governments.[2] Obviously, state and local governments are having a hard time keeping up with the rising cost of bridge maintenance.

Now along comes professional sports team owners -- and to that problem, they add another: They want a new stadium. And not just a new stadium, but new parking facilities, maybe a dedicated ramp from the highway, and the new stadium will have more luxury boxes, even at the expense of fan seating. They want it financed through tax exempt bonds that the city and state would guarantee, because the costs of construction are lower with the reduced interest charges on tax exempt bonds.

What happens? Cities and states compete with one another to offer the larger package of publicly financed incentives. According to one of our witnesses today, Professor Judith Grant Long of Harvard, in both absolute and relative terms, the public spends a lot on professional sports stadiums. In her written testimony, Professor Long finds that the public will have spent $33 billion on professional sports stadiums by the time the last facility currently scheduled for construction is completed. Taxpayers also assume a large share of costs for new professional sports facilities. Among new professional sports facilities built since 1990, the average public share of costs is estimated to be between 55% and 85%.

Clearly, having a professional sports team in one's city is an expensive item. But it is also a bad investment. There a few things economists agree on, but the profession is unanimous on this point. At our last hearing on this topic, sports economist Dr. Brad Humphreys of the University of Illinois stated, "I have not found any evidence whatsoever suggesting that professional sports stadiums create jobs, raise income, or raise local tax revenues." Of course, there is always the warm and fuzzy feeling of pride in having a team. But that is no doubt overrated: it doesn't create jobs, it doesn't raise revenues, and it doesn't grow the economy.

But it is clear that public subsidies for professional sports stadium do enrich the private owners of the teams. Consider the Detroit Tigers and the Detroit Lions. We will hear about them and their stadiums from one of our witnesses today. The value of the Detroit Tigers rose from $83 million in 1995 to $290 million in 2001, the year after the team moved into their new stadium. The Lions' increase in value after moving into their new stadium is even more dramatic, rising from $150 million in 1996 to $839 million in 2006.

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[2] *Ibid.*

Economic benefit to the team owners was certainly the case for President George W. Bush who, in 1989 spent about $600,000 to buy a small stake in the Texas Rangers baseball team. During his ownership, Mr. Bush and his co-investors were able to get voters to approve a sales tax increase to pay more than two-thirds of the cost of a new $191 million stadium for the Rangers as well as surrounding development. Mr. Bush and his partners also received a loan from the public authority charged with financing the stadium to cover their private share of the construction costs.

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The first part of the question has been the subject of considerable discussion, dating back to the 1980's. For instance, in an article entitled, "Holding Government Officials Accountable for Infrastructure Maintenance," Ned Regan, the long-time Republican Comptroller of the State of New York, wrote:

> "[M]aintenance budgets are routinely starved by government at all levels. Neglect, not age, is the root cause of most infrastructure failures in this country. Simply put, deferring maintenance is a handy expedient for public officials faced with problems in balancing their budgets."

Regan identifies two problems that account for that. The first is that politicians like to get credit for what they do, and the credit is more noteworthy when you can "cut the ribbon" at the opening of a new facility. He writes:

> "[M]aintenance activities, while undeniably in the public interest, tend to be regarded as having low visibility and correspondingly low political payoff. A television news editor, for example, is unlikely to be interested in bridge maintenance. Moreover, the consequences of the failure to scrape and paint a bridge in a particular year are not evident at the time. People do not think that the bridge might collapse in the next year..."

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That is accompanied by a lack of public information: "As long as the public remains uninformed bout the extent to which public assets are not being safeguarded, public officials will be encouraged to continue the prevailing pattern of neglect."[3]

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[3] Edward Regan, "Holding Government Officials Accountable for Infrastructure Maintenance," in Restructuring the New York City Government: The Reemergence of Municipal Reform, Proceedings of The Academy of Political Science, Volume 37, Number 3 (1989).

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That should have closed the matter. But sports stadiums continued to be built, with more and more public money, according to Professor Long. When we discussed a specific case in detail with the Chief Counsel of the Internal Revenue Service, who is in charge of enforcing the regulations on tax exempt financing, we discovered that a significant loophole was being exploited that permitted professional sports teams the benefit of tax exempt financing for sports stadiums and their exclusive private use. In that hearing, we questioned the Chief Counsel about a "private letter ruling" that enabled the New York Yankees to benefit from tax exempt financing of the new Yankees Stadium, and a construction cost savings of $189.9 million, according to New York City's Independent Budget Office.[5]

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Clearly, there is more work to be done. Our bridges should be safe. Our children's school buildings should be safe and conducive to learning. And the owners of professional sports teams should pay for their own stadiums. To the extent that the use of public monies to finance professional sports stadiums diverts funds and attention away from maintaining critical public infrastructure, my hope is that these hearings contribute to fixing the problem.

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[4] Since 1968, bond issues are taxable if 1) more than 25% of the proceeds are to be used for a private business, and 2) more than 25% of the revenues for payment of the principal and interest (i.e. debt service) are derived from property used directly or indirectly in a private business. Failing one or both of these tests qualified a project for tax exempt financing. A number of activities were deemed by Congress to have sufficient public purpose that they would be excepted from simple determination by the two-test approach. Prior to 1986, professional sports stadiums were listed, along with airports, multiple dwelling residential real property, sewage facilities and others. The 1986 Tax Reform Act made a number of relevant changes. First, it changed the thresholds to 10 percent, and second, it removed sports facilities from the list of exceptions.

[5] Letter from George Sweeting, Deputy Director, Independent Budget Office (August 9, 2007).

Mr. KUCINICH. Again, for those who just joined us, Mr. Issa had asked me to proceed with this hearing in the anticipation that he will be joining us. I am going to proceed.

I am pleased to have a distinguished panel of witnesses here to address whether professional sports stadiums divert public funds from critical public infrastructure. On today's first panel the subcommittee is pleased to have the following witnesses. First of all, Mr. Eric Solomon. Mr. Solomon was sworn in as Assistant Secretary for Tax Policy, Department of Treasury on December 12, 2006. He joined Treasury's Office of Tax Policy in October 1999 as Senior Advisor for Policy. He subsequently served as Deputy Assistant Secretary, Tax Policy, and Deputy Assistant Secretary, Regulatory Affairs, prior to his December 2006 appointment as Assistant Secretary for Tax Policy.

Mr. Solomon previously served at the Internal Revenue Service from 1991 to 1996 as Assistant Chief Counsel, heading the IRS legal division with responsibility for all corporate tax issues, and as Deputy Associate, Chief Counsel, Domestic Technical.

Mr. Solomon was a partner at Ernst and Young, LLP, where he was a member of the Mergers and Acquisitions Group of the National Tax Department in Washington, DC. He received his A.B. from Princeton, his J.D. from University of Virginia, his LLM in taxation from New York University. Before joining Treasury he was a member of the Executive Committee of the Tax Section of the New York State Bar Association, adjunct professor at Georgetown, teaches a course in corporate taxation.

In 2006 he received the Distinguished Executive Presidential Rank Award in recognition of his exceptional career accomplishments at Treasury.

Mr. Arthur Rolnick is a senior vice president and director of research at the Federal Reserve Bank of Minneapolis, an associate economist with the Federal Open Market Committee. As a top official of the Federal Reserve Bank, Mr. Rolnick regularly attends meetings of the Federal Open Market Committee, the Federal Reserve's principal body responsible for establishing national money and credit policies.

Mr. Rolnick's essays on such public policy issues as Congress Should End the Economic War Amongst States, a plan to address the "too big to fail" problem, and the economics of early childhood development have gained national attention.

His research interests include banking and financial economics, monetary policy, monetary history, the economics of federalism, and the economics of education. He has been a visiting professor of economics at Boston College, the University of Chicago, the University of Minnesota. Most recently he was an Adjunct Professor of Economics at the MBA program at Lingnan College in Guangzho, China and the University of Minnesota's Carlson School of Management. He is Past President of the Minnesota Economic Association, serves on several nonprofit boards, including Minnesota Council on Economic Education, Greater Twin Cities United Way, Citizen's League of Minnesota, and Ready 4K, an advocacy organization for early childhood development. He is on the Minneapolis Star Tribune's Board of Economists, a member of the Minnesota Council of Economic Advisors.

He has had numerous awards for his work in early childhood development, including being named 2005 Minnesotan of the year by Minnesota Monthly Magazine.

A native of Michigan, Mr. Rolnick holds a bachelor's degree in mathematics and a master's degree in economics from Wayne State University in Detroit. He has a doctorate in economics from the University of Minnesota.

I read at length for those who are in attendance the qualifications of these two witnesses because you need to understand that the individuals about to testify are people that have extensive backgrounds in the issues that are before this subcommittee.

I want to thank them for being here.

Gentlemen, it is the policy of the Committee on Oversight and Government Reform to swear in all witnesses before they testify. I would ask that you rise and raise your right hands.

[Witnesses sworn.]

Mr. KUCINICH. Thank you, gentlemen.

Let the record show that the witnesses answered in the affirmative.

I would ask that the witnesses now give a brief summary of their testimony. Keep your summary under 5 minutes in duration. Your complete written statement will be included in the hearing record.

Mr. Solomon, you will be our first witness, and I ask you to proceed.

STATEMENTS OF ERIC SOLOMON, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF TREASURY; AND ARTHUR J. ROLNICK, SENIOR VICE PRESIDENT AND RESEARCH DIRECTOR, FEDERAL RESERVE BANK OF MINNEAPOLIS

STATEMENT OF ERIC SOLOMON

Mr. SOLOMON. Mr. Chairman, thank you for the opportunity to appear before you today to discuss important Federal tax issues regarding tax-exempt bond financing.

Tax-exempt bonds play an important role as a source of lower-cost financing for State and local governments. The Federal Government provides a significant Federal subsidy to tax-exempt bonds through the Federal income tax exemption for interest paid on these bonds, which enables State and local governments to finance public infrastructure projects and other public purpose activities at lower cost.

The cost to the Federal Government of tax-exempt bonds is significant and growing. Unlike direct appropriations, this Federal subsidy is not tracked in the appropriations process. Tax-exempt bonds also are less efficient than direct appropriations because of pricing inefficiencies. The steady growth in the tax-exempt bond volume reflects the importance of this incentive for public infrastructure. At the same time, it is appropriate to ensure that the Federal subsidy for tax-exempt bonds is properly targeted and is justified in light of its significant Federal cost.

I will touch briefly on the legal framework for tax-exempt bonds. I then will highlight certain tax policy considerations regarding tax-exempt bonds in general and stadium financing in particular.

The statute provides for two basic types of tax-exempt bonds: governmental bonds and private activity bonds. The current legal framework under the code treats bonds as governmental bonds if they are either used primarily for State or local governmental use or payable primarily from governmental bonds. Thus, the code generally treats bonds as private activity bonds only if they exceed both a 10 percent private business use limit and a 10 percent private payments limit.

Tax-exempt governmental bonds may finance a wide variety of projects. Tax-exempt private activity bonds may only finance specific types of projects authorized by the code. Most private activity bonds are subject to an annual State bond volume cap. State and local governments often finance traditional public infrastructure projects with governmental bonds based on governmental use of those projects. By comparison, they finance stadiums used for private business use with governmental bonds based on governmental payments for the bonds, including general taxes.

Next I want to highlight certain tax policy considerations. Here it is important to keep in mind that the tax-exempt bond provisions under the existing statutory framework implement a key policy to give State and local governments needed flexibility and discretion to finance a range of projects with governmental bonds and public/private partnerships when they determine that the projects are important enough to warrant commitment of State or local governmental funds.

At the same time, it is important to properly target and justify the Federal subsidy for tax-exempt bonds. The tax policy justification is strongest for traditional public infrastructure projects with clear public purposes. The justification is weaker for projects that lack a clear public purpose or that provide significant benefits to private businesses.

Some have asserted that the availability of governmental bonds for stadiums with significant private business use represents a structural weakness in the targeting of this important Federal subsidy. Several options could be considered to target the tax-exempt bond subsidy further to limit the use of governmental bonds for stadium financing.

One option that Congress could consider would be to repeal the private payments in the private activity bond definition for stadiums only. This possible change would prevent use of governmental bonds to finance stadiums when private business use exceeds 10 percent.

In its January 2005 tax reform options, the Joint Committee on Taxation included this option to repeal the private payments limit for stadium financing.

A second option that Congress could consider would be to allow tax-exempt private activity bonds to finance stadiums under the bond volume cap. This option would require stadiums to compete with other projects for bond volume cap. This option could be combined with the first option to allow governmental bonds for governmentally used stadiums and private activity bonds for privately used stadiums.

A third option that Congress can consider would be to ban tax-exempt bond financing for professional sports stadiums altogether.

Prior legislative proposals have suggested this option, but these proposals have never been enacted into law.

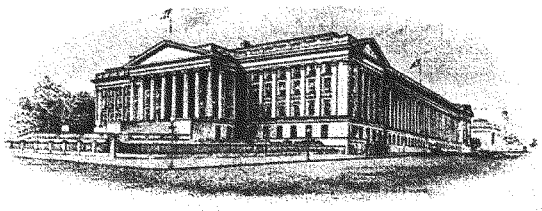
A final, broader possible option that Congress could consider would be to repeal the private payments limit in the private activity bond definition altogether. This possible change would eliminate use of governmental bonds for all projects when private business use exceeds 10 percent. This would affect stadiums and all other types of projects with significant private business use that otherwise could be financed with governmental bonds based on governmental payments. The Joint Committee on Taxation's January 2005 proposals also discuss this broader option.

At this time the administration does not take a position on any specific policy option on possible legislative changes. This topic raises difficult questions which will require the balancing of interests of State and local governments in having flexibility to determine what projects are appropriate and the Federal interest in effectively targeting this Federal subsidy.

In conclusion, the administration would be pleased to work with the Congress in reviewing possible options to try to improve the effectiveness of this important Federal subsidy for tax-exempt bonds.

Thank you, Mr. Chairman, for the opportunity to appear before you today. I would be glad to answer any questions.

[The prepared statement of Mr. Solomon follows:]



U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 2 P.M. EDT October 10, 2007
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TESTIMONY OF TREASURY ASSISTANT SECRETARY FOR TAX POLICY ERIC SOLOMON BEFORE THE HOUSE OVERSIGHT SUBCOMMITTEE ON DOMESTIC POLICY ON TAX EXEMPT BOND FINANCING

Washington, DC— Chairman Kucinich, Ranking Member Issa, and distinguished Members of the Subcommittee:

I appreciate the opportunity to appear before you today to discuss certain Federal tax issues regarding the use of tax-exempt bond financing. The Administration recognizes that tax-exempt bond financing plays an important role as a source of lower-cost financing for State and local governments. As a nation, we are focusing on the critical need to support capital investment in public infrastructure. The Federal government provides an important Federal subsidy for tax-exempt bond financing through the Federal income tax exemption for interest paid on State or local bonds under Section 103 of the Internal Revenue Code (the "Code"), which enables State and local governments to finance public infrastructure projects and other public-purpose activities at lower costs.

The cost to the Federal government of tax-exempt bonds is significant and growing. Unlike direct appropriations, however, the cost of this Federal subsidy receives less attention because it is not tracked annually through the appropriations process. In addition, it also is important to recognize that the Federal subsidy for tax-exempt bonds is less efficient than that for direct appropriations because of the inefficiency of pricing in the tax-exempt bond market. In this regard, since some bond purchasers have higher marginal tax rates than those of the bond purchasers needed to clear the market, tax-exempt bonds cost the Federal government more in foregone revenue than they deliver to State and local governments in reduced interest expenses. The steady growth in the volume of tax-exempt bonds reflects the importance of this incentive in addressing public infrastructure and other needs. At the same time, it is appropriate to review the tax-exempt bond program to ensure that it is properly targeted and that the Federal subsidy is justified in light of the lost Federal revenue and other costs imposed.

My testimony covers four main issues. First, my testimony provides an overview of the legal framework for tax-exempt bonds. Second, it discusses the use of tax-exempt bonds to finance public infrastructure projects and stadium projects under the existing legal framework. Third, my testimony

comments on certain tax policy and regulatory authority considerations. Finally, it provides certain statistical data on tax-exempt bonds for background.

Overview of Legal Framework for Tax-Exempt Bonds

A. Introduction

In general, there are two basic types of tax-exempt bonds: Governmental Bonds and Private Activity Bonds. Bonds generally are classified as Governmental Bonds if the proceeds are used for State or local governmental use or the bonds are repaid from State or local governmental sources of funds. Bonds generally are classified as Private Activity Bonds if they meet the definition of a Private Activity Bond under the Code, based on specified levels of private business involvement. In general, the interest on Private Activity Bonds is taxable unless the bonds meet qualification requirements for financing certain projects and programs specifically identified in the Code.

B. Governmental Bonds

State and local governments issue Governmental Bonds to finance a wide range of public infrastructure projects. The Code does not provide a specific definition of "Governmental Bonds." Instead, bonds are generally treated as Governmental Bonds if they avoid classification as Private Activity Bonds, as defined in the Code, by limiting private business use or private business sources of payment or security, and also by limiting private loans. Here, it is important to appreciate that bonds can qualify as Governmental Bonds if they are either used predominantly for State or local governmental use or payable predominantly from State or local governmental sources of funds, such as generally applicable taxes. Stated differently, under the current legal framework, Governmental Bonds can be used to finance a project that has significant private business use or that are payable from significant private business sources of payment, but not both.

In order for the interest on Governmental Bonds to be excluded from the bond holder's gross income for Federal tax purposes, a number of general eligibility requirements must be met. Requirements generally applicable to all tax-exempt bonds include arbitrage restrictions, bond registration and information reporting requirements, a general prohibition on Federal guarantees, advance refunding limitations, restrictions on unduly long spending periods, and pooled financing bond limitations.

C. Private Activity Bonds

1. In General

Under section 141 of the Code, bonds are classified as Private Activity Bonds if more than 10 percent of the bond proceeds are both:

(1) used for private business use (the "private business use limitation"); and

(2) payable or secured from payments derived from property used for private business use (the "private payments limitation").

Bonds also are treated as Private Activity Bonds if more than the lesser of $5 million or 5 percent of the bond proceeds are used to finance private loans, including business and consumer loans. The permitted private business thresholds are reduced from 10 percent to 5 percent for certain private business use that is "unrelated" to governmental use or that is "disproportionate" to governmental use financed in a bond

issue. These tests are intended to identify arrangements that have the potential to transfer the benefits of tax-exempt financing to nongovernmental persons.

2. Projects and Programs Eligible for Tax-Exempt Private Activity Bond Financing

Private Activity Bonds may be issued on a tax-exempt basis only if they meet the requirements for qualified Private Activity Bonds, including targeting requirements that limit such financing to specifically defined facilities and programs. Under present law, qualified Private Activity Bonds may be used to finance eligible projects and activities, including the following: (1) airports, (2) docks and wharves, (3) mass commuting facilities, (4) facilities for the furnishing of water, (5) sewage facilities, (6) solid waste disposal facilities, (7) qualified low-income residential rental multifamily housing projects, (8) facilities for the local furnishing of electric energy or gas, (9) local district heating or cooling facilities, (10) qualified hazardous waste facilities, (11) high-speed intercity rail facilities, (12) environmental enhancements of hydroelectric generating facilities, (13) qualified public educational facilities, (14) qualified green buildings and sustainable design projects, (15) qualified highway or surface freight transfer facilities, (16) qualified mortgage bonds or qualified veterans mortgage bonds for certain single-family housing facilities, (17) qualified small issue bonds for certain manufacturing facilities, (18) qualified student loan bonds, (19) qualified redevelopment bonds, (20) qualified 501(c)(3) bonds for the exempt charitable and educational activities of Section 501(c)(3) nonprofit organizations, (21) certain projects in the New York Liberty Zone, and (22) certain projects in the Gulf Opportunity Zone.

Qualified Private Activity Bonds are subject to the same general rules applicable to Governmental Bonds, including the arbitrage investment limitations, registration and information reporting requirements, the Federal guarantee prohibition, restrictions on unduly long spending periods, and pooled financing bond limitations. In addition, most qualified Private Activity Bonds are also subject to a number of additional rules and limitations. One notable additional rule limits the annual amount of these bonds that can be issued in each state (the "bond volume cap" limitation) under section 146 of the Code. Another notable additional rule prohibits advance refundings for most Private Activity Bonds under section 149(d)(2) (other than for qualified 501(c)(3) bonds). Further, unlike the tax exemption for interest on Governmental Bonds, the tax exemption for interest on most qualified Private Activity Bonds is generally treated as a preference item under the alternative minimum tax ("AMT"), meaning that the benefit of an exclusion from income for interest paid on these bonds can be taken away by the AMT.

The current legal framework for Private Activity Bonds was enacted as part of the Tax Reform Act of 1986. The basic purpose of the Private Activity Bond limitations was to limit the ability of State and local governments to act as conduit issuers in financing projects for the use and benefit of private businesses and other private borrowers except in prescribed circumstances. Prior to the Tax Reform Act of 1986, the predecessor legal framework had more liberal rules regarding the use of tax-exempt bonds for the benefit of private businesses (then called "industrial development bonds"), including a more liberal 25-percent limitation on permitted private business use and private payments (as compared to the present 10-percent private business and private payment limitations), and it did not include bond volume cap limitations on private activity bonds.

Prior to the Tax Reform Act of 1986, stadiums were on the list of eligible facilities that could be financed with tax-exempt industrial development bonds. Stadiums were removed from the list of facilities eligible for tax-exempt Private Activity Bond financing in 1986, but stadiums remain eligible for Governmental Bond financing notwithstanding the substantial private business use of these facilities if they meet the requirements for Governmental Bonds. Under current law, these requirements can generally be met when State and local governments subsidize the projects with governmental revenues or generally applicable taxes.

3. The Private Business Use Limitation

In general, private business use of more than 10 percent of the proceeds of a bond issue violates the private business use limitation. Private business use generally arises when a private business has legal rights to use bond-financed property. Thus, private business use arises from ownership, leasing, certain management arrangements, certain research arrangements, certain utility output contract arrangements (e.g., certain electricity purchase contracts under which private utilities receive benefits and burdens of ownership of governmental electric generation facilities), and certain other arrangements that convey special legal entitlements to bond-financed property.

Various exceptions and safe harbors apply with respect to the private business use limitation, which allow limited private business use of property financed by Private Activity Bonds in prescribed circumstances. Exceptions to the private business use limitation include exceptions for use in the capacity as the general public, such as use by private businesses of public roads ("general public use"), certain very short-term use arrangements, certain de minimis incidental uses, certain uses as agents of State and local governments, and certain uses incidental to financing arrangements (e.g., certain bondholder trustee arrangements). In addition, safe harbors against private business use apply to certain private management and research arrangements. Thus, for management contracts, in Rev. Proc. 97-13, 1997-1 C.B. 632, the IRS provided safe harbors that allow private businesses to enter into certain qualified management contracts with prescribed terms and compensation arrangements without giving rise to private business use to accommodate public-private partnerships for private management of public facilities. For research contracts, in Rev. Proc. 2007-47, 2007-29 I.R.B. 108 (July 16, 2007), the IRS provided updated safe harbors that allow certain research contract arrangements with private businesses at tax-exempt bond financed research facilities without giving rise to private business use (e.g., certain Federally sponsored research).

4. The Private Payments Limitation

In general, private payments aggregating more than 10 percent of the debt service on a bond issue (on a present value basis) violates the private payments limitation. The private payments limitation considers direct and indirect payments with respect to property used by private businesses that represent sources of payment or security for the debt service on a bond issue. For example, if a private business pays rent for its use of the bond-financed property, the rent payments give rise to private payments. Various limited exceptions apply for purposes of the private payments limitation.

5. The Generally Applicable Taxes Exception to the Private Payments Limitation

A notable exception to the private payments limitation applies to payments from generally applicable taxes. In the legislative history to the Tax Reform Act of 1986, Congress indicated its intent to exclude revenues from generally applicable taxes from treatment as private payments for purposes of the private payments limitation. The Conference Report to the Tax Reform Act of 1986 included the following statement:

> *Revenues from generally applicable taxes are not treated as payments for purposes of the security interest test*; however, special charges imposed on persons satisfying the use test (but not on members of the public generally) are so treated if the charges are in substance fees paid for the use of bond proceeds.[1]

[1] H. Rep. No. 99-841, 99th Cong. 2d Sess. at Page II-688, 1986-3 C.B. Vol. 4 688 (1986) (emphasis added).

Consistent with this legislative history, Treasury Regulations define a generally applicable tax as an enforced contribution imposed under the taxing power that is imposed and collected for the purpose of raising revenue to be used for a governmental purpose. A generally applicable tax must have a uniform tax rate that is applied equally to everyone in the same class subject to the tax and that has a generally applicable manner of determination and collection. By contrast, a payment for a special privilege granted or service rendered is not considered a generally applicable tax. Special assessments imposed on property owners who benefit from financed improvements are also not considered generally applicable taxes. For example, a tax that is limited to the property or persons benefiting from an improvement is not considered a generally applicable tax. Although taxes must be determined and collected in a generally applicable manner, the Treasury Regulations permit certain agreements to be made with respect to those taxes. An agreement to reduce or limit the amount of taxes collected to further a bona fide governmental purpose is such a permissible agreement. Thus, an agreement to abate taxes to encourage a property owner to rehabilitate property in a distressed area is a permissible agreement.

In addition, the Treasury Regulations treat certain "payments in lieu of taxes" and other tax equivalency payments ("PILOTs") as generally applicable taxes.[2] Under the current Treasury Regulations, a PILOT is treated as a generally applicable tax if the payment is "commensurate with and not greater than the amounts imposed by a statute for a tax of general application." For instance, if the payment is in lieu of property tax on the bond-financed facility, it may not be greater in any given year than what the actual property tax would be on the property. In addition, to avoid being a private payment, a PILOT must be designated for a public purpose and not be a special charge. Under this rule, a PILOT paid for the use of bond-financed property is treated as a special charge.

In 2006, the Treasury Department and the Internal Revenue Service (IRS) published Proposed Regulations to modify the standards for the treatment of PILOTs to ensure a close relationship between eligible PILOT payments and generally applicable taxes. Under the Proposed Regulations, a payment is commensurate with general taxes only if the amount of the payment represents a fixed percentage of, or a fixed adjustment to, the amount of generally applicable taxes that otherwise would apply to the property in each year if the property were subject to tax. For example, a payment is commensurate with generally applicable taxes if it is equal to the amount of generally applicable taxes in each year, less a fixed dollar amount or a fixed adjustment determined by reference to characteristics of the property, such as size or employment. The Proposed Regulations permit the level of fixed percentage or adjustment to change one time following completion of development of the property. The Proposed Regulations also provide that eligible PILOT payments must be based on the current assessed value of the property for property taxes for each year in which the PILOTs are paid, and the assessed value must be determined in the same manner and with the same frequency as property subject to generally applicable taxes. A payment is not commensurate if it is based in any way on debt service with respect to an issue or is otherwise set at a fixed dollar amount that cannot vary with the assessed value of the property. The Treasury Department and the IRS are in the process of reviewing the public comments on the Proposed Regulations regarding the treatment of PILOTs.

Governmental Bonds for Public Infrastructure Projects and Private Stadiums Under the Existing Legal Framework

A. Public Infrastructure Projects

[2] In general, the treatment of payments, including PILOTs, as taxes based on their substance is grounded in longstanding Federal income tax principles. *See, e.g.*, Rev. Rul. 71-49, 1971-1 C.B. 103 (PILOTs treated as taxes in substance for purposes of deductibility of taxes under Code Section 164).

For public infrastructure projects, qualification for Governmental Bond financing focuses on limiting private business use to not more than 10-percent private business use under the first prong of the Private Activity Bond definition. In general, Governmental Bonds are an important tool that State and local governments use to finance public infrastructure projects to carry out traditional governmental functions, such as providing public roads, bridges, courthouses, and schools. Typically, State and local governments finance public infrastructure projects with Governmental Bonds based on predominant State or local governmental use of the projects and limited private business use within the permitted 10-percent private business use limitation for Governmental Bonds. Often, State and local governments finance public infrastructure projects with Governmental Bonds based in part on reliance on the general public use exception to private business use. Thus, for example, public roads may be financed with Governmental Bonds even if private businesses use them in the same way as individual members of the general public.

The tax policy justification for a Federal subsidy for tax-exempt bonds is strongest in circumstances where State or local governments use Governmental Bonds to finance public infrastructure projects and other traditional governmental functions to carry out clear public purposes.

B. Private Stadiums

For stadium projects that are acknowledged to exceed the 10-percent private business use limitation, qualification for Governmental Bond financing depends on limiting private payments to comply with the 10-percent private payments under the second prong of the Private Activity Bond definition. Here, it is important to recognize that, under the existing legal framework, bonds are classified as Private Activity Bonds only if they exceed *both* the 10-percent private business use limitation and the 10-percent private payments limitation. Thus, a State or local government may issue tax-exempt Governmental Bonds to finance a project that is 100-percent used for private business use, such as a stadium that a private professional sports team uses 100-percent for private business use, provided that the issuer does not receive private payments from the team or elsewhere that in the aggregate exceed the 10-percent private payments limitation. Alternatively, a State or local government may issue tax-exempt Governmental Bonds to finance a stadium to be used for private business use if it subsidizes the repayment of the bonds with State or local governmental funds, such as generally applicable taxes. For example, a city could pledge revenues from a city-wide sales tax, hotel tax, car tax, property tax, or other broadly based generally applicable tax to pay the debt service on Governmental Bonds to finance a stadium.

The tax policy justification for a Federal subsidy for tax-exempt bonds is weaker when State or local governments use Governmental Bonds to finance activities beyond traditional governmental functions, such as the provision of stadiums, in which the public purpose is more attenuated and private businesses receive the benefits of the subsidy.

Certain Tax Policy and Regulatory Authority Considerations Regarding Tax-Exempt Bond Financing

A. Targeting the Federal Subsidy for Tax-Exempt Bonds in General

In general, it is important to ensure that the Federal subsidy for tax-exempt bonds is properly targeted and justified. A rationale for a Federal subsidy for tax-exempt bonds for State and local governmental projects and activities exists when they serve some broader public purpose. The tax policy justification for a Federal subsidy for State or local governmental projects and activities is clearest in the case of traditional public infrastructure projects to carry out traditional governmental functions where the public purpose is clear, particularly when the Federal subsidy is necessary to induce the projects to be undertaken.

The tax policy justification for this Federal subsidy becomes weaker, however, in circumstances that are more attenuated from traditional State or local governmental activities, such as circumstances that lack a clear public purpose justification, provide significant benefits to private businesses, or involve projects that might have been undertaken in any event without the benefit of the Federal subsidy.

In addition, it also is important to recognize that, in general, the Federal subsidy for tax-exempt bonds is less efficient than that for direct appropriations because of the inefficiency of pricing in the tax-exempt bond market. In this regard, since some bond purchasers have higher marginal tax rates than those of the bond purchasers needed to clear the market, tax-exempt bonds cost the Federal government more in foregone revenue than they deliver to State and local governments in reduced interest expenses. Thus, for example, if taxable bonds yield 10 percent and equivalent tax-exempt bonds yield 7.5 percent, then investors whose marginal income tax rates exceed 25 percent will derive part of the Federal tax benefits, resulting in a subsidy to the State and local governmental issuer that is less than the reduction in Federal revenue.

At the same time, it is important to point out that tax-exempt bond financing has advantages over the use of appropriated funds by government agencies. The involvement of private investors in the decision-making process for infrastructure investment can bring with it greater sensitivity to actual project costs and returns than in public sector investment decision-making. In some cases, this enhanced sensitivity to project costs and returns may compensate for the somewhat lower tax efficiency of tax-exempt bonds and lead to a more efficient investment outcome overall. In 2005, the Administration supported legislation that extended Private Activity Bond authority to qualified highway and surface freight transfer facilities in the highway and transit reauthorization based in part on these considerations.

B. Certain Tax Policy Considerations regarding Tax-Exempt Bond Financing of Stadiums

From a tax policy perspective, the ability to use Governmental Bonds to finance stadiums with significant private business use when the bonds are subsidized with State or local governmental payments, such as generally applicable taxes, arguably represents a structural weakness in the targeting of the Federal subsidy for tax-exempt bonds under the existing legal framework.

At the same time, the tax policy justification in favor of the existing two-pronged Private Activity Bond definition is that it gives State and local governments appropriate flexibility and discretion to finance with Governmental Bonds a range of projects in public-private partnerships with significant private business use when the projects are sufficiently important to warrant subsidizing them with State and local governmental funds, such as generally applicable taxes. Here, political constraints against commitment of such governmental funds ordinarily serve as a sufficient check against excess financing of such projects. An argument can be made, however, that this justification may be debatable in certain cases, such as in the case of certain stadium financings.

Several options could be considered to address the possible structural weakness in the targeting of the tax-exempt bond subsidy relative to tax-exempt Governmental Bonds for stadium financings.

First, Congress could consider repealing the private payments prong of the Private Activity Bond definition for stadiums only. This possible change would prevent use of tax-exempt Governmental Bonds to finance a stadium whenever the stadium has more than 10 percent private business use, as would typically be the case with any professional sports stadium. This option would preserve the ability of State and local governments to use Governmental Bonds to finance stadiums used primarily for governmental use (e.g., stadiums for state universities or city-sponsored amateur sports). This option would ensure targeting of the Federal subsidy for tax-exempt Governmental Bonds to circumstances

involving predominant State or local governmental use of stadiums. In its Options to Improve Tax Compliance and Reform Tax Expenditures (JCS-02-05, January 27, 2005), the Congressional Joint Committee on Taxation included this option to repeal the private payments limitation for stadium financings.

Second, Congress could consider combining the first option described above with an amendment to Section 142 of the Code to allow the use of tax-exempt Private Activity Bonds to finance stadiums used primarily for private business use within the constraint of the annual State tax-exempt Private Activity Bond volume caps. This measured option would constrain stadiums to compete with other eligible projects for allocations of this bond volume cap.

Third, Congress could consider banning tax-exempt bond financing for stadiums altogether. In 1996, Senator Patrick Moynihan sponsored a widely-publicized legislative proposal to this effect, which was never enacted into law.

Fourth, Congress could consider a broader option to repeal the private payments prong of the Private Activity Bond definition altogether. This possible change would treat bonds as Private Activity Bonds whenever private business use exceeded the 10 percent private business use limitation. This broader option would have an effect well beyond stadiums. This broader option would affect all types of projects with significant private business use that otherwise could be financed currently with Governmental Bonds based on payments from governmental funds. In its 2005 tax compliance options mentioned above, the Joint Committee on Taxation also discussed this broader option to repeal the private payments limitation altogether.

At this time, the Administration does not take a position on any specific policy option with respect to possible legislative changes to the tax-exempt bond provisions relative to stadium financings. This topic raises difficult questions which require balancing the interests of State and local governments in flexibility to finance projects they deem sufficiently important to subsidize with governmental funds and the Federal interest in ensuring effective targeting of the Federal subsidy for tax-exempt bonds. The Administration recognizes that review of this important Federal subsidy may be appropriate in considering ways more generally to simplify this area and to ensure effective targeting of this subsidy for public infrastructure in order to justify its cost.

C. Certain Regulatory Authority Considerations

The question has been raised whether the Treasury Department has the regulatory authority to restrict the use of tax-exempt bond financing for professional sports stadiums. The existing legal framework allows the use of Governmental Bonds to finance professional sports stadiums when the bonds are payable from governmental sources of funds, such as generally applicable taxes. In the legislative history to the present tax-exempt bond provisions of the Code, Congress clearly stated its intent to allow Governmental Bonds when secured by generally applicable taxes. The Treasury Department's and the IRS's roles in providing regulatory guidance are to interpret the Code in a manner consistent with Congressional intent.

Therefore, while the Treasury Department and the IRS have broad regulatory authority to interpret the Code, neither the Treasury Department nor the IRS has regulatory authority so broad as to read the private payments limitation out of the Private Activity Bond definition under Section 141 of the Code or to disregard Congress' expressed intent to exclude generally applicable taxes from private payments for this purpose. Thus, we do not believe the Treasury Department has the regulatory authority to prohibit use of Governmental Bonds to finance stadiums under the existing statutory structure.

Certain Statistical Data on Tax-Exempt Bonds

The Treasury Department estimates that Federal tax expenditures for the Federal subsidy for tax-exempt bonds grew from about $26 billion in 1998 to about $30.9 billion in 2006. This tax expenditure is estimated to grow to about $41.1 billion in 2012. Attached to my testimony is certain statistical data on tax-exempt bonds. One chart provides information on long-term new money (versus refinancing) tax-exempt bond issuance from 1991-2005, derived from IRS Statistics of Income data, and shows that annual total tax-exempt bond issuance grew from about $100 billion in 1991 to over $200 billion in 2005. Two additional charts provide breakdowns of the types of projects financed with Governmental Bonds and Private Activity Bonds from 1991-2005.

Although the Treasury Department has no specific data on tax-exempt bond usage for stadiums, in a U.S. Government Accounting Office ("GAO") Report entitled "Federal Tax Policy: Information on Selected Capital Facilities Related to the Essential Governmental Function Test" (GAO-06-1082, dated September 2006), the GAO estimated that, during the period from 2000 through 2004, approximately $5.3 billion in tax-exempt bonds were issued in about 119 bond issues to finance stadiums and arenas.

Conclusion

The Administration recognizes the important role that tax-exempt bond financing plays in providing a source of lower-cost financing for critical public infrastructure projects and other significant public purpose activities. It is important to ensure that the tax-exempt bond program is properly targeted so that it works most effectively and that the Federal subsidy for tax-exempt bonds is justified in light of the revenue costs and other costs imposed. The Administration would be pleased to work with the Congress in reviewing possible options to try to improve the effectiveness of this important Federal subsidy.

Thank you again, Mr. Chairman, Ranking Member Issa, and other Members of the Subcommittee for the opportunity to appear before you today. I would be pleased to answer any questions.

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Mr. KUCINICH. Thank you, Mr. Solomon.
Mr. Rolnick.

STATEMENT OF ARTHUR J. ROLNICK

Mr. ROLNICK. Thank you, Mr. Chairman and members of the subcommittee, for having me here today.

Before I begin, let me say the views that I am about to express are my own and not necessarily those of the Federal Reserve Bank of Minneapolis or the Federal Reserve system.

There is likely no major metropolitan area in this country that has not been held hostage at some point by the owner of a sports franchise who threatened to move his team elsewhere if he did not receive a new taxpayer-funded sports complex. Indeed, such economic blackmail even affects many of our smaller communities, as minor league sports teams have also learned to play this rent-seeking game.

Being from Minnesota, I can personally attest to this rent-seeking game as the Minnesota Twins, after a 10-year campaign, finally persuaded a previously reluctant State legislature to hand over about $400 million in public financing for a new stadium that is now under construction. Not to be outdone, the Minnesota Vikings are currently pressing the legislature for their own share of public largesse, and who can blame them. As long as governments are willing to hand over limited public resources, these teams would be foolish not to accept them.

But make no mistake: it is not just sports teams that demand public money from cities and States. The State and local funds spent competing for sports franchises, though conspicuous, probably represent only a fraction of the billions of dollars spent on more than 8,000 State and local economic development agencies competing to retain and attract businesses through the use of preferential—and let me underline preferential—taxes and subsidies. Businesses know they can get public funding by threatening to move, forcing State and local governments into competition for business that has become economic warfare.

To be clear, from a national perspective, the so-called economic bidding war among States does not create jobs. It only moves them around from one city to another, from one State to another. This is what economists call a zero sum game. It is a zero public return. Indeed, it may be a negative sum game.

While States spend billions of dollars to retain and attract businesses, State and local governments struggle to provide such public goods as schools and libraries, public health and safety, and the roads, bridges, and parks that are critical to the success of any community. Indeed, we in Minnesota have special cause to speak to the importance of adequate funding for infrastructure following the tragic collapse of the I–35 W bridges over the Mississippi River.

Something is wrong with this picture, and I am going to argue only Congress can fix it.

I am here today largely to discuss the wasteful nature of this bidding war among States and to offer a recommendation to end this inefficient use of scarce public resources. However, in addition, I will briefly offer a proposal for the best use of public resources for economic development—that is early childhood development. I will

argue that you should think of early childhood development as economic development with an extraordinary public return. I offer more description in my full testimony that has been submitted to the subcommittee.

To begin, it is important to recognize that not all competition among State and local governments is bad. Competition for businesses through general tax and spending policies—that is, policies that are non-preferential that apply to all business—is beneficial. So, for example, we want Minnesota and Wisconsin competing to see which State can offer the best public education at the lowest cost. Such competition helps State and local governments determine the amount and quality of public goods for which their citizens are willing to pay and to provide these goods efficiently.

But from a national perspective, when competition takes the form of preferential treatment for specific businesses, it creates, at best, a zero sum game. It is more likely to create a competitive game, in fact, that mis-allocates private resources and causes State and local governments to provide too few public goods.

When a business is enticed by being offered preferential favors to relocate, there is no net gain to the overall economy. Jobs are simply moved from one location to another. Furthermore, on closer examination, there will be a loss. There will be fewer public goods produced in the overall economy because in the aggregate States will have less revenue to spend on public goods. In addition to the loss of public goods, the overall economy becomes less efficient because output will be lost as some businesses are enticed to move from their best locations.

Moreover, it is assumed in my remarks so far that States have the information to understand the businesses they are courting. In practice, States have much less than perfect information, assuming States are so handicapped they will finance some businesses that private markets deem too risk to fund.

How can this economic bidding war among State and local governments be brought to an end? The States won't, on their own, stop using subsidies and preferential taxes to attract and retain businesses. As long as a single State engages in this practice, others will feel compelled to compete. Only Congress, under the Commerce Clause of the Constitution, has the power to enact legislation to prohibit States from using subsidies and preferential taxes to compete with one another for businesses, and only Congress can enforce such a prohibition.

There is a congressional precedent for such action. In 1999, then-Representative David Minge of Minnesota introduced the Distorting Subsidies Limitation Act. This bill would end these harmful subsidies by, in effect, taxing them out of existence. Under the bill, subsidies provided by a State or local government to a particular business that is a preferential subsidy to locate or to remain within the business jurisdiction would be taxed at such a level so as to render the subsidy moot. For example, if the subsidy was taxed at 100 percent, they would be rendered ineffective. State and local governments would thus lay down their arms in this escalating economic war and the resulting truce would benefit all society.

If the subsidy war is the wrong way to promote economic development, what is the right way? The tried and true investments

that have served economies well, especially since the second half of the 20th century, are public investments in human capital. To that end, it is also time for congressional action on proposals to increase funding for at-risk kids for early childhood education. These proposals have gained national attention in recent years because of the overwhelming research by neuroscientists on brain development and by economists on economic returns to high-quality early education programs. We have estimated the annual rate of return on a high-quality early education program, inflation adjusted, to be as high as 18 percent.

In summary, the evidence is clear: compared with billions of dollars in public subsidies to professional sports teams and other private businesses, investment in our infrastructure, both physical and human, especially investment in early childhood development for at-risk children, is real economic development, and it is economic development with a very high public return.

Thank you for this opportunity to testify on this important policy issue. I look forward to answering questions.

[The prepared statement of Mr. Rolnick follows:]

Congress Should End the Economic War Among the States

Testimony

**Arthur J. Rolnick*

Senior Vice President

Director of Research
Federal Reserve Bank of Minneapolis

Domestic Policy Subcommittee
Oversight and Government Reform
2154 Rayburn HOB – 2:00 p.m.
October 10, 2007

[The Constitution] was framed upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division.

Justice Benjamin Cardozo
U.S. Supreme Court, 1934 [1]

While states spend billions of dollars competing with one another to retain and attract businesses, they struggle to provide such public goods as schools and libraries, police and fire protection, and the roads, bridges and parks that are critical to the success of any community.[2] Surely, something is wrong with this picture. As Justice Cardozo suggested, the framers of the Constitution had something different in mind in granting Congress the power to regulate interstate commerce under the Commerce Clause. The objective was to create an economic union, particularly by ending the trade war among

* This testimony is based on the Federal Reserve Bank of Minneapolis 1994 Annual Report, "Congress Should End the Economic War Among the States," co-authored with Melvin L. Burstein, then executive vice president and general counsel at the Federal Reserve Bank of Minneapolis. The views expressed in this testimony are those of Arthur Rolnick's and not necessarily those of the Federal Reserve Bank of Minneapolis or the Federal Reserve System.

the states that prevailed under the Articles of Confederation. However, it was the Supreme Court, not Congress, that applied the Commerce Clause to end the trade war among the states.

It is now time for Congress to exercise its Commerce Clause power to end another economic war among the states. It is a war in which states are actively competing with one another for businesses by offering subsidies and preferential taxes. Economists find that there is a role for competition among states when it takes the form of a general tax and spend policy. Such competition leads states to provide a more efficient allocation of public and private goods. But when that competition takes the form of preferential treatment for specific businesses, not only is it not "admirable," it interferes with interstate commerce and undermines the national economic union by misallocating resources and causing states to provide too few public goods. Moreover, the success of a state in attracting and retaining particular businesses is not a mitigating circumstance.

This testimony will largely concern itself with an analysis of economic development programs and a recommendation to end this inefficient use of scarce public resources. However, in addition, I will offer a proposal for a better use of public resources for economic development—early childhood education for at-risk children. This proposal is only briefly described here; more details on early childhood education as economic development can be found in Appendix B and on the Web site of the Federal Reserve Bank of Minneapolis (minneapolisfed.org; details below).

The economic merits of ending the war among the states

To understand why economists conclude that the use of public funds to attract and retain specific businesses does not serve a legitimate local public purpose, we need to understand what they mean by public purpose. Economists' view of public purpose relies critically on a distinction between public and private goods. A public good, unlike a private good, is one in which a single person's consumption of that good does not subtract from another person's consumption. A lighthouse is an often cited example of a pure public good: The light from a lighthouse used by one ship on a foggy night does not prevent its use by another ship. Providing for the national defense, clean air and a legal system are other examples of goods that any citizen can consume without subtracting from what can be consumed by any other citizen in the community.

Besides pure public goods there are some goods that lack the explicit quality of a public good but give off external effects that qualify them as such. Health care provided to an individual is a private good because it subtracts from the consumption of other individuals; nevertheless, it may have external effects that are public. For example, having one person inoculated for some communicable disease makes for a healthier environment, and a healthier environment is a good that any person can consume without subtracting from the consumption of any other person. Similarly, educational services consumed by one individual subtract from the consumption of other individuals, but education increases a community's stock of knowledge and is critical to a well-functioning democracy, two highly regarded public goods.

Economists have found that while the production of private goods is best left to market forces, the production of public goods should be the principal role of government because the market fails to produce enough public goods. The reason the market fails is that since people cannot be excluded from consuming public goods, charging people for what they consume is difficult. It is often impossible to say if and how much of a public good a person consumes. How much does one consume of a healthy environment, or national defense or a lighthouse beam? A private firm producing a public good might try to survey the citizens of its community to uncover how much each consumes of a public good and charge accordingly. However, knowing they will be charged based on how much they say they benefit from the public good, and knowing they will get to consume as much as they want, regardless of the charge, people will tend to understate the benefits. Moreover, private firms could not enforce payment for such goods even if they knew how much to provide. Consequently, left to the market, too few public goods, if any, will be produced.

I turn to the government, then, to finance and provide for the use of public goods. Government, by its very nature, can solve the financing problem for it has the power to appropriate funds from its citizens (the power to tax) for the provision of public goods. Solving the provision problem of public goods is more difficult.

Competition among states through general tax and spend policies leads to the right amount of public goods

For state and local governments there is a form of intergovernment competition that guides them to provide the right amount of public goods. This type of competition among government entities has been compared to the invisible hand that guides private business to produce the right amount of private goods.

Charles M. Tiebout argued in 1956 that as state and local governments compete through general tax and spending programs to attract people and businesses, these government entities are led to produce the desired level of public goods. Tiebout notes that people can vote with their feet and choose to live in the community that provides them with the public services for which they are willing to pay. As a result, people in effect reveal their true preferences, and state and local governments provide more public goods than if these governments were not competing. The problem of providing the right level of public goods is alleviated by competition among state and local government entities.

But competition among states for specific businesses is harmful

When states compete through subsidies and preferential taxes for specific businesses, the overall economy suffers. From the states' point of view each may appear better off competing for particular businesses, but the overall economy ends up with less of both private and public goods than if such competition was prohibited.

State and local officials often boast about the new businesses they have attracted, the old ones they have retained and the number of jobs they have created. And in many instances these officials should boast. They have either managed to maintain their tax base by enticing a local business to stay or they have added to their tax base by enticing an out-of-state business to relocate. As long as the subsidies and preferential taxes given to a

business are worth less than the revenue the business will contribute to the state over its operating years, the citizens of the state are better off than if their state officials had not played this competitive game. The state has more jobs and hence more tax revenue to pay for public goods than if it had not competed.

But even though it is rational for individual states to compete for specific businesses, the overall economy is worse off for their efforts. Economists have found that if states are prohibited from competing for specific businesses there will be more public and private goods for all citizens to consume.[4] To illustrate this point, I will consider several possible outcomes of this competition.

In the first outcome, no business actually moves to a new location. In other words, suppose that each state goes on the offensive to lure businesses away from other states, but defensive strategies prevail; local subsidies and preferential taxes to businesses that might consider moving, keep them from leaving. While each state could claim a victory of sorts (for no state loses a business), clearly all states are worse off than if they had not competed. Competition has simply led states to give away a portion of their tax revenue to local businesses; consequently, they have fewer resources to spend on public goods, and the country as a whole has too few public goods.

It is unlikely, of course, that businesses will not be enticed to relocate. In this second outcome, the damage to the overall economy can be even greater. At first glance, when businesses relocate there appears to be no net loss to the overall economy; jobs that one state loses another gains. Yet on closer examination we can see that this is not just a zero-sum game. As in the case with no relocations, there will be fewer public goods produced in the overall economy because, in the aggregate, states will have less revenue. This follows because the revenue decline in the losing states must be greater than the revenue increase in the winning states. (If this was not true, businesses would not have relocated.) In addition to this loss, the overall economy becomes less efficient because output will be lost as businesses are enticed to move from their optimal locations.

Each business that is enticed to relocate represents a potential loss of efficiency for the overall economy and hence less output, less tax revenue and fewer public and private goods. To be more concrete, let us suppose a company chooses to relocate its manufacturing plant from a warm climate state, like Louisiana, to Alaska, even though its operating costs are substantially higher in a cold weather climate. I will assume that the company is more than fully compensated by Alaska for the move and for the additional operating costs. However, it now takes more resources for this company to produce the same quantity of output in Alaska than it did in Louisiana.

There is another reason businesses will be less productive when states are allowed to compete for individual businesses. States may increase taxes on those firms that are less likely to move to offset the lost revenue from firms that have moved (or have threatened to move). It is a well-known proposition in economics that taxes generally distort economic decisions and at an increasing rate. Business taxes, in particular, induce firms to produce less efficiently. Again to make the argument concrete, consider the hypothetical example of a tax on machines like those used in car washes. Without a tax or with a very small tax, the most efficient and profitable way to operate a car wash is to

invest in high quality machines that require only few workers. As the tax increases, the most profitable way to operate the car wash will be to invest in less sophisticated machines that require more labor; although fewer cars will be washed per day, having less expensive machines reduces the tax payment, more than compensating for the lower productivity. And since tax distortions generally grow at an increasing rate, at higher tax rates relatively fewer cars are washed.

In general, it can be shown that the optimal tax (the tax that distorts the least) is one that is uniformly applied to all businesses. Allowing states to have a discriminatory tax policy, one that is based on location preferences or degree of mobility, therefore, will result in the overall economy yielding fewer private and public goods.[5]

State competition for specific businesses involves one additional loss that could make those already mentioned pale by comparison. I have assumed that states have the information to understand the businesses they are courting; that is, their willingness to move, how long they will stay in existence and how much tax revenue they will generate. In practice, states have much less than perfect information. Assuming all states are so handicapped, they will on average end up with fewer jobs and tax revenues than they had anticipated, and at times the competition may not even be worth winning.

For example, Pennsylvania, bidding for a Volkswagen factory in 1978, gave a $71 million incentive package for a factory that was projected to eventually employ 20,000 workers. The factory never employed more than 6,000 and was closed within a decade.

Minnesota's 1991 deal with Northwest Airlines is another example of a Pyrrhic victory. A state agency agreed to provide the company with a $270 million operating loan at a very favorable rate of interest. In return, Northwest agreed to build (with an additional $400 million of state and local government funding) two airplane repair facilities that would eventually employ up to 2,000 highly skilled workers in an economically depressed region of the state. While the operating loan was made in the spring of 1992, the company has yet to fulfill its part of the bargain. Moreover, the commitment to build the two repair facilities that would employ 2,000 workers has been reduced to a commitment to build one very modest facility and an airline reservation center, which together would employ fewer than 1,000 workers.

Despite the fact that state deals have gone sour, some may still be tempted to argue that competition among states for specific businesses will lead to a good outcome for the overall economy. Some may be tempted to make this argument because it seems, as argued earlier in this essay, people can vote with their feet (or vote policymakers out of office). Hence, if people are unhappy with their state's economic development strategy, there is an internal political check. People, however, may not be unhappy with these strategies--the state is acting in their best interest. Not to compete, while other states are, may be detrimental to a state's economy. Moreover, there may not be a place to go because all states may be competing. For this type of competition there is no invisible hand (or more accurately, no invisible foot) to lead states to do what is best for the country.

Only Congress can end the war among the states

How can this war among the states be brought to an end? The states won't end this war, and the courts are not equipped to do so. Only federal legislation can prevent states from using subsidies and preferential taxes to attract and retain businesses.

The powers granted to Congress under the Constitution enable it to fashion the legislative tools necessary to prevent the states from using subsidies and preferential taxes to attract and retain businesses. For example, Congress could tax the receiving business on the direct and imputed value of these benefits, it could deny tax-exempt status on debt of states that offer such subsidies, or it could deny federal funding that would otherwise be payable to such states, much as it denies highway funds to states that fail to meet federal pollution standards.

The states

The states won't, on their own, stop using subsidies and preferential taxes to attract and retain businesses. There is anecdotal evidence that some state and local governments recognize they are all losing in this economic war. Nevertheless, as long as a single state engages in this practice, others will feel compelled to compete. New York, New Jersey and Connecticut all recognized that they were losing from this competition, and in 1991 they informally agreed to stop competing with each other. It was not long, however, before New Jersey broke the deal.

Even if a number of states were interested in formally agreeing to stop the practice of competing to attract and retain businesses, it would be a practical impossibility to devise an arrangement that would both cover all the forms of subsidies and preferential taxes the states might devise and provide an effective method of enforcement. Also, such a multistate treaty might run afoul of the Compact Clause of the Constitution, which prohibits a state from entering into a compact with another state, in the absence of the consent of Congress.

The courts

To understand why this problem cannot be left to the courts, it is important to know something of the history and purpose of the Commerce Clause and the role that the courts[6] played in its evolution and application.

The economic union—from the Articles of Confederation to the Constitution

A driving force in the nation's movement from the Articles of Confederation to the Constitution was that the Articles did not provide a national economic union. The Annapolis Convention of 1786 was convened to discuss the removal of the impediments to commercial activity, both among the states and between the United States and foreign nations, under the Articles. It ended with a call for a meeting the following year to discuss changes to the Articles to correct the defects that adversely affected commerce. The 1787 meeting evolved into the Constitutional Convention as it became apparent that the commercial problems could not be remedied by simply amending the Articles.

Under the Articles, the states had freely engaged in destructive economic warfare by imposing all types of trade barriers against one another. To address this, James Madison,

the recognized father of the Constitution, added the Commerce Clause to the Constitution, to help promote an economic union of the states. The Commerce Clause grants Congress the power to regulate "Commerce ... among the several States. ..." [7]

Madison expected that Congress would do little to regulate interstate commerce. It was his concept that the Commerce Clause would, in effect, preempt the states from interfering with interstate commerce. In practice, the Commerce Clause did not discourage the states from interfering with interstate commerce and Congress did little, if anything, to constrain them. As a consequence, while Madison intended that the Commerce Clause would almost be self operating in fostering economic union, in the absence of congressional action the courts were left to implement the economic union through ad hoc interpretation of the Commerce Clause.

The courts and the Commerce Clause

The Commerce Clause contains an ambiguity: It gives Congress the power to regulate interstate commerce but does not expressly prohibit the states from interfering with interstate commerce. To address this ambiguity, the Court developed a doctrine known as the "dormant" or "negative" Commerce Clause, which it applies, in the absence of congressional action, to strike down state laws that it has determined excessively burden interstate commerce.

The Court has supported the ideal of an economic union through its application of the dormant Commerce Clause. However, contrary to Madison's vision of the Commerce Clause, the Court will tolerate some state action that imposes a burden on interstate commerce if the burden is not excessive in relation to the benefit accruing to the state from a legitimate local public purpose. A legitimate local public purpose is one for health, safety or welfare, including the economic welfare of the state. The Court recently has said that "a pure subsidy funded out of general revenues *ordinarily imposes no burden on interstate commerce, but merely assists local business.*"[8] (Emphasis added.) In an earlier decision, and more directly to the point of this essay, the Court said that "a State's goal of bringing in new business is legitimate *and often admirable.*"[9] (Emphasis added.)

Therefore, if the Court were to consider the constitutionality of a state subsidy or preferential tax to attract or retain businesses, one would expect it to hold[10] that subsidies or preferential taxes impose no burden on interstate commerce. Even if the Court were to decide that such a state subsidy or tax preference burdens interstate commerce, it would weigh that burden against what it would undoubtedly regard to be a legitimate local public purpose, attracting and retaining businesses.

In any case, the Court may not wish to act because Congress has remained silent.[11] The failure of Congress to speak to an issue can have a profound effect on the Court. When Congress remains silent after the Court has clearly expressed a position in the area of interstate commerce, the Court is likely to regard that silence as tacit approval. Therefore, the Court, having clearly expressed the view that state subsidies to attract and retain businesses do not interfere with interstate commerce, including twice during its 1993-94 term, may take the silence of Congress to be tacit approval.

Finally, the courts are not a practical vehicle for preventing the states from using subsidies and preferential taxes to attract and retain particular businesses. The courts, including the Supreme Court, do not have the power to prevent the states from interfering with interstate commerce. A court can only consider the constitutionality of a state law in the context of a particular case that is before it. As a consequence:

Spasmodic and unrelated instances of litigation cannot afford an adequate basis for the creation of integrated national rules which alone can afford that full protection for interstate commerce intended by the Constitution. We would, therefore, leave the questions raised ... for consideration of Congress. ...[12]

Congress can and should prohibit state business subsidies and preferential taxes

The Supreme Court must be credited with implementing the Commerce Clause and preserving Madison's objective of an economic union. Congress has done little to foster the intended purpose of the Commerce Clause. However, the Court can only decide the cases and controversies that come before it. It can't create laws to implement the Commerce Clause.

Only Congress has the power to enact legislation to prohibit and prevent the states from using subsidies and preferential taxes to compete with one another for businesses. In addition to its power under the Commerce Clause, Congress has the ancillary power it derives from its power to tax and appropriate money, and the power to make all laws that are needed to carry out its enumerated constitutional powers. Moreover, under the Supremacy Clause the Constitution and the laws of the United States are the supreme law of the land.

The power of Congress under the Commerce Clause is so sweeping that to enact legislation to prohibit the states from using subsidies and preferential taxes to compete with one another, it need only make a finding, formal or informal, that such subsidies and taxes substantially affect interstate commerce. The Supreme Court will defer to such a congressional finding if there is any rational basis for the finding. No Supreme Court decision in at least the past 50 years has set aside federal legislation on the ground that Congress did not have a rational basis for such a finding.[13] The Court has recognized that the power of Congress under the Commerce Clause even extends to intrastate activities that have a substantial effect on interstate commerce. Moreover, Congress can legislatively supplement, revise or overturn any of the Court's decisions under the dormant Commerce Clause doctrine.

To illustrate how Congress might discourage states from using subsidies and preferential taxes to compete with one another for businesses, consider the variety of subsidies and preferential taxes a city and state might use to attract a sports franchise away from another city. It would not be unusual for them to offer some or all of the following: 1) build a stadium funded by public, tax-exempt debt, 2) lease the stadium to team owners at bargain rent, 3) rebuild streets and highways to provide stadium access, 4) loan or grant the team owners relocation funds, 5) pay for land with tax increment financing on which team owners can build an office building, and 6) grant the team owners a real estate tax abatement on the building. To implement a legislative prohibition, Congress could impose sanctions such as taxing imputed income, denying tax-exempt status to public

debt used to compete for businesses and impounding federal funds payable to states engaging in such competition.

Conclusion and a proposal for effective economic development

Unfettered competition among private businesses has generally proven to be a very successful economic system. As Adam Smith predicted over 200 years ago, individuals acting in their own best interest are led, as if by an invisible hand, to produce what is best for the overall economy. And experience has shown that Smith was right. Those countries that have relied on a market-oriented economy have outperformed (based on virtually all measures of success) those countries that have relied on a central planning strategy.

But what is true of individuals acting in their own interest is not necessarily true of state governments acting on behalf of their local citizens. Competition among governments based on their general tax-and-spend policies leads to a better outcome for the overall economy. However, when that competition takes the form of preferential financial treatment for specific companies, the overall economy is made worse off. Such competition results in a misallocation of resources and, in particular, too few public goods.

Competition among states for specific businesses is commonplace and growing more costly. Most states today have put in place some type of economic development program to attract and retain businesses. While some state officials have questioned the economic wisdom of this type of competition, there is little likelihood that the states will successfully establish either formal or informal non-compete agreements, because it appears that the incentive to cheat is too great.

The Supreme Court, which has, for the most part, been the surrogate for Congress in preventing activities that interfere with interstate commerce, is not equipped to end this economic war among the states. To the extent that it has power to do so, there is little, if anything, in its decisions to date that suggest that it would.

Only Congress, with its sweeping constitutional powers, particularly under the Commerce Clause, has the ability to end this economic war among the states. And it is time for Congress to act. There is congressional precedence for such action: In 1999, then-Rep. David Minge, Minn., introduced the Distorting Subsidies Limitation Act. This bill would end these harmful subsidies by, in effect, taxing them out of existence. Under the bill, subsidies provided by a state or local government to a particular business—to locate into or remain within that government's jurisdiction—would be taxed at such a level so as to render the subsidy moot. In other words, if subsidies were taxed at 100 percent, for example, they would be rendered ineffective. State and local governments would thus lay down their arms in this escalating economic war, and the resulting truce would benefit all of society. (See Appendix A.)

It is also time for congressional action on a proposal that makes better use of limited public resources for economic development. This proposal has gained national attention in recent years through the introduction of programs at the city, county and state level—early childhood education for at-risk children. Careful academic research demonstrates

that tax dollars spent on early-childhood development provide extraordinary returns compared with investments in the public, and even private, sector. Some of these benefits are private gains for the children involved, in the form of higher wages later in life. But the broader economy also benefits because individuals who participate in high-quality early-childhood-development programs have greater skills than they otherwise would, and they're able to contribute productively to their local economies.

The promise of early-childhood programs is based on fundamental facts about early human development. A child's quality of life and the contributions that child makes to society as an adult can be traced to his or her first years of life. From birth until about the age of 5, a child undergoes tremendous development. If this period of life includes support for growth in language, motor skills, adaptive abilities, and social-emotional functioning, the child is more likely to succeed in school and to later contribute to society. Conversely, without proper support during these early years, a child is more likely to drop out of school, depend on welfare benefits, and commit crime—thereby imposing significant costs on society. Early-childhood-development programs recognize this potential—and this risk—and seek to nurture healthy development from the earliest years.

Several longitudinal evaluations all reach essentially the same conclusion: The return on early-childhood-development programs that focus on at-risk families far exceeds the return on other projects that are funded as economic development. Cost-benefit analyses of the Perry Preschool Program, the Abecedarian Project, the Chicago Child-Parent Centers, and the Elmira Prenatal/Early Infancy Project showed returns ranging from $3 to $17 for every dollar invested. This implies an annual rate of return, adjusted for inflation, of between 7 percent and 18 percent (see Appendix B).

The evidence is clear that investments in early-childhood-development programs for at-risk children pay a high public return. Helping our youngest children develop their life and learning skills results in better citizens and more-productive workers. Compared with the billions of dollars spent each year on high-risk economic-development schemes, an investment in early-childhood programs is a far better and far more secure economic-development tool.

For more information on early childhood education as economic development, please visit minneapolisfed.org/research/studies/earlychild/, which includes the following paper, "Early Intervention on a Large Scale."

Endnotes

1. Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 523 (1934).

2. Unless the context clearly indicates otherwise, all references to "state" or "states" are intended to include local government units as well. For purposes of the Commerce Clause it should not make any difference whether subsidies and preferential taxes are offered by states or local governmental units. Most, if not all, subsidies and preferential taxes are offered by the local government under state enabling legislation, and part of the cost of the benefit is, directly or indirectly, borne by the state.

3. Metropolitan Life Insurance Company v. Ward, 470 U.S. 869, 879 (1985).

4. For a formal analysis of this proposition, see Thomas Holmes, "The Effects of Tax Discrimination When Local Governments Compete for a Tax Base," Research Department Working Paper 544, Federal Reserve Bank of Minneapolis, 1995.

5. Holmes (1995) finds that, in general, the overall economy is worse off when states use preferential tax treatment to attract or retain businesses. In those cases where the overall economy might be better off, the net gain is very small and turns negative if the tax on immobile firms becomes too high.

6. Most of our discussion about the judiciary's role in effectuating the Commerce Clause concerns the U. S. Supreme Court, which I will sometimes refer to as "the Court." Although the Court reviews only a very small number of all the cases involving the Commerce Clause, its holdings are controlling in the absence of federal legislation on the subject. Occasionally, however, I will make more general references to "the courts," which apply decisions of the Court on the Commerce Clause to the cases before them. The term "the courts" will usually include both federal and state courts. Our use of the terms "the Court" and "the courts" is deliberate and the difference in meaning should be clear from the context within which the term is used.

7. U.S. Const. art. I, sec. 8, cl. 3.

8. West Lynn Creamery, Inc. v. Healy, 114 S. Ct. 2205, 2214 (1994).

9. Metropolitan, 470 U.S. at 879.

10. The term "hold" or "holding" refers to the specific issue being decided by the Court. For example, in the West Lynn Creamery case the Court held that the Massachusetts tax on fluid milk unconstitutionally discriminated against interstate commerce. The holding of the Court should be distinguished from observations the Court makes in its opinions. Although such observations may be persuasive evidence of how the Court or a particular justice might rule in a future case before the Court, the observation cannot be cited as authority for a legal proposition.

11. See, e.g., Federal Baseball Club of Baltimore, Inc. v. National League of Professional Baseball Clubs, 259 U.S. 200 (1922). In this case, the Court held that professional baseball was exempt from antitrust legislation because it was not engaged in commerce among the states. No one today would seriously argue that professional baseball is not engaged in commerce among the states; nevertheless, the Court has never overturned that decision, in part because Congress has been silent on the issue.

12. McCarroll v. Dixie Lines, Inc., 309 U.S. 176, 189 (1940), (Justices Black, Frankfurter and Douglas dissenting).

13. See United States v. Lopez, 2 F. 3d 1342, 1363 (5th Cir. 1993), cert. granted 114 S. Ct. 1536 (1994).

Appendix A

Distorting Subsidies Limitation Act of 1999 (H.R. 1060)

Introduced by U.S. Rep. David Minge of Minnesota

HR 1060 IH

106th CONGRESS
1st Session
H. R. 1060

To amend the Internal Revenue Code of 1986 to provide that economic subsidies provided by a State or local government for a particular business to locate or remain within the government's jurisdiction shall be taxable to such business, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

March 10, 1999

Mr. MINGE introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to provide that economic subsidies provided by a State or local government for a particular business to locate or remain within the government's jurisdiction shall be taxable to such business, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the `Distorting Subsidies Limitation Act of 1999'.

SEC. 2. FINDINGS.

Congress finds the following:

(1) Competition among State and local governments for new and existing businesses has become the rule rather than the exception.
(2) State and local governments are being forced to compete against each other for businesses with scarce tax dollars that would otherwise be used for essential public goods and services.
(3) When State and local government competition takes the form of preferential treatment for specific businesses, it undermines our national economic union by distorting the allocation of resources.
(4) There is a role for competition between States and localities when it takes the form of general tax policies, regulation structures, and public services because such competition leads States and localities to provide better service, cost effective regulation, sound tax policies, and more efficient allocation of public and private goods.
(5) Federal program grants have been used by State and local governments to subsidize business location decisions to attract

businesses from other States and localities.
(6) Proceeds from tax-exempt municipal bonds have been used by one State or locality to attract business from other States and localities.
(7) No single State or local government can unilaterally withdraw from this competition. Only Congress with its enumerated powers can end the economic distortions and the public costs caused by economic distortions.

SEC. 3. TAXATION OF VALUE OF TARGETED SUBSIDIES PROVIDED BY STATE AND LOCAL GOVERNMENTS.

(a) IN GENERAL- Subtitle D of the Internal Revenue Code of 1986 (relating to miscellaneous excise taxes) is amended by inserting after chapter 44 the following new chapter:

`CHAPTER 45--EXCISE TAX ON TARGETED STATE OR LOCAL GOVERNMENT DEVELOPMENT SUBSIDIES

`Sec. 4986. Targeted State or local government development subsidies.

`SEC. 4986. TARGETED STATE OR LOCAL GOVERNMENT DEVELOPMENT SUBSIDIES.

`(a) GENERAL RULE- There is hereby imposed for each calendar year an excise tax on any person engaged in a trade or business who derives any benefit during such year from any targeted subsidy provided by any State or local governmental unit.
`(b) AMOUNT OF TAX- The tax imposed by subsection (a) shall consist of a tax computed as provided in section 11(b) as though the aggregate value (determined under regulations prescribed by the Secretary) of benefits referred to in subsection (a) accruing during the calendar year were the taxable income referred to in section 11.
`(c) DEFINITIONS- For purposes of this section--
`(1) TARGETED SUBSIDY-
`(A) IN GENERAL- The term `targeted subsidy' means, with respect to any person, any subsidy--
`(i) which is designed to encourage any trade or business operation of such person to locate in a particular governmental jurisdiction or to remain in a particular governmental jurisdiction, or
`(ii) which is reasonably expected to have the effect of a subsidy described in clause (i).
`(B) CERTAIN MORE BROADLY AVAILABLE SUBSIDIES TREATED AS TARGETED SUBSIDIES-
`(i) IN GENERAL- A subsidy shall not fail to be a targeted subsidy by reason of applying to (or being available to) more than 1 trade or business operation if such subsidy is determined (under regulations prescribed by the Secretary) not to be part of the general long-term taxing or spending policies of the governmental unit.
`(ii) GENERAL LONG-TERM POLICIES- A subsidy shall be treated as part of the general long-term taxing or spending policies of the governmental unit only if the subsidy is available to all trade or business operations

within the jurisdiction of such governmental unit without regard to the period during which any operation has been conducted within such jurisdiction.

`(2) SUBSIDY- The term `subsidy' includes--

`(A) any grant,

`(B) any contribution of property or services,

`(C) any right to use property or services, or any loan, at rates below those commercially available to the taxpayer,

`(D) any reduction or deferral of any tax or any fee (including any payment by any State or local governmental unit of any tax or fee),

`(E) any guarantee of any payment under any loan, lease, or other obligation,

`(F) any use of governmental facilities (including roads, facilities for the furnishing of water, sewage facilities, and solid waste disposal facilities) to the extent that the amount paid by (or assessed against the property of) the trade or business for such use is less than the amount it would pay were the charge for its use (or the assessment) determined under the same formula or other basis as is used by the State or local government with respect to other comparable facilities used by other trades or businesses, and

`(G) any other benefit specified in regulations prescribed by the Secretary.

`(d) EXCEPTION FOR SUBSIDIES FOR EMPLOYEE TRAINING AND EDUCATION- No tax shall be imposed by this section on the value of any subsidy provided for employee training or for other education programs.

`(e) SPECIAL RULES-

`(1) EXCEPTION FOR SUBSIDIES PROVIDED TO GOVERNMENTAL ENTITIES- No tax shall be imposed by this section on the value of any subsidy provided to--

`(A) an agency or instrumentality of any government or any political subdivision thereof, or

`(B) any entity which is owned and operated by a government or any political subdivision thereof or by any agency or instrumentality of one or more governments or political subdivisions.

`(2) AVOIDANCE OF DOUBLE TAX- No amount shall be includible in gross income for purposes of subtitle A by reason of any targeted subsidy on which tax is imposed under this section.

`(3) ADMINISTRATIVE PROVISIONS- For purposes of subtitle F, any tax imposed by this section shall be treated as a tax imposed by subtitle A.'

(b) DENIAL OF INCOME TAX DEDUCTION FOR TAX- Paragraph (6) of section 275(a) of such Code is amended by inserting `45,' after `44,'.

(c) CLERICAL AMENDMENT- The table of chapters for subtitle D of such Code is amended by inserting after the item relating to chapter 44 the following new item:

`Chapter 45. Excise tax on targeted State or local government development subsidies.'

(d) EFFECTIVE DATE- The amendments made by this section shall apply to any subsidy which is provided pursuant to an agreement or arrangement

entered into more than 30 days after the date of the enactment of this Act.

SEC. 4. DENIAL OF EXEMPTION FROM TAX FOR INTEREST ON BONDS PROVIDING TARGETED STATE OR LOCAL GOVERNMENT DEVELOPMENT SUBSIDIES.

(a) IN GENERAL- Subsection (b) of section 103 of the Internal Revenue Code of 1986 (relating to interest on State and local bonds) is amended by adding at the end the following new paragraph:

`(4) BONDS PROVIDING TARGETED DEVELOPMENT SUBSIDIES- Any bond if any portion of the proceeds of such bond is to be used to provide any targeted subsidy (as defined in section 4986(c)).'

(b) EFFECTIVE DATE- The amendment made by subsection (a) shall apply to obligations issued after the date of the enactment of this Act.

SEC. 5. PROHIBITION OF USE OF FEDERAL FUNDS FOR TARGETED SUBSIDIES.

(a) IN GENERAL- Notwithstanding any other provision of law, none of the Federal funds provided to any State or local government may be used to provide any targeted subsidy (as defined in section 4986(c) of the Internal Revenue Code of 1986).

(b) RECOVERY OF FUNDS USED TO PROVIDE TARGETED SUBSIDIES- If the Secretary of the Treasury or the Secretary's delegate finds after reasonable notice and opportunity for hearing that any State or local government used Federal funds in violation of subsection (a), the Secretary or the Secretary's delegate shall take such actions as are necessary (including referring the matter to the Attorney General of the United States with a recommendation that an appropriate civil action be instituted) to recover the amount so used from the State or local government or the trade or business, whichever the Secretary determines to be appropriate.

(c) EFFECTIVE DATE- This section shall apply to funds provided after the date of the enactment of this Act.

Appendix B

Does preschool have long-term educational and economic benefits?

Research suggests the answer may be YES.

Intensive preschool interventions targeting disadvantaged children have been shown to yield significant gains that may last well into adulthood. Longitudinal studies have been conducted to evaluate the enduring outcomes of several well-known preschool programs.

• Michigan's Perry Preschool program served 123 4-year-olds for two years. Participants have been tracked to age 40.
• North Carolina's Abecedarian preschool served 111 children from age 4 months to 5 years. Participants have been followed to age 21.
• Illinois' Chicago Child-Parent Centers served 1,500 children. Participants have been followed to age 20 .

How did children served by these programs fare later in life?

• They were more likely to stay in the regular classroom and out of special education.
• They were more likely to go through school without repeating a grade.
• They were more likely to complete high school without dropping out.
• As adults, they were more likely to be employed and to have higher earnings.

Athough long-term benefits of such interventions have been demonstrated, the costs of some exemplary programs can be quite high. On an annual per-student basis, the Perry Preschool and Abecedarian programs, respectively, spent about $9,000 and $10,500 (adjusted to 2000 dollars). As a result, some have questioned the cost-effectiveness of such programs and the extent to which they can serve as models for larger-scale interventions.

Citations:

Barnett, W.S. & Belfield, C.R. (2006). **Early Childhood Development and Social Mobility**. *The Future of Children: Opportunity in America*, 16(2), 73-98.

Borman, G.D. & Hewes, G.M. (2002). **The Long-Term Effects and Cost-Effectiveness of Success for All**. *Educational Evaluation and Policy Analysis*, 24(4), 243-266.

Cunha, F. & Heckman, J.J. (2006). **"Investing in Our Young People."** Working Paper. University of Chicago.

Mr. KUCINICH. Thank you very much for your testimony, Mr. Rolnick and Mr. Solomon.

Before we go to questions, I want to acknowledge the presence of Mr. Davis and Mr. Tierney and Mr. Cummings. Thanks to all of you for being here.

If the gentlemen have an opening statement, we will be glad to include it in the record.

At this point we are going to go to questions. I will begin with Mr. Solomon.

I think that I should be relieved to learn from the written testimony that "the tax policy justification for a Federal subsidy for tax-exempt bonds is weaker when State or local governments use governmental bonds to finance activities beyond traditional governmental functions, such as a provision of stadiums, in which the public purpose is more attenuated and private businesses receive the benefits of the subsidy." That is a direct quote.

I think that means that you don't think that building professional sports stadiums with public money is a good idea when the traditional government function of making sure bridges are safe isn't being fulfilled. Is that a fair rendering of your position?

Mr. SOLOMON. Mr. Chairman, you raise very important policy concerns, because it is necessary to ensure that the tax-exempt bond program is properly targeted so that it is most effectively used and so that the Federal subsidy is justified in light of the revenue costs and the other costs imposed.

What Congress has done, what the Internal Revenue Code does is it strikes a balance between two different interests. One interest is that it wants to target the use of tax-exempt bonds to critical projects, critical governmental projects, but at the same time, the statutory structure of the Internal Revenue Code does provide currently flexibility and discretion for State and local governments to finance projects that do have private use if the State or local government finds the project sufficiently important to warrant the commitment of State and local government funds to carry out those projects.

So the current structure of the Internal Revenue Code does permit, in situations where there is some private use, it permits State and local governments to decide to go forward with tax-exempt bonds when there is a commitment to use governmental funds.

Mr. KUCINICH. Right. I understand that. Nevertheless, Federal taxpayers will subsidize sports stadiums' construction to the tune of about $2 billion, according to the written testimony of Professor Long. What did Federal taxpayers receive in exchange for that?

Mr. SOLOMON. Well, what the code does is it leaves it to the discretion. The current Internal Revenue Code leaves to the discretion of State and local governments to make the decision whether or not these projects are sufficiently important.

I would also just want to add, as an observation, a GAO report in 2006 noted that there were about $5.3 billion of stadium tax-exempt bonds. Total, there are about a trillion dollars in governmental bonds.

Mr. KUCINICH. Trillion?

Mr. SOLOMON. Trillion.

Mr. KUCINICH. OK. Well, I would like to go to this issue of the benefit principle of taxation. You are familiar with that. In part, it is based on the idea that those who benefit from services should be the ones who pay for them. Now, let's say that City A is told by the owner of a professional sports team that they will have to finance a new stadium or the team will leave, and let's further say that City B offers twice as much to the team to lure it away from City A.

Now, of course, all the bond financing offered by City B and City A, if they choose to give the team what it wants, will be tax exempt. Apply the benefit principle of taxation to this transaction. How do Federal taxpayers benefit from the team moving to City B or, for that matter, staying in City A with a new stadium? How do they benefit?

Mr. SOLOMON. Well, the current structure of the Internal Revenue Code leaves discretion to the State and local governments to make these decisions, and that is part of the framework. We present in our written testimony possible options that one might consider if one were to decide that it is inappropriate policy.

Mr. KUCINICH. So you really can't say, is what you are saying?

Mr. SOLOMON. I am not an expert on local economic issues of the determinations that State and local governments make as to what appropriate projects are.

Mr. KUCINICH. Let me try one more question.

Mr. SOLOMON. Sure. Of course.

Mr. KUCINICH. If the economists are right that building professional sports stadiums do not raise incomes, create jobs, or increase revenues, while new ball parks do increase the value of the team franchise, would you say that building a professional sports stadium is mostly a private activity, or is it a public activity?

Mr. SOLOMON. State and local governments and those who are in State and local government need to make these decisions. And they make these decisions not necessarily on dollars and cents.

Mr. KUCINICH. I see. I got it. I got it. I know where you are coming from.

Mr. Rolnick, would you like to answer that question?

Mr. ROLNICK. Well, our State and local officials are in a difficult position. If you are the Governor of Minnesota, you don't want to lose the Minnesota Vikings. Even if I convince my Governor that it is not a question of jobs, it is very difficult to stand back if another State is going to build a new stadium. So, as I said in my earlier remarks, we put our State and our local officials in difficult positions, and as a result the professional sports teams have been very good at playing one city off against another and one State off another. My estimate is about 80 percent of professional sports facilities have been built with public money, and that is because they are very good at playing this game.

There is no public benefit here, Mr. Chairman. Your question, the way you raise it, is correct. This is not a public good. These are private goods and they would be produced if we ended the bidding war.

Mr. KUCINICH. Mr. Solomon, do you want to add something?

Mr. SOLOMON. Mr. Chairman, yes, if I might just add one point.

Mr. KUCINICH. Sure.

Mr. SOLOMON. This issue is broader than just stadiums. This issue arises with respect to other kinds of redevelopment projects.

Mr. KUCINICH. Right.

Mr. SOLOMON. We are focusing today on stadiums, but it could be other kinds of redevelopment.

Mr. KUCINICH. We understand.

Mr. SOLOMON. We will have the same kinds of policy issues.

Mr. KUCINICH. Right. I mean, that point was made in the testimony.

I am going to go to Mr. Issa.

Thank you for joining us. The ranking member, the gentleman from California.

Mr. ISSA. Thank you, Mr. Chairman. Again, I apologize. Because of two markups in 1 day, I have been going between two other places.

Mr. Chairman, I would ask unanimous consent that my written opening statement be put in the record.

Additionally, the part you can't just have in the record is a wholehearted congratulations to the chairman on the performance of the Cleveland Indians. As someone born and raised in Cleveland and someone who was born in 1953—and that was a good year for Cleveland. We went through a few bad years after that. But certainly, regardless of this being the second hearing and the second question on Jacobs Field and plenty of other places, I think we can both, as Clevelanders, take pride in the performance of the Indians. I just want to make sure that got in the record.

Mr. KUCINICH. You know what? I want to thank my good friend for pointing that out, and I would like to further say that Jacobs Field didn't make the Indians; the Indians made Jacobs Field. Thank you.

The gentleman may proceed.

Mr. ISSA. Thank you.

I am going to just broaden the subject, Mr. Solomon, because I think you are exactly right. We provide tax-free municipal bonds to build schools, don't we?

Mr. SOLOMON. That is correct.

Mr. ISSA. And kids graduate from high school and leave Cleveland, like me to go to California. I graduated from Kent State, left. So Kent State's bonds to build university facilities, in fact, may have benefited southern California and the companies I built out there, but, in fact, it was paid for primarily Federal offset, but also Ohio State offset for those bonds; isn't that right?

Mr. SOLOMON. Correct.

Mr. ISSA. And that goes for noise abatement retaining walls. It goes for lots of things which are at least partially financed by debt instruments sold with Federal and State exemptions. So I guess the first question is: should we, in fact—and this may be what you were leading to—question what narrow, dramatically, what in fact, can receive at least Federal tax exemption, since today everything a State chooses to go into debt for is a benefit subject, of course, only to the AMT where we sometimes get back what we lose elsewhere?

Mr. SOLOMON. Just to add to the point that I made before, again, to broaden our conversation is this issue with respect to situations

whether private use, State and local governments are permitted to issue tax-exempt bonds where the decision is made to use public funds.

And it is not limited to situations with stadiums. It includes convention centers and all sorts of other kinds of projects. The question is how much discretion should be left to State and local governments to make these decisions. And one might make a decision, a policy decision with respect to stadiums, might make a different policy decision for other kinds of decisions. But the question is how much and how specifically you might want to limit that authority.

Mr. ISSA. Well, let me ask a question that sort of goes to the one thing that I think we all understand, which is cities can't print money. States can't print money. Only the Federal Government prints money, so only the Federal Government can essentially monetize its debt; is that correct in your analysis?

Mr. SOLOMON. Well, the Federal Government——

Mr. ISSA. I know we don't officially monetize our debt, but we certainly have the ability to. We could monetize our debt. We have no limit to the amount of debt that we can take on at the Federal level, but, more specifically, States and local governments have debt ratings. If they get too much debt relative to their current earnings, income, and taxes, they ultimately pay a higher percentage and they reach a cap where they can no longer borrow; is that correct?

Mr. SOLOMON. Well, I am not an expert on State and local government financing, but certainly, to the extent that State and local governments take on too much debt, it creates difficulties.

Mr. ISSA. So I will just ask it as a closing question, because we are going to run out of time before the vote. Essentially, the one thing that we are leaving out of this equation is that cities, using cities exclusively here for a moment, cities make a decision about where to invest their debt, and if they invest, as the city of San Diego did, in a number of projects, including a significant new convention center and PetCo Park—looks like Jacobs Field, only with a little more sunny days—in San Diego—and the Padres are doing OK, too, but thank you.

The fact is, they made that decision. They used up a certain amount of debt they could have. And if those debt instruments pay no dividends, pay no revenue, then they are paying for them out of their general fund, so they particularly do that. The cities make that decision.

Why, in your opinion, are cities making that decision if it is a bad business investment? What do you think the real reason that cities are voluntarily doing this and continuing to do this bidding process?

Mr. SOLOMON. Because the cities believe that there are various benefits. Perhaps they cannot be specifically identified, but there are various and tangible benefits. Of course, there are political constraints on their decisions, as well as financial constraints.

Mr. ISSA. Thank you.

Thank you, Mr. Chairman. This really is an opportunity for us to question not just the bigger picture of the tax structure, but I really appreciate the fact that you have given us a chance to look

at how various cities either are or are not spending their money wisely, and I appreciate it.

Mr. KUCINICH. And I thank the ranking member.

Mr. Tierney, if he has questions, is recognized.

Mr. TIERNEY. I will be happy to do so.

Mr. Kucinich, I would be happy to invite both of you Indians fans to Fenway Park Friday and Saturday night where it is obvious you will be getting a thumping, the Indians.

Mr. KUCINICH. You are out of order, of course. [Laughter.]

Those are such famous last words.

Mr. TIERNEY. Yes, they have been some time in the past.

Mr. KUCINICH. Where is the gavel? OK. Go ahead.

Mr. TIERNEY. Mr. Solomon, thank you, and thank you also, Mr. Rolnick. I appreciate your testimony here today.

Mr. Solomon, you made some suggestions in your written testimony that I welcome, and I notice that most of the solutions that you proposed are statutory in nature. I am wondering why that is. Don't you feel as though you could do more on the regulatory basis using your existing powers?

Mr. SOLOMON. Our job is to interpret the statutory framework, and the statutory framework we believe is clear that the statute and the legislative history are clear that bonds, in a situation where there is private use, can nevertheless qualify as governmental bonds as long as the bonds are paid from governmental funds, including generally applicable taxes. So we believe that the statute and legislative history put that constraint upon us.

The 1986 legislative history is very clear that a bond can still be treated as a governmental bond, even if there is private use, as long as the bonds are paid from generally applicable taxes.

Mr. TIERNEY. So are you indicating that you don't think that you could just determine that a PILOT that was used specifically for stadium construction is not generally used for public purpose and make that determination? Do you feel constrained from doing that?

Mr. SOLOMON. We do not think that we could write regulations that say that stadium financing cannot be done through the use of public funds. We do not believe that we have that authority. And so if a stadium is financed and the State or local government says it will come out of general taxes or their equivalent, which are the PILOTs, the payments in lieu of taxes, we don't think we can change that rule. That will require Congress to change that rule. That structure is built into the fabric of what was done in 1986.

In 1986, Congress said you can't use private activity bonds for these kinds of activities, but, nevertheless, Congress nevertheless left the flexibility to say that you can engage in these activities using governmental bonds as long as the governmental bonds are paid for with general governmental funds.

Mr. TIERNEY. Thank you for that.

I yield back, Mr. Chairman. Thank you.

Mr. KUCINICH. All right.

I thank the gentleman. I just want to ask a quick question here on what Treasury was trying to do with the PLR and the rule change.

Mr. Solomon, there are two accounts of the IRS's attempt to regulate PILOTs for stadium construction, one presented by Mr. Korb

in his March 29th testimony to this committee, and a contrary account that I believe is more consistent with the regulatory history. Mr. Korb repeatedly testified that the IRS was compelled by the 1997 regulations to conclude for its 2006 private letter rulings that PILOTs used to pay for bonds issued to finance stadium construction should be treated as generally applicable tax and not a special charge.

He further testified that the proposed regulations were designed to close the loophole and make it more difficult to use PILOTs. Under the contrary account, the IRS's issuance of the private letter rulings in 2006 made it easier, not tougher, to publicly finance stadiums by explicitly allowing stadiums to be financed by PILOTs made by the teams, instead of the previous practice of financing stadiums through the imposition of taxes borne generally by the public, like entertainment and sales taxes.

The private letter rulings, far from being compelled by the 1997 regulations, presented a new and arguably impermissible interpretation of them and prompted the IRS to propose regulations that would put PILOTs on a firmer regulatory footing. This account is supported by a number of facts, many of which are ignored by Mr. Korb, including the fact that the proposed regulations would delete the following sentence from the existing regulation. Here it is: "For example, a PILOT made in consideration for the use of property financed with tax-exempt bonds is treated as a special charge." This language suggests that PILOTs should not be permitted to fund stadium construction.

Because a full response to this question is not possible here, given the time constraints, I am going to present this question to you in a more-detailed form of a letter, and I wonder if you have any basic view on which of these accounts is more accurate.

Mr. SOLOMON. Very briefly, the private letter rules issued by the Internal Revenue Service to private taxpayers preceded the proposed regulations. Proposed regulations were intended to tighten the rules, to tighten the rules with respect to payments in lieu of taxes, to cut back on the use of payments in lieu of taxes. So chronologically the private letter rules preceded the proposed regulations. The proposed regulations are intended to tighten the standard for treating payments in lieu of taxes as the equivalent of general taxes.

Mr. KUCINICH. I thank the gentleman. We will followup with that letter.

[The information referred to follows:]

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JUL 23 2008

The Honorable Dennis J. Kucinich
Chairman, Domestic Policy Subcommittee
Committee on Oversight and Government Reform
Congress of the United States
U.S. House of Representatives
Washington, DC 20515-6143

Dear Mr. Chairman:

Thank you for you letter dated May 23, 2008, regarding private letter rulings and proposed regulations concerning the treatment of payments in lieu of taxes ("PILOTs") for purposes of the exception to the private security or payment test applicable to tax-exempt bonds under Section 141 of the Internal Revenue Code (the "Code"). Commissioner Schulman has asked me to respond because your questions relate to issues under the jurisdiction of the Office of Chief Counsel. In answering your letter we have focused on the questions that relate directly to the work of the IRS Office of Chief Counsel. Your letter was also addressed to Treasury Assistant Secretary Eric Solomon, and we refer you to the answers contained in his response as well.

Question (1): Do you continue to maintain that existing regulations compel the Treasury Department to allow the use of PILOTs that meet the commensurability standard to be used in conjunction with sports stadiums financed by tax-exempt private activity bonds?

If a PILOT meets the commensurability standard under the 1997 Final Regulations (as defined below) to qualify for treatment as a generally applicable tax, it can be used in conjunction with sports stadiums financed with tax-exempt governmental bonds. In the legislative history to the Tax Reform Act of 1986 Congress indicated that "[r]evenues from generally applicable taxes are not treated as payments for purposes of the security interest test [also referred to as the "private payments limitation"]; however, special charges imposed on persons satisfying the use test (but not on members of the public generally) are so treated if the charges are in substance fees paid for the use of bond proceeds."[1] At the time that Congress made this statement, there existed long-standing general federal income tax principles on the definition of taxes under Section 164 of the Code, including a revenue ruling that held that certain PILOTs constituted taxes under that section.[2] In 1997, the Treasury Department and the IRS promulgated comprehensive final regulations on most aspects of the classification tests for tax-exempt governmental bonds and private activity bonds under Section 141

[1] H.Rep. No. 99-841, 99th Cong. 2d Sess. at Page II-688, 1986-3 C.B. Vol. 4, 688 (1986).

[2] Rev. Rul. 61-152, 1961 C.B. 42 (defined general taxes based on substance); Rev. Rul. 71-49, 1971-1 C.B. 103 (treated PILOTs as general taxes).

(the "1997 Final Regulations).[3] Section 1.141-4(e) of the 1997 Final Regulations largely incorporated the general tax principles under Section 164 regarding generally applicable taxes and PILOTs. Thus, under the Code, the legislative history, general tax principles, and the 1997 Final Regulations, if bonds that finance stadiums are secured and paid by generally applicable taxes, which can include PILOTs, they can be issued as tax-exempt governmental bonds (i.e., bonds that are not private activity bonds under Section 141) because the bonds fail to meet the private security or payment test under Section 141(b)(2) of the Code.

Question (1)(a): Whether or not you agree with this interpretation, could the existing regulations be reasonably interpreted to prohibit the use of PILOTs to support tax-exempt private activity bonds financing sports stadiums on the grounds that sports stadium construction involves the use of bonds not designated for a public purpose? See 26 C.F.R. § 1.141-4(e)(5)(ii). If you believe that the IRS retains the authority to make such a finding, would it consider making such a determination, and, if not, why not?

The overall statutory structure of Section 141 of the Code with respect to tax-exempt bonds reflects Congress's decision to give state and local governments flexibility and discretion to finance projects that they determine will carry out public purposes even if the projects have significant private business use, provided that state and local governments determine that the projects are sufficiently important to warrant paying and securing the tax-exempt bonds predominantly with governmental funds, including generally applicable taxes. Thus, stadiums that are privately used can be financed with tax-exempt governmental bonds if they are paid and secured by generally applicable taxes. Further, qualifying PILOTs are be treated as generally applicable taxes for this purpose.

Question (1)(b): Whether or not you agree with this interpretation, could the existing regulations be reasonably interpreted to prohibit the use of PILOTs to support tax-exempt private activity bonds financing sports stadiums on the ground that they generally prohibits the use of "[s]pecial assessments paid by property owners benefiting from financial improvements," such as a "payment in lieu of tax that is limited to the property or persons benefited by an improvement." See 26 C.F.R. § 1.141-4(e)(3). Why didn't the Treasury Department include a discussion of the PILOT example in this provision in the PLRs?

A PILOT will not qualify under Section 1.141-4(e)(5) of the 1997 Final Regulations if it is a special charge as described in Section 1.141-4(e)(3) of the 1997 Final Regulations. Section 1.141-4(e)(3) of the 1997 Final Regulations defines a special charge as follows:

> A payment for a special privilege granted or service rendered is not a generally applicable tax. Special assessments paid by property owners

[3] 62 Fed. Reg. 2275 (January 16, 1997) (codified at 26 C.F.R. §§ 1.141-1 to 1.141-16).

benefiting from financed improvements are not generally applicable taxes. For example, a tax or payment in lieu of tax that is limited to the property or persons benefited by an improvement is not a generally applicable tax.

In determining whether a charge is a generally applicable tax or a special charge, we look to the nature of the charge and, in the case of a PILOT, the nature of the underlying tax on which it is based. If a charge is imposed in a broad way and is to be used for governmental purposes or public purposes to further the general public welfare, such as a generally applicable real estate ad valorem tax imposed on all real property in a taxing jurisdiction, then the charge is a generally applicable tax.[4] In addition, if a PILOT replicates or is based on such a generally applicable tax, it too qualifies as a generally applicable tax. By contrast, if a charge is imposed in a targeted way only on particular property owners because of and based on *benefits* that inure to those property owners from the ultimate use of the collected charge, that charge would be considered a special assessment within the meaning of this provision.[5]

For example, if a municipality were to impose a targeted charge on a stadium property owner and other nearby property owners in a redevelopment area for the purpose of making municipal street improvements in that redevelopment area and the charge was based directly on benefits inuring to those property owners, that charge would be a special assessment and any purported PILOT in lieu of that charge would be considered a special charge. A PILOT in that case would not be eligible for the generally applicable tax exception from the private security or payment test under Section 141 of the Code. On the other hand, if the municipality were to use a portion of its generally applicable real estate ad valorem taxes imposed on all property owners in the municipality to finance the referenced street improvements, a PILOT imposed on the stadium owner based on that generally applicable real estate tax would qualify as a generally applicable tax.

In Private Letter Rulings 200640001 and 200641002 (the "2006 IRS Stadium PLRs"), we determined based on the facts and circumstances of those cases that the PILOTs were derived from and based on the general real property tax system imposed on all property owners. The PILOTs in the 2006 IRS Stadium Rulings did not create a new charge separate and apart from the system of real property taxes. We did not include a specific discussion of the example because we determined that the PILOTs replicated a generally applicable tax, i.e., the real property tax imposed on all property owners. We did include general discussions of the real property tax that the PILOTs were meant to replace.

Question (1)(c): Whether or not you agree with this interpretation, could the existing regulations be reasonably interpreted to prohibit tax-exempt private

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[4] See, e.g., Treas. Reg. §1.164-3 (real property taxes are imposed on interests in real property and levied for the general public welfare).

[5] See, e.g., Treas. Reg. § 1.164-4 (special assessments for local benefits are limited to the property benefited and are not taxes).

activity bonds involving PILOTs funding sports stadium construction, such as those structured like the financing arrangements of the Yankees and Mets, because the regulations state that a PILOT "made in consideration for the use of property financed with tax exempt bonds is treated as a special charge." 26 C.F.R. § 1.141 -4(e)(5)(ii). If not, why not? If they could reasonably be interpreted that way, please explain why you depart from this interpretation.

A payment in the nature of rent for the use of property is not considered a payment of tax but is instead considered a special charge. This example in the regulations is ambiguous because it ignores the substance of the payment and assumes that all PILOTs are payments for the use of property. If a PILOT replicates what is otherwise a generally applicable tax, it should be a qualifying PILOT (assuming it is otherwise eligible under the regulations). If it is instead a payment of rent, it would be considered a special charge and would not be eligible for the generally applicable tax exception from the private security or payment test under Section 141 of the Code. In addition, another interpretative ambiguity arises in this example because the reference to tax-exempt bond financing property is not relevant to the question presented of whether the payment is, in substance, a tax or a payment for the use of property.

Question (2): If you still maintain that the existing regulations compel the interpretation advanced in the PLRs, is it within the Treasury Department's authority under the relevant statutory provisions to propose new regulations that effectively prohibit the use of PILOTs in conjunction with financing of stadiums with tax-exempt private activity bonds? If you do not believe that the Treasury Department retains such authority, please explain why you believe this is the case.

We must interpret the relevant statutory provisions consistent with Congressional intent. Congress clearly stated its intent in the legislative history of the Tax Reform Act of 1986 to exclude revenues from payments that are, in substance, generally applicable taxes, from treatment as private payments for purposes of the private security or payment test under Section 141 of the Code. We gave regulatory effect to Congressional intent for the treatment of generally applicable taxes for purposes of these tax-exempt bond provisions based largely on longstanding federal income tax principles under Section 164 of the Code that treat qualifying PILOTs as generally applicable taxes. Accordingly, we do not have the authority to impose an outright prohibition on the use of generally applicable taxes, which include qualifying PILOTs, as sources of payment in conjunction with the financing of stadiums with tax-exempt governmental bonds.

Question (3): Under the proposed regulations, would the PILOTs described in the PLRs be considered generally applicable taxes?

In October 2006, the Treasury Department and the IRS issued proposed regulations on PILOTs under proposed Treas. Reg. § 1.141-4(e)(5) (the "2006

Proposed Regulations").[6] The PILOTs in the 2006 IRS Stadium PLRs would not be considered generally applicable taxes under the 2006 Proposed Regulations because the PILOTs involved in those rulings were set at fixed amounts. By comparison, the 2006 Proposed Regulations would require that eligible PILOTs correspond more closely or "float" with the underlying generally applicable taxes that the PILOTs are meant to replace. In particular, the 2006 Proposed Regulations would require that an eligible PILOT reflect a fixed percentage of or fixed adjustment to the generally applicable taxes in each year based on current tax assessments.

Question(4): Prior to the 2006 PLRs, were PILOTs used in conjunction with the financing of tax-exempt bonds to fund stadiums, and if so, in which way(s), if any, did the use of PILOTs in these financing arrangements differ from those discussed in the PLRs.

We do not have specific information on the use of tax-exempt bonds to finance stadiums. In a U.S. Government Accounting Office ("GAO") Report entitled "Federal Tax Policy: Information on Selected Capital Facilities Related to the Essential Governmental Function Test" (GAO-06-1082, dated September 2006), the GAO estimated that during the period from 2000 through 2004, approximately $5.3 billion in tax-exempt bonds were issued in 119 bond issues to finance stadiums and arenas. We do not have specific information on how these bonds were secured or paid. To qualify for tax-exempt governmental bonds, these bonds would need to be payable or secured predominantly by some form of governmental payments, including generally applicable taxes or PILOTs, as contrasted with payments from private business use. We note that, although issuers of tax-exempt bonds are required to report certain information about bond issues to the IRS at the time of issuance, issuers are not required to report the specific details of the payments or security for their bonds nor are they required to obtain rulings from the IRS in order to issue tax-exempt bonds.

[6] 71 Fed. Reg. 61693 (October 19, 2006).

Question (5): Since the issuances of the PLRs, to your knowledge, have additional sports franchises sought to use PILOTs as payments to finance tax-exempt stadium or arena construction? To your knowledge, does the Atlantic Yards proposal include use of PILOTs to fund an arena for the Nets?

We are unaware of any new undertakings to use PILOTs for stadium or arena construction. We have received public comments from bar association groups (including the National Association of Bond Lawyers and the American Bar Association) to the effect that the proposed effective date of our proposed regulations (February 16, 2007) may affect some existing state and local governmental programs and transactions in progress that involve PILOTS, but without any specific references to bond issues for stadiums. We have also received public comments from the New York Industrial Development Agency and the Empire State Development Corporation that a new arena for a professional basketball team that is part of the Atlantic Yards project in Brooklyn, New York, was expected to be financed with tax-exempt governmental bonds paid or secured by PILOTs.

I hope this information is helpful. If you have any questions, please contact me or call Floyd L. Williams, Director, Office of Legislative Affairs, at (202) 622-4725.

Sincerely,

Donald L. Korb
Chief Counsel, Internal Revenue Service

cc: The Honorable Darrell Issa
Ranking Member
Domestic Policy Subcommittee
House Committee on Oversight and Government Reform

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

JUL 23 2008

The Honorable Dennis J. Kucinich
Chairman
Domestic Policy Subcommittee
Committee on Oversight and Government Reform
U.S. House of Representatives
2157 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Kucinich:

Thank you for your letter of May 23, 2008, regarding Federal tax guidance on the treatment of certain payments in lieu of taxes ("PILOTs") for purposes of the private payments limitation on tax-exempt governmental bonds under Section 141 of the Internal Revenue Code of 1986, as amended (the "Code").[1] Your letter also was addressed to IRS Commissioner Douglas H. Shulman, and the IRS will provide further perspective in their separate response. The House Domestic Policy Subcommittee considered this subject at its hearings on March 29, 2007 and October 10, 2007, on tax-exempt bond financing of stadiums at which the Chief Counsel of the Internal Revenue Service and I respectively testified.[2] This response to your letter includes an introduction reviewing the legal framework for tax-exempt bonds, responses to your specific questions, and some concluding comments.

Initially, I offer some brief background on the respective roles of the Treasury Department, acting through its Office of Tax Policy (such office is referred to herein as the "Treasury Department"), and the Internal Revenue Service ("IRS") in the Federal tax system. The Treasury Department is primarily responsible for tax policy and advises the Administration on tax legislative matters. The Treasury Department and the IRS share responsibility for, and coordinate closely on, public tax guidance matters, such as Federal tax regulations and IRS revenue rulings. The IRS is primarily responsible for tax administration, collection, and enforcement. The IRS Chief Counsel advises the IRS Commissioner on legal matters. The IRS Chief Counsel's office has jurisdiction over the IRS private letter ruling program because private letter rulings relate to specific taxpayer matters.

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[1] Except as noted, section references herein are to the Code and the Income Tax Regulations.

[2] IRS Chief Counsel Donald L. Korb testified at the March 29, 2007 hearing. I testified at the October 10, 2007 hearing.

I. Legal Framework for Tax-exempt Governmental Bonds.

A. Introduction and Overview.

Bonds generally are classified as tax-exempt "governmental bonds" if the proceeds are used predominantly for state or local governmental use or the bonds are repaid predominantly from state or local governmental sources of funds, including generally applicable taxes. The Code does not define "governmental bonds." Instead, bonds generally are referred to as governmental bonds if they avoid classification as "private activity bonds" under Section 141 of the Code. Section 141 generally classifies bonds as private activity bonds if more than 10 percent of the bond proceeds are both: (1) used for private business use (the "private business use limitation"); and (2) payable or secured from payments derived from property used for private business use (the "private payments limitation").

It is important to appreciate how this statutory legal framework operates with respect to eligibility for tax-exempt "governmental bonds" (as contrasted with "private activity bonds"). State and local governments can qualify for tax-exempt governmental bond financing in two distinct ways.

First, state and local governments can qualify for tax-exempt governmental bond financing if they use at least 90 percent of the bond proceeds to finance projects for state or local governmental use (as contrasted with private business use) in compliance with the private business use limitation under Section 141(b)(1). Most tax-exempt governmental bond issues for public infrastructure projects contemplate this predominant state or local governmental use of the financed projects (e.g., courthouses, schools, and public roads.)

Second, state and local governments alternatively can qualify for tax-exempt governmental bond financing if at least 90 percent of the debt service on the bonds is payable from or secured by state or local governmental funds, including generally applicable taxes (as contrasted with payments derived from private business use) in compliance with the private payments limitation under Section 141(b)(2), regardless of whether the projects financed with the bond proceeds are used entirely for private business use.

In considering the tax policy issues and analysis of stadium bond financing, it is critical to understand that, under the second alternative described above, the statutory framework gives state and local governments discretion and flexibility to use tax-exempt governmental bonds to finance whatever kinds of projects they deem important, including stadiums, convention centers, parking facilities, parks and recreational facilities, schools, economic development projects, or other projects of any kind that are used significantly for private business use, if the state or local governments subsidize repayment of at least 90 percent of the debt service on the governmental bonds with state or local governmental sources of funds.

In addition, as discussed below, Congress expressly intended to include generally applicable taxes within eligible governmental funds that can be used to repay tax-exempt governmental bonds under this second alternative. Further, as discussed below, the Treasury Department and the IRS have issued regulations defining generally applicable taxes for purposes of these tax-exempt bond provisions based on longstanding general tax principles, and those longstanding general tax principles treat PILOTs as generally applicable taxes. Thus, in short, the statutory framework and Congressional intent authorize state and local governments to use tax-exempt governmental bonds to finance projects, including stadiums, that the state and local governments, in their discretion, deem important, and that are used significantly for private business use so long as the bonds are payable from governmental funds, including generally applicable taxes.

B. Treatment of Generally Applicable Taxes as Governmental Payments under the Private Payments Limitation.

1. Legislative History and Regulatory Authority. In the legislative history to the Tax Reform Act of 1986, Congress clearly stated its intent to exclude revenues from generally applicable taxes from treatment as private payments for purposes of application of the private payments limitation on tax-exempt governmental bonds. Specifically, the Conference Report to the Tax Reform Act of 1986 included the following statement:

> Revenues from generally applicable taxes are not treated as payments for purposes of the security interest test [referring to the "private payments limitation," as used in this letter]; however, special charges imposed on persons satisfying the use test (but not on members of the public generally) are so treated if the charges are in substance fees paid for the use of bond proceeds.[3]

Section 7805(a) of the Code grants to the Secretary of the Treasury broad general regulatory authority to provide "all rules and regulations as may be necessary" reasonably to interpret the Code.[4] In this case, the Treasury Department and the IRS have the responsibility to provide regulatory guidance to implement Congressional intent to exclude generally applicable taxes from treatment as private payments for purposes of the private payments limitation under Section 141.

2. Longstanding General Federal Tax Definition of Generally Applicable Tax. In considering how to define a generally applicable tax in regulations

[3] H. Rep. No. 99-841, 99th Cong. 2d Sess. at p. II-688, 1986-3 C.B., Vol. 4, at p. 688 (1986).

[4] The courts have given great deference to such authority. See, e.g., Chevron USA Inc. v. U.S., 537 U.S. 437 (1984); U.S. v. Boyle, 469 U.S. 241 (1985); Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991); U.S. v. Mead Corp., 533 U.S. 218 (2001); U.S. v. Cleveland Indians Baseball Co., 532 U.S. 200 (2001); Boeing Company v. U.S., 537 U.S. 437 (2003); National Cable & Telecommunications Association v. Brand X Internet Service, 545 U.S. 967 (2005); U.S. v. Correll, 389 U.S. 299 (1967); and Swallows Holding, Ltd. v. Commissioner, 515 F.3d 162 (3rd Cir. 2008). See also National Muffler Dealers Association v. U.S., 440 U.S. 472 (1979).

under the tax-exempt bond provisions of the Code, the Treasury Department and the IRS drew from longstanding general Federal tax principles regarding the definition of "taxes" under Section 164, which generally defines state and local taxes as they apply throughout the Code. In this regard, in Rev. Rul. 61-152, 1961 C.B. 42, the IRS ruled that certain charges labeled "service charges" constituted taxes in substance, and the IRS defined taxes as follows:

> In general, the term "tax" includes every burden that may lawfully be laid upon the citizens by virtue of the taxing power, but its application in statutory provisions varies with the intent and purpose of the particular provision. A tax is an enforced contribution, exacted pursuant to legislative authority in the exercise of the taxing power, and imposed and collected for the purpose of raising revenue for public or governmental purposes, and not as a payment for some special privilege granted or service rendered. Taxes are, therefore, distinguishable from various other charges imposed for particular purposes under particular powers or functions of government. In view of such distinctions, the question whether a particular charge is to be regarded as a tax depends upon its real nature. If it is in the nature of a tax, it is not material that it may be called by a different name; conversely, if it is not in the nature of a tax, it is not material that it may be so called.

3. Longstanding General Federal Tax Treatment of PILOTs as Generally Applicable Taxes. Longstanding general Federal tax principles have also treated PILOTs having certain characteristics as generally applicable taxes. The IRS first articulated the treatment of PILOTs as generally applicable taxes in a public revenue ruling in 1971. Notably, in Rev. Rul. 71-49, 1971-1 C.B. 103, the IRS relied upon the above-referenced 1961 definition of taxes and ruled that certain PILOTs constituted taxes under Section 164. This ruling involved the use of PILOTs to finance public schools owned by nonprofit public benefit corporations. In Rev. Rul. 71-49, the IRS made the following statement about PILOTs:

> Ordinarily, when amounts are paid into a specific fund, they are treated as imposed as a regulatory measure (such as licensing fees), or as a charge for a privilege or service rendered. The tax equivalency payments in the instant case cannot be so treated. They are not exacted for the purpose of regulating or restraining an occupation deemed dangerous to the public, nor are they imposed as a charge for a privilege or service rendered. They are charges imposed on the cooperative housing corporation in order to obtain revenue the city would otherwise lose because of its treatment of the Fund as a tax-exempt public benefit corporation. The tax equivalency payments are measured by and are equal to the amounts imposed by the regular taxing statutes, and are themselves imposed by specific state statute even though the vehicle of the leasing agreement is utilized. Although the proceeds from these payments are paid directly to the Fund instead of the state's general revenue fund, they are nonetheless designated for a public purpose rather than for some privilege, service, or regulatory function, or for

some other local benefit tending to increase the value of the property upon which the payment is made.

4. The Tax-exempt Private Activity Bond Classification Regulations. After promulgating proposed regulations in 1994 (the "1994 Proposed Regulations")[5] and considering public comments on the 1994 Proposed Regulations, the Treasury Department and the IRS promulgated final regulations in 1997 that comprehensively addressed most aspects of the classification tests for tax-exempt governmental bonds and private activity bonds under Section 141 (the "1997 Final Regulations").[6]

In § 1.141-4 of the 1997 Final Regulations, the Treasury Department and the IRS provided guidance on governmental payments for purposes of the private payments limitation on tax-exempt governmental bonds, including guidance on the definition of a generally applicable tax for this purpose under § 1.141-4(e), and guidance on the treatment of certain PILOTs as generally applicable taxes for this purpose under § 1.141-4(e)(5).[7]

In defining governmental payments to include generally applicable taxes for purposes of the private payments limitation on tax-exempt governmental bonds consistent with Congressional intent under the 1997 Final Regulations, the Treasury Department and the IRS generally followed the above-mentioned longstanding general Federal tax principles regarding the definition of a tax under Section 164 for purposes of the treatment of "generally applicable taxes" as governmental payments under the private payments limitation. Similarly, for this purpose, the Treasury Department and the IRS generally followed longstanding general Federal tax principles to include certain PILOTs as generally applicable taxes.

In the process of completing the 1997 Final Regulations, the Treasury Department and the IRS responded to public comments on the 1994 Proposed Regulations requesting more flexibility for tax abatements and more flexible PILOT arrangements to accomplish a comparable tax abatement purpose without impairing the nature of such payments as generally applicable taxes. The 1994 Proposed Regulations had proposed to require that eligible PILOTs be "measured by and equal to" amounts imposed by a regular statute for a tax of general application. The 1997 Final Regulations changed this PILOT eligibility standard to a requirement that eligible PILOTs be "commensurate with" and not greater than a generally applicable tax. In this regard, in the preamble to the 1997 Final Regulations, the Treasury Department and the IRS stated that, in response to public comments, the final regulations on generally applicable taxes were intended to be "more

[5] 59 Fed. Reg. 67658 (December 30, 1994).

[6] 62 Fed. Reg. 2275 (January 16, 1997) (codified at 26 C.F.R. §§ 1.141-1 to 1.141-16).

[7] An excerpt of the relevant portion of the 1997 Final Regulations is attached to this letter, together with the relevant section of the 2006 Proposed Regulations discussed subsequently herein.

flexible" for arrangements that reduce the amount of tax paid and to "permit a wider range of tax equivalency payments."[8]

5. The 2006 IRS Stadium PILOT Private Letter Rulings. In July 2006, based on facts presented by a state or local governmental issuer in two specific transactions, the IRS Chief Counsel's office issued two favorable private letter rulings[9] in which it interpreted the applicable Code provisions and regulations (the "2006 IRS Stadium PLRs"). In the PLRs, the IRS Chief Counsel's office concluded that the particular PILOT arrangements presented, which involved the use of PILOTs to secure tax-exempt governmental bonds for stadiums, constituted generally applicable taxes under the applicable regulatory PILOTs standard set out in the 1997 Final Regulations.[10]

6. The 2006 Proposed Regulations on PILOTs. In October 2006, the Treasury Department and the IRS issued proposed regulations on PILOTs under proposed Treas. Reg. § 1.141-4(e)(5) (the "2006 Proposed Regulations").[11] The primary purpose of the 2006 Proposed Regulations was to *tighten* the circumstances under which PILOTs are treated, in substance, as generally applicable taxes, for purposes of the private payments limitation to ensure that eligible PILOTs correspond more closely with changes in the levels of the underlying taxes that they replicate.

Since the 2006 Proposed Regulations were issued, the Treasury Department and the IRS have received public comments, copies of which we have made available to the Subcommittee. We are proceeding with the regulatory process to consider the public comments and to work towards finalizing the 2006 Proposed Regulations.

II. Responses to Specific Questions

Question 1

Do you continue to maintain that existing regulations compel the Treasury Department to allow the use of PILOTs that meet the commensurability standard to be used in conjunction with sports stadiums financed by tax-exempt private activity bonds?[12]

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[8] 62 Fed. Reg. 2279 (January 16, 1997).

[9] Taxpayers may seek private letter rulings from the IRS Chief Counsel's office under prescribed procedures. See Rev. Proc. 2008-1 I.R.B. 1. (January 7, 2008). In general, in the IRS private letter ruling process, the IRS Chief Counsel's office applies applicable law and regulations to address the legal questions presented by specific taxpayers under particular facts. Under Section 6110(k)(3) of the Code, private letter rulings may not be used or cited as precedent.

[10] See PLR 200640001 (July 11, 2006) and PLR 200641002 (July 19, 2006).

[11] 71 Fed. Reg. 61693 (October 19, 2006).

[12] We note that your references in this question and elsewhere in your letter to the use of tax-exempt *private activity bonds* to finance stadiums are not technically accurate. In 1986, Congress repealed the use of tax-exempt private activity bonds to finance stadiums, but Congress preserved the use of tax-exempt

Response to Question 1

As noted above, the statutory framework under Section 141 gives state and local governments discretion and flexibility to use tax-exempt governmental bonds to finance projects they deem appropriate, including projects such as stadiums that have significant private business use, if at least 90 percent of the debt service on the bonds is payable from governmental sources of funds. By contrast, the Code allows the use of tax-exempt private activity bonds only for certain types of projects and purposes,[13] and the Code further expressly bans the use of tax-exempt private activity bonds for certain types of projects altogether.[14]

The legislative history to the Tax Reform Act of 1986, quoted above, shows clear Congressional intent to treat generally applicable taxes as governmental payments for purposes of the private payments limitation on tax-exempt governmental bonds.

The Treasury Department and the IRS have broad general regulatory authority to determine what constitutes a generally applicable tax for this purpose. In the 1997 Final Regulations, the Treasury Department and the IRS provided guidance on the definition of generally applicable taxes under Section 141 based on longstanding general Federal tax principles on the definition of a general tax under Section 164, including longstanding principles dating back to the early 1970s which treat PILOTs having certain characteristics as generally applicable taxes.

Thus, we believe that the 1997 Final Regulations support the treatment of PILOTs in appropriate circumstances as generally applicable taxes that could be used as a source of payment or security for tax-exempt governmental bonds to finance stadiums.

While the Treasury Department and the IRS have broad regulatory authority, we do not believe that regulatory authority under the existing statutory structure would permit a regulatory prohibition on the use of tax-exempt governmental bonds to finance stadiums when the bonds are payable from payments, including PILOTs, that are, in substance, generally applicable taxes. We believe that such a prohibition of the use of PILOTs would require a statutory change to the Code. The 2006 Proposed Regulations

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governmental bonds (i.e., bonds that specifically are not private activity bonds) to finance stadiums and other projects used for private business use when supported predominantly by governmental sources of payment, such as generally applicable taxes.

[13] See Section 141(e) (tax-exempt qualified private activity bonds include exempt facility bonds, qualified mortgage bonds, qualified veterans mortgage bonds, qualified small issue bonds, qualified redevelopment bonds, and qualified 501(c)(3) bonds). See also Section 142 (lists eligible types of exempt facilities).

[14] See Section 147(e) (bans the use of tax-exempt private activity bonds for airplanes, skyboxes or other private luxury boxes, health club facilities, certain gambling facilities, and certain liquor stores). It is important to note that Congress applied these restrictions on qualifying projects only to tax-exempt private activity bonds, and not to tax-exempt governmental bonds.

tighten the circumstances under which PILOTs can be used to ensure that eligible PILOTs correspond more closely with the generally applicable taxes that they replicate.

Question 1, Part (a)

Whether or not you agree with this interpretation, could the existing regulations be reasonably interpreted to prohibit the use of PILOTs to support tax-exempt private activity bonds financing sports stadiums on the grounds that sports stadium construction involves the use of bonds not designated for a public purpose? See 26 C.F.R. § 1.141-4(e)(5)(ii). If you believe that the IRS retains the authority to make such a finding, would it consider making such a determination, and, if not, why not?

Response to Question 1, Part (a)

This question highlights a core feature of the statutory structure that gives state and local governments discretion and flexibility to use tax-exempt governmental bonds to finance projects that they deem will carry out governmental or public purposes, whether or not used for private business use (including stadiums, convention centers, parking facilities, parks and recreational facilities, schools, economic development projects, or other projects of any kind that are used significantly for private business use), when the state and local governments determine that the projects are sufficiently important to warrant commitment of governmental funds, such as generally applicable taxes, to pay more than 90 percent of the debt service on the governmental bonds. While the Treasury Department and the IRS have broad regulatory authority to determine whether or not PILOTs are eligible for treatment as generally applicable taxes under the private payments limitation, the Treasury Department defers to state and local governments on public purpose determinations with respect to the financing of projects with tax-exempt governmental bonds under the existing statutory framework.[15]

Question 1, Part (b)

Whether or not you agree with this interpretation, could the existing regulations be reasonably interpreted to prohibit the use of PILOTs to support tax-exempt private activity bonds financing sports stadiums on the ground that they generally prohibit the use of"[s]pecial assessments paid by property owners benefiting from financial improvements," such as a "payment in lieu of tax that is limited to the property or persons benefited by an improvement." See 26 C.F.R. § 1.141-4(e)(3). Why didn't the Treasury Department include a discussion of the PILOT example in this provision in the PLRs?

[15] My response to the question from Congressman Tierney at the October 2007 hearing regarding whether we could determine that a PILOT that was used specifically for stadium construction is not generally used for a public purpose was not intended to be misleading, as noted in your letter. I interpreted that question as a general question consistent with a recurrent theme at the hearing as to whether the Treasury Department and the IRS could ban tax-exempt governmental bond financing of stadiums by regulation (rather than a technical question about § 1.141-4(e)(5)(ii) of the 2006 Proposed Regulation). My response indicated that we believe a statutory change to the Code would be required to accomplish such a ban.

Response to Question 1, Part (b)

As indicated in the introduction to this letter, the IRS Chief Counsel's office has jurisdiction over the IRS private letter ruling program on specific taxpayer matters. Thus, I would defer to the IRS' response on the issues that the IRS considers appropriate for discussion in IRS private letter rulings.

As a general matter, however, a significant consideration in the analysis of generally applicable taxes and PILOTs under the 1997 Final Regulations is the limitation against "special charges" under § 1.141-4(e)(3), which are defined as follows:

> (3) Special charges. A payment for a special privilege granted or service rendered is not a generally applicable tax. Special assessments paid by property owners benefiting from financed improvements are not generally applicable taxes. For example, a tax or a payment in lieu of tax that is limited to the property or persons benefited by an improvement is not a generally applicable tax.

Special charges include payments for special privileges granted or for services rendered, such as regulatory fees, license fees, or sanitation service fees.[16] Special charges similarly include payments that are, in substance, rent for the use of property.

In addition, special charges also include "special assessments paid by property owners benefiting from financed improvements."[17] These special assessments typically are used to finance infrastructure improvements, such as streets, sidewalks, streetlights, or water and sewer infrastructure, that benefit a limited number of property owners and that are specially assessed against the benefited property owners based upon those benefits rather than on the public at large as would be the case with generally applicable taxes.

We believe that qualifying PILOTs properly are distinguishable from special assessments. Generally applicable taxes (including PILOTs that are based on and replicate underlying generally applicable taxes) are broad-based charges (e.g., generally applicable ad valorem real estate taxes on all property owners based on assessed property values) that are imposed generally without regard to any particular benefit from the ultimate use of the collected taxes. By contrast, special assessments are additional assessments, above and beyond generally applicable taxes, that are imposed on particular

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[16] See, e.g., Rev. Rul. 60-366, 1960-2 C.B. 63 (regulatory filing fees are not taxes); Rev. Rul. 77-29, 1977-1 C.B. 29 (sanitation fees are not taxes), and Cox v. Commissioner, 41 T.C. 161 (1963) (highway tolls are for a governmental privilege or service rather than a tax).

[17] See, e.g., Treas. Reg. § 1.164-4 (special assessments for local benefits are limited to the property benefited and are not taxes), and Estate of Klosterman v. Commissioner, 99 T.C. 313 (1992), aff'd, 32 F.3d 402 (9th Cir. 1994) (special assessments by an irrigation district against irrigable land are not taxes). Compare Treas. Reg. § 1.164-3 (real property taxes are imposed on interests in real property and levied for the general public welfare, but do not include special assessments imposed on local benefits under Treas. Reg. § 1.164-4).

property owners because of, and measured by, benefits inuring from improvements financed with the special assessments.

Based on the foregoing analysis, we do not believe that the 1997 Final Regulations reasonably could be interpreted to prohibit PILOTs that replicate general real property taxes on the grounds that they constitute special assessments giving rise to special charges.

In general, we believe that it would be helpful to clarify our regulatory guidance regarding how the special charge limitation on generally applicable taxes, including the limitation on special assessments, applies in the context of PILOTs. We are considering clarifying this point in connection with finalizing the 2006 Proposed Regulations.

Question 1, Part (c)

Whether or not you agree with this interpretation, could the existing regulations be reasonably interpreted to prohibit tax-exempt private activity bonds involving PILOTs funding sports stadium construction, such as those structured like the financing arrangements of the Yankees and Mets, because the regulations state that a PILOT "made in consideration for the use of property financed with tax-exempt bonds is treated as a special charge." 26 C.F.R. § 1.141-4(e)(5)(ii). If not, why not? If they could reasonably be interpreted that way, please explain why you depart from this interpretation.

Response to Question 1, Part (c)

This question involves an example set forth in the last sentence of the PILOT rule in §1.141-4(e)(5)(ii) of the 1997 Final Regulations, which reads as follows: "[f]or example, a payment in lieu of taxes made in consideration for the use of property financed with tax-exempt bonds is treated as a special charge." In the 2006 Proposed Regulations, we proposed to remove that sentence.

We believe that the Treasury Department and the IRS have the authority based on the statutory legal framework and the legislative history to determine whether or not particular payments called PILOTs are impermissible because they are, in substance, rent or other payments "*made in consideration for the use of property*" for purposes of the above-quoted example of a special charge in the rule on PILOT eligibility requirements under the 1997 Final Regulations.

The quoted example from the 1997 Final Regulations regarding PILOTs, however, has raised technical interpretive questions. Initially, the example describes a payment in the nature of rent or a similar payment for the use of property (i.e., "made in consideration for the use of property") that rather clearly would constitute a special charge rather than a generally applicable tax. At the same time, questions have been raised regarding whether the existence of the tax-exempt bond financing mentioned in the example has any relevance to the determination of whether or not the character of the

payment is a special charge or a generally applicable tax. Stated differently, if a payment is rent for the use of property, it is not a tax, and it properly cannot be used to pay tax-exempt governmental bonds. By contrast, if a payment is in the nature of a generally applicable tax, it is not rent for the use of property, and it properly can be used to pay tax-exempt governmental bonds.

Consequently, in the 2006 Proposed Regulations, we proposed to remove the above-quoted example sentence from the 1997 Final Regulations. This proposed removal represents a technical clarification rather than a substantive change. This proposed change was neither a driving motivation for the 2006 Proposed Regulations nor an effort to liberalize the treatment of PILOTs in the 2006 Proposed Regulations, as suggested in your letter.

Question 2

If you still maintain that the existing regulations compel the interpretation advanced in the PLRs, is it within the Treasury Department's authority under the relevant statutory provisions to propose new regulations that effectively prohibit the use of PILOTs in conjunction with financing of stadiums with tax-exempt private activity bonds? If you do not believe that the Treasury Department retains such authority, please explain why you believe this is the case.

Response to Question 2

As discussed in the response to Question 1, The Treasury Department and the IRS have broad general regulatory authority to interpret the Code consistent with Congressional intent, including the authority to determine what constitutes a generally applicable tax for purposes of the private payments limitation on tax-exempt governmental bonds.

Notwithstanding this broad regulatory authority, we do not believe that the Treasury Department and the IRS have regulatory authority under the existing statutory structure to prohibit the use of tax-exempt governmental bonds to finance stadiums when the bonds are payable from payments that are, in substance, generally applicable taxes. Absent any particular regulatory guidance on PILOTs, the statutory framework under the Code would continue to allow the use of tax-exempt governmental bond financing of stadiums payable from generally applicable taxes and the interpretive question would remain as to whether PILOTs with certain characteristics are, in substance, generally applicable taxes under longstanding general Federal tax principles. In addition, as noted above, we believe that a prohibition against tax-exempt governmental bond financing of stadiums payable from generally applicable taxes would require a statutory change to the Code.

Question 3

Under the proposed regulations, would the PILOTs described in the PLRs be considered generally applicable taxes?

Response to Question 3

The PILOTs described in the 2006 IRS Stadium PLRs would *fail* to constitute eligible PILOTs under the 2006 Proposed Regulations because the PILOTs involved in those rulings were set at a fixed amount. The 2006 Proposed Regulations would require eligible PILOTs to be set at a "floating" amount that corresponds or floats more closely in accordance with changes in the levels of the underlying taxes that they replicate. Public comments that we received from bar association groups (including the American Bar Association and the National Association of Bond Lawyers) on the 2006 Proposed Regulations suggest that the 2006 Proposed Regulations are too restrictive in their treatment of PILOTs.

Question 4

Prior to the 2006 PLRs, were PILOTs used in conjunction with the financing of tax-exempt bonds to fund stadiums, and if so, in which way(s), if any, did the use of PILOTs in these financing arrangements differ from those discussed in the PLRs.

Response to Question 4

The Treasury Department and the IRS have no specific data on tax-exempt bond usage for stadiums in general or PILOTs in particular. In a U.S. Government Accounting Office ("GAO") Report entitled "Federal Tax Policy: Information on Selected Capital Facilities Related to the Essential Governmental Function Test" (GAO-06-1082, September 2006), the GAO estimated that, during the period from 2000 through 2004, approximately $5.3 billion in tax-exempt bonds were issued in about 119 bond issues to finance stadiums and arenas. As discussed above, in order to qualify for the tax exemption for the interest on tax-exempt governmental bonds under Section 103 of the Code, more than 90 percent of the debt service on these governmental bonds that finance stadiums for private business use must be payable or secured by state or local governmental payments, including generally applicable taxes and PILOTs that are, in substance, generally applicable taxes. The GAO report, however, does not identify the extent to which PILOTs were used in these cases, if any.

The Treasury Department does not have knowledge of the incidence of the use of PILOTs for stadiums in particular as a source of payment or security for tax-exempt governmental bonds before the issuance of the 2006 IRS Stadium PLRs. In recognition of the existing statutory framework, which allows the use of tax-exempt governmental bonds backed by generally applicable taxes, including PILOTs, to finance projects used for private business use, it is possible that some of the outstanding tax-exempt

governmental bonds for stadiums and other projects used for private business use are payable from, or secured by, generally applicable taxes in the form of eligible PILOTs.

We note that, although issuers of tax-exempt bonds are required to report certain summary information about tax-exempt bond issues to the IRS at the time of issuance under Section 149(e), the information required to be reported under Section 149(e) and on IRS information reporting forms does not include the specific details of the payments or security for the tax-exempt bonds. Further, issuers are not required to obtain rulings from the IRS in order to issue tax-exempt bonds.

Question 5

Since the issuances of the PLRs, to your knowledge, have additional sports franchises sought to use PILOTs as payments to finance tax-exempt stadium or arena construction? To your knowledge, does the Atlantic Yards proposal include use of PILOTs to fund an arena for the Nets?

Response to Question 5

Since the issuance of the 2006 IRS Stadium PLRs in July 2006, the Treasury Department does not have knowledge of any new undertakings to use PILOTs as a source of payment or security for tax-exempt governmental bonds used to finance stadiums except as noted in public comments received with respect to the 2006 Proposed Regulations. We have received some general public comments from bar association groups (including the American Bar Association and the National Association of Bond Lawyers) to the effect that the proposed February 16, 2007, effective date of the 2006 Proposed Regulations may affect some existing state and local governmental programs and transactions in progress that involve PILOTs, but without any specific references to bond issues for stadiums. We also have received public comments from the Empire State Development Corporation and the New York Industrial Development Agency to the effect that they planned to finance the proposed Atlantic Yards project for a new arena for the Nets professional basketball team in Brooklyn with tax-exempt governmental bonds to be paid or secured by PILOTs.

III. Concluding Comments.

Your Subcommittee has highlighted a key issue regarding the targeting of the Federal subsidy for tax-exempt bonds under the existing statutory framework. It is important to ensure that the Federal subsidy for tax-exempt bonds is properly targeted and justified. We believe that the core question regarding the appropriateness or scope of the use of tax-exempt governmental bonds backed by generally applicable taxes, including PILOTs, to finance stadiums or other similar projects is a legislative tax policy matter that Congress must address in the context of any possible statutory changes to the tax-exempt bond provisions of the Code. In my testimony at the October 10, 2007 hearing of your committee, we outlined various tax policy options that Congress might consider in this area.

Finally, we would be happy to arrange for the appropriate tax experts in the tax-exempt bond area at the Treasury Department and the IRS to meet with members of your staff to discuss this matter further and address any additional technical questions you may have.

Sincerely,

Eric Solomon

Eric Solomon
Assistant Secretary (Tax Policy)

cc: The Honorable Darrell Issa
Ranking Member
Domestic Policy Subcommittee
House Committee on Oversight and Government Reform

1997 Final Regulations on generally applicable taxes under §1.141-4(e) and 2006 Proposed Regulation changes shown in bold

§1.141-4(e) Generally applicable taxes.

(1) General rule. For purposes of the private security or payment test, generally applicable taxes are not taken into account (that is, are not payments from a nongovernmental person and are not payments in respect of property used for a private business use).

(2) Definition of generally applicable taxes. A generally applicable tax is an enforced contribution exacted pursuant to legislative authority in the exercise of the taxing power that is imposed and collected for the purpose of raising revenue to be used for governmental purposes. A generally applicable tax must have a uniform tax rate that is applied to all persons of the same classification in the appropriate jurisdiction and a generally applicable manner of determination and collection.

(3) Special charges. A payment for a special privilege granted or service rendered is not a generally applicable tax. Special assessments paid by property owners benefiting from financed improvements are not generally applicable taxes. For example, a tax or a payment in lieu of tax that is limited to the property or persons benefited by an improvement is not a generally applicable tax.

(4) Manner of determination and collection.

(i) In general. A tax does not have a generally applicable manner of determination and collection to the extent that one or more taxpayers make any impermissible agreements relating to payment of those taxes. An impermissible agreement relating to the payment of a tax is taken into account whether or not it is reasonably expected to result in any payments that would not otherwise have been made. For example, if an issuer uses proceeds to make a grant to a taxpayer to improve property, agreements that impose reasonable conditions on the use of the grant do not cause a tax on that property to fail to be a generally applicable tax. If an agreement by a taxpayer causes the tax imposed on that taxpayer not to be treated as a generally applicable tax, the entire tax paid by that taxpayer is treated as a special charge, unless the agreement is limited to a specific portion of the tax.

(ii) Impermissible agreements. The following are examples of agreements that cause a tax to fail to have a generally applicable manner of determination and collection: an agreement to be personally liable on a tax that does not generally impose personal liability, to provide additional credit support such as a third party guarantee, or to pay unanticipated shortfalls; an agreement regarding the minimum market value of property subject to property tax; and an agreement not to challenge or seek deferral of the tax.

(iii) Permissible agreements. The following are examples of agreements that do not cause a tax to fail to have a generally applicable manner of determination and collection: an agreement to use a grant for specified purposes (whether or not that agreement is secured); a representation regarding the expected value of the property following the improvement; an agreement to insure the property and, if damaged, to restore the property; a right of a grantor to rescind the grant if property taxes are not paid; and an agreement to reduce or limit the amount of taxes collected to further a bona fide governmental purpose. For example, an agreement to abate taxes to encourage a property owner to rehabilitate property in a distressed area is a permissible agreement.

(5) Payments in lieu of taxes. A tax equivalency payment or other payment in lieu of a tax is treated as a generally applicable tax if--

(i) The payment is commensurate with and not greater than the amounts imposed by a statute for a generally applicable tax in each year; and

(ii) The payment is designated for a public purpose and is not a special charge (as described in paragraph (e)(3) of this section). For example, a payment in lieu of taxes made in consideration for the use of property financed with tax-exempt bonds is treated as a special charge.[**The 2006 Proposed Regulations propose to delete the last sentence of §1.141-4(e)(5)(i)(B) which reads: "For example, a payment in lieu of taxes made in consideration for the use of property financed with tax-exempt bonds is treated as a special charge."**)]

The 2006 Proposed Regulations also propose to add the following new language in §1.141-4(e)(5)(ii) (with conforming changes in section references) to elaborate on and limit the commensurate standard:

Commensurate standard. For purposes of this paragraph (e)(5), a payment is "commensurate" with generally applicable taxes only if the amount of such payment represents a fixed percentage of, or reflects a fixed adjustment to, the amount of generally applicable taxes that otherwise would apply to the property in each year if the property were subject to tax. For example, a payment is commensurate with generally applicable taxes if it is equal to the amount of generally applicable taxes in each year, less a fixed dollar amount or a fixed adjustment determined by reference to characteristics of the property, such as size or employment. A payment does not fail to be a fixed percentage or adjustment as a result of a single change in the level of the percentage or adjustment following completion of development of the subject property. The payment must be based on the current assessed value of the property for property tax purposes for each year in which the PILOTs are paid and that assessed value must be determined in the same manner and with the same frequency as property subject to generally applicable taxes. A payment is not commensurate if it is based in any way on debt service on an issue or is otherwise set at a fixed dollar amount that cannot vary with the assessed value of the property determined in the manner described in this paragraph (e)(5)(ii).

Mr. KUCINICH. We are going to have to recess. We have a number of votes. Staff informs me a 45-minute recess would be appropriate.

We are done with Mr. Solomon. Mr. Solomon, do you have to leave?

Mr. SOLOMON. I have to leave at 4, so I could stay for a while.

Mr. KUCINICH. Well, I am going to ask you gentlemen if you can stay. It is up to you. I don't have any more questions of you, but I do have some questions of Mr. Rolnick.

Mr. ROLNICK. We will come back.

Mr. KUCINICH. We will come back, so the committee is recessed for 45 minutes. Thank you.

[Recess.]

Mr. DAVIS OF ILLINOIS [presiding]. The meeting will return to order. Who knows? Our chairman may very well have been summoned by a reporter who wanted to know about the White House and things like that. The chairman has not made it back, and so we will try to begin, because I wanted to get a question in to Mr. Solomon if I could before he had to leave.

Mr. Solomon, prior to the 2006 IRS private letter ruling for the Yankee Stadium, had any tax-exempt stadium construction debt been serviced with a payment in lieu of taxes?

Mr. SOLOMON. I do not know the answer to your question, Congressman. The private letter rule process is run by the Internal Revenue Service. I am in the Office of Tax Policy. I could get back to you with respect to the answer to your question, but I would have to ask them and I would have to research the private letter rulings. So what I would do is I would go to the IRS, their rulings branch, and ask them what they have done in this area. I am sorry that I can't answer your question off the top of my head.

Mr. DAVIS OF ILLINOIS. All right. We would appreciate if you could send us the answer to that in writing.

Mr. SOLOMON. Yes, sir.

Mr. DAVIS OF ILLINOIS. You also testified that you have proposed rulemaking that would tighten the PILOT rules. If those rules had been in effect when the Yankees' representatives applied for a private letter ruling, would they have been able to use a PILOT to service those bonds?

Mr. SOLOMON. I can't speak about any particular taxpayers because of matters of taxpayer confidentiality. I can tell you that the proposed regulations do state that a fixed payment cannot qualify as a payment in lieu of taxes, so a fixed payment, rather than one that is tied to property taxes, that is either tied to valuation either in proportion evaluation or a certain amount different from what would be charged for property taxes, a fixed payment would not qualify under the proposed regulations, which is a tightening of the rules.

Mr. DAVIS OF ILLINOIS. All right. Thank you.

Mr. Rolnick, let me ask you, if I could, when public resources are used to finance or subsidize private deals, what should be the expected return? I mean, what should the public expect in return for that investment? I mean, you would have to call it an investment or a give-away, in a sense, but I would call it an investment. What should the public expect in return?

Mr. ROLNICK. Address the question of public investments, public funds going to private investment. Where you stand matters a lot. If you are looking, do you think very parochial view? If you are the city of St. Paul and you attract a new software company, that creates jobs in the city. It has multiplier effects, meaning the new jobs, people spend money, and it is a way to enhance your economic activity, and actually you might end up with more revenue that way to provide the public services you want, and that is usually the rationale.

The problem with that perspective, it falls apart pretty quickly once you take a broader perspective. Suppose, for example, the company that you just lured to St. Paul came from Minneapolis, so the positive effects in St. Paul are negative effects in Minneapolis. The positive multiplier effects in St. Paul are negative multiplier effects in Minneapolis.

So from the State's point of view—so you are not wearing your city hat, if you will, you are wearing your State hat, you are the Governor of the State and you are watching public money, which you desperately need for your public infrastructure or you could use to lower taxes for all businesses. You are getting a zero public return. Even though St. Paul is going to get positive return, Minneapolis is getting a negative return.

In total, if by the public you mean the citizens of the State, there is a zero return. In fact, as I argued earlier, you could make the case it might be negative because you are interfering in market location decisions, and many times I would argue these subsidies are bluffs. That is, it would have happened, anyway, even without the incentives.

Every once in a while the incentives do affect a location decision, and you have to wonder if that is the best location decision for that company.

So your question, at a parochial level it might look like a positive return, but once you look at a broader level it is a zero return and maybe a negative return to the public.

Mr. DAVIS OF ILLINOIS. Well, let me ask, What if the proposers are suggesting that you are going to draw people into the area who otherwise would not come, and that there is going to be some residual impact that will go to other places outside of what it is that you are primarily dealing with.

Mr. ROLNICK. Mr. Chair, I think you still run into the same problem. Where are they coming from? In Minnesota, for example, we now have something called the Job Z Zone, which is to try to promote economic development in out-State Minnesota with subsidies and preferential tax treatment, and some of the relocation would have happened anyway. Some of it is coming from the Twin Cities. Some of it is coming from Wisconsin. So guess what? The State of Wisconsin now has their Job Zone, and they are now attracting companies from Minnesota to go to Wisconsin.

So at the end of the day, if you look at the big picture of the game, the winners are these companies that are footloose and are able to take advantage of playing one city or one State off against another, but the public is not benefiting. There is no new jobs there; they are just being moved around.

If there are spill-over effects, the market is very good at capturing spill-over effect synergies by being around other companies. They know that. Companies are very good at location decisions. Generally speaking, the best companies, the ones that are going to create their jobs in the future, they want to be around educated workers, they want to be around highly educated, institutional arrangements so that I have argued for many years the best way to promote an economy locally, regionally, nationally, and internationally is to do a better job educating your kids and educating your workers.

Mr. DAVIS OF ILLINOIS. Thank you very much.

I see that the chairman has returned.

[The prepared statement of Hon. Danny K. Davis follows:]

OPENING STATEMENT
CONGRESSMAN DANNY K. DAVIS
DOMESTIC POLICY SUBCOMMITTEE
OVERSIGHT AND GOVERNMENT REFORM COMMITTEE
"PROFESSIONAL SPORTS STADIUMS: DO THEY DIVERT PUBLIC FUNDS FROM CRITICAL PUBLIC INFRASTRUCTURE"

WENDESDAY, OCTOBER 10, 2007

2154 RHOB- 2:00 P.M.

Thank you Chairman Kucinich and Ranking Member Issa for your continued examination of the economic ramifications of Sports Stadiums, particularly as it relates to diverting public funds from critical public infrastructure. This hearing marks the second, or part two of an ongoing investigation on the funding and economic impact of Sports Stadiums in the community and the country at large. The debate before us today is whether or not it's a cost or benefit in diverting public funds from public infrastructure to public stadiums.

At the center of this debate is a critical question we're attempting to answer today; Is it welfare improving? Promoters of sports venues argue that facilities provide both tangible and intangible benefits to the public and should therefore receive public funds. At the same time cost-benefit analysis or input/output economic models suggests stadiums do not pay off financially. "The revenues generated by these stadiums are insufficient to cover ongoing operational expenditures beyond debt service and depreciation of the facility." (***Source:*** Center of Public Policy & Administration, The University of Utah)

This debate mirrors discussion in cities across the country whenever a professional sports team seeks public monies to build a venue. Indeed:

- Nationally, subsidies to professional sports facilities cost taxpayers some $500 million a year;
- A typical sports facility costs local taxpayers more than $10 million a year; and
- According to the Brookings Institution, "a new sports facility has an extremely small (perhaps even negative) effect on overall economic activity and employment. No recent facility appears to have earned anything approaching a reasonable return on investment. No recent facility has been self-financing in terms of its impact on net tax revenues.

Which brings us to today's hearing where we've been called upon to investigate critical public infrastructure tradeoffs. Specifically, does the public financing of public stadiums:

- ***Cause diversion of funds*** from more important public services such as schools, crime prevention, and road building;
- ***Do they create unfair subsidies being imposed upon taxpayers***, where "the average working person is asked to put a tax on their home, or pay sales or some other consumer taxes, to build luxury boxes in which they cannot afford to sit;" and
- ***Do they institute unfair subsidies to other businesses*** where no other industry is given access to public funds as readily as are professional sports teams, yet other businesses must compete with professional sports for labor, materials and customers? (***Source:*** The Heartland Institute)

With this in mind, I welcome insight and recommendations from guest panelists.

Mr. KUCINICH [presiding]. I thought you looked pretty good there, Chairman.

I want to thank Mr. Davis. Actually, I was kind of admiring him sitting here, because I was listening to that rich, mellifluous voice, taking lessons. Thank you very much, Mr. Davis.

Mr. Solomon, I am informed, needs to leave to keep another commitment, so you are discharged. The committee thanks you.

Mr. SOLOMON. Thank you.

Mr. KUCINICH. Thank you, sir.

Mr. Issa.

Mr. ISSA. I will do a couple more questions, and I, too, thank you, Mr. Solomon. You were a big help to us looking at the problem in a larger way.

I guess you get to be the only person, so you get all the questions now. If the State of California has a 10 percent income tax, the State of Florida has no income tax, isn't that every bit as much one State competing against another for a zero sum gain?

Mr. ROLNICK. In my earlier testimony I mentioned there is a form of competition that, after all, is good competition, effective competition. It is when cities and States compete to see who can provide the highest quality public goods at the lowest cost. Then people vote with their feet, so a high tax State like Minnesota provides, on average, pretty good public services. We have and we have been known to have terrific educational system, high-quality workers. You, as a citizen, can decide to move to Minnesota and pay higher taxes or move to another State, like Florida, that has lower taxes, and in turn the public services aren't going to be as good.

It is very difficult for State and local officials to decide how much you should produce. The ability for people to choose where they want to live is one way, the market, if you will, and that is the good competition that can help State and local officials decide.

So the point of your question is a good one. There is a form of competition. It is non-preferential. It is the type of goods that benefit all society, what economists call public goods non-rivalrous; that is, education, safety, good air quality. These are all things we all benefit from. That is a clear distinction between private goods. The market works well for private goods. We don't need government interfering there.

Mr. ISSA. You know, I appreciate that, but let me hypothecate another question, if you will.

Mr. ROLNICK. Sure.

Mr. ISSA. Case Western Reserve University has had a very controversial presidency come and go. These are million-dollar individuals. A million dollars. Now, Case happens to be private. We can go to Kent State has a brand new almost three-quarters of a million dollar package president. They made a decision. A public entity made a decision to pay an awful lot of money to get an individual. They will pay a lot of money to get a whole wing of individuals. So when you talk about education, which I certainly think is a core element of cities, counties, and even States, that is just part of the package.

In Cleveland, where the chairman and I are both from, we have one of the finest metropolitan park systems. Again, these are part of the competition.

We have minor league teams. We have major league teams. We have indoor and outdoor centers that have everything from the Beach Boys playing to more intimate activities when the basketball team isn't playing. Why are those not part of the same package of local control and local decisionmaking that a city makes in harmony with its goal to have so many hotel rooms, to have so much of this, that, and the next thing? Why is that any different?

Regardless of who gets the benefit—and I appreciate that some people would say, yes, but we are giving $400 million of value to an already rich person who owns a professional sports team. But if you take away who is the recipient, because, you know, for the most part landlords are the rich, why is it that the decision to acquire these assets aren't part of the local decision and the right of the city to make?

Mr. ROLNICK. So let me answer in a broad way with the Minnesota example, and then I will get specifically to Cleveland.

Minnesota has one of the best economies in this country today. It has attracted Fortune 500 companies. I think we are the No. 1 per capita in Fortune 500 companies. We have a very high per capita income. We have some of the lowest unemployment rates for many years in the country. It is a very efficient market. So a question, how did Minnesota become that way? Was it because of entertainment? Did they get there because they had the Minnesota Twins and the Minnesota Vikings and the Timber Wolves? Or did something else go on?

We did a study of Minnesota's economy that went back to 1920. In 1920, Minnesota's economy was well below the national average. The big difference was after World War II the State of Minnesota started pouring money into education. We do a much better job now of graduating our kids from high school.

Mr. ISSA. And I appreciate all of that.

Mr. ROLNICK. My point is the underlying cause of the growth was education, high quality. That attracts on its own, without government interference, attracts the businesses.

Mr. ISSA. I appreciate your opinion, but it is your opinion. Your conclusions are drawn by a cause and effect in a State that has professional sports, that, in fact, has been involved in the same sort of activities of competition to attract and keep those professional sports teams, or corporations that might choose to move somewhere else if they don't get tax abatement and so on.

So, although anecdotally I will accept that your truism is probably a good one, my question was local rights, the right of the local municipality, or State's rights to make these decisions, right or wrong. Under federalism we start off with the assumption that States and their derivative entities have these rights unless we preempt them, either in the Constitution or in statute specifically needed by the Federal Government.

So, again, why should I take away an equal right in decisionmaking that the city of Cleveland thinks that maintaining the league-winning Cleveland Indians is a good idea for a city that otherwise was written off as part of the Rust Belt with no hope dec-

ades ago, in addition to having Case Western Reserve, Baldwin Wallace, Cleveland State, and a host of other fine universities, parks, symphonies, and so on, because I am a proud former Clevelander who accepts that Cleveland has all the best things in life except weather and, in fact, also maintains these sports teams. Why is that not a legitimate part of the decision of the State and their derivative entities?

Mr. ROLNICK. Mr. Chair, the answer was partly in your question. Go back to the history of the Constitution and the Commerce Clause, what Madison and Hamilton had in mind. Under the Articles of Confederation, States——

Mr. ISSA. You had better be careful. They didn't think of Federal income tax.

Mr. ROLNICK. Well, they didn't think of that, but States were putting taxes, imports, restricting trade among the States. Both Hamilton and Madison were pretty good economists. They realized that to create a strong national economy we should not allow cities and States to interfere with interstate commerce. We also in the Constitution prohibit States, as you raised earlier, the right to issue bills of credit, which are money.

I am going to argue that allowing cities and States to preferentially go after each other's companies, whether it is sports teams, automobile factories, is a zero sum game. By luring an automobile company from Toledo to Detroit or vice-versa from a national perspective doesn't create any new jobs. The private market will take care of these companies.

Your original point with Cleveland, that is entertainment, that is private market. If Cleveland has a good economy, it will attract all kinds of entertainment. You don't have to subsidize entertainment. You are assuming that if you didn't subsidize that entertainment it wouldn't be there. I am going to argue at a national level if we don't allow cities and States to subsidize private companies, the private market will work just fine. They will figure out the best location decisions.

What the public has to do, what government has to do, is public goods. That is not entertainment. Entertainment is a private market system. It will work just fine. There is no market failure.

So I would argue, if you want to argue States' rights, I would argue this is very similar to prohibiting cities and States from interfering with interstate commerce with taxes. It is very consistent with making sure we have a strong national government.

The European Union, it is interesting, one of the first things they did is eliminated the subsidy wars that were going on between their countries.

Mr. ISSA. I know, and the Russians then bought alternative teams. But I guess that is free market at its finest.

One final question, which is off of the core subject but important to me.

Mr. ROLNICK. Sure.

Mr. ISSA. If we were to take away public bonding, do you believe that cities, in order to ensure that they had the facility, regardless of who pays for it, should be able to continue using its eminent domain in order to ensure that there was a facility in a location agreeable to the city? In other words, Jacobs Field, if it was 100

percent privately paid, would never have been built anywhere in downtown without the right to condemn and take at a fair price the land that was taken. What do you say to that?

Mr. ROLNICK. My view on eminent domain and the spirit of eminent domain, it is an abuse to use eminent domain to take from one private company and give to another. Eminent domain was strictly supposed to be used to build a public institution—a library, a school, not a sports stadium. So I have a lot of trouble.

Mr. ISSA. Thank you, sir.

Thank you, Mr. Chairman.

Mr. KUCINICH. My good friend from California raises some very serious public policy questions here that I would like to meet from another perspective.

We have the issue of the public good, as distinguished from the private benefit. This is a consistent and common theme in the United States, and it has been going on for over a hundred years.

We have what is called public utilities—water systems, sewer systems, light systems. We call airports public utilities. It is commonly understood that the public has certain things they can invest in in order to be able to assure a public benefit. If we accept the argument that there is a public benefit to having a sports team, why, then, using that logic, could not the public use its money to buy a sports team which then the public would own, instead of the public using its money to buy a stadium for the private owners while the owners still own the team? Do you see where I am going with this?

Mr. ROLNICK. Yes.

Mr. KUCINICH. Would you comment on that?

Mr. ROLNICK. I have heard the argument before, Mr. Chairman, in my mind, two bad choices: either you subsidize the stadium or you buy the team, itself. In either way I think it is not a very efficient use of public money. I will admit there is some publicness to professional sports teams. We can all root for our team without ever having to go to a game, to not have to pay a dime. When economists have tried to measure the value of that publicness, it falls far short of owning a team or buying a stadium.

In Minneapolis, at the time that we laid out $400 million, when Hennepin County, through a sales tax, laid out $400 million for that stadium, you can argue maybe they could have bought the team, whatever. At the same time, they were closing libraries in the city of Minneapolis, reducing the hours of the ones that were left open. So recognize, as economists will say, there are opportunity costs here. Lest we think that business you can make a lot of money at——

Mr. KUCINICH. Right. It is conceivable.

Mr. ROLNICK. That is a question.

Mr. KUCINICH. Is it conceivable that if you had a team—now, we are looking at figures that show that the value of teams go up when the public throws in an investment of a stadium.

Mr. ROLNICK. Right. And you would like——

Mr. KUCINICH. Some of those values go up tremendously. So is it conceivable that if a community owns a team and the value of the team goes up and maybe they get into the playoffs and win a

championship and go to the World Series, that you could actually use those revenues to reduce taxes in a community?

Mr. ROLNICK. Mr. Chairman, they like to say in Minnesota we are all above average. All teams can't be above average, and there are going to be some losing teams.

Mr. KUCINICH. Right.

Mr. ROLNICK. Now is a State then going to be in a position to have to purchase a high-price pitcher so we can have a winning team? I would rather have my public officials spending time concentrating on public goods like early childhood development.

Mr. KUCINICH. I am not disagreeing with that, but I think that a case could be made. When is the last time a major league chain was actually worth less money in succeeding years, that it dropped in value? When was the last time that it lost significant amounts of money? I am talking about two books here.

So the point I am making, because in Cleveland, for example, having major league sports is a big deal. It is. When we had the debate over Gateway years ago, I actually opposed building it, and did so publicly because I felt that the taxpayers—well, some of the same arguments that you are raising today. We had Municipal Stadium, where the Indians and the Browns played.

What I proposed is if we wanted to assure that the teams stay in town—and that is really the issue here. The issue is always whether the teams are going to stay in the city. Why do people build stadiums? Why is the public interested in investing? They want to make sure they don't lose the team.

So if the question is keeping the team, then it seems to me, if that is the public good we are talking about, then I don't see anything wrong—and I know my friend here from California might have a different opinion——

Mr. ISSA. From Cleveland in California.

Mr. KUCINICH. From Cleveland in California—and I want to take issue with your indirect criticism of our winters.

Mr. ISSA. I was talking about the summers.

Mr. KUCINICH. Oh, the summers. We are one of the few places in America which has a ski resort a few miles from a steel mill.

The point being that I don't think that public ownership of these franchises should be de-linked from a public good for the community; that it might be harmonious.

Now, when we get to the actual ranking what the priorities are in a community—to repair your bridges, are your schools falling apart, what kind of condition are your roads in. Here again, just before you came in what I suggested, if a city actually invested in a team and owned part of a team, they could take the profits from that and pour it into reducing taxes or providing services.

I know, again, the example is of private enterprise to say wait a minute, you are getting into private enterprise. But some people say that, too, of water systems, sewer systems, electric systems. I am just injecting that as another dimension in this which seldom gets discussed and it is one of the reasons, motivating factors that I have brought that forward.

Mr. Issa, do you have any other questions? We will go to the next panel.

Mr. ISSA. No. I think it has been an excellent panel. Thank you.

Mr. KUCINICH. All right. I will just ask one more question.

The Governor of Minnesota had reportedly vetoed at least one increase in the gasoline tax which funds bridges and road repair prior to the I–35 West bridge collapse. He signed a bill permitting the increase in the Hennepin County sales tax to fund a new stadium for the Twins during that same period. So there is a political process here that needs to be reviewed.

Should it give Congress comfort that elected officials will, on their own, make the tough choices to prioritize critical public infrastructure over give-aways to private concerns? Again, that is the dynamic tension we are looking at here, to go back to my friend from California. I mean, we have to freely understand the pressures that are on communities who don't want to lose a team. But what about it?

Mr. ROLNICK. Mr. Chair, it goes back to my original point. I think I understand your attempt to a better solution than simply subsidizing stadium, having the city or the State buy the team, but I think a much more effective solution is to have Congress end the bidding war. These teams would not be footloose and fancy free. They know where their markets are. They are making money. They wouldn't be moving around as much as they threaten to do if we no longer allowed cities and States to subsidize these teams.

Mr. KUCINICH. One final question, and then I will go to Mr. Issa again.

Mr. ROLNICK. Sure.

Mr. KUCINICH. In our previous hearing we heard the argument made that when one municipality lures a specific business away from another, there could be a distributional benefit, even if there is no net national benefit. That is, a poor community could benefit from hosting a business that would otherwise have been located in a more affluent community.

Can you comment on this distributional benefit to allowing States and municipalities to compete with one another for specific businesses?

Mr. ROLNICK. Sure.

Mr. KUCINICH. And does this distributional benefit justify the Federal tax expenditure?

You can answer that question, and then I want to go to Mr. Issa for a final question.

Mr. ROLNICK. There is no evidence, Mr. Chair, that the distributional benefits go that way. If anything, the richer communities are the ones that outbid the poorer communities. My home town of Detroit is an example of where you have two new stadiums, three casinos, attempts to revitalize a community and not look at the fundamental problem, which is educating their kids.

These are distractions. The notion that there is going to be distributional benefits for low-income families in these bidding wars is, I think, unsupported by any evidence that I have seen. If anything, these subsidies end up in the hands of very wealthy and successful business people.

Mr. KUCINICH. Thank you, Mr. Rolnick.

Mr. Issa.

Mr. ISSA. There is no argument that we talk about more here in Washington than redistribution of wealth. Nobody on the dias here

is going to say please give billionaires more money. I do think it is interesting that if Cleveland would just buy the Indians, then it could, of course, have a cap of $125,000 a year for the salaries of those individuals as city workers, and I know that would make it a much more affordable team. They wouldn't be in the playoffs. But that is a separate question.

I will ask it in two phases. Are you aware that Minnesota could have and perhaps should have rebuilt its own bridge that it did deferred maintenance on and let fall down when it had a $2.1 billion surplus? And the reason I ask that question is I appreciate your zero sum game question, but, see, as a former Clevelander, I am now a Californian. We contribute about one-eighth of the cost of the Federal Government, so when the Federal Government handed out a freebie quickly to Minnesota, what we really did was we gave away money that we don't get back in California. California gets back less than $0.76 on every $1 it sends. So in the co-question of zero sum game and redistribution, essentially wouldn't it be fair for Minnesota to take care of all of Minnesota's responsibilities and we in Washington to quit handing out quickie bills voted overnight in lump sums against a bridge that doesn't even have the first quote on it?

In fact, since your opening testimony talked about I–35 W, why is it, with a $2.1 billion surplus, we had to vote at all? Why wasn't Minnesota assuring the people of Minnesota that it would rebuild their bridge that they deferred maintenance on?

Mr. ROLNICK. Let me just say Minnesota, like California, receives less in public funds than it——

Mr. ISSA. But not on that day.

Mr. ROLNICK. Not on that day. I really can't comment on the details of the decisions on the bridges. They are complicated issues, and it is being debated today. I think it is important for government to take a lesson from what went wrong. I think nationwide we are way under-investing in infrastructure. I don't think Minnesota is the only case in point. I think the argument I am trying to make today, in a major distraction, not just in terms of money but in time, it is trying to lure each other's companies with these tax incentives, and I would strongly argue that if we ended this economic bidding war you would find State and local governments doing a much better job of meeting the direct public needs that we expect.

Mr. ISSA. The reason I ask this question is, you know, I am in southern California where we pay road taxes and we don't get it back to build our roads, even though we are growing, so we end up paying it with local money. Northern California and other places like it, they get huge, huge public works projects to build Metro. In San Francisco it is called BART. And 10.2 percent of the bonds issued—and this is, of course, nationally, but we will just assume for a moment that it was California—goes to transit. The debt for transit is 10 percent of the debt, while the debt for stadiums apparently is 0.4 percent.

On a scale, realizing you would like one to be zero, but, you know, 25 times as much spent on public transportation, isn't that, in fact, a reasonable—if someone told you we spent 25 times as much on transit systems as we send on stadiums, wouldn't you say,

Well, that is pretty good, before you said it should be zero, it should be infinite times? Wouldn't you say 25 times as much is pretty good?

Mr. ROLNICK. So if you are in business, Mr. Chair, if you are in business, the way you ask the question is where should my next dollars be invested, and you are always looking for the low-hanging fruit, the highest return. So I urge you, instead of looking at that ratio, to say what is the return on that public investment.

Now, as I mentioned earlier in my testimony, we did an exercise like that with——

Mr. ISSA. Recognizing that transit is one of the lowest returns, when we build transit what we have to do is keep subsidizing it forever. It never breaks even and never pays. The Metro system here has $3 in subsidies for every $1 paid by the people that ride it.

Mr. ROLNICK. I know there have been some fairly sophisticated analyses looking at how it reduces pollution, congestion, etc. I am not defending the money going into transportation, necessarily; I am just saying that the way you should make these decisions is to look at the next dollar. Where is the benefits relative to the cost the highest. When we did that and we looked at high-quality early childhood education starting prenatal to five, we found extraordinary returns.

Mr. ISSA. I am sure you did. Did you also look at——

Mr. ROLNICK. So I will put that up against transportation and the stadium.

Mr. ISSA. Did you also look at physical fitness, health and welfare, aspirations of young people, everything else that goes when they go to one professional baseball game and they say, I want to be like that. I want to join my Pop Warner and I am going to do this. Did you apply those same metrics to that?

Mr. ROLNICK. Yes, we did. We actually did, and we do know that baseball is going to exist in this country whether we subsidize it or not.

It was interesting, when the Minnesota hockey team left Minneapolis for Dallas a number of years ago, what happened with those kids who loved hockey? They started to go to the high school games, they started to go to the college games. It isn't that sports entertainment disappears; they started to go to some of the minor league games. So recognize this entertainment is going to exist, but if you don't educate those kids starting at prenatal to five and they start school behind, the market doesn't fix that. Those are the kids that end up behind. Those are the kids that cost society a huge amount of money.

Entertainment will be there. I will guarantee you if we end the bidding war between cities and States, you will still see virtually every one of these teams in the major cities as they are today, and your kids will be able to root for them.

Mr. ISSA. Thank you.

Thank you, Mr. Chairman.

Mr. KUCINICH. I thank Mr. Issa for his questions.

I want to thank Mr. Rolnick for his participation and his patience with this process of being interrupted by votes.

Mr. ROLNICK. Thank you.

Mr. KUCINICH. You are much appreciated. This committee wants to thank you.

We are going to move on to our next panel and thank them for waiting, as well.

On our second panel, the subcommittee is going to hear from Professor Judith Grant Long, who is assistant professor of urban planning at the Harvard University Graduate School of Design. Professor Long's research interests focus on physical planning, with particular attention to the growing role of sports, tourism, and cultural infrastructure in cities. Her recent publications include, Full Count: The Real Cost of Public Funding for major league Sports Facilities; Facility Finance: Measurement Trends and Analyses; Transforming Federal Property Management: The Case for Public/Private Partnerships. She is completing a book currently entitled City Sports: Stadiums and Arenas as Urban Development Catalysts.

A certified professional planner, Professor Long has practiced extensively at the local level of government in the Toronto area, managing innovative strategies for downtown development and historic preservation. Her honors include grants and awards from the U.S. Department of Housing and Urban Development, the IBM Center for the Business of Government, the Canada Mortgage and Housing Corp., the Ontario Professional Planners Institute. She is a recipient of the Gerald M. McHugh Medal awarded by the GSD.

Professor Long served as assistant professor of urban planning at Rutgers from 2002 to 2005, a design critic at GSD during 2005 to 2006. She received her B.A. in economics from Huron College at the University of Western Ontario, Canada; her BAA in urban and regional planning from Ryerson Polytechnic University in Canada, her MDES from GSD, and her Ph.D. in urban planning from Harvard Graduate School of Arts and Sciences. Welcome.

Professor David Hale is the director of Aging Infrastructure Systems Center of Excellence, at the University of Alabama. The AISCE works to mitigate and reverse the effects of aging on the Nation's public and private sector infrastructure by using systematic cross-industry application of engineered processes and techniques. Dr. Hale's research has resulted in over 50 scholarly and infrastructure systems professional publications in journals and conference proceedings.

Dr. Hale's research has been funded by the National Science Foundation, the U.S. Department of Commerce, the U.S. Department of Transportation, U.S. Army Corps of Engineers, Accenture, Alabama Department of Transportation, Computer Sciences Corp., KPMG Peat Marwick Research Foundation, Proctor and Gamble, Sterling Software, Texas Instruments, and University Transportation Centers of Alabama. He has consulted for a number of the largest corporations in America.

Dr. Hale currently serves on the State of Alabama's Infrastructure Commission and the Governor's Black Belt Task Force and the State's Information Technology Workforce Development Resource Center. He also directs the Aging Infrastructure Systems Center of Excellence at the University of Alabama.

Ms. Bettina Damiani is the project director of Good Jobs New York, which promotes policies which hold government officials and

corporations accountable to the taxpayers of New York City. At the Good Jobs New York, Ms. Damiani has worked to bring more transparency and public participation to the allocation of subsidies to large economic development projects, including the rebuilding of the World Trade Center site and the new Yankees Stadium in South Bronx. She is a founder of the Liberty Bond Housing Coalition, which advocated for the use of post-September 11th financing to create affordable housing for middle- and low-income New Yorkers.

Ms. Damiani has a BA in communications and peace studies from Manhattan College and has a master's of urban affairs from Hunter College. She is a recipient of the 2006–2007 Revson Fellowship at Columbia University.

Welcome.

Dr. Steven Maguire is currently a Specialist in Public Financing in the Government and Finance Division of CRS. He specialized in the economics of taxation, particularly Federal taxation and State and local public finance.

Recent reports have addressed State use of tax-exempt private activity bonds, tax credit bonds, the alternative minimum tax deductibility of State and local taxes, internet taxes, family tax issues, estate taxes, and estate business taxation. In addition to his work at CRS, his Ph.D. dissertation examined the public subsidy of professional sports stadiums.

He holds a BA in economics from the University of Tennessee and a Ph.D. in economics from the Andrew Young School at Georgia State University. He is a member of the National Tax Association and American Economic Association.

Members of the panel, it is the policy of the Committee on Oversight and Government Reform to swear in all witnesses before they testify.

[Witnesses sworn.]

Mr. KUCINICH. Let the record show that the witnesses, each of them has answered in the affirmative.

As with panel one, I will ask the witnesses to give an oral summary of his or her testimony, to keep this summary under 5 minutes in duration. Bear in mind that your complete written statement will be included in the written record.

I would ask Professor Long to begin. Thank you very much.

STATEMENTS OF JUDITH GRANT LONG, ASSISTANT PROFESSOR OF URBAN PLANNING, GRADUATE SCHOOL OF DESIGN, HARVARD UNIVERSITY; DAVID P. HALE, DIRECTOR, AGING INFRASTRUCTURE SYSTEMS CENTER OF EXCELLENCE, UNIVERSITY OF ALABAMA; BETTINA DAMIANI, DIRECTOR, GOOD JOBS NEW YORK; AND STEVEN MAGUIRE, SPECIALIST IN PUBLIC FINANCE, CONGRESSIONAL RESEARCH SERVICE

STATEMENT OF JUDITH GRANT LONG

Ms. LONG. Thank you, Mr. Chairman, Ranking Member Issa, and members of the subcommittee for the opportunity to speak this afternoon.

I am a professor at the Harvard University Graduate School of Design. I am an urban planner and an economist. I, too, wrote my

dissertation on public subsidies for sports facilities, so I look forward to comparing notes with Professor Maguire.

My main area of expertise is the financing and development of sports, convention, and tourism facilities.

The question before the committee today is whether or not public subsidies for professional sports facilities divert funds and attention away from critical public infrastructure. My testimony will focus on three aspects of this issue: first, how much public money has been spent subsidizing major league sports facilities; second, what portion of this public funding has made use of tax-exempt financing; and, third, are public subsidies for major league sports facilities indeed diverting funds from the repair and maintenance of critical public infrastructure.

Turning to the first question, how much public money has been spent and continues to be spent to subsidize new major league sports facilities, this question is important because the ongoing debate about the appropriateness of these subsidies depends critically on our ability to accurately measure the nature and magnitude of these underlying costs. Starting with cost figures provided by the sports industry, public funding for the 82 facilities opened between 1990 and 2006 totals approximately $12 billion. This estimate is based on an average facility price tag of $253 million, an average public subsidy of $144 million, translating to an average public share of 57 percent.

My research, which is now shown for the elucidation of the audience who don't have the report in front of you, is summarized in a table on the side screens. My research shows that these figures are, in fact, the tip of the iceberg. I argue that governments pay far more to participate in the development of major league sports facilities than is commonly understood, due to the routine and ongoing omission of public subsidies for land, infrastructure, and, as well, the ongoing costs of operations, capital improvements, municipal services, and foregone property tax revenues.

Adjusting for these omissions, my full count estimate of total public funding for these same 82 facilities is $18.5 billion, representing a 55 percent increase over commonly reported industry figures, or $6.5 billion in uncounted costs These figures are based on an average of $80 million in uncounted cost for each individual facility, increasing the average public subsidy to $225 million and the average public share of total costs increasing from 57 percent to 80 percent.

My adjusted public cost data can also be applied to broader time periods. Over the period from 1950 to 2006, I estimate that the public has spent just over $27 billion subsidizing capital costs such as building, land, and infrastructure for 167 major league sports facilities built since 1950. That is an average of $155 million per facility. Now, if we add the $6.5 billion in uncounted ongoing costs and foregone property tax revenues for the period of 1990 to 2006, the total public cost increases to $31.5 billion. Add the seven new facilities scheduled to open in the period of 2007 to 2010, and the total public cost increases by another $1.5 billion to just over $33 billion, and so on.

As to the second question, what portion of the $18.5 billion in public subsidies for sports facilities delivered between 1990 and

2006 used tax-exempt financing, this is an important question because of the ongoing debate about the appropriateness of using tax-exempt bonds to finance sports facilities, since they offer a discounted cost of capital to private individuals paid through a reduction in Federal tax revenues.

Interpreting my preliminary aggregate data very conservatively, I came up with an estimate, for the purposes of today's hearing, which was approximately $10 billion of tax-exempt bonds based on this initial figure from 1990 to 2006 of $18.5 billion. But then when I arrived today, I was happy to see that Dr. Maguire actually had up-to-date data that summarized the total amount of funds used from 1993 to 2006, and, while the total figure wasn't provided, my quick math estimates at about $16 billion. So, in fact, it is higher than the $10 million that I estimated conservatively and represents somewhere between 80 to 90 percent, depending on how one measures these figures, of the total amount of subsidies delivered.

Clearly it is an important, if not the major, instrument of subsidy delivery in the context of major league sports facilities and the public funding for them. What is less clear is whether the total amount of public funding would be lower for sports facilities and, in fact, how much lower would it be if the use of tax-exempt bonds to finance sports facilities was prohibited.

On a smaller scale but still worth noting is the dollar value cost associated with the use of tax-exempt financing whereby taxpayers are paying a share of reduced interest costs through reduced Federal tax revenues. Again, based on my conservative estimates, I was using a participation rate of about 80 percent of the 62 facilities out of the 82 and came up with an average debt issue of $150 million.

Then with the 2 percentage point spread between the tax-exempt and market interest rates, the total resulting loss to the U.S. Treasury on an annual basis would be approximately $2 million per facility per year, and over a period of 20 years the total lost Federal revenues would be close to $2 billion. Again, making use of Dr. Maguire's data, it is clear that this amount would be somewhat higher.

As an example, to finance the Seattle Mariners' new ballpark in 1997, King County issued $310 million in tax-exempt bonds carrying an interest rate of 5.9 percent at a time when equally rated taxable bonds issued by King County carried an interest rate of 8 percent. The difference in tax rates amounted to $6 million in lost Federal revenues.

Turning to the third question, could this $18.5 billion spent between 1990 and 2006 have been better spent by investing in critical public infrastructure, this question of opportunity cost is particularly important given the recent and solemn reminder in Minneapolis where a bridge collapsed killing 13 people 1 day before ground was to be broken on a new major league ballpark financed with close to $400 million in public funds.

A quick look at the numbers reveals that the money spent by the public sector on major league sports facilities is relative pocket change when compared to the money needed to maintain and upgrade critical infrastructure. According to the University of Alabama's Aging Infrastructure Systems Center of Excellence, it takes

approximately $100 billion annually to maintain the Nation's infrastructure at its current level of service, and over the next 5 years an estimated $1.6 trillion is required to bring the Nation's infrastructure up to acceptable standards.

Viewed nationally, if public funding for sports facilities could, indeed, be redirected, the magnitude of spending comes nowhere near to solving the infrastructure problem. Even if the entire $18.5 billion spent on sports facilities by the public sector over the past 16 years could be retroactively applied to infrastructure, only 3 months of current operating costs could be paid.

In annual terms, the picture is bleaker, still, since annual public spending on major league sports facilities is between $1 billion to $2 billion per year, or about $10 million per facility. Moreover, these figures assume that the rate of new construction will continue, whereas by 2010 over 90 percent of the major league facilities' stock will have been replaced and a lull in construction activity is anticipated.

Viewed locally, however, the opportunity cost of public funding for sports facilities is more tangible. If the $1 billion to $2 billion were diverted to the 50-plus U.S. cities that host major league sports facilities, the impact is sizable. Recapturing $10 million per facility per year—and many of these cities have two—would go a long way toward ensuring the effective management, maintenance, and upgrading of local public infrastructure.

It is, of course, also helpful to consider diversions other than transportation infrastructure, since the mis-match in the relative scale of these two public spending issues may, quite mistakenly, infer that public funding for sports facilities is a token amount and therefore insignificant. Nationally, $1 billion per year could support a host of worthy public programs. To take one example, $100 million is the amount the Centers for Disease Control and Prevention plan to distribute to help States boost their smallpox vaccination programs.

Locally, these moneys could be better spent perhaps by supporting schools, health care services, and job creation programs. $10 million could support the creation of over 200 local jobs, assuming a cost of $50,000 per job.

So it appears that there are many ways this money could be better spent, depending on one's perspective, yet under existing regulations it is unreasonable to expect that State and local decision-makers will be able to fend off the considerable political pressure exerted by private individuals to gain access to the benefits of tax-exempt financing.

Diverting public funds away from sports facilities will require removing this authority from State and local political arena through a prohibition of the use of tax-exempt funds for sports facilities. There is very little evidence that there have been $18.5 billion in public benefits generated since 1990 to compensate for the $18.5 billion in public costs that have been expended.

Mr. ISSA [presiding]. Thank you, Professor. The rest of your statement can be put in the record. You are at twice your time.

Ms. LONG. I apologize. I was just about done.

Mr. ISSA. No problem.

[The prepared statement of Ms. Long follows:]

Testimony of

Judith Grant Long, PhD, AICP
Assistant Professor of Urban Planning
Graduate School of Design, Harvard University

Professional Sport Stadiums:
Do They Divert Public Funds From Critical Public Infrastructure?

Domestic Policy Subcommittee
Oversight and Government Reform Committee
Wednesday October 10, 2007
2154 Rayburn HOB – 2:00 P. M.

Thank you, Chairman Kucinich, Ranking Member Issa, and members of the Domestic Policy Subcommittee, for the opportunity to speak with you this afternoon. I am a professor at the Harvard University Graduate School of Design, and one of my areas of expertise is the financing and development of sports, convention, and tourist facilities.

The question before the committee today is whether or not public subsidies for professional sports facilities divert funds and attention away from America's public infrastructure. My testimony focuses on three aspects of this issue:

- How much public money has been spent subsidizing major league sports facilities?
- What portion of this public funding has made use of using tax-exempt financing?
- Are public subsidies for major league sports facilities diverting funds from the repair and maintenance of critical public infrastructure?

Measuring the Cost of Public Subsidies for Major League Sports Facilities

How much public money has been spent, and continues to be spent, to subsidize new major league sports facilities? This question is important because the ongoing debate about the appropriateness of these public subsidies depends critically on our ability to accurately measure the nature and magnitude of the underlying costs.

Starting with cost figures provided by the sports industry, public funding for the 82 new facilities opened between 1990 and 2006 totals approximately $12 billion dollars. This estimate is based on an average facility price tag of $253 million (in 2006 dollars), an average public subsidy of $144 million, translating to an average public share of facility costs measuring 57 percent.

My research summarized in Table 1 below, shows that these figures are the tip of the proverbial iceberg. I argue that governments pay far more to participate in the development of major league sports facilities than is commonly understood due to the routine omission of public subsidies for land, infrastructure, as well as the ongoing costs of operations, capital improvements, municipal services, and foregone property taxes.

TABLE 1:
Public Funding for Major League Sports Facilities [1]
Facilities Opened from 1990 to 2006 [2]
(in 2006 Dollars)

	Industry Estimates	*Adjusted for Land and Infrastructure*	*Adjusted for Ongoing Expenses (Net of Revenues) and Foregone Property Taxes*
Average Facility Cost	$253 Million	$281 Million	$281 Million
Average Public Subsidy	$144 Million	$169 Million	$225 Million
Average Public Share	57%	60%	80%
Total Public Subsidy	$12.0 Billion	$14.0 Billion	$18.5 Billion

1. Major League = MLB, NFL, NBA, NHL

2. A total of 82 new or substantially renovated facilities were opened in between 1990 and 2006.

Adjusting for these omissions, my "full count" estimate of total public funding for these same 82 facilities is $18.5 billion dollars—representing a 55 percent increase over industry

figures, or $6.5 billion dollars in uncounted costs. These figures are based on an average of $80 million dollars of uncounted costs for each individual facility, increasing the average public subsidy to $225 million, and the average public share of total costs from 57 to 80 percent.

My adjusted public cost data can also be applied to broader time periods. Over the period from 1950 to 2006, I estimate that the public has spent just over $27 billion dollars subsidizing the capital costs (building, land, infrastructure) for 167 major league sports facilities—an average subsidy of $155 million per facility (2006 dollars).

Add the $6.5 billion dollars in uncounted ongoing costs and foregone property tax revenues for the period from 1990 to 2006, and the total public cost increases to $31.5 billion dollars.

Add the seven (7) new facilities scheduled to open from 2007 to 2010, and the total public cost increases by another $1.5 billion to just over $33 billion dollars.

Measuring the Cost to the Public of Tax-Exempt Financing

What portion of the $18.5 billion dollars in public subsidies for sports facilities delivered between 1990 and 2006 used tax-exempt financing? This is an important question because of the ongoing debate about the appropriateness of using tax-exempt bonds to finance sports facilities, since they offer a discounted cost of capital to private individuals, paid for through a reduction in federal tax revenues.

Interpreting my preliminary aggregate data conservatively, I estimate that approximately $10 billion dollars of tax-exempt bonds have been issued to fund major league sports facilities for the 82 new facilities opened from 1990 to 2006. Based on the estimated $18.5 billion total public funding over this period (Table 1), the implication is that the majority of those funds—over 55 percent—are delivered through tax-exempt financing. Assuming a participation rate of 80 percent, or 65 out of 82 facilities, the average amount of tax-exempt debt issued is $150 million.

Note that I use the term "preliminary" data because I have yet finished collecting high-quality data on the nature and magnitude of tax-exempt financing for each individual facility. I do, however, have data for a sufficiently large sample to provide this estimate with reasonable confidence. I also deliver my estimate conservatively, both in terms of participation rate and average debt issue.

It is likely that the actual figures for tax-exempt financing are higher. An informal survey conducted by the Washington Post in 2003, where the sample was chosen to highlight issues of tax-exempt financing, yielded a participation rate of 95 percent and average debt issue of $185 million. Using their assumptions, my estimate of the impact of tax-exempt financing would increase dramatically: 85 percent of total public funding would be attributed to tax-exempt bonds, or 85 percent of all public funding from 1990 to 2006, at an average debt issue of $200 million per facility.

Regardless of whether the actual figure lays closer 55 percent or 85 percent, it is clear that tax-exempt financing is the major instrument of subsidy delivery in the context of major league sports facilities during recent years. What is less clear is whether the total amount of public funding for sports facilities would be lower—and how much lower it would be—if the use of tax-exempt bond to finance sports facilities had been prohibited.

On a smaller scale, but still worth noting, is an additional uncounted public cost associated with the use of tax-exempt financing, whereby taxpayers are paying a share of reduced interest costs through reduced federal tax revenues. Based my conservative estimate of 65 out of 82 facilities making use of tax-exempt financing at an average debt issue of $150 million, then a two-percentage-point spread between the tax-exempt and market interest rates would result in a total loss of revenue to the US treasury of approximately $195 million annually. Assuming a declining balance over twenty years, the total lost federal revenues would be close to $2 billion dollars.

That the incidence of tax-exempt financing costs fall nationally on taxpayers raises a point ably articulated by Mr. Neil DeMause, who in testimony earlier this year, points out that

Kansas City Royals fans would no doubt not be pleased to learn that their tax dollars are going to help make the New York Yankees even richer.

Again, it is likely that the actual loss of federal revenues due to tax-exempt financing is higher. As an example, to finance the Seattle Mariners' new ballpark in 1997, King County issued $310 million in tax-exempt bonds carrying an interest rate of 5.9 percent, at a time when equally-rated taxable bonds issued by King County carried an interest rate of 8 percent. The difference in rates amounted to $6 million in lost federal revenues.

Are public subsidies for major league sports facilities diverting funds from public infrastructure?

Could this $18.5 billion dollars have been better spent by investing in critical public infrastructure? This question of opportunity cost is particularly important given the recent and solemn reminder in Minneapolis where a bridge collapsed killing twelve people one day before ground was to be broken on a new major league ballpark financed with close to $400 million in public funds.

A quick look at the numbers reveals that public money spent on major league sports facilities is pocket change relative to the money needed to maintain and upgrade critical infrastructure. According to the University of Alabama *Aging Infrastructure Systems Center of Excellence*, it takes approximately $100 billion annually to maintain the nation's infrastructure at its current level of service, and over the next five years an estimated $1.6 trillion is required to bring the nation's infrastructure up to acceptable standards.

Viewed nationally, if public funding for sports facilities could indeed be redirected, the magnitude of spending comes nowhere near to solving the infrastructure problem. Even if the entire $18.5 billion public dollars spent on sports facilities over the past sixteen years could be retroactively applied to infrastructure, only three months of current operating costs could be paid. In annual terms the picture is bleaker still, since annual public spending on major league sports facilities is between $1 to $2 billion dollars per year, or about $10 million per facility. Moreover, these figures assume that rate of new construction will continue,

whereas by 2010 over 90 percent of the major league facility stock will have been replaced, and a lull in activity is anticipated.

Viewed locally, however, the opportunity cost of public funding for sports facilities is more tangible. If the $1 to $2 billion dollars were diverted to the 50-plus US cities that host major league sports facilities, and the impact is sizeable. Recapturing $10 million dollars per facility per year—and most of these cities have at least two—would go a long way towards ensuring effective management, maintenance and upgrading of local public infrastructure.

It is also helpful to consider diversions other than transportation infrastructure, since the mismatch in the relative scale of these two public spending issues may quite mistakenly infer that public funding of sports facilities is a token amount and therefore insignificant. Nationally, $1 billion per year could support a host of worthy public programs: To take one example, $100 million is the amount the Centers for Disease Control and Prevention planned to distribute to help states boost their smallpox vaccination programs in 2003. Locally, these monies could be better spent supporting local schools, health care services, and job creation programs: $10 million dollars per year could support the creation of two hundred local jobs, assuming a cost of $50,000 per job.

Since the vast majority of these new facilities have been built in urban areas, there may be a stark juxtaposition of the needs of low- and moderate-income residents living near the facilities, versus those of the high-income team owners, athletes, and facility patrons. The contrast is economic, where poorer residents often can only afford to go to game events if they are somehow employed in the facility, as well as physical, with a high degree of amenity and security in the immediate environs of the facility, buffering patrons from these same residents. Tax-exempt financing exacerbates these distributional impacts, since the significant benefits of these bonds accrue to a small group of private individuals at a significant cost to the general public, and with few corresponding public benefits, particularly for local residents.

So it appears that there are many ways this money could be better spent.

Yet under existing regulations, it is unreasonable to expect that state and local decision-makers will be able to fend off the considerable political pressure exerted by private individuals to gain access the benefits of tax-exempt financing.

Diverting public funds away from sports facilities will require removing this authority from the state and local political arena through a prohibition of the use of tax-exempt funds for sports facilities. There is absolutely no evidence that $18.5 billion dollars in public benefits have been generated since 1990 to compensate for the $18.5 billion dollars in public costs. Variations on the loophole, including recent creative use of payments-in-lieu-of-taxes should be similarly prohibited. The opportunity cost is significant, viewed in the context of infrastructure or any of a host of other important public services, and competition between local jurisdictions is becoming increasingly counter-productive when measured at the national level.

Critics of such a prohibition may argue that the private-activity substituted for sports facilities may not fare any better in terms of generating public benefits. If this turns out to be true, then a prohibition on that activity may be required, and so on. In this sense, public policies and the regulations that implement them are living things, subject to fine-tuning over time. It is a particular responsibility of those of us engaged in this collective endeavor to act when change is needed. Our goal should be to ensure that tax-exempt financing is used for its original intent as set out in 1913—that is, aiding the provision public infrastructure that provides truly public benefits—and to stop the diversion of scarce public funds to a select few private individuals and industries.

Mr. ISSA. Professor Hale.

And your entire statement, as the chairman said, will be placed in the record, so you will be as though you said it all, so it is what you say over and above that, in fact, is a benefit to you.

Please.

STATEMENT OF DAVID P. HALE

Mr. HALE. Thank you for the opportunity to testify concerning priority of resource allocation among the Nation's aging infrastructure. This statement is meant as an overview of the issues that dominate this priority.

My name is David Hale. As was previously mentioned, I am director of the Aging Infrastructure Systems Center of Excellence. The Center is a multi-disciplinary research and technology transfer center whose mission is to assist the public and private sector managing and mitigating the effects of aging on the Nation's infrastructure. The Center takes an inclusive definition of infrastructure systems that includes both man-made and natural infrastructure components. Collectively, these systems provide the foundation for economic development, safety, security, and quality of life for the public.

The Center is a collaboration among government agencies, commercial organizations, and universities whose core set of expertise ranges from engineering to business, social, and physical sciences. Our Center's focus is work on an integrated body of knowledge that crosses fields of science, particularly with emphasis on physical structure monitoring and improvement based on risk-based analytic procedures.

This broad perspective leads us to the following. Today the consequences of breakdowns in our aging infrastructure is staggering. Policy-makers of physical infrastructure systems are faced with daunting challenges dealing with prioritization. As the chairman stated, in 2005 the American Society of Civil Engineers placed a report card in the public hands that indicated that all of the Nation's infrastructure had deferred maintenance, which corresponded to low performance marks across the board. Our roads, schools, dams, and water systems are all graded at D or worse. Collectively, $1.6 trillion is needed over the next 5 years to bring the Nation's infrastructure into good condition.

Despite staggering consequences that continue to occur on an ever-increasing scale, financial resources needed for resilient upgrade of the Nation's infrastructure has been slow to materialize. The effects of under-funding is evidenced throughout our society. Recently we have been witness to catastrophic infrastructure failures, as examples are the I–35 bridge collapse in Minnesota, levee failures in New Orleans, contamination of our food supplies, and electrical grid disruptions.

From the chairman's home area in Ohio, at least 35 percent of the urban roads are considered congested, which causes excess fuel usage and lost time. The average Canton area commuter spends $219 a year in excess fuel usage and lost time.

Likewise, Cincinnati commuters have an average cost of $687. In California, 60 percent of the urban roads are considered congested, which accounts for the average L.A. commuter spending over

$1,600 a year. Moreover, 71 percent of the major roads in California are considered poor or mediocre in terms of condition. This level of upkeep costs the average Californian motorist $544 per year, which amounts to $12 billion for the State as a whole.

I serve on the State of Alabama Infrastructure Commission. In that position I am confronted with the tradeoffs between public safety, economic development, ecology, and quality of life. I would like to spend some specific time here talking about one example.

The engineering design life of most bridges built in Alabama is considered to be 50 years. Currently, Alabama has 1,489 bridges that were built 50 years or more ago. In the next 15 years, another 1,495 bridges will reach 50 years of age. That is a 100 percent increase that will bring the total number of bridges in the inventory of bridges within Alabama from 30 percent to 60 percent in the over 50 year category.

Current funding levels for bridge repair and replacement are $65 million annually. This creates a backlog of almost $2 billion today in current dollars, and this backlog will grow to $4.5 billion over the next 20 years.

With such high demand for public sector resources, the prudent question continues to be whether public funding for sports stadiums squeezes out needed funding for public works projects that are critical to the Nation's safety and competitiveness.

The issues I am focused on are accountability, transparency, and responsibility for decisionmaking processes. The complex linkages between allocation decisions and infrastructure performance is difficult to trace. The general public has little objective evidence to hold its officials accountable. Many performance indicators are not mandatory, and many of those indicators that are mandatory are not uniformly defined, calculated, or disseminated.

Thank you.

[The prepared statement of Mr. Hale follows:]

Testimony of

David P. Hale, Ph.D.
Director, Aging Infrastructure Systems Center of Excellence
The University of Alabama

Domestic Policy Subcommittee
Oversight and Government Reform
Professional Sports Stadiums:
Do they Divert Taxpayer Funds from Public Infrastructure?
2154 Rayburn RHOB
2:00 p.m.
October 10, 2007

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THE UNIVERSITY OF
ALABAMA
A I S C E

Chairman Kucinich and members of the committee, thank you for the opportunity to testify concerning the impending crisis regarding prioritization of resource allocations among the nation's aging infrastructure systems. This statement is meant as a general overview of the issues that dominate the prioritization.

My name is David Hale and I am the Director of the Aging Infrastructure Systems Center of Excellence (AISCE) at the University of Alabama. The AISCE is a multi-disciplinary research and technology transfer center whose mission is to assist the public and private sector in ***managing*** and ***mitigating*** the effects of age on the nation's infrastructure systems through the conceptualization, development and dissemination of proven and innovative management and engineering techniques

AISCE takes an inclusive definition of infrastructure systems. The Center's infrastructure systems definition includes both man-made and natural infrastructure components. Collectively these systems provide the foundation for economic development, safety, security, and quality of life for the public.

From a societal perspective, our goal is to

- Preserve jobs and expand economic development in America by improving competitiveness of our aging infrastructure systems.
- Enhance the quality of life and security of Americans by improving the flexibility and reducing the fragility of our aging infrastructure.

The center is a collaborative effort among Governmental Agencies, Commercial Organizations and Universities, with a core faculty set from engineering, business, social and physical sciences.

Our center's work focuses on the creation of an *integrated body of knowledge* that crosses *fields of study* using tools and techniques in:

- Analytic Modeling of Risk based Decision Making, which includes tools from
  - Asset Management, Command and Control Systems, and Network Science to investigate:
    - Diagnostic analysis and 'Health monitoring' of aging systems

        - Financial analysis for aging asset life extension
        - Cultural change management & business process optimization
        - Maintenance optimization of aging systems
- Physical structure monitoring and improvement
    - Automated visual collection and interpretation of pavement condition data.
    - Supporting tools for bridge condition assessment and bridge inspector training.
    - Development of front end planning methods for renovation and retrofit of existing capital projects
    - Sensor monitoring and analysis of existing structural systems.
    - Development of new sensing methods and materials
- Knowledge Management focusing on technical and geospatial documents
    - Digital capture of data,
    - Data and text mining to cleanse and filter data
    - Structuring data for optimized storage and retrieval
- Process management and expert knowledge elicitation to capture aging workforce expertise and managing organizational forgetting
- Other areas of study include:
    - Instrumentation
    - IT legacy system integration & renovation
    - Protecting critical infrastructure
    - Configuration control & regulatory compliance
    - System design for reliability / maintainability

Our support comes from across multiple governmental agencies and foundations including:

- US Army Corps of Engineers
- National Oceanic and Atmospheric Administration.
- Federal Highway Administration
- Alabama Department of Transportation
- Construction Industry Institute
- Center for Transportation Research
- National Science Foundation
- NSF EPSCoR-Alabama
- National Aeronautics and Space Administration
- A.P. Sloan Foundation

The multitude of areas that are covered by the center provides a basis for culling leading practices from one domain and provide customizable patterns to be reused in other domains. This broad perspective leads us to the following.

Today's Challenge:

Today, the owners and operators of physical infrastructure in America face daunting challenges: the infrastructure assets and workforce that operates those assets are both aging. The implications of aging asset breakdowns are staggering. The 24-hour power outage affecting the Northeast in 2003 cost NYC's economy over a billion dollars. Though such incidents have tangible economic, social and personal safety consequences, financial resources needed for security, productivity and resilience have been slow to materialize.

Goals of expansion to meet anticipated demands often conflict with the complex problems associated with aging; that is, natural deterioration, structural obsolescence, unanticipated safety concerns, changing regulations and increased supply chain costs. Fierce competition and tight governmental budgets create pressure to optimize operations at the expense of managing the aging infrastructure. Consequently, the nation's infrastructure is less reliable, difficult to maintain, and more vulnerable to attack or incident.

These conditions are evidenced throughout our society. Recently we have been witness to catastrophic infrastructure failures such as the I35 bridge collapse in Minnesota, levee failures in New Orleans, contamination of our food supply, electric grid disruptions along each of our coasts.

In daily life our aging infrastructure is reducing the quality of our lives. For example[1]:

- in Ohio at least 36% of the urban roads are considered congested, which causes
    - the average Akron-Canton area commuter $203 per year in excess fuel and lost time.
    - Likewise the congestion in Cincinnati costs average commuters $687 per year in excess fuel and lost time.
- in California,

[1] ASCE 2005 Infrastructure Report Card http://www.asce.org/reportcard/2005/index.cfm

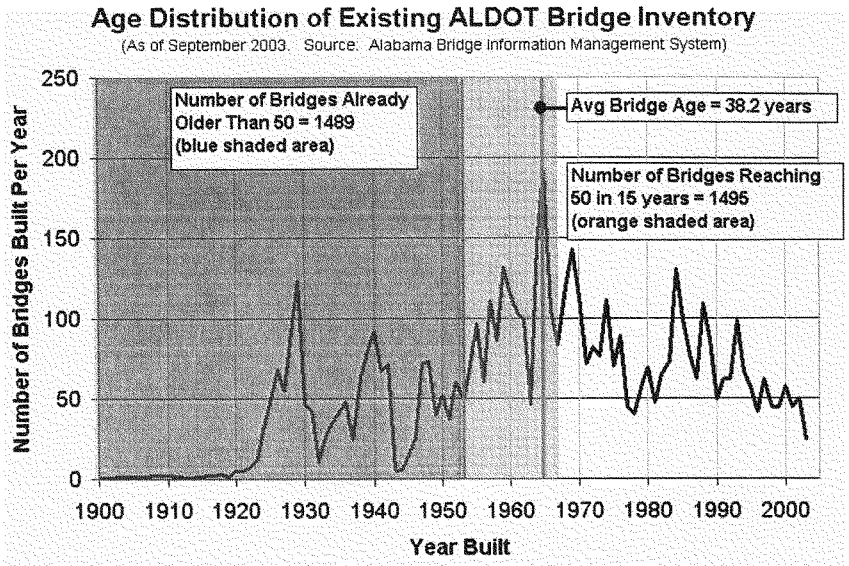
- 60% of urban roads are considered congested, and
- moreover,71% of the major roads are considered poor or mediocre in terms of condition.
- This level of upkeep costs California motorists $12.6 billion a year ($544 per motorist) in extra vehicle repairs and operating costs.

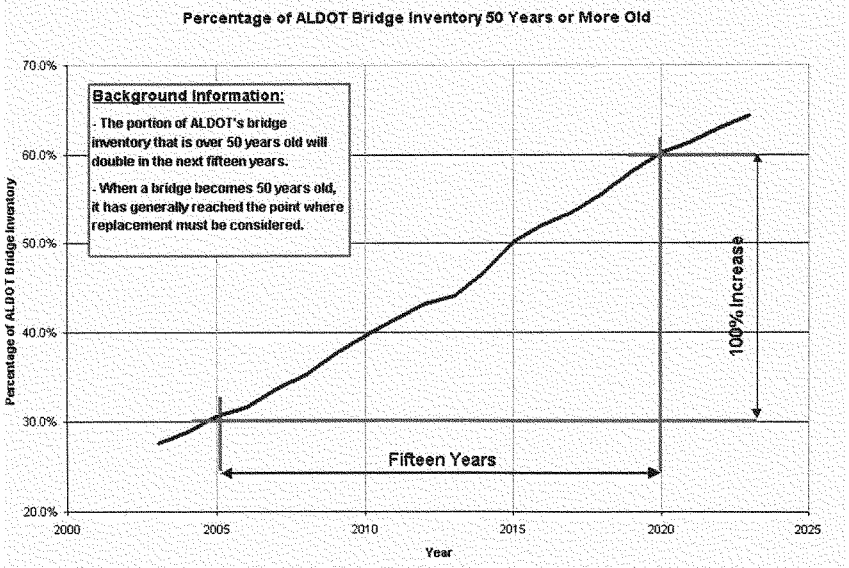
Infrastructure systems permeate society. Society uses multiple infrastructure systems on a daily basis from the time a light is turned on in the morning through the drive to work, obtaining cash from an ATM machine to responding to a tornado warning in the afternoon to checking the stock market prices through the internet at the end of the day. We take these infrastructure systems for granted, in most cases not even thinking about them as they progress through their daily lives. But, when a power blackout occurs; that is, when the power distribution infrastructure system fails as it did in the northeast, the importance of these infrastructure systems to our safety, wellness and happiness becomes apparent.

Many of the infrastructure systems found in the United States have been in place, not only for decades but for centuries. For example, the sewer system found in NYC has portions that were first implemented prior to the civil war and are still in use today. Another example is the Eisenhower Interstate System, which was built between 1950 and 1980, that in many cases is now in a state of decay, with bridges having to carry loads much greater than they were originally designed for.

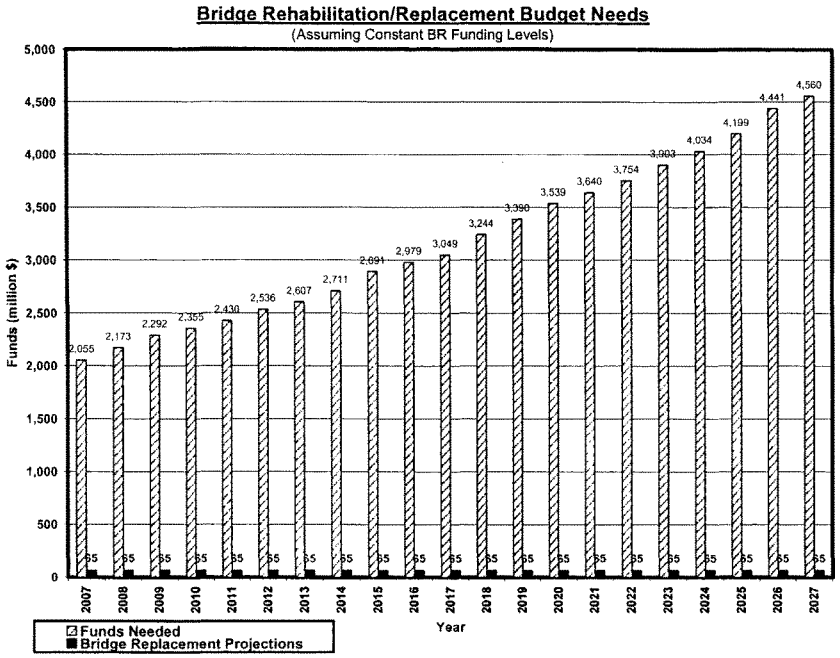
I serve on the State of Alabama's Infrastructure Commission. In that position, I am confronted with the trade-offs between public safety, economic development, ecology, and quality of life. I'd like to be specific in terms of need.

The engineering design life of a bridge built in Alabama is considered to be 50 years. Currently Alabama has 1489 bridges that were built 50 or more years ago. In the next 15 years the number of additional bridges reaching 50 years of age will be an additional 1495 bridges (a 100% increase). The total number of bridges that will be greater than 50 years old will be 60% of the total inventory.


Age Distribution of Existing ALDOT Bridge Inventory
(As of September 2003. Source: Alabama Bridge Information Management System)
Number of Bridges Already Older Than 50 = 1489 (blue shaded area)
Avg Bridge Age = 38.2 years
Number of Bridges Reaching 50 in 15 years = 1495 (orange shaded area)
Number of Bridges Built Per Year
250
200
150
100
50
0
1900 1910 1920 1930 1940 1950 1960 1970 1980 1990 2000
Year Built


Percentage of ALDOT Bridge Inventory 50 Years or More Old
Background Information:
- The portion of ALDOT's bridge inventory that is over 50 years old will double in the next fifteen years.
- When a bridge becomes 50 years old, it has generally reached the point where replacement must be considered.
Percentage of ALDOT Bridge Inventory
70.0%
60.0%
50.0%
40.0%
30.0%
20.0%
100% Increase
Fifteen Years
2000 2005 2010 2015 2020 2025
Year

Current funding levels for bridge repair and replacement are $65 million annually and the current back log of deferred repair and replacement amounts to $2 billion today and will total $4.5 billion in 20 years.



Resource Allocation

Quality of life and economic prosperity are dependent on a collection of critical and interdependent social, man-made and ecological infrastructure systems. Within this context, the decisions on funding and resource allocation priorities are vital to the economic, social and environmental health and well being of each community, region and the nation as a whole. The vitality of our social fabric extends broadly across our education, transportation, manufacturing, energy, and water infrastructures.

Within this context it is then useful to ask two questions that go to the core of genuine progress and a practical translation of sustainable development:

- What do we want to maintain/sustain/preserve?
- What do we want to change/develop for the better?

This is where it is useful to introduce the concepts of *capital.*

The concepts of financial, engineered, natural, social, and cultural capital are familiar to most of us, and it's generally recognized that it is unwise to deplete these forms of capital without provisioning for their replacement. A balanced management of the combined portfolio of five forms of capital is required.

In balancing the management of our infrastructure the application of systems thinking to the five forms of capital in a systemically integrated way provides the objectives for sustainable development from which planning can proceed.

Infrastructure Systems Management provides mechanisms to manage appropriate levels of service of infrastructure system service across its life cycle using risk and uncertainty techniques. Infrastructure Systems Management facilitates risk-based decision making concerning:

- New Investment
- Maintenance
- Recapitalization
- Resource Disposal

The objective is to ensure effective resource allocation using transparent, standard, and repeatable processes. Going beyond the traditional practice of

examining individual assets, infrastructure systems management supports the effective utilization of limited resources through managing systems of assets and all of their components. Comprehensive infrastructure systems management practices link user expectations for system condition, performance, and availability with system management and investment strategies. Increased information accessibility and use will enhance and sharpen decision-making, resulting in more effective investments decisions.

Key questions that can be analytically addressed within the context of infrastructure system resource allocation include:

- What development, preservation, maintenance, recapitalization and decommissioning strategies are best aligned with government's mission?
- Are stakeholder value metrics associated with goals?
- Are target levels identified for each goal?
- Are stakeholder and customer value-producing assets included in the asset inventory?
- What is the value of the service that is provided to the public?
- Beyond the primary authorized function for an asset (or project), what are the secondary functions? How are they valued? How is value allocated across multiple business lines for a multi-purpose asset? What is the risk of not performing a detailed analysis of secondary purpose?
- What are the historic, current, and forecasted condition, risk, performance, and value of services provided by the infrastructure system?
- What resources are available? What is the schedule for resource availability? What performance level would result given increased or decreased funding?
- What investment options may be identified within and among assets at the various levels of the asset hierarchy?
- What are the consequences of not developing or maintaining the infrastructure system? What impact concerning condition and performance can be communicated and to whom will this be important?

Infrastructure Systems Management not only aids in the decision-making process, but also provides for a fact-based dialogue among stakeholders, government leaders and agency managers concerned with daily operations.

High Demand for Resources

As the 2005 American Society of Civil Engineers (ASCE) Infrastructure Report Card indicates all of the nation's infrastructure is has deferred maintenance, which corresponds to low marks across the board.

Aviation:D+	**Bridges:C**	**Dams: D**	**Drinking Water:D-**
Hazardous Waste:D	**Roads:D**	**Schools:D**	**Solid Waste:C+**
Wastewater:D-	**Transit:D+**	**Navigable Waterways:D-**	

Collectively the ASCE estimates that $1.6 trillion dollars is needed over the next 5 years to bring the nation's infrastructure into good condition. With such high demand for pubic sector resources, the pertinent question continues to be whether public funding for ball park expansions squeezes out needed funding for public works projects that are critical to the nation's safety and competitiveness.

Mr. KUCINICH [presiding]. Thank you very much, Professor Hale. Ms. Damiani.

STATEMENT OF BETTINA DAMIANI

Ms. DAMIANI. Thank you. My name is Bettina Damiani. I director of Good Jobs New York. We are a joint project of the Fiscal Policy Institute based in New York and Good Jobs First based in Washington, DC. Good Jobs First is a national resource center promoting accountability in economic development projects.

For over 2 years, we have been keeping track of the massive economic development subsidies going into two of New York's stadiums, Yankee Stadium and what is currently Shea Stadium, but it will be called City Field when it is all said and done. Together, these two projects are going to be costing taxpayers $1.2 billion. We have been urging more transparency and accountability in these projects, and the bulk of our efforts have been around the Yankee Stadium project.

That is not to say that the Mets are not benefiting from taxpayer dollars. They certainly are. But the reality is, a process by which the New York Yankees are building their new stadium is an affront to the democratic process, frankly. They are building their new stadium across the street from their current one on what was 22 acres of heavily used park land in the South Bronx.

Now, the way they got this park land was quite remarkable. There was not one public hearing. There was not one public notice. The process took 9 days. I don't know if you all understand the process in Albany, but they don't move quickly upstate when it comes to legislature, but they managed to take away these parks in 9 days from one of the poorest congressional districts in the country.

This process took not into one ounce consideration for the health, the educational, or the employment needs of the people in the immediate community, much less the economic benefits that it would bring to New York City more broadly.

The stadium is going to cost about $1.3 billion. As I mentioned, it is directly across the street from where it currently is located, so it kind of begs the question of the new economic development that it might be bringing. It is a smaller stadium. Many of the jobs associated with these stadiums are part time and low wage. Granted, there are going to be construction jobs along with this project, and they are certainly good jobs in New York. There are good union jobs there. But what is missing is the issue of making sure that those jobs will benefit people in New York City and in the Bronx.

There is no guarantee for local residents to be hired. There is no job training initiative as a part of this. The New York Yankees claim those are community benefits they say agreement. It is a mitigation agreement. But nobody is watching that store. The only notice that has come out from this project about local hiring has come directly from the Yankees, so we are quite curious where our local elected officials are and who is holding the Yankees accountable. We need to make sure that local residents are getting access to job training and actual jobs.

How did this happen? The Yankees seem to have a variety of maneuvers, and one of them was really an all-hands-on-deck philoso-

phy. They managed to—and quite brilliantly so, depending on how you look at it—hire former public officials and former officials in a variety of agencies in which they needed approvals from, ranging from for subsidies, for land use, and for other infrastructure needs.

I should mention that the president of the New York Yankees is Randy Levine. He was formerly deputy mayor for economic development under Rudy Guiliani, so there is quite an insight. That is just sort of a large example of how this process really started to move along.

The fix was really in once they took the parks, so in June 2005 there was a memorandum of understanding between the city and the Yankees that everything that happened would, indeed, happen, including subsidies and land use and making sure that the process went along as efficiently as possible. Our elected officials have said that this is a privately funded project. There is really nothing further from the truth. It is going to cost taxpayers about $795 million.

Just yesterday there was an approval for parking garages associated with this project. There are going to be about 9,000 parking spaces in a community that has one of the lowest car ownership rates in the city and some of the highest asthma rates in the city, so it is counter as to where we should be putting our money. It should be going into our subways. Those are our highways in New York. That is how we get around. We get to our baseball games, we get to our work, we get to our leisure activities through our subways.

There is a great issue of whether there is enough money going into our subways. The Comptroller recently put out a report saying it is going to need an extra $673 million just to bring up some basic issues in our subways, making sure we have ventilation fans in case there are fires or explosions, bring the lighting up to code. And outdated signal systems make the system unreliable, and an unreliable New York City subway system doesn't do much for our economy.

Our water system, we have tunnels dating back from 1917 and 1936 that need to be greatly improved. We love our water in New York. We push bottled water aside when we can. We think tap water is really the way to go and we want to keep it that way. It is going to cost money.

Our bridges, we have about 800 bridges that are questionably structured in New York. The Brooklyn Bridge—everybody knows the Brooklyn Bridge—is one of the biggest concerns in our city, and there are about 10 other bridges that actually lead to the Brooklyn Bridge that are under consideration as structurally deficient, as well.

So there is a variety of infrastructure issues in the city with the population and growing demands of New York. We expect another one million people in the next 20 years, and we have to address those needs over the needs of the New York Yankees, remembering that they are a private team and they deserve not more than what our basic infrastructure deserves.

Thank you.

[The prepared statement of Ms. Damiani follows:]

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Testimony of Bettina Damiani
Project Director, Good Jobs New York
October 10, 2007

Before the U.S. House of Representatives
Subcommittee on Domestic Policy, Committee on Oversight and Government Reform

Professional Sport Stadiums:
Do they Divert Taxpayer Funds from Public Infrastructure?

Good afternoon, Mr. Chairman, and thank you for inviting us to testify about New York City's use of taxpayer subsidies for baseball stadiums and its possible impact on the city's ability to finance its infrastructure needs.

My name is Bettina Damiani, and I direct Good Jobs New York, a project of Good Jobs First (GJF) and the Fiscal Policy Institute (FPI). FPI focuses on tax, budget, and economic policy issues in New York State; Good Jobs First is a national resource center promoting accountability in economic development and smart growth for working families based here in Washington, DC.

For over two years, we have been investigating and exposing the hidden taxpayer subsidies and undemocratic processes by which New York's two baseball teams, the Yankees in the Bronx and the Mets in Queens, received a total of $1.2 billion in subsidies to build their two new stadiums. Urging more transparency and accountability, we have passed this information on to neighborhood residents who fought the Yankee project, and to elected officials and the news media.

The Yankee Stadium project has drawn most of our attention because it so egregiously undermined democratic planning principles. It put the Yankee's bottom line before the employment, recreational and public health needs of the South Bronx. It threatens to create more air pollution after the team and officials covertly seized 22 acres of heavily used parkland where the new stadium and parking facilities are currently being built. The committee heard from a local resident, Joyce Hogi, at your hearing held last March the impacts this project is having on her community.

Unquestionably the new Mets stadium, to be called CitiField, also benefits greatly from public financing but at least it is being built on land currently used for the team's parking facilities, so it is not displacing park land. Compared to the Yankees' project, the Mets' new stadium is having a less negative impact on the surrounding community.

Background

The Yankees are building a $1.3 billion stadium one block north of their existing location at East 161st Street and River Avenue in the Bronx. The stadium and garages are being built on 22 acres of heavily used public park land, including all of Macombs Dam Park and parts of Mullaly Park that were quietly seized – the technical term is "alienated" – by the New York City Council and New York State legislature in a nine-day period in June 2005.

The project includes the construction and rehabilitation of 9,000 parking spaces, enabling 2,500 more cars to arrive at the new stadium, even though it will have 5,000 fewer seats that the current one. [1] More parking spaces are counter intuitive since officials have invested in a new Metro North commuter station to be built near the stadium. Thus, the neighborhood, which already has one of the city's highest rates of asthma, will gain more asthma polluting cars and genuine park space will be replaced with artificial turf.

After news got out that the parks had been given to the Yankees, residents created a group, Save Our Parks, and the local community board subsequently held hearings and voted overwhelmingly against the plan. The board's resolution concluded that "the alienation of the parkland is against the interests of the community and its children," citing health concerns associated with increased traffic, lack of community input into the plan, and the dangerous precedent of turning over public parkland for private use in the heart of a residential community.

Despite the community board's official role in the city's Uniform Land Use Review Procedure (ULURP), its vote is only advisory and was ignored by Bronx Borough President Adolfo Carrión, who submitted his approval of the project to the City Planning Commission in December 2005. In April 2006, the City Council overwhelmingly approved the overall land-use scheme for the stadium despite opposition from City Council Member Helen Foster, who represents the district where the stadium is situated (although Foster initially co-sponsored the legislation requesting that the parks be alienated). Carrion would later remove those members of the community board who voted against the plan.

How The Yankee Plan Worked

Part 1: All Hands on Deck
To navigate the city's land use and subsidy systems as stealthily as possible, the Yankees hired numerous lawyers, lobbyists and consultants – many of whom are former public officials in the agencies being navigated – to covertly seize the parks without any public hearings and to arrange for several large taxpayer subsidies for the project. [2] The Yankees received extensive assistance from a myriad of officials to ensure the team received the parkland and as many public subsidies as possible.[3]

The park seizure was the linchpin of the project and was accomplished by a June 2005 "message of necessity" sent from the City Council to the Albany State Capital in the waning days of the legislative session[4]. Only after this fait accompli did residents begin to realize what officials had done to them.

The ensuing opposition of the local community board and a "no" vote from Council Member Foster was no match against the Yankees and the stadium project was rammed through so hurriedly in the spring of 2006 that community members were denied any chance to meaningfully participate in the planning process. The result: 22 acres of heavily used public park land, located in the poorest Congressional district in the United States, were seized for the most valuable sports franchise in the nation.

Part 2: Downplay the Subsidies
The Yankees have apparently chosen an Orwellian public relations strategy. The team's leadership has repeatedly stated that the new stadium is being "privately funded" or "privately financed." Yet, nothing could be further from the truth.

As we have documented in two reports (February 2006: *Loot, Loot, Loot for the Home Team* and July 2007: *Insider Baseball*) and as we update regularly on our website (www.goodjobsny.org), today subsidies for the Yankee project stand at approximately $795 million. Just yesterday the New York City Industrial Development Agency approved a proposal to provide $225 million in tax free financing for stadium parking garages, raising the total subsidy to this figure from the previous one of $737 million.

The Justification

1) Team executives and New York officials justify this project and others like it in the name of job creation and the oblique term of "new" economic development. Without question, these projects create construction jobs in New York City – which are good jobs - along with a variety of other employment associated with building a new stadium, (estimated at 5,600). Currently, Yankee Stadium employs about 700 people and City official's estimate that between 500-1,000 new jobs will be created. Many of these jobs are for part-time game-days jobs such as time vendors, ticket-takers, and cleaners.[5]

As the City Council prepared to vote on the project in April of 2006, the Bronx delegation and the Yankees said they would guarantee a community benefits plan that included promises that 25 percent of contracts associated with the project and 25 percent of "total job force" will go to Bronx residents. In addition, a "person of prominence" would oversee $800,000 of annual contributions from the Yankees to the community[6]. To date, no such overseer has been announced. And the only announcement on jobs and contracts has come from the Yankees, suggesting the city is not monitoring hiring practices.

Despite the long involvement of borough and city officials in the project, no efforts have been made to incorporate job training or apprenticeship programs into the stadium

construction for hiring of Bronx residents. It's a tragically missed opportunity given the South Bronx's decades of high poverty and unemployment.

2) Local officials report that these projects are bringing Federal resources to New York City. According to Janel Patterson, a spokesperson for the city's Economic Development Corporation, "The vast majority of the cost of these bonds is borne by the federal government, not the city or state...Bringing federal money to New York City is a good thing, since New York is a net contributor to federal coffers." While you'd be hard pressed to find a municipality that claims to get its fair share from Washington, subsidizing the Yankees is not what we had in mind. Estimates from the New York City Independent Budget office expect the Federal government will forgo $251 million in revenue from the triple tax free bonds allocated for the Yankee project, (see the attached subsidy sheet for a breakdown) and $114.7 million for the Mets stadium.

Better Use of Taxpayer Funds

Good Jobs New York has long argued that company-specific subsidies like those given to the Yankees are bad policy. We believe taxpayer resources are better spent on public goods that benefit all employers and all workers. At the top of that list, right next to skills and workforce development, is infrastructure.

We New Yorkers are proud of our trademark infrastructure: our subways, water tunnels, roads and bridges that connect the islands that make up our city. But some of these connectors holding our city together are well over 100 years old. Far more New Yorkers would benefit if we rehabilitated our infrastructure instead of building new stadiums for wealthy sports franchise owners.

The City's infrastructure systems are severely taxed and will only become more so. New York City's population is projected to increase by a million residents to 9 million in the next 20 years. Of course, we cannot grow physically, so that means ever-more intensive use of our existing systems.

It's already happening. For example, our subway system has seen a dramatic increase in ridership, the highest since 1952, [7] since more efficient payment methods were introduced and crime rates have decreased.

Bridges: As evident in the attached map, New York City has over 800 bridges defined by the state Department of Transportation as "deficient" – that's more than half of the bridges they inspected. While a deficient rating does not necessarily mean that a bridge is unsafe, it does mean the structure requires rehabilitation in order to be fully functional. It's important to note that New York State has a more stringent rating system that the Federal government for its bridges. According to the Federal Highway Administration more than 50 of our bridges that are on the national highway system are deemed "structurally deficient".

While home to some of the most famous bridges in the world, it's easy to forget that New York City is accessible because bridges connect our city; we are surrounded by water - the Hudson and East Rivers surround Manhattan; the Atlantic Ocean greets Brooklyn, Queens and Staten Island and the Long Island Sound surrounds the Bronx. There are even bridges that connect to bridges. For example there are approximately 10 bridges that lead to the Brooklyn Bridge. And in fact the Brooklyn Bridge itself is deemed to be one of the most deficient in the city.

Subways: With over 450 subway stations and 660 miles of tracks, the New York City subway system is an economically and environmentally efficient means of transportation for 5 million people a day, helping to make New York one of the least car dependent cities in the United States. The subways are our highways; it's how we get to work, school and even baseball games. Yet, the system is aging rapidly.

Earlier this year, New York City Comptroller Williams Thompson released a report stating that the Metropolitan Transportation Authority (MTA) needs an additional $673 million more than currently budgeted for our subways and buses to be in a state of good repair. [8] Highlights from the report include:

- Upgrades are necessary to the ventilation fans which clear smoke from subway tunnels in the event of an explosion or fire;
- Just over half of the lighting in the subway system won't reach a state of good repair until 2022;
- The system's service reliability is decreased because of outdated signal systems.

In August of this year, I along with millions of commuters was unable to get to work because an unexpected heavy rainfall brought the subway system to a halt. The MTA's internal investigation found that it will need to invest $30 million in a variety of solutions to better communicate with riders in such situations. It will also "quantify the costs of the longer-term capital fixes needed to permanently repair the system" and those costs are not yet known. [9]

Water System: New Yorkers are also proud of our water supply; water straight from the tap we've been known to argue can go head to head with the best in bottles. Yet, the Water Filtration Plant in the Bronx where two massive tunnels were built in 1917 and 1936 is working overtime. A new tunnel is being built and a federally mandated project to upgrade New York City Water Supply is now underway. But these tunnels – architectural feats – aren't cheap. Officials initially estimated the filtration project would cost $1.3 billion, but last month admitted what local residents have long assumed: the cost has ballooned to over $3 billion. Making matters worse, the Water Board recently announced it would hike water rates by 11 percent.

Conclusion

Although sports entertainment corporations have an entire section of every day's newspaper devoted to them, the Yankees and the Mets are, we must always remember,

privately owned entertainment corporations. It's discouraging that officials are confusing teams with public goods like parks, water and transit that are essential to the city's public health and economic vitality.

Yet, in the case of the Yankees, now headed by Randy Levine, the former Commissioner of the Office of Labor Relations and then Deputy Mayor for Economic Development under Mayor Giuliani, some corporations have learned how to game government for massive stadium subsidies while publicly claiming "private" financing, and announcing phantom "community benefits."

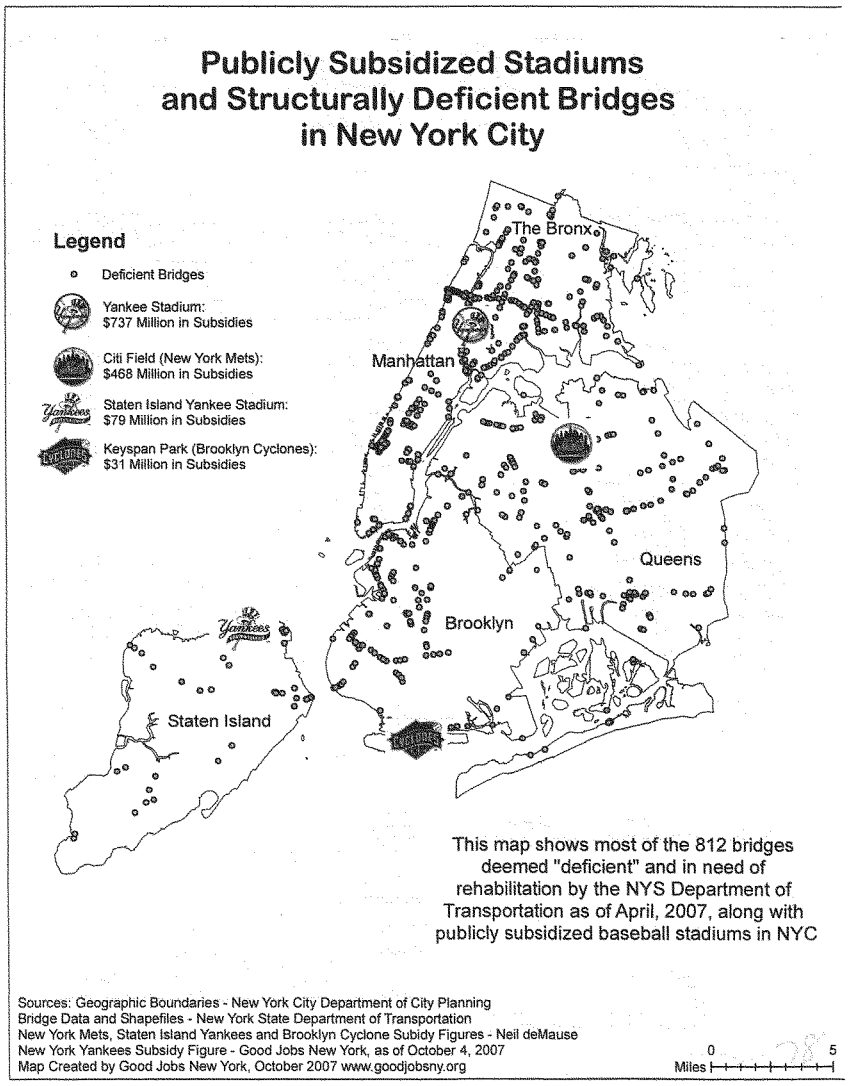
Mayor Bloomberg's ambitious PlaNYC 2030 aims to improve the city with affordable housing, back up systems for our water supply, better transportation and an upgrade to our energy infrastructure.[10] It's welcome news that our officials have a strong vision for the sustainability of our city. It won't come cheap.

New York City's competitive future and public health rest largely on the investments made in our infrastructure. We must not neglect those investments that benefit every employer and every worker while lavishing gifts on private entertainment corporations.

---

[1] The new stadium will have over 4,500 fewer seats than the current one. The current stadium has a seating capacity of 57,545 while the new one will have 53,000 seats.

[2] "Insider Baseball" Good Jobs New York, July 2007. www.goodjobsny.org
[3] A copy of the Memorandum of Understanding between the city and the Yankees is available at : www.goodjobsny.org/yankeestadium_mou.pdf
[4] A time line of the park alienation is available at: http://www.goodjobsny.org/legislativetimeline.htm
[5] Economic and Fiscal Impact of Proposed NY Yankees Ballpark, prepared by Economics Research Associates for the New York City Economic Development Corporation. GJNY obtained via a Freedom of Information request
[6] The Yankees Participation and Labor Force Agreement can be found at: http://www.goodjobsny.org/Yankees_deal.htm
[7] Metropolitan Transportation Authority, http://www.mta.info/mta/news/releases/?en=070202-NYCT22
[8] A Review of MTA New York City Transit "State of Good Repair" Capital Expenditures, February 1, 2007. Office of the New York City Comptroller
[9] Metropolitan Transportation Authority report to Governor Spitzer, September 20, 2007.
[10] Details available at www.planyc2030.com


Publicly Subsidized Stadiums
and Structurally Deficient Bridges
in New York City
Legend
Deficient Bridges
Yankee Stadium:
$737 Million in Subsidies
Citi Field (New York Mets):
$468 Million in Subsidies
Staten Island Yankee Stadium:
$79 Million in Subsidies
Keyspan Park (Brooklyn Cyclones):
$31 Million in Subsidies
The Bronx
Manhattan
Queens
Brooklyn
Staten Island
This map shows most of the 812 bridges deemed "deficient" and in need of rehabilitation by the NYS Department of Transportation as of April, 2007, along with publicly subsidized baseball stadiums in NYC
Sources: Geographic Boundaries - New York City Department of City Planning
Bridge Data and Shapefiles - New York State Department of Transportation
New York Mets, Staten Island Yankees and Brooklyn Cyclone Subidy Figures - Neil deMause
New York Yankees Subsidy Figure - Good Jobs New York, as of October 4, 2007
Map Created by Good Jobs New York, October 2007 www.goodjobsny.org
0
5
Miles

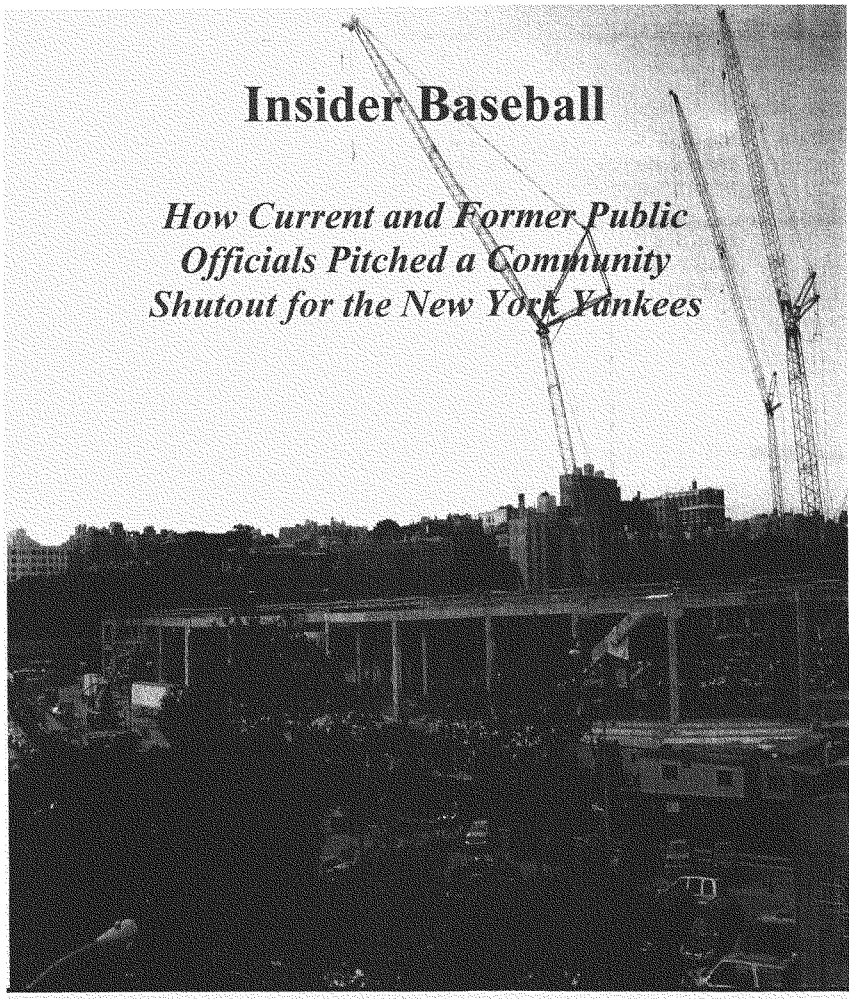
Good Jobs New York

Taxpayer Subsidies for the New Yankee Stadium and Parking Garages

Updated October 9, 2007

City Subsidies	Amount (millions, present value)
Land/Infrastructure/Transit	$203.9[1]
Forgone property taxes	$144.2[2]
Forgone sales taxes	$10.5[3]
Rent rebates	$13.4[4]
Forgone mortgage recording tax	?
Tax-exempt bonds for stadium (income tax exemption on bond interest)	$10[5]
Tax-exempt bonds for garages	$2.6[6]
City Total:	**$384.6**
State Subsidies	
Garage construction/infra.	$70[7]
Maintenance funds	$4.7[8]
Forgone sales taxes	$11.4[9]
Forgone mortgage recording tax	?
Tax-exempt bonds for stadium	$18.3[10]
Tax-exempt bonds for garages	$4.7
State Total:	**$109.1**
MTA-Metro-North Station	**$51.2**
Federal Subsidies	
Tax-exempt bonds for stadium	$200[11]
Tax-exempt bonds for garages	$51
Federal Total:	**$251**
Total W/O Garage Bonds	**$737.6 million**
Total With Garage Bonds	**$795.9 million**

[1] 2008 Executive Capital Commitment Plan
[2] Independent Budget Office, "Update to IBO's Analysis of the Financing for the Proposed Yankee Stadium," April, 2006.
[3] Ibid
[4] Yankee Stadium Memorandum of Understanding (MOU).
[5] Independent Budget Office's revised estimate, August 2007.
[6] The figure listed in the Industrial Development Agency Cost-Benefit Analysis for Bronx Parking Development Company, September 6, 2007, is $2.576 million. State and Federal figures for tax exempt garage bonds were estimated by GJNY.
[7] MOU, ESDC GPP
[8] Ibid.
[9] Independent Budget Office, "Update to IBO's Analysis of the Financing for the Proposed Yankee Stadium," April, 2006.
[10] Independent Budget Office's revised estimate, August 2007.
[11] Independent Budget Office's revised estimate, August 2007.



Insider Baseball

How Current and Former Public Officials Pitched a Community Shutout for the New York Yankees

Good Jobs New York
July 2007

Acknowledgments

The report was written by Good Jobs New York's project director Bettina Damiani, research consultant Eileen Markey, and research analyst Dan Steinberg. Additional research was conducted by Good Jobs First Research Analyst Allison Lack.

Special thanks for the keen eye and editing expertise of Good Jobs First Executive Director Greg LeRoy and Research Director Phil Mattera. Thanks to Frank Mauro, Executive Director of the Fiscal Policy Institute, for his assistance with additional research requests. Thanks to Betty Grdina.

About Good Jobs New York

GJNY investigates and publicizes the way in which public resources are allocated in the name of corporate retention. With this knowledge we hold government officials and companies accountable to taxpayers.

GJNY is a joint project of the Fiscal Policy Institute (FPI) and Good Jobs First (GJF). FPI (www.fiscalpolicy.org) is a nonpartisan research and education organization that focuses on the broad range of tax, budget, economic and related public policy issues that affect the quality of life and the economic well being of New York State residents. Good Jobs First (www.goodjobsfirst.org) is a non-profit, non-partisan national resource center for constituency-based groups and public officials, promoting corporate and government accountability in economic development and smart growth for working families.

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Cover photo: Construction of new Yankee Stadium is well underway where 22 acres of parks once stood. July 2007.

Executive Summary

To seize public parklands, win rapid permitting, and land massive taxpayer subsidies for their new stadium in the South Bronx, the New York Yankees hired numerous former public officials and benefited from the actions of a few current elected officials to play insider baseball, shutting out Bronx residents and New York City taxpayers.

In a secretive, undemocratic process that climaxed in a lightning series of events in June 2005, these past and present officials helped the Yankees seize 22 acres of heavily used public parks and win development subsidies exceeding half a billion dollars. City municipal records, lobbying declarations, legal documents, project plans and corporate filings reveal that the heavy hitters include:

- Former Mayor Rudolph Giuliani, who approved millions of dollars in subsidies to the team including a $21 million rent reduction and whose firm, Giuliani Security and Safety, is listed in court documents as a security consultant for the stadium;

- Randy Levine, former Commissioner of the Office of Labor Relations and then Deputy Mayor for Economic Development under Mayor Giuliani, and now President of the Yankee organization;

- Roberto Ramirez, former Bronx Assembly Member and Bronx County Democratic Chair and now of the Mirram Group, who reported lobbying his former colleagues on behalf of the Yankees;

- Stanley Schlein, a Bronx political operative since the Koch Administration, and an attorney for the Bronx Democratic Party who worked for Assembly Member Rivera while also chairing the civil service commission until Mayor Bloomberg refused to reappoint him after public concerns were raised about his conduct as a judicial appointee.

Numerous other former public servants and officials – once responsible for protecting the public treasury – now work at firms whose priority is the Yankees' pocketbook. For example:

- Joseph Seymour, former executive director of the Port Authority of New York and New Jersey and now senior vice president at the Community Initiatives Development Corporation (conduit for the garage financing);

- Bruce Serchuk, a partner at the firm Nixon Peabody (a firm listed in public documents as being retained as bond counsel for *both* the Yankees and the New York City Industrial Development Agency) and a former senior technical reviewer at the Internal Revenue Service;

- Howard Safir, Giuliani's former police commissioner, now of the firm SafirRosetti, is listed in court documents as a security consultant for the project; and

former government officials and use their expertise and influence to evade participatory planning and established economic development principles.

To guarantee there's no replay of the Yankee Stadium fiasco, Good Jobs New York offers policy options to protect residents' rights.

Honor Land Use Policies and the Community Boards
New York City has a strong democratic planning process on the books (called the Uniform Land Use Review Procedure or ULURP). It should be embraced, not gamed.

Major decisions on this project (the seizure of the park land, the types of public subsidies offered for example) were privately agreed to by the Yankees and public officials in the project's Memorandum of Understanding (MOU)--a copy is available at http://www.goodjobsny.org/yankeestadium_mou.pdf. Agreements should not be negotiated without the consultation of the local community board and until details of proposals are made available and mandated public hearings are held.

Disclose the Revolving Door
Just as elected officials must reveal the companies or partnerships from which they receive income in financial disclosure statements, developers seeking land use approvals or development subsidies should be required to disclose in applications the names of all former government officials involved in the project (either as direct employees or as consultants or lobbyists), including their public and private positions and dates of public service.

Extend the Cooling-Off Period
To reduce the revolving-door influence problem, the City should extend to three years the time period which former elected officials and agency personnel must wait after leaving office before they can work as lobbyists or with firms involved directly on projects involving their public-sector jobs. Currently, the City's conflict of interest law has loopholes permitting public officials to immediately go to work at firms that do business with the city.

Scratch the Parking Garages
City and state officials should act on their stated city-wide commitment to fund public transportation *as an alternative* to driving. Recently officials pledged funds to build a Metro North train station near the Yankee stadium. With an estimated 10,000 fans per game choosing Metro North to get to games, the number of proposed parking spaces can be substantially cut back and park land restored.

Nine Days in June

It was June 2005, and residents of the South Bronx enjoyed the return of summer while playing in their cherished Macombs Dam and Mullaly Parks. They had no idea that in these waning days of the legislative session in Albany city and state representatives were stealthily preparing to introduce "emergency" legislation in Albany that would seize the parks.

On June 15, 2005, city and state officials quietly signed a "Memorandum of Understanding" (MOU) with the Yankees committing land and subsidies for the stadium project. The officials agreed to make a "collaborative effort to seek State legislation as quickly as possible" authorizing the construction of both the stadium and large garages on public parklands, with the Yankees assuming "primary responsibility for gathering" the support of local elected officials.[1]

That weekend, the bills were introduced in the state legislature by Bronx Assembly Member Carmen Arroyo and Queens State Senator Frank Padavan, and on Monday, June 20th, the City Council passed a "home rule message" sponsored by Bronx City Council Members Joel Rivera and Helen Foster requesting that the state move forward (Foster, who represents the stadium neighborhood and is chair of the Council Parks Committee, would later vote against the land-use approvals for the project).[2] By June 23rd, both houses of the state legislature had unanimously approved the legislation, effectively sealing the fate of the parks.

Neighborhood residents had never been informed that such a land grab was being considered. There had never been any public hearing on the proposal, nor had the local community board yet been advised or consulted.

Dumbfounded and outraged, residents organized to protest the deal's remaining formalities. But the land seizure was the biggest hurdle and meant the deal was almost certainly done.

The Yankees are a popular and storied part of New York City, as emblematic of the metropolis as the Statue of Liberty or the Brooklyn Bridge. But the nation's most valuable sports franchise, we found, is also a politically entrenched entertainment corporation well fed at the public trough.

This report is a follow-up to Good Jobs New York's February 2006 *Loot, Loot, Loot for the Home Team* (available at www.goodjobsny.org) report on the stadium deal's public subsidies that investigates the web of political connections that enabled the Yankees to shutout Bronx residents and New York City taxpayers.

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75 East Northfield Road/ Livingston, NJ 07039 / 973–992–6600

SOURCE: AP Financialnews
DATE: 10–04–2007
HEADLINE: Group: NY Yankees Submit Lavish Expenses

Source Website

The Associated Press

NEW YORK

The New York Yankees submitted lavish expenses to the city as planning costs for the new stadium they are building, a watchdog group said.

The group, ***Good Jobs New York***, accused Yankees officials of turning in to the city's Department of Parks and Recreation receipts for 2005 for expenses including crystal baseballs, postseason bar tabs, wool baseball caps and gifts for corporate clients.

The group's project director, Bettina Damiani, called on the city comptroller to conduct an audit to make sure Yankees officials weren't submitting receipts unrelated to planning for the new stadium.

"Elected officials are turning a blind eye to the fact that the Yankees seem to have unfettered access to the public trough," Damiani said. "It goes to show how the Yankees will stop at nothing to squeeze every penny from New Yorkers for this project."

The new ballpark, on city parkland just north of the existing Yankee Stadium in the Bronx, is slated to open in 2009.

In 2001, then–Mayor Rudolph Giuliani authorized the Yankees to deduct up to $5 million a year on planning costs for the new stadium for five years for rent payments to the city, Good Jobs said.

Yankees spokeswoman Alice McGillion said Wednesday that invoices to which Good Jobs referred were never for rent credits.

"It has now been suggested that all items that were submitted were the subject of a rent credit request by the Yankees," she said. "This is entirely, absolutely and definitively incorrect."

Good Jobs, a privately funded organization that claims to keep track of how the city allocates subsidies for large economic development projects, said it is trying to "debunk the myth that this is a privately financed project," Damiani said. In fact, Good Jobs said, the project is costing taxpayers $795 million in subsidies.

Good Jobs said it made a public records request with the parks department in April 2006 for the 2005 receipts. It says the parks department released the records in September.

The comptroller's office did not immediately respond to a message left through an after–hours telephone number on Wednesday night.

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Highlights: Good Jobs New York

Mr. KUCINICH. Thank you very much for your testimony.
Dr. Maguire.

STATEMENT OF STEVEN MAGUIRE

Mr. MAGUIRE. Good afternoon. My name is Steven Maguire, and I am a Specialist in Public Finance at the Congressional Research Service. I would like to thank Chairman Kucinich, Ranking Minority Member Issa, and the committee for allowing me the opportunity to testify before you today.

The Joint Committee on Taxation has recently estimated that the Federal exclusion of interest on public purpose State and local government bonds will generate a tax expenditure of $156 billion over the next five fiscal years, 2007 to 2011. This tax expenditure includes the expenditures arising from tax-exempt bonds issued for public infrastructure, in many cases sports stadiums and arenas.

Today I will present data from the Bond Buyer Yearbook from various years. After reviewing these data, two things arise. First, annual issuance of private activity bonds has declined as a share of total issuance since 1987. Second, viewed from a national perspective, bonds used for stadiums do not seem to substitute for transportation infrastructure bonds.

As it is late in the day and most of what I was going to say has been said, I will be brief and go right to the data.

The Bond Buyer reports annual issuance by bond characteristics and by function. The bond characteristic at issue here is the treatment of bond interest for purposes of calculating the alternative minimum tax. A&T bonds are private activity bonds whose interest must be added back when calculating A&T liability.

Figure two in my written testimony talks total bond issuance and A&T bonds as a subset of that total. The secondary axis on the right-hand side in figure two reports the A&T share of the total and plots an estimated trend line. The trend line clearly shows decline in the annual issuance of private activity bonds' share of total volume from 1987 to 2006. From this, one could conclude that the volume cap may constrain the use of qualified private activity bonds.

Data on transportation and sports facility bonds: the Bond Buyer also reports the type of activity financed by bonds. Transportation bonds as defined by the Bond Buyer Yearbook includes issues sold for airports, seaports and marine terminals, roads, highways, toll roads and bridges, tunnels, parking facilities, mass transit systems, and miscellaneous transportation projects. Sports facility bonds are included in the broader category, public facilities. Notably, the largest public facility issue in 2006 reported by the Bond Buyer Yearbook was the New York Convention Center Development Corp.'s $943 million sale on August 16, 2006, for Yankee Stadium.

Generally, bonds for transportation infrastructure appear to consume roughly 10 percent of total annual bond volume, and bonds for stadiums approximately 0.4 percent. Figure three in my written testimony charts the annual volume of bonds for transportation projects and stadium as a percentage of total annual bond volume for the 1987 to 2006 time period. Bonds for transportation infrastructure seemed to be trending upward, as with stadiums. The trend for stadiums, however, is not as robust. In fact, the bonds for

Yankee Stadium accounted for one-fourth of the total for stadiums from 2006, likely generated a one-time spike in the stadium percentage, in turn generating the upward slope.

Conclusions: the data as presented here do not support the notion that bonds used for stadia could have been used for transportation projects. If so, one would have expected the share of transportation bonds to increase more slowly than that for stadiums. That is not the case. Nevertheless, the national data may mask State-specific or local tradeoffs between bond funding for stadiums and transportation infrastructure.

Thank you, and I look forward to any questions you may have.

[The prepared statement of Mr. Maguire follows:]

Statement Submitted for the Hearing Record
Subcommittee on Domestic Policy
October 10, 2007

Tax-Exempt Bonds For Infrastructure and Private Activities: An Analysis of Recent Data

Steven Maguire
Specialist in Public Finance
Government and Finance Division
Congressional Research Service

Introduction

Good afternoon. My name is Steven Maguire and I am a Specialist in Public Finance at the Congressional Research Service. I would like to thank Chairman Kucinich, Ranking Minority Member Issa, and the committee for the allowing me the opportunity to testify before you today.

The Joint Committee on Taxation has recently estimated that the federal exclusion of interest on public purpose state and local government bonds will generate a tax expenditure of $156 billion over the next 5 fiscal years, 2007 to 2011.[1] This tax expenditure includes the expenditure arising from tax-exempt bonds issued for public infrastructure — in many cases, sports stadiums and arenas. You asked me to describe how the relative mix of tax-exempt bonds issued for these purposes has changed over time. Today, I will present data from the U.S. Census Bureau's Governments Division and the *Bond Buyer Yearbook* from various years. I will first describe how tax-exempt bonds are classified as government or private activity and discusses how the mix has changed over time. For the remainder of my testimony, I will present analysis on the available data for possible changes in the types of projects that are financed by tax-exempt bonds.

Types of Tax-Exempt Bonds

State and local governments generally issue two types of tax-exempt bonds: (1) government bonds; and (2) private activity bonds. The federal government does not limit the use of tax-exempt bonds for governmental activities but does restrict the use of tax-exempt bonds for private activities. Most states have statutory or constitutional limits on state and local debt, including tax-exempt government bonds.

A private activity bond is one that primarily benefits or is used by a private entity. The federal tax code defines private business (or private entity) use as:

> ...use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For purposes of the preceding sentence, use as a member of the general public shall not be taken into account.[2]

The federal limit on bonds issued for private activities is governed by a two-part test. Private activity bonds are not tax-exempt if **both** of the following conditions are met:[3]

- [use test] more than 10% of the proceeds of the issue are intended for any *private business use*,... [and]

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[1] Joint Committee on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 2007-2011, JCS-3-07, Sept. 24, 2007.

[2] 26 U.S.C. 141(b)(6)(A)

[3] 26 U.S.C. 141(b)

- [security test] if the payment on the principal of, or the interest on, more than 10% of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly secured by any interest in (1) property used or to be used for a private business use, or (2) payments in respect to such property. Or [if the payment is] to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

If a bond issue meets both conditions, (i.e., passes the tests), the bonds are taxable and would carry a higher interest rate. Nevertheless, bond issues that pass both tests can still qualify for tax-exempt financing if they are identified in the tax code as *qualified* private activities. Thus, when those in the bond community usually refer to tax-exempt private activity bonds, the more technically correct reference is tax-exempt, *qualified* private activity bonds.

If bonds fail one part of the two part test, they are identified as government bonds. It is often the case that bonds fail the security test. Bonds used to finance professional sports stadiums are a good example of the test application. Clearly, stadiums and arenas that host professional sporting events would pass the private business use test. Bonds used to finance the stadium must then fail the "security" test to retain federal tax-exempt status. In other words, repayment of the bonds must be derived from a revenue source unrelated to the private business use. Stadium and arena financing that is structured to ensure they fail the security test and are classified as government bonds. And, as described earlier, government bonds are not subject to federal volume limits.

Census Data on Outstanding State and Local Government Debt

The U.S. Census, through its Census of Governments program, tracks and reports the volume of both types of outstanding tax-exempt debt. A consistent series of annual outstanding debt data are available for FY1993 through the FY2005. Total outstanding long-term debt increased from $995 billion in FY1993 to $2,036 billion in FY2005, an average annual increase of 6.1%. Tax-exempt debt issued for private activities also increased, though at a slower annual rate of 3.7%. Thus, private debt as a share of total debt outstanding actually declined over the 1993 to 2005 window. These data are reported in **Table 1** and represented graphically in **Figure 1**. The following is the Census definition for its category "public debt for private purposes":

> Public debt for private purposes comprises credit obligations of a government or any of its dependent agencies for the purpose of funding private sector activities, including debt that is backed solely by the private organization(s) involved. Such debt is assigned to the government whose bond-issuing authority was used to secure its tax-exempt status or, in the case of taxable debt, was used for its issuance. Examples of private sector activities funded include industrial and commercial development, pollution control, housing and mortgage loans, private hospital facilities, student loans, and such private ventures as sports stadiums [emphasis added], convention centers, and shopping malls.[4]

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[4] U.S. Census Bureau, Governments Division, Chapter 9 of the *Classification Manual*. Available (continued...)

The Census data, as reported in **Table 1**, do not disaggregate the "pubic debt for private purposes debt outstanding" into specific functions. In addition, Census does not report what portion of the outstanding private debt is taxable or what portion is for *qualified* private activities and tax-exempt. Nevertheless, it does appear as though public debt for private purposes as a share of total debt outstanding has declined significantly since 1993. Census does not report outstanding debt for infrastructure or sports stadiums. We next examine annual data from the *Bond Buyer Yearbook* to discern annual changes in bond volume, by function, e.g., infrastructure and sports stadiums.

Table 1. State and Local Government Debt Outstanding, 1993 to 2005

Fiscal Year	Outstanding Debt (in $ millions)				Private Share
	Total	Percent Change	Private	Percent Change	
1993	994,968	--	305,974	--	30.75%
1994	1,047,994	5.33%	301,635	-1.42%	28.78%
1995	1,088,331	3.85%	300,614	-0.34%	27.62%
1996	1,145,666	5.27%	312,630	4.00%	27.29%
1997	1,204,943	5.17%	na	--	na
1998	1,266,308	5.09%	335,838	--	26.52%
1999	1,351,408	6.72%	351,072	4.54%	25.98%
2000	1,427,524	5.63%	372,642	6.14%	26.10%
2001	1,531,897	7.31%	395,131	6.04%	25.79%
2002	1,642,864	7.24%	415,906	5.26%	25.32%
2003	1,772,197	7.87%	431,361	3.72%	24.34%
2004	1,913,286	7.96%	448,359	3.94%	23.43%
2005	2,035,717	6.40%	472,983	5.49%	23.23%

Source: U.S. Census Bureau, Governments Division. The data are available online at: [http://www.census.gov/govs/www/estimate.html].

[4] (...continued)
online at: [http://www.census.gov/govs/www/class_ch9.html]. The manual notes that the definition used is broader than the tax code definition of qualified private activity bonds.

Bond Buyer Yearbook Data on Annual Issuance of State and Local Government Debt

The Census data, described above, does not provide the detail offered by the annual data published in the *Bond Buyer Yearbook* (BBY). The BBY compiles recent market data and is published by Source Media Inc., headquartered in New York, NY. The BBY reports annual bond issuance by bond characteristics and by function. The bond characteristic at issue here is the treatment of the bond interest for purposes of calculating the alternative minimum tax (AMT).

AMT bonds are private activity bonds whose interest must be added back when calculating AMT liability. These bonds roughly correspond to the Census defined "public bonds for private purposes." **Figure 2** plots total bond issuance and as a subset of that total, AMT bonds. The annual issuance as exhibited in **Figure 2** roughly follows the pattern for bonds outstanding in **Figure 1**. The secondary (on the right-hand side) axis in **Figure 2** reports the AMT share of total and an estimated trend line. The trend line clearly shows a decline in the annual issuance of private activity bonds' share of total volume from 1987 to 2006, reinforcing the findings gleaned from the Census data.

Bond Buyer Yearbook Data on Transportation and Sports Facility Bonds

The BBY also reports the activity financed by the bonds. Transportation bonds, as defined by the BBY, includes issues sold for: airports, seaports and marine terminals, roads, highways, toll roads bridges, tunnels, parking facilities, mass transit systems, and miscellaneous transportation projects. These projects are often considered "infrastructure" bonds. The sports facility bonds are included in the broader BBY category "Public Facilities." Notably, the largest public facility issue in 2006 reported by BBY was the New York Convention Center Development Corporation's $943 million sale on August 16, 2006 for Yankee Stadium.

Table 2 shows BBY data for 1987 through 2006. Generally, bonds for transportation infrastructure appear to consume roughly 10% of total bond volume and bonds for stadiums approximately 0.4% in any given year. **Figure 3** charts the annual volume of bonds for transportation projects and stadiums, as defined by BBY, as a percentage of total annual bond volume for the 1987 to 2006 time period. Bonds for transportation infrastructure seem to be trending upward as with stadiums. The trend for stadiums, however, is not as robust. In fact, the bonds for Yankee Stadium, accounting for one-fourth of the total for stadia, likely generated a one-time spike in the stadia percentage, generating the upward slope.

The data, as presented here, do not support the notion that bonds used for stadia could have been used for transportation projects. If so, one would have expected a negative relationship between the two variables. Nevertheless, the national data may mask state specific or local tradeoffs between bond funding for stadia and transportation infrastructure.

Conclusions

The cause of the increase in debt, and the declining share of debt identified as public debt for private purposes, cannot be traced to one primary factor. The following factors may help explain the growth and possibly the relative decline of private purpose debt: (1) changes in the market interest rates; (2) the private activity bond volume cap; and (3) broad macroeconomic cycles.

Table 2. Bonds Issued for Transportation and Stadiums, 1987 to 2006

Year	Total Volume (in 000's)	Transportation Bonds (in 000's)	Stadia Bonds (in 000's)	Percent of Total	
				Transit	Stadia
1987	$105,485,500	$6,015,600	$122,700	5.7%	0.1%
1988	$119,367,800	$9,902,500	$88,000	8.3%	0.1%
1989	$125,530,500	$10,881,300	$478,000	8.7%	0.4%
1990	$128,045,800	$13,370,400	$913,200	10.4%	0.7%
1991	$173,071,500	$16,581,200	$284,100	9.6%	0.2%
1992	$235,413,100	$26,845,100	$975,200	11.4%	0.4%
1993	$293,052,200	$28,549,700	$637,600	9.7%	0.2%
1994	$165,101,300	$14,912,100	$472,200	9.0%	0.3%
1995	$161,817,100	$16,908,700	$601,500	10.4%	0.4%
1996	$185,207,400	$16,832,200	$1,403,400	9.1%	0.8%
1997	$220,671,700	$24,347,000	$1,867,400	11.0%	0.8%
1998	$286,816,900	$31,709,100	$2,269,900	11.1%	0.8%
1999	$227,740,500	$23,436,000	$1,163,200	10.3%	0.5%
2000	$200,880,000	$26,743,400	$1,238,400	13.3%	0.6%
2001	$288,082,900	$32,080,900	$1,806,000	11.1%	0.6%
2002	$358,568,600	$45,013,800	$789,800	12.6%	0.2%
2003	$383,559,300	$40,435,700	$704,000	10.5%	0.2%
2004	$359,717,200	$32,527,500	$478,000	9.0%	0.1%
2005	$408,265,600	$45,251,400	$1,525,600	11.1%	0.4%
2006	$388,716,700	$42,362,000	$3,996,300	10.9%	1.0%
Average Annual Percentage Share				10.2%	0.4%

Source: The *Bond Buyer Yearbook*, various years.

Changes Interest Rates. Generally, governments issue more debt when interest rates are relatively low. Changes in interest rate, however, are unlikely to influence the *composition* of debt. **Figure 4** charts total bond volume and interest, and the relationship between the two variables appears very robust. Using a straight-forward statistical

technique, one can confirm the relationship between bond volume and interest rate. A correlation coefficient measures the "...strength of the association between..." two paired variables.[5] In this case, pairing bond volume with the interest rate and estimating the correlation coefficient should yield a strong and significant linear relationship. Correlation coefficients generate values between negative one (-1) and positive one (1), inclusive. A result of one or negative one implies perfect correlation; zero implies no correlation, and thus no association or relationship. The correlation coefficient for these variables is negative 0.91, which means there is a very strong inverse (or negative) relationship between bond volume and interest rate. The decline in interest rates is a likely contributor to the growth in total bond volume.

The Private Activity Bond Volume Cap. In 1986, Congress implemented the private activity bond volume cap as it is currently structured. This action raised the "price" to state and local governments of issuing debt for qualified private activities.[6] As such, incentives exist for bond issuers, particularly governments in populous state where the cap is binding, to structure bond financed projects to avoid claiming cap space.[7] The relative decline of public bonds for private purposes, as suggested by the Census and *Bond Buyer* data, appears to reinforce the notion that the cap has been effective in limiting these types of bonds *as they are defined in the tax code.*

Other Macroeconomic Factors. The business cycle is characterized by periods of expansion and contraction. During expansionary phases, one would expect that public investment in both infrastructure and sports stadia would also expand. To the extent sports stadia are considered a public "luxury" good, economic expansion may induce more investment in sports stadia relative to infrastructure. The data on government debt, however, do not show definitively a cyclical investment pattern in either sports stadia or public infrastructure.

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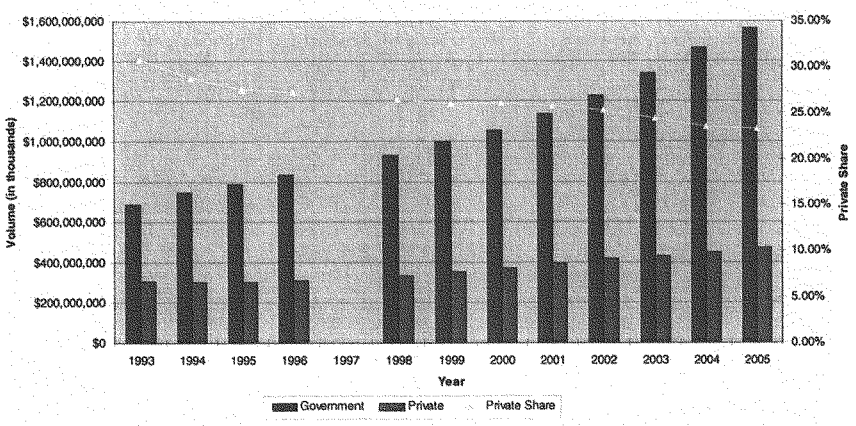
[5] Mario Triola, *Elementary Statistics*, 7th ed. (Reading, MA: Addison Wesley, 1998), p. 479.

[6] For more on private activity bonds, see: CRS Report RL31457, *Private Activity Bonds: An Introduction*, by Steven Maguire.

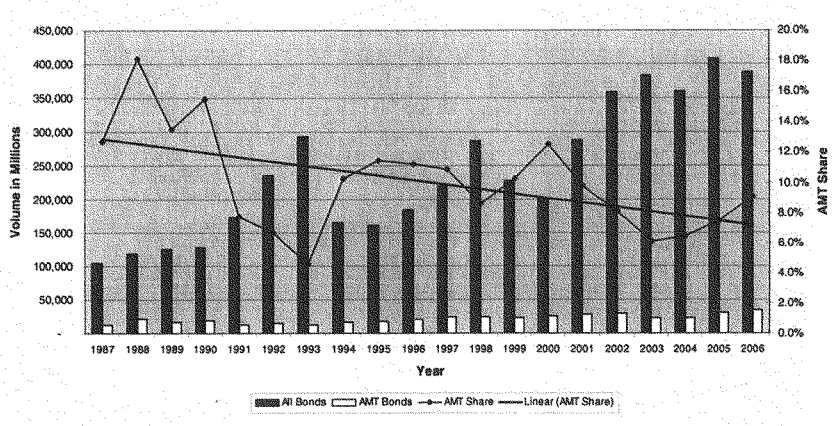
[7] For more on state use of the private activity bond volume cap, see CRS Report RL34159, *Private Activity Bonds: An Analysis of State Use, 2001 to 2005*, by Steven Maguire and Heather Negley.

Figure 1. Total Outstanding Debt and the Share of Private Debt



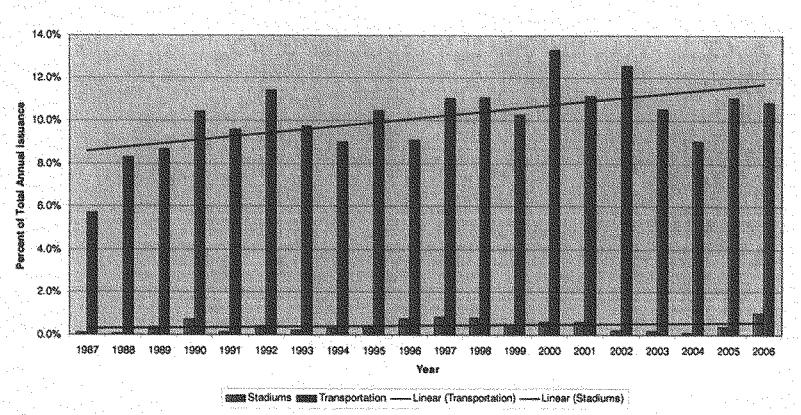
Source: U.S. Census Bureau, Governments Division.

Figure 2. *Bond Buyer* Data for Annual Issuance of State and Local Government Debt, 1987 to 2006



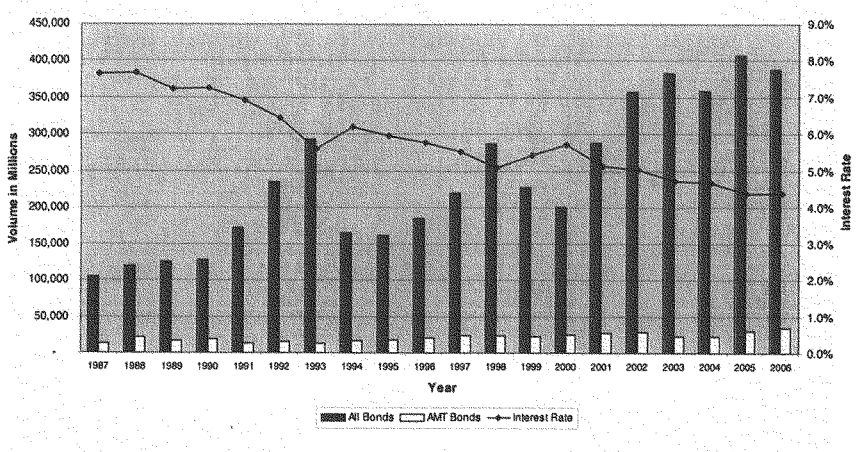
Source: *Bond Buyer Yearbook*, various years.

Figure 3. Percent of Bonds Issued for Transportation and Stadiums, 1987 to 2006



Source: *Bond Buyer Yearbook*, various years.

Figure 4. *Bond Buyer* Data on Bond Volume and Interest Rates



Source: *Bond Buyer Yearbook*, various years.

Mr. KUCINICH. Thanks again to all members of the panel.

Professor Long, I would like to begin questioning with you. You are a trained urban planner. Does it make sense for urban plans to feature a professional sports stadium?

Ms. LONG. Brief elucidation. Are you asking whether or not it makes sense for cities to use stadiums and arenas as an urban development catalyst?

Mr. KUCINICH. Yes, and also are there other publicly financed facilities that make for better cities?

Ms. LONG. Good question, broad question. In terms of studies that have looked at whether or not stadiums and arenas are effective catalysts in either an urban development sense or an economic development sense—and by economic development I mean, and this is the term used in most of the studies and in previous testimony, economic development is jobs and taxes, urban development tends to focus on the physical, i.e., new development, reduction in vacancy rate. Then there is a set of intangible benefits.

Mr. KUCINICH. So does it make economic sense then?

Ms. LONG. The economic sense, in terms of the data on the economy, you have heard previous testimony on this subject matter, and the overwhelming consensus is that there are negligible new benefits from an economic perspective. From an urban development perspective, there are some current investigations into this question, and the reason it is a very difficult question to answer at this particular point in time is that the majority of the new stadiums of this 82 built in the last 15 years, the majority of them came online between 1996 and 2000. If they are intended to anchor new development in an under-developed area of a city, it typically takes a time horizon of 10 to 15 years to see anything close to 50 percent build-out, let alone full build-out.

So the short answer is not enough time has passed to know the answer to that question. The hypothesis from urban planners is that we will start to see some physical development in these areas that might not have occurred in that city had it not been for the facility. So the long answer is it is possible.

Mr. KUCINICH. You have drawn a distinction in your testimony between the national view on the question of whether public financing for professional sports stadiums diverts funds from infrastructure and the local view. Which is the more appropriate view on the question of existence of a diversion from meeting critical public infrastructure needs, a national or local view? And why?

Ms. LONG. I think that the local perspective is more important. First of all, because we are talking about major league sports facilities, there is only a relative handful of large cities that host these stadiums and arenas, slightly over 50, whereas at the national level, infrastructure is an issue in the over 40,000 jurisdictions in the United States. So the local level I think is more important, because if we substitute these funds that is where it is happening, so the $1 billion to $2 billion a year subdivided by those 50 cities, we are talking about, on average, $10 million per facility per city. That is a lot of money.

Mr. KUCINICH. Thank you.

Professor Hale, as you may know, former New York State Comptroller Mr. Regan wrote an article where he identified an absence

of a process based on sound science and analysis to compare and prioritize infrastructure needs. He also noted there was little public information about inherent choices before they are made. What is your explanation, from a process perspective, on why the public infrastructure is not adequately maintained? And then where should elected officials place the desire to build a professional sports stadium in a list of infrastructure priorities?

Mr. HALE. As you read the initial statement at the opening of this hearing, you mentioned that there was very little data that had been going out. This is part of the rationale. We don't have a closed loop system here. Much of the data that is being collected is being collected ad hoc. The data that is being processed is being processed in multiple different ways. One of the issues that brings this all to bear is that the stakeholders who should be judging this, basically the constituents, are not getting reports on what performance should be in most of the infrastructure.

For example, in Alabama one of the areas that we do have reporting is in our freshwater drinking, and in our drinking system each year we get a report card basically on the quality of water. In that system, the variation of quality is much less than in the other infrastructures that we see within our own State.

Mr. KUCINICH. Thank you very much.

I want to go to Mr. Issa right now.

Mr. ISSA. Thank you, Mr. Chairman.

This panel is even more intriguing than the previous one, and I appreciate all of your testimonies.

Ms. Damiani, you have a wonderful name. You have my sympathies, because I have hated the damn Yankees my whole live, and as a Clevelander who kicked their ass with a lot less money this year, as far as I am concerned the Bronx Bombers can just flat go out of business. It won't bother me a bit. And Steinbrenner and all his millions can go do something else.

So, just so we understand, I am on your side on this, and I do believe that your complaints, which were also heard in the first previous hearing we held, are a classic example of a failure of local city government and State government to maintain any or all interest groups, particularly when it relates to a public park and a redevelopment. It is not unique. In California we certainly have had the taking of one group's land for the purpose of what a city council or State assembly thought was to the benefit of somebody else's. On that you have total agreement.

So I am not going to ask any questions except to say, one, I wouldn't buy the Yankees a new stadium; two, that, in fact, your point is well taken on the absence of the kind of local control that should be in every project.

Dr. Maguire, I have just a couple of questions for you. I am using a little bit of Professor Long's testimony. If I take her figures and her figures, there is not a lot of controversy, so let's just assume for a moment that 75 cents on every $1 is somehow not by the private company—in other words, professional sports, the National Baseball League or the NFL or whatever—that 25 percent comes from them and the other 75 percent comes from public contribution, which is then repaid all or in part by taxes and fees. Fair assessment that the two of you agree on that as good a figure as any?

Mr. MAGUIRE. Sure.

Mr. ISSA. OK. And we will assume for a moment we are going to take the 1993 to 2005 and call it $18 billion. You two can kind of agree on that, because I think it is important. If it is $18 billion, 33 percent Federal bracket, we are talking $6 billion in Federal subsidy over that period of time. Right?

Mr. MAGUIRE. Sure.

Mr. ISSA. OK. The $6 billion, when we play with $2.5 trillion a year here, I do have to ask are we talking about a relatively small amount of money in the sense that it is a few hundred million per year of Federal taxes lost, if I did my math right: $6 billion over 12 years is $500 million a year of lost Federal revenue. Am I doing my math right?

Mr. MAGUIRE. I assume you are, yes.

Mr. ISSA. OK. Now, if we look at Federal revenues on a global basis, because I think in the earlier panel there was a good faith statement that I think is to be considered as a fact, and that is that if you move these things all around from city to city, at the end of the day you have the same amount of teams and they are in some city, and I think that is something we can all agree on. This is a very bipartisan subcommittee, so we look for what we can agree on as much as we can. We all kind of agree on that, that whatever the benefit is to the Federal Government for its $500 million a year, it is roughly the same no matter what city it is in, with the possible exception of New York, but we are not going to go there.

If that is the case, what would it take for $18 billion to get $500 million of benefit to the Federal Government per year if a city instead just didn't have those hotel taxes that typically pay for stadiums? What would be the benefit of that slightly lower tax and not having the stadium to the city? Because, if I understand it correctly, since it is paid for by taxes almost always that are levied commensurate in some way with the activity—and in San Diego we did it with hotel taxes, hotel and drink taxes and so on—those taxes would either not have been levied or, if they were levied, they still would have been reasonably justifiable only to promote that same activity—in other words, clean up the downtown area, dig out some public other amusement park.

Realistically, can either one of you—and Dr. Maguire first, but, Professor, you, too—can you put a dollar figure on what not having this $1.5 billion a year spread over the whole country, this $500 million spread over the whole country if we just didn't tax that? The Federal Government wouldn't get the benefit because it just wouldn't have been taxed. What would we really get for it if we just didn't spend the money on it and closed down every team for a moment and just don't have them? How would you say that impact is to the $500 million to the Federal Government per year?

Mr. MAGUIRE. Well, I have been instructed not to testify beyond what was in the written testimony and what I spoke about today, but I will kind of divert things a bit.

Mr. ISSA. Be brave. Be bold.

Mr. MAGUIRE. Be brave and bold. It is about the stadiums, and it brings back something that happened in a hearing a couple of months ago, what Dennis Zimmerman said, that the number of

professional sports teams is restricted, and so one could say on the demand side a lot of cities want a team but they can't get them. Some might even say there should be several more teams in New York. If you had a more free market for sports teams, you would have a lot more teams out there without the ability to blackmail cities into paying more than what they should have for the team.

So if you start with the assumption that there is a perfectly competitive market for sports teams, then I think you have started on the wrong path. You have to assume that there is some sort of monopoly restriction on the number of teams that are out there. And then from there you have to wonder what role has the Federal Government played in that somewhat dysfunctional market.

I think I should stop there and defer.

Mr. ISSA. I think that is great. I apologize, I have been running over to Judiciary all day. We have and we continue to review the question of antitrust and whether or not, particularly as to limitation of number of teams, whether that is something that we should take out of the antitrust exemption that, in fact, allows for a single entity to restrict the number on a national basis.

I will give Professor Long the final word, but I was only trying to get the ability to say, look, $500 million to the Federal Government in abatement—because that is the only cost, because the rest of it are taxes that wouldn't have occurred normally because you are not going to normally tax the hotel if they don't feel that they are getting back a benefit in revenues greater. How big an offset is it? I think we have been talking in big terms here, but when you break them down it is actually a relatively small amount into a $2.5 trillion a year Federal Government.

Ms. LONG. If I understand your question correctly—and I am not sure that I do—the $10 million on average that a city and a county government are spending subsidizing a sports facility, how might that $10 million be better used? Is that your question? Is it the notion of opportunity cost?

Mr. ISSA. Yes. It is strictly a matter of if you didn't tax because it didn't happen, then those two-thirds of the revenues would disappear because the revenues are generally commensurate with the new construction, so the only difference is the $500 million a year of Federal taxes. The question is: how big an impact would that have to those of us in Washington, because our jurisdiction on this committee is somewhat limited to whether or not that is a fair assessment to give the tax treatment. We have to wrap up. I apologize.

Ms. LONG. This is actually an interesting question and an interesting point. It brings up the point of Denver, where there was a specific increase in the sales tax in the five-county area that was dedicated to repayment of the debt issuance for the two facilities in that case. They expected the bonds to have a duration of 30 years, but, in fact, the bonds were retired after 6 years because the sales tax revenue had created so much additional revenue more than they had anticipated.

Then I believe they did rescind the tax increase, so that is an example of a good outcome where the tax is directly and 100 percent tied to the nature of the cost.

I am not convinced that in every case there is a complete and perfect nexus to the cost, and I think that is where the issue lies. Hotel taxes are not paid exclusively by people who come to town to view a sports game. In fact, in many case the hospitality industry dislikes additional taxes on tourism revenues because it has an impact on their other visitors. So I think it is a more nuanced issue.

Mr. ISSA. Thank you. And thank you for the second hearing, Mr. Chairman.

Mr. KUCINICH. I want to thank the gentleman.

In order to keep the time evened out here, I am going to ask my 5 minutes and then we are going to be done, if that meets with your approval.

Mr. ISSA. That is fine.

Mr. KUCINICH. Ms. Damiani, you have testified and previously written about a process by which the Yankees got a new publicly financed stadium. What is the experience which you have documented about how the Yankees got public money for the new stadium? What does it say, if anything, about the process, itself?

Ms. DAMIANI. I wish I could say there was a real process. They needed to go through our city's land use procedure, which on paper looks somewhat extensive. There needs to be community hearings. The Bronx Borough president needs to be involved and the entire City Council has to approve the project. The local community board voted overwhelmingly against the project, and afterwards the borough president removed every single one of the members that voted against it.

The entire city council minus the representative that is right around Yankee Stadium voted for the project under the guise that there is this community benefits—I am saying agreement, but please note that is really not what it was. That is a lingo that has been picked up. Unfortunately, it doesn't seem to be clear in the Bronx what it is.

So they were saying that the reason why many of these officials were voting for it and approving of this process was because there were going to be guaranteed benefits on the other end.

Mr. KUCINICH. Let me ask you this question. You said that the former commissioner of the Office of Labor Relations and Deputy Mayor for Economic Development ended up as an official of the Yankees?

Ms. DAMIANI. Yes. Yes, sir. Randy Levine is——

Mr. KUCINICH. Was there any evidence that he was involved in any of the decisionmaking with respect to the use of land that then became a benefit to the Yankees?

Ms. DAMIANI. There were some agreements that were approved at the very end of the Rudy Guiliani administration. Randy Levine wasn't there at that exact moment, but suffice to say the experience that he picked up on the taxpayer tab I am sure has greatly benefited the Yankees' bottom line.

Mr. KUCINICH. The Yankees are benefiting greatly by the public financing of the new stadium and parking garage. Have they been careful with the public money they have used?

Ms. DAMIANI. The public money?

Mr. KUCINICH. You know, it is undisputed that the Yankees are benefiting greatly——

Ms. DAMIANI. Yes.

Mr. KUCINICH [continuing]. By the public financing of the new stadium and the parking garage. Have they been at least careful with the public money they have used?

Ms. DAMIANI. I am not quite——

Mr. KUCINICH. They have a public benefit, I mean, how they——

Ms. DAMIANI. I am going to say no. There hasn't been a clear definition as to how the local residents are going to be getting jobs from this. There have been many conversations about it, but as far as people——

Mr. KUCINICH. What about the planning money?

Ms. DAMIANI. Rudy Guiliani allowed the Yankees to deduct $5 million a year for 5 years to plan the new stadium, and Mayor Bloomberg actually extended that for another 5 years. Those planning expenses seem to have done two things: hired former public officials and experts to make sure that they could get the land use and the subsidies. So in a sense New York City taxpayers are allowing themselves to sort of be taken advantage of because the Yankees used that money to then benefit the expediting of the process.

Most recently, we finally got documents from 2006 that the Yankees gave to the city—now, we are not quite sure whether they have actually officially deducted them or not, but the receipts were nothing related to planning costs. There were deductions for crystal baseballs and salmon dinners on post-season nights and lots of teeshirts and jerseys and the like. So I just want to reinforce that the local issue that, Congressman, you brought up is very important, and it is greatly lacking in New York.

Mr. KUCINICH. Final question, Dr. Maguire. As a Ph.D. economist who wrote his dissertation on the economics of professional sports stadiums, does it make sense for public officials to spend taxpayer funds on professional sports stadiums? And do stadiums deliver jobs and revenues as their proponents claim?

Mr. MAGUIRE. I will agree with all the economists that have appeared before you in the past, not found any tangible benefit, just a shifting of jobs and economic activity, not a new or net gain.

Mr. KUCINICH. Thank you very much, Dr. Maguire.

I want to thank Mr. Issa for his participation in this hearing. It has been an excellent discussion.

I am Dennis Kucinich, chairman of the Domestic Policy Subcommittee of the Oversight and Government Reform Committee. This has been a hearing on Professional Sports Stadiums: Do they Divert Public Funds from Critical Public Infrastructure. I want to thank all of the witnesses who are here today and thank all of those who have been in attendance and who are watching the proceedings, and the staff of both the majority and minority for their assistance in preparing for this hearing.

This committee stands adjourned.

[Whereupon, at 5:25 p.m., the subcommittee was adjourned.]

[The prepared statement of Hon. Diane E. Watson follows:]

Opening Statement
Congresswoman Diane E. Watson
Oversight & Government Reform Subcommittee on Domestic Policy
Hearing: "Professional Sports Stadiums: Do they Divert Public Funds from Critical Public Infrastructure?"
Tuesday, September 25, 2007

Thank you Mr. Chairman for holding today's hearing asking the question, do professional sports stadiums take funds away from public infrastructure?

I represent an area of Los Angeles that includes South L.A. where the Los Angeles Coliseum is located. The coliseum was the former home of two professional football teams, the Los Angeles Rams and Los Angeles Raiders. The City of Los Angeles is one of the largest markets for professional football, but to this day is without a team. Why does the second largest city in America not have a professional football team?

The answer is that in 2002 government officials from the City of Los Angeles feared that taxpayer funds would ultimately be used to underwrite the $450 million, 64,000 seat facility.

A plan for a new stadium in Los Angeles was ultimately pulled off the table after the Los Angeles County Board of Supervisors voted to sue the city, "arguing that the redevelopment plan that would ease the way for a new stadium ultimately strips tax revenue from the county."

If tax revenue is stripped from the local government, I believe this means that there is less funds for public infrastructure projects. The NFL's 32 teams share at least $3.7 billion dollars a year from the sale of

television rights, and that is not including profits from tickets sales, parking and retail merchandising.

Why does public money go into building private enterprise's projects? Some argue that there is an economic benefit, but from our first hearing about this topic in March of this year, economist Brad Humphrey's testified that he had not found any evidence that supported the idea that professional sports stadiums create more jobs, raise income, or raise local tax revenues.

If there is no long-term economic benefit to local communities, why does the public continue to share a large portion of the costs for new professional stadiums? Information from the committee memo

states that according to Professor Judith Grant Long, who is an Assistant Professor of Urban Planning and Policy Development in the Bloustein School of Planning and Public Policy at Rutgers, "by 2001, taxpayers had spent about $17.5 billion on all 99 major league sports facilities."

In my opinion, that is $17.5 billion that could have been spent on upgrades to public infrastructure projects or the creation of new services to ailing communities. Congress has already seen the negative affects of not spending the necessary capital on public infrastructure projects. We have bridges that are collapsing, like the I-35 Mississippi River Bridge collapse in Minnesota killing 13 innocent people and injuring 100 more; and according to the Bureau of

Transportation there are 72,264 structurally deficient bridges across the United States.

Mr. Chairman, I hope that we can find a solution to prohibit the further use of public funds for the benefit of private corporations, so we can use those funds for the rebuilding of our public's ailing infrastructure. Thank you and I yield back the remainder of my time.

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